Preliminary Results

QINETIQ

23 May 2019

Our strategy is delivering – third year of growth

Results for the year ended 31 March 2019

	Statutory results		Underlying* results	
	2019	2018	**2019**	2018
Revenue	**£911.1m**	£833.0m	**£911.1m**	£833.0m
Operating profit	**£113.8m**	£141.0m	**£123.9m**	£122.5m
Profit after tax	**£113.9m**	£138.1m	**£111.5m**	£109.0m
Earnings per share	**20.1p**	24.4p	**19.7p**	19.3p
Full year dividend per share	**6.6p**	6.3p	**6.6p**	6.3p
Total funded order backlog[1]			**£3,133.6m**	£2,005.4m
Total orders in the period[2]			**£776.4m**	£587.2m
Net cash inflow from operations	**£125.6m**	£132.4m	**£126.3m**	£126.5m
Net cash			**£188.5m**	£266.8m

* Definitions of the Group's 'Alternative Performance Measures' can be found in the glossary
[1] 2019 includes LTPA amendment signed 5 April 2019
[2] Includes share of Joint Ventures, excludes LTPA contract amendments

Delivered third year of organic growth

- Orders up 32%, record £3.1bn high-quality backlog[1]
- Revenue up 9%, 8% on an organic basis
- Underlying operating profit up 1% including ~£7m non-recurring trading items (2018: ~£9m), excluding them up 3% on an organic basis, offsetting UK single source profit headwind
- 102% underlying cash conversion pre-capex
- Underlying EPS up 2%; 5% increase in full year dividend

Driving growth through disciplined execution of strategy

- Secured £1.3bn amendment to Long Term Partnering Agreement (LTPA) with UK MOD
- Won five competitive long-term programmes: UK, US & Canada
- Completed one acquisition and one strategic investment to grow training offering
- Grown international revenue from 21% to 30% in three years
- Engaged employees in driving and sharing benefits of growth

Priorities for FY20

- Operational performance; 74% revenue under contract (2018: 69%)
- Deliver first year of amended LTPA contract and develop growth opportunities
- Win further competitions and accelerate growth by pursuing campaigns globally
- Drive sustainable profitable growth through continued investment
- Maintaining expectations for Group performance in FY20

Steve Wadey, Group Chief Executive Officer said:
"This has been an excellent year with strong operational performance. By improving our customer focus and competitiveness, we have delivered a third successive year of revenue growth, increased our international revenue share from 21% to 30% over the last three years, offset the UK single source profit headwind and delivered organic profit growth.

"Securing the LTPA amendment and winning five major competitive, long-term programmes demonstrates that our strategy is working, providing a platform for sustainable profitable growth."

Preliminary results presentation:

There will be a presentation of the preliminary results at 0900 hours UK time on 23 May 2019 at the London Stock Exchange, 10 Paternoster Square, EC4M 7LS. A webcast of the presentation is available at: www.QinetiQ.com/investors and through which participants will be able to ask questions. An audiocast of the event will also be available by dialling +44 20 3936 2999 Participant Access Code: 681325

About QinetiQ:

QinetiQ (QQ.L) is a leading science and engineering company operating primarily in the defence, security and critical infrastructure markets. We work in partnership with our customers to solve real world problems through innovative solutions delivering operational and competitive advantage. Visit our website www.QinetiQ.com. Follow us on LinkedIn and Twitter @QinetiQ. Visit our blog www.QinetiQ-blogs.com.

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Basis of preparation:

Throughout this document, certain measures are used to describe the Group's financial performance which are not recognised under IFRS or other generally accepted accounting principles (GAAP). The Group's Directors and management assess financial performance based on underlying measures of performance, which are adjusted to exclude certain 'specific adjusting items'. In the judgment of the Directors, the use of alternative performance measures (APMs) such as underlying operating profit and underlying earnings per share are more representative of ongoing trading, facilitate meaningful year-to-year comparison and, therefore, allow the reader to obtain a fuller understanding of the financial information. The adjusted measures used by QinetiQ may differ from adjusted measures used by other companies. Details of QinetiQ's APMs are set out in the glossary to the document.

Year references (FY20, FY19, FY18, 2020, 2019, 2018) refer to the year ended 31 March.

Disclaimer

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

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

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

Chief Executive Officer's Review

We are pleased to report another year of organic revenue growth and record order backlog. Three years since launching our vision-based strategy we have reversed five years of revenue decline and delivered three years of growth. In addition, we drove performance across the Group to successfully offset a ~£5-6m profit headwind from UK single source regulations in FY19 and delivered organic growth in operating profit. For FY20, we are maintaining expectations for Group performance, excluding non-recurring trading items, with revenue growth at stable margins resulting in continued operating profit progression.

This year marked a number of significant strategic achievements that will underpin sustainable profitable growth of QinetiQ in the years ahead.

Shortly after the period end we agreed a significant amendment to the Long Term Partnering Agreement (LTPA) for test, evaluation and training services, our largest single contract and the foundation for many of the capabilities we offer. This secures our market leading position in this critical UK capability, facilitates investment to enhance this capability at appropriate returns for our shareholders, and provides a platform for UK and international growth.

During the year we won five long-term, competitive programmes that mark a step change in our ability to understand our customer requirements, draw on resources across the whole of QinetiQ and identify key industry partners. In every case, these wins provide us with opportunities to enhance our expertise and the value we can derive from these capabilities in the future.

In the UK, we were selected with our partners to become the Engineering Delivery Partner (EDP) to the UK Ministry Of Defence (MOD) procurement agency Defence Equipment & Support (DE&S), establishing the default contracting route for all engineering services. We also won the Battlefield Tactical Communication and Information Systems (BATCIS) contract, our largest competitive UK win, awarded by an area of the UK MOD we had not worked with regularly before. Winning these types of contract moves us up the value chain and deepens our relationship with key customers creating further opportunities.

We are applying the same approach in markets outside of the UK to deliver our ambition of 50% of revenues from international customers.

In the US, we won two robotic programs of record: the Common Robotic System-Individual (CRS-I) program for small robots worth up to $164m over 7 years, and a $12m order as part of the Route Clearance and Interrogation System (RCIS) program for route clearance vehicles which is worth up to $44m. This positions us well for future growth in an attractive and dynamic market. Our focus on strategic business winning will deliver greater stability in the performance of our Global Products division, through expansion of the product portfolio and larger, longer-term programmes.

In Canada, we were awarded a C$51m contract to provide Unmanned Aerial System (UAS) services to the Royal Canadian Navy and Canadian Special Operations Forces Command. We won this competition, our largest ever export order, by combining the strong relationship with the Canadian customer, expertise in unmanned systems and manufacturing facilities acquired through QinetiQ Target Systems, with broader defence capabilities from across the QinetiQ Group.

We completed one further acquisition and one strategic investment during the year that complement our capabilities and allow us to access attractive adjacent markets in UK and international training. With a strong balance sheet, we have the ability to continue to acquire attractive businesses that complement our strategy, enhance our capabilities and increase our international reach.

QinetiQ is a company built on the expertise of its people who are critical to our success. Our focus is on creating the right culture and ensuring everyone feels engaged in our strategy and driving growth. This year we launched a new all-employee incentive scheme, the first time QinetiQ has provided a company-wide bonus. The scheme aligns our employees and shareholders by incentivising and rewarding growth and I am delighted that in its first year of introduction it will pay out £1,000 to every employee in the company.

It has been an excellent year for QinetiQ, with strong operational performance and further evidence of our strategy delivering results. I would like to take this opportunity to thank the hard work of all our people who have been instrumental in delivering such significant change, and who will be critical to sustaining our strategy and delivering continued profitable growth in the years ahead.

Strategy

Our strategy was developed in anticipation of the market conditions we see today and launched three years ago to deliver our vision of becoming the chosen partner around the world for mission-critical solutions, innovating for our customers' advantage.

We have been consistent in the application of our strategy over the past three years, and the improvements we are delivering in our financial performance, our ability to win new business and our increasing international footprint are the direct result of its implementation.

In 2016 we also launched a transformation programme to put in place the key changes that we needed to deliver growth. The programme has improved our customer focus and competitiveness by delivering key changes in leadership and organisation, operational excellence, and business winning, and ensuring a disciplined approach to investment in our future. To enable our ambition of generating 50% of revenue from outside the UK, the focus of the programme is now on the transformational change that is required for QinetiQ to become a high-performing, global, and digitally-enabled company.

UK defence test and evaluation

QinetiQ has a unique role in UK defence. Defining and supporting this set of capabilities is the Long Term Partnering Agreement (LTPA), our largest contract, underpinning UK defence test and evaluation (T&E) capability.

Our strategy is to invest in and modernise this unique capability, enabling us to meet our customers' growing demand for more complex and integrated testing and training. This approach provides us with a strong foundation, securing UK customers and growing international users. Being a leader in UK T&E is also critical to supporting our international ambitions. Our ability to win work internationally is in part built upon our credibility within the UK. Our work within UK T&E enables us to grow into near adjacent markets such as cost-effective training.

In April 2019, we hosted a seminar explaining more about this element of our strategy, a replay of which is available at https://www.qinetiq.com/investors/investor-seminars

Highlights included:

- Agreeing, shortly after year end, a second amendment to the LTPA which secures £1.3bn of revenue until 2028 and allows us to invest £190m in modernising its capabilities. This transforms QinetiQ's ability to enable the delivery of the MOD's future programmes, such as the Queen Elizabeth Class aircraft carrier, Dreadnought submarine and future combat aircraft. Securing this amendment delivers significant benefits:
    - For our customers, it future-proofs our ability to help create and assure the next generation of defence capabilities, more efficiently and cost effectively;
    - For our people, it provides exciting career opportunities by introducing new ways of working and ensuring we continue to work on some of the most challenging issues our customers face; and

    - For our shareholders, it secures nine years of revenue and delivers appropriate returns which we can enhance further by delivering efficiencies, growing our UK market share, increasing the work we do with large defence prime contractors and attracting more international customers.

- Successfully delivering our new fleet of aircraft and syllabus for test aircrew training. The enhanced facilities, which were part of our investment under the December 2016 LTPA amendment, are attracting international customers from Australia, the Netherlands, Switzerland and Singapore as well as the first students for the civil course.
    - The modern fleet of aircraft is significantly more cost effective to run and is civil-, rather than military-certified, broadening their customer scope. With their modern "glass cockpits" that are representative of aircraft in customers' fleets, they provide highly relevant training to students.

- Investment in our air ranges is driving growth by supporting more complex and realistic exercises with increasing levels of threats. The US Navy has committed to running its large NATO ballistic missile training exercise, known as Formidable Shield, on a bi-annual basis at the Hebrides range we operate for the MOD. These exercises also demonstrate QinetiQ's expertise to the other nations participating, and have led to subsequent work with the Canadian and Polish navies.

Focus for FY20:

- Our primary focus will be to implement the first year of the amended LTPA contract. This includes embedding new ways of working, investing in facilities and securing new opportunities for growth.

International

We have made significant progress to becoming a truly international company, increasing our international share of revenue from 21% to 30% over the last three years.

Our home countries are the UK, US and Australia and are defined by our significant in-country presence. We complement these home markets with export sales into selective international markets.

In September 2018, we hosted a seminar explaining more about this element of our strategy, a replay of which is available at https://www.qinetiq.com/investors/investor-seminars

Highlights during the year included:

- We won our largest ever export sales order, a C$51m (c£30m) contract to deliver unmanned aircraft systems (UAS) that will drive better situational awareness for the Canadian Armed Forces. This contract is an example of how QinetiQ can utilise its UK capabilities and acquisitions to grow internationally. The vertical take-off and landing unmanned air systems that we will provide under this contract will deliver enhanced Intelligence, Surveillance, Target Acquisition and Reconnaissance (ISTAR) services to Canadian military units at sea and on land, for both domestic and international operations.

- QinetiQ Target Systems continues to perform well. During the year we received our first order for Rattler, a supersonic target developed with investment and technical support from across the QinetiQ Group.

- We completed the acquisition of E.I.S Aircraft Operations, now known as QinetiQ Germany, a business specialising in aerial training services. The acquisition delivers a number of strategic benefits to QinetiQ, providing us with a permanent presence in Germany and strengthening our capability integration, threat representation and operational readiness offering to our German customer.

- QinetiQ North America delivered a strong performance in FY19 and won two programs of record with the US Department of Defence:
    - We were awarded a $12m order as part of the Route Clearance and Interrogation Systems (RCIS) Type 1 robotics program worth up to $44m.
    - We were also successful in the competition for the US Army's Common Robotic System-Individual (CRS(I)) program. This seven-year Indefinite Delivery Indefinite Quantity (IDIQ) contract, worth up to $164m, includes a Low Rate Initial Production phase worth approximately $20m over the next one-to-two years.

- Our Australian business delivered record breaking orders of over A$100m during FY19, further expanding its consulting and customer advice side business.

- We have established three joint ventures in countries in the Middle East, partnering with government and commercial companies, to accelerate the delivery of our products and services in the region, and opened an office in Kuala Lumpur, Malaysia.

Focus for FY20:

- Further expand our presence in the Canadian market, building on the work that we are delivering to our customers in Ottawa and the unmanned aircraft services that we are delivering from Medicine Hat, Alberta.

- Grow our recently acquired business in Germany by expanding our current aerial training and aircraft modification services.

- Mature our sales pipeline in the Middle East and Asia.

Innovation

We are a company which is founded on innovation. Our people, using their extensive technical and scientific expertise, innovate to overcome some of the most challenging problems our customers face. A core part of our strategy to grow QinetiQ is to build on this technical expertise with commercial innovation, and to apply this approach across all our activities and geographies, as a major source of competitive advantage.

Highlights during the year included:

- We were appointed with our partners Atkins and BMT, to become the Engineering Delivery Partner (EDP) for the UK MOD's procurement agency Defence Equipment & Support (DE&S). EDP will help the MOD to reduce the cost of engineering services, while ensuring the UK's Armed Forces receive the best equipment and support, using an innovative delivery model that QinetiQ first pioneered through the Strategic Enterprise contract for air engineering services. During the second half of FY19, we secured £69m of orders through EDP, the total programme value of which could be more than £1bn over the next ten years.

- We were awarded a three-year contract with options to extend for a further two years to support the MOD in delivering next generation Battlefield Tactical Communication and Information Systems (BATCIS). The initial order was £41m under a programme worth up to £95 million with an initial term of three years and options to extend by a further two years. To win the award, we combined our extensive technical capabilities with an innovative approach to satisfying customer requirements demonstrating our increasing customer focus and more strategic approach to business winning.

- Our ground-breaking Solar Electric Propulsion System, developed following significant investment and manufactured by an industrial consortium led by QinetiQ, provided the engine power behind the BepiColombo mission to Mercury which successfully launched in October 2018.

Focus for FY20

- Learning from the successes and losses in FY19, we are maturing our approach to delivering commercial innovation through our business winning activities in three areas:
    - Foundation sales, which are shorter-term opportunities that are normally won and delivered in year.
    - Strategic captures, which are medium-term opportunities that are specific and competitive in nature.
    - Global campaigns, where we are evolving our campaign-based approach to create and pursue longer-term opportunities globally.

Outlook – FY20

We enter FY20 with confidence having delivered a third successive year of organic revenue growth and an organic increase to operating profit.

- As we build on our record order backlog and benefit from the full year contribution from our recent acquisition of E.I.S. Aircraft Operations and strategic investment into Inzpire, we anticipate delivering mid-single digit revenue growth including further organic revenue progression.
- In EMEA Services, we expect divisional margins in FY20 to be consistent with FY19.
- In Global Products, we also expect more stability in divisional margins due to the expansion of our product portfolio combined with our success in winning longer-term programmes.
- We will continue to invest to drive future growth, including capex of £80-100m, the majority of which will be invested into the LTPA at an appropriate return. We expect working capital outflows of £20-30m and continued strong cash conversion pre-capex.

Overall we are maintaining expectations for Group performance in FY20, excluding non-recurring trading items, with revenue growth at stable margins resulting in continued operating profit progression.

Outlook – longer term

We will continue to grow by implementing our strategy and investing in our people, technology, systems and infrastructure. By doing so, our objective is to deliver continued organic revenue growth, further supported by acquisitions, resulting in sustainable profitable growth at stable margins.

Steve Wadey, Chief Executive Officer, 23 May 2019

Chief Financial Officer's Review

Overview of full year results

We reported a strong performance in FY19, delivering growth across orders, revenue and profitability and building on the strategic progress we have made over the past three years. Our rigorous focus on performance and ensuring we keep costs under control means we were successfully able to offset the well flagged headwind to profitability in the UK. We enter FY20 in a strong position, with a record order backlog and a robust balance sheet. Strong cash generation from the company is expected to be sufficient to fund our organic investment, while net cash of £188.5m provides support for bolt-on acquisition opportunities.

Revenue was up 9% at £911.1m (2018: £833.0m), including a £15.1m contribution from E.I.S. Aircraft Operations (now known as QinetiQ Germany) and Inzpire Ltd which completed during the second half of FY19. Revenue grew by 8% on an organic basis, with a 4% increase in EMEA Services and a 22% increase in Global Products driven by strong performance in QinetiQ North America (QNA) and QinetiQ Target Systems (QTS).

Orders in the year excluding LTPA amendments totalled £776.4m (2018: £587.2m) a 28% increase on an organic basis. This was driven by a strong performance in EMEA Services in both large, multi-year contracts, such as Engineering Delivery Partner (EDP), and in smaller value contracts. Key orders won in FY19 included £69m relating to EDP, £41m for Battlefield Tactical Communications and Information Systems (BATCIS) and C$51m for Canadian Armed Forces Unmanned Air System work.

At the beginning of the new financial year, 74% of the Group's FY19 revenue was under contract, compared to 69% at the same point last year. This reflects increased multi-year contracts and securing the LTPA amendment in April 2019, the work for which is included in the calculation.

Underlying operating profit was up 1% at £123.9m (2018: £122.5m), assisted by ~£7m (2018: ~£9m) non-recurring trading items including: a £6.9m gain on sale of aircraft following investment in a new fleet of aircraft for test aircrew training; a £5.4m benefit related to project risk re-assessments following technical successes on a major contract in the EMEA Services division; and a £5.0m charge relating to redundancy costs. During the year we completed the full acquisition of QinetiQ Germany and a strategic investment in Inzpire which together contributed £1.3m of operating profit in the five months of our ownership, as we increased investment to support future growth. Excluding the non-recurring trading items, the QinetiQ Germany acquisition and strategic investment into Inzpire, and the effect of foreign exchange, underlying operating profit for the Group increased by ~£3m (3%).

EMEA Services operating profit grew 2% (1% organic) offsetting an approximate £5-6m headwind due to the lower baseline profit rate for single source contracts, which was in line with our expectations. The level of non-recurring items was similar in both years and had minimal impact on EMEA Services growth. Global Products underlying operating profit fell by 2% but was impacted adversely by ~£2m of non-recurring trading items, and was up 7% on an organic basis (excluding non-recurring trading items) driven by increased revenue in QinetiQ North America (QNA) and QinetiQ Target Systems (QTS).

Total operating profit was £113.8m (2018: £141.0m), including £3.9m amortisation of acquired intangibles (2018: £2.6m), £3.7m impairment of property (2018: £nil) and £2.0m acquisition costs (2018: £nil). FY18 profit was higher due to £14.6m profit recognised on the disposal of property and a £5.9m gain on the sale of intellectual property.

Underlying profit before tax increased 2% to £124.0m (2018: £122.1m) broadly in line with the increase in underlying operating profit, with underlying net finance income at £0.1m (2018: cost £0.4m).

Total profit before tax fell to £123.2m (2018: £144.8m) due to higher specific adjusting items in FY18.

Specific adjusting items

Specific adjusting items, shown in the 'middle column', at the profit after tax level amounted to a total net profit of £2.4m (2018: £29.1m). This included £3.9m (2018: £2.6m) amortisation of acquired intangible assets, £3.7m impairment of property and £2.0m acquisition costs, offset by £8.2m (2018: £4.2m) finance income related to the defined benefit pension asset and £3.2m (2018: £6.4m) of tax movements (see below). FY18 contained a significantly higher value of specific adjusting items due to a profit of £14.6m (2019: £0.2m) recognised on the disposal of property and a £5.9m gain (2019: £nil) on the sale of intellectual property.

Net finance costs

Net finance income was £8.3m (2018: £3.8m). The underlying net finance income was £0.1m (2018: cost £0.4m) with additional income of £8.2m (2018: £4.2m) in respect of the defined benefit pension asset reported within specific adjusting items.

Tax

The total tax charge was £9.3m (2018: £6.7m). The underlying tax charge was £12.5m (2018: £13.1m) with an underlying effective tax rate of 10.1% for the year ending 31 March 2019 (2018: 10.7%). The effective tax rate continues to be below the UK statutory rate, primarily as a result of the benefit of research and development expenditure credits ('RDEC') in the UK which are accounted under IAS12 within the tax line. An adjusted effective tax rate before the impact of RDEC would be 15.0%. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to any tax legislation changes, the geographic mix of profits, the recognition of unrecognised tax losses and while the benefit of net RDEC retained by the Group remains in the tax line.

A £2.8m credit in respect of initial recognition of corporate tax deductions for certain equity-settled share based payment schemes has been classified as a specific adjusting item. Together with a £0.4m tax effect of the pre-tax specific adjusting items, the total specific adjusting items tax credit was £3.2m (2018: £6.4m).

At 31 March 2019 the Group had unused tax losses and surplus interest costs of £114.9m which are available for offset against future taxable profits.

Cash flow, working capital, capex and net cash

Underlying net cash flow from operations was £126.3m (2018: £126.5m) with an underlying operating cash conversion of 102% (2018: 103%). This included a £27.5m working capital unwind.

Net cash flow associated with capex increased to £80.7m (2018: £54.5m) following the settlement of £23.5m FY18 year end capex creditors in FY19. After paying tax and net interest of £10.1m the Group generated free cash flow of £35.5m (2018: £56.3m), before property disposal proceeds of £5.3m (2018: £23.1m).

Overall capex between FY20-22 is expected to be in the range of £70-100m per annum, of which the majority reflects our investment into the LTPA. Given the nature of our business model, we expect to be able to fund our capex requirements from operational cash flow.

As at 31 March 2019 the Group had £188.5m net cash (2018: £266.8m). The reduction in net cash was primarily due to the £81.2m of consideration and associated repayment of acquired debt for the acquisition of QinetiQ Germany and the strategic investment into Inzpire, and payment of £35.7m of dividends; these were partially offset by £35.5m free cash flow and £5.3m of property disposals.

In September 2018 the Group completed the re-financing of its revolving credit facilities, putting in place a new £275m facility with an 'accordion' facility to expand this up to a maximum of £400m. The facility has an initial term of five years with two one-year options to extend the final maturity to 27 September 2025. The larger facility size, longer term and additional operational flexibility provide the maximum scope to execute our strategic growth plans. QinetiQ has introduced positive incentive language into the facility agreement to reinforce our environmental, social and governance policies, and sustainability agenda; this has the effect of providing a modest margin adjustment of +/- 0.02% if we exceed greenhouse gas emission targets over the life of the facility.

Capital allocation

Priorities for capital allocation are:

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

Earnings per share

Underlying basic earnings per share increased by 2% to 19.7p (2018: 19.3p) benefiting from the higher underlying profit after tax. Basic earnings per share for the total Group (including specific adjusting items) decreased 18% to 20.1p (2018: 24.4p).

The average number of shares in issue during the year, as used in the basic earnings per share calculations, was 566.0m (2018: 565.2m) and there were 566.3m shares in issue at 31 March 2019 (all net of Treasury shares).

Dividend

The Board proposes a final FY19 dividend per share of 4.5p (2018: 4.2p) making the full year dividend 6.6p (2018: 6.3p). The full year dividend represents an increase of 5% in line with the Group's progressive dividend policy.

Subject to approval at the Annual General Meeting, the final FY19 dividend will be paid on 30 August 2019 to shareholders on the register at 2 August 2019.

Pensions

In the UK the Group operates a defined benefit pension scheme. The Scheme is closed to future accrual and there is no on-going service cost. Prior to the year end the Scheme completed its first bulk annuity insurance buy-in for approximately £700m. This transaction has removed longevity risk, interest rate risk and inflation risk for approximately one third of the Scheme and is in line with the Group's strategy of de-risking the pension liabilities. As a result of the transaction the accounting pension surplus recorded on the Group's balance sheet reduced by an estimated £120m with no related cash impact.

The Scheme is in a very healthy position with the most recently completed actuarial valuation (prior to the buy-in) showing a surplus of £139.7m (as at 30 June 2017) and the net asset position, post the buy-in transaction, was £259.1m on an accounting basis under IAS19 as at 31 March 2019 (2018: £316.2m). As at year end the Scheme was hedged against approximately 93% of the interest rate risk and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis. Full details are set out in note 14.

During the reporting period the High Court ruled on a case involving Lloyds Banking Group in respect of equalising (between men and woman) Guaranteed Minimum Pensions ('GMPs'). QinetiQ's pension scheme has not been significantly impacted by this court ruling but an increase in liabilities of £0.7m has been recognised in the period, through a past service charge to operating profit. This is reported as a 'significant adjusting item' in the income statement in accordance with historical Group policy.

Implementation of IFRS 15 'Revenue from contracts with customers'

The adoption of accounting standard IFRS 15 for the Group's FY19 financial year has not had a significant impact on QinetiQ's reported financial performance. This was as expected given the nature of our contracts and QinetiQ's historic method of accounting (using 'percentage of completion' accounting for service contracts as opposed to milestone accounting). Additional disclosures (eg in respect of backlog and contract assets and liabilities) are required, and these will be provided in the FY19 Annual Report.

Implementation of IFRS 9 'Financial instruments'

The adoption of accounting standard IFRS 9 for the Group's FY19 financial year has not had a significant impact on QinetiQ's reported financial performance. The Group assessed that certain financial assets would be reclassified from being measured at fair value through other comprehensive income to fair value through profit and loss. The changes to impairment and hedge accounting have not has a material impact on the results of the Group and these accounting policies have also been updated.

'Recent accounting developments adopted by the Group' within note 1 provides further insight into the implementation of both IFRS 15 and IFRS 9.

Implementation of IFRS 16 'Leases'

The new accounting standard IFRS 16 'Leases' will be adopted for the FY20 financial year. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. Lessor accounting remains similar to current practice i.e. lessors continue to classify leases as finance and operating leases.

The standard will be effective for periods beginning on or after 1 January 2019, i.e. FY20 for QinetiQ, using either the full retrospective approach or the modified retrospective approach. Early adoption is permitted but QinetiQ plans to adopt the new standard on the required effective date, 1 April 2019, using the full retrospective approach. The main impact on QinetiQ's financial statements in FY20 will be the introduction of a right-of-use asset on day one of approximately £23.8m, largely offset by an incremental lease liability of approximately £26.6m i.e. a reduction in net assets of ~£2.8m. There will also be an immaterial impact on the income statement with <£1m of finance cost being reclassified from operating costs. Detailed analysis is included in note 1 to the financial statements in the Annual Report.

Foreign exchange

The principal exchange rate affecting the Group was the Sterling to US Dollar exchange rate and the Sterling to Australian Dollar rate.

	12 months to 31 March 2019	**12 months to 31 March 2018**
£/US$ - opening	1.40	1.25
£/US$ - average	1.31	1.33
£/US$ - closing	1.30	1.40
£/A$ - opening	1.83	1.64
£/A$ - average	1.80	1.71
£/A$ - closing	1.83	1.83

Trading Environment

The UK, US and Australia are our home countries where we have our own indigenous industrial capabilities.

UK

The UK's total defence spending of £42bn in 2019 makes it the largest among European nations. The Modernising Defence Programme (MDP) reported in December 2018 and recognised the need for driving innovation and generating new technologies. It placed an emphasis on the value of cutting edge technology in areas such as artificial intelligence, cyberspace and space; all areas in which QinetiQ holds significant expertise.

The MOD is focused on driving efficiencies to generate savings while also maintaining and enhancing its capability. As a result, QinetiQ remains a proactive strategic partner to the MOD providing capability generation and assurance. The UK is expected to spend approximately £1.5bn on research & development and test & evaluation in 2019 and therefore remains a key market for QinetiQ where we can continue to support the MOD. The signing of the LTPA amendment will help to deliver efficiencies while also enhancing this critical capability.

While the UK's exit from the European Union could create short-term fiscal pressure for the Government, it is likely that the current geopolitical environment and the UK's commitment to NATO will offer support to overall defence spending.

US

With a military budget of $725bn in 2019, the US defence budget continues to dwarf that of other nations and is more than the next ten largest military budgets combined. In addition, continued trade tension between the US and China, a more assertive Russia and a deteriorating environment in the Middle East, supported by a strong US economy could drive further growth in US defence spending.

The 2019 budget was the first prepared since the publication of the National Defence Strategy (NDS) which cited the need for investment and modernisation of US defence capability. The NDS also highlighted the need to shift the focus from the global war on terror to state-on-state conflict and recognised the value of collaboration with the private sector.

QinetiQ remains at the forefront in supporting the US Department of Defence (DoD) in modernising its defence capability, evidenced by the award of two 'programs of record' for robotics. Our expertise in robotics and autonomous systems is well aligned with the DoD's ambition to make greater use of this technology.

Australia

Modernising and enhancing defence capability remains a key priority for the Australian military. As a result, defence spending, which is expected to be US$31.6bn in 2019, is forecast to grow at ~5% per annum to 2024. The core focus for Australian forces continues to be the Navy as the trend of the 'pivot to the Pacific' continues following ongoing tension in the South China Sea.

The 2018 Defence Industrial Capability Plan outlines ten areas of focus key to enhancing Australian sovereign industrial capability. These include advancing signal processing capability in electronic warfare, cyber and information security, and conducting test, evaluation, certification and systems assurance. Australian research, development, test and evaluation spending is expected to exceed $1bn in 2019. We work closely with the Australian military providing test and evaluation and we see opportunities to continue developing our offering and expertise.

Broader international markets

Supported by our strategy, our aim is to grow international revenue to 50% of Group revenue. To achieve this we will need to grow revenue not just in our home countries, but also in broader international markets. We aim to leverage the skills and expertise developed in our home countries to support allies in high growth markets in developing their own indigenous capability.

In the Middle East widespread unrest, including conflicts in Iraq, Syria and Yemen, as well as growing concern over a resurgent Iran, has driven defence spending higher. The nations driving this spending have predominantly focused procurement on new equipment and, as their sophistication grows, are more aware of the benefits of integrating and assuring this equipment to create military capabilities. Being independent from the supply chain, and leveraging our experience in the UK, we are well placed to help these countries assure their defence capabilities.

We continue to see good opportunities in Canada to support the modernisation of their domestic capability. Canadian defence spending is expected to be US$16.4bn in 2019, with the drive to modernise their capability likely to result in continued growth in expenditure over the medium term.

Europe accounts for roughly 20% of global defence spending with many European forces currently in the process of renewing their ageing capability. The work we have done in the UK through the modernisation of the LTPA is an example of the value we can create for other countries in how to update their own test and evaluation capabilities. Germany is an attractive market for QinetiQ with defence spending expected to increase by 10% in 2019 and further increases expected in 2020 and 2021. Our acquisition of E.I.S. Aircraft Operations, now known as QinetiQ Germany, supports our future growth in training in Germany and other attractive international markets.

Operating review

EMEA Services

	2019 £m	2018 £m
Orders excluding LTPA amendments[1]	**534.6**	355.9
Revenue	**687.7**	651.4
Underlying operating profit	**96.3**	94.3
Underlying operating margin	**14.0%**	14.5%
Book to bill ratio[2]	**1.2x**	0.8x
Total funded order backlog[3]	**2,916.8**	1,804.9

(1) Includes share of orders from Joint Ventures
(2) B2B ratio is orders won divided by revenue recognised, excluding the LTPA contract and share of JV orders
(3) 2019 includes LTPA amendment signed 5 April 2019

Overview

EMEA (Europe, Middle East and Australasia) Services combines world-leading expertise with unique facilities to provide integrated capability generation and assurance. Our core value proposition is built upon our expertise in capability integration, threat representation and operational readiness underpinned by long-term contracts that provide good visibility of revenues and cash flows. The division is also a market leader in research and advice in specialist areas such as C4ISR, weapons and energetics, cyber security and procurement advisory services.

Financial performance

Orders for the year were £534.6m (2018: £355.9m), including £23.3m from the two companies acquired in the year, growing £157.1m (44%) on an organic basis excluding acquisitions and foreign exchange. The increase was driven by key orders won including £69m relating to Engineering Delivery Partner (EDP) and £41m for Battlefield Tactical Communications and Information Systems (BATCIS).

Performance was particularly strong on smaller value contracts which accounted for £115m of the £157m growth.

Revenue increased by 6% to £687.7m (2018: £651.4m), including £15.1m from acquisitions, and increased by 4% on an organic constant currency basis, principally driven by our Cyber, Information & Training business.

At the beginning of the new financial year, 79% of EMEA Services' FY20 revenue was under contract, compared with 75% at the beginning of the prior year. The growth is a reflection of the increase in key multi-year contracts and securing of the LTPA amendment in April 2019 which is included in this figure.

Underlying operating profit was £96.3m (2018: £94.3m) assisted by ~£9m (2018: ~£8m) of non-recurring trading items. Excluding these non-recurring trading items, the QinetiQ Germany acquisition and strategic investment into Inzpire and the effect of foreign exchange, underlying operating profit for EMEA Services increased by 2%. This is despite an approximate £5-6m headwind during FY19 (~£10m cumulatively over three years) due to the lower baseline profit rate for single source contracts, which was in line with our expectations.

Including the LTPA, approximately 70% of EMEA Services revenue is now derived from single source contracts (2018: approximately 75%), reflecting a greater proportion of revenue derived from competitive contracts. By investing in our core contracts and extending their duration we have increased the proportion of revenue contracted on a long-term basis providing visibility and reducing our exposure to future changes in the baseline profit rate set annually by the Single Source Regulations Office.

Overall, we expect FY19 to have represented the peak in SSRO headwind at ~£5-6m. Based on changes to the profit rate for single source contracts and the actions we have taken, we expect the headwind from the SSRO to abate in FY20 and beyond.

FY19 review

Air & Space (26% of EMEA Services revenue)

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

- We continued to build on the investment made under the December 2016 LTPA amendment to modernise our test aircrew training, read more on page 5.
- BepiColombo, a joint mission between the European Space Agency and Japanese Space Agency to explore Mercury, that showcases QinetiQ's significant investment in developing ion engine technology, successfully launched in October 2018, read more on page 7.
- Our 'Aurora' partnership was successful in being appointed as the Engineering Delivery Partner for Defence Equipment & Support (DE&S), read more on page 6.
- Whilst we were disappointed that the MOD has cancelled the competitive process for ASDOT, we believe our synthetic and live-virtual-constructive technologies are increasingly relevant to the UK's operational training needs.

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

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

- In April 2019, we signed an amendment to the LTPA securing £1.3bn of revenue and saving taxpayers £85m, read more on page 4.

- Several high value trials were delivered including 'Information Warrior', a three-week exercise with the Royal Navy exploring the adoption of emerging technologies to secure information advantage at sea.
- We experienced strong demand from international customers. For example, in Australia we deployed our autonomous systems command, control and communication capabilities in support of a significant military exercise.
- We continue to work closely with the Royal Navy to develop their approach to Carrier Task Group operations. Supporting the Royal Navy in developing this strategic capability should deepen our relationship with a key customer and lead to further potential opportunities.

Cyber, Information & Training (CIT) (18% of EMEA Services revenue)

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

- We are repositioning our CIT business to be a 'Mission Assurance Partner' to key strategic clients in the defence and security markets. This should result in a change in the revenue profile of the business unit from short-term contracts to multi-year service and product revenue streams, increasing visibility and supporting growth.
- In line with this approach, in July 2018 we won a contract to support the UK Ministry of Defence in delivering next generation battlefield tactical communications and information systems (BATCIS) worth up to £95m, highlighting our progress in moving to multi-year service contracts. This win reflects our extensive technical capabilities and approach to delivering real innovation for customers.
- We were awarded a £10m contract to provide support to key combat aircraft mission data systems in one of our target markets in the Middle East.
- We completed our strategic investment into Inzpire, a leading provider of operational training, in November 2018. Inzpire is pursuing multiple opportunities in areas such as mission data and aircrew training.
- We opened a new office in Lincoln to act as a hub for our CIT business in support of the work we do with the UK's Royal Air Force in mission data and training. The hub will support our further growth in this critical area and our strategic investment into Inzpire.

International (11% of EMEA Services revenue)

Our International business leverages our expertise and skills developed in the UK, and applies them to opportunities in attractive markets globally. Revenue derived from outside of the UK is reported in many of our businesses, and are not exclusive to our International business.

- We completed the acquisition of E.I.S. Aircraft Operations in October 2018, read more on page 5.
- We expanded our consulting and customer advice side business in Australia:
    - A significant proportion of this work was awarded through integrated work packages made possible by our new status as a Major Support Provider, which was awarded to QinetiQ as part of Team Nova at the end of FY18.
    - As a result of these wins our Australian business achieved record order intake, breaking through the A$100m mark for the first time.
- Recognising opportunities in South East Asia, we opened an office in Kuala Lumpur, Malaysia. We achieved two contract wins in the region: one to provide maritime design and hydrodynamic modelling services and the other to provide key engineering and test services for an indigenous product development programme. We will look to leverage our capabilities in Australia to support development in South East Asia.
- In the Middle East we now operate three joint ventures, and are seeing encouraging opportunities in the region. We anticipate that in FY20 the investments in these joint ventures

will start to deliver increased contract wins, development of indigenous capability and product sales, but recognise that geopolitical issues remain a risk.

Global Products

	2019 £m	2018 £m
Orders	**241.8**	231.3
Revenue	**223.4**	181.6
Underlying operating profit	**27.6**	28.2
Underlying operating margin	**12.4%**	15.5%
Book to bill ratio	**1.1x**	1.3x
Funded backlog	**216.8**	200.5

Overview

Global Products delivers innovative solutions to meet customer requirements and undertakes contract-funded research and development, developing intellectual property in partnership with key customers and through internal funding with potential for new revenue streams. The division is technology-based and has shorter order cycles than EMEA Services so can have a more lumpy revenue profile. Our strategy is to expand the product portfolio and win larger, longer-term programmes to improve the consistency of the financial performance of this division.

Financial performance

Orders increased to £241.8m (2018: £231.3m) including a contract to deliver unmanned air system services to the Canadian armed forces and underpinned by growth on smaller contracts particularly in QinetiQ North America (QNA) and QinetiQ Target Systems (QTS).

The Global Products division had 60% of its FY20 revenue already under contract at the beginning of the new financial year compared with 51% at the same time last year, reflecting key multi-year contracts secured over the last two years.

Revenue was up 23% on a reported basis at £223.4m (2018: £181.6m). On an organic constant currency basis, revenue increased by 22% driven by new research work delivered by QNA for Common Robotics System Individual (CRS(I)) and Route Clearance Interrogation System (RCIS) and new QTS Banshee sales to the Indian Airforce and Army.

Underlying operating profit was £27.6m (2018: £28.2m) impacted by £1.7m of one-off charges in FY19 compared with £1.0m of one-off gains in FY18. Adjusting for these non-recurring trading items and the impact of foreign exchange, underlying operating profit increased by 7% at constant currency. This was driven by increased volume of product shipments in QTS and QNA, partially offset by an unfavourable change in product mix, with a lower volume of high-margin licence income in FY19.

FY19 review

QinetiQ North America (39% of Global Products revenue)

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

- QNA delivered a strong performance in FY19 winning two programs of record with the US Department of Defence (DoD) with initial values of up to $44m and $164m. Read more on page 6.
- The business was also awarded a $90m Indefinite Delivery/ Indefinite Quantity (IDIQ) contract to support the sustainment of the TALON family of robotic systems providing on-going

maintenance, upgrades and servicing of the US Army's existing, fielded fleet of TALON robots. The contract wins within the robotics market reflect our leading capability and create opportunities to work with the DoD to deliver further innovative solutions.
- We were unsuccessful in winning the Man-Transportable Robotic System (MTRS) Program of Record for the US Army. We undertook an extensive exercise to identify why we were unsuccessful and applied what we learnt to our subsequent successful bids.

<u>OptaSense (11% of Global Products revenue)</u>

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

- Our OptaSense business delivered strong order growth during the year in key areas of infrastructure and oil field services, including our first orders in the North Sea; the business enters FY20 with its largest backlog to date.
- Overall revenues remained stable during the period with a greater contribution from repeat customers as they increasingly recognise the value OptaSense creates.
- OptaSense has developed a new innovative service-based model that has received positive traction in initial testing. If successful, this should deliver larger value contracts over longer durations increasing overall revenue visibility in the division.
- We continue to make good progress on the delivery of the 1,841km Trans Anatolian Natural Gas Pipeline (TANAP), our largest system award to date.

<u>Space Products (11% of Global Products revenue)</u>

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

- We delivered a contract for the preliminary design activities of the Altius Satellite. This European Space Agency (ESA) satellite will study the distribution of ozone in the earth’s stratosphere and chart climate change. In FY20, we have the potential to convert this design contract into a further order for the Altius satellite.
- We invested in a new, higher grade clean room in facilities in Belgium allowing us to produce up to four major products at any one time. The Altius satellite and the International Berthing and Docking Mechanism are likely to be the first products to benefit from this investment.

<u>EMEA Products (39% of Global Products revenue)</u>

EMEA Products provides research services and bespoke technological solutions developed from intellectual property spun out from EMEA Services. It also includes various product-based acquired businesses including QinetiQ Target Systems (QTS).

- QTS continues to perform well. During the year we received our first contract for the sale of Rattler, our supersonic ground and air launched target that represents high dive, sea skimming missile threats. This first contract with the Royal Navy will see Rattler integrated and certified for use on UK ranges. This is the first new product released by QTS since the acquisition of the business at the end of 2016 and was developed with the technical support of the broader QinetiQ Group.
- Leveraging QTS expertise, we won our largest contract to date in Canada with a C$51m contract to deliver unmanned aircraft systems (UAS) to the Canadian armed forces, read more on page 5.
- With our partner, we secured a contract for the provision of aerial target services to the UAE armed forces for weapons acceptance and training activities. We will be building our Banshee aerial targets in-country and opening a new product assembly and service facility in Dubai.

- We successfully launched our Obsidian counter drone system and won our first order from the Canadian Government. In addition, we expect the UK Government to go live with the system in the second half of FY20.

Principal risks and uncertainties

The Group continues to be exposed to a number of risks and uncertainties which management continue to identify, assess and mitigate to minimise their potential impact on the reported performance of the Group. An explanation of risks and their mitigations, together with details of our risk management framework can be found in the annual report which will be available for download at: https://www.qinetiq.com/investors.

A summary of the significant risks and uncertainties is set out below:

- Reduced spending in the core markets in which the Group operates;
- Failure to execute the international strategy or adequately to mitigate specific risks arising from international business;
- Failure to create a culture of innovation or to invest adequately in, or create value from, our innovation investment;
- A material element of the Group's revenue is dependent on a number of UK Government contracts.
- Group performance is adversely affected by application of the Single Source Contract Regulations;
- A future skills shortage;
- The Group operates in highly regulated environments and recognises that its operations have the potential to have an impact on a variety of stakeholders; and
- A breach of physical data security, cyber-attacks or IT systems failure could have an adverse impact on our customers' operations.

Consolidated income statement for the year ended 31 March

All figures in £ million	Note	2019 Underlying*	2019 Specific adjusting items*	2019 Total	2018 Underlying*	2018 Specific adjusting items*	2018 Total
Revenue[1]		**911.1**	**-**	**911.1**	**833.0**	**-**	**833.0**
Operating costs excluding depreciation and amortisation		(762.5)	(2.7)	(765.2)	(690.9)	-	(690.9)
Other income		10.6	0.2	10.8	9.7	21.1	30.8
EBITDA (earnings before interest, tax, depreciation and amortisation)		**159.2**	**(2.5)**	**156.7**	**151.8**	**21.1**	**172.9**
Depreciation and impairment of property, plant and equipment		(32.1)	(3.7)	(35.8)	(25.6)	-	(25.6)
Amortisation of intangible assets		(3.2)	(3.9)	(7.1)	(3.7)	(2.6)	(6.3)
Operating profit/(loss)		**123.9**	**(10.1)**	**113.8**	**122.5**	**18.5**	**141.0**
Gain on sale of investments		-	1.1	1.1	-	-	-
Finance income	6	1.2	8.2	9.4	0.7	4.2	4.9
Finance expense	6	(1.1)	-	(1.1)	(1.1)	-	(1.1)
Profit/(loss) before tax		**124.0**	**(0.8)**	**123.2**	**122.1**	**22.7**	**144.8**
Taxation (expense)/income	7	(12.5)	3.2	(9.3)	(13.1)	6.4	(6.7)
Profit for the year attributable to equity shareholders		**111.5**	**2.4**	**113.9**	**109.0**	**29.1**	**138.1**
Earnings per share							
Basic	8	19.7p		20.1p	19.3p		24.4p
Diluted	8	19.6p		20.0p	19.2p		24.3p

[1] Revenue excludes the share of revenue of joint ventures (FY19: £1.9m, FY18: nil).

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

Consolidated comprehensive income statement for the year ended 31 March

All figures in £ million	**2019**	2018
Profit for the year	**113.9**	**138.1**
Items that will not be reclassified to profit and loss:		
Actuarial (loss)/gain recognised in defined benefit pension schemes	(66.4)	143.6
Tax on items that will not be reclassified to profit and loss	11.3	(24.4)
Total items that will not be reclassified to profit and loss	**(55.1)**	**119.2**
Items that may be reclassified subsequently to profit and loss:		
Foreign currency translation gains/(losses) on foreign operations	4.6	(9.7)
Movement in deferred tax on foreign currency translation	(0.4)	(1.0)
Increase/(decrease) in fair value of hedging derivatives	1.8	(2.2)
Movement in deferred tax on hedging derivatives	(0.2)	0.4
Recycling of gain on disposal of investments	(1.1)	-
Fair value gains/(losses) on available for sale investments	0.7	(0.6)
Total items that may be reclassified to profit and loss	**5.4**	**(13.1)**
Other comprehensive (expense)/income for the year, net of tax	**(49.7)**	**106.1**
Total comprehensive income for the year	**64.2**	**244.2**

Consolidated statement of changes in equity for the year ended 31 March

All figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Hedge reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
At 1 April 2018	**5.7**	**40.8**	**147.6**	**(1.8)**	**(0.4)**	**552.2**	**744.1**	**0.2**	**744.3**
Profit for the year	-	-	-	-	-	113.9	113.9	-	113.9
Acquisition of partially owned subsidiary	-	-	-	-	-	-	-	2.0	2.0
Other comprehensive income/(expense) for the year, net of tax	-	-	-	1.6	4.2	(55.5)	(49.7)	-	(49.7)
Purchase of own shares	-	-	-	-	-	(0.7)	(0.7)	-	(0.7)
Share-based payments charge	-	-	-	-	-	5.9	5.9	-	5.9
Deferred tax on share options	-	-	-	-	-	1.0	1.0	-	1.0
Dividends	-	-	-	-	-	(35.7)	(35.7)	-	(35.7)
At 31 March 2019	**5.7**	**40.8**	**147.6**	**(0.2)**	**3.8**	**581.1**	**778.8**	**2.2**	**781.0**
At 1 April 2017	**5.7**	**40.8**	**147.6**	**-**	**10.3**	**328.0**	**532.4**	**0.2**	**532.6**
Profit for the year	-	-	-	-	-	138.1	138.1	-	138.1
Other comprehensive income/(expense) for the year, net of tax	-	-	-	(1.8)	(10.7)	118.6	106.1	-	106.1
Purchase of own shares	-	-	-	-	-	(0.7)	(0.7)	-	(0.7)
Share-based payments charge	-	-	-	-	-	2.7	2.7	-	2.7
Dividends	-	-	-	-	-	(34.5)	(34.5)	-	(34.5)
At 31 March 2018	**5.7**	**40.8**	**147.6**	**(1.8)**	**(0.4)**	**552.2**	**744.1**	**0.2**	**744.3**

Consolidated balance sheet as at 31 March

All figures in £ million	Note	2019	2018
Non-current assets			
Goodwill	13	148.6	101.5
Intangible assets		88.5	41.1
Property, plant and equipment		298.0	269.0
Other financial assets		0.9	0.3
Equity accounted investments		4.5	2.2
Retirement benefit surplus	14	259.1	316.2
Deferred tax asset		7.8	6.4
		807.4	**736.7**
Current assets			
Inventories		40.1	38.1
Other financial assets		0.5	16.9
Trade and other receivables		208.5	150.3
Investment		-	0.7
Current tax receivable		1.5	-
Assets held for sale		1.9	1.2
Cash and cash equivalents		190.8	254.1
		443.3	**461.3**
Total assets		**1,250.7**	**1,198.0**
Current liabilities			
Trade and other payables		(346.6)	(334.9)
Current tax payable		(8.5)	(8.9)
Provisions		(6.2)	(6.0)
Other financial liabilities		(1.8)	(2.6)
		(363.1)	**(352.4)**
Non-current liabilities			
Deferred tax liability		(73.1)	(66.4)
Provisions		(10.7)	(14.3)
Other financial liabilities		(1.9)	(1.9)
Other payables		(20.9)	(18.7)
		(106.6)	**(101.3)**
Total liabilities		**(469.7)**	**(453.7)**
Net assets		**781.0**	**744.3**
Capital and reserves			
Ordinary shares		5.7	5.7
Capital redemption reserve		40.8	40.8
Share premium account		147.6	147.6
Hedging reserve		(0.2)	(1.8)
Translation reserve		3.8	(0.4)
Retained earnings		581.1	552.2
Capital and reserves attributable to shareholders of the parent company		**778.8**	**744.1**
Non-controlling interest		2.2	0.2
Total shareholders' funds		**781.0**	**744.3**

Consolidated cash flow statement for year ended 31 March

All figures in £ million	Note	2019	2018
Underlying net cash inflow from operations	9	**126.3**	**126.5**
(Less)/add back specific adjusting items	9	(0.7)	5.9
Net cash inflow from operations	9	125.6	132.4
Tax paid		(10.7)	(15.7)
Interest received		1.3	0.7
Interest paid		(0.7)	(0.7)
Net cash inflow from operating activities		**115.5**	**116.7**
Purchases of intangible assets		(10.6)	(8.5)
Purchases of property, plant and equipment		(77.0)	(46.0)
Proceeds from disposals of plant and equipment		6.9	-
Proceeds from sale of property		5.3	23.1
Proceeds from sale of investments		1.5	-
Acquisition of businesses		(61.2)	(1.1)
Investment in joint venture		(1.6)	(0.5)
Proceeds from disposal of available-for-sale investments		15.7	-
Investments in available-for-sale investments		-	(5.0)
Net cash outflow from investing activities		**(121.0)**	**(38.0)**
Purchase of own shares		(0.7)	(0.7)
Dividends paid to shareholders		(35.7)	(34.5)
Repayment of external bank loan		(20.0)	-
Payment of bank facility arrangement fees		(1.5)	-
Capital element of finance lease payments		(0.4)	-
Net cash outflow from financing activities		**(58.3)**	**(35.2)**
(Decrease)/increase in cash and cash equivalents		**(63.8)**	**43.5**
Effect of foreign exchange changes on cash and cash equivalents		0.5	(1.2)
Cash and cash equivalents at beginning of year		254.1	211.8
Cash and cash equivalents at end of year		**190.8**	**254.1**

Reconciliation of movement in net cash for the year ended 31 March

All figures in £ million	Note	2019	2018
(Decrease)/increase in cash and cash equivalents in the year		**(63.8)**	43.5
Add back net outflows not impacting net cash		6.2	5.0
Change in net cash resulting from cash flows		(57.6)	48.5
Finance lease and debt recognised on acquisition		(22.7)	-
Other movements including foreign exchange		2.0	(3.6)
(Decrease)/increase in net cash as defined by the Group		(78.3)	44.9
Net cash as defined by the Group at beginning of the year		266.8	221.9
Net cash as defined by the Group at end of the year	10	**188.5**	**266.8**
Less: other financial asset and liabilities	10	2.3	(12.7)
Total cash and cash equivalents	10	**190.8**	**254.1**

Notes to the financial statements

1. Significant accounting policies

Basis of preparation

QinetiQ Group plc is a public limited company, which is listed on the London Stock Exchange and is incorporated and domiciled in the United Kingdom.

The financial information included within the preliminary announcement has been prepared using accounting policies consistent with International Financial Reporting Standards (IFRSs) as endorsed by the European Union. The accounting policies followed are the same, subject to the changes noted below, as those published by the Group within its Annual Report for the year ended 31 March 2018 which is available on the Group's website, www.QinetiQ.com.

The preliminary announcement was approved by the Board of Directors on 23 May 2019. The financial information in this preliminary announcement does not constitute the statutory accounts of QinetiQ Group plc ('the Company') within the meaning of section 435 of the Act.

The statutory accounts for 2019 were approved by the Board of Directors on 23 May 2019 and will be delivered to the Registrar of Companies following the Company's Annual General Meeting on 24 July 2019. The financial information for 2018 is derived from the statutory accounts for 2018 which have been delivered to the Registrar of Companies. The auditors have reported on the 2019 and 2018 accounts. The reports were (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

In the income statement, the Group presents specific adjusting items separately. In the judgement of the Directors, for the reader to obtain a proper understanding of the financial information, specific adjusting items need to be disclosed separately because of their size and nature. Underlying measures of performance exclude specific adjusting items. Specific adjusting items include:

Item	Distorting due to irregular nature year on year	Distorting due to fluctuating nature (size and sign)	Does not reflect in-year operational performance of continuing business
Amortisation of intangible assets arising from acquisitions			✓
Pension net finance income and pension past service cost		✓	✓
Gains/losses on disposal of property, investments and intellectual property	✓	✓	✓
Transaction & integration costs in respect of business acquisitions	✓		✓
Impairment of property	✓		
The tax impact of the above	✓	✓	✓
Other significant non-recurring tax movements	✓	✓	✓

All items treated as a specific adjusting item in the current and prior year are detailed in note 3.

Recent accounting developments adopted by the Group

The following IFRS and EU-endorsed standards and amendments have become applicable and have been adopted for the first time in the current reporting period by the Group. The Group updated its accounting policies where applicable.

IFRS 15 Revenue from Contracts with Customers

The Group adopted IFRS 15 using the cumulative effect transitional method without using the practical expedients for modified contracts in IFRS 15.C5(c). This method would require an adjustment to the opening balance of equity in the period of adoption without having to restate comparative amounts. However, following the conclusion that the impact is not material, no adjustment has been required for the Group on implementation of IFRS 15 during the current reporting period.

We have not identified any contracts in total, or part contracts (in the form of performance obligations), where we would need to move from recognising revenue over time to recognising revenue at a point in time. The majority of QinetiQ's contracts are largely either long-term service contracts where the customer benefits from QinetiQ's performance throughout the contract, or they are long-term design, build and delivery contracts which are highly bespoke and have no alternative use to QinetiQ (and QinetiQ have a right to payment for work performed to date). Therefore, it remains appropriate to recognise revenue over time using an input-based methodology (cost-to-cost). Where IFRS 15 has required the disaggregation of contracts into distinct performance obligations, this does not materially alter the revenue recognised compared to the long-term percentage completion methodology previously applied.

IFRS 15 requires the recognition of an asset in respect of incremental costs of obtaining a contract with a customer where it is expected these costs will be recovered. We have determined that this has minimal impact to the Group, as even though many of our contracts are single-sourced, we do not typically incur qualifying incremental costs (including third party expenses) in securing those contracts that would be considered recoverable.

Following the adoption of IFRS 15 the Group has updated its accounting policies and note disclosures to reflect new terminology and components of the standard. The Group has disclosed the disaggregation of revenue from contracts with customers in note 2. All other accounting policy changes will be included in the Annual Report for the year ending 31 March 2019. The Group continues to view revenue and profit recognition as one of its critical accounting policies due to the skill, knowledge and experience required from a variety of sources within the business to assess the status of a contract. Judgement is required when considering the likelihood of meeting the contractual requirements, particularly around technologically challenging contracts, and the resulting costs.

IFRS 9 Financial Instruments
IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities, and introduces a new impairment model for financial assets, as well as new rules for hedge accounting. The new standard replaces IAS 39 in its entirety and is effective for annual periods beginning on or after 1 January 2018. The Group adopted IFRS 9 in the current reporting period without restating comparative period figures. All components of the standard, including new rules for hedge accounting and impairment, are applied prospectively.

Following the adoption of IFRS 9 the Group has updated its accounting policies to reflect new financial asset classification, measurement and recognition criteria. The Group assessed that certain financial assets will be reclassified from being measured at fair value through other comprehensive income to fair value through profit and loss and presented within finance income or expense. The changes to impairment and hedge accounting have not had a material impact on the results of the Group and these accounting policies have also been updated.

The adoption of IFRS 9 from 1 April 2018 for the Group resulted in changes in certain accounting policies, however no adjustments to comparative periods were required.

The Group has various classes of financial assets and liabilities which must be appropriately classified into the IFRS 9 classification categories from 1 April 2018. Available for sale investments previously classified as fair value through other comprehensive income under IAS 39 no longer meet the criteria to be classified as such and have been classified as fair value through profit and loss under IFRS 9. Previously recognised gains in other comprehensive income have been reclassified to retained earnings on initial application being 1 April 2018.

Derivative financial instruments designated as cash flow hedges under IAS 39 in the prior period shall continue to be classified as such and continue to qualify for hedge accounting under IFRS 9.

Trade and other receivables previously classified as ‘loans and receivables’ and measured at amortised cost under IAS 39 are now classified as ‘financial assets at fair value through profit and loss’ and measured at amortised costs under IFRS 9. Loans and receivables no longer exist as a classification category under IFRS 9.

Trade and other payables previously classified and measured at amortised cost under IAS 39 shall continue to be classified and measured at amortised costs under IFRS 9.

The Group’s trade receivables are subject to the new expected credit loss model under IFRS 9. In determining the recoverability of trade receivables, the Group considers any change in the credit quality of each trade receivable from the date credit was granted to the reporting date using forward looking information. The Group assessed credit risk to be limited as a result of the high percentage of revenue derived from UK and US government agencies. For non-government customers the Group considers the expected credit loss to be immaterial to the financial statements.

The new hedge accounting rules under IFRS 9 have not had a material impact on the Group’s financial statements.

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

IFRS 16 Leases
IFRS 16 is effective 1 January 2019, replacing IAS 17 in its entirety. The Group will not early adopt the standard in the current reporting period. Under IFRS 16 the Group will recognise a right-of-use asset and a lease liability for future lease payments, bringing added transparency to the balance sheet. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Within the income statement, depreciation on the right-of-use asset and interest expense on the lease liability will replace lease expense. The Group expects to recognise a right-of-use asset of £23.8m (1 April 2019) and £16.7m (31 March 2020) and lease liabilities of £26.6m (1 April 2019) and £19.3m (31 March 2020) based on the current lease portfolio.

Going concern basis

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

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

2. Disaggregation of revenue and segmental analysis

Revenue by category and other income

for the year ended 31 March

All figures in £ million	**2019**	2018
Service contracts with customers	790.9	733.4
Sale of goods contracts with customers	105.6	85.8
Royalties and licences	14.6	13.8
Total revenue	**911.1**	**833.0**
Less: acquired businesses^	(15.1)	-
Adjust to constant prior year exchange rates	1.4	-
Total revenue on an organic, constant currency basis	**897.4**	**833.0**
Organic revenue growth at constant currency	*8%*	*3%*

^ For the period of which there was no contribution in the equivalent period in the prior year which was pre-ownership by the Group

Other income	**2019**	2018
Share of joint ventures' and associates' profit after tax	0.6	0.3
Other income	10.0	9.4
Other income – underlying	**10.6**	**9.7**
Specific adjusting item: gain on sale of assets	0.2	21.1
Total other income	**10.8**	**30.8**

Revenue by customer geographical location

for the year ended 31 March

All figures in £ million	**2019**	2018
US	105.3	81.6
Australia	55.2	54.8
Europe	60.8	43.2
Middle East	11.0	13.9
Rest of World	41.4	32.5
International	**273.7**	**226.0**
United Kingdom	637.4	607.0
Total revenue	**911.1**	**833.0**

Reconciliation of international revenue to organic international revenue including share of joint ventures
for the year ended 31 March

All figures in £ million	**2019**	2018
International revenue	**273.7**	**226.0**
Less: international revenue from businesses acquired in current financial year	(9.8)	-
Add: incremental share of revenue from joint ventures	1.9	-
Organic international revenue including share of joint ventures	**265.8**	**226.0**

The year on year organic growth in international revenue including share of joint ventures was £39.8m. This metric is used for management remuneration purposes under the Deferred Share Plan remuneration scheme.

Revenue by major customer type

for the year ended 31 March

All figures in £ million	**2019**	2018
UK Government	562.7	544.2
US Government	83.1	65.5
Other	265.3	223.3
Total revenue	**911.1**	**833.0**

'Other' does not contain any customers with revenue in excess of 10% of total Group revenue.

Operating segments

for the year ended 31 March

All figures in £ million		**2019**		2018
	Revenue from external customers	**Underlying operating profit***	Revenue from external customers	Underlying operating profit*
EMEA Services	687.7	96.3	651.4	94.3
Global Products	223.4	27.6	181.6	28.2
Total operating segments	**911.1**	**123.9**	**833.0**	**122.5**
*Underlying operating margin**		*13.6%*		*14.7%*

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

Reconciliation of segmental results to total profit

for the year ended 31 March

All figures in £ million	Note	**2019**	2018
Underlying operating profit		123.9	122.5
Specific adjusting items (loss)/profit	3	(10.1)	18.5
Operating profit		**113.8**	**141.0**
Gain on sale of investment		1.1	-
Net finance income		8.3	3.8
Profit before tax		**123.2**	**144.8**
Taxation expense		(9.3)	(6.7)
Profit for the year attributable to equity shareholders		**113.9**	**138.1**

3. Specific adjusting items

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

All figures in £ million	Note	**2019**	2018
Gain on sale of property		0.2	14.6
Gain on sale of investment		-	0.6
Gain on sale of intellectual property		-	5.9
Pension past service costs in respect of GMP equalisation		(0.7)	-
Acquisition transaction costs		(1.3)	-
Acquisition integration costs		(0.7)	-
Specific adjusting items before interest, tax, depreciation and amortisation		**(2.5)**	**21.1**
Impairment of property		(3.7)	-
Amortisation of intangible assets arising from acquisitions		(3.9)	(2.6)
Specific adjusting items operating (loss)/profit		**(10.1)**	**18.5**
Gain on sale of investment		1.1	-
Defined benefit pension scheme net finance income		8.2	4.2
Specific adjusting items (loss)/profit before tax		**(0.8)**	**22.7**
Specific adjusting items - tax	7	3.2	6.4
Total specific adjusting items profit after tax		**2.4**	**29.1**

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

all figures in £ million	2019	2018
Underlying profit after tax - total Group	111.5	109.0
Total specific adjusting items profit after tax	2.4	29.1
Total profit for the year attributable to equity shareholders	**113.9**	**138.1**

4. Profit before tax

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

All figures in £ million	2019	2018
Cost of inventories expensed	28.5	25.4
Owned assets: depreciation	29.0	25.6
Leases assets: depreciation	0.4	-
Foreign exchange loss	0.5	-
Research and development expenditure - customer funded contracts	272.9	284.3
Research and development expenditure - Group funded	26.0	25.8

5. Business combinations

Acquisitions in the year to 31 March 2019

all figures in £ million

					Contribution post-acquisition	
Company acquired	**Date acquired**	**Cash consideration**	**Goodwill**	**Fair value of net assets acquired**	**Revenue**	**Operating profit**
E.I.S Aircraft Operations	16 October 2018	46.8	(33.3)	13.5	9.8	1.1
Inzpire Group Limited	19 November 2018	22.9	(11.7)	13.2	5.3	0.2
Total current year acquisitions		**69.7**	**(45.0)**	**26.7**	**15.1**	**1.3**
Deferred consideration in respect of prior year acquisitions[1]		0.1				
Less: cash acquired		(9.9)				
Plus: transaction costs[2]		1.3				
Net cash outflow in the year		**61.2**				

[1] Deferred consideration has been paid in respect of the prior year acquisition of Rubikon Group Pty Limited.
[2] Transaction costs have been included in 'Operating costs excluding depreciation and amortisation' as a specific adjusting item.

E.I.S Aircraft Operations (EIS), now QinetiQ Germany

QinetiQ acquired 100% of the share capital of E.I.S. Holding GmbH in October 2018 for €52.6m (£46.8m). EIS had €22.5m (£20.0m) of bank funding as at acquisition and this loan was paid off by the Group post acquisition. EIS is a leading provider of airborne training services based in Germany, delivering threat-representation and operational readiness for military customer. EIS has natural synergies with QinetiQ's existing air engineering, test aircrew training and unmanned target service capabilities which we will exploit to strengthen our position in defence operational training. EIS will continue to be led by its existing management team and will form part of QinetiQ's International business unit and will be reported within QinetiQ's EMEA Services division. If the acquisition had occurred on the first day of the financial year, Group revenue for the year would have been £925.2m and the Group profit before tax would have been £125.9m.

Identifiable assets acquired and liabilities assumed

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

all figures in £ million	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets	-	37.3	37.3
Property, plant and equipment	4.8	-	4.8
Inventory	0.4	-	0.4
Trade and other receivables	9.2	-	9.2
Cash and cash equivalents	6.4	-	6.4
Trade and other payables	(6.7)	-	(6.7)
Finance lease liabilities	(2.7)	-	(2.7)
Corporation tax	(2.5)	-	(2.5)
Bank loan	(20.0)	-	(20.0)
Deferred tax liability	(0.8)	(11.9)	(12.7)
Net assets acquired	**(11.9)**	**25.4**	**13.5**
Goodwill			33.3
Consideration			**46.8**

The consideration of £46.8m was satisfied entirely in cash in the financial year, with no deferred consideration.

The fair value adjustments include £37.3m in relation to the recognition of acquired intangible assets of which £31.8m relates to customer relationships and £5.5m relates to existing technology. The goodwill is attributable mainly to the skills and technical talent of the EIS work force and the synergies expected to be achieved from integrating the company into the Group's existing business.

Inzpire Group Limited (Inzpire)

In November 2018 QinetiQ acquired 85% of the shares of Inzpire Group Limited for £22.9m with an arrangement to acquire the remaining 15% after two years. Inzpire is a highly regarded provider of training services to the Royal Air Force and British Army and this strategic investment further enhances our capability in defence operational training. With a leading position within the UK, the investment allows us to further leverage the capability in attractive markets internationally, complementing our acquisitions of QTS and EIS and supporting our strategic objectives. If the acquisition had occurred on the first day of the financial year, Group revenue for the period would have been £921.4m and the Group profit before tax would have been £124.8m.

Following completion, Inzpire will continue to be led by its existing management team. It is aligned to QinetiQ's CIT business unit and is reported within QinetiQ's EMEA Services division.

Identifiable assets acquired and liabilities assumed

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

all figures in £ million	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets	-	9.6	9.6
Property, plant and equipment	0.4	-	0.4
Inventory	0.1	-	0.1
Trade and other receivables	3.3	-	3.3
Cash and cash equivalents	3.5	-	3.5
Trade and other payables	(2.0)	-	(2.0)
Deferred tax liability	-	(1.7)	(1.7)
Net assets acquired	**5.3**	**7.9**	**13.2**
Non-controlling interest			(2.0)
Goodwill			11.7
Consideration			**22.9**

The consideration of £22.9m was satisfied entirely in cash in the financial year, with no deferred consideration.

The fair value adjustments include £9.6m in relation to the recognition of acquired intangible assets (£4.6m customer relationships and £5.0m other intangibles) less the recognition of deferred tax liability of £1.7m in relation to these intangible assets. The goodwill is attributable mainly to the skills and technical talent of Inzpire's work force and the synergies expected to be achieved from integrating the company into the Group's existing business.

6. Finance income and expense

All figures in £ million	2019	2018
Receivable on bank deposits	1.2	0.7
Finance income before specific adjusting items	**1.2**	**0.7**
Amortisation of deferred financing costs	(0.3)	(0.3)
Payable on commitment fees	(0.6)	(0.7)
Finance lease expense	(0.1)	-
Unwinding of discount on financial liabilities	(0.1)	(0.1)
Finance expense before specific adjusting items	**(1.1)**	**(1.1)**
Specific adjusting items:		
Defined benefit pension scheme net finance income	8.2	4.2
Net finance income	**8.3**	**3.8**

7. Taxation

All figures in £ million	2019			2018		
	Underlying	**Specific adjusting items**	**Total**	Underlying	Specific adjusting items	Total
Profit/(loss) before tax	**124.0**	**(0.8)**	**123.2**	**122.1**	**22.7**	**144.8**
Taxation (expense)/income	(12.5)	3.2	(9.3)	(13.1)	6.4	(6.7)
Profit for the year attributable to equity shareholders	**111.5**	**2.4**	**113.9**	**109.0**	**29.1**	**138.1**
Effective tax rate	10.1%			10.7%		

The total tax charge was £9.3m (2018: £6.7m). The underlying tax charge was £12.5m (2018: £13.1m) with an underlying effective tax rate of 10.1% for the year ending 31 March 2019 (2018: 10.7%). The effective tax rate continues to be below the UK statutory rate, primarily as a result of the benefit of research and development expenditure credits ('RDEC') in the UK which are accounted under IAS12 within the tax line. The adjusted effective tax rate before the impact of RDEC would be 15.0%. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to any tax legislation changes, the geographic mix of profits, the recognition of unrecognised tax losses and while the benefit of net RDEC retained by the Group remains in the tax line.

Tax losses and specific adjusting items
A £2.8m credit in respect of initial recognition of corporate tax deductions for certain equity-settled share based payment schemes has been classified as a specific adjusting item. Together with a £0.4m tax effect of the pre-tax specific adjusting items, the total specific adjusting items tax credit was £3.2m (2018: £6.4m).

At 31 March 2019 the Group had unused tax losses and surplus interest costs of £114.9m which are available for offset against future taxable profits. A deferred tax asset of £4.9m is recognised in respect of £21.1m of US net operating losses. No deferred tax asset is recognised in respect of the remaining £93.8m of losses/interest costs due to uncertainty over the timing and extent of their utilisation. The Group has £60.0m of time-limited losses of which US capital losses of £28.2m will expire in 2020 and US net operating losses of £21.2m will expire in 2035, £9.1m in 2036 and £1.5m in 2038. Deferred tax has been calculated using the enacted future statutory tax rates.

Factors affecting future tax charges
The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to the impact of any tax legislation changes, the geographic mix of profits and the assumption that the benefits of net R&D expenditure credits retained by the Group remain in the tax line. Future recognition of unrecognised tax losses will also affect future tax charges.

8. Earnings per share

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

for the year ended 31 March		**2019**	2018
Weighted average number of shares	**Million**	**566.0**	**565.2**
Effect of dilutive securities	Million	4.0	2.0
Diluted number of shares	**Million**	**570.0**	**567.2**

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

Underlying EPS

for the year ended 31 March		**2019**	2018
Profit attributable to equity shareholders	£ million	113.9	138.1
Remove profit after tax in respect of specific adjusting items	£ million	(2.4)	(29.1)
Underlying profit after taxation	**£ million**	**111.5**	**109.0**
Weighted average number of shares	Million	566.0	565.2
Underlying basic EPS	**Pence**	**19.7**	**19.3**
Diluted number of shares	Million	570.0	567.2
Underlying diluted EPS	**Pence**	**19.6**	**19.2**

Basic and diluted EPS

for the year ended 31 March		**2019**	2018
Profit attributable to equity shareholders	£ million	113.9	138.1
Weighted average number of shares	Million	566.0	565.2
Basic EPS – total Group	**Pence**	**20.1**	**24.4**
Diluted number of shares	Million	570.0	567.2
Diluted EPS – total Group	**Pence**	**20.0**	**24.3**

9. Cash flows from operations

All figures in £ million	2019	2018
Profit after tax for the year	113.9	138.1
Adjustments for:		
Taxation expense	9.3	6.7
Net finance income	(8.3)	(3.8)
Gain on sale of investment	(1.1)	(0.6)
Gain on sale of property	(0.2)	(14.6)
Impairment of property, plant and equipment	6.4	-
Acquisition transaction costs	1.3	-
Pension past service cost	0.7	-
Amortisation of purchased or internally developed intangible assets	3.2	3.7
Amortisation of intangible assets arising from acquisitions	3.9	2.6
Depreciation of property, plant and equipment	29.4	25.6
(Profit)/loss on disposal of plant and equipment	(5.5)	2.9
Share of post-tax profit of equity accounted entities	(0.6)	(0.3)
Share-based payments charge	6.1	2.4
Retirement benefit contributions in excess of income statement expense	(1.8)	(12.4)
Net movement in provisions	(3.6)	(3.7)
Increase in inventories	(0.5)	(10.8)
(Increase)/decrease in receivables	(48.7)	19.0
Increase/(decrease) in payables	21.7	(22.4)
Changes in working capital	(27.5)	(14.2)
Net cash flow from operations	**125.6**	**132.4**

Reconciliation of net cash flow from operations to underlying net cash flow from operations and to free cash flow

All figures in £ million	2019	2018
Net cash flow from operations	125.6	132.4
Add back specific adjusting item: acquisition integration costs	0.7	-
Add back specific adjusting item: proceeds from sale of intellectual property	-	(5.9)
Underlying net cash flow from operations	**126.3**	**126.5**
Add: proceeds from disposal of plant and equipment	6.9	-
Less: tax and net interest payments	(10.1)	(15.7)
Less: purchases of intangible assets and property, plant & equipment	(87.6)	(54.5)
Free cash flow	**35.5**	**56.3**

Underlying cash conversion ratio

	2019	2018
Underlying operating profit - £ million	123.9	122.5
Underlying net cash flow from operations - £ million	126.3	126.5
Underlying cash conversion ratio - %	**102%**	**103%**

10. Net cash

All figures in £ million	2019	2018
Current financial assets/(liabilities)		
Available-for-sale investment	-	15.7
Deferred financing costs	0.4	0.1
Derivative financial assets	0.1	1.1
Finance leases	(0.7)	-
Derivative financial liabilities	(1.1)	(2.6)
Total current net financial (liabilities)/assets	(1.3)	14.3
Non-current financial assets/(liabilities)		
Deferred financing costs	0.9	-
Derivative financial assets	-	0.3
Finance leases	(1.6)	-
Derivative financial liabilities	(0.3)	(1.9)
Total non-current net financial liabilities	(1.0)	(1.6)
Total net financial (liabilities)/assets	**(2.3)**	**12.7**
Cash and cash equivalents	190.8	254.1
Total net cash as defined by the Group	**188.5**	**266.8**

11. Financial risk management

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1 – measured using quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – measured using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). Level 2 derivatives comprise forward foreign exchange contracts which have been fair valued using forward exchange rates that are quoted in an active market; and

Level 3 – measured using inputs for the assets or liability that are not based on observable market data (i.e. unobservable inputs).

The Group’s assets and liabilities that are measured at fair value, as at 31 March 2019, are as follows:

All figures in £ million	Level 1	Level 2	Level 3	Total
Assets:				
Current derivative financial instruments	-	0.1	-	0.1
Non-current derivative financial instruments	-	-	-	-
Liabilities:				
Current derivative financial instruments	-	(1.1)	-	(1.1)
Non-current derivative financial instruments	-	(0.3)	-	(0.3)
Total	**-**	**(1.3)**	**-**	**(1.3)**

The following table presents the Group's assets and liabilities that are measured at fair value at 31 March 2018:

All figures in £ million	Level 1	Level 2	Level 3	Total
Assets:				
Available-for-sale investments	15.7	-	-	15.7
Current other investments	0.7	-	-	0.7
Non-current other investments	-	1.1	-	1.1
Non-current derivative financial instruments	-	0.3	-	0.3
Liabilities:				
Current derivative financial instruments	-	(2.6)	-	(2.6)
Non-current derivative financial instruments	-	(1.9)	-	(1.9)
Total	16.4	(3.1)	-	13.3

For cash and cash equivalents, trade and other receivables and bank and current borrowings, the fair value of the financial instruments approximate to their carrying value as a result of the short maturity periods of these financial instruments. For trade and other receivables, allowances are made within the carrying value for credit risk. For other financial instruments, the fair value is based on market value, where available. Where market values are not available, the fair values have been calculated by discounting cash flows to net present value using prevailing market-based interest rates translated at the year-end rates, except for unlisted fixed asset investments where fair value equals carrying value. There have been no transfers between levels.

12. Dividends

An analysis of the dividends paid and proposed in respect of the years ended 31 March 2019 and 31 March 2018 is provided below:

	Pence per ordinary share	**£m**	**Date paid/payable**
Interim 2019	2.1	11.9	Feb 2019
Final 2019 (proposed)	4.5	25.5	Aug 2019
Total for the year ended 31 March 2019	**6.6**	**37.4**	
Interim 2018	2.1	11.9	Feb 2018
Final 2018	4.2	23.8	Aug 2018
Total for the year ended 31 March 2018	6.3	35.7	

The Directors propose a final dividend of 4.5p (2018: 4.2p). The dividend, subject to shareholder approval, will be paid on 30 August 2019. The ex-dividend date is 1 August 2019 and the record date is 2 August 2019.

13. Goodwill

All figures in £ million	**2019**	2018
Cost		
At 1 April	203.0	220.4
Acquisitions	45.0	-
Foreign exchange	9.4	(17.4)
At 31 March	**257.4**	**203.0**
Impairment		
At 1 April	(101.5)	(112.6)
Foreign exchange	(7.3)	11.1
At 31 March	**(108.8)**	**(101.5)**
Net book value at 31 March	**148.6**	**101.5**

The goodwill acquired of £45.0m arises from the acquisitions of E.I.S Aircraft Operations (now QinetiQ GmbH) and Inzpire Group Limited in the year, generating goodwill of £33.3m and £11.7m respectively. Foreign exchange movements in respect of the E.I.S goodwill post acquisition result in the E.I.S closing goodwill as at 31 March 2019 decreasing to £32.2m (as per the following table).

Cash-generating units (CGU)

Goodwill is allocated across four cash generating units ('CGUs') within the EMEA Services segment and five CGUs within the Global Products segment. The full list of CGUs that have goodwill allocated to them is as follows:

All figures in £ million	Primary reporting segment	2019
QinetiQ North America ('QNA')	Global Products	41.9
Target Systems	Global Products	24.3
Boldon James	Global Products	10.7
Commerce Decisions	Global Products	6.4
Space Products	Global Products	5.7
QinetiQ Germany (acquired in year, see note 5)	EMEA services	32.2
Inzpire (acquired in year, see note 5)	EMEA services	11.7
Advisory Services	EMEA services	9.8
Australia	EMEA Services	5.9
Net book value at 31 March		**148.6**

Goodwill is attributable to the excess of consideration over the fair value of net assets acquired and includes expected synergies, future growth prospects and employee knowledge, expertise and security clearances. The Group tests each CGU for impairment annually, or more frequently if there are indications that goodwill might be impaired. Impairment testing is dependent on management's estimates and judgments, particularly as they relate to the forecasting of future cash flows, the discount rates selected and expected long-term growth rates. Significant headroom exists in all CGUs and management considers that there are no likely variations in the key assumptions which would lead to an impairment being recognised.

Key assumptions
Cash flows

The value in use calculations generally use discounted future cash flows based on financial plans approved by the Board covering a three-year period. Cash flows for periods beyond these periods are extrapolated based on the last year of the plans, with a terminal growth-rate assumption applied.

Terminal growth rates
The specific plans for each of the CGUs have been extrapolated using a terminal growth rate of 1.0%-2.4% (2018: 1.0%-2.5%). The US terminal growth rate was 1.9% (2018: 1.7%). Growth rates are based on management's estimates which take into consideration the long-term nature of the industry in which the CGUs operate and external forecasts as to the likely growth of the industry in the longer term.

Discount rates
The Group's weighted average cost of capital was used as a basis in determining the discount rate to be applied, adjusted for risks specific to the market characteristics of CGUs, as appropriate on a pre-tax basis. This is considered an appropriate estimate of a market participant discount rate. The pre-tax discount rates applied to the cash flows of the QNA CGU and to the Target Systems CGU were 14.6% and 11.3% respectively. Discount rates ranging from 11.2% to 12.0% were applied to the cash flows of the other, less significant, CGUs.

Sensitivity analysis shows that the value of the terminal year cash flow, the discount rate and the terminal growth rates have a significant impact on the value of the discounted cash flow.

Significant CGUs
QinetiQ North America ('QNA')
The carrying value of the goodwill for QNA CGU, was £41.9m as at 31 March 2019 (2018: £38.8m). The recoverable amount of this CGU as at 31 March 2019, based on value in use and calculated using the assumptions noted above, is higher than the carrying value of net operating assets (of £52.4m). The key sensitivity impacting on the value in use calculations is the terminal year cash flows. These cash flows include certain assumptions about revenue and profit in respect of new product lines still to be launched and the success of winning certain government contracts. An increase in the discount rate by 1%, a decrease in the terminal growth rate by 1% or a decrease in the terminal year cash flows of £2.0m would not cause the net operating assets to exceed their recoverable amount.

Target Systems
The recoverable amount of this CGU as at 31 March 2019, based on value in use and calculated using the assumptions noted above, is higher than the carrying value of net operating assets (of £29.4m). The key sensitivity impacting on the value in use calculations is the terminal year cash flows. An increase in the discount rate by 1%, a decrease in the terminal growth rate by 1% or a decrease in the terminal year cash flows of £2.0m would not cause the net operating assets to exceed their recoverable amount.

14. Post-retirement benefits

In the UK the Group operates a defined benefit pension scheme ('the Scheme'). The Scheme is closed to future accrual and there is no on-going service cost. Prior to the year end the Scheme completed its first bulk annuity insurance buy-in for approximately £700m. This transaction has removed longevity risk, interest rate risk and inflation risk for approximately one third of the Scheme and is in line with the Group's strategy of de-risking the pension liabilities. As a result of the transaction, the accounting pension surplus recorded on the Group's balance sheet reduced by an estimated £120m with no related cash impact.

Set out below is a summary of the financial position of the Scheme. The fair value of the Scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the Scheme's liabilities, which are derived from cash flow projections over long periods, and thus inherently uncertain, are as follows:

All figures in £ million	**2019**	2018
Equities – quoted	127.0	115.8
Equities – unquoted	51.8	58.9
Liability Driven Investment	690.8	1,050.9
Corporate bonds	96.0	311.3
Alternative bonds	304.4	232.9
Property fund	145.6	138.7
Cash and cash equivalents	75.1	80.2
Insurance buy-in policy	566.4	-
Outstanding payment due in respect of buy-in	(96.0)	-
Derivatives	2.5	1.8
Total market value of scheme assets	**1,963.6**	**1,990.5**
Present value of scheme liabilities	(1,704.5)	(1,674.3)
Net pension asset before deferred tax	**259.1**	**316.2**
Deferred tax liability	(48.6)	(58.6)
Net pension asset after deferred tax	**210.5**	**257.6**

Per the Scheme rules, the Company has an unconditional right to a refund of any surplus that may arise on cessation of the Scheme in the context of IFRIC 14 paragraphs 11(b) and 12 and therefore the full net pension asset can be recognised on the Group's balance sheet and the Group's minimum funding commitments to the Scheme do not give rise to an additional balance sheet liability.

Changes to the net pension asset

All figures in £ million	**2019**	2018
Opening net pension asset	316.2	156.0
Net finance income	8.2	4.2
Net actuarial (loss)/gain	(66.4)	143.6
Administration expenses	(0.9)	(1.0)
Past service cost	(0.7)	-
Contributions by the employer	2.7	13.4
Closing net pension asset	**259.1**	**316.2**

Assumptions

The major assumptions used in the IAS 19 valuation of the Scheme

	2019	2018
Discount rate applied to Scheme liabilities	2.45%	2.60%
CPI inflation assumption	2.35%	2.25%
Assumed life expectancies in years:		
Future male pensioners (currently aged 60)	87	88
Future female pensioners (currently aged 60)	89	90
Future male pensioners (currently aged 40)	89	90
Future female pensioners (currently aged 40)	91	92

The sensitivity of the gross Scheme liabilities to each of the key assumptions is shown in the following table:

Key assumptions	Change in assumption	Indicative impact on gross Scheme liabilities before deferred tax	Indicative impact on net pension asset
Discount rate	Increase by 0.1%	Decrease by £31m	Decrease by £15m
Rate of inflation	Increase by 0.1%	Increase by £30m	Increase by £13m
Life expectancy	Increase by one year	Increase by £59m	Decrease by £39m

The impact of movements in Scheme liabilities will, to an extent, be offset by movements in the value of Scheme assets as the Scheme has assets invested in a Liability Driven Investment portfolio. As at 31 March 2019 this hedges against approximately 93% of the interest rate and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis.

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method (projected unit credit method) has been applied as when calculating the pension liability recognised within the statement of financial position. The methods and types of assumption did not change.

The accounting assumptions noted above are used to calculate the period end net pension asset in accordance with the relevant accounting standard, IAS 19 (revised) 'Employee benefits'. Changes in these assumptions have no impact on the Group's cash payments into the scheme. The payments into the scheme are reassessed after every triennial valuation. The latest triennial valuation of the Scheme was a net surplus of £139.7m as at 30 June 2017. The next triennial valuation will be performed as at 30 June 2020. The currently agreed recovery plan requires £2.7m per annum distributions to the Scheme until 25 March 2032, indexed by reference to CPI. Such distributions are from the Group's Pension Funding Partnership.

The triennial valuations are calculated on a 'funding basis' and use a different set of assumptions, as agreed with the pension Trustees. The key assumption that varies between the two methods of valuation is the discount rate. The funding basis valuation uses the risk-free rate from UK gilts as the base for calculating the discount rate, whilst the IAS 19 accounting basis valuation uses corporate bond yields as the base.

During the reporting period the High Court ruled on a case involving Lloyds Banking Group in respect of equalising (between men and woman) Guaranteed Minimum Pensions ('GMPs'). QinetiQ's pension scheme has not been significantly impacted by this court ruling but an increase in liabilities of £0.7m has been recognised in the period, through a past service charge to operating profit. This is reported as a 'significant adjusting item' in the income statement in accordance with historical Group policy.

15. Own shares and share-based awards

Own shares represent shares in the Company that are held by independent trusts and include treasury shares and shares held by the employee share ownership plan. Included in retained earnings at 31 March 2019 are 6,946,678 shares (2018: 7,934,634 shares). In the year ended 31 March 2019 the Group granted/awarded 4.0m new share-based awards to employees (2018: 3.7m).

16. Contingent liabilities and assets

Subsidiary undertakings within the Group have given unsecured guarantees of £29.9m at 31 March 2019 (2018: £30.1m) in the ordinary course of business.

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

17. Related party transactions with equity accounted investments

During the year there were sales to associates and joint ventures of £10.1m (2018: £10.4m). At the year end there were outstanding receivables from associates and joint ventures of £1.4m (2018: £4.5m).

18. Capital commitments

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

All figures in £ million	**2019**	2018
Contracted	40.6	76.2

Capital commitments at 31 March 2019 include £20.6m (2018: £74.3m) in relation to property, plant and equipment that will be wholly funded by a third party customer under a long-term contract arrangements. These primarily relate to investments under the LTPA contract.

Glossary

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

Alternative performance measures ('APM's)

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

Measure	Explanation	Note reference to calculation or reconciliation to statutory measure
Organic growth	The level of year-on-year growth, expressed as a percentage, calculated at constant prior year foreign exchange rates, adjusting for business acquisitions and disposals to reflect equivalent composition of the Group	Note 2
Underlying operating profit	Operating profit as adjusted to exclude 'specific adjusting items'	Note 2
Underlying operating margin	Underlying operating profit expressed as a percentage of revenue	Note 2
Underlying net finance income/expense	Net finance income/expense as adjusted to exclude 'specific adjusting items'	Note 6
Underlying profit before/after tax	Profit before/after tax as adjusted to exclude 'specific adjusting items'	Note 7
Underlying effective tax rate	The tax charge for the year excluding the tax impact of 'specific adjusting items' expressed as a percentage of underlying profit before tax	Note 7
Underlying basic and diluted EPS	Basic and diluted earnings per share as adjusted to exclude 'specific adjusting items'	Note 8
Orders	The level of new orders (and amendments to existing orders) booked in the year. Includes share of orders won by joint ventures	N/A
Backlog, funded backlog or order book	The expected future value of revenue from contractually committed and funded customer orders	N/A
Book to bill ratio	Ratio of funded orders received in the year to revenue for the year, adjusted to exclude revenue from the 25-year LTPA contract due to significant size and timing differences of LTPA order and revenue recognition which may distort the ratio calculation.	N/A
Underlying net cash flow from operations	Net cash flow from operations before cash flows of specific adjusting items	Note 9
Underlying operating cash conversion or cash conversion ratio	The ratio of underlying net cash flow from operations to underlying operating profit	Note 9
Free cash flow	Underlying net cash flow from operations less net tax and interest payments less purchases of intangible assets and property, plant and equipment plus proceeds from disposals of plant and equipment	Note 9
Net cash	Net cash as defined by the Group combines cash and cash equivalents with other financial assets and liabilities, primarily available for sale investments and derivative financial instruments.	Note 10
Specific adjusting items	Amortisation of intangible assets arising from acquisitions; impairment of property; gains/losses on disposal of property, investments and intellectual property; net pension finance income; pension past service costs; acquisition costs; tax impact of the preceding items and significant non-recurring deferred tax movements	Note 3