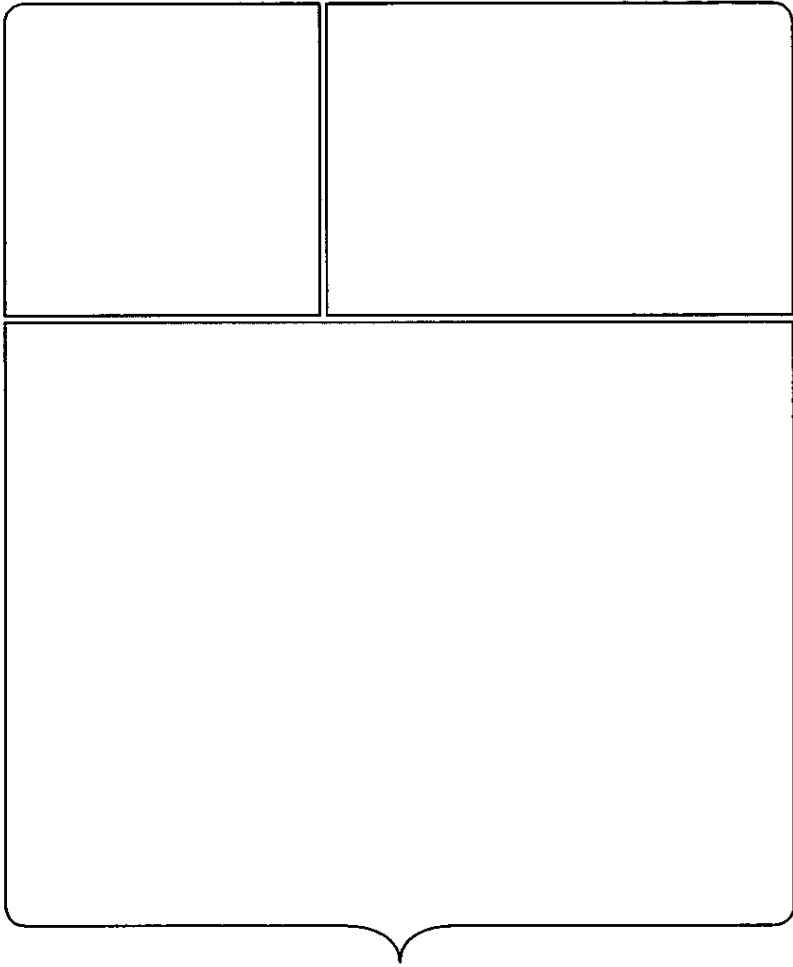



Inspired solutions for a changing world



THURSDAY

  
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A39 07/08/2008 329  
COMPANIES HOUSE

Today's big problems demand inspired solutions. At QinetiQ, we provide research, technical advice, technology solutions and services to customers in core markets of defence and security. We are increasingly working to transfer our expertise and capabilities into adjacent markets such as energy and environment. We operate principally in the UK and North America and have recently entered the Australian defence consulting market.

| OVERVIEW                         | BUSINESS REVIEW                                 | GOVERNANCE                              | FINANCIAL STATEMENTS                                    | SHAREHOLDER INFORMATION  |
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## Our business at a glance

We create value by delivering inspired solutions to the important problems faced by business, governments and society, utilising our extensive experience, skills and capabilities in the field of science and technology

### QinetiQ North America

QinetiQ North America has quickly established itself as a major provider of technology-based solutions and services to customers primarily within the US Government. Our employees work in partnership with our customers to develop world-class technology and responsive solutions that meet the challenges of national defence, homeland security, communication and information access.

#### Our core capabilities

**Technology Solutions** Delivering high technology research services and development of defence and security-related products to the US defence, civilian government and commercial markets

**Systems Engineering** Providing independent procurement services, systems engineering, education/training and support for the development, modification, fielding and sustainment of military equipment

**IT Services** Providing information technology services including computer systems integration, network engineering and operations, IT architectures and software development

**Mission Solutions** Delivering software, enterprise systems engineering and integration and other consulting services requiring specialised customer/mission knowledge

**40%**  
**£540.2m**

Share of 2008 Group revenue

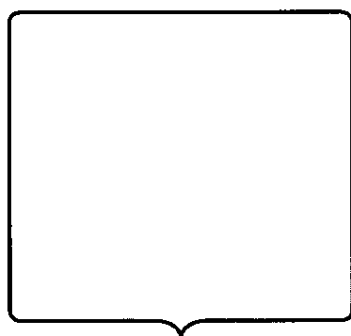
**41%**  
**5,699**

Number of employees

#### Key points from 2008

- Continued growth in technology business fuelled by demand for the TALON® robot
- Strong organic growth in Systems Engineering
- Successful integration of 13 acquisitions since 2004 and the development of a trusted QinetiQ brand in North America
- Positions established on major acquisition contracts including EAGLE and ENCORE II and selection for Alliant
- Scale and brand recognition leading to larger contract wins such as for the \$190m NASA environmental test and integrated services (ETIS) programme and the \$100m US Army Sample Data Collection programme

## QinetiQ EMEA



EMEA (Europe, Middle East and Australasia) is focused on providing services to the defence, security and energy & environment markets. Operating in these sectors requires our employees to adapt their capabilities to meet the changing needs of our customer base, particularly as we move into new territories such as Australia.

### Our core capabilities

**Managed Services** Work on behalf of clients delivering independent expertise to enable them to meet their challenges

**Consulting** Technical advice provided by high-quality consultants with deep technical knowledge and domain experience

**Integrated Systems** Supplies integrated systems, sub-systems or technology to meet the specific challenges our customers face with their information, mission or platform solutions

**Applied Technologies** Delivers a range of solutions to our customers' toughest problems through the repeatable application of technology, fuelled by research

## QinetiQ Ventures

QinetiQ Ventures is the pipeline through which we manage our portfolio of emerging technologies, providing new solutions and services for the future. QinetiQ generates Intellectual Property (IP) from customer-funded research and development work and other services provided to our core defence and security customers. In certain circumstances, this IP is available for use in alternative applications outside our core markets. QinetiQ unlocks value from IP through routes including organic growth, partnering with third parties, IP licensing and business realisations.

### Key points from 2008

- Creation of a new technology venture fund with Collier Capital to accelerate the development and realisation of seven of QinetiQ's venture investments
- Development of a high-power camera system which enhances the capability of the Tarsier® runway foreign object debris detection system

**60%**  
**£820.1m**

Share of 2008 Group revenue

**58%**  
**8,209**

Number of employees

### Key points from 2008

- Growth in services delivered to UK MOD – revenue up 2.5%
- Restructuring to align business on four focused offerings to drive growth: Managed Services, Consulting, Integrated Systems and Applied Technologies
- Restructuring designed to provide sustainable margin improvement through business efficiency
- Reconfirmed our position as a trusted supplier of defence managed services through agreement of the scope and pricing of the second five-year term of the 25 year MOD Long-Term Partnering Agreement (LTPA) and progression of the UK Defence Training Rationalisation (DTR) bid
- Commenced geographic expansion in selected overseas markets, starting with Australia
- MOD research – continued success on competed programmes

## Performance overview

Welcome to our Annual Report for 2008 – another year of strong growth and positive change for QinetiQ

### Revenue

£1,366.0m

### Underlying operating profit

£127.0m

### Orders

£1,277.1m

### Underlying operating profit margin

9.3%

### Financial summary

|                                     | 2008      | 2007       |
|-------------------------------------|-----------|------------|
| Group revenue                       | £1,366.0m | £1,149.5m  |
| Underlying operating profit         | £127.0m   | £106.0m    |
| Underlying operating profit margin  | 9.3%      | 9.2%       |
| Underlying profit before tax        | £109.0m   | £94.0m     |
| Profit before tax                   | £51.4m    | £89.3m     |
| Underlying earnings per share       | 13.4p     | 11.3p      |
| Interest cover                      | 9.2 times | 11.7 times |
| Net debt                            | £379.9m   | £300.8m    |
| Basic earnings per share            | 7.2p      | 10.5p      |
| Cash flow from operating activities | £102.3m   | £94.1m     |
| Orders                              | £1,277.1m | £1,214.0m  |
| Funded backlog (excluding LTPA)     | £947.7m   | £850.9m    |
| Underlying effective tax rate       | 19.3%     | 21.2%      |
| Dividend per ordinary share         | 4.25p     | 3.65p      |

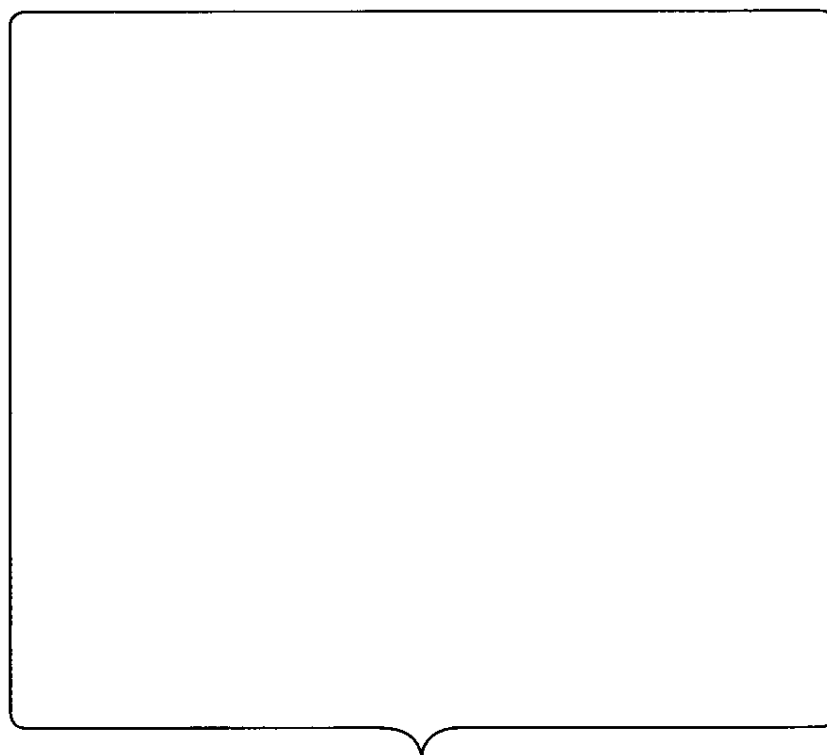
Underlying financial measures are presented as the Board believes these provide a better representation of the Group's long-term performance trends. Definitions of underlying measures of performance can be found in the glossary on page 123. A reconciliation between basic and underlying earnings can be found in note 10 to the accounts on page 87.

#### Cautionary statement

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

## Chairman's statement

"I am pleased to report on another year of strong performance, our second as a publicly listed company. The Group has a distinctive strategy to address a robust core market, which has enabled good growth across all of our key financial metrics. As a result of these strong results, we are continuing with our progressive dividend policy with a proposed final dividend of 2.92p per share giving a total dividend up 16% to 4.25p per share (2007: 3.65p per share), reflecting our confidence in the prospects for the Group."



Sir John Chisholm, Chairman

The challenges to global peace and security are as persistent now as they have ever been. Globalisation is delivering enormous benefit to the world in terms of total GDP growth, however the level of particular community imbalances leads to ethnic tensions, commodity shortages and population dislocation. Advanced nations have a need and an obligation to equip themselves to defend their own populations and to participate in international action to intervene in trouble spots. The Group has a special role to play in bringing innovation and technology-based services to assist nations discharge this mission effectively, economically and with minimum risk of casualties.

Our historic focus is in North America and the UK, but this year we have begun broadening our reach. In all our principal markets the demand for our services is driven by factors above and beyond the current issues in financial markets, giving the Group visible earnings, sustainable growth and strong cash generation.

This year's results show that our North American region is again the fastest growing part of the Group, delivering strong organic growth, which we continue to supplement with selective acquisitions. We are addressing a very large market within which we have carefully chosen to target specific high-end segments in defence, security and intelligence where demand is increasing rapidly. The need is such that it is likely to prove resilient to changes in the US Administration.

Within EMEA, the UK remains the primary market that we serve and the inevitable changes in our relationships with the UK Ministry of Defence (MOD) have enabled the Group to reposition itself away from legacy activity and into competitively acquired roles. The MOD's budget faces tough spending challenges following the conclusion of the Comprehensive Spending Review in 2007. We are well positioned to respond positively to these challenges through our wide range of technology services and solutions that address the value-for-money issues that the MOD faces, as well as enhancing their use and application of technology. During the year, we identified Australia as a country with strong and persistent needs in our field and, after careful analysis, we entered the market with three quality acquisitions.

A key focus of my activity as Chairman has been to ensure we have the strongest Board to oversee the activities of the Group. George Ienet has provided great insight to the Board on the North American market to the extent that, given his other increasing commitments, we agreed that his time with us would be better spent through membership of our QinetiQ North America Board. In addition, we are pleased to have recruited Admiral Edmund Giambastiani Jr who joined the Board in February 2008 as an independent Non-executive Director. He brings with him a vast reservoir of experience from a military career that included service as the second highest-ranking military officer in the United States, serving as the Vice Chairman of the Joint Chiefs of Staff between 2005 and 2007.

Doug Webb leaves the Group at the end of May 2008 to join the London Stock Exchange as its Chief Financial Officer. I would like to take this opportunity to thank him for his considerable contribution to the Group through the IPO process and during QinetiQ's early years as a public company. He will be succeeded by David Mellors who will join the Board as Chief Financial Officer in August 2008 from Logica plc.

Following another successful year for QinetiQ, I would like to thank and congratulate all our people for their continued commitment, hard work and dedication to the Group, in particular our QinetiQ North America team for their success in growing our business and our EMEA employees for their diligent work in reorganising their business to further strengthen our position.



Sir John Chisholm  
Chairman

28 May 2008

## Chief Executive Officer's review

"This has been another year of excellent all-round progress for the Group. We have increasingly good traction in our core markets of defence and security, which has translated into a strong financial performance and we continue to see exciting opportunities in a number of adjacent markets."

Graham Love, Chief Executive Officer



## Our vision

To be the world's leading provider of defence and security technology-based solutions and services

### How we will achieve it

Ensure we have outstanding people, facilities and technologies available to provide innovative, high-value solutions to our customers' important problems

Provide research, technical advice, technology solutions and services to customers in our core markets of defence and security, and transfer know-how and capability into important adjacent markets

### Group strategies

#### Strengthen our North American presence

Continue building our business in North America, delivering good organic growth supplemented by targeted acquisitions

#### Maintain and build existing relationships

Build on our powerful UK defence franchise, growing our market share in technology insertion, advice and managed services, whilst robustly defending our market-leading position in MOD research

#### Further penetrate established defence markets

Build valuable new market positions in selected EMEA markets outside the UK

#### Apply our technologies to commercial markets

Take selected defence technologies into new markets, through direct exploitation, venturing and licensing

## Chief Executive Officer's review continued

**Performance overview**

2008 was another year of strong operating and financial performance and we are well positioned for further growth as a result of effective execution against our key strategies

QinetiQ North America (QNA) once again delivered significant organic growth, supplemented by five further targeted acquisitions. The range of products and services offered to customers continued to grow and diversify, whilst a planned consolidation of our business groups to give greater critical mass will allow us to pursue increasingly larger opportunities

Europe, Middle East and Australasia (EMEA) delivered good growth in both Managed Services and Consulting and we continue to see good opportunities in Integrated Systems and Applied Technologies, including further penetration of overseas markets. Restructuring into fewer business units will improve customer focus whilst delivering measurable benefits to profit margins. Our entry into the Australian market will provide improved access to growing international markets.

Opportunities for technology ventures have developed further and seven ventures were successfully spun out into a separate fund with an external partner. We continue to believe that our selective and targeted approach to investment will generate attractive returns over the medium term.

**Financial overview**

Revenue increased 19% to £1,366.0m, including organic growth of 8.6%, and underlying operating profit increased 20% to £127.0m. Order intake continues to be robust with a book to bill ratio achieving our Group target of 1.1:1. Total funded backlog, including the LTPA, is £5.7bn, which gives us excellent forward visibility for the business.

Net cash inflow from operating activities of £102.3m translates into an underlying operating cash conversion of 77% for the year, up from 56% last year.

Underlying earnings per share increased by 19% to 13.4p per share. We propose to increase the final dividend to 2.92p per share, bringing the total dividend to 4.25p per share. This represents an increase in total dividend of 16.4% over last year and is covered 3.2 times by earnings.

**Delivery against our strategy****Continue building our business in North America, delivering good organic growth supplemented by targeted acquisitions**

QNA has seen another year of strong performance with 17.5% organic growth in revenue. This has been supplemented by our continuing acquisition programme in North America, which added five further businesses. The acquisitions of ITS, 3H Technology and Pinnacle CSI provide the IT Services and Mission Solutions businesses with enhanced access to the homeland security and intelligence communities through excellent customer relationships and strong contractual positions. The acquisitions of Automatika and Applied Perception continue to build on our expertise in robotic and autonomous platforms in the Technology Solutions business.

The existing QNA businesses have delivered impressive operating results in the period. In particular, the Technology Solutions business has had an exceptional year through very strong orders and sales of the TALON® robot range. Over \$200m of further funding for TALON robots was received in the year and in excess of 800 TALON robots were shipped. A \$400m follow-on indefinite delivery/indefinite quantity (IDIQ) contract was received in May 2008. Over 2,000 units have now been shipped to Iraq and Afghanistan, most of which are being used to locate and remotely disable roadside bombs. QNA has also shown an increasing diversity in product offerings such as LAST® Armor and the EARS Sniper Detection systems, gaining traction in the year.

Integration of the QNA businesses has made significant progress with a clear focus on business development activities to ensure that QNA continues to bid for, and win, larger opportunities than its constituent parts have previously been able to achieve. One such example was NASA's award of a \$190m five-year contract to our Mission Solutions business to provide environmental test and integration support (ETIS) services. QNA is now a \$1bn plus integrated business and has been successful in recruiting highly experienced defence industry professionals, with excellent customer insights, to help continue driving strong organic growth from our resilient positions in the defence, security and intelligence markets. At a business unit level, we see further integration opportunities and during the course of the coming year, will merge the IT Services operations into the Systems Engineering and Mission Solutions businesses, thereby continuing to improve customer focus and opportunity exploitation.

**Build on our powerful UK defence franchise, growing our market share in technology insertion, advice and managed services, whilst robustly defending our market-leading position in MOD research**

At the start of the year we created our EMEA sector by combining the Defence & Technology and Security & Dual Use businesses. We are pleased that these integrated EMEA operations have returned to growth in the year, with revenue increasing organically by 4.5% and direct revenue from the MOD increasing by £14.6m to £599.1m. In March, we also successfully completed the £951m re-pricing agreement covering the second five-year term of the 25-year Long-Term Partnering Agreement (LTPA) with the MOD. We continue to work with the MOD towards finalising the 30-year Defence Training Rationalisation (DTR) contract, for which we are the preferred bidder. We expect to agree the customer requirements and pricing in 2008 and to finalise the contract by the end of March 2010.

During the course of the year we have conducted a review of the EMEA structure and, with effect from 1 April 2008, have reorganised the sector into four offering-focused businesses: Managed Services, Consulting, Integrated Systems and Applied Technologies. This reorganisation will improve the engagement with our defence customer base and has also allowed us to remove a significant amount of duplication, as we have consolidated a large number of units into these four businesses. This process will be completed in the first half of the coming year and, once finalised, we expect to deliver full-year annual savings of at least £12m. We have taken the cost of achieving this reorganisation of some £33m as a non-recurring charge in the income statement.

Good progress has been made on using the excellent customer access provided by our North American business to accelerate the deployment of EMEA technology into the largest accessible global market. During the year, we successfully sold our SPO stand-off detectors developed in EMEA to the US Transportation Security Administration through QNA and we are currently pursuing a pipeline of other similar cross-sector opportunities.

**Build valuable new market positions in selected EMEA markets outside the UK**

The creation of the EMEA sector also underlined our ambition to deliver growth from defence markets beyond the UK and North America. We believe that the structure and team we have created will allow us to pursue exciting opportunities to replicate offerings from EMEA's core UK market into selected international defence markets. As other defence markets mature over the coming years, our value-based services and solutions become more relevant to these potential new customers. Our initial view of the likely markets that offer the best prospect in the medium term are in Asia Pacific, Scandinavia and the Middle East.

During the year, we established a footprint in Australia with the acquisition and subsequent integration of three defence consulting businesses as QinetiQ Consulting Pty. Historically we have provided services to the Australian defence marketplace from the UK and the establishment of a QinetiQ base in Australia, with an in-country capability of over 300 employees, provides the mechanism to leverage the wider range of our services to our Australian customers.

We continue to review other geographical markets, although our immediate priority is to bed down our Australian operations. Once achieved, they will provide us with a basis to expand our offering through parts of the South East Asian market. Closer to home, we are looking to establish a representative office in Scandinavia, with the volume of business opportunities making it increasingly important for us to maintain a closer interface with our customers in this region.

## Chief Executive Officer's review continued

**Take selected defence technologies into new markets, through direct exploitation, venturing and licensing**

The EMEA reorganisation will allow us to improve our targeting of key non-defence markets such as security and energy & environment where many of our consulting-led solutions and services are in demand as these markets develop. Evidence of the significant role we can undertake in these markets was demonstrated through the award of a contract worth up to £33m as part of the UK Home Office's e-Borders programme where we are providing security accreditation and human factors services. We have added to our capabilities in the security marketplace through the October 2007 acquisition of Boldon James, a company offering high-end secure messaging solutions for government, military and security customers worldwide.

We continue to develop a pipeline of new ventures where we believe these will deliver attractive returns on investment in the medium term. In August 2007, we completed a transaction with Collier Capital to establish a technology venture fund consisting of seven of our ventures. The creation of the fund enables these ventures to be managed by an independent team focused on accelerated growth with access to Collier Capital's expertise in commercialising technology and further funding from QinetiQ and Collier Capital. These businesses continue to make satisfactory progress. The Tarsier<sup>®</sup> integrated camera enhancement programme has attracted significant additional interest, with an order placed for a radar and camera system from BAA for London Heathrow Airport and a camera system order from Vancouver International Airport, our original launch customer for the radar system.

**Our people**

The expertise, commitment and integrity of our people is an essential component of the strong results delivered this year and the continued successful implementation of our strategy. During the year, we have welcomed new employees into the Group who will further enhance our strong existing capabilities. Over 1,300 new employees have joined the Group through acquisitions with many more joining to meet the demand of our organic growth. I thank all our people for their hard work and dedication during the year. We place great emphasis on talent management to ensure the effective recruitment, retention and development of key skills across the organisation. The professionalism and quality of our people is paramount to our continued success.

Our recruitment strategy recognises the need to replenish and refresh our capabilities and we look to maximise this pipeline by using a comprehensive programme encompassing graduate recruitment, student placement and apprenticeships to ensure that a broad mix of scientific, engineering, technical and managerial talent joins the Group and provides leadership to the organisation. We also continue to strengthen our senior management team with key additions in both QNA and EMEA.

To keep the Group's capability at the leading edge of our customers' expectations and to provide opportunities for our employees to develop and fulfil their potential, we continually invest in programmes and activities alongside customer delivery. The Competing to Win project launched in the UK last year, which focused on developing staff to lead and win major new business opportunities, has become an invaluable training and development programme. Graduates of the programme have taken key roles throughout the business including leadership of our successful bid into the Home Office e-Borders programme.

**Future prospects and outlook**

We are well positioned in our key primary markets and will continue to execute our strategy effectively in the coming year

In North America our business has delivered strong organic growth and is well positioned to continue to benefit from the market opportunities that exist. We believe that the specific markets we serve, and the high-end solutions and services we provide, are key to the defence, homeland security and intelligence policies of any future US Administration. We believe our highly focused North American business will continue outpacing the expected growth rate of the overall US defence budget and we are targeting continued double-digit organic growth.

Our newly restructured EMEA business is well positioned to respond in a flexible and agile way to meet its customers' needs. Our opportunity going forward is to respond to the challenges faced by our customers and to use technology-rich solutions to provide them with value-for-money propositions. Technology development and insertion into new platforms to extend the life of existing platforms is a key strength that we add to the defence supply chain. On the Consulting and Managed Services axis, our specialist procurement, test and evaluation services help ensure the MOD acquires and utilises equipment that gives the right balance of through-life capability and value to the UK armed forces. The EMEA business has the organisation and capabilities in place to maintain the growth trajectory it has now established. Looking further out, as the headwind of MOD research fully opening to competition recedes, we are well placed to deliver accelerated growth from EMEA.

We will continue to target selective acquisitions to complement and grow our capabilities and to access new markets. The Group's strong balance sheet position, inherently cash generative operations and access to committed financing facilities allow us to continue to make value-enhancing acquisitions at a similar rate to that delivered in recent years. We will also continue to invest in opportunities to exploit our defence technologies in other markets, where these opportunities offer attractive projected returns.

Our business model and forward visibility to earnings are robust. Our ability to innovate and respond quickly to our customers' needs with value-for-money solutions through the deep expertise of our people ensures that the Group is well positioned to benefit from the opportunities that exist in all of our key markets. We enter the new year with confidence and expect to continue making good progress towards our Group targets including our increased medium-term operating margin of 11%.



Graham Love  
Chief Executive Officer

28 May 2008

## Key performance indicators

## Key performance indicators

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

| KPI                                    | 2008    | 2007    | 2006    | Comment   |
|--|---------|---------|---------|---|
| Organic revenue growth                 | 8.6%    | 2.3%    | 2.3%    | The rate of organic growth in revenue. The Group is targeting to deliver sustainable organic growth of at least 6.7% per annum, supplemented by growth from major opportunities such as DTR.  |
| Proportion of revenue generated by QNA | 39.5%   | 31.2%   | 23.6%   | The Group aims to generate 50% of its revenue in the medium term from QNA through a combination of organic growth and acquisitions.   |
| Book to bill ratio                     | 1.09:1  | 1.24:1  | 0.93:1  | The ratio of orders to revenue to identify the rate of prospective growth in the business. LTPA non-tasking revenue is excluded from this calculation as no annual order is associated with this revenue. The Group aims to achieve an average of at least 1.1:1 over the medium term.  |
| Funded backlog                         | £947.7m | £850.9m | £608.4m | The value of contractually funded future orders (excluding the LTPA) providing visibility over future revenues. Total funded backlog including the LTPA is £5.7bn.  |
| Underlying operating profit margin     | 9.3%    | 9.2%    | 8.6%    | The percentage return on sales achieved based on underlying operating profit. The Group is targeting an underlying operating margin of 11% in the medium term.  |
| Underlying EPS growth                  | 18.8%   | 10.4%   | 16.3%   | The rate at which underlying earnings per share increased over the prior year expressed as a percentage. The entry point for the Group's long term incentive schemes equates to an average EPS growth rate of 7.0% per annum with full vesting achieved if the EPS growth rate averages 15.0% per annum.  |
| Total shareholder return               | 4.5%    | (2.3)%  | n/a     | The measure of total shareholder value creation (including dividends) each year expressed as a percentage.  |
| Operating cash conversion              | 77%     | 56%     | 84%     | The percentage of underlying operating profit converted into underlying operating cash flow (after capital expenditure). The Group targets an underlying operating cash conversion rate of 80%.   |
| Health and safety of employees         |         |         |         | UK Reporting of Injuries, Diseases & Dangerous Occurrences Regulations (RIDDOR) is expressed as the number of RIDDOR events in any period per 1,000 people amongst our EMEA employee base. Our target is to remain below the industrial average for all industries, which was 5.36 for 2006/2007. The average for public administration and defence companies was 13.46 in 2006/2007. |
| UK RIDDOR                              | 2.28    | 3.47    | 3.85    |   |
| USA OSHA                               | 5.66    | 10.78   | n/a     | Expressed as the number of Occupational Safety & Health Administration (OSHA) 'days away from work' cases per 1,000 employees amongst our North America employee base.  |
| Employee attrition rate                | 10.3%   | 7.1%    | 5.8%    | Employee turnover (excluding redundancies) measured as the number of resignations expressed as a percentage of total headcount per annum. The increase in attrition reflects the increasing proportion of our business in North America where the workforce is historically more mobile.  |

## Group trading performance

QinetiQ delivered improved organic growth in 2008 whilst investing for the future through complementary acquisitions and a margin-enhancing reorganisation of the EMEA business. Our balance sheet remains strong, our financing is secure and free cash flow improved.

### Group summary

| <i>all figures in £ million except where stated</i> | <b>2008</b>    | <b>2007</b> | <b>2006</b> |
|---|----------------|-------------|-------------|
| Orders  | <b>1,277.1</b> | 1,214.0     | 816.7       |
| Revenue   | <b>1,366.0</b> | 1,149.5     | 1,051.7     |
| Underlying <sup>1</sup> EBITDA                      | <b>165.0</b>   | 140.5       | 124.5       |
| Underlying <sup>1</sup> operating profit            | <b>127.0</b>   | 106.0       | 90.7        |
| Underlying <sup>1</sup> operating margin            | <b>9.3%</b>    | 9.2%        | 8.6%        |
| Operating profit                                    | <b>76.4</b>    | 93.4        | 69.5        |
| Underlying <sup>1</sup> profit before tax           | <b>109.0</b>   | 94.0        | 80.1        |
| Profit before tax                                   | <b>51.4</b>    | 89.3        | 72.5        |
| Underlying <sup>1</sup> operating cash flow         | <b>100.3</b>   | 60.1        | 76.9        |
| Operating cash conversion                           | <b>77%</b>     | 56%         | 84%         |
| Net debt  | <b>379.9</b>   | 300.8       | 233.0       |
| Funded backlog <sup>2</sup>                         | <b>947.7</b>   | 850.9       | 608.4       |
| Underlying <sup>1</sup> effective tax rate          | <b>19%</b>     | 21%         | 23%         |
| Underlying <sup>1</sup> earnings per share          | <b>13.4p</b>   | 11.3p       | 10.2p       |
| Dividend per share                                  | <b>4.25p</b>   | 3.65p       | 2.25p       |

<sup>1</sup> Underlying financial measures are presented as the Board believes these provide a better representation of the Group's long-term performance trends. Definitions of underlying measures of performance can be found in the glossary on page 123. A reconciliation between basic and underlying earnings can be found in note 10 to the accounts on page 87.

<sup>2</sup> Excluding remaining £4.7bn (2007: £4.8bn, 2006: £5.0bn) backlog in respect of LTPA contract.

Revenue increased £216.5m with organic revenue growth of 8.6%. Underlying operating profit increased by 20% to £127.0m with organic growth across QNA and EMEA of 16%. Orders increased £63.1m on the prior year with the Group maintaining a healthy book to bill ratio of 1.1:1 (excluding the LTPA).

The EMEA sector was reorganised during the year into four businesses focused on the delivery of discrete capabilities and offerings. A charge of £32.6m was incurred which is expected to yield annual benefits of at least £12m from the second half of calendar 2008.

A strong level of cash conversion was maintained allowing the Group to continue to fund both acquisitions and organic growth opportunities.

### Revenue

| <i>all figures in £ million</i> | <b>2008</b>    | <b>2007</b>    | <b>2006</b>    |
|---------------------------------|----------------|----------------|----------------|
| <b>Revenue</b>                  |                |                |                |
| QinetiQ North America           | <b>540.2</b>   | 358.2          | 248.4          |
| EMEA                            | <b>820.1</b>   | 779.3          | 797.2          |
| Ventures                        | <b>5.7</b>     | 12.0           | 6.1            |
| <b>Total</b>                    | <b>1,366.0</b> | <b>1,149.5</b> | <b>1,051.7</b> |

Group revenue increased 19% to £1,366m due to a combination of strong organic growth and the contributions made by recent acquisitions. In constant currency terms using the average rate from the prior year, the Group would have reported revenues of £1,391m.

QNA revenue increased £182.0m with organic growth of 17.5%. Strong demand for both TALON® robots and LAST® Armor products provided organic growth of 35% within the Technology Solutions business. The Systems

Engineering business delivered organic growth of 18%. IT Services revenue increased by £53.0m with good organic growth of 6.7% in a market adversely impacted by budget pressures faced by federal customers.

The EMEA sector grew revenue from £779m to £820m with growth in Consulting and Managed Services more than offsetting a reduction in Integrated Systems. EMEA achieved organic growth in revenue of 4.5% (2007: 2.2% decline).

### Revenue by customer type (£m)

■ MOD ■ DoD ■ Commercial defence ■ DHS  
■ Other governmental agencies ■ Civil

MOD remains the Group's largest customer accounting for 44% of 2008 revenues (2007: 51%). The absolute level of revenue from MOD work increased by £14.6m despite considerable pressure on MOD budgets, highlighting QinetiQ's trusted advisor relationship with our key core customers. As the Group grows, the relative dependence on MOD is expected to continue to decrease.

### Orders and backlog

| <i>all figures in £ million</i> | <b>2008</b>    | <b>2007</b>    | <b>2006</b>  |
|---------------------------------|----------------|----------------|--------------|
| <b>Orders</b>                   |                |                |              |
| QinetiQ North America           | <b>607.1</b>   | 416.0          | 227.9        |
| EMEA                            | <b>662.5</b>   | 783.7          | 579.0        |
| Ventures                        | <b>7.5</b>     | 14.3           | 9.8          |
| <b>Total</b>                    | <b>1,277.1</b> | <b>1,214.0</b> | <b>816.7</b> |
| <b>Funded backlog</b>           |                |                |              |
| QinetiQ North America           | <b>300.5</b>   | 210.7          | 129.2        |
| EMEA <sup>1</sup>               | <b>640.8</b>   | 632.6          | 474.7        |
| Ventures                        | <b>6.4</b>     | 7.6            | 4.5          |
| <b>Total</b>                    | <b>947.7</b>   | <b>850.9</b>   | <b>608.4</b> |

<sup>1</sup> Excluding remaining £4.7bn (2007: £4.8bn, 2006: £5.0bn) backlog in respect of LTPA contract.

Total orders increased by 5.2% during the year against a strong comparative that included £157m total orders from the large multi-year contracts for the Combined Aerial Target System and the Typhoon programme.

QNA order growth was driven by strong levels of contract awards across the sector. In particular, the business received over \$200m of additional contract funding for TALON robots. In addition to the funded backlog, the QNA sector has unfunded backlog of over £350m (\$700m). The unfunded backlog principally derives from multi-year US Government contracts for which only one year of funding has yet been released.

## Business review – Group trading performance continued

QinetiQ's positions on Government Wide Acquisition Contracts (GWACs) and indefinite delivery/indefinite quantity (IDIQ) contracts add significant further visibility to the accessibility of future revenues

The Group's strong orders performance has resulted in a book to bill ratio (excluding the LTPA) of 1.1:1 (2007: 1.2:1), in line with our target of 1.1:1

**Underlying operating profit**

| <i>all figures in £ million except where stated</i> | 2008         | 2007         | 2006        |
|---|--------------|--------------|-------------|
| <b>Underlying operating profit</b>                  |              |              |             |
| QinetiQ North America                               | 62.1         | 39.9         | 24.5        |
| EMEA  | 80.0         | 73.0         | 73.7        |
| Ventures  | (15.1)       | (6.9)        | (7.5)       |
| <b>Total</b>  | <b>127.0</b> | <b>106.0</b> | <b>90.7</b> |
| <b>Underlying operating profit margin</b>           | <b>9.3%</b>  | <b>9.2%</b>  | <b>8.6%</b> |

Underlying operating profit has increased by 20% to £127.0m through organic growth in the EMEA and QNA sectors and the contribution from the new acquisitions partly offset by the planned increase in investment in Ventures. On a constant currency basis, using the average exchange rate for the prior year, QNA would have contributed an additional £3.0m of operating profit.

Underlying operating profit margin has improved to 9.3% (2007: 9.2%), driven largely by changes in the revenue mix with strong product and spares demand in the Technology Solutions business in QNA, offset by the planned increase in investment in Ventures.

**Finance costs**

Net finance costs increased to £18.0m (2007: £12.0m). A higher level of average borrowings from acquisitions at the end of last year and in the first quarter of this year was partially offset by lower average interest rates on the predominantly dollar-denominated borrowings. The interest cover ratio, measured as underlying EBITDA net finance costs was 9.2 times (2007: 11.7 times).

**Profit before tax**

Profit before tax, non-recurring items, disposals and acquisition amortisation increased by £15.0m to £109.0m, a rise of 16%. The growth includes the acquisitions made in this financial year and the benefit of a full-year contribution from the Analex acquisition completed in March 2007.

**Tax**

The underlying effective tax rate for the year is 19% compared to 21% in the prior year. The Group's statutory effective tax rate was 8% (2007: 23%).

As a technology business with significant involvement in research and development, the Group benefits from UK tax incentives designed to encourage greater investment in innovation. The UK Government recognises the importance of research and development as a driver of productivity growth. The Group reinvests the benefits of these tax incentives into ventures and other intellectual property commercialisation investments.

The business will benefit from the reduction in corporation tax rates from 30% to 28% as announced in the 2007 UK Government Budget. Restatement of

deferred tax balances resulted in a £1.5m benefit in year. However, over the next two years the underlying Group effective tax rate is expected to rise by 1-2% as the proportion of Group profit generated in North America continues to increase.

Due to the availability of research and development relief and deductions for past service pension contributions made in prior years, the Group has not paid corporation tax on UK profits in-year and does not anticipate paying cash tax in the UK in the near term.

**Profit for the year**

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

| <i>all figures in £ million</i>   | 2008        | 2007        | 2006        |
|---|-------------|-------------|-------------|
| Profit for the period   | 47.4        | 69.0        | 60.4        |
| Minority interest   | –           | –           | (2.3)       |
| <b>Profit for the period attributable to equity shareholders of the parent company</b>          | <b>47.4</b> | <b>69.0</b> | <b>58.1</b> |
| EMEA reorganisation   | 32.6        | –           | –           |
| Loss/(gain) on business divestments and unrealised impairment of investment                     | 7.0         | (4.6)       | –           |
| Profit on disposal of non-current assets  | –           | (3.3)       | (8.9)       |
| Amortisation of intangible assets arising from acquisitions                                     | 18.0        | 12.6        | 12.3        |
| IPO related items   | –           | –           | 4.2         |
| Tax impact of items above   | (17.0)      | 0.4         | (0.7)       |
| Brought forward tax losses utilised   | –           | –           | (5.4)       |
| <b>Underlying profit for the year attributable to equity shareholders of the parent company</b> | <b>88.0</b> | <b>74.1</b> | <b>59.6</b> |

Non-recurring items that have been excluded from underlying profit relate to gains on business divestments, EMEA reorganisation costs, investment impairment and profits on disposal of non-current assets, principally surplus property. The Board believes that the underlying profit provides a better representation of the Group's long-term performance trends.

**Earnings per share**

Underlying earnings per share increased by 19% to 13.4p compared to 11.3p in the prior year. Basic earnings per share decreased from 10.5p to 7.2p, principally as a result of the £32.6m costs of the EMEA reorganisation.

**Dividend**

The Board is recommending a final dividend of 2.92p per share (2007: 2.45p) bringing the total dividend for the year to 4.25p per share (2007: 3.65p), representing an increase of 16%. The proposed dividend is 3.2 times covered by underlying earnings (2007: 3.1 times).

The record date for the final dividend will be 8 August 2008. Subject to approval at the Annual General Meeting, the final dividend will be paid on 5 September 2008.



## QinetiQ North America

QinetiQ North America has established itself as a significant provider of technology-based solutions and services to US defence, security and intelligence customers. With annual revenues of \$1.1bn, the business is well placed to target larger sales opportunities. Successful integration of the acquisitions completed since we entered North America in 2004 has yielded benefits from brand recognition, increased breadth and depth of offerings, cross-selling opportunities, major new umbrella contract vehicles and cost efficiencies.

### Our principal markets and customers

US Department of Defense (DoD)  
Department of Homeland Security (DHS)  
National Aeronautics and Space Administration (NASA)  
US security intelligence community

Duane Andrews, Chief Executive,  
QinetiQ North America

Share of Group revenue

### Achievements

As a \$1.1bn revenue business, QNA has achieved a critical mass that allows it to target larger contract opportunities. Integration of the 13 businesses acquired since 2004 is largely complete allowing the separate acquired businesses to consolidate under one consistent umbrella whilst retaining a focus on local customer delivery.

The Technology Solutions business received over \$200m of further funding for TALON® robots and spares. Over 800 TALON robots were shipped during the year. The cumulative number of robots shipped is now over 2,000 units.

The Technology Solutions business was also awarded a \$15.4m contract by the Naval Research Laboratory, for research in the areas of ocean dynamics and predictive oceanography.

The Systems Engineering business was awarded a \$13.3m contract to provide technical services, systems engineering and management expertise to the Apache Attack Helicopter Project Manager's Office for one year plus four further option years.

The IT Services business was awarded a position (subject to resolution of protests from other bidders) on the \$50bn ten-year Alliant contract and a second-term position on the \$12bn Encore II contract. These umbrella agreements provide significant opportunities for growth in the medium term.

The Mission Solutions business won a contract to provide a wide range of environmental test and integration services (ETIS) to support projects at NASA's Goddard Space Flight Center. The contract is expected to yield \$190m in total revenue for the business over its five-year life.

Year-end headcount has increased to 5,699 (2007: 4,258) including 988 from the acquisitions made in the year.

During April 2008, QNA realigned the resources of the IT Services business into the existing Mission Solutions and Systems Engineering businesses. The reorganisation provides increased reach and resources for new and improved solutions, providing additional growth opportunities for the sector.

40%  
£540m

■ Share of 2008 Group revenue

Revenue increased

£182m

Underlying operating profit

+56%

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## \$42m contract

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QNA is providing support to C<sup>4</sup> Acquisition Engineering and Integration (CAEI) in a \$4.7m indefinite delivery/indefinite quantity cost-plus-fixed fee performance-based contract. This contract is for a base year with four option periods and three award term provisions, which if exercised, would bring the cumulative value of the contract to an estimated \$42m.

The CAEI department provides integration of command, control, communications, computers and intelligence (C<sup>4</sup>I) systems for new ships and also the conversion of land vehicles, ships, submarines and other systems used by the US Navy and other services.

The contract includes support by QinetiQ in the following areas: data systems engineering, IT support, project monitoring and tracking, measurement and analysis, quality assurance and risk management.

## Helping the US Navy manage contracts

The contract for land vehicles includes equipping of the high-profile mine-resistant ambush-protected (MRAP) vehicle, currently used for operations in Iraq and Afghanistan

The Program Engineering Management Analysis (PEMA) programme oversees four contracts supporting CAEI at the Space and Naval Warfare System Center in Charleston, USA

"Our team members are trusted advisors to CAEI, committed to improving performance and productivity. We support CAEI with project monitoring by measurement and analysis at all levels to improve efficiencies and save costs. CAEI's aim is to ensure that their contracts are executed in the most efficient way – better than any other department in the US Navy. QinetiQ's operations in Charleston provide quality advice to manage CAEI's interests effectively and with integrity, ultimately making sure that CAEI achieves its goals over the next five to eight years." **Michael Henson**, Programme Manager

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## \$100m contract

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QinetiQ has provided the US Army with sample data collection and analysis services since 1992. The current re-compete contract, worth \$100m, provides continued support to the US Army's Sample Data Collection programme.

"From our base at Fort Hood in Texas, we coordinate the data collection activities of 28 locations worldwide, encompassing three continents and two war zones. Our main challenges are time and distance."

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**Maurice Squires** Weapons System Analyst

## Keeping track of US Army equipment

Under the contract, QNA continues to meet the challenge of collecting data on all US Army equipment – ground combat systems, tactical wheeled vehicles and aviation systems – from across the US and all areas overseas in which the US Army has a presence. QNA then provides the Army with timely and accurate logistics data for comprehensive studies and analyses.

BUSINESS REVIEW

“We carry out lifecycle tracking on all US Army equipment, from small arms, wheeled and tracked land vehicles, to aircraft – mainly helicopters. We will take statistically valid samples of, say, a group of vehicles or other equipment, for instance, a sample of 100 vehicles of the same model used in different locations worldwide. This enables us to show how the same model of vehicle performs in different areas, under different conditions in different terrains, whether in the US or overseas. We faced fierce competition in the bidding to retain this contract, but the Army is very happy with the service we provide. We have experienced people and undertake quality work.” **Ed Williams**, Data Supervisory Monitor

“We are proud to have been chosen to design and deliver our add-on armour for the C-5 transport fleet. This contract will help protect aircrew and allow them to operate the aircraft in critical situations.”

Michael McCormack, Vice President, LAST® Armor

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## \$16.3m contract

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Under a \$16.3m contract from the US Air Force, QNA is designing and delivering LAST® Armor kits for C-5 aircraft. QNA's LAST Armor division is the largest approved supplier of add-on armour for fixed-wing aircraft in the United States.

LAST Armor is an add-on armour attached to vehicles without the need for welding or drilling the base vehicle or aircraft. The aircraft armour kits are tailored to defeat primarily small arms fire and the installation can be performed in the field by the crew.

## Helping protect aircraft for the US Air Force

“In the past, QNA worked with the US Air Force to armour C-130 Hercules and C-17 Globemaster aircraft, so LAST Armor is a proven system. We have already supported the US Air Force’s operational tours in Iraq and Afghanistan and have in place a spares and support network covering the entire US Air Force.

There are over 100 people in the team working on the programme, some with over 15 years’ experience of working with LAST Armor. Their effort and dedication is vital in responding to the compelling need for the US Air Force to armour the entire C-5 fleet.” **Michael McCormack**, Vice President, LAST Armor

## Business review – QinetiQ North America continued

**Market review****US defence**

The US defence market is by far the world's largest accessible market for QinetiQ. In the US Fiscal Year 2009 (year ending 30 September 2009) the US DoD budget request rose 7.3% to \$515bn (FY08: \$480bn) continuing the trend of strong growth seen in recent years. In addition to the base budget there have been additional supplemental requests in recent years which have primarily been directed towards US 'Global War on Terror' programmes primarily funding the campaigns in Iraq and Afghanistan. In US Fiscal Year 2008, the supplemental request totalled \$189bn and in Fiscal Year 2009, while visibility has so far been limited to the first of two expected supplemental requests which covered \$70bn of bridge funding, a further request is expected later in 2008. Overall growth in the DoD budget is expected to moderate from 2010 onwards, however QinetiQ's position in this market is directed towards high-priority, critical focus areas and the increasing trend to outsource means our available market is growing faster than the overall budget. These factors position QNA to continue to grow at a rate above the headline growth in the budget.

Should there be a significant reduction in the scale of current campaigns then the level of supplemental budgets will more than likely decline, although significant reset work to refresh US defence inventory is likely to provide some mitigation against such change. QinetiQ's mix of business streams in QNA is such that it has limited exposure to campaign-related expenditure. Any impact on the levels of campaign funding is likely to be mitigated by such reset work or the return of funding to areas of government spending that had been under pressure during the campaigns.

One area affected by the redirection of budgets is the federal IT services market, which has been subject to significant budget pressures. QinetiQ's offerings in this market are highly technical, built on a strong foundation of excellent customer relationships and a strong cadre of security-cleared employees ensuring that this business is well placed within the more robust, high-end sector of this market place. Were operations abroad to be condensed, the markets for outsourced services, IT and training could see budget pressures dissipate and QinetiQ would be in a strong position to benefit from the resultant increased funding.

The winner of the presidential elections in November 2008 will submit their first defence budget for US Fiscal Year 2011, but will have significant influence over spending before this. The most likely influence will be over the level of supplemental funding predominantly in relation to ongoing operations in Iraq and Afghanistan, which on balance are broadly neutral for QNA.

**Security and counter terrorism**

In the US, there is increasing emphasis on homeland security, intelligence and cyber-security and these are key issues for all of the US Presidential candidates. QinetiQ's acquisition of ITS, 3H Technology and Pinnacle CSI complement and broaden the existing security-related services provided by the North American operations and build on existing relationships within the security and intelligence community.

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

Source: US DoD Congressional Research Service, Congressional Budget Office, Company estimates

Note: US fiscal years ended 30 September

**Financials**

|                             | 2008<br>£m   | 2007 <sup>1</sup><br>£m | 2008<br>\$m    | 2007 <sup>1</sup><br>\$m |
|-----------------------------|--------------|-------------------------|----------------|--------------------------|
| <b>Revenue</b>              |              |                         |                |                          |
| Technology Solutions        | 176.0        | 134.8                   | 353.2          | 257.9                    |
| Systems Engineering         | 104.0        | 98.4                    | 208.7          | 188.3                    |
| IT Services                 | 164.8        | 111.8                   | 330.6          | 213.8                    |
| Mission Solutions           | 95.4         | 13.2                    | 191.5          | 25.3                     |
| <b>Total</b>                | <b>540.2</b> | <b>358.2</b>            | <b>1,084.0</b> | <b>685.3</b>             |
| Underlying operating profit | 62.1         | 39.9                    | 124.9          | 75.8                     |
| Underlying operating margin | 11.5%        | 11.1%                   | 11.5%          | 11.1%                    |
| <b>Orders</b>               |              |                         |                |                          |
| Technology Solutions        | 211.2        | 155.4                   | 424.3          | 296.5                    |
| Systems Engineering         | 121.8        | 128.1                   | 244.7          | 244.5                    |
| IT Services                 | 173.8        | 125.2                   | 349.2          | 238.8                    |
| Mission Solutions           | 100.3        | 7.3                     | 201.4          | 13.9                     |
| <b>Total</b>                | <b>607.1</b> | <b>416.0</b>            | <b>1,219.6</b> | <b>793.7</b>             |
| Book to bill ratio          | 1.12.1       | 1.16.1                  | 1.13.1         | 1.16.1                   |
| Funded backlog              | 300.5        | 210.7                   | 598.0          | 413.0                    |

<sup>1</sup> Prior year Technology Solutions and IT Services results have been restated to reflect the transfer of part of the IT Services business to the Technology Solutions business. The transferred business unit reported turnover of £7.7m (\$15.4m) in the prior period and orders of £8.4m (\$16.9m). Total QinetiQ North America results are unchanged.

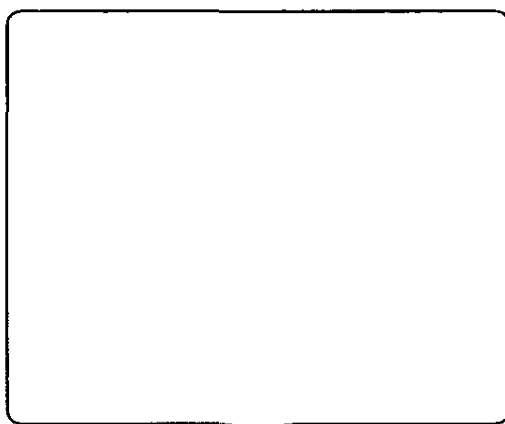
The Mission Solutions business was formed with the acquisition of Analix Corporation in March 2007. Prior period Mission Solutions and IT Services results have been restated to reflect the transfer of an element of the IT Services business acquired with OSEC in 2007 to the Mission Solutions business.

Revenue increased by 51% to £540m. 2008 included first time contributions of £55.3m from acquisitions made in the year. The business delivered strong organic growth of 17.5% on a constant-currency basis.

Underlying operating margin has improved 40 basis points to 11.5% driven by strong product revenue, principally from TALON® and LAST® Armor and an unusually high level of TALON spares sales.

The book to bill ratio continues to be above the Group's medium term target of 1.1, reflecting the business ability to grow at a rate above the overall level of growth in US Government defence and security budgets.





#### OCEANOGRAPHIC RESEARCH

QNA's Technology Solutions business was awarded a \$15m contract by the Naval Research Laboratory (NRL) for research in the areas of ocean dynamics and prediction oceanography. The research benefits the Navy's capabilities for real-time ocean monitoring and forecasting. It supports NRL's Oceanography Division's mission of planning and executing a broad-spectrum research, development, test and evaluation programme.

Image: Naval Research Laboratory Washington DC

In addition to the funded orders reflected in the table, QNA has further forward visibility of income through unfunded backlog of over \$700m principally reflecting business awarded to QinetiQ on multi-year contract awards, where funding is released on an annual basis. Further opportunities exist through QinetiQ's position on large IDIQ contracts such as the \$400m IDIQ award for TALON® and from GWAC vehicles such as the \$50bn Alliant (subject to resolution of protests from other bidders), ETIS contract, \$45bn EAGLE contract and \$12bn Encore II contract to provide IT Services to US Government agencies.

#### Acquisitions

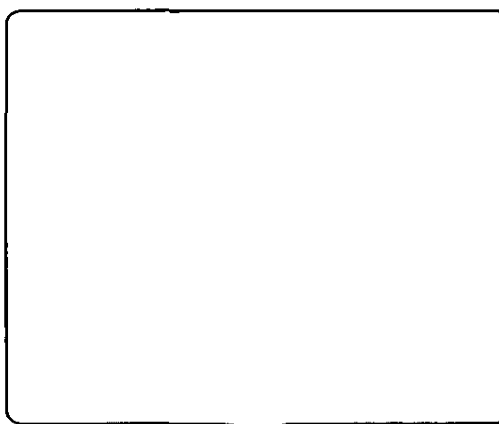
QNA made five acquisitions during the year, strengthening its capabilities in robotics technologies, IT programmes and mission critical services provided to the US intelligence community.

The two largest acquisitions in the year were ITS Corporation for £43.1m and 3H Technology LLC for £26.2m. These acquisitions enhanced our IT Services business.

The integration of the North American acquisitions continues to progress well, with increasing recognition of the QinetiQ brand, tangible evidence of bidding synergies and integration cost savings funding business development initiatives. The Group continues to see a healthy pipeline of further acquisition opportunities in North America, although vendor price expectations remain high.

#### Technology Solutions

The Technology Solutions business provides high-end technology research services and defence and security related products to the US DoD, other government agencies and commercial customers in North America. The business conducts funded technology research and development services for US defence and security



#### TALON® ROBOTIC SYSTEMS

Sales of TALON robots and spares continued to grow throughout the year with major orders from the Robotic Systems Joint Program Office in the Naval Air Warfare Training Systems Division (NAVAIR) and the Naval Explosive Ordnance Disposal Technology Division (NAVEDOTTECHDIV).

During the year, a new addition to the TALON family was introduced – the 'transformer-like' armed robotic platform named Modular Advanced Armed Robotic System (MAARS).

organisations and develops products using the intellectual property derived from such research.

Revenue grew by 31%. The business has experienced strong organic growth (in constant currency) of 35% due to continued high demand for TALON robots and spares and LAST® Armor products. In the year, the business delivered \$176.3m (2007: \$111.6m) of TALON revenue with new product shipments of 800 units contributing \$94.0m (2007: \$66.0m). LAST Armor contributed \$41.3m to revenue in the year. The book to bill ratio for the Technology Solutions business was 1.20:1 (2007: 1.15:1).

#### NASA

A five-year, \$190m contract with NASA is using a simulated space environment for the testing of spacecraft and payloads prior to launching them into space. It is providing support to projects at NASA's Goddard Space Flight Center in Maryland, USA, including structural and electromagnetic testing, engineering design and analysis, and vibration and acoustic test support for advanced space systems like the Hubble Space Telescope and the James Webb Space Telescope. The programme will help ensure that all future spacecraft can endure the environmental hardships of space travel.

**Joseph Broadwater,**  
Executive Vice President  
Mission Solutions

### Systems Engineering

The Systems Engineering business offers expertise in independent support for the procurement, development, modification and fielding of key military and missile defence equipment to US Government agencies of which the US DoD is the prime customer. After excluding £6.1m (\$11.8m) of revenue generated from the Air Filtration Systems business sold in February 2007, organic growth in revenue was 18.2%. This has been driven largely by increased demand for both logistics services and software engineering work by the business US Army customers.

The business won a five-year task order valued at over \$35m to provide technical publication services to support the US Army Aviation & Missile Command. The business was also awarded a \$13.3m five-year contract (including options) to provide technical services, systems engineering and management expertise to the Apache Attack Helicopter Project Manager's Office.

### IT Services

The IT Services business provides solutions to a range of US Government agencies, particularly the US DoD and the DHS. Key offerings include enterprise architecture, software development and systems integration, network engineering and operations, and energy and environmental engineering.

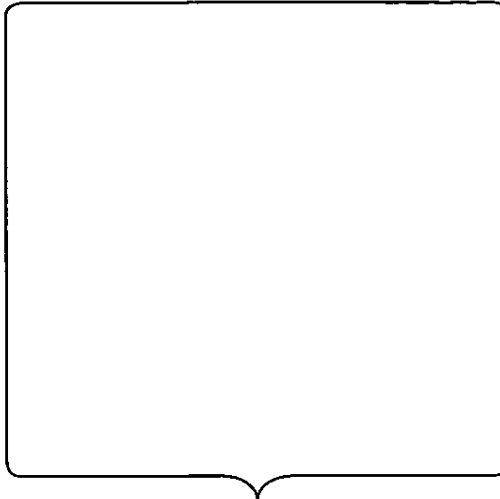
Despite US federal IT spending budget pressures with funds diverted to ongoing operations in Iraq and Afghanistan, the business achieved organic growth of 6.7% during the year. This reflects the focus of high-end IT services for mission critical systems which are less exposed to fluctuations in US federal IT spending.

The QNA position on the \$45bn EAGLE and \$12bn Encore II contract vehicles provide the business with significant opportunities for future growth. QNA was also awarded a position on the \$50bn ten-year Alliant contract. The Alliant contract vehicle is currently being protested by unsuccessful bidders, but we are confident that QinetiQ will remain as a participant when this protest is resolved.

### Mission Solutions

The Mission Solutions business was established following the acquisition of Analex Corporation in March 2007. The business has trusted experts in the fields of information technology, mission assurance, system design and programme security. Services are provided to NASA and US intelligence agencies on both defence and security applications. Mission Solutions focuses on high-growth markets and is principally centred on providing solutions in command, control, communications, computers, intelligence, surveillance and reconnaissance to support customers in meeting their mission-critical needs. The business achieved organic growth in revenue of 4.5%.

The Mission Solutions business was awarded a five-year, \$30m follow-on contract to provide support to the Counterintelligence Field Activity (CIFA). The award of this contract highlights the business's trusted relationships with CIFA as this contract follows an earlier agreement awarded in December 2003.



### RESEARCH AND TECHNOLOGY PROTECTION

The Security and Intelligence unit of QNA's Mission Solutions business was awarded a \$35.8m five-year firm fixed price contract with the US Army to operate the Army Research and Technology Protection Center (ARTPC).

QNA is providing research and technology protection expertise and support to research and engineering centres and acquisition programmes throughout the US Army.

Image: ARTPC at Fort Monro, VA

### SPAWAR SUPPORT

The US department of Navy Space and Naval Warfare Systems Command has awarded the Mission Solutions business a five-year, \$24m task order to supply systems engineering, technical support to include systems engineering, technical review, process execution, technical studies and acquisition documentation drafting.

### ENGINEERING AND AVIATION TESTING SERVICES

The US Army Aviation Technical Test Center awarded QNA a five-year, \$22m contract for engineering and aviation testing services ranging from developmental testing of advanced aircraft survivability systems to complex preliminary airworthiness evaluations of the MH-60M Black Hawk helicopter for the Army's special operations forces. The contract is being delivered by a 54 member team which includes flight test engineers, instrumentation and electrical engineers, technicians, structural engineers, human factors engineers, test coordinators and special project officers.

## QinetiQ EMEA

Our EMEA business is built on a heritage of deep technical expertise at the forefront of research in a wide field of technologies. Our position as a trusted advisor to the MOD provides us with access to every major UK military programme and enables expansion into other maturing defence and security markets. The EMEA business was reorganised in April 2008, and now focuses on Managed Services, technology-led Consulting, Integrated Systems and Applied Technologies.

### Our principal markets and customers

Our primary markets are defence, security and energy & environment. We serve the following principal customers:

UK Ministry of Defence (MOD)

US Department of Defense (DoD)

Australian Department of Defence

UK National Security Agencies

Other UK Government agencies

**Clive Richardson** Chief Operating Officer, QinetiQ EMEA

### Share of Group revenue

### Achievements

The reorganisation of the EMEA business into four offering-focused businesses was completed with effect from 1 April 2008. Consolidation of multiple existing business groups into the four sectors provided opportunity for elimination of duplicate overheads. It is expected that the charge of £32.6m will yield benefits of at least £12m per annum from the second half of 2008.

MOD confirmed that Package 1 of the Defence Training Rationalisation (DTR) programme would progress with financial close now expected by the end of 2009. DTR is the largest incremental opportunity for the UK business.

A £951m firm price agreement in respect of the second five-year term of the Long-Term Partnering Agreement (LTPA) from 1 April 2008 was signed during March 2008.

Our Consulting business was part of Trusted Borders, the winning consortium for the Home Office's e-Borders programme, an order worth up to £33m to QinetiQ.

The Managed Services business won several contracts worth up to £16m for the modification work required to release eight heavy-lift Chinook helicopters to service. We expect the first of the Chinooks will be operational in 2009.

The US Transportation Security Administration (TSA) purchased 12 SPO threat detection systems from the Applied Technologies business as part of a package of measures that will enhance security technology for travellers in the US.

The Integrated Systems business sold four Towed Array Handling Systems (TAHS) to the Spanish Navy, utilising electronic drive technology that provides a compact, robust and reliable solution, minimising the impact on other inboard systems.

**60%**  
**£820m**

■ Share of 2008 Group revenue

### Revenue increased

**£41m**

### Underlying operating profit

**+9.6%**

## Delivering long-term partnerships

The Long-Term Partnering Agreement (LTPA) for test and evaluation and training support services between QinetiQ and the Ministry of Defence (MOD) provides significant and steadfast support for the MOD's capabilities on the front line. One of the largest contracts of its kind in the United Kingdom, the 25-year LTPA which includes four pricing reviews, is valued at £5.6bn to 2028. Over its second five-year term, the LTPA will provide services to the MOD at a firm price of £951m.

**£951m**  
second term agreement

The test and evaluation and training support services provided under the LTPA covers air, maritime and land environments. It includes MOD Boscombe Down, which is the primary national centre for the provision of independent advice, research support, development, and test and evaluation services to the MOD for Air Systems. The site provides an integrated offering of complex services and facilities that support capability improvement for every current UK air platform in the defence area. The diverse and numerous range of services provided throughout the UK by the LTPA includes missile and air flight weapon testing, environmental testing of explosives and munitions, ordnance disposal and maritime operational signature measurement.

"The Long-Term Partnering Agreement is a contract for change. No one can predict what may happen in the military arena in 20 years, so our job is to prepare for the unexpected challenges that will inevitably arise in the future. We have devoted time to developing performance management systems and continuous improvement programmes which have achieved enhanced quality systems, working practices, training programmes, safety regimes and a better understanding of the MOD's needs. Working as a team with other divisions within QinetiQ, we have already delivered annual cost savings of £22m to the MOD during the first five years of the LTPA." **Shaun Pethybridge**, Head of Contract Negotiation Team

## Keeping UK borders safe

e-Borders is an advanced border control and security programme, for the UK Home Office. The programme is being delivered by Trusted Borders, the consortium led by Raytheon Systems Limited and including QinetiQ. It will be implemented by 2011, when the maintenance phase will commence, and will deliver increased security at strategic border sites in the UK – ports, harbours, stations and airports.

"I make sure that the team meets the Home Office requirements for QinetiQ's part of the programme in conformance with regulatory and industry standards. Our team's responsibility is two-fold. We advise on the border security system and its accreditation, including the documentation, making sure the IT is secure. We also provide human factors consultancy and support. These are two of QinetiQ's major strengths and contribute to the smooth functioning of the system as a whole." **Luisa Godfrey**, Practice Leader, Transport and Security

## Helping improve Sea King helicopter performance

Limited aircraft performance at higher altitudes was preventing the Joint Helicopter Command Sea King Mk 4 from being deployed in battlefield operations. Modified main rotor blades, manufactured by Carson Helicopters, a US-based commercial operator, offered the potential to address the shortfall in performance without redesign of the helicopter.

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**£5.25m**  
contract

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In response to an MOD Urgent Operation Requirement (UOR), the Aircraft Test and Evaluation Centre, a unique collaboration between MOD and QinetiQ, put forward a solution for the fitting and certification of modified blades. The successful £5.25m, 12-month project was delivered in partnership with AgustaWestland, who supplied a modified tail rotor, and has enabled increased forward speeds of Sea King helicopters, with performance gains of up to 20%. The result gives greater operational flexibility and increased support by UK battlefield helicopters to the multi-national task force in Afghanistan.

"A rigorous and intensive programme of performance evaluation and flight testing was carried out on a QinetiQ-owned Sea King helicopter, which we needed to fully instrument to collect the data required. We designed, manufactured and installed the instrumentation on the aircraft. The system was designed to allow on-board monitoring of all parameters in real-time, enabling trials to be carried out safely and efficiently." **Charles Ford**, Project Manager

“We were able to complete the testing in a short timeframe which allowed Joint Helicopter Command Sea King HC Mk 4 helicopters to be deployed in action as quickly as possible and provide the much needed added capability to operations”

Charles Ford, Project Manager

## Supporting the Royal Air Force with front line operations

Converting and flight testing eight Chinook helicopters for heavy lift front line duties as soon as possible is the challenge facing the QinetiQ team at MOD Boscombe Down. This major modification programme involves QinetiQ working with Boeing in a deal worth approximately £11m.

During the course of the work, the aircraft will be stripped, modified, reassembled and tested. Once converted, all eight Chinooks will join the existing fleet of the UK Royal Air Force Chinook helicopters supporting front line operations.

“My team provides the coordination of the whole supply chain involved in the conversion of eight Chinook Mk 3 helicopters for heavy-lift front line duties. Our responsibility is to control the supply of all the parts we need for the programme and the development of the control-metrics to ensure we deliver the programme to schedule. The time scales are extremely demanding. In our coordinating role, we are responsible for manufactured parts made at MOD Boscombe Down and all government-furnished assets, as well as equipment supplied by Boeing and third-party suppliers. We ensure that all equipment is available at the correct time, together with the supporting documentation. This is typical of the kind of agile engineering work carried out by QinetiQ Flight Engineering Services.” **Peter Hoadley**, Head of Engineering, Logistics and Support Services, Flight Engineering Services



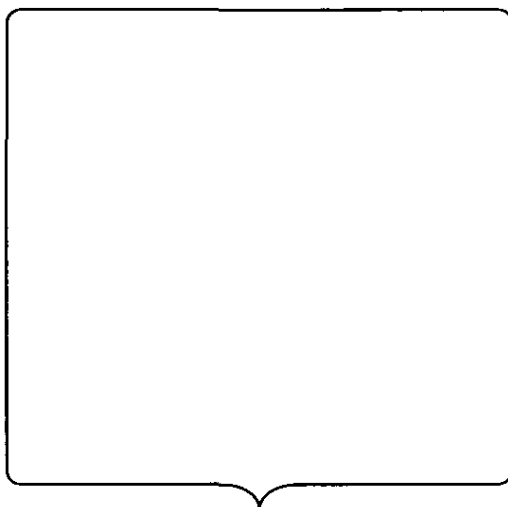
## Helping the Ministry of Defence prepare for airborne threats

Mission Training through Distributed Simulation Capability Concept Demonstrator (MTDS-CCD) provides a realistic virtual synthetic training environment for training aircrews. The facility comprises a mix of immersive air and land 'front line' capabilities enabling participants to experience combat conditions and allowing air crews to conduct realistic exercises simultaneously with remote sites. The principal aim of the programme is to address key investigative areas, defined by MOD, and provide recommendations to support the requirements of a future 'full' MTDS.

**£7.8m**  
contract

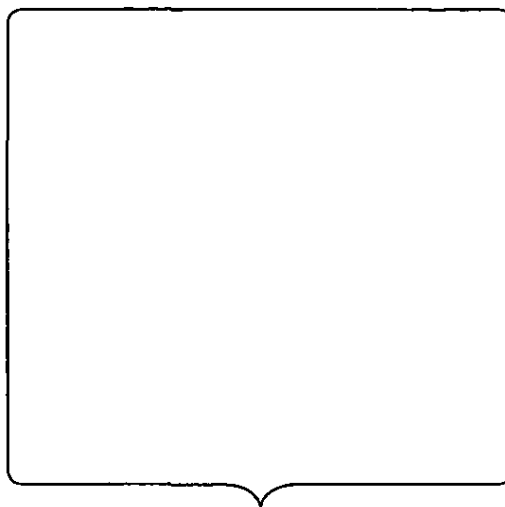
The 30-month £7.8m programme is being delivered by Team ACTIVE, the QinetiQ-led consortium which includes Boeing as principal partner, Aviation Training International Ltd and Rockwell Collins.

"I am a member of a team providing technical input for the MTDS-CCD programme. One aspect of the team's responsibility is to integrate all aspects of a synthetic environment – from flight simulators and exercise management to the briefings delivered to the training audience – carried out over distributed networks to support a series of pre-planned events. The continually evolving nature of the programme makes it exciting to be a part of." Fraser Bruce, Systems and Software Engineer



#### DEFENCE TRAINING RATIONALISATION

The Defence Training Rationalisation (DTR) is a nationally important programme for the delivery of specialist training to the UK Armed Forces. In January 2007 the Metrix consortium, a joint venture between QinetiQ and Land Securities Trillium, was awarded Preferred Bidder status for Package 1 of the DTR. Package 1 involves training in aeronautical and electro-mechanical engineering, communications and information systems. In March 2008, QinetiQ received a commitment from the MOD to underwrite costs for a body of preparatory work in advance of the contract award for Package 1, which is expected in late 2009.



#### SOLAR-POWERED SPACECRAFT PROPULSION

QinetiQ has developed an advanced spacecraft propulsion technology that will enable the European Space Agency (ESA) to propel future spacecraft using electrical energy from solar arrays. The ion engine, which uses accelerated beams of xenon ions to provide thrust, will be flown for the first time on the ESA's Gravity Field and Steady State Ocean Circulation Explorer (GOCE) spacecraft in a mission to measure and map the earth's gravity. The spacecraft is due for launch in the summer of 2008.

#### Market review

##### UK defence

The UK Government completed its Comprehensive Spending Review in late 2007 and the MOD announced that the defence budget would grow at an average 1.5% per annum in real terms over the next three years. With the Government committed to the current campaigns in Afghanistan and Iraq as well as several significant new platform programmes such as the plans for new aircraft carriers and replacing the nuclear deterrent capability, MOD have confirmed budgets are under pressure. This has resulted in uncertainty and delays in letting new contracts more widely. However, the budget challenges that this presents in the medium term are likely to provide QinetiQ with opportunities for technology insertion and consulting to enhance existing military capabilities and extend their life span and to facilitate the affordability of these larger programmes over a longer timeframe.

The MOD continues to utilise outsourcing, partnering and managed services arrangements to deliver improved defence services in support of the front line. The success of the Long-Term Partnering Agreement (LTPA) between

QinetiQ and MOD positions QinetiQ well for future managed service operations as they arise. Our success in achieving preferred bidder status for Package 1 of the Defence Training Rationalisation (DTR) programme highlights QinetiQ's position as a trusted advisor to key customers. Across other areas of technical support, procurement advice and efficiency programmes, the MOD continues to increase its use of flexible third-party service providers to balance the cost and improved front line delivery challenges it faces.

The MOD is keen to combine its own technology strategy with those within industry with the aim of producing a joint national strategy. MOD has been seeking to do this through the Technology Foresight programme to identify areas in which technological excellence might best be concentrated and developed. QinetiQ's extensive network within universities and SMEs positions the Group well to meet the MOD's desire to draw knowledge and technology from a wider science base in delivering research programmes.

#### Australian defence

The Australian defence budget is set to grow in real terms at an average of 3% per annum until 2015 as originally outlined in the 2000 Defence White Paper. The new Australian Government reiterated its commitment to this level of growth in the Defence Capability Plan 2006-2016. The market structure and dynamics in Australia are similar to those in the UK and QinetiQ already has a good working relationship with the Australian Department of Defence. In February 2008, QinetiQ made its first three acquisitions in Australia establishing an in-country presence focused on the provision of independent technical consulting to the Australian Department of Defence. This business will be able to enhance its offerings into the Australian market by leveraging the broader and deeper technical consulting and advisory capabilities from our UK and North American businesses.

#### Other defence markets

QinetiQ provides services across other international defence markets, principally from its UK operational base. As these markets continue to mature, they become more focused on procuring bespoke technology solutions and ensuring that they retain the ability to manage the development path through the life of a platform or capability. The technical consulting support services, innovative performance enhancements and test and evaluation services offered by QinetiQ are becoming increasingly relevant to such customers in selective Asia Pacific, Scandinavian and Middle Eastern markets.

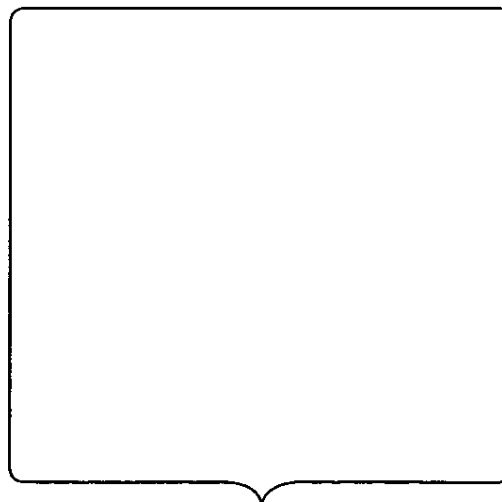
#### Security and counter terrorism

Governments across the world continue to increase their spending on homeland security, intelligence and counter-terrorism in response to the emergence of new, rapidly-evolving local and global threats. There is a growing focus on heightened security in public spaces such as large events and public transport. There is also a large commercial market, in particular for information security. It is likely that a significant proportion of this demand will be satisfied through the effective use of high-technology solutions and intelligence services such as QinetiQ's stand-off people scanning technology which is being used in mass transit screening applications by the Transportation Security Administration in North America.

The first National Security Strategy for the UK was released in March 2008, setting out the nature of new security challenges and how the UK Government will respond. Funding for counter-terrorism is set to increase to £3.5bn by 2010/11, with the Government continuing to invest in order to strengthen security and build capacity. QinetiQ is well placed within this community through its existing relationships with national security agencies and police forces to provide services, as evidenced by the award of a substantial contract under the Home Office's e-Borders programme in the year

#### Energy & environment

The level of concern about the impact of the global economy on the levels of energy usage and on climate change is at an all-time high. At a governmental level, there are an increasing number of international harmonisation agreements being established. At a business level, there is a greater awareness and focus on tackling the increasing environmental and economic costs of effectively using scarce natural resources. Funding has historically been fragmented in these areas, however there is now an improving level of clarity in national budgets and it is estimated that climate change, environment & energy and resource efficiency budgets available from EU and US Governments are in the region of £3bn. Responding to these opportunities, QinetiQ's technical expertise focuses on areas such as primary energy supply solutions, through our work on fuel cells and gas turbines, renewable energy expertise, low-carbon transport technologies and environmental impact management.



#### TORNADO F3 FOR BVRAAM

QinetiQ secured a £5.1m contract from the MOD to use the Tornado F3 as the test platform on which to support trials for the Beyond Visual Range Air-Air Missile (BVRAAM – Meteor). The programme of work offers the MOD a low-risk and cost-effective alternative option to Typhoon in the Meteor trials while protecting other issues such as agreed work shares with the five other European nations involved: Sweden, Spain, Germany, Italy and France.

**Trend in UK defence spending**  
**UK defence budget £ billions**

Source: UK MOD  
Note: UK fiscal years ended 31 March

**Financials**

|                             | 2008<br>£m   | 2007<br>£m   |
|-----------------------------|--------------|--------------|
| <b>Revenue</b>              |              |              |
| Managed Services            | 370.7        | 336.2        |
| Consulting                  | 105.4        | 97.5         |
| Integrated Systems          | 268.2        | 270.7        |
| Applied Technologies        | 75.8         | 74.9         |
| <b>Total</b>                | <b>820.1</b> | <b>779.3</b> |
| Underlying operating profit | 80.0         | 73.0         |
| Underlying operating margin | 9.8%         | 9.4%         |
| <b>Orders</b>               |              |              |
| Managed Services            | 195.5        | 301.8        |
| Consulting                  | 121.2        | 117.2        |
| Integrated Systems          | 264.9        | 288.6        |
| Applied Technologies        | 80.9         | 76.1         |
| <b>Total</b>                | <b>662.5</b> | <b>783.7</b> |
| Book to bill ratio          | 1.05:1       | 1.29:1       |
| Funded backlog <sup>1</sup> | 640.8        | 632.6        |

<sup>1</sup> Excluding remaining £4.7bn (2007: £4.8bn; 2006: £5.0bn) backlog in respect of the LTPA contract

Revenue increased by 5.2% in EMEA (2007: 2.2% decline) with organic growth of 4.5%. The Managed Services and Consulting businesses in particular have strengthened their position, delivering revenue from the Combined Aerial Target System (CATS) and Typhoon contracts won in 2007.

Underlying operating profit improved by 40 basis points to 9.8% reflecting the benefits of improved revenue growth and ongoing programmes to improve business efficiency.

Funded backlog, including the remainder of the LTPA, amounted to £5.3bn at the year end (2007: £5.3bn).

**EMEA reorganisation and portfolio review**

The EMEA sector was reorganised during the year and, with effect from 1 April 2008, operates through four offering-based businesses: Managed Services Consulting, Integrated Systems and Applied Technologies. The analysis of 2007 and 2008 orders and revenue is reported in line with the new sectors. The principal movements are in the reallocation of the MOD Research and Security & Dual Use businesses which largely move to Integrated Systems and Applied Technologies respectively. Additionally, tasking orders and certain other accreditation services move from Procurement & Capability Support to Managed Services.

The reorganisation provided the opportunity to consolidate business groups into the four new sectors, eliminating duplicate overhead roles. An investment of £32.6m in rationalisation is now expected to yield sustainable annual benefits of at least £12m per annum from the second half of calendar 2008.

A portfolio review of the EMEA sector is under way to identify any non-core activities. The review may lead to further strategic partnering, IP licensing, new venture creation or exit from certain non-core activities.

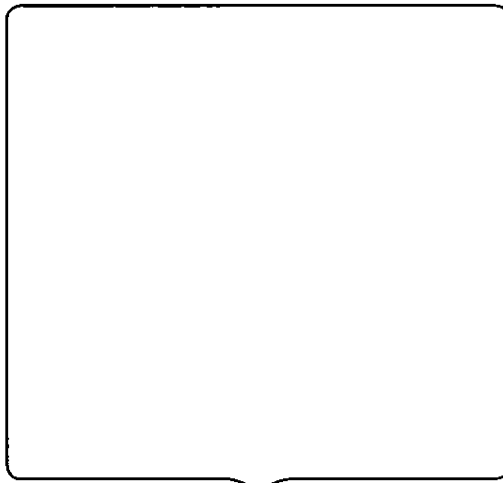
**Managed Services**

The Managed Services business provides long-term, technology-rich outsourced services to Government customers and independent accreditation services. The business focuses on transformational opportunities through the deployment of QinetiQ's broad and distinctive technical capabilities.

Revenue growth of 10% in Managed Services reflects the strong order flow in both 2007 and 2008 and £9m of additional LTPA revenue on closing out the first five-year pricing period.

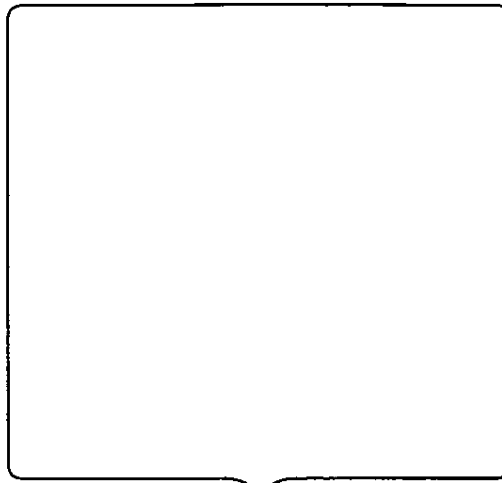
The 25-year LTPA established QinetiQ as a trusted advisor to MOD. It provides a platform for further growth and positions QinetiQ as a technology independent accreditation services supplier to government and prime manufacturer organisations. Our composite average performance scoring during the first five-year period of the LTPA to 31 March 2008 was 92.6% against a minimum target of 80%, with a score of 95.1% last year. The pricing negotiations for the second five-year period that commenced on 1 April 2008 set the price and confirmed the capabilities required by the customer for this period.

The single largest incremental growth opportunity for Managed Services is Package 1 of the UK MOD Defence Training Rationalisation (DTR) programme. Pre-contract funding was confirmed in April 2008, which will support detailed planning for the contract. During the year, £71m of bid costs were capitalised with respect to the Group's preferred bidder status, which is lower than the expected spend due principally to the timing of due diligence work streams. Up to £15m of costs are expected to be capitalised during the next 12 months as the contract progresses through to financial close expected by the end of 2009.

**ZEPHYR® UNMANNED AIR VEHICLE**

An ultra-lightweight carbon fibre aircraft weighing just 30kg despite a wingspan of 18 metres the Zephyr Unmanned Air Vehicle (UAV) flies on solar power. The aircraft uses a bespoke autopilot system to navigate between way points.

Zephyr secured a place in the history of UAV development by establishing the British record for the longest duration unmanned flight. The high-altitude long-endurance (HALE) aircraft achieved a 54-hour flight, reaching an altitude of 58 370 feet in July 2007.

**OVER-ROOFING STRUCTURE TESTING**

UK military forces currently experience mortar and rocket attacks on a daily basis in camps across both Iraq and Afghanistan. QinetiQ conducted a series of trials during 2007 to establish design data for protective structures capable of resisting the blast fragmentation and ballistic penetrative capabilities of dynamically fired rockets and mortars. The trial series was a success and the advice provided to MOD has contributed to the improved protection of UK forces.

Image: Test munition

**Consulting**

Consulting provides technical advice as a result of harnessing our unique and distinctive combination of technical and process insight, innovation and integrity. The business delivers decision and project support for both civil and defence customers, reducing risk, increasing programme coherence and providing cost-modelling services. Areas of expertise include security, transportation, aerospace, energy, environment and safety.

Revenue increased by 8.1% to £105.4m, of which organic growth was 5.6%. The book to bill ratio of 1.15:1 supports the growth objectives for the business.

The Consulting business was part of the winning consortium for the Home Office's e-Borders programme, an order worth up to £33m. It is well positioned to target a pipeline of larger opportunities similar to the e-Borders programme and benefit from greater outsourcing by defence ministries across the EMEA region.

In line with QinetiQ's strategy to build valuable new market positions outside the UK, the Group made its first three acquisitions in Australia in February 2008. The Australian defence market is similar to that in the UK and the budget of A\$22bn (£10bn) is set to grow at 3% per annum in real terms to 2015. The acquisitions of Ball Solutions Group, Novare Group and AeroStructures Group, with collectively 300 employees, provide the opportunity to build on existing relationships that QinetiQ has developed with the Australian Department of Defence.

### Integrated Systems

The Integrated Systems business focuses on delivering leading-edge technology capabilities into the air, land and sea arenas, primarily to defence customers. This business specialises in underwater systems, maritime platform systems, ground systems, sonar systems, intelligence solutions, distributed training and simulation, integrated airborne surveillance and space technologies. Its strategy is to grow through the pull-through of research technology into the supply chain, which will be achieved both by leading consortia on research and development programmes and by acting as the technical authority or system integrator in the implementation of solutions in the defence supply chain.

Revenue and order intake remained relatively flat in year at £268.2m and £264.9m respectively. Growth in the Integrated Systems business was held back by the well-publicised budget pressures at the MOD following the UK Government Comprehensive Spending Review, which has significantly delayed the letting of new supply contracts, as well as by the expected decline in MOD research revenue.

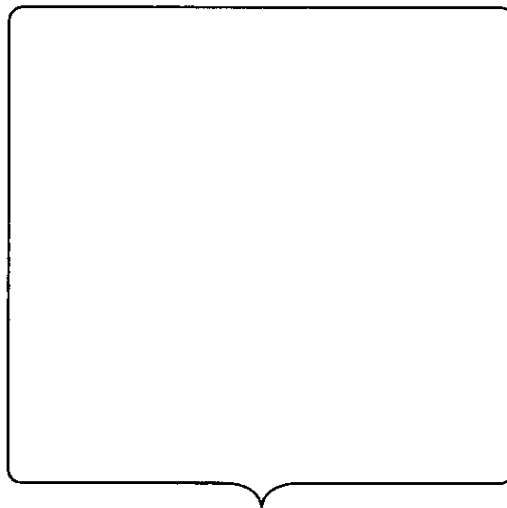
The Integrated Systems business conducts a significant amount of the total customer-funded research and development activities within EMEA. QinetiQ continues to retain its position as the leading independent provider of research services to MOD. The 3.3% decline in MOD research across the Group was lower than expected despite the further opening of the MOD research budget to competition. Total MOD research revenue across the EMEA business was £166.7m (2007: £172.4m). The success in maintaining research revenue reflects QinetiQ's deep understanding of its customers' needs, allied to the increased partnering with internationally recognised experts within universities and industry. The MOD research budget available to industry is fully open to competition with effect from 1 April 2008 (2007: 83%).

### Applied Technologies

The Applied Technologies business addresses opportunities in the core defence market together with growing physical security, digital security and energy & environment sectors. The repeatable technology propositions it develops principally derive from customer-funded research and development programmes.

Total revenue increased by £0.9m to £75.8m during the year, reflecting the part-year benefit of the Boldon James acquisition. Boldon James is a provider of secure messaging software for military, government and security customers worldwide, enhancing QinetiQ's portfolio of security-based products, broadening the customer base and providing additional routes to market.

The Applied Technologies business developed the SPO stand-off threat detection system, a passive device capable of identifying potential concealed threats located on individuals from distance without requiring people to slow their pace or pass through a physical portal. A number of units were sold by our North American business to the US Transportation Security Administration (TSA) as part of a package of measures under an indefinite delivery/indefinite quantity (IDIQ) contract that allows for additional purchases over the next two years.



### WELL PERFORATION

In a concentrated three-year joint effort, Shell International E&P, QinetiQ and GEODynamics have succeeded in developing a breakthrough perforating technology called ReActive™ Perforating that has the potential to substantially improve hydrocarbon recovery by producing clean, debris-free perforating tunnels. This is achieved by applying a revolutionary concept created and patented by QinetiQ, utilising a new shaped charge liner technology that creates a beneficial secondary reaction upon detonation. This novel well perforation solution started as a Shell GameChanger project and is now marketed by GEODynamics as CONNEX™ Perforating. (ReActive™ and CONNEX™ are trademarks of GEODynamics Inc.)

Image: Comparative penetration tests

## QinetiQ Ventures

QinetiQ Ventures is responsible for realising value from QinetiQ technology outside our core markets. Value is created through the development of new revenue streams, the creation of spin-out businesses and the sale or licensing of intellectual property.

### Achievements

The Tarsier® runway foreign object detection (FOD) system was designed to monitor operating runways and provide real-time information in support of improving safety standards and aircraft throughput at airports across the world. A supplemental camera system has been developed during the year to provide day and night visual capabilities alongside the radar detection and imaging. Operational highlights from Tarsier include:

- Landmark order from BAA for an installation of four units covering both runways at London Heathrow Airport
- Radar installation at Dubai airport now ready to go live
- Order from Doha International Airport for radar units secured
- Order from Vancouver International Airport for camera units secured
- Ongoing successful trials at TF Green Airport in Warwick, Rhode Island on behalf of the Federal Aviation Administration (FAA)

In August 2007 QinetiQ created, with Collier Capital, a new Technology Venture Fund to accelerate the development and value realisation of seven of its venture investments. Both QinetiQ and Collier Capital have committed to provide funding up to £20m each over the initial five-year life of the fund.

**Clive Richardson**, Chairman,  
QinetiQ Ventures

### Our strategy

QinetiQ Ventures strategy is to deliver incremental value from intellectual property developed through the funded research & development and other core operations of the Group.

The business exploits QinetiQ intellectual property (IP) in sectors adjacent to our core defence and security technology markets.

Value is optimised for each venture through a number of routes including organic growth, partnering with third parties, IP licensing and business realisations.

## Monitoring and tracking valuable assets

One of the seven companies in the QinetiQ Ventures LP fund, Omni-ID was granted its first patent in August 2007. Further patents are pending.

Historically, Radio Frequency Identification (RFID) tags could not be used with items or products which had any metallic or liquid component. Now, after two years' research, Omni-ID™ has overcome this problem with a major breakthrough in RFID technology. The result is the Omni-ID (passive UHF) RFID tag, which can be used to track and identify assets no matter what material they are made from. This has enabled the use of RFID in applications such as the tracking of high value IT assets where the presence of metals has historically prevented RFID being used.

"My role is to oversee and improve the development of our RFID tag technology. With data security and IT asset management becoming ever more important, Omni-ID™ tags are set to play a key role in enabling more streamlined business processes and greatly reduced IT infrastructure costs. Unlike conventional RFID tags, ours are immune to the detrimental effects of metals and liquids and have a small form factor: our smallest tag, the Omni-ID Prox™, has a footprint half that of a postage stamp and is only 3mm thick. Our tags have enabled RFID to be used where previously it couldn't be, so now everything can have an Omni-ID tag instead of a barcode, which represents a significant potential market for our products." **James Brown**, Technical Manager, Omni-ID



## Improving airport operations

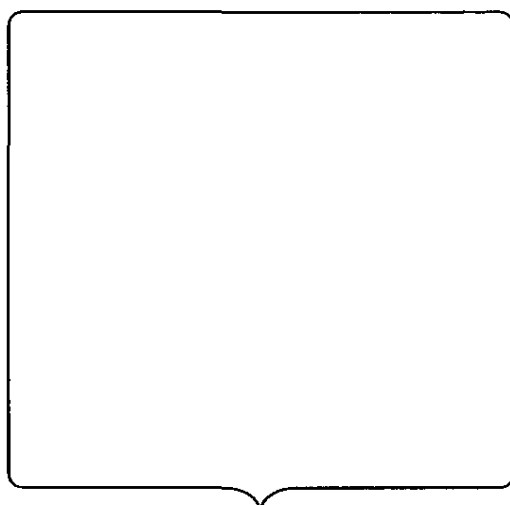
Developed to meet the challenge of foreign object debris (FOD) on airport runways, the QinetiQ Tarsier® runway debris detection system solves an age-old problem which threatens safety and costs airlines and airport authorities around £4bn a year worldwide. While current FOD detection and removal methods involve scheduled visual runway inspections, typically every few hours, the Tarsier radar system scans a runway once every minute, throughout the day and night.

Installed by QinetiQ for BAA at London Heathrow Airport, the system is assisting operational teams by ensuring that FOD is quickly detected and removed, thereby easing congestion by minimising flight disruptions and delays.

“BAA was an early adopter of the technology and needed to know that it was fit for the proposed task. My role was to support and work with BAA to help them understand how the system would benefit them, both operationally and in terms of safety. As the system helps avoid flight disruptions and passenger delays caused by FOD, it is of benefit to the airlines and the airport.”

Andy Blay, BAA Account Manager

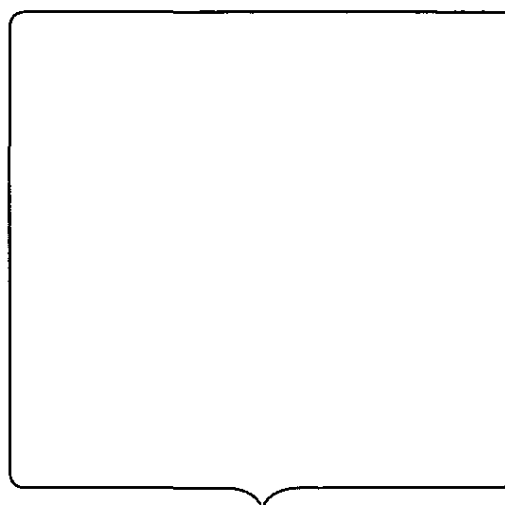
“Tarsier is a world first, no other automatic FOD detection system of any kind is deployed and integrated into an airport’s operations. My job at Heathrow was to put the Tarsier system into operation, including the management of the physical installation and its components, from the IT infrastructure, concrete foundations and steel tower to the innovative electronics and software. Our challenge was to demonstrate the capability of the system at Heathrow and to work with them to develop appropriate operational procedures.” Andy Wicks, Project Lead



#### SCIEMUS

The space sector was Sciemus' entry point into the insurance market when it was established in 2002, providing advanced risk modelling and quantification. QinetiQ, which holds a minority stake in the company, contributes with its proprietary intelligence and mathematical modelling capability.

In partnership with Liberty Syndicates, the LibSat consortium was formed, which is now the largest satellite insurance provider in the world. Sciemus has three further models in the pipeline, developed in partnership with QinetiQ: Power Station risk, Property risk and Cyber risk.



#### STINGRAY GEOPHYSICAL LTD

Listening with light® Fosar® is a passive fibre optic seismic monitoring system which can be deployed permanently on the seabed to provide high-quality time-lapse images of oil and gas reservoirs. This data can be used to help oil companies to increase the amount of oil and gas extracted.

During 2007, Stingray Geophysical Ltd continued the development and testing of its Fosar system based on technology licensed from QinetiQ. It was awarded grants totalling almost £2.5m from the UK's Technology Strategy Board and Norway's Demo 2000 programme.

Stingray became part of the QinetiQ Ventures LP fund in August 2007.

#### Operations

The QinetiQ Ventures LP fund has made good progress during the short period since its creation in August 2007. The ZBD zero power, shelf-edge, labelling display business announced further trials with Tesco in March 2008. Omni-ID won the Best in show award at the RFID Journal's 2008 showcase exhibition which provided exposure to a number of potential customers.

Ventures transferred into the QinetiQ Ventures LP fund include:

| Name                     | Ownership at the point of contribution | Activity                              |
|--------------------------|--|---------------------------------------|
| Intrinsic Materials Ltd  | 100%                                   | Test and production of nanomaterials  |
| Omni-ID Ltd              | 100%                                   | Low cost RFID tagging                 |
| Quintel Technology Ltd   | 50%                                    | 3G mast sharing antennas              |
| Aurix Ltd                | 88%                                    | Audio data mining                     |
| ZBD Displays Ltd         | 31.6%                                  | Zero power LCD displays for retailers |
| Stingray Geophysical Ltd | 19.9%                                  | Geophysical survey technologies       |
| Metalysis Ltd            | 16.3%                                  | Low cost production of metal powder   |

#### Financials

|                | 2008<br>£m | 2007<br>£m |
|----------------|------------|------------|
| Revenue        | 5.7        | 12.0       |
| Operating loss | (15.1)     | (6.9)      |
| Orders         | 7.5        | 14.3       |
| Funded backlog | 6.4        | 7.6        |

The reduction in reported orders, revenue and backlog in 2008 reflects the transfer of businesses previously consolidated into the QinetiQ Venture fund, which is now equity accounted, and certain one-off licence revenue booked in the prior year.

Operating losses, which include the Group's share of the QinetiQ Venture fund, increased to £15.1m for the year reflecting the planned increased level of QinetiQ revenue investment in the Ventures portfolio.

£3.3m of cash funding was contributed to the QinetiQ Venture fund to accelerate development of the fund's portfolio companies.

Sciemus, the insurance risk assessment specialist in which the Group holds a 10.7% interest, completed an external funding round in which the Group participated, allowing an increase in fair value of £3.2m to be recognised through equity.

## Other Group financial information

### Cash flow

Group cash inflow from operations before investing activities was £138.3m (2007: £107.0m). The Group had an underlying operating cash conversion of 77%, in line with the Group target of 80% over the medium term compared to 56% in the prior year. The benefit of approximately £20m cash collection from high levels of MOD debtors during the first few weeks of the year was offset by investment in product-related working capital and pre-contract costs relating to the DTR bid.

Investment in acquisitions in the year totalled £106.7m (2007: £137.2m) as set out in note 13 to the financial statements.

The Group paid £17.7m in US corporation tax in the year, £5.9m of which relates to the prior-year disposal of AFS. In the UK, no cash tax was paid due to the availability of deductions for research and development relief and additional pension contributions made in previous years. Going forward, this cash tax profile is expected to continue for the next two to three years.

Dividend payments of £24.9m were made in the year comprising the final dividend of £16.2m for the year ended 31 March 2007 (paid in August 2007) and an interim dividend of £8.7m (paid in February 2008).

During the period, the Company has provided £12.8m of funding to the trustees of its employee share scheme trusts to facilitate the purchase of shares in the Company to hedge outstanding share options and other share-based awards that have been made since IPO. The trusts acquired 7.3m shares at an average price of 175p.

As part of the EMEA reorganisation programme to re-position the business in the year to 31 March 2008, there was a cash outflow of £5.6m. A further outflow of £27.0m is expected in the first half of the year to 31 March 2009 when the programme completes.

### Net debt and liquidity

At 31 March 2008, net debt was £379.9m, an increase of £79.1m on the prior year. 91% of the Group's debt is denominated in dollars. The ratio of net debt to pro-forma EBITDA was 2.27:1 (2007: 2.11:1). The increase in net debt reflects investment in acquisitions.

As at 31 March 2008, £233.3m of additional borrowing capacity was available to the Group, representing the unutilised element of the principal revolving credit facility. In August 2007, the Group exercised its second and final option to extend the duration of this facility by a further year to August 2012 and also negotiated a number of beneficial changes to its terms, including a lower margin on amounts drawn under the facility. The Group operated comfortably within its banking covenants during the year.

### Facilities and borrowings maturity profile

#### Capital expenditure and fixed asset disposals

Purchase of property, plant and equipment and intangible assets totalled £43.6m (2007: £46.9m), including £13.7m (2007: £16.9m) in relation to assets funded as part of the LTPA contract.

QinetiQ received £14.9m of net proceeds from the disposal of surplus property at Bedford which completed at the end of March 2007.

#### Pensions

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

New entrants to QinetiQ in EMEA join the Defined Contribution section of the QinetiQ Pension Scheme. Pension benefits in QNA are provided on a defined contribution basis through 401k plans.

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

|                                     | 2008<br>£m | 2007<br>£m |
|-------------------------------------|------------|------------|
| Schemes assets                      | 784.2      | 794.1      |
| Schemes liabilities                 | (807.6)    | (884.9)    |
| Schemes deficit before deferred tax | (23.4)     | (90.8)     |
| Deferred tax asset                  | 6.5        | 27.1       |
| Net pension liability               | (16.9)     | (63.7)     |

The £46.8m reduction in net pension liability in the year is primarily driven by an increase in the discount rate. The higher discount rate reflects current volatility in global equity and debt markets and consequent wider spreads in the AA bond yields mandated for accounting purposes. This is partially offset by increases in inflation rate and mortality assumptions used to value the scheme liabilities. The net pension liability based on a notional discount rate of 5.6% reflecting average credit spreads over the past nine years, would be closer to £220m, assuming all other factors influencing the scheme valuation remain unchanged.

## Business review – Other Group financial information continued

The key assumptions used in the IAS 19 valuation are

| Assumption        | 31 March 2008 | 31 March 2007 |
|-------------------|---------------|---------------|
| Discount rate     | 6.6%          | 5.4%          |
| Inflation         | 3.5%          | 3.1%          |
| Salary increase   | 5.0%          | 4.6%          |
| Mortality male*   | 88            | 86            |
| Mortality female* | 91            | 89            |

Future pensioner (currently aged 40)

Each assumption is selected by management in consultation with the Company actuary and taking account of the industry practice amongst comparator listed companies. During the year the Group adjusted its mortality assumptions from the short cohort to medium cohort basis. The sensitivity of each of these key assumptions is shown in the table below and this illustrates how a small change in each assumption can have a material effect on the magnitude of the IAS 19 calculated deficit.

| Assumption                    | Change in assumption      | Indicative effect on scheme liabilities |
|-------------------------------|---------------------------|---|
| Discount rate                 | Increase/decrease by 0.1% | Decrease/increase by £21m               |
| Inflation and salary increase | Increase/decrease by 0.1% | Increase/decrease by £19m               |
| Life expectancy               | Increase by 1 year        | Increase by £16m                        |

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

The funding of the defined benefit schemes is decided by the Group in conjunction with the trustees of the schemes and the advice of external actuaries. The next full actuarial valuation of the QinetiQ Pension Scheme is due to be undertaken in June 2009 and will be the first valuation under the new regulations for scheme-specific funding of defined benefit schemes.

During the year, the net pension cost charged to the income statement before curtailments, for the defined benefit scheme was £30.5m (2007: £41.6m). Contributions to defined contribution pension schemes amounted to £14.6m (2007: £13.4m).

During the year the Group announced its intention to change the terms of the defined benefit section of the pension scheme from June 2008. Key changes include raising the normal pension age from 60 to 65, supplemented by a range of options that allow the employee to maintain future benefit accrual at rates similar to their current levels based on a higher rate of employee contribution or to retain current employee contribution levels by accepting a reduction in the rate of future benefit accrual. The changes will not affect past service obligations and the Group is not making any additional cash funding to the scheme as part of these arrangements. Future cost increases driven by changes to actuarial assumptions such as mortality rates will be dealt with through a risk-sharing agreement between the Company and its employees.

The pension charge for the year to March 2009 is expected to be lower than the current year due to the changes in the terms of the defined benefit pension schemes, based on the assumptions prevailing at the year end. The Group's cash funding of the QinetiQ Pension Scheme will remain unchanged at 17.5% of pensionable salaries.

#### Research & development

Research & development (R&D) is a significant focus for the Group with the majority of R&D-related expenditure incurred on behalf of customers as part of specific funded research contracts. R&D costs are included in the relevant income statement cost category and R&D income is reflected within revenue. In the financial year, the Group recorded £560.6m (2007: £520.1m) of total R&D related expenditure of which £547.8m was customer funded work (2007: £511.1m).

In the year to 31 March 2008, £12.8m (2007: £9.0m) of internally-funded R&D was charged to the income statement, £1.4m (2007: £3.2m) of late stage development costs were capitalised and £1.5m (2007: £1.5m) of capitalised development costs were amortised in the year.

#### Treasury risks

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 a strict control on the use of financial instruments and speculative trading in financial instruments is not permitted.

## Business review – Other Group financial information continued

**Interest rate risk management**

At 31 March 2008, 66% (31 March 2007: 80%) of the Group's borrowings are fixed or capped through a combination of interest rate swaps, collars and fixed rate debt

**Foreign exchange risk management**

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

|                       | 2008 | 2007 |
|-----------------------|------|------|
| £/US\$ – average      | 2.01 | 1.92 |
| £/US\$ – closing rate | 1.99 | 1.96 |
| £/US\$ – opening rate | 1.96 | 1.73 |

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 by the Group. The Group continues its practice of not hedging income statement translation exposure. A one cent movement in the average exchange rate for the year has approximately £3m of turnover and £0.3m of operating profit impact on the translation of the QNA results.

**Tax risk management**

The central principle of QinetiQ's tax strategy is to manage effective and cash tax rates whilst fully complying with relevant legislation. Tax is managed in alignment with the corporate strategy and with regard to QinetiQ's core value of integrity in all business dealings. These principles are applied in a responsible and transparent manner in pursuing the Group's tax strategy and in all dealings with tax authorities around the world.

**Credit risk**

Credit risk arises when a counterparty fails to perform its obligations. The Group is exposed to credit risk on financial instruments such as liquid assets, derivative assets and trade receivables. Credit risk is managed by investing liquid assets and acquiring derivatives from high-credit quality financial institutions. Trade receivables are subject to credit limits, control and approval procedures across the Group. The nature of the Group's operations leads to concentrations of credit risk on its trade receivables. The majority of the Group's credit risk is with the UK and US Governments and is therefore considered minimal.

**Insurance**

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

**Employees**

| At 31 March | 2008   | 2007   |
|-------------|--------|--------|
| QNA         | 5,699  | 4,258  |
| EMEA        | 8,209  | 8,231  |
| Ventures    | 77     | 82     |
| Corporate   | 80     | 210    |
| Group       | 14,065 | 12,781 |

As at 31 March 2008, the Group employed 14,065 people, a rise of 10% on the prior year. In EMEA, the net decrease in the UK employee base through normal in-year attrition and departures under the restructuring programme was offset by the acquisitions in Australia and of Boldon James in the UK. The acquisitions in North America increased staff numbers by 988. Reorganisation of the EMEA business is expected to result in a reduction of up to 320 positions, as a result of which 51 employees had left at 31 March 2008.

**Accounting standards**

There have been no significant changes to financial reporting standards in the year and no impact on Group profit for the year. The Group has implemented the enhanced disclosures as required by IFRS 7 Financial Instruments for the first time this year. As required by IFRS 3 Business Combinations, the formal valuation of goodwill and intangibles relating to acquisitions made in the prior year was completed in the year and is reflected in a restated balance sheet. The adjustments were not significant and did not affect profit or net assets.

**Critical accounting estimates and judgements in applying accounting policies**

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

## Management of principal risks and uncertainties

The Group operates on an international basis with its primary activities derived from the UK and US defence markets. As such, the Group's operations are exposed to a number of risks and uncertainties which could have an impact on the Group's future performance and cause actual results to differ materially from historic and expected performance. The principal risks and uncertainties are described below, together with management's view on how these are assessed, managed and mitigated to minimise their potential impact on the reported performance of the Group.

### **There are high levels of competition in the markets in which the Group operates**

The defence and security markets are highly competitive. The Group places great importance on the capabilities of its employees and their track record for delivering innovative solutions to complex customer requirements. QinetiQ's expertise and capabilities provide a compelling proposition for customers, which is a significant advantage for the Group in competitive bidding. QinetiQ's long-standing relationships with its customers, coupled with the investment made to sustain and enhance its offerings, provides QinetiQ with a deep understanding of its customers' needs and how to respond to them. QinetiQ North America has improved its competitive position by gaining access to a number of Government Wide Acquisition Contracts (GWACs). US Government spending on certain activities is restricted to businesses which have been awarded a position to supply their services under such GWACs.

### **The Group is dependent on governmental defence and security spending levels**

A reduction in UK and US Government defence and security spending could adversely impact the Group. Current UK and US defence and security spending forecasts do not indicate budget reductions but the focus of spending within the budgets will change to meet emerging needs. The asymmetric nature of modern warfare and current high threat level from terrorism have resulted in increasing expenditure on capabilities that QinetiQ offers. QinetiQ is positioned in important focus areas of defence and security spending in accordance with the MOD Defence Industrial Strategy, MOD Defence Technology Strategy and DoD Quadrennial Defense Review. The Group will continue to review trends in defence and security expenditure in order to align the business with those trends. QinetiQ's broad reach across the defence spectrum ensures that any single delay or cancellation of a new or replacement defence platform in the UK or US defence budgets would not materially impact the Group. As a technology specialist, QinetiQ is well positioned to benefit from any delay or cancellation as this will often lead to the requirement for technology insertion and upgrades to extend an existing platform's operational lifespan.

### **The regulatory environment may adversely change**

The Group's operations deal with sensitive defence and security technologies and revenue generation could be affected by regulatory changes in the geographical markets in which it can operate or restrictions on technology transfer. The majority of revenue is derived from domestic sales of services and products within the UK and US and is therefore largely unaffected by export controls and other such restrictions. QinetiQ's ability to export outside of these jurisdictions is subject to export controls and other regulations, and significant changes in the regulatory environment may limit QinetiQ's ability to expand into other export markets. The Group has formal procedures in place to ensure that it meets all current export regulations. In the US, the Group undertakes work that is deemed to be of importance for US national security and arrangements are in place to insulate these activities from undue foreign influence as a result of foreign ownership. The Group has procedures in place to ensure that these arrangements remain effective and to respond to any changes that might occur in US attitudes to foreign ownership of such activities.

### **Policies or attitudes towards Organisational Conflict of Interest (OCI) may change**

The Group provides services to its defence customers that meet their needs as part of the defence supply chain and also as a technical advisor through consultancy services. To mitigate against the potential conflict of interest that could arise, the Group takes proactive steps to manage any potential OCI and to maintain its ability to provide independent advice through its consulting and systems engineering activities. In the UK, a formal compliance regime operates with the MOD to monitor and assess potential conflicts of interest as part of its sales acceptance process. Should the attitudes or policies adopted by our customers change such that greater restrictions are placed over the ability to undertake supply and advisory contracts by the same organisation, this could materially impact the rate of future growth of these businesses.

### **Significant change in demand from reduced military operations in Iraq and Afghanistan**

QinetiQ's overall performance in recent years has not been significantly reliant on the current allied operations in Iraq and Afghanistan. While individual operating units, such as QNA's Technology Solutions business, have experienced high levels of demand for products such as the TALON® robot to help counter the threat of improvised explosive devices (IEDs), other parts of the business have been adversely affected by customer budgetary pressures reducing demand, such as for services to improve the efficiency of government processes. In the event of a reduction in the level of operations in Iraq and Afghanistan it is expected that such discretionary expenditure will resume.

**A material element of Group revenue is derived from a single large contract**

In the current year, the LTPA directly contributed 14% of Group revenue and supported a further 7.2% through tasking services using LTPA managed facilities. These percentages will decrease proportionately as the Group grows. The Group continues to achieve high customer performance and satisfaction ratings, maintain excellent relations with key customers and anticipates that the contract will continue to run for the full duration of its initial 25-year term through to 2028. The first break point in the contract is 2013. QinetiQ's performance is regularly monitored across a number of key performance indicators. QinetiQ achieved a weighted performance rating of 95.1% for the year ended 31 March 2008 and earned a performance bonus on this contract. The LTPA operates under five-year periods with specific programmes, targets and performance measures set for each period. On 3 March 2008, the Group signed a five-year pricing agreement with the MOD covering the second period of the LTPA after a successful first five-year period. The loss cancellation or termination of this contract would have a material adverse impact on the Group's future reported performance.

**Acquired businesses could fail to perform as expected**

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

**Defence Training Rationalisation (DTR) programme Package 1 is not brought to financial close**

In January 2007, Metrix, the Group's joint venture with Land Securities Trillium, was confirmed as the preferred bidder for Package 1 for the proposed 30-year DTR contract to outsource technical training for the UK Armed Forces. Currently, the Group is working with MOD to refine the final scope of work as the next stage in moving to financial close. The Group anticipates that financial close will occur by the end of 2009. In January 2008, the MOD confirmed negotiations for Package 1 were progressing successfully. DTR is expected to generate a significant level of revenue and profit once it is operational. There is a risk that the MOD may materially change the final scope or delay or cancel the implementation of the programme, which would have a significant effect on the future expected growth of the Group.

Additionally, were financial close not to be reached on the DTR contract, the bid costs incurred since preferred bidder status was achieved would need to be expensed through the income statement. It is anticipated that the Group would be able to recover certain of these costs in such circumstances.

**Volatility in foreign exchange rates impact Group financial performance**

The Group is exposed to volatility in foreign exchange rates due to its international operations. The Group has limited transactional foreign exchange exposure as most of its revenues and related costs arise in the same currencies, principally sterling and US dollars. The Group hedges all significant transactional foreign exchange exposure. Foreign currency income statement and balance sheet translation risks are not fully hedged. QinetiQ North America represents more than 39.5% of Group revenue and profit and a one cent movement in the dollar exchange rate has an approximate £3m impact on revenue and £0.3m on operating profit. US acquisitions have been funded through US dollar borrowings, thus partially mitigating the economic risk as US dollar earnings are used to service and repay US dollar-denominated indebtedness.

**Availability of financing and volatility of interest rates may impact the Group**

The Group is exposed to fluctuations in the credit markets which could impact the availability and cost of financing for the Group. The Group manages this risk by maintaining a sufficient level of committed funding facilities, with a phased maturity profile, and by the use of fixed-rate debt instruments and interest-rate swap derivatives to provide stability in the ongoing cost of utilising these facilities. There is a risk that a substantial expansion of the Group's operations could not be financed through debt financing if sufficient facilities were not available in the credit markets on economically viable terms.

**Defined benefit pension scheme deficit and/or cash funding contributions may increase**

The Group's defined benefit pension scheme valuation is subject to market changes beyond the control of QinetiQ. Actual returns achieved on assets may be lower than expected, inflation could be higher than expected and life expectancy may rise faster than expected. All these factors could contribute to the reported deficit increasing significantly beyond the current level. The Group has made considerable additional contributions to the scheme in previous years to reduce the funding deficit over the long term and scheme member contributions have also been increased. With effect from June 2008, QinetiQ is implementing changes to future benefit accruals and in addition future cost increases will be dealt with through a risk-sharing agreement between the Company and employees. The Group has taken these actions in conjunction with the scheme trustees and maintains an active dialogue with the trustees, to seek to manage and contain the magnitude and volatility of the pension scheme deficit and associated cash funding, and their impact on the performance of the Group.

**The Group's tax liabilities may increase due to changes in tax legislation**

QinetiQ is liable to taxation in the countries in which it operates, principally the United Kingdom and the United States. Changes to the tax legislation in these countries could have an adverse impact on the quantum of tax paid on the profits generated by the Group.

**The realisation of value from intellectual property may be delayed**

The funded research and development work the Group undertakes for defence and other customers creates intellectual property that the Group retains and can utilise for commercial applications. Where opportunities exist, the Group may seek to realise the value of the intellectual property through licence sales, development of new business streams or creation of spin-out ventures. The uncertainty that exists over new technologies and markets may result in delays or failure to realise value from intellectual property or in a higher level of investment required for the opportunity to be realised. The Group only invests in the development of intellectual property where it believes there is a substantial and realistic market opportunity for the technology and it undertakes a portfolio approach, recognising that not all investments will be successful. The performance of intellectual property realisation programmes is actively monitored to increase support for successful prospects and reduce expenditure where realisation appears less likely. The Group brings in external experts and funders as partners in a variety of structures to enhance the performance of certain intellectual property realisation projects as evidenced by the creation of the Venture fund with Collier Capital.

**Fixed-price contracts may cost more to complete than envisaged**

The Group enters into fixed-price contracts with customers. The Group seeks to minimise the exposure to changes in the cost of completing these contracts by only taking on delivery obligations that it can manage and by regular review of forecast costs throughout contract bidding and delivery stages. Additionally the nature of much of the services provided under such fixed-price arrangements for contract R&D, advisory and consulting services are often for a defined amount of effort or resource rather than firm product deliverables and as such the risk of cost escalation in such contracts is substantially mitigated. With the exception of the LTPA, no individual fixed-priced contract is material to the revenue of the Group.



## Corporate Responsibility

We are embedding Corporate Responsibility (CR) in our organisation through the management of our sites, the delivery of our operations, the values of our people and our stakeholder relationships

Our framework for delivering a responsible and sustainable business is to structure our initiatives into four themes – Our People, Community, Environment and Marketplace

“With a dedicated CR manager and board level support, we are making good progress and have much to be proud of. There is genuine commitment and enthusiasm to deliver tangible improvements, building on strong foundations within the organisation, but we recognise that there is still work to be done and we are committed to our programmes going forward. With CR integral to our values and business practice, we will ensure our business sustainability. In recognition of our commitment to responsible business practice, QinetiQ joined Business in the Community in November 2007. This section demonstrates how we met our 2008 objectives and outlines our goals for further improvement in 2009.”

**Graham Love**, Chief Executive Officer

“QinetiQ has already developed innovative and meaningful ways to engage with its community stakeholders and address the sciences talent and skills shortage faced by many of today’s businesses in the UK. The Lab in a Lorry is a great example of a fun programme that both stimulates interest in the sciences for young learners and is rewarding for QinetiQ employees. We are excited to assist as QinetiQ further develops business practices and programmes that integrate its key stakeholder and sustainable business priorities into its overall business strategy.”

**Business in the Community**

**Graham Love**, Chief Executive Officer

### Highlights

Royal Society for the Prevention of Accidents (RoSPA) Gold Awards for Health and Safety practices in the UK

UK Report for Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) rate at 2.28 accidents per 1,000 employees – well below the HSE industries average

Investors in People accreditation in the UK

New learning and development programmes on business ethics and corporate responsibility for employees in the UK

Education outreach programmes in the US and UK

Science for Society programme

ISO 14001 certification gained for three further sites in the UK

Recycling up by 8% at major UK sites

Increase in customer satisfaction

## Our People

At QinetiQ, we know it is our people that make us successful and we create a climate and culture to enable them to deliver outstanding performance. Our aim is to attract and engage the best people, providing a framework where they can realise their full potential.

### Nurturing our talent – investing in people

QinetiQ is committed to retaining our status as a top-quartile investor in employee learning and development. In 2008, we met this target with employees receiving in the UK, on average, five days of training. We provide a range of programmes, including our three-year engineering apprenticeship, the early career management scheme and the Competing to Win programme for bid managers.

Since 2001, QinetiQ in the UK has maintained Investors in People accreditation and we are delighted that we are now demonstrating areas of best practice.

We were encouraged by the high response rate to the UK annual employee engagement survey. Improvements were seen in the areas relating to performance management and communication, demonstrating the successful impact of the initiatives introduced last year. We aim for further improvements to address development areas highlighted by the survey.

### Health and Safety

QinetiQ is committed to the safety and well-being of our people. Support to employees is provided through a network of professionally qualified health, safety and environment advisors, occupational health nurses and the Employee Assistance Programme in the UK. Health and Safety campaigns this year focused on ensuring the safety and well-being of contractors and on muscular-skeletal issues.

In 2008, the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) rate for QinetiQ's UK employees was 2.28 accidents per 1,000 employees, compared with the Health and Safety Executive (HSE) 'all industries' rate of 5.36. This is an improvement on last year's rate of 3.47 accidents per 1,000 employees.

“Across the organisation, high regard is given to Health and Safety”

Investors in People report,  
December 2007

### Accidents per 1,000 UK employees

■ HSE all industries' rate    □ QinetiQ UK RIDDOR rate

Work at QNA is generally low risk and so there is no formal requirement to report accidents according to the Occupational Safety and Health Administration (OSHA) code. Our North American business monitors accidents and recorded 5.66 days away from work per 1,000 employees in 2008 (2007: 10.78).

“The high standard of Health and Safety management was recognised by RoSPA, with the award of Gold Achievement Awards to significant parts of the Company”

Colin Shimell, UK Chief Health, Safety and Environment Advisor

### What next?

- Continue to retain our status as a top-quartile investor in employee learning and development
- Continue to maintain UK RIDDOR rates at better than the HSE benchmark rate and develop appropriate US benchmarks
- Increase programmes to support safer driving
- Increase levels of health, safety and environmental training for all appropriate managers

The QinetiQ Inventor Awards Scheme recognises and rewards employees for both invention and the commercial benefits from invention. Chris Lyddon, head of the QinetiQ team that developed X-Net®, has been honoured under the QinetiQ Inventors Awards Scheme along with his colleague Julian Moody for his pioneering work on the product. To date, X-Net has earned £12m in revenues for QinetiQ.

Chris Lyddon, X-Net inventor

## Community

Investing in Community programmes enables our people to commit their time and expertise to support local and wider society issues. As well as fundraising activities for a range of good causes, we are proud of our education outreach programme, where we aim to inspire the next generation of scientists and engineers. Our Science for Society initiative uses our technical skills and technology to make a difference.

### Education

As one of Europe's largest employers of scientists and engineers, QinetiQ has for many years been committed to Science Technology Engineering and Maths (STEM) outreach programmes. Engaging with young people in a variety of STEM activities encourages them to consider careers in science and engineering. Increasing the number of scientists and engineers in the workforce will benefit the UK in an ever more competitive global marketplace. In November 2007, QinetiQ set up a steering group to provide coherency and a stronger direction to our programmes. Key achievements in the past year have been the Lab in the Lorry tours to schools near our sites in Scotland, Essex and Kent, projects organised with schools across the UK as part of the Engineering Education Scheme, our own School Link Scheme and placements through Nuffield Science Bursaries and Year in Industry Scheme. In North America, the Systems Engineering Group provided a number of educational scholarships, for example at the University of Missouri-Columbia under the Westar Systems Engineering and Software Development Scholarships. QinetiQ North America (QNA) also sponsored the winning team of the FIRST Robotics Competition in Colorado.

### Science for society

QinetiQ recognises that through the unique capabilities of our employees and our technology, it is possible to make a real difference to society.

In December 2007, QinetiQ employees made their third visit to the remote village of Kongtayoun, Southern Laos to assist with the clearance of unexploded ordnance (UXO). Working with the Swiss de-mining organisation FSD, the team's aim was to build local capability in UXO detection techniques and mapping, as well as developing simple and inexpensive equipment to improve transport in rough terrain.

"The technology and skills that the QinetiQ team have taken to Laos are sustainable so local people can clear the land of unexploded ordnance after the team leave. The ultimate aim of the project is to return the land to economic use by restoring the roads and making land available for the production of rice and silk."

Brett Lowery, Engineer, Laos UXO project

QinetiQ has over 100 Science and Engineering Ambassadors (SEAs) and they work on a wide range of projects with schools. Annette Smart was chosen from over 1,000 SEAs in the West Midlands for an award in recognition of her significant contribution to the programme.

### Charitable giving and community support

Throughout the Group, we support a number of charities that are important to our employees. Charitable giving initiatives included matched giving, payroll giving and volunteering. Total charitable giving across the Group in 2008 was £184,000, of which £97,000 was to UK-registered charities. In addition, employees in the UK raised a further £64,000.

Our sites continue to support a range of local issues in their communities. Some of the highlights this year in the UK include provision of funding for a community centre in Benbecula and funding for a library in a school near Boscombe Down. Aberporth employees improved playground facilities at a local school and employees from our site in the Kyle of Lochalsh worked with a local school to highlight health and safety issues. We also contributed to the Motov8 scheme at Pershore, supporting increased education and awareness among disaffected young people. In QNA, employees are actively involved in a number of community initiatives including Habitat for Humanity, Women in Technology and the Junior League of Huntsville Alabama Sports Festival.

### What next?

- 9,000 students will be visited by Lab in the Lorry by the end of 2009
- Continue to focus and deliver our STEM outreach programmes

## Environment

We recognise the need to understand the impact we have on the environment and to put in place measures to reduce our carbon footprint and our waste. We are also adding positive benefit through our conservation initiatives.

### Environmental management

QinetiQ has in place an environmental management system for all of our UK estate. We have an ongoing programme of gaining ISO 14001 certification and, in 2008, we met an important target and successfully gained certification for two of our major sites, Malvern and Farnborough. Ahead of schedule we have also gained certification for our Rosyth site. This takes the total with certification to 23 sites and includes all of the sites we manage under the LTPA, as well as the major QinetiQ-owned sites.

### Resource and energy management

Across our sites, we have many programmes to reduce our consumption of energy and resources and to ensure that we reduce, reuse and recycle where possible.

**Waste** Reuse of surplus equipment by other departments is routinely considered before recycling or disposal. Most sites recycle a variety of materials – from paper to batteries. An awareness campaign was run in October 2007 to provide information and advice to employees. Total waste for our major UK sites in 2008 was 2,115 tonnes, of which 638 tonnes (30%) was recycled, compared to 22% recycled in 2007.

**Water** A 2008 objective was to continue to monitor our water usage. Across the QinetiQ estate, water metering has been in place for several years. This allows early detection of leaks and prompt repairs. Steady and lasting progress continues to be made in water conservation by introducing more efficient systems, detection and repair of leaks and by educating employees.

**Energy** We successfully met our target to ensure we did not exceed current levels of CO<sub>2</sub> emissions from UK energy consumption relative to business output (94 tonnes CO<sub>2</sub> per £m revenue in 2008, 2007: 144 tonnes). This has been achieved by investment in, and expansion of, site building energy management systems, installation of more remote utility metering systems, energy awareness campaigns, investment in automated lighting systems and lower use of our high-pressure wind tunnel. Total energy used in 2008 was equivalent to 77,781 tonnes of CO<sub>2</sub>, compared to 90,483 tonnes in 2007 (CO<sub>2</sub> calculated with the new Defra and Carbon Trust recommended conversion factor for electric of 0.523kgCO<sub>2</sub>/kWh).

### UK energy consumption and CO<sub>2</sub> emissions

<sup>1</sup> CO<sub>2</sub> calculated with the historical recognised conversion factor for electric of 0.43kgCO<sub>2</sub>/kWh

<sup>2</sup> CO<sub>2</sub> calculated with the new recommended conversion factor for electric of 0.523kgCO<sub>2</sub>/kWh

### Conservation

QinetiQ owns and operates sites that contain valuable conservation areas, many of which are of national or international importance, including Sites of Special Scientific Interest (SSSI) and Special Areas of Conservation. The sites provide areas of undisturbed land for wildlife to flourish and help preserve habitats that would otherwise be lost. By maintaining and enhancing the condition of conservation areas, we make a valuable contribution to national biodiversity objectives. This is a long-term commitment and, in August 2007, the Boscombe Down Conservation Group marked 20 years of conservation effort.



We have been working with Marwell Zoological Park to restore the 79 hectare Eelmoor Marsh at Farnborough, Hampshire, which is now a nature reserve and home to many species of rare plants and wildlife. Not only is the site restored as heathland, it also provides a soft release environment that will ensure the preservation of the endangered Przewalski's horse, which was introduced to the marsh in conjunction with Marwell.

### What next?

- Extend ISO 14001 certification to all significant sites
- Introduce an enhanced carbon footprint management programme
- Increase our recycling rates by 3% in 2009

## Marketplace

QinetiQ strives to be a responsible business to work with and we place great value on our relationships with our customers and supply chain

### The Customer Equation programme

Our Customer Equation programme is helping us to understand and improve our performance relative to customer needs, for today and for the future. We are working to use 'voice of the customer' feedback to support improvement and help us all to further develop a customer-focused culture throughout our organisation. QinetiQ has been rapidly changing and we recognise the need to work with our customers so they understand our capability. Results from the 2007 survey showed an increase in customer satisfaction over the last three years, and highlighted the positive relationships between our customers and account managers.

### Business ethics

QinetiQ's business ethics policy continues to be guided by our core values of integrity, excellence, care, teamwork and commitment and with respect for human rights and the best interests of employees and stakeholders. This policy is implemented throughout the Group, irrespective of business or operational context. QinetiQ is a member of the UK Anti-Corruption Forum.

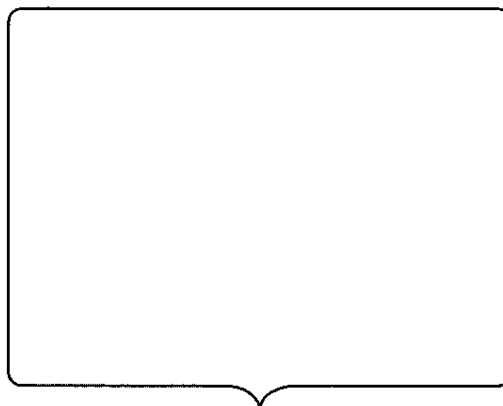
In QNA, each employee is required to undergo periodic ethics training. Training on business ethics has been developed as part of the induction programme for all new employees in the UK. This accompanies the training course on CR, which informs employees of QinetiQ's wider approach to responsible business.

### Responsible purchasing

A key priority for our purchasing team is ensuring that we are working responsibly with our supply chain to address improvements in both environmental and societal issues. The process of establishing a clear set of criteria with which to engage all QinetiQ suppliers is under way, with initial focus being placed on key suppliers. Plans for the future include working with our preferred suppliers to identify ways in which our procurement activities can directly support our objectives.

### Energy and environment solutions

QinetiQ recognises the importance of technology solutions in addressing issues such as climate change. Our scientists and engineers are developing a range of solutions looking at low-carbon transport, renewable energy and waste management.



A prototype of a Stirling power system that will use landfill and other waste gases to generate electricity is being developed by QinetiQ North America. The Stirling system offers the potential for significant economic and environmental benefits.

### What next?

- Introduce responsible purchasing criteria into all our key procurement activities
- Continue to embed a customer-focused culture throughout the Group

QinetiQ was part of the development consortium behind the Morgan Life Car that was showcased at the Geneva Motor Show and has been responsible for the design of the proton membrane exchange fuel cell which converts hydrogen, plus oxygen taken from the air around it, into electrical energy.

## Our Board of Directors

### 1 Sir John Chisholm <sup>a b</sup>

#### Chairman (Non-executive Director)

Sir John Chisholm (61) the Non executive Chairman of QinetiQ was Chief Executive Officer of QinetiQ (previously DERA) from 1991 to 2005 transforming it into a successful trading fund and developing its commercial business. Until October 2006 he was the Executive Chairman of QinetiQ. Previously Sir John was UK Managing Director of Sema Group plc and prior to that he was a Director of CAP Group plc. In 1979 he founded and became Managing Director of CAP Scientific Ltd. After a degree at Cambridge in Mechanical Sciences, Sir John's work experience included periods at General Motors and Sacon Ltd. part of BP. Sir John was formerly President of the Institution of Engineering and Technology and is currently Chairman of the Medical Research Council. He is also a Fellow of the Royal Academy of Engineering, the Royal Aeronautical Society and the Institute of Physics. The Board considers Sir John's extensive knowledge of Defence and Security Technology markets and his unrivalled experience of QinetiQ's business gained whilst Chief Executive Officer to be a valuable asset to the Board in terms of decision-making and understanding the strategic issues affecting the Group.

### 2 Graham Love <sup>a</sup>

#### Chief Executive Officer (Executive Director)

Graham Love (54) is the Chief Executive Officer of QinetiQ having previously been Chief Financial Officer. Prior to rejoining DERA in 2001, he was Chief Executive of Comax Secure Business Services Ltd leading it through its privatisation in 1997 before its sale to Amey plc in 1999. Before that Graham was Finance Director of DERA from 1992 to 1996. After a degree in English at Cambridge his career included management roles with Ernst & Young, KPMG and Shandwick plc as well as several years in international consulting. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

### 3 Doug Webb

#### Chief Financial Officer (Executive Director)

Doug Webb (47) is the Chief Financial Officer of QinetiQ. Doug was appointed to the Board in September 2005, having previously been Group Financial Controller. He joined QinetiQ in June 2003 from LogicaCMG where he had most recently been the Regional Finance Director for Continental Europe. During his eight years with Logica Doug spent the period from 1995 to 2000 in the US in various management roles at its US subsidiary including Chief Operating Officer, Chief Financial Officer and Executive Vice President, Telecoms Division. He trained as an accountant with Price Waterhouse and is a Fellow of the Institute of Chartered Accountants in England and Wales. On 17 January 2008 Doug announced his intention to take up the position of Chief Financial Officer with London Stock Exchange Group plc and resigned as a Director on 30 May 2008.

### 4 Sir David Lees <sup>a b d</sup>

#### Deputy Chairman (Senior Independent Non-executive Director)

Sir David Lees (71) joined the Board of QinetiQ in August 2005. He is currently Chairman of Tate & Lyle plc. He has also been a member of the UK Panel on Takeovers and Mergers since June 2001. Sir David joined GKN plc in 1970 and became Group Finance Director in 1982. He was appointed Group Managing Director in 1987 and Chairman and Chief Executive in 1988 before becoming Non-executive Chairman in 1997 until his retirement in May 2004. Other notable roles include being a member of the National Defence Industries Council between 1995 and 2004, Chairman of Courtaulds plc from 1996 to 1998, a Non-executive Director of the Bank of England between 1991 and 1999 and Chairman of the CBI Economic Affairs Committee from 1988 until 1994 as well as being a member of the CBI President's Committee from 1988 to 1996. From 2001 to 2006, he was Non-executive Joint Deputy Chairman of Brambles Industries plc and Brambles Industries Limited. Sir David is currently a Non-executive Director of the Royal Opera House and he is also a Fellow of the Institute of Chartered Accountants in England and Wales. The Board considers that Sir David's detailed understanding of the Defence sector coupled with his extensive experience of corporate governance and the City and its institutions significantly enhances the operation of the Board particularly in the context of Sir David's dual role of Deputy Chairman and Senior Independent Non-executive Director.

### 5 Colin Balmer <sup>a</sup>

#### Non-executive Director

Colin Balmer CB (61) was appointed to the Board of QinetiQ in February 2003. He served as Managing Director of the Cabinet Office from 2003 until his retirement in 2006. Previously, Colin was Finance Director of the MOD with responsibility for QinetiQ's privatisation and the subsequent investment by Carlyle as part of the PPP Transaction. He has extensive experience across the MOD including periods as Private Secretary of two Ministers for Defence Procurement, a secondment to the UK Delegation to the North Atlantic Treaty Organisation (NATO) and as a Minister for Defence Materiel in Washington DC, United States. Colin was formerly a member of the Independent Financial Reporting Advisory Board and the Advisory Council of Partnerships UK and is currently a member of the Foreign and Commonwealth Office's Audit and Risk Committee and is on the Board of the Royal Mint chairing their Audit Committee. The Board considers that Colin's extensive knowledge of the development of QinetiQ throughout its public-private partnership and his in-depth understanding of the working of Government particularly the UK MOD provides the Board with a unique insight into the issues facing Government in delivering its procurement objectives and partnering with industry suppliers.

## Our Board of Directors continued

**6 Noreen Doyle<sup>c,d</sup>****Non-executive Director**

Noreen Doyle (59) was appointed to the Board of QinetiQ in October 2005 and serves as an independent Non-executive Director. She also sits on the Board and Audit Committee of Credit Suisse Group (Zurich) and is a Non-executive Director of Newmont Mining Corporation (Denver) and Rexam plc. In August 2005 Noreen completed her four-year term as First Vice President of the European Bank for Reconstruction and Development (EBRD) where she chaired the EBRD's Operations Committee and was a member of the Executive Committee. Prior to her appointment as First Vice President Noreen was firm-wide head of Risk Management. She joined the EBRD in 1992 to establish its syndications functions. Before joining the EBRD Noreen had a distinguished career at Bankers Trust Company (now Deutsche Bank) in corporate finance and leveraged financing with a concentration in oil, gas and mining. Noreen has a BA from the College of Mount Saint Vincent, Riverdale, New York and an MBA from Tuck School at Dartmouth College. The Board considers that Noreen's extensive international business experience, particularly in the areas of corporate finance, risk management and banking, to be of significant benefit to the Board as QinetiQ continues its strategy of developing new business opportunities outside its traditional UK market, particularly in North America.

**7 Dr Peter Fellner<sup>b,c,d</sup>****Non-executive Director**

Dr Peter Fellner (64) joined the Board of QinetiQ in September 2004. Peter is Executive Chairman of Vernalis plc and is also the Chairman of both Acambis plc and the privately held biotechnology company, Astex Therapeutics Limited. In addition he serves as a Director of two European biotechnology companies, UCB SA and Evotec AG and also Consort Medical plc. Previously Peter served as Chairman of Celltech Group plc from 2003 to July 2004, having been Chief Executive Officer from 1990 onwards. Before joining Celltech, he was Chief Executive of Roche UK from 1986 to 1990, having previously been a Director of Roche UK Research Centre. The Board considers that Peter's detailed understanding of the commercialisation of innovative technologies and his experience of bringing high-technology businesses to the public markets are a valuable asset to the Board in terms of the development of QinetiQ's portfolio of leading technologies and the evolution of QinetiQ's remuneration policies, particularly in the context of his role as Chairman of the Remuneration Committee.

**8 Edmund P Giambastiani Jr****Non-executive Director**

Admiral Giambastiani (60) was appointed to the Board of QinetiQ in February 2008 and serves as an independent Non-executive Director. Between 2005 and 2007 Ed was the second highest-ranking military officer in the United States, having served as the seventh Vice Chairman of the Joint Chiefs of Staff, which was the culmination of a 37-year career in the US Navy. Ed's distinguished career has also included assignments as Special Assistant to the CIA's Deputy Director for Intelligence, Senior Military Assistant to the US Defense Secretary and Commander, US Joint Forces Command. He also served as NATO's first Supreme Allied Commander Transformation when he led the transformation of the military alliance. Ed currently serves as the Non-executive Chairman of the Board of Directors for Alenia North America, Inc and is a Non-executive Director of SRA International, Inc and Monster Worldwide, Inc. The Board considers that Ed's extensive knowledge of the US Defence and Security domain significantly enhances the operation of the Board as QinetiQ continues to pursue its strategy of growing its US platform in the defence and security technology sector.

**9 Nick Luff<sup>c</sup>****Non-executive Director**

Nick Luff (41) joined the Board of QinetiQ in June 2004 and serves as an independent Non-executive Director. Nick was appointed Finance Director of Centrica plc in March 2007, having previously served as CFO of the P&O Group. He trained as a chartered accountant with KPMG and is a member of the Institute of Chartered Accountants in England and Wales. Nick joined P&O in 1991 and held various finance roles before joining the Board as Finance Director in 1999. In October 2000 he became Chief Financial Officer of P&O Princess Cruises plc on its demerger from the P&O Group and returned as Chief Financial Officer of P&O in May 2003. Nick has also served as a Non-executive Director on the board of Royal P&O Nedlloyd NV, the Dutch-listed international container shipping company. The Board considers that Nick's experience of operating as Chief Financial Officer/ Finance Director with P&O and Centrica, coupled with his extensive exposure to a variety of industrial sectors, provides the rigorous financial and commercial scrutiny required of a FTSE-listed company at the Board level, particularly in the context of his role as Chairman of the Audit Committee.

<sup>a</sup> Member of Compliance Committee   <sup>b</sup> Member of Nomination Committee   <sup>c</sup> Member of Audit Committee   <sup>d</sup> Member of Remuneration Committee   \* Chair of Committee

# Corporate Governance Report

This part of the Annual Report, together with the Report of the Remuneration Committee on pages 58 to 64, describes how QinetiQ has applied the principles contained in the revised Combined Code on Corporate Governance published in June 2006 (the Combined Code)

## Combined Code

On appointment as Chairman in 2005 Sir John Chisholm was not regarded as independent under the Combined Code as he was formerly QinetiQ's Chief Executive Officer. The Combined Code recommends that a company's chairman should be independent on appointment and that its Chief Executive Officer should not become chairman of the same company. The Board considers that departure from the Combined Code in this area is appropriate and gave its reasons for non-compliance both in the prospectus published as part of the Company's Initial Public Offering (IPO) in 2006 and the 2007 Annual Report.

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

## The Board – governance, processes and systems

### Composition of the Board

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

The Board comprises a Non-executive Chairman, six Non-executive Directors and two Executive Directors, namely the Chief Executive Officer and the Chief Financial Officer<sup>1</sup>, with the objective of achieving a balance of Executive and Non-executive Directors. The Board considers its overall size and composition to be appropriate, having regard in particular to the independence of character and integrity of all the Directors and the experience and skills which they bring to their duties, which prevents any individual or small group from dominating the Board's decision making.

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

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

## Directors' independence

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

In February 2008, Admiral Edmund P. Giambastiani replaced George Tenet as an independent Non-executive Director. Admiral Giambastiani has extensive knowledge of the US Defence and Security domain which will enhance the operation of the Board as QinetiQ continues its strategy of growing its US platform in the Defence and Security Technology sector. Admiral Giambastiani was selected through an open process with the assistance of an international search and selection consultant.

Based on the above, the Board considers that over half of its members were independent Non-executive Directors throughout the last financial year.

## Board structure

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 mergers and acquisitions, have been fundamental in the pursuit of QinetiQ's growth strategies (as described in the Business Review section of this Annual Report) in the past year. In addition, the quoted company experience available to members of the Board in a variety of industry sectors and international markets has also been invaluable to the Company as it seeks to penetrate new markets and geographic territories.

## Operation of the Board

The Board is responsible for managing the Group's operations and in this capacity determines the Group's strategic and investment policies. The Board also monitors the performance of the Group's senior management team and organises its business to have regular interaction with key members of the Group, including those based in North America. The following is a summary of the approach taken by the Board to corporate governance in the financial year ended 31 March 2008.

- The Board has agreed a schedule which contemplates eight Board meetings being held in each financial year. Members of the Board are also invited to attend a dinner on the occasion of each Board meeting, which assists in the process of relationship building and ensuring that key strategic initiatives are thoroughly discussed. In the last financial year the Board met on ten separate occasions, two of these meetings were unscheduled and were convened to allow the Board to consider the merits of acquisition opportunities in both the US and Australia. The Board intends to hold two of its scheduled meetings in the US in each financial year to give members of the Board an opportunity to meet with senior management in the QinetiQ North America region. It is proposed

<sup>1</sup> Doug Webb, the Chief Financial Officer of the Company throughout the financial year ended 31 March 2008, announced on 17 January 2008 his intention to take up the position of Chief Financial Officer with The London Stock Exchange Group plc. Mr Webb will resign as a Director of the Company on 30 May 2008. Following the announcement made on 21 May 2008, we anticipate that David Mellors will be appointed as Chief Financial Officer from the end of August 2008.



that a further two Board meetings will be held at QinetiQ UK sites each year to provide members of the Board with greater opportunity to understand the operational dynamics of the EMEA business at first hand

- The Board receives written reports from the CEO and CFO each month together with a separate report on investor relations (which is prepared in consultation with QinetiQ's brokers) and a report produced by the Company Secretary on key legal and regulatory issues affecting the Group. The Board also considers reports from the respective Chairmen of the Committees of the Board at the next scheduled Board meeting following the date on which each such Committee Meeting was held. The CEO's monthly report addresses the key strategic initiatives impacting the Group since the last meeting of the Board and focuses in particular on the strategic progress of each of the EMEA, QNA and Ventures businesses. Other key areas of focus include health, safety, environmental, employee and organisational issues, the status of key account management/customer relationship initiatives and the pipeline of potential acquisitions, disposals and investments. Of particular significance in the last financial year was the consideration given to a number of acquisition opportunities which culminated in the completion of the Boldon James transaction in the UK, the Automatika, Applied Perception, 3H Technology ITS and Pinnacle CSI acquisitions in the US, and QinetiQ's entry into the Australian Defence consultancy business through the acquisitions of Ball Solutions, Novare and Aerostructures. The Board also oversaw the restructuring activity in the EMEA region during the second half of the financial year together with the creation of a new Technology Venture fund in collaboration with Collier Capital and the programme of work for progressing the contractual arrangements for the Defence Training Rationalisation programme (conducted through Metrix). Any proposed acquisitions, disposals and investments which exceed the CEO's delegated authority are considered by the Board in the context of the CEO's report.
- The CFO's monthly report addresses the financial performance and outlook of the Group and each of the sectors, both on a monthly and year-to-date basis, with the key performance indicators analysed being those identified on page 10 of the CEO review. The Group Risk Register also forms part of the CFO's report on a quarterly basis and highlights the dozen or so principal risks capable of having a material impact at a Group level, the materiality of each risk, the assumptions underlying each such risk, the actions required to manage the risk and the relevant key performance indicators for each headline risk. The risks covered by the Group Risk Register cover a range of financial and non-financial items, based on the 'Principal risks and uncertainties' identified on pages 42 to 44 of the Business Review. The CFO also reports on a monthly basis, as part of his investor relations report, on the key issues raised by shareholders, potential investors and other important stakeholders on QinetiQ's performance and key strategic initiatives.
- On at least two occasions each year, one of the sector heads will give a presentation to the Board on the key strategic, operational and performance issues impacting their business. The Board also receives updates from the CEO's key functional reports on an 'as needed' basis, on issues such as Human Resources, Real Estate and Pensions throughout the financial year. The Board devotes one entire meeting each year to consider strategy and planning issues

impacting the Group, from which the five-year corporate plan is generated. A key part of this process involves the Board having the opportunity to question the sector heads and the Executive Directors in relation to the formulation of the corporate plan at sector level and the impact of these plans on the Group strategy as a whole. The Non-executive Directors also have an opportunity to meet with other members of staff within the QinetiQ Group (including, but not limited to, other members of the senior management team) at lunchtime events, which are scheduled to coincide with Board meetings. During the last financial year, two such events were held in Farnborough and Washington DC and the Board also had the opportunity to review QinetiQ's LTPA operations at Boscombe Down.

- The Board operates through a comprehensive set of processes, which define the schedule of matters to be considered by the Board and its Committees during the annual business cycle, the level of delegated authorities (both financial and non-financial) available to both Executive Directors and other layers of management within the business, and QinetiQ's Business Ethics, Risk Management and Health, Safety and Environmental processes. The Board also has a clearly articulated set of matters which are specifically reserved to it for consideration, which include reviewing the annual budgets, raising indebtedness, granting security over Group assets, approving Group strategy and the corporate plan, approval of the annual and interim report and accounts, approval of significant investment, bid, acquisition and divestment transactions, approval of Human Resources policies (including pension arrangements), reviewing material litigation and monitoring the overall system of internal controls, including risk management.
- QinetiQ has been a member of the UK Defence Industry Anti-corruption Forum since 2006, the primary objective of which is to promote the prevention of corruption in the international defence markets. In furtherance of this objective, QinetiQ has enhanced its existing internal procedures which are designed not only to comply with, but to exceed, international best practice in this area. This is facilitated by the engagement of an independent, internationally recognised organisation known as TRACE (Transparent Agents and Contracting Entities) which conducts anti-bribery due diligence reviews and compliance training on behalf of the Group, particularly in circumstances in which QinetiQ is planning to engage third-party agents overseas.

#### Performance of the Board

During the financial year ended 31 March 2008, the Board repeated the self-assessment process first used in the previous year to evaluate the performance of the Board, its Committees and individual Directors. This evaluation process was based on a detailed questionnaire, covering issues ranging from value creation and 'strategic planning' through to the operation of the Board/its Committees and 'risk management'. The evaluation process was led by the Chairman, who supplemented the detailed responses derived from the self-assessment questionnaire with a series of meetings held individually with each of the Directors at which the performance of the Board as a whole, as well as the Committees and individual Board members were discussed. In addition, Sir David Lees in his capacity as the Senior Independent Non-executive Director, met with individual members of the Board to evaluate the performance of the Chairman. The evaluation process revealed that

## Corporate Governance Report continued

in virtually all areas, the operation of the Board and its Committees had improved in the past 12 months. The Board concluded from the evaluation exercise that its business is conducted in a positive and open manner, with the Board possessing the requisite skills and diversity necessary to fulfil its leadership role and having a detailed understanding of its stewardship responsibilities. The Board agreed that in the financial year ending 31 March 2009, and once every three years thereafter, it would conduct the evaluation process through an external facilitator.

As a separate exercise, the Chairman has held various meetings with the Non-executive Directors in the last financial year, without the Executive Directors present, in order to review both the operation of the Board and the performance of the Executive Directors. In addition, the Executive Directors were appraised as part of the annual salary review process, which was overseen by the Remuneration Committee.

#### Directors' induction, training and information

All newly appointed Directors participate in an induction programme, which is tailored to meet their specific needs in relation to information on the Group. This induction programme includes an induction pack, which is refreshed to ensure it contains the most up-to-date information available on the Group.

All Directors are encouraged to visit QinetiQ's principal sites and to meet a wide cross-section of QinetiQ's employee base. During the last financial year, the Board held two of its meetings at QinetiQ facilities located in the Washington DC area, which allowed members of the Board to better appreciate the dynamics of QinetiQ's newly acquired ITS and Analex businesses. The Board also held one of its meetings at QinetiQ's Boscombe Down site, during which a tour was undertaken of the LTPA facilities located at the site, which provided members of the Board with exposure to a range of Managed Services capabilities in the fixed wing/rotary aircraft and environmental sectors.

Training is also available to the Board on key business issues or developments in policy, regulation or legislation on an 'as needed' basis. By way of example, the Board was provided with a detailed presentation on recent changes in legislation and corporate practice as a result of the introduction of parts of the Companies Act 2006 and amendments to the Listing Rules, with particular emphasis on the clarification of the law relating to directors' duties. Each of the Directors has access to the services of the Company Secretary, and there is also an agreed procedure for the Directors to seek independent advice at the Company's expense.

#### Directors' responsibilities

Statements explaining the Directors' responsibilities for preparing the Group's financial statements and the auditors' responsibilities for reporting on those statements are set out on pages 68 and 69.

#### Other Directors' information

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

In October 2006, Sir John Chisholm was appointed Chairman of the Medical Research Council, a role for which he does not take a fee.

Each serving member of the Board will be put forward for re-election at the Annual General Meeting of the Company in 2008.

#### Committees of Directors

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

Details of each of these Committees are summarised below.

#### Audit Committee

Each member of the Audit Committee is an independent Non-executive Director. The Committee is chaired by Nick Luff, who has been a member of the Institute of Chartered Accountants in England and Wales since 1991, and the Board considers him to have recent and relevant financial experience given his former roles as CFO of P&O and P&O Princess Cruises and his current position as Finance Director of Centrica. The other members of the Committee are Dr Peter Fellner and Noreen Doyle. The Audit Committee meets as necessary and at least four times a year. During the financial year ended 31 March 2008, the Committee met on five occasions. The external auditors have the right to request that a meeting of the Audit Committee be convened. During the past financial year, the Committee met with QinetiQ's external auditors on two separate occasions without Executive Directors present to discuss the audit process, and the Committee Chairman also met with the Group Head of Internal Audit on the same basis. The Group Chairman, Chief Executive Officer, Chief Financial Officer, Group Financial Controller, Group Head of Internal Audit, the Internal Audit Manager and a representative of the external auditors normally attend Audit Committee meetings except where not permitted.

During the last financial year, consideration of the audit process for the full year and interim results represented the principal area of focus for the Audit Committee. The Committee also continued to assess the effectiveness of the Internal Audit function through the review of a balanced scorecard process designed to measure the achievement of Internal Audit objectives, which also resulted in the approval of a detailed 12-month work programme for the function. In the context of the Group's North American business, the Committee held its first meeting with the newly appointed Head of Internal Audit for QNA in the last financial year, which included a review of the application of internal controls in respect of the proxy regime and considered KPMG's approach to auditing the newly acquired US businesses. As part of its regular review of internal controls, the Committee considered in detail the operations of QinetiQ's Treasury function, and paid particular attention to those areas of internal audit review which had failed to achieve at least a satisfactory rating. As part of the regular reporting process, the Committee also reviewed the activities of the tax and insurance functions, as well as overseeing the level of KPMG's audit fees. The Committee has also been involved in the recruitment process to replace the Group Head of Internal Audit, Graham Coley, who retired in February 2008.

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

KPMG has been the Company's auditors since 2003 The members of the Audit Committee have declared themselves satisfied with the performance of KPMG as the Company's auditors in the last financial year There has been a rotation of KPMG's lead audit partner during the financial year ended 31 March 2008 it is anticipated that he will continue in this role for a maximum term of five years

#### Remuneration Committee

Each member of the Remuneration Committee is an independent Non-executive Director The Committee is chaired by Dr Peter Fellner The other members of the Remuneration Committee are Sir David Lees and Noreen Doyle The Committee meets as necessary although normally not less than three times a year During the financial year ended 31 March 2008 the Remuneration Committee met on six occasions Although not members of the Committee the Group Chairman, the Chief Executive Officer, the Group Head of Human Resources and the Head of Performance and Reward normally attend Committee meetings together with representatives of QinetiQ's external consultants Deloitte & Touche LLP as necessary Executive Directors are not present when their own remuneration is being discussed

#### Nominations Committee

The Nominations Committee consists of the Committee Chairman Sir David Lees, together with Dr Peter Fellner and Sir John Chisholm A majority of the Committee throughout the year were Non-executive Directors The Committee meets as necessary and when called by its Chair During the financial year ended 31 March 2008, the Committee met formally on one occasion and consulted informally on several other occasions

The principal focus of the Committee's activities during the financial year ended 31 March 2008 was to review QinetiQ's succession planning processes at both the Executive and Non-executive Director level and for other key management positions within the Group, which the Committee considered in terms of the need to plan for immediate cover in respect of key roles, as well as succession

planning to cover vacancies arising over a two to five-year timeframe The Committee also oversaw the selection process for a new independent Non-executive Director with experience of the US Defence and Security sector, which culminated in the appointment of Admiral Edmund P Giambastiani to the Board in February 2008 The Committee was responsible for initiating this recruitment process using external recruitment agents and retained responsibility for finalising the terms of Admiral Giambastiani's engagement through to completion of his appointment The Committee also initiated the recruitment process for a new Chief Financial Officer to replace Doug Webb, who announced on 17 January 2008 his intention to take up the position of Chief Financial Officer with The London Stock Exchange Group plc

#### Compliance Committee

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

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

In designing the Compliance Regime, the MOD and QinetiQ sought to achieve a balance between meeting the needs of the procurement customers within the MOD (principally Defence Equipment and Support) and the need to allow QinetiQ flexibility to exploit research into the supply chain and pursue its planned commercial activities, without compromising the defence or security interests of the UK The Compliance Regime is largely self-policing, in that it is applied by QinetiQ in respect of its activities without extensive intervention or oversight by the MOD Since the inception of the Compliance Regime, over 97% of the requests to the MOD to allow QinetiQ to operate on the supply side of the commercial defence market have been approved Oversight of the operation of the Regime is provided by the Compliance Committee chaired by Sir David Lees Colin Balmer a Non-executive Director, is a member of the Committee and the Group Chairman Chief Executive Officer and Compliance Audit Director are also members The Board nominates two senior executives to act as Compliance Implementation Director and Compliance Audit Director

QinetiQ's Compliance Committee meets on four occasions each year to monitor the operation of the Regime It receives a report from the Company's Compliance Implementation Director which describes the permissions which have been sought and granted since the last meeting of the Committee, and the status of projects where the potential conflicts of interest are being managed The Committee

## Corporate Governance Report continued

also receives, from the Compliance Audit Director, a report on the effectiveness of the controls that are in place to ensure that the Regime is operated correctly. The Committee reviews the systems that support the Compliance Regime and those that may impact it directing changes if appropriate. The Committee is the forum that would address any issues arising out of QinetiQ's failure to comply with the requirements of the Regime. The Committee has supported the MOD in conducting its own internal audit review of the Compliance Regime during the course of the last financial year.

A computer-based training package continues to be used to ensure that all relevant employees have a satisfactory knowledge of the operation of the Regime. For key roles, competence is demonstrated by passing a mandatory test annually.

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

During the year, a total of eight new permissions were sought from the MOD under the Compliance Regime where potential conflicts of interest were identified by QinetiQ, with one permission request being outstanding from the previous year. Of these nine requests two were approved, three were not pursued, one was rejected and three remained outstanding at the end of March 2008. At the end of the year, 27 firewalls were in place with seven being established and 16 being closed down during the year. Since vesting in 2001, a total of 110 firewalls have operated with 83 now closed. No breaches of the MOD Compliance Regime have been noted during the year. A firewall is a series of rules and procedures governing written and oral communication between staff contributing to products in an MOD competition with industry (outside the wall) and staff assessing those products for MOD (inside the wall).

The Compliance Committee also provides oversight of QinetiQ's activities that fall within the scope of the Helsinki Protocol covering trials involving human volunteers.

#### Going concern

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

#### Communication with shareholders

The Company attaches significant importance to the effectiveness of its communications with shareholders. During the last financial year, the Company has maintained regular dialogue with institutional shareholders and the financial community which has included presentations of the full-year and interim results (including investor road shows held in the UK, Europe and US), regular meetings with major shareholders and industry analysts, participation in stockbrokers' seminars and investor site visits held at Malvern and Boscombe Down. In addition, each member of the Board attended the Company's Annual General Meeting in July 2007 and a number of Non-executive Directors attended key shareholder events in the last financial year, including the full year and interim results presentations, at which they were available to take questions from shareholders. All shareholders and potential shareholders can gain access to the Annual Report presentations to investors and other significant information about the QinetiQ Group on the Company's website at [www.QinetiQ.com](http://www.QinetiQ.com).

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

Responsibility for maintaining regular communications with shareholders rests with the Executive Team, led by the Chief Executive Officer, assisted by an investor relations function which reports to the Chief Financial Officer. The Board is informed on a regular basis of key shareholder issues, including share price.

#### Attendance at Board and Committee meetings April 2007 – March 2008

|                                     | Board | Remuneration Committee | Audit Committee | Compliance Committee | Nomination Committee |
|-------------------------------------|-------|------------------------|-----------------|----------------------|----------------------|
| Colin Balmer                        | 9/10  | –                      | –               | 4/4                  | –                    |
| Sir John Chisholm                   | 10/10 | –                      | –               | 4/4                  | 1/1                  |
| Noreen Doyle                        | 9/10  | 6/6                    | 5/5             | –                    | –                    |
| Dr Peter Fellner                    | 9/10  | 6/6                    | 5/5             | –                    | 1/1                  |
| Sir David Lees                      | 8/10  | 5/6                    | –               | 3/4                  | 1/1                  |
| Graham Love                         | 10/10 | –                      | –               | 4/4                  | –                    |
| Nick Luff                           | 9/10  | –                      | 5/5             | –                    | –                    |
| George Tenet <sup>1</sup>           | 4/10  | –                      | –               | –                    | –                    |
| Doug Webb                           | 10/10 | –                      | –               | –                    | –                    |
| Edmund P. Giambastiani <sup>2</sup> | –     | –                      | –               | –                    | –                    |

<sup>1</sup> George Tenet resigned from the Board on 1 February 2008.

<sup>2</sup> Admiral Edmund P. Giambastiani was appointed to the Board on 1 February 2008, which followed the date of last Board meeting held in the financial year ended 31 March 2008.

performance, the composition of the shareholder register and City expectations. The Chairman, the Senior Independent Director and Non-executive Directors make themselves available to meet with shareholders as required.

#### Management and control of US subsidiaries

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

#### Internal controls

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

A process of hierarchical self-certification has been established within the organisation which provides a documented and auditable trail of accountability for the operation of the system of internal control. This process is informed by a rigorous and structured self-assessment that addresses all of the guidance cited in the Combined Code. The process provides for successive assurances to be given at

increasingly higher levels of management and finally to the Board. The process is informed by the Internal Audit function, which also provides a degree of assurance as to the operation and validity of the system of internal control. Planned corrective actions are independently monitored for their timely completion. The managers report on risks (which are recorded at corporate, sector and divisional level of profit and loss, as well as within all customer-facing projects) and how these are managed on a monthly basis to the QinetiQ Executive Team and the Board formally on a quarterly basis.

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

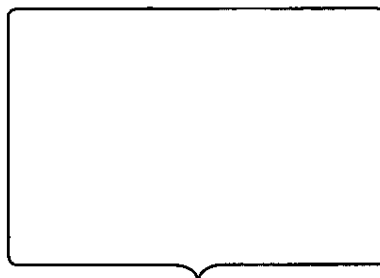
- the authority, resources and coordination of those involved in the identification, assessment and management of significant risks faced by the organisation
- the response to the significant risks which have been identified by management and others, the monitoring of reports from Group management and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

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

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

The Audit Committee also reviews the assurance process, ensuring that an appropriate mix of techniques is used to obtain the level of assurance required by the Board. It presents its findings to the Board on a regular basis. The Board has reviewed the effectiveness of the system of internal control that has been in operation during the financial year ended 31 March 2008. The Board also routinely challenges the management to ensure that the systems of internal control are constantly improving to maintain their continuing effectiveness.

## Report of the Remuneration Committee



Dr Peter Fellner,  
Chairman of the Remuneration Committee

**Our aim is to drive QinetiQ's business performance and shareholder value through the Group's remuneration strategy and to ensure governance of executive reward. The key purpose of the Committee is to ensure that the remuneration strategy is aligned to the Group's strategy and that we are able to attract, retain and motivate the very best calibre executives in an increasingly competitive market for talent.**

We are committed to providing transparent disclosure of Executive Directors' remuneration to all stakeholders. This report provides clear details of the component parts of each Executive's remuneration and explains the policies and principles to which we have adhered.

The Remuneration Committee remains confident that the existing reward structure is appropriate to support the business strategy. As a result of this year's annual review, the following changes were made:

- In line with US market practice, in order to retain and motivate US executives, we implemented a Restricted Stock Plan. This was listed in our IPO Prospectus and approved by shareholders. The plan is in line with share structures operating in the US. Executives receive a share grant, equal amounts of which vest based on time and the rate of organic growth within the US business. Vesting occurs annually over a four-year period.
- Within the UK, we introduced a Performance Share Plan and a Deferred Annual Bonus Plan, both of which were approved by Shareholders at our July 2007 AGM.

These new arrangements will become the key mechanism for long-term incentivisation amongst our senior executives.

The Remuneration Committee continues to review the total reward package to assess how well incentive awards match with the Group's performance. I am confident that we continue to align executives and shareholders' interests whilst enabling the Group to engage a high-calibre team.

The Board recommends that shareholders vote to approve the Report on Directors' Remuneration.

Dr Peter Fellner  
Chairman of the Remuneration Committee

28 May 2008

The following report and recommendation of the Remuneration Committee have been approved by the Board for submission to shareholders. The report covers the remuneration for Directors and includes specific disclosures relating to their emoluments, shares and other interests. It also describes the share-based incentive plans available to Executive Directors and to other employees. This report has been produced in accordance with the Directors' Remuneration Report Regulations 2002.

### Membership

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

- Dr Peter Fellner,
- Sir David Lees, and
- Noreen Doyle.

The full Terms of Reference of the Committee can be found on the QinetiQ website ([www.QinetiQ.com](http://www.QinetiQ.com)) and copies are available on request.

### Governance

The Committee is chaired by Dr Peter Fellner and all of its members are independent Non-executive Directors. In 2008, the Committee met six times.

During the year the Committee received advice from its appointed independent advisors, Deloitte & Touche LLP (Deloitte). Towers Perrin and Monks Partnership provided market information. Deloitte provided other consulting services during the year to QinetiQ, but did not provide advice on executive remuneration matters other than to the Committee.

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

#### Activities

During the year the following activities were undertaken by the Committee

- evaluation of Executive Directors and senior management performance to determine salaries and prior-year bonus payments,
- establishment of parameters and performance targets for annual bonus plans,
- group Share Option Scheme grants to managers in the UK and US,
- review of Long-Term Incentive arrangements,
- grants under the QinetiQ North America Stock Award Plan,
- introduction of the 2007 Performance Share Plan and a Deferred Annual Bonus Plan
- approval of awards under the Performance Share Plan,
- market-based review of the total compensation packages of the Group's most senior executives, and
- review of remuneration for Non-executive Directors of the Group including the Chairman. Independent advice was provided by Deloitte. Recommendations were made to the Board with regard to the level of remuneration

#### Directors' remuneration policy

The Committee aims to maintain a remuneration policy, consistent with the Group's business objectives, which

- attracts, retains and motivates individuals of high calibre, and
- is responsive to both business and personal performance

The remuneration policy is built on the following philosophy

- remuneration packages will be structured in order to support business strategy whilst conforming to current best practice,
- total rewards are achieved through the attainment of stretching performance targets based on measures which are consistent with the interests of shareholders and
- transparent disclosure of remuneration will be provided to the Company's shareholders

The current structure of remuneration (excluding pension) for Executive Directors under this policy is illustrated below

| Fixed (c40%) | Variable (c60%)  |   |
|--------------|--|---|
|              | Short/Medium-Term incentive  | Long-Term Incentive                         |
| Base Salary  | Annual cash bonus with an element deferred into the Deferred Annual Bonus Plan | Performance Shares<br>Deferred Annual Bonus |

Each element of an Executive Director's remuneration package aligns and supports the achievement of different Company objectives. This alignment is illustrated below

| Element   | Objective   | Performance Metric   |
|---|---|--|
| Base Salary   | Reflects market practice based on size of role and complexity   | Based on individual performance  |
| Annual Bonus with a deferred element                              | <ul style="list-style-type: none"> <li>– Drives achievement of medium-term metrics</li> <li>– Provides a co-investment opportunity</li> <li>– Drives achievement of annual business metrics</li> <li>– Facilitates greater alignment with shareholders</li> </ul> | <ul style="list-style-type: none"> <li>– Profit Before Tax</li> <li>– Earnings Per Share</li> <li>– Cash Flow</li> <li>– Turnover</li> <li>– Orders</li> </ul> |
| Performance Share Plan<br>(replaces share options for Executives) | <ul style="list-style-type: none"> <li>– Drives earnings growth, share price and dividend growth</li> <li>– Aligns with shareholders</li> </ul>   | <ul style="list-style-type: none"> <li>– EPS Growth</li> <li>– Total Shareholder Return</li> </ul>   |

## Report of the Remuneration Committee continued

**Base salary**

Executive Directors' base salaries are reviewed annually on the same basis as all other employees and adjustments may be made to reflect competitive pay levels, business and individual performance. External remuneration consultants provide data about market salary levels. For market comparison purposes account is taken of company type, sector and measures of company size in terms of both market capitalisation and turnover.

**Annual bonus**

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

The 2008 bonus scheme was based on a target of 50% of base salary and measured against the five key performance indicators (KPIs): Profit before tax, earnings per share, cash generation, turnover and orders.

An entry level is defined for each KPI and no payment will be made unless it is achieved. Performance against the KPIs is measured independently. However, if the entry level trigger for the profit KPI is not satisfied, the Committee has the discretion to reduce the bonus applicable to the other KPIs.

Where Group performance exceeds the entry level, bonus elements for each KPI accrue on a straight line to the target level. If there is over-achievement against one or more KPIs, then the proportion of bonus increases linearly to the maximum level.

Consideration is also given to the achievement of personal objectives.

As a percentage of salary the on-target, maximum and actual bonuses paid to Executive Directors are as illustrated below:

|             | On Target % | Maximum % | 2008 Actual % |
|-------------|-------------|-----------|---------------|
| Graham Love | 50          | 100       | 61.28         |
| Doug Webb   | 50          | 100       | 61.28         |

**Benefits**

Benefits include a pension or contribution in lieu, car allowance, health insurance, life insurance and membership of the Group's employee Share Incentive Plan which is open to all UK employees. The Company also pays an insurance premium in respect of death in service cover for those Executives not covered by the QinetiQ Pension Scheme.

Executives whose benefits are likely to exceed the Lifetime Allowance may opt out of the QinetiQ Pension Plan. In such cases, the individual will be paid a salary supplement in lieu of pension contributions.

**Long-term incentives**

The objective is to align the rewards of Executives with returns to shareholders by focusing on increasing the share price over the medium to long term. Executive Directors are eligible to participate in both the Performance Share Plan and the Deferred Annual Bonus plan.

**QinetiQ Share Option Scheme (QSOS)**

Share options align rewards of managers with returns to shareholders by focusing on increases in the share price over the medium to long term.

The QSOS is used to retain and motivate key managers below the level of the CEO's direct reports who do not receive awards under the PSP. Annual share option awards with a value up to 300% of salary can be made.

In line with market practice, the performance target is QinetiQ's earnings per share growth. EPS growth of at least 22.5% must be achieved over the performance period. 25% of the award vests at that level of performance with full vesting for achieving 52% as illustrated in the graph below. EPS growth performance is measured over three years and there is no re-testing of performance.

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

In 2007 the Remuneration Committee received shareholder approval for the establishment of the following new plans:

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

These new arrangements will become the key mechanism for long-term incentivisation for Executive Directors and direct reports of the CEO. Participants in the 2007 PSP do not receive QSOS grants.

**2007 Performance Share Plan (2007 PSP)**

Awards of performance shares were made to Executive Directors and other senior executives in July 2007. Conditional share awards are contingent on meeting pre-determined performance criteria. Individual participants' award levels are determined by the Remuneration Committee annually, with due regard to seniority as well as business and individual performance.

Executive Directors are eligible to receive awards with a face value of up to 100% of base salary, with awards for other participants not exceeding 75% of base salary.

Awards are earned based on an equal weighting of relative total shareholder return (TSR) performance and absolute underlying earnings per share (EPS) growth.



## Report of the Remuneration Committee continued

The TSR part of the award is measured against the constituents of a comparator group of companies

|                            |                                 |
|----------------------------|---------------------------------|
| Babcock International plc  | IMI plc                         |
| BAE Systems plc            | Invensys plc                    |
| BBA Aviation plc           | Logica plc                      |
| Bodycote International plc | Meggitt plc                     |
| Capita Group plc           | The Morgan Crucible Company plc |
| Chemring Group plc         | Rolls-Royce plc                 |
| Cobham plc                 | Serco plc                       |
| Cookson Group plc          | Tomkins plc                     |
| Detica plc                 | Ultra Electronics plc           |
| Enodis plc                 | Victrex Group plc               |
| FKI plc                    | VT Group plc                    |
| GKN plc                    | WS Atkins plc                   |
| Halma plc                  |                                 |

The TSR element is earned only if relative performance is at least at median against this comparator group over a three-year performance period, calculated by an independent third party. The graph below illustrates the TSR performance conditions

The EPS element of the award requires a minimum absolute growth of 22.5% over the three-year performance period, for which 25% of the EPS part of the award would vest. This will increase on a straight line basis to full vesting if EPS growth of 52% is achieved. This is the same as applies for QSOS as illustrated in the EPS performance graph

#### 2007 Deferred Annual Bonus Plan (DAB)

The Deferred Annual Bonus aligns the interests of Executives with shareholders and aids retention of key individuals by ensuring that Executives are incentivised to take part of their annual bonus awards in shares rather than cash

Awards are in the form of matching shares delivered after three years, subject to the achievement of performance conditions

In this first year of application (2008) Executives can voluntarily defer up to 50% of their bonus under this plan, with the Committee setting a mandatory 20% deferral for the next financial year (2009). Deferred bonus will be matched to a maximum of 1.1 based on EPS performance

Where an individual participates in the Deferred Annual Bonus and also participates in the PSP they will not receive share awards which in aggregate, exceed 150% of their base salary in any one year

#### All Employee Share Schemes

QinetiQ has historically operated an HMRC-approved Share Incentive Plan (SIP) for its UK employees, including Executive Directors. Under this arrangement employees may purchase ordinary shares in QinetiQ on a monthly basis. QinetiQ provides a matching share for every three shares purchased by an employee. Dividends paid in respect of shares accumulated through the SIP are reinvested as dividend shares.

Due to expansion into overseas territories, the Company will be launching all employee share plans in North America and Australia. Within North America the plan will operate through an approved Shareholder Stock Purchase Plan, more commonly referred to as a S423 plan. Subject to certain restrictions, eligible employees will be able to purchase QinetiQ shares at a discount to the prevailing market rate. These purchased shares will be subject to a 12-month holding period. The envisaged all employee share plan for Australia will operate on a similar premise.

#### QinetiQ North America – Equity-Based Incentives

During the year, valid share awards reflecting local market practice were made to 250 executives and senior managers in our North American business. Initial awards were made in the form of Restricted Stock Units (RSU) under the Stock Award Plan adopted at IPO and/or in the form of Share Options. Share option awards were made under the QSOS.

The RSU awards vest progressively over a four-year period, with 30% vesting after two years, a further 30% after three years and the balance after four years. Half of the award vests based on a time basis with half vesting based on the organic revenue growth of QNA.

In the year, 7.8m equity-settled awards were granted (2007 10.2m) of these 5.4m were under QSOS, 0.7m under PSP and 1.7m under RSU.

The quantum of awards reflects both the performance of the QNA business and our determination to recruit, retain and motivate high-calibre employees in an increasingly competitive employment market where equity incentivisation forms a significant part of an executive's and senior manager's remuneration package.

#### Personal Shareholding Policy

The Committee believes that a powerful way to align Executives' interests with those of shareholders is for the Executives to build up and retain a personal holding in QinetiQ shares.

The CEO and CFO will be required to hold the equivalent of one times their base salary in QinetiQ shares. Each Executive Director currently meets the Committee's guideline on minimum shareholding requirement. Direct reports to the CEO will be required to accumulate a shareholding equivalent to 50% of base salary over a four-year period from appointment.

#### Dilution limits

The Committee has agreed that with regard to new issue or treasury shares, no more than 10% of the Company's issued share capital will be used under all the Company's share schemes over a period of ten years in accordance with ABI guidelines. The dilution as at 31 March 2008 was significantly below this 10% level and, equally significantly, under the 5% level for Executive schemes. The Board intends to continue to satisfy a proportion of awards with shares purchased by the employee benefit trusts.

## Report of the Remuneration Committee continued

2

**Performance Graph**

The graph below compares the Company's Total Shareholder Return over the period from IPO to 31 March 2008 with the FTSE 250 and FTSE 350 Aerospace & Defence sector Total Return Indices over the same period. These were chosen for comparison as QinetiQ is a constituent of both indices.

**Relative share price performance****Non-executive Directors' terms, conditions and fees**

The Chairman reviews the fees of the Non-executive Directors on a biennial basis and makes recommendations to the Board. Non-executive Directors receive additional fees as agreed by the Board for the chairmanship of Board committees to take account of the additional responsibilities of the role. The level of fees paid in UK organisations of a similar size and complexity to QinetiQ are considered in setting remuneration policy for Non-executive Directors. The fees are not performance related or pensionable. Non-executive Directors are not eligible to participate in bonus, profit sharing or employee share schemes.

Current fee structures for Non-executive Directors are shown below

|                                       |          |
|---------------------------------------|----------|
| Non-executive Chairman                | £215,000 |
| Board Member base fee                 | £40,000  |
| Committee Chairmanship additional fee | £7,000   |
| Deputy Chairman/Senior Independent    | £10,000  |
| NED additional fee                    |          |

The annual fees were reviewed in September 2007 and are due for further review in October 2009.

**Directors' terms and conditions**

Service Agreements for the most senior Executives and the Non-executives are reviewed annually and amended as appropriate.

|                                      | Notice to be given by the Company | Date of most recent Service Agreement | Date of appointment |
|--------------------------------------|-----------------------------------|---------------------------------------|---------------------|
| <b>Executives</b>                    |                                   |                                       |                     |
| Graham Love                          | 12 months                         | 1 December 2005                       | February 2003       |
| Doug Webb <sup>1</sup>               | 12 months <sup>1</sup>            | 1 October 2005                        | September 2005      |
| <b>Non-executives</b>                |                                   |                                       |                     |
| Sir John Chisholm                    | —                                 | 1 October 2006                        | February 2003       |
| Sir David Lees                       | —                                 | 16 February 2006                      | August 2005         |
| Nick Luff                            | —                                 | 16 February 2006                      | June 2004           |
| Dr Peter Fellner                     | —                                 | 16 February 2006                      | September 2004      |
| Noreen Doyle                         | —                                 | 16 February 2006                      | October 2005        |
| Colin Balmer                         | —                                 | 16 February 2006                      | February 2003       |
| Admiral Ed Giambastiani <sup>2</sup> | —                                 | 1 February 2008                       | February 2008       |
| <b>Former Directors</b>              |                                   |                                       |                     |
| George Tenet <sup>3</sup>            | —                                 | 26 October 2006                       | October 2006        |

<sup>1</sup> Doug Webb has resigned and will leave the Board on 30 May 2008.

<sup>2</sup> Admiral Ed Giambastiani joined the Board on 1 February 2008.

<sup>3</sup> George Tenet resigned from the Board on 1 February 2008 to join the Board of QinetiQ North America.

QinetiQ's policy is that Executive Directors should have contracts with a rolling term providing for a maximum of one year's notice. Consequently, no Executive Director has a contractual notice period in excess of 12 months. In the event of early termination, this ensures that compensation is restricted to a maximum of 12 months' basic salary and benefits. The Committee will generally require mitigation to reduce the compensation payable to a departing Executive Director.

Non-executive Directors' contracts are renewed on a rolling 12-month basis subject to reappointment at the Annual General Meeting. There are no provisions in their contracts for compensation on early termination.

## Report of the Remuneration Committee continued

**External appointments**

QinetiQ allows Executives to broaden their knowledge and experience by becoming Non-executive Directors of other companies. Appointments are approved by the Board or Committee on the basis that there is no conflict of interest or deterioration in the Executives' performance. Fees are normally retained by the individual. During the year ended 31 March 2008, neither of the Executive Directors held such an appointment at a public company.

**Audited information**

The information about Directors' remuneration and Directors' interests on pages 63 and 64 has been audited.

|                                      | Salary/fees           | Bonus <sup>a</sup> | Benefits <sup>b</sup> | Total 2008 | Total 2007 |
|--------------------------------------|-----------------------|--------------------|-----------------------|------------|------------|
| <b>Executives</b>                    |                       |                    |                       |            |            |
| Graham Love                          | £341,817              | £214,480           | £83,748 <sup>c</sup>  | £640,045   | £544,899   |
| Doug Webb                            | £305,580 <sup>d</sup> | £193,032           | £16,730 <sup>e</sup>  | £515,342   | £415,279   |
| <b>Non-executives</b>                |                       |                    |                       |            |            |
| Sir John Chisholm                    | £207,500              | —                  | £13,265               | £220,765   | £388,653   |
| Sir David Lees                       | £57,000               | —                  | —                     | £57,000    | £50,000    |
| Nick Luff                            | £43,500               | —                  | —                     | £43,500    | £40,000    |
| Dr Peter Fellner                     | £43,500               | —                  | —                     | £43,500    | £40,000    |
| Noreen Doyle                         | £37,500               | —                  | —                     | £37,500    | £35,000    |
| Colin Balmer                         | £37,500               | —                  | —                     | £37,500    | £35,000    |
| Admiral Ed Giambastiani <sup>f</sup> | £29,128               | —                  | —                     | £29,128    | —          |
| <b>Former Directors</b>              |                       |                    |                       |            |            |
| George Tenet <sup>g</sup>            | £50,464               | —                  | —                     | £50,464    | £47,754    |
|                                      | £1,153,489            | £407,512           | £113,743              | £1,674,744 | £1,596,585 |

<sup>a</sup> 2008 Performance bonuses were earned but not paid in the financial year.

<sup>b</sup> Benefits apart from pensions.

<sup>c</sup> Includes car allowance, health insurance benefits and payment in lieu of pension contributions.

<sup>d</sup> Before deductions to basic salary for SMART pensions (salary sacrifice arrangements).

<sup>e</sup> Includes car allowance, life assurance and health insurance benefits.

<sup>f</sup> Admiral Ed Giambastiani joined the Board on 1 February 2008. Fees are inclusive of initial fee of \$40,000 for joining the Board.

<sup>g</sup> George Tenet resigned from the Board on 1 February 2008 to join the Board of QinetiQ North America.

**Pensions**

The Group's policy is to offer all UK employees membership of the QinetiQ Pension Scheme, as described in note 39 to the financial statements. This scheme contains both defined benefit and defined contribution sections. Doug Webb is a member of the defined contribution section of the QinetiQ Pension Scheme. Graham Love receives contributions in lieu of a pension.

**Disclosures in respect of Doug Webb**

Details of the contributions payable to the Defined Contribution section of the QinetiQ Pension Scheme, as required under Schedule 7A section 12(3) of the Companies Act 1985 and LR 9.8.8 (11) of the FSA's Listing Rules are shown below.

The Company contributions payable in respect of the 12 months to 31 March 2008 were £59,545. These represent payments before SMART pension arrangements.

**Directors' interests**

The interests of the Directors in office at 31 March 2008 in the shares of QinetiQ Group plc at that date were as follows:

**Directors' interest in the All Employee Share Incentive Plan**

|                   | Interest as at 1 April 2007 | Partnership Shares acquired during year | Matching Shares appropriated during year | Dividend Shares allocated during year | Interest as at 31 March 2008 |
|-------------------|-----------------------------|---|--|---------------------------------------|------------------------------|
| Sir John Chisholm | 254                         | —                                       | —  | 6                                     | 260                          |
| Graham Love       | 1,263                       | 808                                     | 269                                      | 37                                    | 2,377                        |
| Doug Webb         | 1,263                       | 808                                     | 269                                      | 37                                    | 2,377                        |

## Report of the Remuneration Committee continued

## Interests of Directors in office as at 31 March 2008 including shares held under SIP

|                       | Number 1p<br>Ord Shares<br>held at<br>1 April 2007 | Number 1p<br>Ord Shares<br>held at<br>31 March 2008 | Number 1p<br>Ord Shares<br>held at<br>28 May 2008 |
|-----------------------|--|---|---|
| <b>Executives</b>     |  |   |   |
| Graham Love           | 7 779 513  | 4 930 627   | 4 930 796   |
| Doug Webb             | 619,130  | 320,244   | 320,413   |
| <b>Non-executives</b> |  |   |   |
| Sir John Chisholm     | 13,001,004   | 3 731,808 <sup>1</sup>                              | 3,731,808   |
| Sir David Lees        | 17,000   | 63,000  | 63,000  |
| Nick Luff             | 27 000   | 27 000  | 50,000  |
| Dr Peter Fellner      | 17,000   | 17 000  | 17 000  |
| Noreen Doyle          | 17,000   | 17 000  | 17 000  |

<sup>1</sup> The decrease in the interest of Sir John Chisholm reflects a transfer made into a trust established for the benefit of his family. Sir John Chisholm and Mr Nicolas John Shaw are the Trustees. Sir John has confirmed that the transfer was effected for CGT planning purposes and that he will reacquire the shares on 26 June 2008. The Trustees held 9 269 202 1p ordinary shares as at 31 March 2008 (1 April 2007: nil).

## Interests of Directors in office as at 31 March 2008 under long-term incentives

| Executive Directors                            | Grant Date | Number at<br>1 April 2007 | Granted<br>in Year | Exercised<br>in Year | Lapsed<br>in Year | Number at<br>31 March<br>2008 | Exercise<br>price | Earliest<br>exercise date | Expiry<br>Date |
|--|------------|---------------------------|--------------------|----------------------|-------------------|-------------------------------|-------------------|---------------------------|----------------|
| Graham Love                                    |            |                           |                    |                      |                   |                               |                   |                           |                |
| PSP-TSR  | 26/07/07   | —                         | 50 288             | —                    | —                 | 50 288                        | —                 | 26/07/10                  | 26/07/11       |
| PSP-EPS  | 26/07/07   | —                         | 50 287             | —                    | —                 | 50 287                        | —                 | 26/07/10                  | 26/01/11       |
| Doug Webb <sup>1</sup>                         |            |                           |                    |                      |                   |                               |                   |                           |                |
| QinetiQ Share<br>Option Scheme<br>(Approved)   | 22/02/06   | 14 403                    | —                  | —                    | —                 | 14,403                        | 208p              | 22/02/09                  | 22/08/09       |
| QinetiQ Share<br>Option Scheme<br>(Unapproved) | 22/02/06   | 230 789                   | —                  | —                    | —                 | 230,789                       | 208p              | 22/02/09                  | 22/08/09       |
| PSP-TSR  | 26/07/07   | —                         | 45 259             | —                    | —                 | 45,259                        | —                 | 26/07/10                  | 26/01/11       |
| PSP-EPS  | 26/07/07   | —                         | 45 258             | —                    | —                 | 45,258                        | —                 | 26/07/10                  | 26/01/11       |
| <b>Total</b>                                   |            | <b>245,192</b>            | <b>191,092</b>     | <b>—</b>             | <b>—</b>          | <b>436,284</b>                |                   |                           |                |

<sup>1</sup> Due to resignation awards made under the Performance Share plan Group Share Option and matching shares in the SIP plan will lapse on 30 May 2008.

The interests in the table above are subject to the performance conditions described on pages 60 and 61. The price of a QinetiQ share at 31 March 2008 was 193p. The highest and lowest price of a QinetiQ share at 31 March 2008 were 206 5p and 165p respectively.

# Report of the Directors

The Directors present their report and the audited financial statements for the year to 31 March 2008. The report from the Directors on Corporate Governance is set out on pages 52 to 57 and the Remuneration Committee report on pages 58 to 64.

## Principal activity

QinetiQ Group plc is a public limited company listed on the London Stock Exchange and incorporated in England and Wales with registered number 4586941.

QinetiQ Group plc is the parent company of a Group whose principal activities during the year were the supply of technology-based solutions and products and provision of technology-rich support services for government defence and security organisations, such as the UK MOD and the US DoD, and for commercial customers around the world.

## Business review and Group results

The profit on ordinary activities of the Group before tax was £51.4m (2007 £89.3m). The profit attributable to ordinary shareholders of the parent company was £47.4m (2007 £69.0m).

A description of the Group's performance during the year and the likely future developments is contained in the reports of the Chairman and Chief Executive Officer on pages 2 to 10 and in the Business Review on pages 11 to 49.

## Principal risks and uncertainty

A description of the Group's principal risks and uncertainty is contained in the Business Review on pages 42 to 44.

## Principal changes to the Group

The Group made a number of acquisitions and disposals in the year which are disclosed in detail in notes 13 and 5 respectively.

## Research & development

One of the Group's principal business streams is the provision of funded research and development for customers. The Group also invests in the commercialisation of promising technologies across all areas of business. Further description of the Group's research & development activity is contained in the Business Review on page 40.

## Proposed dividend

During the year the Group paid an interim dividend of 1.33p per share (2007 1.20p). The Directors recommend the payment of a final dividend of 2.92p per ordinary share (2007 2.45p). Subject to the approval of shareholders the final dividend will be paid on 5 September 2008 to shareholders on the share register on 8 August 2008.

## Policy and practice on payment of suppliers

The policy of the Group is to agree terms of payment prior to commencing trade with a supplier and to abide by those terms based on the timely submission of satisfactory invoices. At 31 March 2008, the trade creditors of the Group represented 35 days of annual purchases (2007 31 days).

## Principal financial instruments risks and uncertainty

The Group's principal risks in relation to the use of financial instruments arise on contracting with customers in foreign currencies and through the use of interest rate swaps and caps to manage interest rate exposure on the Group's borrowings. A more detailed description of the Group's principal risks and uncertainties and policies related to the use of financial instruments is contained in the Business Review on pages 42 to 44.

## Directors and Directors' interests

The Directors in office at the date of this report and details of the Board committees on which they sit are detailed on pages 50 and 51. The dates of Director appointments can be found on page 62. Details of the Directors' emoluments and interests are shown in the Report of the Remuneration Committee on pages 58 to 64.

## Directors' appointment, removal and powers

Rules concerning the appointment and replacement of Directors of the Company are contained in the Articles of Association and changes to these Articles must be submitted to shareholders for approval. The Shareholder Relationship Agreement entered into between QinetiQ and MOD at IPO entitles MOD to nominate one Non-executive Director to the Board for so long as MOD does not dispose of any further ordinary shares in the Company and thereafter for so long as it holds at least 10% of QinetiQ's issued ordinary share capital. The Directors are responsible for the management of the business of the Company and their powers are subject to the Memorandum and Articles of Association and any applicable legislation and regulation.

## Employees

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

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

## Environment

Details of the Group's policy and practice in relation to the environment is detailed in the Corporate Responsibility report, contained in the Business Review on pages 45 to 49.

## Political and charitable contributions

The Group made no political donations in the year. Donations during the year to UK charities amounted to £184,000 (2007 £19,000).

## Report of the Directors continued

**Corporate Governance**

The Company's application of the principles of good governance in respect of the Combined Code as revised by the Financial Reporting Council June 2006 is described in the Corporate Governance Report on pages 52 to 57

**Share capital**

As at 31 March 2008 the Company had

(1) Authorised share capital of 1,400,000,000 of ordinary 1p shares with aggregate nominal value of £14,000,000 and 1 Special Share with an aggregate nominal value of £1

(2) Allotted and fully paid share capital of 660,476 373 ordinary shares of 1p each with an aggregate nominal value of £6.6m (including shares held by employee share trusts)

Details of the shares issued during the financial year are shown in note 32 on page 108

The rights of ordinary shareholders are set out in the Articles of Association. 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 such a purpose

The Special Share is held by HM Government and it confers certain rights under the Articles of Association which are detailed in note 32 on page 108. These include the right to require certain persons with a material interest in QinetiQ to dispose of some or all of their ordinary shares. The Special Share may only be held by and transferred to HM Government. 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 capital before other shareholders. Any variation of the rights attaching to the Special Share requires the written approval of the MOD.

**Change of control – significant agreements**

The following significant agreements contain provisions entitling the counter-parties 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 no longer remains a UK company

The Combined Aerial Target Service contract is a 20 year contract awarded to QinetiQ by MOD on 14 December 2006. The terms of this contract require QinetiQ Ltd 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 Ltd's share capital, unless the change relates to shares listed on a regulated market, with material defined as being 10% or more of the share capital. Additionally 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 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 where 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 MOD is a party

The Company is party to a £500m Revolving Credit Facility with Lloyds TSB Bank plc (as agent) expiring 19 August 2012. Under the terms of the Facility, if either (1) the MOD ceases to retain in its capacity as Special Shareholder its Special Shareholders Rights or (2) there is a change of control of the Company, any Lender may request by not less than 90 days' notice to the Company that its commitment be cancelled and all outstanding amounts be repaid to that lender at the expiry of such notice period.

On 6 December 2006, QinetiQ North America, Inc (as Borrower) and the Company (as Guarantor) entered into a Note Purchase Agreement to issue \$135m 5.44% Senior Notes due 6 December 2013 and \$125m 5.50% Senior Notes due 6 December 2016. Under the terms of the agreement, if either (1) the MOD ceases to retain in its capacity as Special Shareholder its Special Shareholders Rights or (2) there is a change of control of the Company, the Notes must be prepaid within 90 days of the change of control, provided only that there is no rating downgrade or where there are no rated securities a rating of at least investment grade is obtained.

**Major shareholders**

At 19 May 2008 being the latest practicable date prior to the issuance of this report the Group had been notified of the following shareholdings of at least 3% in the ordinary share capital of the Group

|                                     |       |
|-------------------------------------|-------|
| UK Ministry of Defence              | 18.9% |
| Lansdowne Partners Ltd              | 9.1%  |
| BlackRock Investment Management Ltd | 5.0%  |
| Fidelity International Ltd          | 5.0%  |
| Allianz SE                          | 3.1%  |
| Legal & General Group plc           | 3.0%  |

**Allotment/purchase of own shares**

At the Company's AGM held in July 2007, the shareholders passed resolutions which authorised the Directors to allot relevant securities up to an aggregate nominal value of £2,322,756 to disapply pre-emption rights (up to 5% of the issued ordinary share capital) and for the Company to purchase Ordinary Shares (up to 10% of its ordinary share capital). Equivalent resolutions will be laid before the 2008 AGM.

During the year the Company provided funding to the trustees of its employee share schemes to make market purchases of the Company's ordinary shares to cover future obligations under outstanding share option and other share-based awards. Further details are disclosed in the Business Review on page 39.

**Restrictions on Transfer Shares**

As outlined on page 108, the Special Share confers certain rights under the Company's Articles of Association to require certain persons with an interest in QinetiQ's shares which exceed certain prescribed thresholds to dispose of some or all of their ordinary shares on grounds of national security or conflict of interest.

In addition, at IPO, certain members of the senior management team (which includes the Chairman and the Executive Directors) entered into a Lock Up agreement which prohibited the disposal of ordinary

shares in the Company (save in certain limited circumstances) for a period of three years ending on 15 February 2009. The practical impact of such arrangements is that for each member of the senior management team subject to the Lock Up agreement, 28% of their respective ordinary shares held at IPO continue to be subject to the prohibition on disposal.

#### Articles of Association

Save in the respect of any variation to the rights attaching to the Special Share, the Company has not adopted any special rules relating to the amendment of the Company's Articles of Association other than as provided under UK corporate law.

#### Employee Share Scheme

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 send a Form of Direction to all employees holding shares under the Plan, and will vote on all resolutions proposed at general meetings in accordance with the instructions received. In circumstances where ordinary shares are held by the corporate sponsored nominee service Equiniti Corporate Nominees Limited will send a Proxy Form to all shareholders utilising such corporate nominee service and will vote on all resolutions proposed at general meetings in accordance with the instructions received.

#### Auditors

KPMG Audit Plc has expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the Annual General Meeting.

#### Statement of disclosure of information to auditors

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

#### Annual General Meeting

The Company's Annual General Meeting will be held on Wednesday 30 July 2008 at 2.00 pm at the Institute of Mechanical Engineers, 1 Birdcage Walk Westminster, London SW1H 9JJ. Details of the business to be proposed and voted upon at the meeting is contained in the Notice of the Annual General Meeting which is sent to all shareholders and also published on the website [www.QinetiQ.com](http://www.QinetiQ.com).

By order of the Board



**Lynton Boardman**  
Company Secretary

85 Buckingham Gate  
London SW1E 6PD  
28 May 2008

## Statement of Directors' responsibilities in respect of the Annual Report and the Financial Statements

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

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

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

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

- to select suitable accounting policies and then apply them consistently,
- to make judgements and estimates that are reasonable and prudent,
- to state for the Group financial statements, whether they have been prepared in accordance with IFRS as adopted by the EU,
- to state for the parent company financial statements, whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements, and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume the Group and the parent company will continue in operational business for the foreseeable future

The Directors confirm they have complied with the above requirements in preparing the financial statements

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985 and 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 Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with the law and those regulations

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

### Responsibility statement of the Directors in respect of the Annual Report

We, the Directors of the Company, confirm that to the best of our knowledge

- the financial statements of the Group have been prepared in accordance with IFRSs as adopted by the EU and for the Company under UK GAAP in accordance with applicable United Kingdom law and give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that face the Group

By order of the Board



**Graham Love**  
Chief Executive Officer



**Doug Webb**  
Chief Financial Officer



## Independent Auditors' Report to the Members of QinetiQ Group plc

We have audited the Group and parent company financial statements (the 'financial statements') of QinetiQ Group plc for the year ended 31 March 2008 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group Cash Flow Statement, the Group Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors Remuneration Report that is described as having been audited.

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

### Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the parent company financial statements and the Directors' Remuneration Report in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' responsibilities on page 68.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the reports of the Chairman, Chief Executive Officer and the Business Review that is cross referred from the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

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

### Basis of audit opinion

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

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

### Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 March 2008 and of its profit for the year then ended,
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation,
- the parent company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 March 2008
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc  
Chartered Accountants  
Registered Auditor  
London

28 May 2008

*KPMG Audit Plc*

## Consolidated income statement

## Consolidated income statement

for the year ended 31 March

|  |     | 2008         |   | 2007   |              |                                 |                          |
|--|-----|--------------|---|--|--------------|---------------------------------|--------------------------|
|  |     | note         | Before restructuring and acquisition amortisation | EMEA reorganisation and acquisition amortisation | Total        | Before acquisition amortisation | Acquisition amortisation |
| <i>all figures in £ million</i>  |     |              |   |  |              |                                 |                          |
| Revenue  | 2 3 | 1,366 0      | –   | 1,366 0  | 1,149 5      | –                               | 1,149 5                  |
| Employee costs   | 9   | (576 2)      | (32 6)  | (608 8)  | (513 4)      | –                               | (513 4)                  |
| Third-party project costs  |     | (333 2)      | –   | (333 2)  | (258 7)      | –                               | (258 7)                  |
| Other operating costs excluding depreciation and amortisation                |     | (296 6)      | –   | (296 6)  | (246 7)      | –                               | (246 7)                  |
| Share of post-tax loss of equity accounted joint ventures and associates     | 17  | (4 0)        | –   | (4 0)  | (1 2)        | –                               | (1 2)                    |
| Other income   | 4   | 9 0          | –   | 9 0  | 11 0         | –                               | 11 0                     |
| <b>EBITDA (earnings before interest, tax, depreciation and amortisation)</b> |     | <b>165 0</b> | <b>(32 6)</b>                                     | <b>132 4</b>                                     | <b>140 5</b> | <b>–</b>                        | <b>140 5</b>             |
| Depreciation of property, plant and equipment                                | 14  | (33 0)       | –   | (33 0)   | (31 7)       | –                               | (31 7)                   |
| Amortisation of intangible assets  |     | (5 0)        | (18 0)  | (23 0)   | (2 8)        | (12 6)                          | (15 4)                   |
| <b>Group operating profit</b>  | 3   | <b>127 0</b> | <b>(50 6)</b>                                     | <b>76 4</b>                                      | <b>106 0</b> | <b>(12 6)</b>                   | <b>93 4</b>              |
| (Loss)/gain on business divestments and unrealised impairment of investment  | 5a  | (7 0)        | –   | (7 0)  | 4 6          | –                               | 4 6                      |
| Profit on disposal of non-current assets                                     | 5b  | –            | –   | –  | 3 3          | –                               | 3 3                      |
| Finance income   | 6   | 3 6          | –   | 3 6  | 4 2          | –                               | 4 2                      |
| Finance expense  | 6   | (21 6)       | –   | (21 6)   | (16 2)       | –                               | (16 2)                   |
| <b>Profit before tax</b>   | 4   | <b>102 0</b> | <b>(50 6)</b>                                     | <b>51 4</b>                                      | <b>101 9</b> | <b>(12 6)</b>                   | <b>89 3</b>              |
| Taxation expense   | 7   | (20 2)       | 16 2  | (4 0)  | (25 0)       | 4 7                             | (20 3)                   |
| <b>Profit for the year</b>   |     | <b>81 8</b>  | <b>(34 4)</b>                                     | <b>47 4</b>                                      | <b>76 9</b>  | <b>(7 9)</b>                    | <b>69 0</b>              |
| <b>Profit attributable to</b>  |     |              |   |  |              |                                 |                          |
| Equity shareholders of the parent company                                    | 33  | 81 8         | (34 4)  | 47 4   | 76 9         | (7 9)                           | 69 0                     |
| Minority interest  | 33  | –            | –   | –  | –            | –                               | –                        |
|  |     | <b>81 8</b>  | <b>(34 4)</b>                                     | <b>47 4</b>                                      | <b>76 9</b>  | <b>(7 9)</b>                    | <b>69 0</b>              |
| <b>Earnings per share</b>  |     |              |   |  |              |                                 |                          |
| Basic  | 10  |              |   | 7 2p   |              |                                 | 10 5p                    |
| Diluted  | 10  |              |   | 7 2p   |              |                                 | 10 3p                    |
| Underlying   | 10  |              |   | 13 4p  |              |                                 | 11 3p                    |

## Consolidated balance sheet

## Consolidated balance sheet

as at 31 March

| <i>all figures in £ million</i>  | <i>note</i> | <i>2008</i>    | <i>2007<br/>Restated</i> |
|--|-------------|----------------|--------------------------|
| <b>Non-current assets</b>  |             |                |                          |
| Goodwill   | 11          | 437.4          | 371.9                    |
| Intangible assets  | 12          | 109.1          | 66.1                     |
| Property, plant and equipment  | 14          | 332.4          | 341.5                    |
| Financial assets   | 16          | 15.3           | 18.8                     |
| Equity accounted investments   | 17          | 9.3            | 0.3                      |
| Other investments  | 18          | 14.7           | 28.5                     |
| Deferred tax asset   | 25          | —              | 11.0                     |
|  |             | <b>918.2</b>   | <b>838.1</b>             |
| <b>Current assets</b>  |             |                |                          |
| Inventories  | 19          | 56.9           | 39.5                     |
| Financial assets   | 16          | 7.4            | 4.0                      |
| Trade and other receivables  | 20          | 469.0          | 401.2                    |
| Current tax  |             | 3.0            | —                        |
| Investments  | 21          | 1.3            | 4.0                      |
| Non-current assets classified as held for sale                                 |             | 1.8            | 1.8                      |
| Cash and cash equivalents  | 22          | 24.5           | 20.0                     |
|  |             | <b>563.9</b>   | <b>470.5</b>             |
| <b>Total assets</b>  |             | <b>1482.1</b>  | <b>1,308.6</b>           |
| <b>Current liabilities</b>   |             |                |                          |
| Trade and other payables   | 23          | (374.4)        | (340.0)                  |
| Current tax  |             | —              | (6.9)                    |
| Provisions   | 24          | (31.8)         | (1.1)                    |
| Financial liabilities  | 26          | (11.8)         | (15.9)                   |
|  |             | <b>(418.0)</b> | <b>(363.9)</b>           |
| <b>Non-current liabilities</b>   |             |                |                          |
| Retirement benefit obligation (gross of deferred tax)                          | 39          | (23.4)         | (90.8)                   |
| Deferred tax liability   | 25          | (30.8)         | (30.2)                   |
| Provisions   | 24          | (13.9)         | (13.1)                   |
| Financial liabilities  | 27          | (415.3)        | (327.7)                  |
| Other payables   | 23          | (47.7)         | (5.5)                    |
|  |             | <b>(531.1)</b> | <b>(467.3)</b>           |
| <b>Total liabilities</b>   |             | <b>(949.1)</b> | <b>(831.2)</b>           |
| <b>Net assets</b>  |             | <b>533.0</b>   | <b>477.4</b>             |
| <b>Capital and reserves</b>  |             |                |                          |
| Ordinary Shares  | 32          | 6.6            | 6.6                      |
| Capital redemption reserve   | 33          | 39.9           | 39.9                     |
| Share premium account  | 33          | 147.6          | 147.6                    |
| Hedging and translation reserve  | 33          | (21.3)         | (13.1)                   |
| Retained earnings  | 33          | 360.1          | 296.3                    |
| <b>Capital and reserves attributable to shareholders of the parent company</b> |             | <b>532.9</b>   | <b>477.3</b>             |
| Minority interest  | 33          | 0.1            | 0.1                      |
| <b>Total shareholders' funds</b>   |             | <b>533.0</b>   | <b>477.4</b>             |

The financial statements were approved by the Board of Directors and authorised for issue on 28 May 2008 and were signed on its behalf by



Graham Love  
Chief Executive Officer



Doug Webb  
Chief Financial Officer

## Consolidated cash flow statement

## Consolidated cash flow statement

for the year ended 31 March

| <i>all figures in £ million</i>   | <i>note</i> | <b>2008</b>    | <b>2007</b>    |
|---|-------------|----------------|----------------|
| <b>Profit for the year</b>  |             | <b>47 4</b>    | <b>69 0</b>    |
| Taxation expense  |             | 4 0            | 20 3           |
| Net finance costs   |             | 18 0           | 12 0           |
| (Loss)/gain on business divestments and unrealised impairment of investment |             | 7 0            | (4 6)          |
| Profit on disposal of non-current assets                                    |             | –              | (3 3)          |
| Depreciation of property, plant and equipment                               |             | 33 0           | 31 7           |
| Amortisation of intangible assets   |             | 23 0           | 15 4           |
| Share of post-tax loss of equity accounted joint ventures and associates    |             | 4 0            | 1 2            |
| Increase in inventories   |             | (17 3)         | (15 5)         |
| Increase in receivables   |             | (49 0)         | (33 9)         |
| Increase in payables  |             | 36 7           | 27 0           |
| Increase/(decrease) in provisions   |             | 31 5           | (12 3)         |
| <b>Cash inflow from operations</b>  |             | <b>138 3</b>   | <b>107 0</b>   |
| Tax paid  |             | (17 7)         | (3 3)          |
| Interest received   |             | 1 7            | 4 2            |
| Interest paid   |             | (20 0)         | (13 8)         |
| <b>Net cash inflow from operating activities</b>                            |             | <b>102 3</b>   | <b>94 1</b>    |
| Purchase of intangible assets   |             | (19 9)         | (12 1)         |
| Purchase of property, plant and equipment                                   |             | (23 7)         | (34 8)         |
| Sale of property, plant and equipment                                       |             | 14 9           | 8 6            |
| Equity accounted investments and other investment funding                   |             | (7 3)          | (9 4)          |
| Purchase of subsidiary undertakings   |             | (106 7)        | (137 2)        |
| Net (debt)/cash acquired with subsidiary undertakings                       |             | (2 0)          | 2 9            |
| Sale of interest in subsidiary undertakings                                 |             | –              | 17 9           |
| <b>Net cash outflow from investing activities</b>                           |             | <b>(144 7)</b> | <b>(164 1)</b> |
| Net costs from IPO  |             | –              | (2 0)          |
| Cash outflow from repayment of loans  |             | –              | (79 2)         |
| Cash outflow from repayment of loan notes                                   |             | (0 1)          | (1 4)          |
| Cash inflow from loans received   |             | 87 6           | 131 3          |
| Cash inflow from loan notes issued  |             | 0 5            | 1 3            |
| Payment of deferred finance costs   |             | (0 5)          | (0 4)          |
| Purchase of own shares  |             | (12 8)         | –              |
| Equity dividends paid   |             | (24 9)         | (22 7)         |
| Capital element of finance lease rental payments                            |             | (3 2)          | (5 9)          |
| Capital element of finance lease rental receipts                            |             | 3 0            | 3 5            |
| <b>Net cash inflow from financing activities</b>                            |             | <b>49 6</b>    | <b>24 5</b>    |
| <b>Increase/(decrease) in cash and cash equivalents</b>                     | 29          | <b>7 2</b>     | <b>(45 5)</b>  |
| Effect of foreign exchange changes on cash and cash equivalents             |             | (0 3)          | (0 5)          |
| Cash and cash equivalents at beginning of year                              |             | 12 6           | 58 6           |
| <b>Cash and cash equivalents at end of year</b>                             |             | <b>19 5</b>    | <b>12 6</b>    |
| Cash and cash equivalents   | 22          | 24 5           | 20 0           |
| Overdrafts  | 30          | (5 0)          | (7 4)          |
| <b>Cash and cash equivalents at end of year</b>                             |             | <b>19 5</b>    | <b>12 6</b>    |

## Consolidated statement of recognised income and expense

## Consolidated statement of recognised income and expense

for the year ended 31 March

| <i>all figures in £ million</i>  | <i>note</i> | <b>2008</b> | <b>2007</b>  |
|--|-------------|-------------|--------------|
| Net loss on hedge of net investment in foreign subsidiaries              | 33          | (3.3)       | (14.4)       |
| Decrease in fair value of hedging derivatives                            | 33          | (6.8)       | (5.6)        |
| Movement in deferred tax on hedging derivatives                          | 33          | 1.9         | 2.0          |
| Fair value gains on available for sale investments                       | 33          | 3.2         | 10.0         |
| Impairment of available for sale investments                             | 33          | (2.9)       | —            |
| Recycle of unrealised gain on disposal of businesses                     | 33          | (3.5)       | —            |
| Actuarial gains recognised in the defined benefit pension schemes        | 33          | 65.5        | 85.8         |
| Decrease in deferred tax asset due to actuarial gains in pension deficit | 33          | (12.2)      | (17.9)       |
| <b>Net income recognised directly in equity</b>                          |             | <b>41.9</b> | <b>59.9</b>  |
| Profit for the year  |             | 47.4        | 69.0         |
| <b>Total recognised income and expense for the year</b>                  |             | <b>89.3</b> | <b>128.9</b> |
| <b>Attributable to</b>   |             |             |              |
| Equity shareholders of the parent company                                |             | 89.3        | 128.9        |
| Minority interest  |             | —           | —            |
|  |             | <b>89.3</b> | <b>128.9</b> |

# Notes to the financial statements

## 1 Significant accounting policies

### Accounting policies

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

### Basis of preparation

The Group's financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards and Interpretation pronouncements as adopted by the EU ('Adopted IFRS') and the Companies Act 1985 applicable to companies reporting under IFRS. The consolidated financial statements also comply fully with IFRSs as issued by the International Accounting Standards Board. The Company has elected to prepare its parent company financial statements in accordance with UK GAAP, these are presented on pages 119 to 121.

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

### Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings up to 31 March 2008. The purchase method of accounting has been adopted. Under this method, the results of subsidiary undertakings acquired or disposed in the period are included in the consolidated income statement from the date control is obtained to the date that control is lost (usually on acquisition and disposal respectively).

A subsidiary is an entity over which the Group has the power to govern financial and operating policies in order to obtain benefits. Potential voting rights that are currently exercisable or convertible are considered when determining control.

An associate is an undertaking over which the Group exercises significant influence (usually from 20% to 50% of the equity voting rights) over 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 up 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 if necessary to ensure compliance with Group accounting policies.

On consolidation, all intra-Group income, expenses and balances are eliminated.

### Revenue

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

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

### Third-party project costs

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

### Profit recognition

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

## Notes to the financial statements continued

## 1 Significant accounting policies continued

**Segmental information**

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

- EMEA (Europe, Middle East and Australasia) which primarily delivers technology solutions, consultancy and managed services to the Ministry of Defence in the UK and civil and other government customers in the UK and Australia
- QinetiQ North America which primarily provides technology and services to the US Government and
- Ventures which primarily comprises commercial product businesses and business venturing activities

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

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

**Research and development expenditure**

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

Internally funded development expenditure is capitalised in the balance sheet where there is a clearly defined project, the expenditures are separately identifiable, the project is technically and commercially feasible, all costs are recoverable by future revenue and the resources are committed to complete the project. Such capitalised costs are amortised over the forecast period of sales resulting from the development. All other research and development 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 interest income and expense in financing.

**Taxation**

The taxation charge is based on the profit for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes. 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 change in the tax rates are recognised in the income statement unless related to items directly recognised in equity. Deferred tax liabilities are recognised on all taxable temporary differences excluding non-deductible goodwill. Deferred tax assets are recognised on all deductible temporary differences provided that it is probable that future taxable income will be available against which the asset can be utilised. Deferred tax assets and liabilities are only offset where there is a legally enforceable right to offset and there is an intention to settle balances net.

**Goodwill**

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

## Notes to the financial statements continued

**1 Significant accounting policies** continued**Intangible assets**

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

|                              |  |
|------------------------------|--|
| Intellectual property rights | 2–8 years  |
| Development costs            | Useful economic life or unit of production method subject to a minimum amortisation of no less than straight line method over economic life of 1–4 years |
| Other                        | 1–7 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 but excluding interest.

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

**Investment property**

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

**Impairment of tangible, goodwill, intangible and held for sale assets**

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

**Inventories**

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

**Bid costs**

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

**Amounts recoverable on contracts and payments received on account**

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

**Cash and cash equivalents**

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

**Current and non-current liabilities**

Current liabilities include amounts due within the normal operating cycle of the Group.

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

**Provisions**

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

**Non-current assets held for sale**

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



## Notes to the financial statements continued

**1 Significant accounting policies** continued**Financial instruments**

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

**Investments in debt and equity securities**

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

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

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

**Derivative financial instruments**

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

**Hedging – fair value**

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

**Hedging – cash flow**

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

**Hedging – net investment**

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

**Loan issue costs**

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

**Leased assets**

Leases are classified as finance leases when substantially all of 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.

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

**Post-retirement benefits**

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

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

## Notes to the financial statements continued

**1 Significant accounting policies** continued

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

**Share-based payments**

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

**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.

**Restatement of prior periods for finalisation of fair values arising on acquisitions**

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

**Recent accounting developments**

With effect from 1 April 2007 the Group has adopted IFRS 7, Financial Instruments: Disclosures. This introduces additional required disclosures for financial instruments, but does not have any impact on the consolidated income statement or balance sheet.

The following amendments and interpretations to published standards are also effective for accounting periods beginning on or after 1 April 2007:

IFRIC 7: Applying the restatement approach under IAS 29,

IFRIC 8: Scope of IFRS 2,

IFRIC 9: Reassessment of embedded derivatives,

IFRIC 10: Interim financial reporting and impairment,

IFRIC 11: IFRS2, Group and Treasury Share Transactions, and

Amendment to IAS1: Presentation of financial statements – capital disclosures.

None of these have any significant impact on the Group's financial statements.

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

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

The following standards and interpretations to existing standards have not yet been endorsed by the EU:

**IAS 1, (Amended) Presentation of Financial Statements – A Revised Presentation** (effective for annual periods beginning on or after 1 January 2009). This revision is intended to improve users' ability to analyse and compare information given in financial statements and included within the changes is the introduction of a statement of comprehensive income. This is not expected to have any significant impact on the Group's financial statements.

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

**IAS 32, Financial Instruments and related amended to IAS 1 Presentation of Financial Statements** (effective for annual periods beginning on or after 1 January 2009). These amendments deal with the balance sheet classification of puttable financial instruments and obligations arising only on liquidation. This is not expected to have any significant impact on the Group's financial statements.

**IFRS 2, Share-based payment (Amendment) Vesting conditions and cancellations** (effective for annual periods beginning on or after 1 January 2009). This amendment clarifies that vesting conditions are only service conditions and performance conditions and that other features of share-based payments are non-vesting conditions. It also specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. This is expected to accelerate the recognition of share-based payment charges in respect of leavers which would not have any significant impact on the Group's financial statements given current employee attrition rates.

## 1 Significant accounting policies continued

**IFRS 3, Business Combinations (Revised) and related revisions to IAS 27 Consolidated and Separate Financial Statements (Revised)** (both effective for annual periods beginning on or after 1 July 2009)

These revisions introduce some changes to the application of the acquisition method of accounting for business combinations. For example, all transaction costs will be expensed, all payments to purchase a business will be recorded at fair value at the acquisition date with some contingent payments subsequently re-measured at fair value through the income statement, and goodwill may be calculated based on the parent's share of net assets or it may include goodwill related to the minority interest. These revisions will impact the way in which the Group reports business combinations in future periods, in particular the expensing of transaction costs and adjustments to the fair value of contingent consideration through the income statement.

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

**IFRIC 13, Customer Loyalty Programmes** (effective for annual periods beginning on or after 1 July 2008) IFRIC 13 addresses accounting for loyalty award credits to customers who buy other goods and services. This is not expected to have any impact on the Group's financial statements.

**IFRIC 14, IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction** (effective for annual periods beginning on or after 1 January 2008) IFRIC 14 requires an entity to only recognise a surplus on a defined benefit post-retirement scheme if there is an unconditional right to realise them at some point during the life of the plan or when the plan is settled. It can also require schemes with deficits to recognise additional deficits to reflect agreed future funding commitments.

### Critical accounting estimates and judgements in applying accounting policies

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

#### Revenue and profit recognition

The estimation process required to evaluate the potential outcome of contracts and projects requires skill, knowledge and experience from a variety of sources within the business to assess the status of the contract, costs to complete, internal and external labour resources required and other factors. This process is carried out continuously throughout the business to ensure that project and contract assessments reflect the latest status of such work. No profit is recognised on a contract until the outcome can be reliably estimated.

#### Business combinations

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

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

#### Post-retirement benefits

The Group's defined benefit pension obligations and net income statement costs are based on key assumptions including return on plan assets, discount rates, mortality, inflation and future salary and pension increases. Management exercises their 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 deficit or the net income statement costs.

#### Research and development expenditure

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

#### Tax

In determining the Group's provisions for income 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 if the final outcome differs from the tax that has been provided, adjustments will be made to income tax and deferred tax provisions held in the period the determination is made.

#### Provisions

Provisions relate to constructive obligations arising principally from restructuring programmes. Such provisions are calculated based on estimates such as the expected calculation of redundancy costs or the future marketability of surplus property from such programmes. Actual costs incurred may differ from these estimates.

#### Unquoted equity investments

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

## Notes to the financial statements continued

## 2 Revenue

Revenue and other income is analysed as follows

| <i>all figures in £ million</i> | 2008           | 2007           |
|---------------------------------|----------------|----------------|
| Sales of goods                  | 143.9          | 133.5          |
| Services                        | 1,217.4        | 1,009.1        |
| Royalties                       | 4.7            | 6.9            |
| <b>Revenue</b>                  | <b>1,366.0</b> | <b>1,149.5</b> |
| <b>Property rental income</b>   | <b>9.0</b>     | <b>11.0</b>    |

## 3 Segmental analysis

## Business segments

Year ended 31 March 2008

| <i>all figures in £ million</i>   | QinetiQ<br>North<br>America | Europe,<br>Middle East<br>and Australasia | Ventures      | Eliminations | Total          |
|---|-----------------------------|---|---------------|--------------|----------------|
| <b>Revenue</b>  |                             |   |               |              |                |
| External sales  | 540.2                       | 820.1                                     | 5.7           | –            | 1,366.0        |
| Internal sales <sup>1</sup>   | 0.3                         | 0.5                                       | –             | (0.8)        | –              |
|   | <b>540.5</b>                | <b>820.6</b>                              | <b>5.7</b>    | <b>(0.8)</b> | <b>1,366.0</b> |
| <b>Other information</b>  |                             |   |               |              |                |
| EBITDA before restructuring costs and share of equity accounted joint ventures and associates                                   | 66.2                        | 112.1                                     | (9.3)         | –            | 169.0          |
| Share of equity accounted joint ventures and associates   | 0.1                         | 0.1                                       | (4.2)         | –            | (4.0)          |
| <b>EBITDA before restructuring costs</b>  | <b>66.3</b>                 | <b>112.2</b>                              | <b>(13.5)</b> | <b>–</b>     | <b>165.0</b>   |
| Depreciation of property, plant and equipment – own equipment   | (4.1)                       | (17.9)                                    | (0.7)         | –            | (22.7)         |
| Depreciation of property plant and equipment – LTPA funded  | –                           | (10.3)                                    | –             | –            | (10.3)         |
| Amortisation of purchased or internally developed intangible assets   | (0.1)                       | (4.0)                                     | (0.9)         | –            | (5.0)          |
| <b>Group operating profit/(loss) before EMEA reorganisation and amortisation of intangible assets arising from acquisitions</b> | <b>62.1</b>                 | <b>80.0</b>                               | <b>(15.1)</b> | <b>–</b>     | <b>127.0</b>   |
| Amortisation of intangible assets arising from acquisitions   | (16.2)                      | (1.8)                                     | –             | –            | (18.0)         |
| EMEA reorganisation   | –                           | (32.0)                                    | (0.6)         | –            | (32.6)         |
| <b>Group operating profit/(loss)</b>  | <b>45.9</b>                 | <b>46.2</b>                               | <b>(15.7)</b> | <b>–</b>     | <b>76.4</b>    |
| Loss on business divestments and unrealised impairment of investments   |                             |   |               |              | (7.0)          |
| Net finance expense   |                             |   |               |              | (18.0)         |
| <b>Profit before tax</b>  |                             |   |               |              | <b>51.4</b>    |
| Taxation expense  |                             |   |               |              | (4.0)          |
| <b>Profit for the year</b>  |                             |   |               |              | <b>47.4</b>    |

<sup>1</sup> Inter-segment sales are priced at fair value and treated as an arm's length transaction

### 3 Segmental analysis continued

#### Business segments

Year ended 31 March 2007

| <i>all figures in £ million</i>   | QinetiQ<br>North<br>America | Europe<br>Middle East<br>and Australasia | Ventures     | Eliminations | Total          |
|---|-----------------------------|--|--------------|--------------|----------------|
| <b>Revenue</b>  |                             |  |              |              |                |
| External sales  | 358.2                       | 779.3                                    | 12.0         | –            | 1,149.5        |
| Internal sales <sup>1</sup>   | 0.6                         | –  | –            | (0.6)        | –              |
|   | <b>358.8</b>                | <b>779.3</b>                             | <b>12.0</b>  | <b>(0.6)</b> | <b>1,149.5</b> |
| <b>Other information</b>  |                             |  |              |              |                |
| EBITDA before share of equity accounted associates  | 43.1                        | 102.2                                    | (3.6)        | –            | 141.7          |
| Share of equity accounted associates  | 0.1                         | –  | (1.3)        | –            | (1.2)          |
| <b>EBITDA</b>   | <b>43.2</b>                 | <b>102.2</b>                             | <b>(4.9)</b> | <b>–</b>     | <b>140.5</b>   |
| Depreciation of property, plant and equipment – own equipment   | (3.2)                       | (20.8)                                   | (0.7)        | –            | (24.7)         |
| Depreciation of property, plant and equipment – LTPA funded   | –                           | (7.0)                                    | –            | –            | (7.0)          |
| Amortisation of purchased or internally developed intangible assets                                     | (0.1)                       | (1.4)                                    | (1.3)        | –            | (2.8)          |
| <b>Group operating profit/(loss) before amortisation of intangible assets arising from acquisitions</b> | <b>39.9</b>                 | <b>73.0</b>                              | <b>(6.9)</b> | <b>–</b>     | <b>106.0</b>   |
| Amortisation of intangible assets arising from acquisitions   | (10.7)                      | (1.9)                                    | –            | –            | (12.6)         |
| <b>Group operating profit/(loss)</b>  | <b>29.2</b>                 | <b>71.1</b>                              | <b>(6.9)</b> | <b>–</b>     | <b>93.4</b>    |
| Gain on business divestments and unrealised impairment of investment                                    |                             |  |              |              | 4.6            |
| Profit on disposal of non-current assets  |                             |  |              |              | 3.3            |
| Net finance expense   |                             |  |              |              | (12.0)         |
| <b>Profit before tax</b>  |                             |  |              |              | <b>89.3</b>    |
| Taxation expense  |                             |  |              |              | (20.3)         |
| <b>Profit for the year</b>  |                             |  |              |              | <b>69.0</b>    |

<sup>1</sup> Inter-segment sales are priced at fair value and treated as an arm's length transaction

The segmental analysis has been modified from the prior year to align with the operational change in the year in which the Defence & Technology and Security & Dual Use sectors have been combined to form the EMEA segment

## Notes to the financial statements continued

## 3 Segmental analysis continued

Year ended 31 March 2008

| <i>all figures in £ million</i>      | QinetiQ<br>North<br>America | Europe,<br>Middle East<br>and Australasia | Ventures    | Unallocated    | Consolidated |
|--------------------------------------|-----------------------------|---|-------------|----------------|--------------|
| Segment assets*                      | 644.0                       | 755.7                                     | 41.4        | 41.0           | 1,482.1      |
| Segment liabilities*                 | (91.1)                      | (398.9)                                   | (6.9)       | (47.8)         | (544.7)      |
| Unallocated net debt excluding cash  |                             |   |             | (404.4)        | (404.4)      |
| <b>Net assets</b>                    | <b>552.9</b>                | <b>356.8</b>                              | <b>34.5</b> | <b>(411.2)</b> | <b>533.0</b> |
| <b>Other information</b>             |                             |   |             |                |              |
| Capital expenditure – own equipment* | 6.8                         | 24.9                                      | 0.4         | –              | 32.1         |
| Capital expenditure – LTPA funded*   | –                           | 13.7                                      | –           | –              | 13.7         |

Year ended 31 March 2007

| <i>all figures in £ million</i>      | QinetiQ<br>North<br>America | Europe,<br>Middle East<br>and Australasia | Ventures    | Unallocated    | Consolidated |
|--------------------------------------|-----------------------------|---|-------------|----------------|--------------|
| Segment assets – restated*           | 546.7                       | 680.7                                     | 33.0        | 48.2           | 1,308.6      |
| Segment liabilities – restated*      | (77.1)                      | (326.3)                                   | (5.2)       | (101.8)        | (510.4)      |
| Unallocated net debt excluding cash  |                             |   |             | (320.8)        | (320.8)      |
| <b>Net assets – restated</b>         | <b>469.6</b>                | <b>354.4</b>                              | <b>27.8</b> | <b>(374.4)</b> | <b>477.4</b> |
| <b>Other information</b>             |                             |   |             |                |              |
| Capital expenditure – own equipment* | 4.1                         | 25.0                                      | 0.9         | –              | 30.0         |
| Capital expenditure – LTPA funded*   | –                           | 16.9                                      | –           | –              | 16.9         |

\* Segment assets and liabilities exclude unallocated net debt before cash

\* Capital expenditure is defined as cash paid for property, plant and equipment additions and purchased and internally developed intangible assets

### 3 Segmental analysis continued

#### Geographical segments

##### Revenue by customer location

| <i>all figures in £ million</i> | 2008           | 2007           |
|---------------------------------|----------------|----------------|
| North America                   | 566.1          | 385.7          |
| United Kingdom                  | 760.0          | 729.9          |
| Other                           | 39.9           | 33.9           |
| <b>Total</b>                    | <b>1,366.0</b> | <b>1,149.5</b> |

##### Assets/liabilities by location

| <i>all figures in £ million</i> | Gross assets   |                | Gross liabilities |                |
|---------------------------------|----------------|----------------|-------------------|----------------|
|                                 | 2008           | 2007 Restated  | 2008              | 2007 Restated  |
| North America                   | 644.3          | 557.0          | (340.0)           | (213.4)        |
| United Kingdom                  | 808.8          | 743.7          | (585.7)           | (614.1)        |
| Other                           | 29.0           | 7.9            | (23.4)            | (3.7)          |
| <b>Total</b>                    | <b>1,482.1</b> | <b>1,308.6</b> | <b>(949.1)</b>    | <b>(831.2)</b> |

##### Capital expenditure by location

| <i>all figures in £ million</i> | 2008        | 2007        |
|---------------------------------|-------------|-------------|
| North America                   | 6.8         | 4.1         |
| United Kingdom                  | 39.0        | 42.8        |
| <b>Total</b>                    | <b>45.8</b> | <b>46.9</b> |

### 4 Profit before tax

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

| <i>all figures in £ million</i>                                      | 2008       | 2007       |
|--|------------|------------|
| Fees payable to the auditor  |            |            |
| – Statutory audit  | 0.7        | 0.7        |
| – Other services supplied pursuant to legislation                    | 0.2        | 0.2        |
| – Other services relating to taxation                                | 0.1        | 0.2        |
| – Other services   | 0.5        | 0.1        |
| <b>Total auditor's remuneration</b>                                  | <b>1.5</b> | <b>1.2</b> |
| Property rental income   | 9.0        | 11.0       |
| Inventories recognised as an expense                                 | 66.0       | 74.6       |
| Depreciation of property, plant and equipment                        |            |            |
| – Owned assets   | 32.5       | 29.6       |
| – Under finance lease  | 0.5        | 2.1        |
| Research and development expenditure under customer-funded contracts | 547.8      | 511.1      |
| Research and development expenditure – Group funded                  | 12.8       | 9.0        |

## 5a (Loss)/gain on business divestments and unrealised impairment of available for sale investments

| <i>all figures in £ million</i>                        | 2008         | 2007       |
|--|--------------|------------|
| (Loss)/gain on business divestments                    | (1.8)        | 13.4       |
| Unrealised impairment of available for sale investment | (5.2)        | (8.8)      |
|  | <b>(7.0)</b> | <b>4.6</b> |

The loss on business divestment of £1.8m represents the net book loss arising on the establishment of QinetiQ Ventures LP with Collier Capital involving the deconsolidation of certain previously consolidated subsidiaries (Intrinsic Materials Ltd formerly named QinetiQ Nanomaterials Ltd, Aurix Ltd, Omni-ID Ltd and Quintel Technology Ltd) and investments (Metalysis Ltd, ZBD Displays Ltd and Stingray Geophysical Ltd) that were transferred into the fund at completion of the transaction.

The current year unrealised impairment of investments relates to a £2.9m (2007: £8.8m) charge to the income statement in respect of the impairment in the carrying value of the quoted pSivida investment (see note 21 for further details) and a £2.3m charge in relation to the carrying value of other investments.

## 5b Profit on disposal of non-current assets

| <i>all figures in £ million</i>                 | 2008     | 2007       |
|---|----------|------------|
| <b>Profit on disposal of non-current assets</b> | <b>–</b> | <b>3.3</b> |

### Prior year disposals

On 29 March 2007 the Group unconditionally exchanged on the contract to dispose of its Bedford site resulting in the recognition of £2.5m of profit on disposal, net of costs. Initial proceeds of £1.8m were received on exchange of contracts. The sale completed on 13 April 2007 and a further £15.7m was received at that date. Other disposals in the year generated a net profit of £0.8m, of which £0.7m came from property disposals.



## Notes to the financial statements continued

## 6 Finance income and expense

| <i>all figures in £ million</i>              | 2008          | 2007          |
|--|---------------|---------------|
| Receivable on bank deposits                  | 1 7           | 2 1           |
| Finance lease income                         | 1 9           | 2 1           |
| <b>Finance income</b>                        | <b>3 6</b>    | <b>4 2</b>    |
| Amortisation of recapitalisation fee         | (0 2)         | (0 2)         |
| Payable on bank loans and overdrafts         | (11 9)        | (12 3)        |
| Payable on US\$ private placement debt       | (7 1)         | (1 6)         |
| Finance lease expense                        | (1 6)         | (1 9)         |
| Unwinding of discount on financial liability | (0 8)         | (0 2)         |
| <b>Finance expense</b>                       | <b>(21 6)</b> | <b>(16 2)</b> |
| <b>Net finance expense</b>                   | <b>(18 0)</b> | <b>(12 0)</b> |

## 7 Taxation expense

| <i>all figures in £ million</i>                    | 2008        | 2007        |
|--|-------------|-------------|
| <b>Analysis of charge</b>                          |             |             |
| UK corporation tax                                 | –           | –           |
| Overseas corporation tax                           | 10 1        | 13 9        |
| Overseas corporation tax in respect of prior years | –           | (0 2)       |
| <b>Total corporation tax</b>                       | <b>10 1</b> | <b>13 7</b> |
| Deferred tax                                       | (4 6)       | 6 6         |
| Deferred tax in respect of prior years             | (1 5)       | –           |
| <b>Taxation expense</b>                            | <b>4 0</b>  | <b>20 3</b> |

**Factors affecting the tax charge in year**

The principal factors reducing the Group's current year tax charge below the UK statutory rate are explained below

|  |             |             |
|--|-------------|-------------|
| Profit before tax  | 51 4        | 89 3        |
| <b>Tax on profit before tax at 30% (2007: 30%)</b>   | <b>15 4</b> | <b>26 8</b> |
| Effect of  |             |             |
| Expenses not deductible for tax purposes, research and development relief and non-taxable items arising on consolidation | (13 4)      | (10 3)      |
| Unprovided tax losses of overseas subsidiaries, joint ventures and associates  | 2 3         | 1 0         |
| Effect of change in deferred tax rate  | (1 5)       | –           |
| Deferred tax in respect of prior years   | (1 5)       | (0 2)       |
| Effect of different rates in overseas jurisdictions  | 2 7         | 3 0         |
| <b>Taxation expense</b>  | <b>4 0</b>  | <b>20 3</b> |

**Factors affecting future tax charges**

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

## 8 Dividends

An analysis of the dividends paid and proposed in respect of the years ended 31 March 2008 and 2007 are provided below

|   | Pence per share | £m          | Date paid/payable |
|---|-----------------|-------------|-------------------|
| Interim                                       | 1 33            | 8 7         | February 2008     |
| Final (proposed)                              | 2 92            | 19 3*       | September 2008    |
| <b>Total for the year ended 31 March 2008</b> | <b>4 25</b>     | <b>28 0</b> |                   |
| Interim                                       | 1 20            | 7 9         | February 2007     |
| Final   | 2 45            | 16 2        | August 2007       |
| <b>Total for the year ended 31 March 2007</b> | <b>3 65</b>     | <b>24 1</b> |                   |

\* Estimated cost for final proposed dividend in respect of the year ended 31 March 2008. The record date for this dividend will be 8 August 2008

## 9 Analysis of employee costs

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

|                                   | Year end       |                | Monthly average |                |
|-----------------------------------|----------------|----------------|-----------------|----------------|
|                                   | 2008<br>number | 2007<br>number | 2008<br>number  | 2007<br>number |
| QinetiQ North America             | 5 699          | 4 258          | 5,479           | 3,154          |
| Europe, Middle East & Australasia | 8,209          | 8 231          | 7 993           | 8 417          |
| Ventures                          | 77             | 82             | 75              | 85             |
| Corporate                         | 80             | 210            | 80              | 214            |
| <b>Total</b>                      | <b>14,065</b>  | <b>12,781</b>  | <b>13,627</b>   | <b>11,870</b>  |

The aggregate payroll costs of these persons were as follows

| <i>all figures in £ million</i>                        | <i>note</i> | <b>2008</b>  | <b>2007</b>  |
|--|-------------|--------------|--------------|
| Wages and salaries                                     |             | 485 9        | 414 9        |
| Social security costs                                  |             | 41 4         | 36 4         |
| Other pension costs                                    |             | 45 1         | 61 0         |
| Cost of share based payments                           | 34          | 3 8          | 1 1          |
| <b>Employee costs before EMEA reorganisation costs</b> |             | <b>576 2</b> | <b>513 4</b> |
| EMEA reorganisation costs                              |             | 32 6         | –            |
| <b>Total employee costs</b>                            |             | <b>608 8</b> | <b>513 4</b> |

The EMEA reorganisation costs principally comprise redundancy costs resulting from the restructuring of EMEA into four capability-focused businesses

## Notes to the financial statements continued

## 10 Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year (less those non-vested shares held by employee ownership trusts). For diluted earnings per share the weighted average number of shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares arising from unvested share-based awards including share options. Underlying earnings per share figures are presented below in addition to the basic and diluted earnings per share as the Directors consider this gives a more relevant indication of underlying business performance and reflects the adjustments for the impact of non-recurring items, amortisation of acquired intangible assets and tax thereon on basic earnings per share.

Year ended 31 March 2008

|   | Earnings<br>£m | Weighted<br>average<br>number<br>of shares<br>million* | Per share<br>amount<br>pence |
|---|----------------|--|------------------------------|
| <b>Basic</b>                            | 47.4           | 656.2  | <b>7.22</b>                  |
| Effect of dilutive securities – options |                | 3.5  | (0.03)                       |
| <b>Diluted</b>                          | 47.4           | 659.7  | <b>7.19</b>                  |

Underlying earnings per share

|   | Earnings<br>£m | Weighted<br>average<br>number<br>of shares<br>million* | Per share<br>amount<br>pence |
|---|----------------|--|------------------------------|
| <b>Basic</b>  | 47.4           | 656.2  | <b>7.22</b>                  |
| EMEA reorganisation costs   | 32.6           |  | 4.97                         |
| Amortisation of intangible assets arising from acquisitions           | 18.0           |  | 2.74                         |
| Loss on business divestments and unrealised impairment of investments | 7.0            |  | 1.07                         |
| Tax impact of items above   | (15.5)         |  | (2.36)                       |
| Tax rate change   | (1.5)          |  | (0.23)                       |
| <b>Underlying</b>   | <b>88.0</b>    | <b>656.2</b>   | <b>13.41</b>                 |

\* The weighted average number of shares is calculated net of the shares held by the employee benefit trusts

Year ended 31 March 2007

|   | Earnings<br>£m | Weighted<br>average<br>number<br>of shares<br>million | Per share<br>amount<br>pence |
|---|----------------|---|------------------------------|
| <b>Basic</b>                            | 69.0           | 656.6   | <b>10.51</b>                 |
| Effect of dilutive securities – options |                | 11.0  | (0.17)                       |
| <b>Diluted</b>                          | 69.0           | 667.6   | <b>10.34</b>                 |

Underlying earnings per share

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

## Notes to the financial statements continued

## 11 Goodwill

| <i>all figures in £ million</i>              | <i>note</i> | <i>2008</i>  | <i>2007<br/>Restated</i> |
|--|-------------|--------------|--------------------------|
| <b>Cost</b>                                  |             |              |                          |
| At 1 April                                   | 40          | 372.4        | 315.4                    |
| Acquisitions                                 | 13          | 72.3         | 100.5                    |
| Disposals                                    |             | (2.2)        | (7.1)                    |
| Foreign exchange                             |             | (4.6)        | (36.4)                   |
| <b>At 31 March</b>                           |             | <b>437.9</b> | <b>372.4</b>             |
| <b>Impairment</b>                            |             |              |                          |
| At 1 April and 31 March                      |             | (0.5)        | (0.5)                    |
| <b>Net book value at 31 March – restated</b> |             | <b>437.4</b> | <b>371.9</b>             |

Net book value of goodwill at 31 March 2006 amounted to £314.9m

Goodwill at 31 March 2008 was primarily allocated to cash generating units (CGUs) in QNA Technology Solutions £85.0m, Systems Engineering £59.5m, IT Services £169.9m and Mission Solutions £84.5m. Other allocations of goodwill include goodwill in relation to HVR Boldon James Verhaert and the three Australian acquisitions. Goodwill is attributable to the excess of consideration over the fair value of net assets acquired and includes expected synergies, future growth prospects and staff knowledge, expertise and customer contacts. The Group tests goodwill for impairment annually and uses discounted cash flow as the recoverable amount. The Group has made a number of assumptions in determining the value in use of goodwill allocated to a cash generating unit. It is assumed that cash generating units perform to the five-year corporate plan. This is consistent with the current and prior performance of the cash generating units and current UK and US defence and security spending forecasts. The estimates of the long-term growth rates for the CGUs are based on macro-economic assumptions and do not exceed the long-term estimate for the sectors in which CGUs operate. Future cash flows have been discounted at a post-tax discount rate of 8.7%. Sensitivity analysis has indicated that no reasonably foreseeable changes in the key assumptions in the impairment model would result in significant impairment charges being recorded in the financial statements.

## Notes to the financial statements continued

## 12 Intangible assets

Year ended 31 March 2008

| <i>all figures in £ million</i>        | <i>note</i> | <i>Acquired<br/>intangible<br/>assets*</i> | <i>Development<br/>costs</i> | <i>Other<br/>intangible<br/>assets</i> | <i>Total</i> |
|--|-------------|--|------------------------------|--|--------------|
| <b>Cost</b>                            |             |  |                              |  |              |
| At 1 April 2007 – restated             |             | 74.8                                       | 10.1                         | 11.1                                   | 96.0         |
| Additions – internally developed       |             | –  | 1.4                          | 0.2                                    | 1.6          |
| Additions – purchased                  |             | –  | –                            | 20.6                                   | 20.6         |
| Additions – recognised on acquisitions | 13, 40      | 45.6                                       | –                            | –                                      | 45.6         |
| Disposals                              |             | –  | (0.8)                        | (0.1)                                  | (0.9)        |
| Foreign exchange                       |             | (1.0)                                      | –                            | –                                      | (1.0)        |
| <b>At 31 March 2008</b>                | <b>40</b>   | <b>119.4</b>                               | <b>10.7</b>                  | <b>31.8</b>                            | <b>161.9</b> |
| <b>Amortisation and impairment</b>     |             |  |                              |  |              |
| At 1 April 2007                        |             | 27.2                                       | 0.7                          | 2.0                                    | 29.9         |
| Amortisation charge for the year       |             | 18.0                                       | 1.5                          | 3.5                                    | 23.0         |
| Disposals                              |             | –  | (0.1)                        | –                                      | (0.1)        |
| <b>At 31 March 2008</b>                |             | <b>45.2</b>                                | <b>2.1</b>                   | <b>5.5</b>                             | <b>52.8</b>  |
| <b>Net book value at 31 March 2008</b> |             | <b>74.2</b>                                | <b>8.6</b>                   | <b>26.3</b>                            | <b>109.1</b> |

Year ended 31 March 2007

| <i>all figures in £ million</i>                   | <i>note</i> | <i>Acquired<br/>intangible<br/>assets*</i> | <i>Development<br/>costs</i> | <i>Other<br/>intangible<br/>assets</i> | <i>Total</i> |
|---|-------------|--|------------------------------|--|--------------|
| <b>Cost</b>                                       |             |  |                              |  |              |
| At 1 April 2006                                   | 40          | 63.7                                       | 8.6                          | 2.9                                    | 75.2         |
| Additions – internally developed                  |             | –  | 3.2                          | 3.5                                    | 6.7          |
| Additions – purchased                             |             | –  | –                            | 5.4                                    | 5.4          |
| Additions – recognised on acquisitions – restated | 13          | 18.7                                       | –                            | –                                      | 18.7         |
| Disposals   |             | (1.2)                                      | (1.3)                        | (0.7)                                  | (3.2)        |
| Transfers to plant, property and equipment        |             | –  | (0.4)                        | –                                      | (0.4)        |
| Foreign exchange                                  |             | (6.4)                                      | –                            | –                                      | (6.4)        |
| <b>At 31 March 2007 – restated</b>                |             | <b>74.8</b>                                | <b>10.1</b>                  | <b>11.1</b>                            | <b>96.0</b>  |
| <b>Amortisation and impairment</b>                |             |  |                              |  |              |
| At 1 April 2006                                   |             | 16.8                                       | 0.5                          | 0.8                                    | 18.1         |
| Amortisation charge for the year                  |             | 12.6                                       | 1.5                          | 1.3                                    | 15.4         |
| Disposals   |             | (0.7)                                      | (1.3)                        | (0.1)                                  | (2.1)        |
| Foreign exchange                                  |             | (1.5)                                      | –                            | –                                      | (1.5)        |
| <b>At 31 March 2007</b>                           |             | <b>27.2</b>                                | <b>0.7</b>                   | <b>2.0</b>                             | <b>29.9</b>  |
| <b>Net book value at 31 March 2007 – restated</b> |             | <b>47.6</b>                                | <b>9.4</b>                   | <b>9.1</b>                             | <b>66.1</b>  |
| <b>Net book value at 31 March 2006</b>            |             | <b>46.9</b>                                | <b>8.1</b>                   | <b>2.1</b>                             | <b>57.1</b>  |

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

## Notes to the financial statements continued

## 13. Business combinations

In the year to 31 March 2008 the Group made nine acquisitions. If these acquisitions had been completed as at 1 April 2007 Group revenue for the year ended 31 March 2008 would have increased by £30.6m to £1,396.6m and Group profit before tax would have increased by £2.1m to £53.5m. The Group acquired five businesses based in the USA, three in Australia and one in the UK.

## Acquisitions in the year to 31 March 2008

*all figures £ million*

| all figures £ million  |               |   |                        |             |  | Contribution post acquisition |                  |
|--|---------------|---|------------------------|-------------|--|-------------------------------|------------------|
| Company acquired   | Date acquired | Initial cash consideration <sup>1</sup> | Deferred consideration | Goodwill    | Fair value of assets acquired <sup>2</sup> | Revenue                       | Operating profit |
| <b>QNA acquisitions</b>  |               |   |                        |             |  |                               |                  |
| ITS Corporation  | 16 Apr 07     | 43.1                                    | 5.3                    | 29.9        | 18.5                                       | 35.0                          | 3.2              |
| Automatika, Inc  | 5 June 07     | 4.2                                     | 0.6                    | 1.8         | 3.0  | 1.4                           | 0.2              |
| Applied Perception, Inc  | 5 June 07     | 4.4                                     | 0.6                    | 1.8         | 3.2  | 1.7                           | 0.0              |
| 3H Technology LLC  | 26 June 07    | 26.2                                    | 1.0                    | 14.6        | 12.6                                       | 16.0                          | 1.4              |
| Pinnacle CSI   | 21 Jan 08     | 3.0                                     | —                      | 0.7         | 2.3  | 1.2                           | 0.1              |
| <b>EMEA acquisitions</b>   |               |   |                        |             |  |                               |                  |
| Boldon James Holdings Ltd  | 24 Oct 07     | 13.2                                    | 4.3                    | 15.1        | 2.4  | 3.4                           | 0.2              |
| Ball Solutions Group Pty Ltd   | 15 Feb 08     | 3.5                                     | —                      | 3.4         | 0.1  | 0.9                           | 0.0              |
| AeroStructures Group   | 15 Feb 08     | 5.5                                     | —                      | 1.9         | 3.6  | 0.8                           | 0.1              |
| Novare Services Pty Ltd  | 15 Feb 08     | 3.6                                     | 0.4                    | 2.7         | 1.3  | 0.3                           | 0.1              |
| <b>Current year acquisitions</b>   |               | <b>106.7</b>                            | <b>12.2</b>            | <b>71.9</b> | <b>47.0</b>                                | <b>60.7</b>                   | <b>5.3</b>       |
| Update in respect of acquisitions made in the year to 31 March 2007 <sup>3</sup> |               | —                                       | 0.4                    | 0.4         | —  | —                             | —                |
| <b>Total</b>   |               | <b>106.7</b>                            | <b>12.6</b>            | <b>72.3</b> | <b>47.0</b>                                | <b>60.7</b>                   | <b>5.3</b>       |

<sup>1</sup> Initial cash consideration includes acquisition costs and price adjustments for working capital and net debt.

<sup>2</sup> Fair value of assets acquired are provisional.

<sup>3</sup> Goodwill in relation to the OSEC and Analox acquisitions completed in the prior year increased by £0.4m (\$0.8m) due to additional payments being accrued to the vendors.

## Notes to the financial statements continued

## 13 Business combinations continued

Set out below are the allocations of purchase consideration, assets and liabilities of the acquisitions made in the year 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. These allocations and adjustments are provisional.

## Acquisitions in the year to 31 March 2008

| <i>all figures in £ million</i> | note | Book value  | Fair value adjustment | Fair value at acquisition |
|---------------------------------|------|-------------|-----------------------|---------------------------|
| Intangible assets               |      | 1.4         | 44.2                  | 45.6                      |
| Property, plant and equipment   |      | 2.5         | —                     | 2.5                       |
| Trade and other receivables     |      | 16.6        | (0.1)                 | 16.5                      |
| Other current assets            |      | 3.9         | —                     | 3.9                       |
| Trade and other payables        |      | (10.3)      | (0.5)                 | (10.8)                    |
| Cash and cash equivalents       |      | 4.5         | —                     | 4.5                       |
| Debt and other borrowings       |      | (6.5)       | —                     | (6.5)                     |
| Deferred taxation               | 25   | (0.5)       | (8.2)                 | (8.7)                     |
| <b>Net assets acquired</b>      |      | <b>11.6</b> | <b>35.4</b>           | <b>47.0</b>               |
| Goodwill                        |      |             |                       | 71.9                      |
|                                 |      |             |                       | <b>118.9</b>              |
| Consideration satisfied by      |      |             |                       |                           |
| Cash                            |      |             |                       | 105.8                     |
| Deferred consideration          |      |             |                       | 12.2                      |
| <b>Total consideration</b>      |      |             |                       | <b>118.0</b>              |
| Related costs of acquisition    |      |             |                       | 0.9                       |
|                                 |      |             |                       | <b>118.9</b>              |

The fair value adjustments include £44.2m in relation to the recognition of acquired intangible assets less the recognition of a deferred tax liability of £8.2m in relation to these intangible assets.

## Notes to the financial statements continued

## 14 Property, plant and equipment

Year ended 31 March 2008

| <i>all figures in £ million</i>        | Land and buildings | Plant, machinery and vehicles | Computers and office equipment | Assets under construction | Total          |
|--|--------------------|-------------------------------|--------------------------------|---------------------------|----------------|
| <b>Cost</b>                            |                    |                               |                                |                           |                |
| At 1 April 2007                        | 304.0              | 104.9                         | 31.9                           | 25.2                      | 466.0          |
| Additions                              | 1.3                | 3.5                           | 3.7                            | 15.2                      | 23.7           |
| Acquisition of subsidiaries            | 0.3                | 0.6                           | 1.6                            | —                         | 2.5            |
| Disposals                              | —                  | (2.1)                         | (0.2)                          | (0.2)                     | (2.5)          |
| Disposal of businesses                 | —                  | (1.7)                         | (0.8)                          | (0.5)                     | (3.0)          |
| Transfers                              | 1.2                | 10.4                          | 6.1                            | (17.7)                    | —              |
| Foreign exchange                       | —                  | (0.1)                         | (0.3)                          | —                         | (0.4)          |
| <b>At 31 March 2008</b>                | <b>306.8</b>       | <b>115.5</b>                  | <b>42.0</b>                    | <b>22.0</b>               | <b>486.3</b>   |
| <b>Depreciation</b>                    |                    |                               |                                |                           |                |
| At 1 April 2007                        | 43.3               | 61.6                          | 19.6                           | —                         | 124.5          |
| Charge for the year                    | 11.3               | 15.0                          | 6.7                            | —                         | 33.0           |
| Disposals                              | —                  | (2.0)                         | (0.2)                          | —                         | (2.2)          |
| Disposal of businesses                 | —                  | (0.6)                         | (0.5)                          | —                         | (1.1)          |
| Foreign exchange                       | —                  | (0.1)                         | (0.2)                          | —                         | (0.3)          |
| <b>At 31 March 2008</b>                | <b>(54.6)</b>      | <b>(73.9)</b>                 | <b>(25.4)</b>                  | <b>—</b>                  | <b>(153.9)</b> |
| <b>Net book value at 31 March 2008</b> | <b>252.2</b>       | <b>41.6</b>                   | <b>16.6</b>                    | <b>22.0</b>               | <b>332.4</b>   |

Year ended 31 March 2007

| <i>all figures in £ million</i>        | Land and buildings | Plant, machinery and vehicles | Computers and office equipment | Assets under construction | Total        |
|--|--------------------|-------------------------------|--------------------------------|---------------------------|--------------|
| <b>Cost</b>                            |                    |                               |                                |                           |              |
| At 1 April 2006                        | 299.4              | 87.3                          | 26.4                           | 25.7                      | 438.8        |
| Additions                              | 0.3                | 3.3                           | 3.3                            | 27.9                      | 34.8         |
| Acquisition of subsidiaries            | —                  | —                             | 2.0                            | —                         | 2.0          |
| Disposals                              | (3.4)              | (0.6)                         | (2.6)                          | (0.5)                     | (7.1)        |
| Disposal of businesses                 | —                  | —                             | (0.4)                          | —                         | (0.4)        |
| Transfers from development costs       | —                  | —                             | —                              | 0.4                       | 0.4          |
| Transfers                              | 8.2                | 15.5                          | 4.5                            | (28.2)                    | —            |
| Foreign exchange                       | (0.5)              | (0.6)                         | (1.3)                          | (0.1)                     | (2.5)        |
| <b>At 31 March 2007</b>                | <b>304.0</b>       | <b>104.9</b>                  | <b>31.9</b>                    | <b>25.2</b>               | <b>466.0</b> |
| <b>Depreciation</b>                    |                    |                               |                                |                           |              |
| At 1 April 2006                        | 33.5               | 51.9                          | 13.1                           | —                         | 98.5         |
| Charge for the year                    | 11.3               | 10.6                          | 9.8                            | —                         | 31.7         |
| Disposals                              | (1.1)              | (0.6)                         | (2.3)                          | —                         | (4.0)        |
| Disposal of businesses                 | —                  | —                             | (0.1)                          | —                         | (0.1)        |
| Foreign exchange                       | (0.4)              | (0.3)                         | (0.9)                          | —                         | (1.6)        |
| <b>At 31 March 2007</b>                | <b>43.3</b>        | <b>61.6</b>                   | <b>19.6</b>                    | <b>—</b>                  | <b>124.5</b> |
| <b>Net book value at 31 March 2007</b> | <b>260.7</b>       | <b>43.3</b>                   | <b>12.3</b>                    | <b>25.2</b>               | <b>341.5</b> |
| Net book value 31 March 2006           | 265.9              | 35.4                          | 13.3                           | 25.7                      | 340.3        |

Assets held under finance leases, capitalised and included in computers and equipment have

- a cost of £5.2m (31 March 2007 £5.7m)
- aggregate depreciation of £5.2m (31 March 2007 £5.0m), and
- a net book value of £nil (31 March 2007 £0.7m)

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



## 15 Investment property

| <i>all figures in £ million</i> | 2008     | 2007     |
|---------------------------------|----------|----------|
| <b>Cost and net book value</b>  |          |          |
| At 1 April                      | –        | 5.8      |
| Disposals                       | –        | (5.8)    |
| <b>At 31 March</b>              | <b>–</b> | <b>–</b> |

| <i>all figures in £ million</i>   | 2008 | 2007  |
|---|------|-------|
| <b>The following amounts have been credited/(charged) in arriving at Group operating profit</b> |      |       |
| Rental income from investment property  | –    | 0.7   |
| Direct operating expenses arising on investment property generating rental income               | –    | (0.2) |

## 16 Financial assets

| <i>all figures in £ million</i>           | 2008        | 2007        |
|---|-------------|-------------|
| Derivative financial instruments          | 1.4         | 1.0         |
| Escrow financial assets                   | 3.0         | –           |
| Net investment in finance lease           | 3.0         | 3.0         |
| <b>Total current financial assets</b>     | <b>7.4</b>  | <b>4.0</b>  |
| Net investment in finance lease           | 13.0        | 14.1        |
| Escrow financial assets                   | –           | 3.1         |
| Derivative financial instruments          | 2.3         | 1.6         |
| <b>Total non-current financial assets</b> | <b>15.3</b> | <b>18.8</b> |
| <b>Total financial assets</b>             | <b>22.7</b> | <b>22.8</b> |

## Notes to the financial statements continued

## 17 Equity accounted investments

Year ended 31 March 2008

| <i>all figures in £ million</i> | Joint venture<br>and associates<br>financial<br>results | Group net<br>share of joint<br>ventures and<br>associates |
|---------------------------------|---|---|
| Revenue                         | 9 0   | 2 9   |
| Loss after tax                  | (8 0)   | (4 0)   |
| Non-current assets              | 21 1  | 10 4  |
| Current assets                  | 9 1   | 4 1   |
|                                 | <b>30 2</b>   | <b>14 5</b>   |
| Current liabilities             | (5 8)   | (2 6)   |
| Non-current liabilities         | (5 2)   | (2 6)   |
|                                 | <b>(11 0)</b>   | <b>(5 2)</b>  |
| <b>Net assets</b>               | <b>19 2</b>   | <b>9 3</b>  |

Year ended 31 March 2007

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

In August 2007 the Group completed the establishment of a new technology venture fund QinetiQ Ventures LP, with Collier Capital. The fund is accounted for as a joint venture with a 50% economic interest held by the Group but with the potential for an increase to 75% dependent on the future financial results of the fund. The Group transferred the following businesses into the fund which had previously been partially or wholly owned: Intrinsic Materials Limited (formerly named QinetiQ Nanomaterials Limited, and formerly a 100% subsidiary), Aurix Limited (formerly 88% subsidiary), Omni-ID Limited (formerly 100% subsidiary), Quintel Technology Limited (formerly 50% subsidiary), Metalysis Limited (formerly 16.3% investment), ZBD Displays Limited (formerly 31.6% investment), Stingray Geophysical Limited (formerly 19.9% investment). The Group invested cash of £3.5m into the fund during the year and there were losses of £4.0m recorded in the income statement. There was a loss on business divestment of £1.8m recorded in the income statement on the establishment of the fund (see note 5a for further details) and there was a charge of £3.5m to equity for the recycling of unrealised gains on previous revaluations of these businesses.

The unrecognised share of losses of equity accounted investments at 31 March 2008 was £nil (31 March 2007: £nil). During the year ended 31 March 2008 there were sales to joint ventures of £1.3m (2007: £nil) and to associates of £1.4m (2007: £nil). At year end there were outstanding receivables from joint ventures of £0.4m (2007: £nil) and £nil (2007: £nil) from associates. There were no other related party transactions between the Group and its joint ventures and associates in the year.

## Notes to the financial statements continued

## 18 Other non-current investments

| <i>all figures in £ million</i>                                  | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|
| Available for sale investments at 1 April                        | 28.5        | 1.3         |
| Cash invested in year  | 4.1         | 7.7         |
| Non-cash addition in year  | —           | 9.5         |
| Impairment charged to income statement in year                   | (2.3)       | —           |
| Unwind of discount credited to income statement                  | 0.2         | —           |
| Impairment of a previously revalued investment charged to equity | (2.9)       | —           |
| Increase in fair value in year credited to equity                | 3.2         | 10.0        |
| Disposals  | (16.1)      | —           |
| <b>Available for sale investments at 31 March</b>                | <b>14.7</b> | <b>28.5</b> |

In August 2007, the Group transferred its holding in Metalysis Limited, Stingray Geophysical Ltd and ZBD Displays Limited to a venture fund in which QinetiQ holds a 50% interest and Collier Capital holds the remaining interest. The interest in this joint venture fund is disclosed in equity accounted investments in note 17. Prior to this date the Group invested cash of £1.2m in Metalysis Limited.

During the year the Group made other cash investments of £2.9m. There were revaluation gains of £3.2m in the Sciemus Limited investment following a funding round that established a new fair value and £2.3m impairments of other investments.

## 19 Inventories

| <i>all figures in £ million</i> | <b>2008</b> | <b>2007</b> |
|---------------------------------|-------------|-------------|
| Raw materials                   | 6.1         | 3.5         |
| Work in progress                | 19.9        | 17.7        |
| Finished goods                  | 30.9        | 18.3        |
|                                 | <b>56.9</b> | <b>39.5</b> |

## 20 Trade and other receivables

| <i>all figures in £ million</i>     | 2008         | 2007         |
|-------------------------------------|--------------|--------------|
| Trade debtors                       | 300.1        | 250.7        |
| Amounts recoverable under contracts | 134.2        | 106.3        |
| Other debtors                       | 9.4          | 21.8         |
| Prepayments                         | 25.3         | 22.4         |
|                                     | <b>469.0</b> | <b>401.2</b> |

In determining the recoverability of trade receivables the Group considers any changes in the credit quality of the trade receivable from the date credit was granted up to the reporting date. Credit risk is limited due to the high percentage of turnover being derived from UK and US defence and other government agencies. Accordingly the Directors believe there is no further credit provision required in excess of the allowance for doubtful debts. As at 31 March 2008 the Group carried a provision for doubtful debts of £6.2m (2007: £2.5m).

Ageing of past due but not impaired receivables

| <i>all figures in £ million</i> | 2008        | 2007        |
|---------------------------------|-------------|-------------|
| Up to 3 months                  | 48.0        | 20.8        |
| Over 3 months                   | 3.3         | 6.6         |
|                                 | <b>51.3</b> | <b>27.4</b> |

Movements on the Group doubtful debt provision

| <i>all figures in £ million</i> | 2008       | 2007       |
|---------------------------------|------------|------------|
| At 1 April                      | 2.5        | 3.5        |
| Created                         | 4.5        | 0.3        |
| Released                        | (0.5)      | (1.3)      |
| Utilised                        | (0.3)      | –          |
| <b>At 31 March</b>              | <b>6.2</b> | <b>2.5</b> |

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.

## 21 Current asset investments

| <i>all figures in £ million</i>      | 2008       | 2007       |
|--------------------------------------|------------|------------|
| <b>Available for sale investment</b> | <b>1.3</b> | <b>4.0</b> |

At 31 March 2008 the Group held 35.7 million shares in pSivida Limited (31 March 2007: 35.7 million) 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 2008 of A\$0.08 per share (31 March 2007: A\$0.27). During the year the reduction in value of £2.9m (2007: £8.8m) before £0.2m of foreign exchange gain has been recognised in the income statement as an impairment.

## 22 Cash and cash equivalents

| <i>all figures in £ million</i> | 2008        | 2007        |
|---------------------------------|-------------|-------------|
| <b>Cash</b>                     | <b>24 5</b> | <b>20 0</b> |

At 31 March 2008 £14.7m (31 March 2007 £12.7m) of cash is held by the Group's captive insurance subsidiary. The amount is included in the above but can only be used for insurance purposes or utilised by the Group with prior approval by the subsidiary Board and relevant insurance regulator.

## 23 Trade and other payables

| <i>all figures in £ million</i>                   | 2008         | 2007<br>Restated |
|---|--------------|------------------|
| Payments received on account                      | 77.0         | 96.9             |
| Trade creditors                                   | 51.3         | 31.3             |
| Other tax and social security                     | 47.2         | 46.3             |
| Other creditors                                   | 31.4         | 20.4             |
| Accruals and deferred income                      | 167.5        | 145.1            |
| <b>Total current trade and other payables</b>     | <b>374.4</b> | <b>340.0</b>     |
| Payments received on account                      | 36.1         | —                |
| Other payables                                    | 11.6         | 5.5              |
| <b>Total non-current trade and other payables</b> | <b>47.7</b>  | <b>5.5</b>       |
| <b>Total trade and other payables</b>             | <b>422.1</b> | <b>345.5</b>     |

## 24 Provisions

Year ended 31 March 2008

| <i>all figures in £ million</i> | Reorganisation | Other       | Total       |
|---------------------------------|----------------|-------------|-------------|
| At 1 April 2007                 | 0.9            | 13.3        | 14.2        |
| Created in year                 | 36.6           | 5.4         | 42.0        |
| Released in year                | (0.4)          | (0.3)       | (0.7)       |
| Utilised in year                | (7.8)          | (2.0)       | (9.8)       |
| <b>At 31 March 2008</b>         | <b>29.3</b>    | <b>16.4</b> | <b>45.7</b> |
| Current liability               | 29.3           | 2.5         | 31.8        |
| Non-current liability           | —              | 13.9        | 13.9        |
| <b>At 31 March 2008</b>         | <b>29.3</b>    | <b>16.4</b> | <b>45.7</b> |

Year ended 31 March 2007

| <i>all figures in £ million</i> | Reorganisation | Other       | Total       |
|---------------------------------|----------------|-------------|-------------|
| At 1 April 2006                 | 9.4            | 17.1        | 26.5        |
| Created in year                 | 0.7            | 5.9         | 6.6         |
| Released in year                | (0.8)          | (7.5)       | (8.3)       |
| Utilised in year                | (8.4)          | (2.2)       | (10.6)      |
| <b>At 31 March 2007</b>         | <b>0.9</b>     | <b>13.3</b> | <b>14.2</b> |
| Current liability               | 0.9            | 0.2         | 1.1         |
| Non-current liability           | —              | 13.1        | 13.1        |
| <b>At 31 March 2007</b>         | <b>0.9</b>     | <b>13.3</b> | <b>14.2</b> |

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

## 25 Deferred tax

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

Movements on the deferred tax assets and liabilities are shown below

Year ended 31 March 2008

### Deferred tax asset

| <i>all figures in £ million</i>                  | Pension liability | Hedging    | Other       | Total       |
|--|-------------------|------------|-------------|-------------|
| At 1 April 2007                                  | 27.1              | —          | 0.7         | 27.8        |
| Created  | —                 | 1.9        | 11.1        | 13.0        |
| Transfer from deferred tax liability             | —                 | (0.7)      | —           | (0.7)       |
| Released   | (20.6)            | —          | —           | (20.6)      |
| <b>Gross deferred tax asset at 31 March 2008</b> | <b>6.5</b>        | <b>1.2</b> | <b>11.8</b> | <b>19.5</b> |
| Less liability available for offset              | —                 | —          | —           | (19.5)      |
| <b>Net deferred tax asset at 31 March 2008</b>   | <b>—</b>          | <b>—</b>   | <b>—</b>    | <b>—</b>    |

The net deferred tax asset released in the year relating to the pension liability includes £12.2m (2007: £17.9m) released to equity

### Deferred tax liability

| <i>all figures in £ million</i>                      | Accelerated tax depreciation and amortisation |
|--|---|
| At 1 April 2007 – restated                           | (47.0)  |
| Acquisitions   | (8.7)   |
| Created  | 4.4   |
| Transfer to deferred tax asset                       | 0.7   |
| Foreign exchange                                     | 0.3   |
| <b>Gross deferred tax liability at 31 March 2008</b> | <b>(50.3)</b>                                 |
| Less asset available for offset                      | 19.5  |
| <b>Net deferred tax liability at 31 March 2008</b>   | <b>(30.8)</b>                                 |

Deferred tax movements on hedging have been recognised in equity. At the balance sheet date, the Group had unused tax losses of £53.8m (2007: £46.2m) potentially available for offset against future profits. No deferred tax asset has been recognised in respect of this amount due to uncertainty over the timing of their utilisation. These losses can be carried forward indefinitely.

## Notes to the financial statements continued

## 25 Deferred tax continued

Year ended 31 March 2007

## Deferred tax asset

| <i>all figures in £ million</i>                  | Pension liability | Other      | Total       |
|--|-------------------|------------|-------------|
| At 1 April 2006                                  | 50.4              | –          | 50.4        |
| Released   | (23.3)            | –          | (23.3)      |
| Transferred from deferred tax liabilities        | –                 | 0.7        | 0.7         |
| <b>Gross deferred tax asset at 31 March 2007</b> | <b>27.1</b>       | <b>0.7</b> | <b>27.8</b> |
| Less liability available for offset              |                   |            | (16.8)      |
| <b>Net deferred tax asset at 31 March 2007</b>   |                   |            | <b>11.0</b> |

## Deferred tax liability

| <i>all figures in £ million</i>                                 | Accelerated tax depreciation and amortisation | Other    | Hedging  | Total         |
|---|---|----------|----------|---------------|
| At 1 April 2006   | (43.2)  | (1.6)    | (2.0)    | (46.8)        |
| Acquisitions – restated   | (5.4)   | –        | –        | (5.4)         |
| Created   | (0.6)   | –        | –        | (0.6)         |
| Released  | 1.9   | 2.3      | 2.0      | 6.2           |
| Transferred to deferred tax assets                              | –   | (0.7)    | –        | (0.7)         |
| Foreign exchange  | 0.3   | –        | –        | 0.3           |
| <b>Gross deferred tax liability at 31 March 2007 – restated</b> | <b>(47.0)</b>                                 | <b>–</b> | <b>–</b> | <b>(47.0)</b> |
| Less asset available for offset                                 |   |          |          | 16.8          |
| <b>Net deferred tax liability at 31 March 2007 – restated</b>   |   |          |          | <b>(30.2)</b> |

## 26 Financial liabilities – current

| <i>all figures in £ million</i>  | 2008        | 2007        |
|----------------------------------|-------------|-------------|
| Bank overdraft                   | 5.0         | 7.4         |
| Loan notes                       | 0.5         | 5.2         |
| Deferred financing costs         | (0.2)       | (0.2)       |
| Finance lease creditor           | 2.8         | 3.2         |
| Derivative financial investments | 3.7         | 0.3         |
|                                  | <b>11.8</b> | <b>15.9</b> |

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

## Notes to the financial statements continued

## 27 Financial liabilities – non-current

| <i>all figures in £ million</i>        | 2008                     | 2007         |
|--|--------------------------|--------------|
| Bank loan                              | 266.7                    | 180.1        |
| Deferred financing costs               | (0.9)                    | (0.6)        |
|  | <b>265.8</b>             | <b>179.5</b> |
| US\$260m loan, repayable 2013 and 2016 | 132.3                    | 134.3        |
| Finance lease creditor                 | 12.8                     | 13.9         |
| Derivative financial instruments       | 4.4                      | –            |
|  | <b>415.3<sup>†</sup></b> | <b>327.7</b> |

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

## 28 Financial risk management

Financial assets and liabilities comprise

| <i>all figures in £ million</i>        | 2008             |                       | 2007             |                       |
|--|------------------|-----------------------|------------------|-----------------------|
|  | Financial assets | Financial liabilities | Financial assets | Financial liabilities |
| Trade and other receivables/(payables) | 469.0            | (422.1)               | 401.2            | (345.5)               |
| Cash and cash equivalents              | 24.5             | –                     | 20.0             | –                     |
| Bank borrowings, loans and loan notes  | –                | (403.4)               | –                | (326.2)               |
| Finance leases                         | 16.0             | (15.6)                | 17.1             | (17.1)                |
| Investments                            | 16.0             | –                     | 32.5             | –                     |
| Derivative financial instruments       | 3.7              | (8.1)                 | 2.6              | (0.3)                 |
| Escrow financial asset                 | 3.0              | –                     | 3.1              | –                     |
|  | <b>532.2</b>     | <b>(849.2)</b>        | <b>476.5</b>     | <b>(689.1)</b>        |

## (A) Fair values of financial instruments

All financial assets and liabilities have a fair value identical to book value at 31 March 2008 and 31 March 2007 except the following

| <i>all figures in £ million</i>  | 2008       |            | 2007       |            |
|--|------------|------------|------------|------------|
|  | Fair value | Book value | Fair value | Book value |
| Primary financial instruments held or issued to finance the Group's operations |            |            |            |            |
| Bank borrowings, loans and loan notes  | (403.7)    | (403.4)    | (324.1)    | (326.2)    |
| Other financial assets/(liabilities)   |            |            |            |            |
| Finance lease assets   | 19.2       | 16.0       | 23.1       | 17.1       |
| Finance lease liabilities  | (17.7)     | (15.6)     | (21.9)     | (17.1)     |

Market values, where available, have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting cash flows to net present values using prevailing market-based interest rates translated at year-end exchange rates, except for unlisted fixed asset investments where a fair value equals book value.



## Notes to the financial statements continued

## 28 Financial risk management continued

**(B) Interest rate risk**

At 31 March 2008

| <i>all figures in £ million</i> | Financial asset |             |                      | Financial liability |                |                      |
|---------------------------------|-----------------|-------------|----------------------|---------------------|----------------|----------------------|
|                                 | Fixed or capped | Floating    | Non-interest bearing | Fixed or capped     | Floating       | Non-interest bearing |
| Sterling                        | 16 0            | 10 2        | 18 4                 | (15 6)              | (19 4)         | (6 1)                |
| US dollar                       | –               | 16 7        | –                    | (268 0)             | (90 4)         | (2 0)                |
| Euro                            | –               | 0 6         | –                    | –                   | (10 0)         | –                    |
| Australian dollar               | –               | –           | 1 3                  | –                   | (15 6)         | –                    |
|                                 | <b>16 0</b>     | <b>27 5</b> | <b>19 7</b>          | <b>(283 6)</b>      | <b>(135 4)</b> | <b>(8 1)</b>         |

31 March 2007

| <i>all figures in £ million</i> | Financial asset |             |                      | Financial liability |               |                      |
|---------------------------------|-----------------|-------------|----------------------|---------------------|---------------|----------------------|
|                                 | Fixed or capped | Floating    | Non-interest bearing | Fixed or capped     | Floating      | Non-interest bearing |
| Sterling                        | 17 1            | 14 3        | 28 5                 | (22 2)              | (12 7)        | –                    |
| US dollar                       | –               | 8 4         | 2 4                  | (256 6)             | (41 4)        | (0 1)                |
| Euro                            | –               | 0 4         | 0 2                  | –                   | (6 8)         | (0 2)                |
| Australian dollar               | –               | –           | 4 0                  | –                   | (3 6)         | –                    |
|                                 | <b>17 1</b>     | <b>23 1</b> | <b>35 1</b>          | <b>(278 8)</b>      | <b>(64 5)</b> | <b>(0 3)</b>         |

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) are excluded from this analysis.

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

|                       | 2008                  |  |  | 2007                  |  |                                       |
|-----------------------|-----------------------|--|--|-----------------------|--|---------------------------------------|
|                       | Fixed or capped<br>£m | Weighted average<br>interest rate<br>% | Weighted average<br>years<br>to maturity | Fixed or capped<br>£m | Weighted average<br>interest rate<br>% | Weighted average years<br>to maturity |
| Financial assets      |                       |  |  |                       |  |                                       |
| Sterling              | 16 0                  | 13 4%                                  | 6 9                                      | 17 1                  | 13 4%                                  | 7 9                                   |
| Financial liabilities |                       |  |  |                       |  |                                       |
| Sterling              | (15 6)                | 12 1%                                  | 7 4                                      | (22 2)                | 10 9%                                  | 6 3                                   |
| US dollar             | (268 0)               | 4 8%                                   | 5 2                                      | (256 6)               | 4 9%                                   | 5 8                                   |
|                       | <b>(283 6)</b>        | <b>5 2%</b>                            | <b>5 3</b>                               | <b>(278 8)</b>        | <b>5 3%</b>                            | <b>5 8</b>                            |

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

**Interest rate risk management**

At 31 March 2008 66% (31 March 2007 80%) of the Group's bank borrowings, loans and loan notes were fixed or capped through a combination of interest rate swaps, collars and fixed rate debt.

## Notes to the financial statements continued

## 28 Financial risk management continued

**(C) Currency risk**

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

**Functional currency of the operating company**

| <i>all figures in £ million</i> | Net foreign currency monetary assets/(liabilities) |       |                   |       |       |
|---------------------------------|--|-------|-------------------|-------|-------|
|                                 | US dollar  | Euro  | Australian dollar | Other | Total |
| 31 March 2008 – sterling        | 12.3   | 0.8   | (0.1)             | (0.3) | 12.7  |
| 31 March 2007 – sterling        | 0.5  | (0.3) | –                 | 1.2   | 1.4   |

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

**(D) Liquidity risk**

The following are the contractual maturities of financial liabilities, including interest payments.

At 31 March 2008

| <i>all figures in £ million</i>             | Book value     | Contractual cash flows | 1 year or less | 1-2 years     | 2-5 years     | More than 5 years |
|---|----------------|------------------------|----------------|---------------|---------------|-------------------|
| <b>Non-derivative financial liabilities</b> |                |                        |                |               |               |                   |
| Trade and other payables                    | (422.1)        | (422.1)                | (374.4)        | (7.8)         | (39.9)        | –                 |
| Bank overdrafts                             | (5.0)          | (5.0)                  | (5.0)          | –             | –             | –                 |
| US\$260m loan, repayable 2013 and 2016      | (132.3)        | (159.1)                | (7.1)          | (7.1)         | (7.1)         | (137.8)           |
| Multi-currency revolving facility*          | (265.6)        | (267.4)                | (267.4)        | –             | –             | –                 |
| Loan notes                                  | (0.5)          | (0.5)                  | (0.5)          | –             | –             | –                 |
| Finance leases                              | (15.6)         | (21.1)                 | (2.8)          | (2.8)         | (8.5)         | (7.0)             |
| <b>Derivative financial liabilities</b>     |                |                        |                |               |               |                   |
| Interest rate swaps used for hedging        | (4.8)          | (4.8)                  | (2.0)          | (2.0)         | (0.8)         | –                 |
| Forward exchange contracts used for hedging | (3.3)          | (3.3)                  | (1.7)          | (1.1)         | (0.5)         | –                 |
|   | <b>(849.2)</b> | <b>(883.3)</b>         | <b>(660.9)</b> | <b>(20.8)</b> | <b>(56.8)</b> | <b>(144.8)</b>    |

\* Although the contractual maturities of the loans drawn under the £500m committed multi-currency revolving facility fall within 12 months, the facility is available until 19 August 2012.

At 31 March 2007

| <i>all figures in £ million</i>             | Book value     | Contractual cash flows | 1 year or less | 1-2 years     | 2-5 years     | More than 5 years |
|---|----------------|------------------------|----------------|---------------|---------------|-------------------|
| <b>Non-derivative financial liabilities</b> |                |                        |                |               |               |                   |
| Trade and other payables                    | (345.5)        | (345.5)                | (340.0)        | (5.5)         | –             | –                 |
| Bank overdrafts                             | (7.4)          | (7.4)                  | (7.4)          | –             | –             | –                 |
| US\$260m loan, repayable 2013 and 2016      | (134.3)        | (161.8)                | (7.3)          | (7.3)         | (7.3)         | (139.9)           |
| Multi-currency revolving facility           | (179.3)        | (183.0)                | (183.0)        | –             | –             | –                 |
| Loan notes                                  | (5.2)          | (5.2)                  | (5.2)          | –             | –             | –                 |
| Finance leases                              | (17.1)         | (24.2)                 | (3.2)          | (2.8)         | (8.5)         | (9.7)             |
| <b>Derivative financial liabilities</b>     |                |                        |                |               |               |                   |
| Interest rate swaps used for hedging        | –              | –                      | –              | –             | –             | –                 |
| Forward exchange contracts used for hedging | (0.3)          | (0.3)                  | (0.3)          | –             | –             | –                 |
|   | <b>(689.1)</b> | <b>(727.4)</b>         | <b>(546.4)</b> | <b>(15.6)</b> | <b>(15.8)</b> | <b>(149.6)</b>    |

## 28 Financial risk management continued

### (E) Gains and losses on cash flow hedges

| <i>all figures in £ million</i>  | 2008       |              |              | 2007       |              |            |
|--|------------|--------------|--------------|------------|--------------|------------|
|  | Gains      | Losses       | Net          | Gains      | Losses       | Net        |
| Derivative assets/(liabilities) at the beginning of the year                 | 2.7        | (0.3)        | 2.4          | 8.5        | (0.5)        | 8.0        |
| Removed from equity and included in income statement within interest expense | (1.1)      | —            | (1.1)        | (1.7)      | 0.3          | (1.4)      |
| Recognised in equity during the year   | 2.1        | (7.8)        | (5.7)        | (4.1)      | (0.1)        | (4.2)      |
| Derivative assets/(liabilities) at the end of the year                       | <b>3.7</b> | <b>(8.1)</b> | <b>(4.4)</b> | <b>2.7</b> | <b>(0.3)</b> | <b>2.4</b> |

| <i>all figures in £ million</i>                    | 2008       |              |              | 2007       |              |            |
|--|------------|--------------|--------------|------------|--------------|------------|
|  | Gains      | Losses       | Net          | Gains      | Losses       | Net        |
| Expected to be recognised                          |            |              |              |            |              |            |
| In one year or less                                | 1.4        | (3.7)        | (2.3)        | 1.0        | (0.3)        | 0.7        |
| In more than one year but not less than five years | 2.3        | (4.4)        | (2.1)        | 1.7        | —            | 1.7        |
|  | <b>3.7</b> | <b>(8.1)</b> | <b>(4.4)</b> | <b>2.7</b> | <b>(0.3)</b> | <b>2.4</b> |

### (F) Maturity of financial liabilities

At 31 March 2008

| <i>all figures in £ million</i>                         | Trade and other payables | Bank borrowings and loan notes | Finance leases and derivative financial instruments | Total        |
|---|--------------------------|--------------------------------|---|--------------|
| Due in one year or less                                 | 374.4                    | 5.3                            | 6.5   | 386.2        |
| Due in more than one year but not more than two years   | 7.8                      | —                              | 3.3   | 11.1         |
| Due in more than two years but not more than five years | 39.9                     | 265.8                          | 10.0  | 315.7        |
| Due in more than five years                             | —                        | 132.3                          | 3.9   | 136.2        |
|   | <b>422.1</b>             | <b>403.4</b>                   | <b>23.7</b>   | <b>849.2</b> |

At 31 March 2007

| <i>all figures in £ million</i>                         | Trade and other payables | Bank borrowings and loan notes | Finance leases and derivative financial instruments | Total        |
|---|--------------------------|--------------------------------|---|--------------|
| Due in one year or less                                 | 340.0                    | 12.4                           | 3.5   | 355.9        |
| Due in more than one year but not more than two years   | 5.5                      | —                              | 2.2   | 7.7          |
| Due in more than two years but not more than five years | —                        | 179.5                          | 6.7   | 186.2        |
| Due in more than five years                             | —                        | 134.3                          | 5.0   | 139.3        |
|   | <b>345.5</b>             | <b>326.2</b>                   | <b>17.4</b>   | <b>689.1</b> |

## Notes to the financial statements continued

## 28 Financial risk management continued

**(G) Borrowing facilities**

At 31 March 2008, the following committed facilities were available to the Group

|   | Interest rate<br>% | Total<br>£m  | Drawn<br>£m  | Undrawn<br>£m |
|---|--------------------|--------------|--------------|---------------|
| Multi-currency revolving facility         | LIBOR plus 0.30%   | 500.0        | 266.7        | 233.3         |
| US\$135m loan repayable 2013              | 5.44%              | 68.8         | 68.8         | 0.0           |
| US\$125m loan repayable 2016              | 5.50%              | 63.5         | 63.5         | 0.0           |
| Loan notes                                | Base minus 1.0%    | 0.5          | 0.5          | 0.0           |
| <b>Committed facilities 31 March 2008</b> |                    | <b>632.8</b> | <b>399.5</b> | <b>233.3</b>  |
| Committed facilities 31 March 2007        |                    | 639.5        | 319.6        | 319.9         |

Loans drawn under the £500m multi-currency revolving facility are repayable within 12 months, but have been classified as due in more than two years as the relevant committed facilities are available until 19 August 2012. The loans bear interest at a variable margin over LIBOR of between 0.30% and 0.525% dependent on the ratio of EBITDA to Net Debt and the level of utilisation.

Loan notes total £0.5m of which £0.4m relates to the acquisition of Boldon James and £0.1m relates to the acquisition of HVR Consulting Ltd. The Boldon James notes were repaid in April 08 and the HVR loan notes are repayable on request of the holders, but no later than 31 July 2009 and bear interest at a discount to the Lloyds TSB Base Rate.

**(H) Sensitivity and analysis**

The Group's sensitivity to changes in market rates on financial assets and liabilities as at 31 March 2008 is set out in the table below. 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.

The amounts generated from the sensitivity analysis are forward-looking estimates of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from those projected results due to developments in the global financial markets which may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the table below, which therefore should not be considered 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 2008, with all other variables remaining constant. The estimated changes for foreign exchange rates are based on an instantaneous 10% weakening in sterling against all other currencies from the levels applicable at 31 March 2008 with all other variables remaining constant. An increase in interest rates or a strengthening in sterling would have an equal and opposite effect. Such analysis is for illustrative purposes only – in practice market rates rarely change in isolation.

At 31 March 2008

| all figures in £ million | 1% decrease in interest rates |                   | 10% weakening in sterling |                   |
|--------------------------|-------------------------------|-------------------|---------------------------|-------------------|
|                          | Equity                        | Profit before tax | Equity                    | Profit before tax |
| US dollars               | (4.0)                         | 0.7               | (38.5)                    | (1.7)             |
| Other                    | —                             | 0.2               | (2.7)                     | (0.2)             |
|                          | (4.0)                         | 0.9               | (41.2)                    | (1.9)             |

At 31 March 2007

| all figures in £ million | 1% decrease in interest rates |                   | 10% weakening in sterling |                   |
|--------------------------|-------------------------------|-------------------|---------------------------|-------------------|
|                          | Equity                        | Profit before tax | Equity                    | Profit before tax |
| US dollars               | (3.0)                         | 0.3               | (31.9)                    | (2.0)             |
| Other                    | —                             | 0.1               | (0.7)                     | (0.1)             |
|                          | (3.0)                         | 0.4               | (32.6)                    | (2.1)             |

## Notes to the financial statements continued

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

| <i>all figures in £ million</i>                     | <i>note</i> | <i>Year ended<br/>31 March 2008</i> | <i>Year ended<br/>31 March 2007</i> |
|---|-------------|-------------------------------------|-------------------------------------|
| Increase/(decrease) in cash in the year             |             | 7.2                                 | (45.5)                              |
| New loans   |             | (87.6)                              | (131.3)                             |
| New loan notes                                      |             | (0.5)                               | (1.3)                               |
| Bank loan repayments                                |             | –                                   | 79.2                                |
| Loan note repayments                                |             | 0.1                                 | 1.4                                 |
| Payment of deferred financing costs                 |             | 0.5                                 | 0.4                                 |
| Capital element of finance lease payments           |             | 3.2                                 | 5.9                                 |
| Capital element of finance lease receipts           |             | (3.0)                               | (3.5)                               |
| <b>Change in net debt resulting from cash flows</b> |             | <b>(80.1)</b>                       | <b>(94.7)</b>                       |
| Amortisation of deferred financing costs            |             | (0.2)                               | (0.2)                               |
| Foreign exchange movements                          |             | 2.7                                 | 30.2                                |
| Accrued US\$ loan interest                          |             | –                                   | (1.6)                               |
| Loan note disposed as part of business disposal     |             | 5.1                                 | –                                   |
| Finance lease receivables                           |             | 1.9                                 | 2.6                                 |
| Finance lease payables                              |             | (1.7)                               | (2.9)                               |
| Movement on escrow cash                             |             | (0.1)                               | 3.1                                 |
| Movement on derivatives                             |             | (6.7)                               | (4.3)                               |
| Net debt at the start of the year                   |             | (300.8)                             | (233.0)                             |
| <b>Net debt at the end of the year</b>              | <b>30</b>   | <b>(379.9)</b>                      | <b>(300.8)</b>                      |

## Notes to the financial statements continued

## 30 Analysis of net debt

| <i>all figures in £ million</i>               | Year ended<br>31 March 2007 | Cash flow     | Non-cash<br>movements | Year ended<br>31 March 2008 |
|---|-----------------------------|---------------|-----------------------|-----------------------------|
| <b>Due within one year</b>                    |                             |               |                       |                             |
| Bank and cash                                 | 20 0                        | 4 8           | (0 3)                 | 24 5                        |
| Bank overdraft                                | (7 4)                       | 2 4           | –                     | (5 0)                       |
| Recapitalisation fee                          | 0 2                         | –             | –                     | 0 2                         |
| Loan notes                                    | (5 2)                       | (0 4)         | 5 1                   | (0 5)                       |
| Finance lease debtor                          | 3 0                         | (3 0)         | 3 0                   | 3 0                         |
| Finance lease creditor                        | (3 2)                       | 3 2           | (2 8)                 | (2 8)                       |
| Escrow cash                                   | –                           | –             | 3 0                   | 3 0                         |
| Derivative financial assets                   | 1 0                         | –             | 0 4                   | 1 4                         |
| Derivative financial liabilities              | (0 3)                       | –             | (3 4)                 | (3 7)                       |
|   | <b>8 1</b>                  | <b>7 0</b>    | <b>5 0</b>            | <b>20 1</b>                 |
| <b>Due after one year</b>                     |                             |               |                       |                             |
| Bank loan                                     | (180 1)                     | (87 6)        | 1 0                   | (266 7)                     |
| Recapitalisation fee                          | 0 6                         | 0 5           | (0 2)                 | 0 9                         |
| US\$260m loan repayable 2013 and 2016         | (134 3)                     | –             | 2 0                   | (132 3)                     |
| Finance lease debtor                          | 14 1                        | –             | (1 1)                 | 13 0                        |
| Finance lease creditor                        | (13 9)                      | –             | 1 1                   | (12 8)                      |
| Escrow cash                                   | 3 1                         | –             | (3 1)                 | –                           |
| Derivative financial assets                   | 1 6                         | –             | 0 7                   | 2 3                         |
| Derivative financial liabilities              | –                           | –             | (4 4)                 | (4 4)                       |
|   | <b>(308 9)</b>              | <b>(87 1)</b> | <b>(4 0)</b>          | <b>(400 0)</b>              |
| <b>Total net debt as defined by the Group</b> | <b>(300 8)</b>              | <b>(80 1)</b> | <b>1 0</b>            | <b>(379 9)</b>              |

## 31 Finance leases

### Group as a lessor

The minimum lease receivables under finance leases fall as follows

| <i>all figures in £ million</i>                | Minimum lease payments |             | Present value of minimum lease payments |             |
|--|------------------------|-------------|---|-------------|
|  | 2008                   | 2007        | 2008                                    | 2007        |
| <b>Amounts receivable under finance leases</b> |                        |             |   |             |
| Within one year                                | 3 0                    | 3 0         | 3 0                                     | 3 0         |
| In the second to fifth years inclusive         | 12 0                   | 12 0        | 8 9                                     | 8 9         |
| Greater than five years                        | 7 5                    | 10 5        | 4 1                                     | 5 2         |
|  | <b>22 5</b>            | <b>25 5</b> |   |             |
| Less unearned finance income                   | (6 5)                  | (8 4)       |   |             |
| <b>Present value of minimum lease payments</b> | <b>16 0</b>            | <b>17 1</b> | <b>16 0</b>                             | <b>17 1</b> |
| Classified as follows                          |                        |             |   |             |
| Financial asset – current                      |                        |             | 3 0                                     | 3 0         |
| Financial asset – non-current                  |                        |             | 13 0                                    | 14 1        |
|  |                        |             | <b>16 0</b>                             | <b>17 1</b> |

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

### Group as a lessee

The minimum lease payments under finance leases fall due as follows

| <i>all figures in £ million</i>                | Minimum lease payments |             | Present value of minimum lease payments |             |
|--|------------------------|-------------|---|-------------|
|  | 2008                   | 2007        | 2008                                    | 2007        |
| <b>Amounts payable under finance leases</b>    |                        |             |   |             |
| Within one year                                | 2 8                    | 3 2         | 2 8                                     | 3 2         |
| In the second to fifth years inclusive         | 11 3                   | 11 3        | 8 9                                     | 8 9         |
| Greater than five years                        | 7 0                    | 9 7         | 3 9                                     | 5 0         |
|  | <b>21 1</b>            | <b>24 2</b> |   |             |
| Less future finance charges                    | (5 5)                  | (7 1)       |   |             |
| <b>Present value of minimum lease payments</b> | <b>15 6</b>            | <b>17 1</b> | <b>15 6</b>                             | <b>17 1</b> |
| Classified as follows                          |                        |             |   |             |
| Financial liability – current                  |                        |             | 2 8                                     | 3 2         |
| Financial liability – non-current              |                        |             | 12 8                                    | 13 9        |
|  |                        |             | <b>15 6</b>                             | <b>17 1</b> |

The Group utilises certain buildings and computer equipment under finance leases. Average lease terms are typically between two and ten years (31 March 2007 between two and ten years)

## 32 Share capital

Authorised share capital at 31 March 2008 and 2007

|                                      | £                 | Number               |
|--------------------------------------|-------------------|----------------------|
| Attributable to equity interests     |                   |                      |
| Ordinary Shares of 1p each           | 14 000 000        | 1,400,000,000        |
| Attributable to non-equity interests |                   |                      |
| Special Share of £1                  | 1                 | 1                    |
| <b>Total authorised share</b>        | <b>14,000,001</b> | <b>1,400,000,001</b> |

Shares allotted, called up and fully paid

|                  | Ordinary Shares of 1p each (equity) |                    | Special Shares of £1 (non-equity) |          | Total            |                    |
|------------------|-------------------------------------|--------------------|-----------------------------------|----------|------------------|--------------------|
|                  | £                                   | Number             | £                                 | Number   | £                | Number             |
| At 1 April 2006  | 6,505,650                           | 650,565,024        | 1                                 | 1        | 6 505 651        | 650 565 025        |
| Issued in year   | 95,500                              | 9,550,032          | —                                 | —        | 95,500           | 9,550,032          |
| At 31 March 2007 | <b>6,601,150</b>                    | <b>660,115,056</b> | <b>1</b>                          | <b>1</b> | <b>6,601,151</b> | <b>660,115,057</b> |
| Issued in year   | 3,614                               | 361,317            | —                                 | —        | 3 614            | 361 317            |
| At 31 March 2008 | <b>6,604,764</b>                    | <b>660,476,373</b> | <b>1</b>                          | <b>1</b> | <b>6,604,765</b> | <b>660,476,374</b> |

Except as noted below all shares at 31 March 2008 rank *pari passu* in all respects

### Rights attaching to the Special Share

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

- a) to require the Group to implement and maintain the Compliance System (as defined in the Articles of Association) so as to make at all times effective its and each member of QinetiQ Controlled Group's application of the Compliance Principles in a manner acceptable to the Special Shareholder,
- b) to refer matters to the Board or the Compliance Committee for its consideration in relation to the application of the Compliance Principles,
- c) to veto any contract, transaction, arrangement or activity which the Special Shareholder considers:
  - i) may result in circumstances which constitute unacceptable ownership, influence or control over QinetiQ or any other member of the QinetiQ consolidated Group contrary to the defence or security interests of the United Kingdom, or
  - ii) would not, or does not ensure the effective application of the Compliance Principles to and/or by all members of the QinetiQ Controlled Group or would be or is otherwise contrary to the defence or security interests of the United Kingdom
- d) to require the Board to take any action (including but not limited to amending the Compliance Principles) or rectify any omission in the application of the Compliance Principles if the Special Shareholder is of the opinion that such steps are necessary to protect the defence or security interest of the United Kingdom,
- e) to exercise any of the powers contained in the articles in relation to the Compliance Committee, and
- f) to demand a poll at any of the QinetiQ's meetings (even though it may have no voting rights except those specifically set out in the Articles)

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



## Notes to the financial statements continued

## 33 Changes in equity

| <i>all figures in £ million</i>                                    | Issued<br>share<br>capital | Capital<br>redemption<br>reserve | Share<br>premium | Hedge<br>reserve | Translation<br>reserve | Retained<br>earnings | Total        | Minority<br>interest | Total<br>equity |
|--|----------------------------|----------------------------------|------------------|------------------|------------------------|----------------------|--------------|----------------------|-----------------|
| <b>At 1 April 2006</b>   | <b>6 5</b>                 | <b>39 9</b>                      | <b>147 5</b>     | <b>4 7</b>       | <b>0 2</b>             | <b>164 7</b>         | <b>363 5</b> | <b>(0 6)</b>         | <b>362 9</b>    |
| Effective portion of change in fair value of net investment hedges | –                          | –                                | –                | –                | 31 3                   | –                    | 31 3         | –                    | 31 3            |
| Foreign currency translation differences for foreign operations    | –                          | –                                | –                | –                | (45 7)                 | –                    | (45 7)       | –                    | (45 7)          |
| Profit for the year  | –                          | –                                | –                | –                | –                      | 69 0                 | 69 0         | –                    | 69 0            |
| Dividends paid   | –                          | –                                | –                | –                | –                      | (22 7)               | (22 7)       | –                    | (22 7)          |
| Issue of new shares  | 0 1                        | –                                | 0 1              | –                | –                      | (0 1)                | 0 1          | –                    | 0 1             |
| Share-based payments   | –                          | –                                | –                | –                | –                      | 1 1                  | 1 1          | –                    | 1 1             |
| Deferred tax on exercise of share options                          | –                          | –                                | –                | –                | –                      | 4 8                  | 4 8          | –                    | 4 8             |
| Gain on fair value of available for sale financial assets          | –                          | –                                | –                | –                | –                      | 1 6                  | 1 6          | –                    | 1 6             |
| Increase in fair value of available for sale investments           | –                          | –                                | –                | –                | –                      | 10 0                 | 10 0         | –                    | 10 0            |
| Decrease in fair value of hedging derivatives                      | –                          | –                                | –                | (5 6)            | –                      | –                    | (5 6)        | –                    | (5 6)           |
| Deferred tax on hedging derivatives                                | –                          | –                                | –                | 2 0              | –                      | –                    | 2 0          | –                    | 2 0             |
| Arising on acquisition/disposal                                    | –                          | –                                | –                | –                | –                      | –                    | –            | 0 7                  | 0 7             |
| Actuarial gain recognised in the defined benefit pension schemes   | –                          | –                                | –                | –                | –                      | 85 8                 | 85 8         | –                    | 85 8            |
| Deferred tax asset on pension deficit                              | –                          | –                                | –                | –                | –                      | (17 9)               | (17 9)       | –                    | (17 9)          |
| <b>At 31 March 2007</b>  | <b>6 6</b>                 | <b>39 9</b>                      | <b>147 6</b>     | <b>1 1</b>       | <b>(14 2)</b>          | <b>296 3</b>         | <b>477 3</b> | <b>0 1</b>           | <b>477 4</b>    |
| Effective portion of change in fair value of net investment hedges | –                          | –                                | –                | –                | 1 0                    | –                    | 1 0          | –                    | 1 0             |
| Foreign currency translation differences for foreign operations    | –                          | –                                | –                | –                | (4 3)                  | –                    | (4 3)        | –                    | (4 3)           |
| Profit for the year  | –                          | –                                | –                | –                | –                      | 47 4                 | 47 4         | –                    | 47 4            |
| Dividends paid   | –                          | –                                | –                | –                | –                      | (24 9)               | (24 9)       | –                    | (24 9)          |
| Purchase of own shares   | –                          | –                                | –                | –                | –                      | (12 8)               | (12 8)       | –                    | (12 8)          |
| Share-based payments   | –                          | –                                | –                | –                | –                      | 3 8                  | 3 8          | –                    | 3 8             |
| Deferred tax on share-based payments                               | –                          | –                                | –                | –                | –                      | 0 2                  | 0 2          | –                    | 0 2             |
| Impairment of a previously revalued available for sale investment  | –                          | –                                | –                | –                | –                      | (2 9)                | (2 9)        | –                    | (2 9)           |
| Increase in fair value of available for sale investments           | –                          | –                                | –                | –                | –                      | 3 2                  | 3 2          | –                    | 3 2             |
| Decrease in fair value of hedging derivatives                      | –                          | –                                | –                | (6 8)            | –                      | –                    | (6 8)        | –                    | (6 8)           |
| Deferred tax on hedging derivatives                                | –                          | –                                | –                | 1 9              | –                      | –                    | 1 9          | –                    | 1 9             |
| Release unrealised gain on disposal of businesses                  | –                          | –                                | –                | –                | –                      | (3 5)                | (3 5)        | –                    | (3 5)           |
| Actuarial gain recognised in the defined benefit pension schemes   | –                          | –                                | –                | –                | –                      | 65 5                 | 65 5         | –                    | 65 5            |
| Deferred tax asset on pension deficit                              | –                          | –                                | –                | –                | –                      | (12 2)               | (12 2)       | –                    | (12 2)          |
| <b>At 31 March 2008</b>  | <b>6 6</b>                 | <b>39 9</b>                      | <b>147 6</b>     | <b>(3 8)</b>     | <b>(17 5)</b>          | <b>360 1</b>         | <b>532 9</b> | <b>0 1</b>           | <b>533 0</b>    |

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

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

## Notes to the financial statements continued

## 34 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 £3.8m (year to 31 March 2007: £1.1m).

**2003 employee share option scheme (2003 ESOS)**

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

|   | 2008             |                                 | 2007             |                                 |
|---|------------------|---------------------------------|------------------|---------------------------------|
|   | Number           | Weighted average exercise price | Number           | Weighted average exercise price |
| Outstanding at start of year                      | 1,725,828        | 2.3p                            | 12,121,644       | 2.3p                            |
| Forfeited in year                                 | (95,312)         | 2.3p                            | (275,724)        | 2.3p                            |
| Exercised in year                                 | (420,394)        | 2.3p                            | (10,120,092)     | 2.3p                            |
| <b>Outstanding and exercisable at end of year</b> | <b>1,210,122</b> | <b>2.3p</b>                     | <b>1,725,828</b> | <b>2.3p</b>                     |

The 2003 ESOS are equity settled awards and those outstanding at 31 March 2008 had an average remaining life of 5.3 years (31 March 2007: 6.3 years).

**QinetiQ Share Option Scheme (QSOS)**

In the year, the Group granted options to certain senior employees under the QSOS. The exercise price of the options is equal to the average market price of the Group's shares on the date of the grant. The options vest after three years. For 13,631,708 (2007: 10,382,585) of the options outstanding at the end of the year the number that will vest is dependent upon the growth of earnings per share ('EPS') over the measurement period. 25% of options will vest if EPS growth is 22.5% for the period and 100% will vest if growth is at least 52%. No options will vest if EPS growth is below 22.5%. Options will vest on a straight line basis if EPS growth is between 22.5% and 52%. For the remaining 411,876 (2007: 160,112) options the EPS growth target is replaced by a performance target based on QinetiQ's ranking by reference to total shareholder return ('TSR') against a comparator group of FTSE listed companies over a three-year performance period such that a below median ranking will result in nil shares vesting; at the median level 30% of the options would vest and the amount vested will increase on a straight line basis such that 100% would vest if TSR reaches the upper quartile of the ranking over a three-year period.

|                                      | 2008              |                                 | 2007              |                                 |
|--------------------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
|                                      | Number            | Weighted average exercise price | Number            | Weighted average exercise price |
| Outstanding at the start of the year | 10,542,697        | 195p                            | 377,917           | 208p                            |
| Granted during the year              | 5,356,392         | 174p                            | 10,178,883        | 195p                            |
| Lapsed during the year               | (1,855,505)       | 195p                            | (14,103)          | 195p                            |
| <b>Outstanding at end of year</b>    | <b>14,043,584</b> | <b>187p</b>                     | <b>10,542,697</b> | <b>195p</b>                     |

QSOS grants are equity settled awards and those outstanding at 31 March 2008 had an average remaining life of 1.5 years (2007: 2.5 years). QSOS option awards in the year were made at an exercise price of 174p (2007: exercise prices from 188p–208p).

## Notes to the financial statements continued

## 34 Share-based payments continued

**Performance Share Plan (PSP)**

In the year the Group made awards to certain UK senior executives under the Performance Share Plan. The options vest after three years with 50% of the awards subject to total shareholder return conditions and 50% subject to earnings per share conditions as detailed in the QSOs TSR and EPS conditions above.

|                                      | Number of shares |
|--------------------------------------|------------------|
| Outstanding at the start of the year | –                |
| Granted during the year              | 700,804          |
| Lapsed during the year               | –                |
| <b>Outstanding at end of year</b>    | <b>700,804</b>   |

PSP are equity settled awards and those outstanding at 31 March 2008 had an average remaining life of 2.3 years. The exercise price for the PSP is £nil.

**Restricted Stock Units (RSU)**

In the year, the Group granted awards to certain senior US employees under the Restricted Stock Unit Plan. 30% of the options vest over two years, 30% over three years and 40% over four years. Half of the awards vest on conditions of QNA organic growth and half on a time-based criteria. QNA organic revenue growth is measured over a two, three and four-year period, with 125% awarded at annual QNA organic revenue growth rates above 15%, 100% at 12.5%, 75% at 10% and 25% at 5%. The time-based criteria requires continued employment for vesting eligibility for the relevant two, three or four-year period.

|                                      | Number of shares |
|--------------------------------------|------------------|
| Outstanding at the start of the year | –                |
| Granted during the year              | 1,739,869        |
| Lapsed during the year               | (82,539)         |
| <b>Outstanding at end of year</b>    | <b>1,657,330</b> |

RSU are equity settled awards and those outstanding at 31 March 2008 had an average remaining life of 2.3 years. The exercise price for the RSU is £nil.

**Group Share Incentive Plan (SIP)**

Under the QinetiQ Share Incentive Plan the Group offers UK employees the opportunity of purchasing up to £125 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.

|                                      | Number of matching shares |
|--------------------------------------|---------------------------|
| Outstanding at the start of the year | 428,878                   |
| Granted during the year              | 489,850                   |
| Lapsed during the year               | (47,397)                  |
| <b>Outstanding at end of year</b>    | <b>871,331</b>            |

SIP matching shares are equity-settled awards and those outstanding at 31 March 2008 had an average remaining life of two years. The exercise price for the SIP matching shares is £nil.

**Option pricing**

Share-based payments have been valued using a binomial option pricing model. Assumptions used within the model include expected volatility of 22%–30%, an expected life of three years and a risk-free rate of return of 4.5%–5.5%. The average share price in the year was 186p (2007: 185p).

For the 2003 Share Option scheme, there was a pre-bonus issue-weighted average share price of £1 and a weighted average exercise price of £1 based on third-party transactions in the Company's shares in the period immediately prior to the issue of the share options. Prior to IPO in February 2006 there was no active market for the Company's shares therefore expected volatility was determined using the average volatility for a comparable selection of businesses. At this time the Group had no established pattern of dividend payments therefore no dividends were assumed in this model.

## Notes to the financial statements continued

## 35 Operating leases

**Group as a lessor**

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

| <i>all figures in £ million</i>        | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|
| Within one year                        | <b>8 1</b>  | 5 4         |
| In the second to fifth years inclusive | <b>19 1</b> | 4 6         |
| Greater than five years                | <b>—</b>    | 2 2         |
|  | <b>27 2</b> | 12 2        |

**Group as a lessee**

| <i>all figures in £ million</i>   | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|
| <b>Lease and sublease income statement expense – minimum lease payments</b> | <b>16 6</b> | 12 2        |

The Group had the following future minimum lease payment commitments

| <i>all figures in £ million</i>        | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|
| Within one year                        | <b>13 8</b> | 18 0        |
| In the second to fifth years inclusive | <b>36 7</b> | 31 2        |
| Greater than five years                | <b>25 4</b> | 13 7        |
|  | <b>75 9</b> | 62 9        |

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

## 36 Transactions with the MOD

The MOD is an 18.9% (2007: 18.9%) shareholder in the Group. Detailed below are the agreements that have been entered into and the trading that has taken place with the MOD.

### Trading

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

| <i>all figures in £ million</i>                   | 2008         | 2007         |
|---|--------------|--------------|
| Sales to the MOD excluding property rental income | 599.1        | 584.5        |
| Property rental income                            | 6.4          | 6.8          |
| <b>Total income from the MOD</b>                  | <b>605.5</b> | <b>591.3</b> |
| <b>Purchased services from the MOD</b>            | <b>8.8</b>   | <b>12.4</b>  |

| <i>all figures in £ million</i> | 2008  | 2007 |
|---------------------------------|-------|------|
| Trade debtors                   | 104.8 | 81.3 |
| Trade creditors                 | —     | 0.1  |

### Freehold land and buildings and surplus properties

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

#### i) Restrictions on transfer of title

The title deeds of those properties with strategic assets (see below) include a clause that prevents their transfer without the approval of MOD. The MOD also has the right to purchase any strategic assets in certain circumstances.

#### ii) Property clawback agreement

The MOD retains an interest in future profits on disposal following a 'trigger event'. A 'trigger event' includes the granting of planning permission for development and/or change of use and the disposition of any of the acquired land and buildings. During the 12 years from 1 July 2001 following a 'trigger event' the MOD is entitled to clawback a proportion of the gain on each individual property transaction in excess of a 30% gain on a July 2001 professional valuation. The proportion of the excess gain due to the MOD is based on a sliding scale which reduces over time from 50% to 9% and at 31 March 2008 stands at 37%. The July 2001 valuation was approximately 16% greater in aggregate than the consideration paid for the land and buildings on 1 July 2001.

### Compliance Regime

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

### 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 2008 was £2.9m (31 March 2007: £3.1m), the principal items being plant and machinery.

### Long-Term Partnering Agreement

On 27 February 2003 QinetiQ Limited entered into a Long-Term Partnering Agreement to provide the Test and Evaluation (T&E) facilities and training support services to the MOD. This is a 25-year contract with a total revenue value of up to £5.6bn dependent on the level of usage by MOD under which QinetiQ Limited is committed to providing the T&E services with increasing efficiencies through cost saving and innovative service delivery.

## Notes to the financial statements continued

### 37 Directors and other senior management personnel

The Directors and other senior management personnel of the Group during the year to 31 March 2008 comprise the Board of Directors and the QinetiQ Executive Committee

| <i>all figures in £ 000 s</i>            | 2008         | 2007         |
|--|--------------|--------------|
| <b>Directors</b>                         |              |              |
| Short-term employee benefits             | 1 675        | 1 597        |
| Post-employment benefits                 | 60           | 57           |
| <b>Total</b>                             | <b>1,735</b> | <b>1,654</b> |
| <b>Other senior management personnel</b> |              |              |
| Short-term employee benefits             | 1,443        | 982          |
| Post-employment benefits                 | 128          | 80           |
| <b>Total</b>                             | <b>1,571</b> | <b>1,062</b> |

Short-term employee benefits include salary, bonus, and benefits. Post-employment benefits relate to pension amounts.

### 38 Contingent liabilities and assets

Subsidiary undertakings within the Group have given unsecured guarantees of £5.8m at 31 March 2008 (31 March 2007: £2.0m) in the ordinary course of business.

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

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

## 39 Post-retirement benefits

### Introduction and background to IAS 19

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

### The QinetiQ Pension Scheme

In the UK the Group operates the QinetiQ Pension Scheme for the majority of its UK employees, a mixed benefit scheme. The Defined Benefit (DB) section of the scheme provides future service pension benefits to transferring Civil Service employees. All Group employees who were members, or eligible to be members, of the Principal Civil Service Pension Scheme or the UKAEA principal Non-Industrial Superannuation Scheme were invited to join the DB section of the scheme from 1 July 2001, together with all new employees who were previously members of schemes who are part of the Public Sector Transfer Club. The Group has given notice to withdraw from the Public Sector Transfer Club from 31 March 2009. The Defined Contribution (DC) section of the scheme was set up for employees who were not eligible or did not wish to join the DB section of the scheme.

The most recent full actuarial valuation of the DB section was undertaken as at 31 March 2005 and resulted in an actuarially assessed deficit of £106.5m. On the basis of this full valuation the Trustees of the scheme and the Company agreed that the 17.5% employer contribution rate would continue. The Company paid £90.3m into the scheme on 30 March 2006 and there were no additional employer contributions in the year to 31 March 2007 and 31 March 2008.

### Other UK schemes

In the UK the Group operates a further two small defined benefit schemes: QinetiQ Prudential Platinum Scheme and a scheme for the subsidiary company ASAP Calibration Limited. The net pension deficits of these schemes at 31 March 2008 amounted to £0.2m (31 March 2007: £0.3m). The defined benefit scheme relating to ASAP Calibration Limited was closed to future benefit accruals in the year to 31 March 2007.

There were no outstanding or prepaid contributions at the balance sheet date (March 2007: £nil). Set out below is a summary of the overall IAS 19 defined benefit pension schemes' liabilities. The fair value of the schemes' assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the schemes' liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

| <i>all figures in £ million</i>                  | 2008          | 2007          | 2006           | 2005           |
|--|---------------|---------------|----------------|----------------|
| Equities   | 620.8         | 641.5         | 551.1          | 361.6          |
| Corporate bonds                                  | 83.9          | 74.5          | 85.2           | 44.4           |
| Government bonds                                 | 76.3          | 74.7          | 74.8           | 45.7           |
| Cash   | 3.2           | 3.4           | 4.9            | 2.4            |
| <b>Total market value of assets</b>              | <b>784.2</b>  | <b>794.1</b>  | <b>716.0</b>   | <b>454.1</b>   |
| Present value of scheme liabilities              | (807.6)       | (884.9)       | (884.4)        | (617.2)        |
| <b>Net pension liability before deferred tax</b> | <b>(23.4)</b> | <b>(90.8)</b> | <b>(168.4)</b> | <b>(163.1)</b> |
| Deferred tax asset                               | 6.5           | 27.1          | 50.4           | 48.8           |
| <b>Net pension liability</b>                     | <b>(16.9)</b> | <b>(63.7)</b> | <b>(118.0)</b> | <b>(114.3)</b> |

## Notes to the financial statements continued

39 Post-retirement benefits *continued***Assumptions**

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

|  | 2008 | 2007 |
|--|------|------|
| Rate of increase in salaries                 | 5.0% | 4.6% |
| Rate of increase in pensions in payment      | 3.5% | 3.1% |
| Rate of increase in pensions in deferment    | 3.5% | 3.1% |
| Discount rate applied to scheme liabilities  | 6.6% | 5.4% |
| Inflation assumption                         | 3.5% | 3.1% |
| Assumed life expectancies in years           |      |      |
| Future male pensioners (currently aged 60)   | 87   | 85   |
| Future female pensioners (currently aged 60) | 90   | 88   |
| Future male pensioners (currently aged 40)   | 88   | 86   |
| Future female pensioners (currently aged 40) | 91   | 89   |

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice. It is important to note that these assumptions are long term and in the case of the discount rate and the inflation rate are measured by external market indicators. In light of evidence of improvements in life expectancy the assumptions for mortality have changed in the year to 31 March 2008 so that the allowance for improvements in life expectancy is in line with the Medium Cohort projections rather than the Short Cohort assumptions used in the prior year. The Medium Cohort assumptions use the mortality tables PMA92MC (for males) and PFA92MC (for females) for the year of birth, with no underpin for the annual improvement beyond Medium Cohort improvements, as published by the Continuous Mortality Investigation and adopted by the actuarial profession.

**Scheme assets**

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

|                         | 2008        | 2007        |
|-------------------------|-------------|-------------|
| Equities                | 7.7%        | 7.7%        |
| Corporate bonds         | 6.2%        | 5.3%        |
| Government bonds        | 4.4%        | 4.6%        |
| Cash                    | 6.0%        | 5.5%        |
| <b>Weighted average</b> | <b>7.2%</b> | <b>7.2%</b> |

**Return on scheme assets**

| <i>all figures in £ million</i>              | 2008          | 2007        |
|--|---------------|-------------|
| Actual return on plan assets                 |               |             |
| Expected return on scheme assets             | 56.8          | 50.4        |
| Actuarial (loss)/gain on scheme assets       | (84.0)        | 7.5         |
| <b>Actual (loss)/return on scheme assets</b> | <b>(27.2)</b> | <b>57.9</b> |

**Value of scheme assets**

| <i>all figures in £ million</i>            | 2008         | 2007         |
|--|--------------|--------------|
| Changes to the fair value of scheme assets |              |              |
| Opening fair value of scheme assets        | 794.1        | 716.0        |
| Expected return on assets                  | 56.8         | 50.4         |
| Actuarial (loss)/gain                      | (84.0)       | 7.5          |
| Contributions by the employer              | 32.3         | 33.4         |
| Curtailment contributions by employer      | —            | 6.1          |
| Contributions by plan participants         | 6.5          | 5.6          |
| Scheme disposal – Aurix Limited            | (1.5)        | —            |
| Net benefits paid out and transfers        | (20.0)       | (24.9)       |
| <b>Closing fair value of scheme assets</b> | <b>784.2</b> | <b>794.1</b> |



### 39 Post-retirement benefits *continued*

#### Changes to the present value of the defined benefit obligation

| <i>all figures in £ million</i>           | 2008         | 2007         |
|---|--------------|--------------|
| Opening defined benefit obligation        | 884.9        | 884.4        |
| Current service cost                      | 38.9         | 47.7         |
| Interest cost                             | 48.4         | 44.3         |
| Contributions by plan participants        | 6.5          | 5.6          |
| Actuarial gains on scheme liabilities     | (149.5)      | (78.3)       |
| Scheme disposal – Aurix Limited           | (1.6)        | –            |
| Net benefits paid out and transfers       | (20.0)       | (24.9)       |
| Curtailments                              | –            | 6.1          |
| <b>Closing defined benefit obligation</b> | <b>807.6</b> | <b>884.9</b> |

#### Total expense recognised in the income statement

| <i>all figures in £ million</i>   | 2008        | 2007        |
|---|-------------|-------------|
| Pension costs charged to the income statement                                   |             |             |
| Current service cost  | 38.9        | 47.7        |
| Interest cost   | 48.4        | 44.3        |
| Expected return on plan assets  | (56.8)      | (50.4)      |
| Curtailment cost  | –           | 6.1         |
| <b>Total expense recognised in the income statement (gross of deferred tax)</b> | <b>30.5</b> | <b>47.7</b> |

#### Analysis of amounts recognised in statement of recognised income and expenses

| <i>all figures in £ million</i>   | 2008          | 2007           | 2006           | 2005           |
|---|---------------|----------------|----------------|----------------|
| Total actuarial gain/(loss) (gross of deferred tax)   | 65.5          | 85.8           | (105.4)        | (9.9)          |
| <b>Cumulative total actuarial losses recognised in the Statement of Recognised Income and Expense</b> | <b>(97.5)</b> | <b>(163.0)</b> | <b>(248.8)</b> | <b>(143.4)</b> |
| <b>History of scheme experience gains and losses*</b>   |               |                |                |                |
| Experience (losses)/gains on scheme assets  | (83.9)        | 7.4            | 85.7           | 12.0           |
| Experience gains/(losses) on scheme liabilities   | (1.0)         | –              | (81.0)         | (8.3)          |

Experience gains and losses exclude the impact of changes in assumptions

The expected employer cash contribution to the defined benefit scheme for the year ending 31 March 2009 is expected to be £29.1m

#### Defined contribution schemes

Payments to the defined contribution schemes totalled £14.6m (March 2007: £13.3m)

## Notes to the financial statements continued

## 40 Restatement of prior-year comparatives

IFRS 3 Business Combinations requires the Group to finalise the fair value of the provisional value of assets and liabilities acquired from business combinations within one year of the acquisition date except certain deferred tax balances. During the year the Group was required to adjust goodwill, intangible assets, deferred tax and accrued costs balances upon finalisation of the fair value of assets and liabilities on the prior-year acquisitions of OSEC and Analex. These balances have been restated in the prior-year comparatives as follows:

| <i>all figures in £ million</i> | 2007<br>As reported | 2007<br>Adjustment | 2007<br>Restated |
|---------------------------------|---------------------|--------------------|------------------|
| Goodwill                        | 373.1               | (1.2)              | 371.9            |
| Intangible assets               | 65.0                | 1.1                | 66.1             |
| Deferred tax liability          | (30.9)              | 0.7                | (30.2)           |
| Other net assets                | 70.2                | (0.6)              | 69.6             |
| <b>Net assets</b>               | <b>477.4</b>        | <b>–</b>           | <b>477.4</b>     |

## 41 Capital commitments

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

| <i>all figures in £ million</i> | 2008       | 2007        |
|---------------------------------|------------|-------------|
| <b>Contracted</b>               | <b>9.4</b> | <b>13.2</b> |

Capital commitments at 31 March 2008 include £7.4m (2007: £11.7m) in relation to property, plant and equipment that will be wholly funded by a third-party customer under long-term contract arrangements.

## 42 Subsidiaries

The principal subsidiary undertakings at 31 March 2008, all of which are included in the consolidated financial statements, are shown below:

| Name of company                       | Principal area of operation | Country of incorporation | Proportion of voting rights held <sup>1</sup> | Nature of business       |
|---------------------------------------|-----------------------------|--------------------------|---|--------------------------|
| <b>Subsidiaries<sup>1</sup></b>       |                             |                          |   |                          |
| QinetiQ Holdings Limited              | UK                          | England & Wales          | 100%  | Holding company          |
| QinetiQ Limited                       | UK                          | England & Wales          | 100%  | Research and development |
| QinetiQ Overseas Holdings Limited     | UK                          | England & Wales          | 100%  | Holding company          |
| QinetiQ Overseas Trading Limited      | UK                          | England & Wales          | 100%  | Research and development |
| QinetiQ North America Operations LLC  | USA                         | USA                      | 100%  | Holding company          |
| QinetiQ North America, Inc            | USA                         | USA                      | 100%  | Holding company          |
| Analex Corporation                    | USA                         | USA                      | 100%  | Research and development |
| Apogen Technologies Inc               | USA                         | USA                      | 100%  | Research and development |
| Foster-Miller, Inc                    | USA                         | USA                      | 100%  | Research and development |
| Westar Aerospace & Defence Group, Inc | USA                         | USA                      | 100%  | Research and development |

<sup>1</sup> Accounting reference date is 31 March. All principal subsidiary undertakings listed above have financial year ends of 31 March.

<sup>2</sup> QinetiQ Holdings Limited is a direct subsidiary of QinetiQ Group plc. All other subsidiaries are held indirectly by other subsidiaries of QinetiQ Group plc.

## Company balance sheet

## Company balance sheet

as at 31 March

| <i>all figures in £ million</i>                          | <i>note</i> | <i>2008</i>  | <i>2007</i>  |
|--|-------------|--------------|--------------|
| <b>Fixed assets</b>                                      |             |              |              |
| Investments in subsidiary undertaking                    | 2           | 97 3         | 92 3         |
|  |             | <b>97 3</b>  | <b>92 3</b>  |
| <b>Current assets</b>                                    |             |              |              |
| Debtors  | 3           | 182 4        | 170 7        |
|  |             | <b>182 4</b> | <b>170 7</b> |
| <b>Current liabilities</b>                               |             |              |              |
| Creditors amounts falling due within one year            |             | -            | -            |
| <b>Net current assets</b>                                |             | <b>182 4</b> | <b>170 7</b> |
| <b>Net assets</b>  |             | <b>279 7</b> | <b>263 0</b> |
| <b>Capital and reserves</b>                              |             |              |              |
| Equity share capital                                     | 4 5         | 6 6          | 6 6          |
| Capital redemption reserve                               | 5           | 39 9         | 39 9         |
| Share premium account                                    | 5           | 147 6        | 147 6        |
| Profit and loss account                                  | 5           | 85 6         | 68 9         |
| <b>Capital and reserves attributable to shareholders</b> |             | <b>279 7</b> | <b>263 0</b> |

There are no other recognised gains and losses

The financial statements were approved by the Board of Directors and authorised for issue on 28 May 2008 and they were signed on its behalf by



Graham Love  
Chief Executive Officer



Doug Webb  
Chief Financial Officer

# Notes to the Company financial statements

## 1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements

### Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable UK accounting standards. As permitted by section 408(4) of the Companies Act 2006, a separate profit and loss account dealing with the results of the Company has not been presented.

### Investments

In the Company's financial statements, investments in subsidiary undertakings are stated at cost less any impairment in value.

### Share-based payments

FRS 20 share-based payments became effective for accounting periods beginning on or after 1 January 2005. The fair value of equity settled options for share-based payments is determined on grant and expensed straight line over the period from grant to the date of earliest exercise. The fair value of cash settled options for share-based payments is determined each period end until exercised or they lapse. The value is expensed on a straight line basis over the period from grant to the date of earliest exercise. The fair value of both equity settled and cash settled share options is calculated by a binomial option pricing model. The cost of share-based payments is charged to subsidiary undertakings.

## 2 Investment in subsidiary undertaking

| <i>all figures in £ million</i>  | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|
| <b>Subsidiary undertaking – 100% of ordinary share capital of QinetiQ Holdings Limited</b> | <b>97.3</b> | <b>92.3</b> |

A list of all principal subsidiary undertakings of QinetiQ Group plc is disclosed in note 42 to the Group financial statements. The £5.0m increase in investment in the year relates to the capital contribution in relation to share-based payments for employees of subsidiary companies.

## 3 Debtors

| <i>all figures in £ million</i>    | <b>2008</b>  | <b>2007</b>  |
|------------------------------------|--------------|--------------|
| Amounts owed by Group undertakings | 182.3        | 170.6        |
| Other debtors                      | 0.1          | 0.1          |
|                                    | <b>182.4</b> | <b>170.7</b> |

## 4 Share capital

The Company's share capital is disclosed in note 32 to the Group financial statements.

## Notes to the Company financial statements continued

## 5 Reserves

| <i>all figures in £ million</i> | Issued<br>share capital | Capital<br>redemption<br>reserve | Share<br>premium | Profit<br>and loss | Total<br>equity |
|---------------------------------|-------------------------|----------------------------------|------------------|--------------------|-----------------|
| <b>At 1 April 2006</b>          | <b>6.5</b>              | <b>39.9</b>                      | <b>147.5</b>     | <b>51.6</b>        | <b>245.5</b>    |
| Profit                          | –                       | –                                | –                | 38.1               | 38.1            |
| Dividend paid                   | –                       | –                                | –                | (22.7)             | (22.7)          |
| Share-based payments            | –                       | –                                | –                | 1.9                | 1.9             |
| Issue of new shares             | 0.1                     | –                                | 0.1              | –                  | 0.2             |
| <b>At 31 March 2007</b>         | <b>6.6</b>              | <b>39.9</b>                      | <b>147.6</b>     | <b>68.9</b>        | <b>263.0</b>    |
| Profit                          | –                       | –                                | –                | 11.5               | 11.5            |
| Purchase of own shares          | –                       | –                                | –                | (12.8)             | (12.8)          |
| Dividend received               | –                       | –                                | –                | 40.0               | 40.0            |
| Dividend paid                   | –                       | –                                | –                | (24.9)             | (24.9)          |
| Share-based payments            | –                       | –                                | –                | 2.9                | 2.9             |
| <b>At 31 March 2008</b>         | <b>6.6</b>              | <b>39.9</b>                      | <b>147.6</b>     | <b>85.6</b>        | <b>279.7</b>    |

The capital redemption reserve is not distributable and was created following redemption of Preference Share capital

## 6 Share-based payments

The Company's share-based payment arrangements are set out in note 34 to the Group financial statements

## 7 Other information

The Company had no employees during the year. Details of the employees of the Group are shown in note 9 to the Group financial statements. Directors' emoluments, excluding Company pension contributions, were £1.7m (2007: £1.6m). 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 Report of the Remuneration Committee.

The remuneration of the Company's auditors for the year to 31 March 2008 was £5,000 (2007: £5,000) all of which was for statutory audit services. No other services were provided by the auditors to the Company.

## Five-year review for the years ended 31 March (unaudited)

## Five-year review

for the years ended 31 March (unaudited)

| <i>all figures in £ million</i>     | IFRS<br>2008   | IFRS<br>2007   | IFRS<br>2006   | IFRS<br>2005 | UK GAAP<br>2004 |
|-------------------------------------|----------------|----------------|----------------|--------------|-----------------|
| QinetiQ North America               | 540.2          | 358.2          | 248.4          | 70.1         | 0.3             |
| EMEA                                | 820.1          | 779.3          | 797.2          | 780.8        | 790.7           |
| Ventures                            | 5.7            | 12.0           | 6.1            | 5.0          | 1.5             |
| Central                             | —              | —              | —              | —            | 2.9             |
| <b>Revenue</b>                      | <b>1,366.0</b> | <b>1,149.5</b> | <b>1,051.7</b> | <b>855.9</b> | <b>795.4</b>    |
| QinetiQ North America               | 62.1           | 39.9           | 24.5           | 8.0          | (0.6)           |
| EMEA                                | 80.0           | 73.0           | 73.7           | 67.2         | 62.6            |
| Ventures                            | (15.1)         | (6.9)          | (7.5)          | (10.0)       | (9.9)           |
| Central                             | —              | —              | —              | —            | 2.0             |
| <b>Operating profit<sup>1</sup></b> | <b>127.0</b>   | <b>106.0</b>   | <b>90.7</b>    | <b>65.2</b>  | <b>54.1</b>     |
| Operating margin <sup>1</sup>       | 9.3%           | 9.2%           | 8.6%           | 7.6%         | 6.8%            |
| Profit before tax                   | 51.4           | 89.3           | 72.5           | 78.0         | 51.3            |
| Profit after tax                    | 47.4           | 69.0           | 60.4           | 72.3         | 41.2            |
| Average number of employees         | 13,627         | 11,870         | 11,024         | 9,632        | 8,898           |
| Cash flow from operations           | 138.3          | 107.0          | 107.6          | 36.9         | 142.7           |
| Free cash flow                      | 73.6           | 55.8           | 141.3          | 55.7         | 135.9           |
| Net debt                            | 379.9          | 300.8          | 233.0          | 176.6        | 3.6             |
| Orders                              | 1,277.1        | 1,214.0        | 816.7          | 668.3        | 725.4           |

<sup>1</sup> Before amortisation of intangibles arising from acquisitions. EMEA reorganisation costs in 2008 and restructuring costs in 2005. IPO costs in 2006. gains/(losses) on business divestments 2005-2007 and 2008 and unrealised impairment of investments in 2007 and 2008.

## Glossary

## Glossary

|                              |   |   |   |
|------------------------------|---|---|---|
| <b>AGM</b>                   | Annual General Meeting  | <b>LSE</b>  | London Stock Exchange   |
| <b>Backlog</b>               | the expected future value of revenue from contractually committed and funded customer orders (excluding £4.7bn value of remaining 21 years of LTPA contract)              | <b>LTPA</b>   | Long-Term Partnering Agreement – 25-year contract established in 2003 to manage the MOD's test and evaluation ranges  |
| <b>bn</b>                    | billion   | <b>m</b>  | million   |
| <b>Book to bill ratio</b>    | ratio of orders received in the year to revenue for the year, adjusted to exclude revenue from the 25-year LTPA contract  | <b>MOD</b>  | Ministry of Defence   |
| <b>BPS</b>                   | Basis points  | <b>NASA</b>   | National Aeronautics and Space Administration (USA)   |
| <b>C<sup>4</sup></b>         | command, control, communications, computers and intelligence  | <b>Non-recurring items and acquisition amortisation</b> | IPO costs, major restructuring costs, disposal of non-current assets, business divestments, amortisation of intangible assets arising from acquisitions and impairment of investments   |
| <b>C<sup>4</sup>ISR</b>      | command, control, communications, computers, intelligence, surveillance and reconnaissance  | <b>OEM</b>  | Original Equipment Manufacturer   |
| <b>CATS</b>                  | Combined Aerial Target Service  | <b>Organic growth</b>                                   | The level of year-on-year growth, expressed as a percentage based on the businesses that were part of the Group at the start of the initial period  |
| <b>CIFA</b>                  | US Department of Defense Counterintelligence Field Activity   | <b>OSEC</b>   | Ocean Systems Engineering Corporation   |
| <b>Compliance Principles</b> | The principles underlying the Compliance Regime covering impartiality, integrity, conflicts, confidentiality and security   | <b>OSHA</b>   | Occupational Safety & Health Administration   |
| <b>CR</b>                    | Corporate Responsibility  | <b>QNA</b>  | QinetiQ North America sector  |
| <b>DARPA</b>                 | US Defense Advanced Research Projects Agency  | <b>R&amp;D</b>  | Research and development  |
| <b>DHS</b>                   | US Department of Homeland Security  | <b>RFID</b>   | Radio frequency identification  |
| <b>DoD</b>                   | US Department of Defense  | <b>RIDDOR</b>   | Reporting of Injuries, Diseases & Dangerous Occurrences Regulations   |
| <b>dstl</b>                  | Defence Science & Technology Laboratory   | <b>RoSPA</b>  | Royal Society for the Prevention of Accidents   |
| <b>DTR</b>                   | MOD's Defence Training Rationalisation programme  | <b>SME</b>  | Small and medium sized enterprises  |
| <b>EBITDA</b>                | earnings before interest, tax, depreciation, amortisation, gains on business divestments, unrealised impairment of investment and disposal of non-current assets          | <b>TSR</b>  | Total shareholder Return  |
| <b>EMEA</b>                  | Europe, Middle East and Australasia   | <b>UK GAAP</b>  | UK Generally Accepted Accounting Practices  |
| <b>EPS</b>                   | Earnings per share  | <b>Underlying effective tax rate</b>                    | the tax charge for the year excluding the tax impact of non-recurring items and acquisition amortisation expressed as a percentage of underlying profit before tax  |
| <b>ESA</b>                   | European Space Agency   | <b>Underlying operating cash conversion</b>             | the ratio of cash flow from operations (excluding impact of major restructuring) less outflows on purchase of intangible assets and property, plant and equipment to underlying operating profit excluding share of post-tax loss of equity accounted joint ventures and associates |
| <b>ETIS</b>                  | environmental test and integration support  | <b>Underlying operating margin</b>                      | underlying operating profit expressed as a percentage of revenue  |
| <b>EU</b>                    | European Union  | <b>Underlying operating profit</b>                      | earnings before interest, tax, IPO-related items (2006 only), gains on business realisations, major restructuring costs, impairment of investments, profit on disposal of non-current assets and amortisation of intangible assets arising on acquisitions                          |
| <b>Free cash flow</b>        | net cash flow from operating activities less the net cash flow from the purchase and sale of intangible assets and the purchase and sale of plant, property and equipment | <b>Underlying profit before tax</b>                     | profit before tax excluding IPO-related items (2006 only), gains on business realisations, major restructuring costs, impairment of investments, profit on disposal of non-current assets and amortisation of intangible assets arising from acquisitions                           |
| <b>GWAC</b>                  | Government Wide Acquisition Contract  |   |   |
| <b>IAS</b>                   | International Accounting Standard   |   |   |
| <b>IDIQ</b>                  | Indefinite delivery indefinite quantity   |   |   |
| <b>IFRS</b>                  | International Financial Reporting Standard  |   |   |
| <b>Interest cover</b>        | the number of times that net finance costs are covered by EBITDA  |   |   |
| <b>IP</b>                    | Intellectual property   |   |   |
| <b>IPO</b>                   | Initial Public Offering   |   |   |
| <b>KPI</b>                   | Key Performance Indicator   |   |   |
| <b>LIBID</b>                 | London inter-bank bid   |   |   |
| <b>LIBOR</b>                 | London inter-bank borrowing rate  |   |   |

## Financial calendar

|                          |   |
|--------------------------|---|
| <b>30 July 2008</b>      | Interim management statement                    |
| <b>30 July 2008</b>      | Annual General Meeting                          |
| <b>6 August 2008</b>     | Ex-dividend date                                |
| <b>5 September 2008</b>  | Final ordinary dividend payable                 |
| <b>30 September 2008</b> | Interim financial period end                    |
| <b>26 November 2008</b>  | Interim results announcement                    |
| <b>January 2009</b>      | Interim management statement (provisional date) |
| <b>February 2009</b>     | Interim dividend payment (provisional date)     |
| <b>31 March 2009</b>     | Financial year end                              |
| <b>May 2009</b>          | Preliminary announcement                        |

## Analysis of shareholders\*

|   |      |
|---|------|
| Financial institutions with shareholding greater than 0.5m shares                                   | 62%  |
| Ministry of Defence   | 19%  |
| Other (including employees, management and financial institutions with shareholding less than 0.5m) | 19%  |
|   | 100% |

\* Analysis as at 19 May 2008

## Advisors

### Auditors

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