

A STRONGER, MORE FOCUSED GROUP

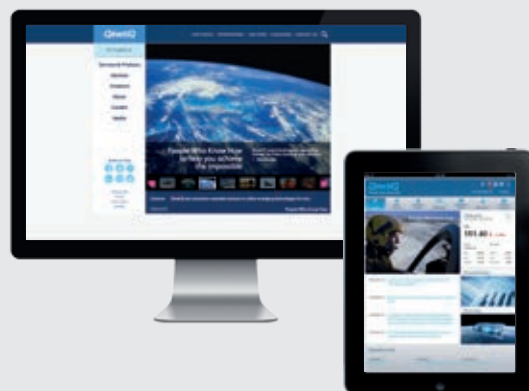
QinetiQ Group plc Annual Report and Accounts 2014

QinetiQ

People Who Know How

Through their technical expertise, know-how and rigorous independent thinking, our engineers and scientists are uniquely placed to help customers meet challenges that define the modern world. Our prized possession is trust. We inspire confidence by working in partnership with our customers to ensure that they meet their goals, first time, every time.

The innovation developed in partnership with our customers provides QinetiQ with a dynamic platform of domain knowledge from which to generate new business offerings. The Group prioritises sectors and markets where it can become a leading provider of technology solutions in order to optimise its portfolio, generate sustainable growth in earnings and provide fulfilling careers for its people.



Stay up to date

You can view this Annual Report and Accounts and all other results materials at www.QinetiQ.com. In addition, the QinetiQ Investor Relations iPad App gives you the latest investor and financial media information. The App allows you to get the latest share price information and corporate news, as well as view financial reports.

Additional information is also available online on the case studies and QinetiQ employees featured in this report.

Front cover:



Name: Samantha Prichard
Role: Aircraft Technician



Read more online www.QinetiQ.com

Group overview

Markets – Defence, aerospace and security, but with a growing position in select adjacent markets

Customers – Predominantly government organisations, including defence departments, as well as international customers in other targeted sectors

Capabilities – High-end technical expertise and advice underpinned by world-class knowledge, research and innovation. Specifically research, innovation, advice, assurance, test and evaluation, engineering solutions and training

Divisions[^] – The Group operates two divisions: EMEA Services and Global Products

People

6,233[^]

people worldwide

Geographies – Based in the UK with an established US footprint and growing positions in targeted international markets

[^]Excluding US Services – sale agreed post year end (see note 33)

Cautionary statement:

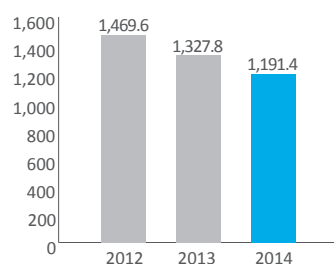
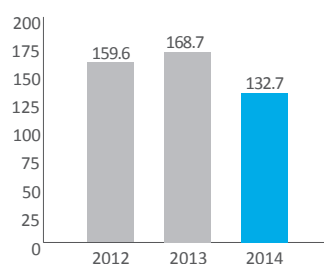
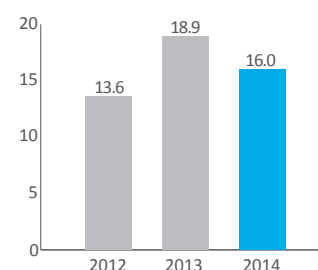
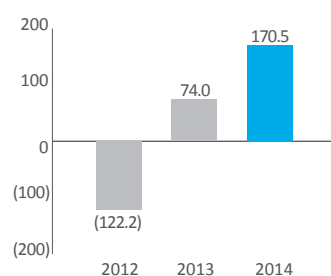
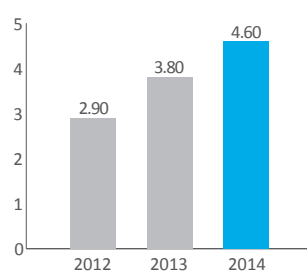
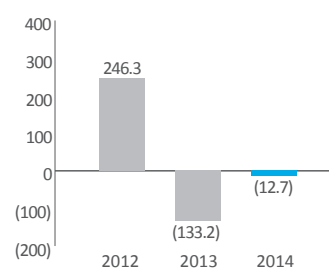
All statements other than statements of historical fact included in this Annual Report, including, without limitation, those regarding the financial condition, results, operations and businesses of QinetiQ and its strategy, plans and objectives and the markets and economies in which it operates, are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

This Annual Report is intended to provide information to shareholders and is not designed to be relied upon by any other party. The Company and its Directors accept no liability to any other person other than under English law.



Financial highlights

STRONG FINANCIAL POSITION

Revenue
£1,191.4mUnderlying operating profit*
£132.7mUnderlying EPS*
16.0pNet cash/(debt)
£170.5mTotal dividend
4.60p(Loss)/profit after tax
(£12.7m)

Note: Year references (2014, 2013, and 2012) relate to the year ended 31 March.

* Definitions of underlying measures of performance can be found in the glossary on page 150.

Strategic report



Overview



02 Chairman's statement

Strategy

04 Chief Executive's strategic review

06 Our business model and strategy

08 How we create value

10 Understanding the new Group

12 Understanding our markets

14 People Who Know How

18 Relationships

19 Key performance indicators

22 Risks and uncertainties



Performance

28 EMEA Services

32 US Services

33 Global Products

36 Corporate responsibility and sustainability review

42 Chief Financial Officer's review

Directors' report



Governance

48 Chairman's introduction to governance

50 Corporate Governance Statement

54 Board of Directors



Directors' remuneration report

69 Annual Statement

73 Remuneration Policy

84 Annual Report on Remuneration



Directors' report

93 Directors' report

96 Statement of Directors' responsibilities

Financial statements

97 Independent auditor's report

101 Consolidated income statement

102 Consolidated statement of comprehensive income

102 Consolidated statement of changes in equity

103 Consolidated balance sheet

104 Consolidated cash flow statement

104 Reconciliation of movement in net cash

105 Notes to the financial statements

146 Company balance sheet

147 Notes to the Company financial statements

Additional information

149 Five-year record

150 Glossary

151 Shareholder information

152 Additional information

Read information



In the book



Online

STRENGTH THROUGH CHANGE



Key highlights

- Organic-Plus strategy has recorded some notable milestones this year
- Sale of US Services provides route to maximum value from this division
- The Board intends to return £150m to shareholders by way of a share buyback
- The full year dividend represents an increase of 21%
- The Board's policy is that the dividend will be progressive from this new base
- Ensuring effective stewardship of QinetiQ is a priority for the Board along with succession planning and strategic growth

QinetiQ is a company clearly focused on the future, with skills and technologies that will help shape and secure that future. However, in a year that sees many nations marking the 100th anniversary of the First World War, it is appropriate to recognise the ongoing contribution that science and technology make to our security, and to note that QinetiQ is the custodian of a rich heritage. With this heritage comes distinctive knowledge and unique facilities that are utilised for the benefit of our customers.

The results

The results for the year were in line with the Board's expectations. In the year to 31 March 2014, Group revenue was £1,191.4m (2013: £1,327.8m), and underlying operating profit* was £132.7m (2013: £168.7m) due to the impact of US military drawdown on product sales. Full year underlying earnings per share* were 16.0p (2013: 18.9p), in line with the lower underlying operating profit partially offset by the reduced net finance costs and lower underlying effective tax rate*. Underlying operating cash conversion* remained strong at 103% (2013: 104%) with net cash increasing to £170.5m (31 March 2013: £74.0m).

Strategy

We believe that driving an increase in sustainable earnings represents the best route to delivering shareholder value and I am encouraged that our Organic-Plus strategy has recorded notable milestones this year.

During the year the Group initiated a strategic review of US Services, because the division was not delivering its role in the portfolio which, as a small player in a large market, was to grow profitably by building market share. The division was too small to benefit from significant economies of scale, but too large to benefit from US Government small-business set-aside initiatives.

Following a market testing exercise, the Board concluded that a sale of US Services provided the route to maximum value and that the price agreed after the year end with The SI Organization, Inc. fully recognised its market position and future prospects.

Following the disposal the Board considers the continuing Group to be highly differentiated and well positioned to deliver an increase in sustainable earnings.

Capital return

Given the strength of the balance sheet, I was pleased to be able to announce that we intend to return £150m to shareholders by way of a share buyback. The Board believes that the scale of the return reflects the strong cash generative characteristics of the Group, as well as its confidence in the Organic-Plus strategy, while taking into account the continuing uncertainty in QinetiQ's end markets, its pension obligations and the strength of its working capital position. We remain committed to maintaining an efficient balance sheet.

Dividend

The Board proposes a final dividend of 3.20p per share for the year ended 31 March 2014 (2013: 2.70p) making the full year



dividend 4.60p (2013: 3.80p). Subject to approval at the Annual General Meeting (AGM) the final dividend will be paid on 5 September 2014 to shareholders on the register at 8 August 2014. The full year dividend represents an increase of 21% reflecting the Board's confidence that the Group's Organic-Plus strategy will deliver value to shareholders over the medium term. The Board's policy is that the dividend will be progressive from this new level which is consistent with the strength of the retained Group.

The Board

The priorities that I have set for the Board are strategic growth, succession planning and to ensure the effective stewardship of QinetiQ through appropriate governance processes and systems of control. Strong corporate governance is essential in ensuring that the Group's transformation and growth are sustainable and create long-term value.

Earlier this year we announced the retirement of Colin Balmer effective at the end of January 2014. He participated in the formative years as QinetiQ became a commercial entity and provided important insight to the current Board and Executive team as we have continued the transformational journey. I thank him on behalf of the Board and the shareholders. I would also like to welcome Susan Searle who joined as a Non-executive Director in March. I am confident that her experience in the commercialisation of technology will reinforce the Board's contribution and oversight of the Group's implementation of its Organic-Plus strategy.

Our people

QinetiQ is a people business and I am proud of the expertise of our people, and the drive that they exhibit in the day-to-day service of our customers. On behalf of the Board, I would like to thank all of our employees for the commitment that they have demonstrated again this year.

We encourage diversity and believe that a diverse workforce can make the biggest contribution to helping our customers meet their challenges. We also prioritise the development of our employees, particularly in commercial skills and technical knowledge that contribute to our customers' future success.

The safety of our people is an absolute requirement across all of our sites, as well as proper recognition of the role that we play in local community and in the environmental stewardship of these sites.

Our leaders play a crucial role in the ongoing transformation of QinetiQ. We encourage candour, transparency and empowerment amongst our leadership team. This underpins our prized possession of trust driving ethical and responsible business practice throughout the organisation. I would like to thank all our leaders for continuing to drive a more open and commercial culture across the Group.

Mark Elliott

Chairman

22 May 2014

Outlook

Notwithstanding the strong performance in EMEA Services last year, the MOD transformation programme is likely to create some short-term uncertainty in the UK defence market, and the division's performance as a whole is expected to remain steady this year.

At the same time there is a wide range of possible outcomes for the performance of Global Products as the division has a lumpy revenue profile which is dependent on the timing and shipment of key orders. Although newer products are recording notable milestones, the drawdown of American overseas military forces is expected to continue to depress demand for conflict-related products, and the division is unlikely to see significant benefits from the repositioning of its US operations until later in the year.

The Board is maintaining its expectations for overall Group performance in the current financial year.

Key governance highlights

Good corporate governance is fundamental to the successful running of a business and remains a Board priority. Key areas of focus during the year were:

- The oversight of strategy and leadership, particularly in light of the establishment of a new Operating Committee and the strategic review of US Services
- Succession planning, with changes in the Board taking place during the year
- The review of risk management and assurance processes, with the setting up of the Governance Committee occurring during the year
- The review of financial reporting systems and processes, to ensure robust financial oversight and reporting



Read more on page 48.

Chief Executive's strategic review

A STRONGER GROUP



“Four years ago, QinetiQ faced significant challenges. Our response has been to build a stronger Group from the ground up: leaner, debt-free and focused on exactly those capabilities most needed by our customers following the recent reset in defence budgets. Critically this was achieved by engaging the capacity of the organisation and only one year's dividend suspension, following our decision not to seek further equity. The sale of US Services is a key milestone in the Group's transformation.”

Four years ago, QinetiQ faced significant challenges. Our response has been to build a stronger Group from the ground up: leaner, debt-free and focused on those capabilities most needed by our customers following the recent reset in defence budgets. Critically this was achieved by engaging the capacity of the organisation and only one year's dividend suspension, following our decision not to seek further equity. The sale of US Services is a key milestone in the Group's transformation.

From this foundation, our people are working hard across QinetiQ to deliver our growth strategy.

In continuing uncertain markets, our EMEA Services division has achieved its first sales uplift in five years with all the core services businesses playing their part.

A new Proxy Board and Chairman were appointed just after the year end to assist management in repositioning US Global Products and addressing its performance.

Among our newer operations, OptaSense® is executing on landmark contracts in its three vertical markets and received Queen's Awards for its Export and Innovation. Our developing cyber offerings and Procurement Advisory Services, have been established as strategic business units to realise their full potential.

We now have a Group strongly differentiated by its expertise, innovation and financial discipline. Our portfolio combines high-quality earnings with growth opportunities in new sectors and geographies, importantly underpinned by the right values and commercial culture.

Leo Quinn

Chief Executive Officer

22 May 2014



Key highlights

- With a refocused portfolio, the Group is well positioned for the next phase of its strategy
- The knowledge and capabilities of employees, coupled with physical assets, means we are uniquely placed to provide independent advice
- Our engineers and scientists, in partnership with our customers, develop intellectual property (IP) which underpins current and future revenue streams
- The cash generative nature of our business provides a good return through the progressive dividend and allows us to self-fund investments in growth opportunities

Q Why do you say the Group is stronger?

A The Group is well positioned today for the next phase of its strategy. Initially we had three challenges, of which the most urgent was that of strengthening our balance sheet after the diversification that had taken place in the past. We've also moved significantly forward in terms of our agenda around cultural transformation, including upgrading our leadership, and leaning out the organisation which is an ongoing process, engaging our employees in a practical way to be part of the solution through our 'My Contribution' initiative. But our single most important achievement is to have refocused the portfolio – knowing where we make money, where we were losing money and which business models we have in the Group that are scalable.

Q Does QinetiQ have truly sustainable capabilities?

A Our 'People Who Know How' strapline actually sums it up very nicely: QinetiQ's core strength is that it is a group of people with unique knowledge and capabilities. This, coupled with our physical assets, means that we are in fact uniquely placed – and trusted to give our customers independent advice. This in turn fosters another key competitive advantage: QinetiQ's level of customer intimacy, which has been built over a long time and is maintained by the fact that we are constantly working with them to understand their challenges, where they play and what result they require.

If I look at the defence space, QinetiQ doesn't compete directly with any of the major players but it does form the 'light blue lubricant' that keeps the industry moving forward. In many areas, whether it be airworthiness or range capabilities – in terms of submarines, ships or weapons – it's our partnership with industry and customers that is key.

Q So where is QinetiQ's future? In defence or commercial markets?

A As a Group we would never abandon our roots in defence for two reasons. First and foremost, what we do has a very noble purpose – it helps strengthen the defence capability of the UK and its allies, which is important to our people. That work in turn drives a business model where the IP and knowledge we generate then feeds the Group's current and future growth.

Q Is QinetiQ going to be a UK-only player?

A If you look around the world today you see many governments under fiscal pressures looking to spend their available money better. QinetiQ has developed capabilities to support and advise by virtue of our history and built-up knowledge base which helps ensure that customers obtain the right outcomes. So, if we look at countries like Canada and Australia they want to understand how to get better value from their defence expenditure. If you've got less money you've got to spend it more wisely, therefore you need to partner with companies that can ensure that your capabilities are developed right, first time, and within budget.

Q So why did you not sell all your US interests?

A Not only does the US Products business give QinetiQ a foothold in the world's largest defence market, it also – unlike US Services – lends itself to global synergies. That, combined with new management and governance, means that we believe there is more value to be captured for shareholders.

Q Why sell the US Services division?

A Our US Services division, which was acquired between 2004 and 2009, was primarily a portfolio diversification. By virtue of the way that defence assets have to be held in the US there are no synergies between that division and our core EMEA Services business. Nor is it the same business model of generating sellable IP. QinetiQ, as a UK-listed company, also faced additional administrative obligations and costs associated with US national security, to which the purchaser, as a US company, will not be subject. We are not the right owner of this business because we are disadvantaged in terms of costs.

Q Why did you decide to return capital to shareholders rather than invest in the business?

A Cash is an asset to be deployed where we think the returns can be maximised. If that's returning it to shareholders we're very happy to do that. If we can see a more value-accretive way within the Group of using it we'll use it in that way as well.

Chief Executive's strategic review continued

OUR BUSINESS MODEL AND STRATEGY

Q In a nutshell what is the QinetiQ business model?

A We attract and retain highly skilled, highly knowledgeable engineers and scientists who, in partnership with our customers, develop IP and knowledge which underpins current and future revenue streams.

Q And what is the investment case?

A We have a strong core business, with high barriers to entry and strong competitive advantage which generates good cash returns that underpin the progressive dividend. The business conducts about £100m of funded research each year, in partnership with both defence customers and industry. That gives rise to a portfolio of IP which in QinetiQ's case is quite unique because it is effectively a zero cost option. In a drug company they pay for their drug pipeline. In QinetiQ our customers commission our pipeline. And from that we carefully select about a dozen areas that we look to exploit at any one time for break-out growth. And therefore you have a core that provides strong cash, progressive returns and also the option on a portfolio of potential growth businesses.

Q Is the balance sheet strength still an important part of the investment case?

A Yes, the strong cash generative nature of the core business means as an investor you get a good return through the dividend but then, through our capacity to self-fund prudent investments, you get additional optionality opportunities from our 'Explore' portfolio.

Q As a management team what are your priorities for this business in 2015?

A Our priorities for 2015 are focused on building momentum in our Organic-Plus strategy – that is, to continue to build our market share in defence and to take further ground in the areas of our 'Explore' portfolio, particularly in new sectors.

Q What's the timescale on breakout growth?

A I have to say that the timing of the success of a business is always the biggest conundrum, but the one thing I am more confident of is it's not a question of 'if', it's a question of 'when'.

Our business model

QinetiQ creates value by making the expertise and know-how of its people available to customers, both through contracts to provide services and by the creation of IP. The resulting knowledge base, which has been built up over decades, is continually updated by innovations generated during the advisory, test and evaluation stages, and research work undertaken by the Group in partnership with its customers.

All QinetiQ's business operations are graded within a 'Value Pipeline'. Whether well-established business models or new capabilities with unclear commercial potential, each is managed and invested according to three criteria:

- Maturity: how ready is our offering and is there a ready market?
- Possible size: can it one day earn significant profits?
- Investment: how much will it cost to become a success?

Each individual business is responsible for its own research and development (R&D), customer relations, sales and delivery within the Group's obligatory processes and controls. The business units develop their own 'growth options', reported to and reviewed regularly by

the Group, in line with the size of investment. A growth option with up to \$100m sales potential may be separated out as a new 'Explore' unit in its own right, with support from the corporate team. The units designated as 'Test for Value' are generally funded by customers as R&D programmes, with subsequent decisions as to their future in the Group made at the corporate level.

The Group itself manages the QinetiQ brand, defines the operating and governance framework, provides expertise in specific areas centrally where this increases efficiency, and is responsible for all decisions on any additional investment into a business – financial, technological or otherwise.

Investments are rigorously evaluated, reviewed and approved or rejected in line with defined processes and controls on a regular basis.

This 'Value Pipeline' approach gives the Group full visibility of, and direction over, its assets and capabilities, which combine to set it apart from competitors in helping to meet its customers' biggest challenges.

Role of the Group

- Strategic direction and implementation
- Leadership and people development
- Portfolio management
- Budgeting and planning
- Investment appraisal and review
- Resource allocation and monitoring
- Process design and functional support
- Governance and risk management
- Brand stewardship

Role of the business units

- Business unit strategy
- Development of investment options
- Customer engagement and sales
- Safe and ethical delivery
- Human resource management
- Adherence to Group policy and regulatory frameworks



Our Organic-Plus Strategy

Strategic drivers

1 Customers

2 People

3 Innovation

4 Productivity

Value Pipeline

Core

Maximise
c85%
revenue



QinetiQ's core businesses are focused on relatively resilient sectors in which the deep domain expertise of our people is used to provide trusted independent advice and solutions for customers' critical operations.

These are the Group's sustainable and defensible core capabilities, mostly comprising EMEA Services, and operating largely in the aerospace, defence and security markets.

Much of the revenue is derived from longer-term contracts, with known dates for renewal and re-tender. These contracts exhibit relatively low-risk characteristics with low capital requirements and strong, predictable cash flows.

QinetiQ's core businesses retain and win market share by applying the technical expertise of their people, as well as their detailed understanding of customer domains, to provide support for customers' ongoing and developing needs. Core businesses receive investment on a sustainable basis as these opportunities emerge and where existing expertise can be deployed in adjacent sectors and geographic markets, from the proven platform of EMEA Services or Global Products capability.

This is the 'engine' on which the Group's reputation and customer relationships are built, the driver for continual renewal of its expertise and technology, and the source of the majority of its profit and cash flow.

These businesses generate cash that can be invested in the Group for future growth, and a strong portfolio of IP that is initially collected and categorised in 'Test for Value' and managed through a 'Value Pipeline' which includes a range of new capabilities at various stages of maturity.

Priorities for 2015:

- Invest in key capabilities
- Drive market share growth in existing markets
- Deploy capabilities into new sectors and/or geographical territories

Explore

Scale
c10%
revenue



QinetiQ's 'Explore' businesses are high potential, emerging businesses, typically with a proven competitive offering in a growth market. They represent the best opportunities for future growth, to at least \$100 million of revenue per annum, from both the Group's services and products divisions.

These are established, commercially viable businesses that have proven technology and customers, but have yet to prove that they can achieve significant scale.

The Group is 'nurturing' a select number of these opportunities to determine their ability to deliver both UK and international growth.

The challenge they face is to demonstrate a compelling business model that is scalable to a significant and sustainable size, in order to become value-accretive core businesses which increase the diversification of the Group.

The Group is selectively investing in these businesses to create a broader base of significant and, therefore, core businesses for the future.

Priorities for 2015:

- Invest in opportunities for growth
- Develop requisite business models
- Drive profitable growth
- Partner appropriately

Test for Value

Maintain the rigour
c5%
revenue



QinetiQ's 'Test for Value' offerings are early-stage options that are typically based around innovative technology or know-how that have yet to demonstrate commercial viability.


These technologies are often proven under customer-funded programmes, so the portfolio can be likened to a drug pipeline for a pharmaceutical company, except that development takes place in partnership with a customer who provides the majority of 'early-stage' funding.

The Group evaluates emerging technologies to determine their potential for value. Investment is required to achieve full commercialisation, so the IP is often licensed out to reduce implementation and sales risks, or taken to market with partners.

Over the medium term, these early-stage technologies are managed rigorously to resolution. They can be moved to 'Explore' and receive investment, or divested, closed or traded through until project completion.

Priorities for 2015:

- Sustain the rigour in the evaluation of emerging offerings
- Continue to assess viability of technology and markets
- Develop partnerships to commercialise options
- Monetise IP through licensing

 Read more on page 18 about how we work in partnership to develop IP and take technologies to market.

Objective:
An increase to sustainable earnings

Chief Executive's strategic review continued

HOW WE CREATE VALUE

Q What dashboard do you use to run the Group?

A One of the fundamental principles about the way QinetiQ is run is that we have a portfolio which combines both mature and growth businesses; but we have the same dashboard with a single central database generating all financial data. So it is a little like driving a car. You get in the car and you know where to find the speedo, oil gauge and petrol gauge and you know you can trust the readings. The importance of the dashboard is that, just as when you give someone the keys to the car, after a period of time they begin to understand the measurements that drive success. The other thing that is really important to us is that we have a regular drum beat in the Group and that really creates a dialogue around the business strategy, but not necessarily just around the business numbers.

Q Why is The 5% Club so important to you?

A As a business we are faced with the issue of ensuring that we have the best technical and engineering competency available, to serve our customers in the future. It is quite clear that in order to do that, it is not enough to rely on the education system: people do need practical on-the-job training. We actually have to invest ourselves and The 5% Club was a way of galvanising not only what we, QinetiQ, do, but what industry does in order to ensure that there is a pipeline of skills and talented people available to the UK in the future. And at the same time, whereas that is a business imperative, it actually solves what is probably the biggest social problem of our time in this country: youth unemployment, with about 900,000 under-25s without jobs. The 5% Club is about making a public declaration and commitment that 5% of our employees will be made up of apprentices or graduates on a formal training scheme. We look to achieve that by 2015. That measurement element is key – I believe what gets measured gets done. Nothing is more important than the sustainability of the enterprise and this should always be a Board level responsibility.

Strategic driver

Deliver outstanding value for all stakeholders through the expertise of our people in chosen technology-based sectors

Related KPIs
Profit after tax
Underlying EPS
Total Shareholder Return

Related risks

1 Customers

Ensure relationships which build mutual trust and deliver unique benefits

Customers around the world rely on the ideas, innovations and drive of our people to help them meet their goals – often in environments where their mission has no second chance for success.

So in QinetiQ listening to the customer is the starting point for everyone – working together to ensure that our know-how helps our customers meet their challenges today and in the future.

We aim to help customers do more with less, enabling them to build something once and derive the benefits many times.

Our objective is to be a partner of choice for the long term, because having satisfied customers underpins market share growth. We know that a customer who extols our virtues quickly becomes our best source of future business.

We consistently strive to serve our customers better, asking them about our performance, so we can learn from what we do well and what we could improve.

Customer satisfaction

Defence market
Contract profile
US foreign ownership regulations
Breaches of security and IT systems



| | 2 People | 3 Innovation | 4 Productivity |
|--|---|---|---|
| | <p>Develop and empower highly skilled employees wholly committed to customer service excellence</p> <p>QinetiQ employs highly qualified and experienced engineers, scientists and technicians who are dedicated to making a difference to their customers.</p> <p>Through their knowledge, insight, integrity and commitment, our teams work in partnership with our customers to help them meet their challenges.</p> <p>Our people are our principal source of competitive advantage, directly impacting our ability to win and retain business. As such, QinetiQ's future success lies in its ability to recruit, retain and develop our employees. Since satisfied employees deliver satisfied customers, our goal is to make QinetiQ a great place to work.</p> <p>The new leaders running our businesses are building an open, empowered culture and are committed to investing in our people particularly to develop commercial, customer engagement, and people leadership and development skills.</p> <p>We are increasing our own intake of graduates and apprentices and, in recognition of the business and social imperative of inspiring a new generation of engineers and scientists, have also launched The 5% Club, a campaign calling on industry to adopt a new 5% target for graduates, apprentices and sponsored students in their organisations.</p> | <p>Grow using the deep domain knowledge developed in our core to drive a continuous pipeline of new opportunities, complemented by alliances and partnerships</p> <p>QinetiQ continues to reshape the Group, actively managing the portfolio to optimise business returns.</p> <p>This includes positioning the portfolio around growth in the core to deliver repeatable earnings, both in traditional markets and new geographies.</p> <p>In our strategy of turning technologies into commercial businesses, we rigorously evaluate investment opportunities to prioritise resources, with the primary objective of identifying those capable of break-out success.</p> <p>We also engage selectively in partnerships, alliances and acquisitions to accelerate compelling business development strategies and sustainable earnings growth.</p> <p>In addition we look to exploit our knowledge and IP via increased use of licensing approaches.</p> | <p>Maintain our focus on high performance and self-help to ensure that we always provide more from less</p> <p>The Group has addressed its immediate financial situation, restoring the balance sheet to strength and providing the capacity for carefully targeted investment choices.</p> <p>We continue the robust financial disciplines established during the prior self-help phase, to maintain and grow margins and ensure strong cash management.</p> <p>The long-term cultural transformation of the Group continues, building QinetiQ into a more competitive and commercial company which embraces new values and operating principles.</p> <p>We are building competitiveness across the Group, de-layering the organisation to make us more agile, more accountable and more responsive to our customers.</p> <p>As a business that prides itself on innovation, QinetiQ provides a fertile foundation for new ideas to flourish. My Contribution is the channel through which employees' insights are captured to propose improved ways of working, ways to drive out unnecessary cost and to deliver continuous productivity improvements for the benefit of the Group and our customers.</p> |
| | Health and safety Employee engagement Apprentices and graduates Voluntary employee turnover | Orders Backlog Organic revenue growth | My Contribution Operating profit/margin Cash conversion Net cash |
| | Recruitment and retention | Defence market Working in a global marketplace | Contract profile Risks relating to financial management |

Emerging and reputational risk
 Significant breach of relevant laws and regulations

Foundation: Brand, reputation and integrity

➤ Corporate governance – read more on page 48.

➤ Corporate Responsibility and Sustainability Review – read more on page 36.

Chief Executive's strategic review continued

UNDERSTANDING THE NEW GROUP

QinetiQ Group plc is a global business, listed on the London Stock Exchange. Based in the UK, it has an established US footprint and growing positions in targeted international markets.

As a people-based business, our service offerings account for the majority of sales. In addition our products division provides technology-based solutions on a global basis.

Divisions

EMEA Services








EMEA Services combines world-leading expertise with unique facilities to provide technical assurance, test and evaluation, and training services. The division is also a market leader in research and advice in specialist areas such as C4ISR, acquisition services and cyber security.

[Read more on page 28.](#)

Markets

Defence

Businesses

| |  Air |  Weapons |  Maritime |  Australia |  Training |  C4ISR |  Procurement Advisory Services |
|--|--|--|--|--|---|--|--|
| Research Relationship-based value selling at a fixed price or cost plus project consultancy contracts. | • | • | • | | • | • | • |
| Advice Contracts based on the provision of advice and specific facility services including manpower services. | • | • | • | • | • | • | • |
| Test & Evaluation Long-term fixed price contracts with additional one-off testing and evaluation projects. | • | • | • | • | • | | |
| Advanced technology solutions Low-volume, bespoke requirements with incremental revenue from software, services and after sales support. | • | • | • | | • | • | • |
| Intellectual property exploitation and licensing Royalties and licence fees from third-party exploitation of intellectual property. | • | • | • | • | • | • | • |



Global Products


Global Products provides technology-based solutions to meet customer requirements and contract-funded research and development.

[Read more on page 33.](#)

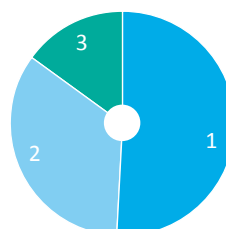
Security

Defence

Other

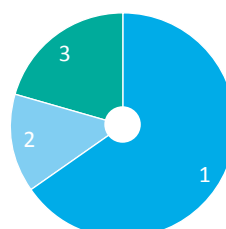
| |  |  |  |  |  |  |
|--|--|---|---|---|---|---|
| | Cyber Security | Cyveillance® | Survivability | Unmanned Systems | OptaSense® | Space Products |
| | • | • | • | • | • | • |
| | • | • | | | | • |
| | • | • | • | • | • | • |
| | • | • | • | • | • | • |

Revenue by division



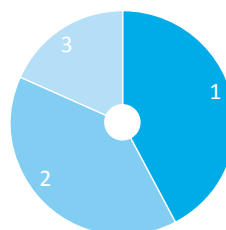
| 2014 | £m |
|--------------------|----------------|
| 1. EMEA Services | 607.0 |
| 2. US Services | 408.8 |
| 3. Global Products | 175.6 |
| Total | 1,191.4 |

Underlying operating profit* by division



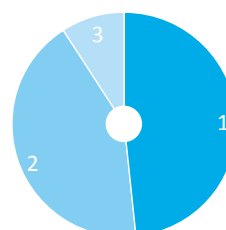
| 2014 | £m |
|--------------------|--------------|
| 1. EMEA Services | 86.7 |
| 2. US Services | 19.0 |
| 3. Global Products | 27.0 |
| Total | 132.7 |

Revenue by major customer type



| 2014 | £m |
|------------------|----------------|
| 1. UK Government | 503.9 |
| 2. US Government | 472.1 |
| 3. Other | 215.4 |
| Total | 1,191.4 |

Revenue by geography



| 2014 | £m |
|--------------|----------------|
| 1. UK | 578.8 |
| 2. US | 503.9 |
| 3. Other | 108.7 |
| Total | 1,191.4 |

* Definitions of underlying measures of performance can be found in the glossary on page 150.



Chief Executive's strategic review continued

UNDERSTANDING OUR MARKETS

Key highlights

- The Group accesses budgets for research, technical advice and test and evaluation in the UK
- EMEA Services aligned with Front Line Commands
- DE&S transformation is creating some uncertainty in the UK defence market
- International order momentum leverages core strengths
- Sale of US Services removes exposure to US federal services market
- Global Products has a significant US footprint which provides a route to the world's largest defence market

UK

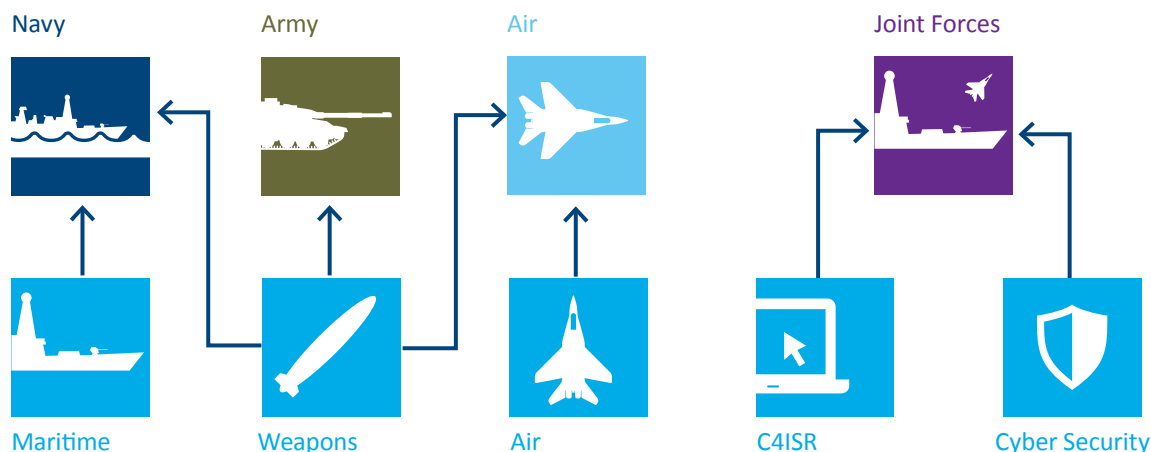
Service offerings to government customers account for the majority of UK sales, principally to the Ministry of Defence (MOD). This position, providing client-side support independent from the defence supply chain, sets QinetiQ apart from the majority of the larger UK defence suppliers with whom the Group often works in partnership.

This position in the supply chain also defines which elements of the MOD's budget account for the majority of revenue. In general, QinetiQ is not impacted by changes in single procurement projects and their budgets. Instead the Group accesses a broad range of budgets for research, technical advice, and test and evaluation across all military domains and the majority of equipment programmes.

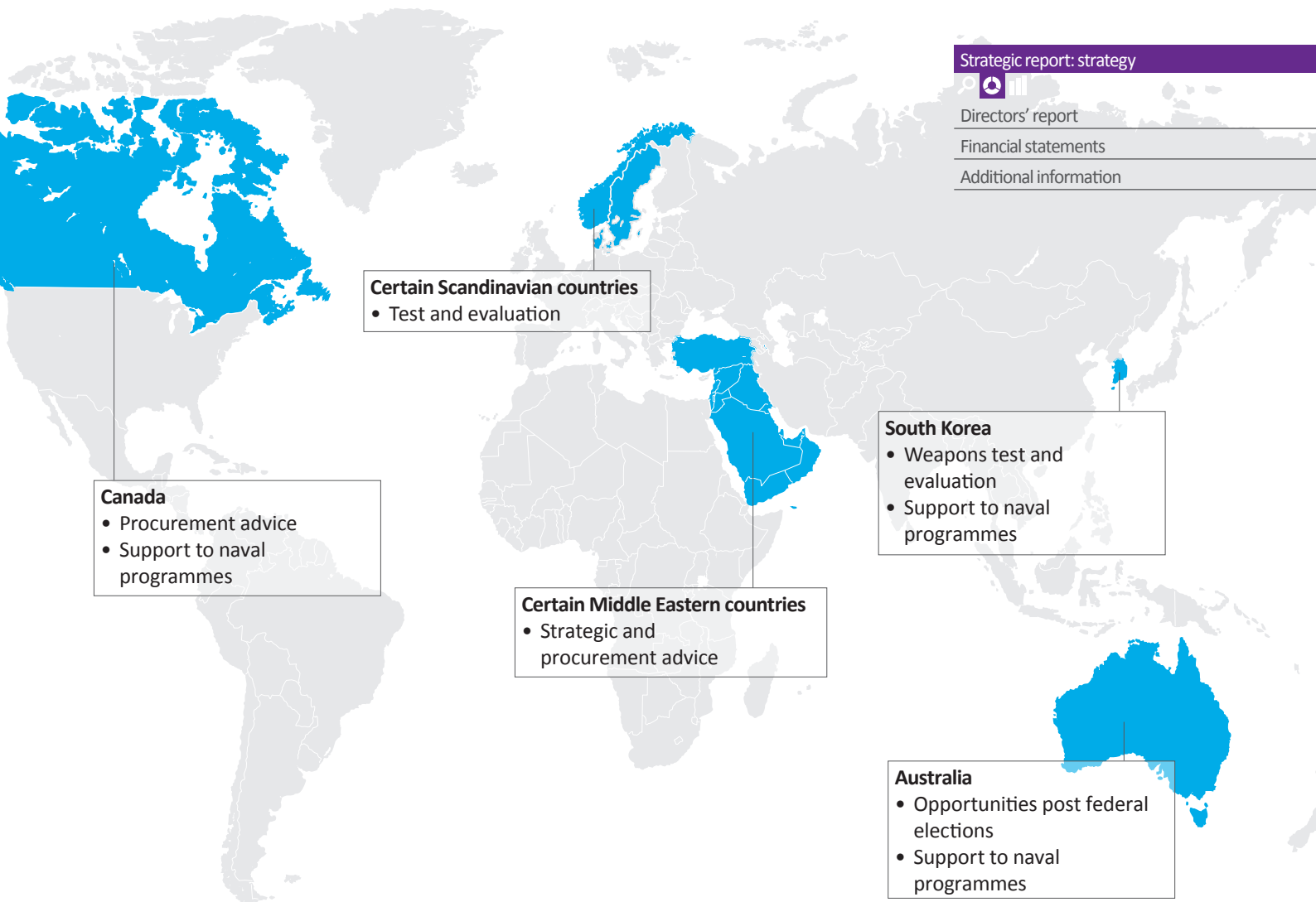
The UK Government's priorities for defence (beyond success in current operations) are financial stability coupled with essential transformation. The MOD has made considerable progress in the last three years balancing its budget. In addition, although the MOD did not adopt a Government Owned Contractor Operated model for its procurement agency, DE&S, the agency is for the first time operating at arm's length from government with greater responsibility for managing its business, outputs and workforce. This is creating some uncertainty in the UK defence market as DE&S shapes its policies and procedures. A new set of regulations and pricing terms for single source contracts, known as the 'Yellow Book', is also progressing through Parliament as part of this transformation programme. Because QinetiQ's combination of facilities and capabilities is unique in the UK, EMEA Services often contracts under single source rules so the Group is following closely the implementation of the new regime.

The EMEA Services division is well placed to capitalise on opportunities created by the defence transformation programme having aligned its structure to the Front Line Commands (Navy, Army, Air) that have taken on responsibility for managing military capability and budget. In addition, the creation of a Joint Forces Command provides a new channel into which the C4ISR and Cyber businesses can deliver their capabilities. As the private sector leader in defence research, QinetiQ's EMEA Services division has also benefited from improved visibility of defence research spending, which has been stabilised at around £400m per annum until 2015.

Front Line Commands



QinetiQ businesses



US

QinetiQ's disposal of its US Services division removes the Group's exposure to the US federal services market. US Services was not delivering on its role in the portfolio which was to grow profitably by building market share, because it was too small to generate significant economies of scale, but too large to benefit from US Government small business set-aside initiatives. QinetiQ, as a UK-listed company, also faced additional administrative obligations and costs associated with US national security to which the purchaser, as a US company, will not be subject.

The Global Products division continues to have a significant US footprint which provides a route to the world's largest defence market. While demand for conflict-related products is being impacted by the drawdown of US military forces from Afghanistan, US military customers are currently assessing their post-war requirements and formulating new programs of record. To reduce the volatility of the division's revenue over time, QinetiQ is seeking both to widen its products portfolio, and to find new sectors and applications for existing technology offerings.

International

QinetiQ's traditional geographic markets are the UK and the US, but the Group is now pursuing a pipeline of international opportunities to build on the order momentum achieved in the 2014 financial year. Many of these opportunities leverage the reputation of EMEA Services for a unique range of capabilities and facilities. For example, as the Canadian and Australian Governments pursue similar defence transformation programmes to the UK, they value the independent advice, test and evaluation provided by QinetiQ to support better procurement. Governments in Europe, the Middle East and Asia are also building their defence and security capabilities, increasing the demand for such expertise as offered by QinetiQ businesses such as C4ISR and Unmanned Systems, both of which increased their international sales in the year.

New market sectors

Much of QinetiQ's innovation arises from working closely with defence customers to address their requirements, generating technology and expertise with potential to be transferred into new sectors offering higher growth potential. The Group's Organic-Plus strategy is designed to manage, test and triage these options appropriately to develop the portfolio beyond defence into commercial lines of revenue. The Group then invests in and monitors the resulting businesses to develop significant sales and scale.



Name: Brendon Purnell

Role: Senior Fibre Optics Engineer

Our OptaSense® bespoke fibre sensing business continues to reach new markets and customers with its remarkable acoustic sensing solutions. The first year of trading outside an exclusivity contract with Shell saw OptaSense® move from a single downhole oil and gas client to contracts with seven international oil companies. Two contracts are notable strategic milestones in creating a truly robust and scalable business geared for continued growth. Our relationship with Shell has continued, with a new contract to waterproof OptaSense® for sub-sea operations: this industry vote of confidence underlines the fact that our technology is now proven onshore. In another world-first we agreed the industry's first contract for multi-well 4D distributed vertical seismic profiling with Petroleum Development Oman, covering up to 12 wells simultaneously and helping improve safety, reduce costs and increase yields. This five-year deal means assured revenues for the business.

People Who Know How

STRENGTH THROUGH OUR PEOPLE

**Name: Daniel Yong****Role: Ordnance Engineer**

'We're on our way' is how QinetiQ Australia employees feel right now. 'A business on the move' is how our customers and industry partners have described the business, which has continued its turnaround in a challenging market with a second year of sustainable growth: the product of customer confidence and employee optimism. Importantly, the business has broken the mould of defence contracting for advisory services with two three-year multimillion-dollar partnership contracts for Airworthiness and Munitions advice, plus new military maritime contracts. Plans to further accelerate growth include moving into adjacent markets such as exploring Asia Pacific opportunities. Alan Woolford, CEO QinetiQ Australia: "I'm proud of our remarkable team, in particular how we've strengthened the QinetiQ brand at the heart of Australian government and defence while becoming an employer of choice. There's a real buzz around the business."



Name: Alex Slater

Role: Weapons Apprentice

We want to attract and retain the best talent: our 'unfair share' of great people. But QinetiQ's approach runs deeper. Our goal is to inspire a generation and initiatives like The 5% Club are designed to give young people fresh opportunities, challenge the status quo and drive innovation. Our attitude – building greater pride in who we are and what we do – makes sense for our current and future employees, customers and local communities. We want people to be here for a career, not just a job. In practical terms, this means investing in people and looking to the long term: networking with other employers, recognising technical excellence, launching an Employee Referral Scheme, and creating new Career Development Frameworks so people can go further, faster. And the minute people join us, a new Induction and Onboarding programme is setting the tone and giving joiners confidence that they made the right decision.



Name: Ross Sproule and
Sheena MacDonald
Role: Mechanical Technicians

As testament to our increasing ability to bid competitively in open markets, QinetiQ's Maritime business recently won a £5.3m, five-year contract to deploy and maintain the Royal Navy's underwater mobile acoustic targets. These targets support submarine crew certification and platform readiness at the British Underwater Test & Evaluation Centre (BUTEC), Kyle of Lochalsh – a Maritime range QinetiQ operates on behalf of the MOD through the Long-Term Partnering Agreement (LTPA). Up against one of the country's major providers as the incumbent, the competition was tough; however, our value-for-money approach – allowing the customer to do more for less money – alongside the knowledge and expertise of our people, won through for us. Already providing a large proportion of services at BUTEC, for which we recently scored feedback scores of 10/10, this new contract sees us providing a one-stop-shop service. One of our core beliefs – that delighted customers underpin market share growth – has again borne fruit.



Relationships

STRENGTH THROUGH PARTNERSHIP

Working in partnership with our suppliers

QinetiQ is uniquely placed to help customers meet their challenges due to the know-how and independence of its people, but we recognise that working in partnership with our suppliers, rather than working alone, is often the best way to meet these challenges. These partnerships also benefit other organisations in the supply chain, allowing small businesses and academic institutions the opportunity to access customers with whom QinetiQ has well-established relationships.

[Read more about how QinetiQ works in partnership through the Weapons Science and Technology Centre on page 29.](#)

Working in partnership with our customers

Much of QinetiQ's innovation arises from working closely with customers to address their requirements and is proven in partnership with them. These customer-funded research and development programmes are mutually beneficial, in both our traditional and newer markets. For example, many OptaSense® applications for the downhole oil and gas market were developed in partnership with Shell.



Name: Sandeep 'Sid' Gill
Role: Technical Engineering and Product Lead

Reflecting 70 years of radar expertise, a team of scientists, designers and engineers achieved the near-impossible: creating a unique weapons detection system that predicts the impact of low trajectory rocket attacks, better protecting personnel by giving them time to take evasive action. Alarm™ was an R&D triumph: initial research funded by external sources transformed concept into prototype in eight months, delivering an unprecedented 100% success rate in tests. Amazingly, it was only 18 months from blank page to delivering a qualified automated system that people can assemble in three hours. With its market-leading capabilities being software-based rather than hardware-restricted, the product's inherent flexibility enables rapid adaptation for a raft of military and civilian applications: from software tweaks to detect slower moving unmanned aerial vehicles, to revised hardware set-up for easy deployment at government sites, oil installations and other locations.

Working in partnership with our peers

New technology offerings can be taken to market with our peers. This includes licensing our IP to reduce implementation and sales risk, with revenue dependent on third-party sales channels, and working with manufacturers to take technology to market in partnership.



Name: Phil Cork
Role: Persistent Surveillance Business Manager

The Modular Electronic Warfare System (MEWS) is a brilliant illustration of how QinetiQ's know-how and IP can be combined with fresh thinking to achieve sales success. Few companies share our rich heritage in electronic warfare, including our ability to rapidly take prototypes through to operational theatre. However, one stumbling block has been being able to replicate and scale those successes, typically being able to manufacture in volume and enter new markets confidently. When it came to taking our land electronic warfare capabilities to market, a decision was taken to partner with a proven hardware provider, namely L-3 TRL Technology. Combining our electronic warfare processing and software expertise with L-3 TRL's 20 years' defence manufacturing and their access to new overseas markets effectively 'de-risked' launching this remarkable product for both companies in 2012/13, with global sales ahead of plan.

Working in partnership to inspire a new generation

QinetiQ's future success relies on its ability to recruit and retain employees with the skills required to meet customer needs. Our commitment to inspiring and attracting the next generation of scientists and engineers is reflected in our outreach programme which focuses on providing support in science, technology, engineering and maths (STEM) subjects. This is primarily targeted at students aged 11 and older, and is delivered in partnership with schools and recognised national organisations such as STEMNET and Cyber Security Challenge UK.



[Read more about Cyber Security Challenge UK on page 39.](#)

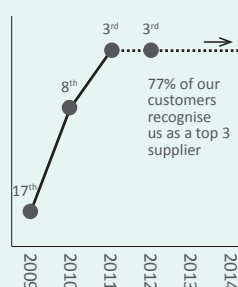


Key performance indicators

MEASURING OUR PROGRESS

Non-financial KPIs

Customer satisfaction



Description

QinetiQ's customer satisfaction survey was introduced in 2014 following the suspension of the MOD's survey to ask all MOD customers with contracts over £200,000 about QinetiQ's delivery, engagement and relationship. 77% of our customers stated that QinetiQ was performing as a 'top 3' supplier, consistent with the results of the MOD survey in 2011 and 2012. In the US, customer satisfaction metrics are reviewed on a contract-by-contract basis.

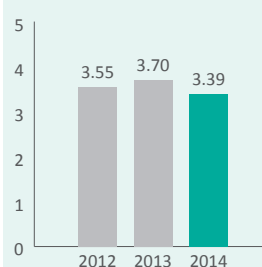
Comment

The survey will be conducted annually to improve the number of projects performing well and the percentage of our customers who rate QinetiQ as a top 3 supplier.

Strategic driver

1 Customers

Health and safety



Description

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

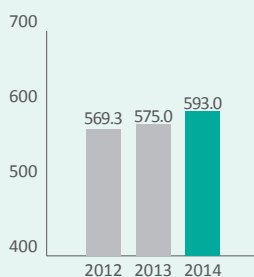
Comment

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

Strategic driver

2 People

Employee engagement



Description

A measure of employee engagement on a scale of 0-1,000, based on the Best Companies Employee Survey. Through this channel, employees share their views of working at QinetiQ under the headings of management, leadership, My Company, personal growth, My Team, giving back to the community, fair deal and well-being.

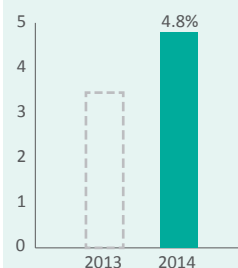
Comment

The annual survey enables comparison between QinetiQ and other UK companies. A separate engagement survey is undertaken for the US business.

Strategic driver

2 People

Apprentices and graduates



Description

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

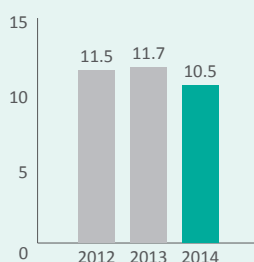
Comment

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

Strategic driver

2 People

Voluntary employee turnover (%)



Description

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

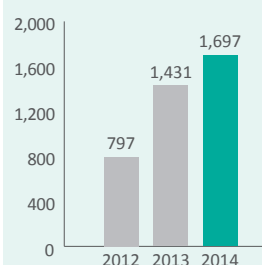
Comment

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

Strategic driver

2 People

My Contribution



Description

My Contribution is the channel through which employees' insights are captured and activated to improve ways of working, drive out unnecessary costs and drive productivity improvements. The graph shows the total number of projects. The financial returns and benefits are also measured through the My Contribution tracker.

Comment

My Contribution improves the work environment for employees and how the business delivers for customers.

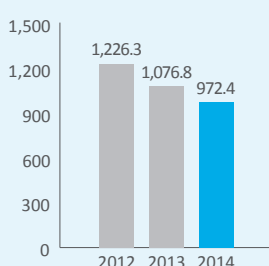
Strategic driver

4 Productivity

Key performance indicators continued

Financial KPIs

Orders (£m)



Description

The level of new orders (and amendments to existing orders) booked in the year.

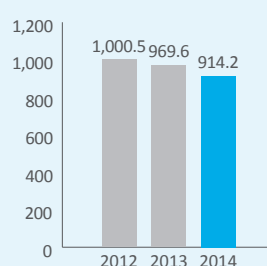
Comment

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

Strategic driver

3 Innovation

Backlog (£m)



Description

This is a measure of the value of work that the Group has on contract but is yet to deliver. It excludes the remaining value of the 25-year LTPA contract.

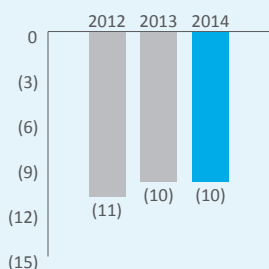
Comment

The closing backlog at year end underpins the revenue that will be delivered in the following year. Growing backlog represents growth in the overall business.

Strategic driver

3 Innovation

Organic revenue growth (%)



Description

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

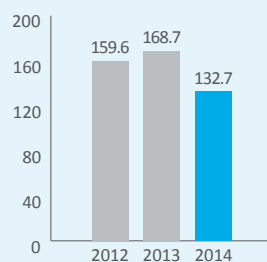
Comment

Organic revenue growth demonstrates the Group's capability to expand its core operations within its chosen markets before the effect of acquisitions, disposals and currency translation.

Strategic driver

3 Innovation

Underlying operating profit* (£m)



Description

The underlying earnings before interest and tax.

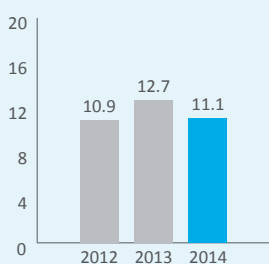
Comment

Underlying operating profit* is used by the Group for internal performance analysis as a measure of operating profitability that is tracked over time.

Strategic driver

4 Productivity

Underlying operating margin* (%)



Description

Underlying operating profit margin is calculated by taking the underlying earnings before tax and interest as a percentage of revenue.

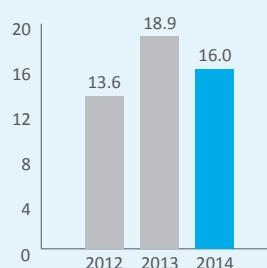
Comment

Underlying operating profit margin* can be used to show the underlying profitability of the revenue delivered by the Group. It can also be used to compare the Group's performance with that of our peers, providing the definition of underlying operating profit is consistent.

Strategic driver

4 Productivity

Underlying EPS* (p)



Description

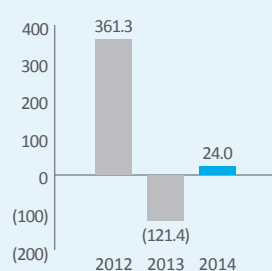
The underlying earnings per share* (EPS) expressed in pence per share.

Comment

EPS provides shareholders with a measure of the earnings generated by the business after deducting tax and interest. Underlying EPS also determines the level of payout for certain of the Group's long-term incentive plans.



Group operating profit/(loss) (£m)



Description

This measures the earnings before interest and tax including all specific adjusting items that are excluded in the underlying operating profit measure.

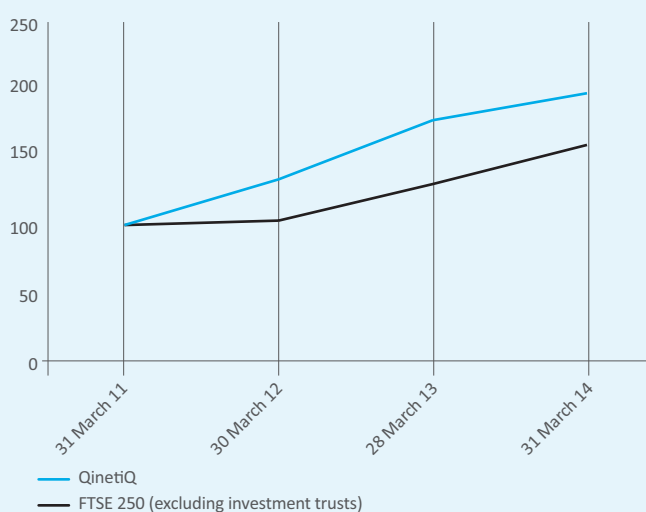
Comment

To obtain a proper understanding of financial performance, the Group focuses on 'underlying' measures of performance excluding specific adjusting items*. The overall performance of the Group, however, does include all adjusting items and the total Group operating profit/loss is the key financial measure used to reflect overall operating performance for the year.

Strategic driver

4 Productivity

Total Shareholder Return (TSR)



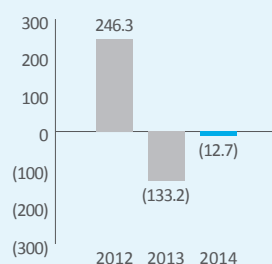
Description

TSR represents the value returned to shareholders through a combination of share price appreciation and cash dividends.

Comment

This measure provides an indication of the success of the Group in the view of the investor. It is impacted by macro-economic factors and for management remuneration purposes relative TSR is the performance indicator that determines vesting of certain share-based payments.

Profit/(loss) after tax (£m)



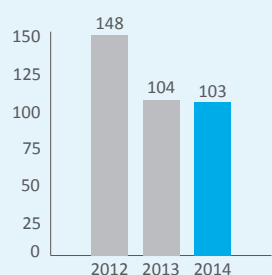
Description

This is the total Group profit/(loss) including all specific adjusting items.

Comment

To obtain a proper understanding of financial performance the Group focuses on 'underlying' measures of performance excluding specific adjusting items*. The overall performance of the Group, however, does include all adjusting items and the total profit/(loss) is a key financial measure used to reflect overall financial performance for the year.

Underlying operating cash conversion* (%)



Description

The ratio of our net cash flow from operations (before restructuring), less outflows on the purchase of intangible assets and property, plant and equipment to underlying operating profit* excluding the share of post-tax results of equity accounted joint ventures and associates.

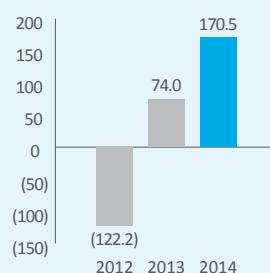
Comment

Provides a measure of the Group's ability to generate cash from normal operations and gives an indication of its ability to pay dividends, service its debt and make discretionary investments.

Strategic driver

4 Productivity

Net cash/(debt) (£m)



Description

The Group's measure of liquidity and borrowings. Includes finance lease debtors/creditors and assets/liabilities in respect of derivative financial instruments.

Comment

The level of net cash/(debt) provides a measure of the Group's financial strength.

Strategic driver

4 Productivity

* Definitions of underlying measures of performance can be found in the glossary on page 150.

Risks and uncertainties

UNDERSTANDING AND MANAGING OUR RISKS

Risk management

Risk management includes the methods and processes used by QinetiQ to manage risks and seize opportunities related to the achievement of our strategic objectives. It provides a framework for identifying particular events or circumstances relevant to the Group's objectives (risks and opportunities), assessing them in terms of likelihood and magnitude of impact, determining a response strategy and monitoring progress. By identifying and proactively addressing risks and opportunities, we are better able to protect and create value for our stakeholders.

Progress continues to be made to fully embed these processes and to improve their effectiveness. The Risk & CSR Committee has run for a full year focusing on risks where the primary impact is non-financial, with the Audit Committee retaining a focus on what might be termed purely financial risks. The differentiation between pure financial and non-financial risk has aided both the Executive and Board risk review process, allowing for greater focus on the effectiveness of relevant mitigations.

Risk appetite

The QinetiQ Board recognises that risk management is a complex process and should reflect both the need to take risk and avoid harm. It also recognises that in today's operational environment closed statements do not help the organisation, as inevitably issues are rarely black and white and ultimately success or failure will be determined by shareholders and regulators as well as public opinion.

The QinetiQ risk appetite focuses on critical risk areas necessary to achieve our strategic goals. It aims to provide clear boundaries, operational flexibility and guidance to support the thinking of executives and senior leaders so that they can make and provide evidence for decisions that reflect the need to protect our prized possession, trust. Three categories of appetite are defined as follows:

- **Hungry:** Willing to consider all delivery options and eager to be innovative and to choose options offering potentially higher business rewards, with a mature understanding of inherent risk
- **Balanced:** Preference for delivery options that have a low or moderate degree of residual risk and where successful delivery also provides an acceptable level of reward and value for money
- **Cautious:** Avoidance of risk and uncertainty is the key objective, a greater level of control and mitigation may be required. Significantly greater returns expected for commercial opportunities to offset risk

All QinetiQ business operations are graded within a Value Pipeline. Within the context of the 'Core', 'Explore' and 'Test for Value' strategy the Board's commercial appetite is:

- **Hungry** for opportunities relating to increased market share where we have proven delivery to existing and potential new customers
- **Balanced** for opportunities that translate proven delivery into new markets or new capability/delivery into existing customers or that commit QinetiQ to unlimited or excessive liabilities
- **Cautious** for opportunities that involve new capability or delivery into new markets and any opportunity into a new country outside the US and the UK

The Board agrees and reviews its tolerance of risk through appropriate delegations of authority to the Executive and senior leaders.

The Board recognises that QinetiQ operates in complex geographical and regulatory environments and supports local decision making within defined delegation of authority. The Board requires all employees to abide by relevant legal requirements as a minimum.

The Group Risk Register

The Group Risk Register consists of material risks relating to effective delivery of our strategy. These risks may emerge as standalone risks or be present through the aggregation or interlinking of risks. The register considers:

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

The Group Risk Register is reviewed by the Executive and the Board. In addition, the risk owners present an update of current status and mitigating actions by rotation throughout the year.



Risks relating to strategy

| Potential impact | Mitigation | Associated strategic driver |
|--|--|-----------------------------|
| Defence market | | |
| <ul style="list-style-type: none"> Any reduction in government defence and security spending in either the UK or the US could have an adverse impact on the Group's financial performance. The financial burden on both UK and US Government budgets from the current economic downturn may lead to reduced spending in the markets in which the Group operates. This could be exacerbated by: <ul style="list-style-type: none"> Structural changes in UK MOD Defence Equipment and Support UK General Election in May 2015 and the next Strategic Defence and Security Review (SDSR) Current plans of both US and UK Governments are to drawdown troops from Afghanistan by the end of 2014. | <ul style="list-style-type: none"> Our focus on a range of markets in aerospace, defence and security as well as adjacent sectors provides a degree of portfolio diversification. The Group will continue to review trends in its traditional markets expenditure in order to align the business with those trends. The MOD has made considerable progress in balancing its budget. In defence research, where QinetiQ is the private sector market leader, spending has been stabilised at about £400m p.a. until 2015. The sale of US Services removes the Group's exposure to the US federal services market. The Group is managing the impact of drawdown from Afghanistan by maintaining a market focus and competitive positioning in adjacent markets, which are not directly conflict-related. | 1 3 |
| <ul style="list-style-type: none"> Following the Currie Review, a Bill and regulations to introduce the Single Source Procurement Reform are now subject to the Parliamentary process and scheduled to be approved mid-2014. The impact will be to replace the Yellow Book in 2015 with a legally binding framework for how single sourced work must be contracted to ensure that a fair and reasonable price is paid for goods and services procured in the absence of competition. This could have an adverse impact on the Group's financial performance. The Reform Bill as currently drafted only affects new single sourced contracts from the beginning of 2015. | <ul style="list-style-type: none"> QinetiQ and other defence industry partners have been fully engaged with the MOD in the development of the new framework and its practical application. The MOD has requested that industry test and provide feedback on the proposed new reporting as it is developed prior to implementation, so that the transition is effective for all parties. | |
| <ul style="list-style-type: none"> Organisational Conflicts of Interest (OCI) may occur where the Group provides services to both a defence end-user customer as well as those within the defence supply chain. | <ul style="list-style-type: none"> QinetiQ takes proactive steps to manage any potential OCI and maintain its ability to provide independent advice. Since March 2012, QinetiQ has operated under the generic formal compliance regime, replacing a QinetiQ-specific one. This change has not affected the rigour of the compliance process. | |
| <ul style="list-style-type: none"> The aerospace, defence and security markets are highly competitive. The Group's performance may be adversely affected should it not be able to compete in the markets in which it aims to operate. | <ul style="list-style-type: none"> QinetiQ seeks to focus on areas within these markets in which its deep customer understanding, domain knowledge, technical expertise and platform independence provide a strong proposition and a significant advantage in competitive bidding. | |

Key to strategic drivers

1 Customers

2 People

3 Innovation

4 Productivity

A All

Risks and uncertainties continued

Risks relating to strategy continued

| Potential impact | Mitigation | Associated strategic driver |
|--|---|-----------------------------|
| Contract profile | | |
| <ul style="list-style-type: none"> A material element of the Group's revenue is derived from one contract. The LTPA is a 25-year contract to provide test, evaluation, and training services to the MOD. The original contract was signed in 2003. The LTPA operates under five-year periods with specific programmes, targets and performance measures set for each period. The LTPA directly contributed 16% of the Group's revenue and supported a further 10% through tasking services using LTPA managed facilities. | <ul style="list-style-type: none"> In February 2013 the Group signed the LTPA for a third five-year period with the MOD. The next break point is in 2018. The Group continues to achieve strong customer performance and satisfaction levels, and significantly exceeded the agreed minimum performance rating of 80% in 2013. The Group has achieved significant cost savings for the MOD on delivered services, and is on track to deliver £180m of savings over the life of the contract. | 1 4 |
| <ul style="list-style-type: none"> The amounts payable under some government contracts can be significant and the timing of the receipt of orders could have a material impact on the Group's performance in a given reporting period. | <ul style="list-style-type: none"> The contracts and orders pipeline is regularly reviewed by senior operational management. | |
| <ul style="list-style-type: none"> Some of the Group's revenue is derived from contracts that have a fixed price. There is a risk that the costs required for the delivery of a contract could be higher than those agreed in the contract as a result of the performance of new or developed products, operational over-runs or external factors. Any significant increase in costs which cannot be passed on to a customer may reduce the profitability of a contract or even result in a contract becoming loss making. Some of the Group's contracts have terms, not unusual in defence, that provide for unlimited liabilities for the Group, or termination rights for the customer. | <ul style="list-style-type: none"> The nature of many of the services provided under such fixed-price arrangements is often for a defined amount of effort or resource rather than firm deliverables and, as a result, mitigates the risk of costs escalating. The Group ensures that its fixed-price bids and projects are reviewed for early detection and management of issues which may result in cost over-run or excessive delivery risk. | |
| Working in a global marketplace | | |
| <ul style="list-style-type: none"> QinetiQ operates internationally. Risks include: regulation and administration changes, taxation policy, political instability, civil unrest, and differences in culture. Negative events could disrupt some of the Group's operations and have a material impact on its future financial performance. | <ul style="list-style-type: none"> While the Group has a growing geographical footprint, its traditional activities are confined to the UK and the US. Relationships or contracts in new markets are assessed for their inherent risks, using our International Business Risk Assessment process, before being formally agreed. | 3 |
| Emerging and reputational risk | | |
| <ul style="list-style-type: none"> Our reputation is a highly valuable asset and as an innovative company we can operate at the cutting edge of current scientific and regulatory thinking. Failure to identify, measure and manage emerging, political, public, regulatory and reputational trends could materially impact Group performance and shareholder value. | <ul style="list-style-type: none"> An internal project has been launched to identify potential emerging reputational risks and evaluate their materiality on an ongoing basis. | A |



Risks relating to strategy continued

| Potential impact | Mitigation | Associated strategic driver |
|--|--|-----------------------------|
| US foreign ownership regulations | | |
| <ul style="list-style-type: none"> In the US, the Group undertakes work that is deemed to be of importance to US national security and is therefore conducted under foreign ownership regulations, which require operation under a Proxy agreement. The regulations are designed to insulate these activities from undue foreign influence as a result of foreign ownership. Failure to comply with the regulations could result in sanctions, suspension or debarment from government contracts, as well as reputational damage to our brand. The Proxy agreement itself may present operational/management challenges impacting performance. | <ul style="list-style-type: none"> The Group maintains procedures to ensure that extant arrangements remain effective and to respond to any changes that might occur in US attitudes to foreign ownership of such activities. Successful migration of Cyveillance® to a legal entity not governed by these regulations, the creation of a revised proxy regime for Global Products and the agreed divestment of the US Services division have reduced the burden of these regulations. <p>> The section entitled 'Management and control of US subsidiaries' on page 61 of this report provides details of the Proxy agreement.</p> | 1 |

Risks relating to people

| | | |
|--|--|---|
| Recruitment and retention | | |
| <ul style="list-style-type: none"> The Group operates in many specialised engineering, technical and scientific domains. Key capabilities and competencies may be lost through failure to recruit and retain employees due to internal factors, as well as macro factors across the sector affecting the desirability, intake and training of engineers, scientists and technologists. | <ul style="list-style-type: none"> The Group conducts regular activities to identify key roles and personnel. Succession plans are in place looking internally at candidates ready now or in need of development to fill particular roles and externally to identify people QinetiQ may wish to attract. QinetiQ has made improvements in employee engagement and conducts an annual satisfaction survey. QinetiQ is leading industry in The 5% Club, a campaign to increase the recruitment of graduates and apprentices. <p>> See also KPIs on page 19.</p> <p>> See also case study on page 16.</p> | 2 |
| Breaches of security and IT systems failure | | |
| <ul style="list-style-type: none"> The Group operates in a highly regulated IT environment. The data held by QinetiQ is confidential and needs to be secure, against a background of increasing cyber threat. A breach of data security or IT systems failure could have an impact on our customers' operations, resulting in significant reputational damage, as well as the possibility of exclusion from some types of government contracts. The Group's financial systems are required to be adequate to support US and UK Government contracting regulations. | <ul style="list-style-type: none"> Information systems are designed with consideration to single points of failure and the removal of risk of minor and major system failures. The Group maintains business continuity plans that cover geographical assets as well as the technical capability of employees. These plans cover a range of scenarios (including loss of access to IT) and are regularly tested. Data security is assured through a multi-layered approach that provides a hardened environment, including robust physical security arrangements and data resilience strategies. Comprehensive internal and external testing of potential vulnerabilities is conducted along with 24/7 monitoring. The Group engages with US and UK Government contracting audit agencies, to enable them to test relevant financial systems and data, and implements any recommended improvement plans. | 1 |

Risks and uncertainties continued

Risks relating to people continued

| Potential impact | Mitigation | Associated strategic driver |
|--|---|-----------------------------|
| Significant breach of relevant laws and regulations | | |
| <ul style="list-style-type: none"> The Group operates in highly regulated environments and recognises that its operations have the potential to have an impact on a variety of stakeholders. Failure to comply with particular regulations could result in a combination of fines, penalties, civil or criminal action. In addition, failure may also lead to suspension or debarment from government contracts, as well as reputational damage to the QinetiQ brand. | <ul style="list-style-type: none"> The Group has robust policy, procedures and training in place to ensure that it meets all current regulations. The Group manages the effective identification, measurement and control of regulatory risk. Local management continuously monitor local laws. Professional advice is sought when engaging in new territories to ensure that the Group complies with local and international regulations. | A |

Key areas of focus for the Group include the following:

| | | |
|--|---|--|
| <ul style="list-style-type: none"> Safety liability of products, services and advice. | <ul style="list-style-type: none"> QinetiQ continues to be externally authorised for regulated design and maintenance services in the aviation sector. A Director of Engineering and Technology has been appointed and is leading programmes focused on engineering and technical competency and independent technical assurance. | |
| <ul style="list-style-type: none"> Workplace and occupational health, safety and environmental matters. | <ul style="list-style-type: none"> Safety and environmental systems continue to be accredited to international standards. QinetiQ is building on existing programmes to focus on human factors and behavioural safety training to embed its safety culture. <p>> See page 37</p> | |
| <ul style="list-style-type: none"> Bribery and ethics. | <ul style="list-style-type: none"> The QinetiQ Code of Conduct states that the Group does not tolerate bribery and corruption. Annual business ethics training is mandatory for all employees across the Group and the Board. Systems exist for managing international business, agents, gifts and hospitality. Performance is reviewed externally and benchmarked against others in this sector. <p>> See page 36</p> | |
| <ul style="list-style-type: none"> International trade controls. | <ul style="list-style-type: none"> Continual compliance has been supported by a programme to improve QinetiQ's handling of legacy materials as well as to further improve our systems and processes for the handling and management of new materials and electronic data. Investment in this area supports our plans for growth in the international arena as well as building confidence in managing existing requirements. | |



Risks relating to financial management and markets

| Potential impact | Mitigation | Associated strategic driver |
|--|---|-----------------------------|
| Defined benefit pension obligations | | |
| <ul style="list-style-type: none"> The Group operates a defined benefit pension scheme. There is currently a deficit between the projected liability of the scheme and the value of the assets it holds. The size of the deficit may be materially affected by a number of factors, including inflation, investment returns, changes in interest rates and improvements in life expectancy of members. An increase in the deficit may require the Group to increase the cash contributions to the scheme, which would reduce the Group's cash available for other purposes. At the last triennial funding valuation on 30 June 2011, the deficit was £74.7m; the likely cost of a 'buyout' would be significantly higher. | <ul style="list-style-type: none"> Scheme performance is reviewed regularly by Group management in conjunction with the scheme's independent Trustees. External actuarial and investment advice is regularly taken to ensure the best interests of both the Group and the scheme members. The Group and Trustees reduced future liabilities in March 2012 by switching from RPI to CPI for indexation purposes and agreeing recovery payments of £10.5m per annum over six years. The scheme was closed to future accrual on 31 October 2013. A hedge of 20% of liabilities and an inflation cap for liabilities was agreed in 2013. | 4 |
| Tax legislation | | |
| <ul style="list-style-type: none"> QinetiQ is liable to pay tax in the countries in which it operates, principally the UK and the US. Changes in tax legislation in these countries could have an adverse impact on the level of tax paid on profits generated by the Group. In the UK, R&D Expenditure Credits (RDEC) were introduced from 1 April 2013 and will be mandatory from 1 April 2016, replacing the R&D super deduction. Until that date, QinetiQ will continue to claim the super deduction while the treatment of RDEC for MOD single source contracts remains under discussion between industry and the Government. | <ul style="list-style-type: none"> External advice and consultation are sought on potential changes in tax legislation in the UK and the US enabling the Group to plan for and mitigate potential changes. The Group is currently actively engaging with industry, MOD and industry bodies regarding R&D tax credits. Opportunities continue to be explored to manage both effective tax rate (ETR) and cash tax impacts in line with the Board endorsed Tax Strategy. The Group has £191.4m of UK tax losses carried forward as at 31 March 2014 (2013: £202.7m). | 4 |
| Exchange rates | | |
| <ul style="list-style-type: none"> The Group is exposed to volatility in exchange rates as a result of the international nature of its operations. This includes a translational impact on the key financial statements as a result of the Group reporting its financial results in sterling. The Group has limited transaction exposure as its revenue and related costs are often borne in the same currency, principally US dollars or sterling. Of the Group's total revenue, approximately 50% is contracted in sterling, 40% in US dollars and 3% in euros. | <ul style="list-style-type: none"> The Group actively hedges all significant transactional foreign exchange exposure as described in the notes to the financial statements and has adopted hedge accounting. The Group's objective is to reduce medium-term volatility to cash flow, margins and earnings. The Group protects its balance sheet and reserves from adverse foreign exchange movements by financing acquisitions in North America with US dollar-denominated borrowings, thereby partially mitigating the risk as US dollar earnings are used to service and repay US dollar-denominated debt. | 4 |
| Inflation, credit and interest rates | | |
| <ul style="list-style-type: none"> The Group relies on the proper functioning of the credit markets which could have an impact on both the availability and associated costs of financing. The Group is exposed to interest rate risk to the extent that borrowings are issued at floating interest rates. | <ul style="list-style-type: none"> The Group maintains a prudent level of committed funding facilities: a five-year multi-currency facility totalling £268m was provided by its relationship banks and signed in 2011. This is currently undrawn. The Group also uses fixed-rate debt instruments issued to US private placement investors with maturity dates up to 2019. | 4 |
| <ul style="list-style-type: none"> The Group is exposed to inflation spikes above the long-term average. | <ul style="list-style-type: none"> The Group manages inflation risks through appropriate contractual terms. | 4 |

RETURN TO ORGANIC GROWTH

Key highlights

Revenue

£607.0m
2013: £594.6m[^]

Underlying operating margin*

14.3%
2013: 14.3%[^]

Underlying operating profit*

£86.7m
2013: £84.8m

No. employees

5,399
2013: 5,352[^]

- EMEA Services performed well throughout the year
- The C4ISR business performed particularly strongly and the other core Air, Weapons and Maritime businesses all produced good results
- Orders grew 11%, demonstrating the unique strengths of the division
- The division delivered organic growth for the first time in five years

* Definitions of underlying measures of performance can be found in the glossary on page 150.

[^] Restated to reflect the reclassification of product sales from EMEA Services to Global Products and the reclassification of the Cyveillance® business from US Services to EMEA Services.

Value pipeline

| Core | Explore | Test for value |
|-----------|-------------------------------|--------------------------------------|
| Air | Training | International procurement advice |
| Weapons | Cyber Security | Smart metering assurance |
| Maritime | Cyveillance® | Directed Energy Weapons |
| C4ISR | Procurement Advisory Services | Secured navigation systems (Galileo) |
| Australia | International ranges | |
| | UAS Services | |

Market and operational review

EMEA Services (formerly UK Services) performed well throughout the year in an environment where the UK Government remains focused on financial stability and defence transformation. The division delivered organic growth for the first time in five years, increasing revenue by 3% on an organic basis at constant currency. The C4ISR business performed particularly strongly and the other core Air, Weapons and Maritime businesses all produced good results.

Orders grew 11% to £447.8m (2013: £402.2m[^]), demonstrating the unique strengths of the division and its highly differentiated position in the UK market. International order intake was also encouraging, and the division was renamed EMEA Services during the year to reflect its current and potential geographic end markets.

Underlying operating profit* increased to £86.7m (2013: £84.8m[^]) as a result of continued productivity improvements and better project execution embedded during the self-help phase, enhanced by the contribution of certain international projects.

Organic-Plus update

EMEA Services combines world-leading expertise with unique facilities to provide technical assurance, test and evaluation, and training services, mainly under long-term contracts. The division is also a market leader in research and advice in specialist areas such as C4ISR, acquisition services and cyber security. Its structure is closely aligned to the Front Line Commands (Navy, Army and Air) that have taken on responsibility for managing military capability, and the creation of a Joint Forces Command provides a new sales channel for its C4ISR and Cyber businesses. The EMEA Services division is also leveraging its core strengths and intellectual property to pursue a pipeline of opportunities in new sectors and international markets.

QinetiQ's Air business combines unique facilities, capabilities and world-class experts to de-risk complex aviation programmes by testing military aircraft and equipment, evaluating the risks and assuring safety. Its core business delivers test and evaluation for the MOD as well as aircraft manufacturers. During the year it was awarded a £16m contract to support the conversion of Merlin helicopters for maritime use, and renewed a multi-year contract with Boeing for the wind tunnel



testing of future aircraft designs. The business is building market share beyond test and evaluation and won its first major engineering services contract to extend the life of an RAF aircraft type. The year also saw the first flight of the Watchkeeper Unmanned Air System (UAS) from Boscombe Down, which QinetiQ operates and manages for the MOD. The business is looking to leverage its UAS expertise through an agreement to develop the Llanbedr Airfield in Wales as a test range for UAS development, and through the provision of turn-key remotely piloted aircraft services to military and commercial customers.

The Weapons business provides independent research, evaluation and training services for integrated weapons systems. Its core business operates ranges, managing upgrades and enhancements for these strategically important facilities. It also provides research and advice, principally through a four-year contract to manage the Weapons Science and Technology Centre which was awarded at the start of the year. The Weapons business is working with its customers and supply chain partners to combat the growing threat from Fast In-Shore Attack Craft and is supporting the MOD's 'soft market testing' phase of a new, more efficient approach to the management of the UK's £6bn munitions inventory. The business delivered test and evaluation services to international governments in Europe and South Korea during the year. It is also responding to increased demand for advice on range design, management and operations from international customers looking to enhance their in-country capabilities.

QinetiQ's Maritime business provides independent research, design, integration, test and evaluation to naval clients worldwide, with significant revenue underpinned by three long-term contracts. The core UK Maritime business delivered strong order intake throughout the year driven by demand for expertise to support vital submarine capability. As well as test and evaluation, the business is establishing a new hydrodynamic development facility and designing



Name: Dr Jonathan Collier

Role: Research Delivery Lead, Weapons Science and Technology Centre

QinetiQ continues to manage the Weapons Science and Technology Centre (WSTC) on behalf of the MOD in a highly successful four-year contract, with options for a further three years. This covers the strategy, planning, management and delivery of research valued at circa £10m annually to support complex weapons, general munitions and energetic materials. What is genuinely ground-breaking about QinetiQ's WSTC model is its scalability, flexibility and how it brings industry and MOD together in an open and collaborative way: gathering requirements from all parties, including Front Line Commands, then using deep technical specialists drawn from the 58 partner organisations to plan and prioritise potential technology solutions to form a coherent programme. Delivery is by a 'best of breed' basis and includes taking concepts through R&D through to practical demonstration. However, it is the planning which is truly innovative and informs all research activities by capturing and translating MOD and industry requirements and capabilities into a programme that delivers best value for money.

signature measurement facilities for the 'Successor' (future nuclear deterrent) and Maritime Underwater Future Capability programmes. In addition, the Maritime business opened a Communications Development and Integration Facility during the year to de-risk the procurement of future communications systems, and won a £5m contract from a competitor shortly after year end to deploy and maintain the MOD's mobile underwater targets. It is also leveraging core strengths to win new international work, securing a contract from Daewoo Shipbuilding to support the development of the Republic of Korea's new KSS-III attack submarine.

Understanding our business



Air

Core

What we do

De-risks complex aviation programmes by testing military aircraft and equipment, evaluating the risks and assuring safety.



Weapons

Core

What we do

Provides independent research, evaluation and training services for integrated weapons systems.



Maritime

Core

What we do

Provides independent research, design, integration, test and evaluation to naval clients worldwide – underpinned by three long-term contracts.

EMEA Services continued

QinetiQ's C4ISR business is a leading supplier of research and advice on sensors, communications and intelligence. The business manages significant enabling contracts, working with partners to deliver C4ISR research for the MOD. During the year it was awarded two new research enabling contracts, unseating the incumbent supplier to win an enabling contract for defence logistics research, and winning the next stage of the contract under which it leads research into secure information infrastructure. The independent technical expertise of its scientists and engineers is in demand in the UK to provide advice on the transition required following the Afghanistan conflict and in support of the new Joint Forces Command. There is also encouraging demand from international customers, and during the year the business advised governments in Europe, the Middle East and South East Asia on the procurement of complex C4ISR technology.




QinetiQ Australia is a multi-disciplinary engineering and consultancy business, within the defence, maritime and rail markets. Despite short-term uncertainty following September's federal election, the core defence business has continued to grow, underpinned by partnership contracts with the Department of Defence to support the airworthiness of military aircraft and develop sovereign munitions manufacturing facilities. During the year the business won positions on new government framework contracts known as 'panels' and grew its footprint in the maritime market by supporting the Hydrographic Systems, Frigates and Helicopter Dock Program Offices. Future opportunities exist as a result of the Coalition Government's commitment to restore defence expenditure to 2% of GDP within ten years, as well as in adjacent markets such as rail.

In the 'Explore' category of its portfolio, QinetiQ is nurturing certain products and services to determine their ability to scale. While some of these solutions remain embedded within the appropriate core business, significant progress has been made establishing the more

mature growth opportunities as distinct, agile business units better placed to realise their potential.

QinetiQ's Cyber Security business protects critical national infrastructure and high-value commercial enterprises through the provision of consultancy, managed security services, secure information exchange, and threat and risk assessments. During the year the business transferred responsibility for certain core capabilities to the C4ISR business, and is now focused on growth in the UK public sector and smart infrastructure markets. The ability to monitor and identify incidents on IT systems is a key customer concern and the Cyber business was awarded a multi-year contract by the Ministry of Justice to provide protective monitoring of its networks. It was also awarded an £8m contract to provide data security services to the UK Government's smart meter programme. Opportunities also exist for international growth, with training and capability development providing important routes to market outside the UK, and to leverage the cyber intelligence capabilities provided by Cyveillance®.

Cyveillance®, which provides cyber intelligence and was formerly managed and reported under the US Services division, did not form part of the strategic review of that division but was instead extracted from the proxy governance into a standalone commercial entity. It complements QinetiQ's UK-based cyber activities and has been established as an 'Explore' business that is now reported as part of EMEA Services. A new leadership team has successfully commercialised Cyveillance®, with a renewed focus on the delivery of higher margin, repeatable security services to commercial markets. During the year, the business increased its revenue from US Fortune 500 customers as companies, particularly in regulated markets such as finance, energy and healthcare, established threat intelligence centres to predict and combat cyber risks. Cyveillance® is also extending its offering to small and medium-sized

| Understanding our business | | |
|---|---|---|
|  Australia Core |  C4ISR Core |  Procurement Advisory Services Explore |
| What we do A multi-disciplinary engineering and consultancy business within the defence, maritime and rail markets. | What we do A leading supplier of research and advice on sensors, communications and intelligence. | What we do Delivers government procurement advice including tender assessment, cost and risk advisory services. |




enterprises, investing in cloud-based platforms and in integrated support services that assist customers in collecting and prioritising threat intelligence.

The Group has also established a new Procurement Advisory Services business to deliver government procurement advice including tender assessment, cost and risk advisory services. The business, which employs a software and services model, is targeting complex procurement programmes in the highly regulated government, transport, energy and minerals markets. QinetiQ's safety capabilities, previously delivered by this business and focused primarily on defence customers, have been transferred to the Air business, where they complement existing release-into-service work. Procurement Advisory Services incorporates Commerce Decisions, a QinetiQ subsidiary, and its AWARD® procurement evaluation software used on projects totalling \$140bn worldwide. The refocused business unit also provides a route of entry into international markets, as well as a bridgehead for capabilities offered across EMEA Services. Building on early successes in the Australian market, it won a position on the framework contract through which the Canadian Government procures technical and acquisition support in the second half of the year.

The Training and Simulation Services business has been renamed QinetiQ Training. While the business remains differentiated by its use of technology to reduce the cost of training, it will draw on training capability from across QinetiQ, allowing it to address larger opportunities. The Training business consolidated its position in the UK market during the year, increasing revenue on its flagship Distributed Synthetic Air Land Training (DSALT) programme at RAF Waddington and securing a two-year extension for the Defence Simulation Centre it has established for Joint Forces Command. It also won the re-compete of a £4m underpinning contract with the UK's Defence Science and Technology Laboratory (Dstl)

Name: Wendy Wates
Role: Managing Director, QinetiQ Commerce Decisions Limited



QinetiQ Commerce Decisions enables more intelligent procurement through its expert people, best practice insights and powerful AWARD® software used on projects worldwide totalling \$140 billion. The company's ongoing transformation is already bringing considerable success: orders and revenue increased last year. "This is sustainable growth, founded on a culture of success and commitment shared by our people and our customers," says Wendy Wates, MD. "Existing customers know how important they are to us, new customers recognise our credibility and commitment, the market understands how we can help and our own people know they're valued. Our strategy includes retaining and growing our core, continued UK growth – particularly in commercial sectors – and pushing even harder internationally. We're already achieving success in Australia, winning a contract for a maritime programme, and have qualified opportunities in Canada. This is a great place to be right now."

for demonstrating the applicability of commercial off-the-shelf technologies, such as gaming technologies, to defence and security applications. The business has yet to realise the potential offered by the US market, but QinetiQ opened an office during the year in Orlando at the heart of the US simulation community.

Understanding our business



Training

Explore

What we do

Uses technology to reduce the cost of training, drawing on training capability from across QinetiQ.



Cyber Security

Explore

What we do

Protects critical national infrastructure and high-value commercial enterprises through the provision of consultancy, managed security services, secure information exchange, and threat and risk assessments.



Cyveillance®

Explore

What we do

Provides open source threat intelligence and remediation to customers across the world including many of the Fortune 500.

MAXIMISING VALUE

Key highlights

Revenue

£408.8m
2013: £463.8m[^]

Underlying operating margin*

4.6%
2013: 5.1%[^]

Underlying operating profit*

£19.0m
2013: £23.7m[^]

No. employees

2,704
2013: 3,219[^]

[^] Restated to reflect the reclassification of the Cyveillance® business from US Services to EMEA Services.

* Definitions of underlying measures of performance can be found in the glossary on page 150.

Post year end QinetiQ agreed to sell the US Services division to The SI Organization, Inc.

Market and operational review

The performance of US Services was impacted by continued uncertainties in the US federal services market, despite a deal on the US defence budget being signed into law in December 2013, providing a more gradual path to lower defence spending than was previously mandated.

In this slower contracting environment, orders fell 17% from £450.7m[^] in 2013 to £375.5m as a result of budget reductions and delays to customer decision making on both new and incremental orders. This was exacerbated by the routine lodging of protests by unsuccessful bidders.

Revenue declined 12% on an organic basis at constant currency, impacted by funding reductions on certain contracts, some work ending in period, and the switching of some work to small-business set-aside contracts.

Underlying operating profit* was £19.0m (2013: £23.7m[^]) with the widespread adoption of lowest-price-technically-acceptable evaluations driving highly competitive market conditions. However, the reduced performance of US Services was somewhat mitigated by actions implemented last year to place the US cost base on a more competitive footing which included reducing management and property costs, as well as the ongoing control of overheads to maintain competitive rates.

Organic-Plus update

US Services is a leading provider of technical services and solutions to the US federal government. The division has a broad client base with key customers including NASA, the Department of Homeland Security, the US Government's General Services Administration (GSA) and the Intelligence Community as well as the US military.

At the beginning of the year, the division's two defence-focused businesses – Lifecycle Solutions and Software & Systems Engineering – were integrated to create Defense Solutions, which provides systems engineering, fleet management and software development services to defence agencies, as well as modelling and simulation for training. The business has a long record of providing aviation engineering services, and during the year it was awarded task orders totalling more than \$30m on its two major framework contracts with the US Army Air Corps. The US Government's 'pacific pivot' represents a resource shift to naval markets, and during the period the Defense Solutions business built on its strong base of contracts in the maritime domain by winning a \$19m contract to provide Technical Authority Support to the Chief Engineer at the Space and Naval Warfare System Command (SPAWAR) and a \$16m contract with the Office of Naval Research.

Aerospace Operations and Systems is one of the largest contractors to NASA and the largest contractor at the Kennedy Space Center, providing spaceflight and launch support, mission analytics, satellite integration, scientific data analysis and independent launch verification. The business is building on its reputation for the successful delivery of major engineering contracts to grow revenue on its major contracts with NASA, including the Engineering Services Contract at the Kennedy Space Center and the Environmental Test and Integration Services contract at the Goddard Space Flight Center. Key projects included re-manufacturing the Crawler Transporter at Kennedy and testing of the James Webb Space Telescope, NASA's replacement for the Hubble Space Telescope due for launch in 2018. The business is also leveraging its R&D credentials with NASA and the US Air Force to meet the need for scientific and intelligence data analysis in support of military intelligence organisations.

Mission Solutions provides enterprise IT, systems design and integrated software solutions to defence, security, intelligence agencies and other customers in the federal and civil markets. The business has reduced its overhead costs significantly over the last two years in response to headwinds from reduced spending on non-differentiated IT professional services and lowest-price-technically-acceptable acquisitions. The specialist expertise of its employees remains attractive to a range of customers and during the year Mission Solutions increased revenue from the General Services Administration, winning a new \$14m contract from the Public Buildings Service for enterprise data management. It was also awarded a \$15m follow-on contract for software development by the Maryland Procurement Office. Although revenue fell from the Department of Homeland Security, the business was awarded a position on the Department's EAGLE II contract that will serve as its platform for acquiring IT services over the next seven years.



Global Products

DRIVING A CHANGE IN FOCUS

Key highlights

Revenue

£175.6m

2013: £269.4m[^]

Underlying operating margin*

15.4%

2013: 22.3%[^]

Underlying operating profit*

£27.0m

2013: £60.2m[^]

No. employees

834

2013: 927[^]

- Reduction in US conflict-related product sales and profits against strong prior year
- Reduction partially offset by the contribution from UK Global Products and TALON® orders from Iraq and Pakistan
- New Proxy Board and Chairman appointed just after year end
- To reduce the volatility of its revenue profile over time, QinetiQ is seeking to increase its portfolio of products and to find new markets and applications

[^] Restated to reflect the reclassification of product sales from EMEA Services to Global Products.

* Definitions of underlying measures of performance can be found in the glossary on page 150.

Value pipeline

| Core | Explore | Test for value |
|-------------|-----------------------|---------------------------------|
| TALON® | OptaSense® | Alarm™ |
| Q-Net® | Robotic applique kits | Integrated Warrior System™ |
| LAST® Armor | Robotic controllers | MEWS™ |
| SWATS™ | Space Products | Power Line Sensors (Linewatch™) |
| | | E-X-Drive® |

Market and operational review

The performance of Global Products was impacted by the drawdown of overseas US military forces that had an increased negative effect on demand for US conflict-related products, against a strong prior year. This was partially offset by the contribution from UK Global Products which benefited from deliveries of the Alarm™ radar system and the Modular Electronic Warfare System (MEWS™). A new Proxy Board and Chairman for US Products were appointed just after the year end to assist in repositioning the business and addressing its performance.

Orders were £149.1m (2013: £223.9m[^]) due to the reduced demand for US military products and spares. The division has shorter order cycles than the services divisions and was impacted by budget reductions and slippages in order flow as a result of the drawdown, partially offset by TALON® orders from Iraq and Pakistan with a combined value of \$28m.

Revenue was £175.6m (2013: £269.4m[^]), underlining the division's dependency on the timing of delivery schedules for key orders. Q-Net® revenue during the year was \$20m (2013: \$120m) with minimal spares sales as a result of the reduced operational tempo as US forces leave Afghanistan.

As anticipated, this decline in Q-Net® deliveries, including spares, reduced underlying operating profit* to £27.0m (2013: £60.2m[^]), partially offset by an increased profit contribution from the UK products business and a £6m benefit from a favourable legal ruling on an historic onerous contract.

Organic-Plus update

Global Products combines cutting-edge technologies with an intimate understanding of customer problems and strong productisation skills to deliver innovative solutions to meet customer requirements. The division also undertakes contract-funded research and development, developing intellectual property in partnership with key customers, with potential for new revenue streams. To reduce the volatility of its revenue profile over time, QinetiQ is seeking to increase its portfolio of products and to find new markets and applications for its existing offerings.

The Unmanned Systems business is a world-leading provider of military robots. With the US military assessing their post-war requirements for robotics and formulating new programs of record, demand from customers in the US fell during the year but international sales more than doubled with \$20m of TALON® robots delivered to Iraq, \$8m to Pakistan and \$3m of Dragon Runner™ sales to the Netherlands. The Unmanned

Global Products continued



Name: Tom Debraekeleer and Bart De Wilde
Role: Small satellite assurance and safety



QinetiQ's Space Products business continues to grow in reach and reputation. Europe's leading manufacturer of small satellites, the last year saw us further commercialise the expertise and IP developed with the European Space Agency (ESA), launching into new international territories. Part of a Belgian consortium, we are creating an observation satellite for the Vietnamese Government designed for resource, environment and disaster monitoring. This small satellite is similar to the ESA's Proba-V, which we successfully launched and tested in 2013. Proba-V exemplifies innovation in action, requiring us to miniaturise technologies to fit the payload of this highly compact satellite. Incidentally, our Proba-1 that launched in 2001 was only designed for two years: it's already celebrated its 12th anniversary in space. We are currently prepping a remarkable follow-up mission for ESA: formation flying two satellites only 200 metres apart in a controlled way. Watch this space.

Systems business is also increasing its portfolio of products, often partnering with universities such as the University of Texas at Arlington, Virginia with whom it works to develop advanced robotic control systems. New offerings include low-cost, lightweight robots controlled by mobile devices that are designed for non-military applications.

The survivability business provides innovative products that protect people and assets, thereby saving lives. During the year the business delivered its Q-Net® vehicle survivability product to Oshkosh to fit to M-ATV vehicles under an \$18m contract. It is also finding new markets outside the US as European governments rebuild military capabilities and governments in the Middle East and Asia increase their expenditure on security and defence. International product sales during the year included delivery of the Precision Air Drop System (PADS®) to a Middle Eastern customer and the Shoulder-Worn Acoustic Targeting System (SWATS™) to Germany. In the 'Test for Value' category, the business has developed an Integrated Warrior System™ that enables a soldier to plug-and-play multiple sensors through a lightweight vest and access data via a tablet or smartphone. The system has a wide range of applications including training, mission rehearsal and operations.

The division continues to diversify its product portfolio, especially beyond defence. In the 'Explore' category some products, such as newer robotic technologies, remain embedded within the appropriate core business, but other more mature growth opportunities, such as OptaSense® and QinetiQ's Space Products business, have been established as distinct business units. Early-stage emerging technologies are classified in the 'Test for Value' category, with the relevant core business responsible for their development.

Understanding our business



Survivability

Core

What we do

Provides innovative products that protect people and assets thereby saving lives.



Unmanned Systems

Core

What we do

A world leading provider of military robots.



OptaSense®

Explore

What we do

A bespoke fibre sensing business that delivers Decision Ready Data to multiple vertical markets.



Space Products

Explore

What we do

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



The OptaSense® bespoke fibre sensing business is the most mature of the 'Explore' opportunities in QinetiQ's portfolio, recently winning Queen's Awards for Export and Innovation. The development of the business has been accelerated by the acquisition of Redfern Integrated Optics (RIO), a market leading supplier of low noise semi-conductor lasers, with a turnover of \$5m in 2013. The acquisition provides OptaSense® with access to current and future generations of highly coherent semi-conductor lasers that are ideally suited to distributed fibre sensing particularly in the harsh environment of oil and gas. OptaSense® technology has applications in multiple vertical markets in which the business normally looks to partner to achieve the necessary access and scale. The largest of these markets is down-hole oil and gas, and discussions are already underway with oilfield services companies to establish the optimum model to address this market. Following the end of the exclusivity period with Shell in 2013, the business has signed enabling agreements to supply its products and services to seven oil and gas companies including BP and Conoco Philips. OptaSense® continues to work with Shell under a three-year product development contract that was extended during the year to include the marinisation of its technology for the subsea and deep water market. The business also won the oil and gas industry's first multi-year 4D distributed acoustic sensing contract for the vertical seismic profiling of up to 12 oil wells simultaneously in Oman. In the rail market OptaSense® is partnering with Deutsche Bahn under an 18-month contract to develop applications and validate their ability to replace current rail sensors. The business also delivered trials for Austrian Rail on its infrastructure near Vienna and on the M5 and M4 motorways in the UK. In the infrastructure security market, OptaSense® won three key orders to protect over 1,600km of pipeline in the Middle East. This brought the total of new contracts from customers in the Middle East to \$24m for the year and follows the decision to invest in the region two years ago. The business is also engaged in four pilot programmes for border security.

QinetiQ's Space Products business provides satellites, payload instruments, sub-systems and ground station services. The business is a partner in the European Space Agency (ESA) ground station at Redu, Belgium and recently signed an agreement that ensured the long-term development of this facility as a strategic focus for European space activities. Proba-V, the latest of the Space Products business' family of small satellites, was launched in May and is being used by ESA to study vegetation following its successful commissioning in December. The business is also a member of a Belgian consortium that won a contract to design and build an



Name: Jeff Travis and Jim Godfrey

Role: Electrical engineers



Our Linewatch™ product is uniquely placed to capitalise on the next wave of smart grid technologies to monitor, manage and automate power distribution networks in real-time; we are already piloting innovative low-voltage and medium-voltage power line sensors for major North American power companies. With increasing energy generated from distributed sources outside the main utilities and sold back into the grid – notably by wind, solar and other 'green' suppliers – managing the grid is increasingly challenging. How can you manage peaks in demand and dips in supply, ensure quality of service for customers, monitor assets, cope with severe weather events, locate interruptions fast, reduce outages, and protect against losses due to theft? Linewatch™ sensors tick the boxes in all these critical areas. Fitted to power lines quickly and safely, a range of valuable data is communicated to the utility operations centre for analysis and actionable response.

agriculture monitoring satellite for the Vietnam Academy of Science and Technology, an important first step in growing its international satellite business.

In the 'Test for Value' category, early-stage offerings are evaluated as they emerge to determine the best route to maximise value. During the year, there were further sales of the Alarm™ radar system to provide warning of ultra-low-level rocket attacks in support of UK military operations in Afghanistan. While some emerging military technologies will be impacted by the drawdown, others have potential beyond operations in Afghanistan. One example is the Modular Electronic Warfare System (MEWS™) which is being taken to market with L-3 TRL and received a £4m order from the government of a NATO country.

Other 'Test for Value' technologies are focused on non-defence markets, such as the secured navigation systems currently being proven on ESA's Galileo programme and stealth wind turbine technology, which achieved its first licence sale during the year. In addition a pilot of the Linewatch™ power line sensor system, that precisely measures voltage and current on power grids, is currently under way with a major North American hydro-electric company to support its smart metering programme.

COMMITTED TO EMBEDDING A SUSTAINABLE APPROACH

“We recognise that our prized possession is trust and welcome the value our customers, employees and shareholders place on QinetiQ being a responsible business.”

Leo Quinn, Chief Executive Officer

Key highlights

- **Launch of The 5% Club**
- **Introduction of a diversity policy**
- **Reporting Group greenhouse gas emissions**
- **MOD conservation award**

Managing corporate responsibility

Strong governance underpins responsible business practice and the Group has Board and executive level Commitment to corporate responsibility through the Group Risk & CSR Committee (page 66 of this report). The Committee meets regularly and receives reports and briefings on all material CR issues including business ethics, environment, health and safety, diversity and human rights. In the US, the Proxy Board oversees these activities, obtaining independent assurance on the adequacy of its compliance programmes on an ongoing basis.

The Group's policies and management systems underpin our CR programmes. In the UK, the business assurance tool provides internal assurance and we have the external certification ISO 14001 for our environmental management system, ISO 9001 for our quality management system and OHSAS 18001 for our health and safety management system. In the UK we have a Sustainable Procurement Code and we take a number of steps to ensure that we buy responsibly and sustainably. Similarly in the US, the business has policies and programmes in place to ensure compliance with US federal labour, health and safety, environmental and other laws and regulations. Our US business is ISO 9001:2008 and ISO 9001:AS9100 certified at three key sites. QinetiQ's commercial success depends on our ability to conduct business in overseas territories, transacting with foreign governments and commercial organisations in a legally compliant manner, controlling the international movement of certain strategic items.

Our CR strategy reflects the material issues for our business – defined by our stakeholder priorities. We ensure that we understand these priorities through regular dialogue such as investor meetings, involvement in the MOD-industry Sustainable Procurement Working Group and employee engagement programmes.

Best practice in CR is evolving and to ensure that as we continuously improve, we regularly introduce new programmes and initiatives.

Business ethics

The Group Code of Conduct (updated July 2013) underpins how we do business. Its purpose is to clearly articulate our ethical standards and provide employees with a guide to what is expected of them in their behaviour and business activities. It provides information on how they can get help and also guidance on their responsibility to report if they identify a problem. Employees are advised to talk to their manager first but we also provide ethics email advice services and a whistleblowing line. The whistleblowing line is independently run and provides a confidential 24/7 service. We respond to a number of queries through the ethics advice services each year and all communication through the whistleblowing line is investigated. Annual business ethics training is mandatory for all employees across the Group and for the Board. It covers a range of issues including anti-bribery. We also provide more in-depth anti-bribery training for those in higher risk roles, for example those who carry out overseas business. Anti-bribery risk management is embedded in our business processes; we have a robust process for undertaking due diligence, monitoring and audit of our use of commercial intermediaries, and we use expert third-party providers of due diligence, where appropriate. Our anti-bribery programmes are overseen by our Chief Ethics Officers who are senior executives. We adopt a zero tolerance approach to bribery and corruption.

Human rights

QinetiQ recognises that the UN Guiding Principles on Business and Human Rights set a standard of conduct expected of companies. We seek to anticipate, prevent and mitigate potential negative human rights impacts through our policy and process, and through our Code of Conduct and business ethics training for employees, all of which underpin our commitment to ethical business conduct. QinetiQ has policies in place to support meeting internationally recognised human rights principles, including adherence to export controls, health and safety, non-discrimination, anti-bribery and environmental issues. This is further supported by our procedures on product safety, sustainable procurement, due diligence and risk



management (which are described in more detail elsewhere in this Corporate responsibility and sustainability Review). We monitor the application of these policies and procedures through our business assurance processes. We are presently reviewing the benefits of this embedded approach, as compared with the implementation of a specific human rights policy. We will also be looking at best practice in tracking how human rights issues are addressed within our business.


Employees

2014 highlights and 2015 priorities

2014 highlights

- **Launch of The 5% Club**
- **Introduction of a diversity policy**
- **Launch of Safe for Life in the UK**

2015 priorities

- Continue to improve our diversity programme
- Introduce a UK Safety Culture Climate Survey score
- Continuing reduction in Lost Time Incident Rate
- 5% of UK workforce to be on apprenticeship or graduate programmes by March 2015

Our employees

Safety, health and wellbeing

QinetiQ recognises that the safety, health and wellbeing of our people are intrinsically linked to our strategic success. We continue to focus on reducing accidents and work-related ill health as part of our continuous improvement activity.

The UK RIDDOR (Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013) rate rose from 1.90 in 2014 to 2.74, missing our 2013 objective of reducing reportable UK incidents. However, this remains well below the Health and Safety Executive's 'all industries' average of 3.11 per 1,000 employees. Within these reportable accidents, severity of injuries has reduced and our RIDDOR rate is down overall in the last four years, from 5.35 to 2.74. Given the relatively low number of reportable incidents, a small change in absolute numbers can significantly impact annual rates. Taking this and our increasing international presence into consideration, QinetiQ has decided to change focus from UK RIDDOR rate to an overall Lost Time Incident Rate (see non-financial KPIs on page 19) which provides a relevant lagging indicator for the Group. We also recognise the need to incorporate leading indicators into our annual reporting. As part of our new UK Safe

for Life programme we will be using a Safety Culture Climate Survey score as a safety performance indicator from 2015.

There were no prosecutions or prohibition notices issued by regulators in the UK in 2014. A single improvement notice was issued to the Company following the UK Health and Safety Executive's investigation of an incident at one of the sites we manage on behalf of the MOD. Although the incident was relatively minor in nature and did not result in any injuries, several improvement actions were identified relating to the risk assessment process and training of employees. These actions have all been completed, the Improvement Notice formally closed and lessons shared across the organisation.

Safe for Life represents a logical progression of our safety strategy, incorporating existing activity focused on safety leadership, human factors, error management and behavioural safety. It provides a single framework to deploy flexible resources, systems and tools at a business and operational site level to address local safety culture, and is underpinned by an objective safety assurance review and Safety Culture Climate Survey. This programme is currently being piloted in our Weapons business with plans for wider roll-out across the UK.

In our US business, focus continues to be on empowering employees to operate safely through provision of further specialist training.

| Lost Time Incident Rate | 2012 | 2013 | 2014 |
|----------------------------|-------------|-------------|-------------|
| QinetiQ Group excluding US | 5.53 | 5.36 | 4.29 |
| US business | 1.12 | 1.45 | 1.37 |
| Total | 3.55 | 3.70 | 3.39 |

Our health and wellbeing programmes in both the UK and US continue to develop. The UK Wellbeing programme and QinetiQ Benefits+ scheme in the UK are offering more services, with increasing uptake by employees. Free flu jabs and health assessments (measuring BMI, blood pressure and cholesterol) are proving particularly popular. The Vitality Wellness Program has been running in our US business for over three years, as part of the existing Health in Motion initiative. It supports employees and their spouses, and benefits include reduced health insurance premiums, prizes for attaining point levels and discounts on health clubs and equipment.

Safety of products

Delivering products and services safely fundamentally underpins our offering to customers. We invest in attracting and developing our engineers and scientists with specialist safety expertise. In the UK, technical assurance and Independent Design Review have been fully integrated into our day-to-day business delivery processes. Improvements continue to be driven by

Corporate responsibility continued

our Engineering, Science and Technical Leadership Team, supported by independent assurance activity. In addition to maintaining and developing its design and maintenance accreditations for safety-critical work, QinetiQ actively supports collaborative working with the MOD and other industry organisations to develop and implement common safety standards and practices. Our US business continues to use technical excellence to improve the safety and usability of their products.

Employee engagement

We seek to utilise a range of communication channels to engage with employees in respect of factors affecting the performance of the Group. An independent annual employee engagement survey for EMEA employees had a response rate of 73% and recorded a 3% increase in Employee Engagement compared with 2013 (see page 19). Action planning is taking place at a business unit level to build on successes and address priority areas for improvement. The UK Employee Engagement Group (EEG) comprises 42 representatives elected by employees covering both local and national level to improve engagement and act as a consultative body on developments within the Company. The EEG is entering its third year and continues to play an active role in monitoring and providing feedback on employees' views on topics such as pensions, employee wellbeing and engagement. In our US business we engage with employees through a range of channels such as town halls and employee focus groups. We also use various channels, including the intranet, management briefings and widespread training programmes to involve employees in the running of the business.

Diversity and inclusion

In the US, we have a Diversity Recruiting Strategy which was introduced during 2013 to focus on the recruitment of under-represented groups. A Group-wide equality, diversity and inclusion policy was introduced during 2014. We have become core members of the Employers Network for Equality and Inclusion (ENEI) which promotes diversity and inclusion in employment. We are committed to the fair treatment of people with disabilities in relation to applications, training, promotion and career development. If an existing employee becomes disabled, the Group's policy is to provide continuing employment and training, wherever practicable. We have 'Two Ticks' accreditation in the UK – a commitment to employing disabled people.

The breakdown of the number of employees by gender at the end of March 2014 is shown in the table below:

| Level | Female | Male |
|-----------------|--------|-------|
| Board Directors | 2 | 6 |
| Senior managers | 38 | 231 |
| All employees | 1,998 | 6,939 |

Learning and development

We deliver business-focused learning and development, to enhance individual and team performance to deliver results and achieve our strategic goals.

In the UK, professional development begins during an employee's 'First 100 Days' programme, including induction, workshops, online learning and knowledge acquisition. Tailored learning (personal and role specific) continues for all employees, including mandatory training such as health and safety, and business ethics. Career development can be technical or managerial, with some employees combining both. Our UK engineering, science and technical communities now have a clear Career Development Framework reflecting an ever-changing marketplace. Development packages have been enhanced in 2014 for line managers and business leaders, including the launch of the QinetiQ Manager Programme. Our graduate programme has been maturing through 2014 and will result in an all-new offering in 2015. We also continue to grow the number of apprenticeships we offer. In 2015, the UK Performance Management process will be updated and we will provide a Career Development Framework for each employee community.

In the US, the employee performance appraisal process has been enhanced to improve employee ownership of career development, planning by supervisors and to better align employee development with our US business objectives. Employees are supported in the attainment of professional and technical certifications and degrees. Our US business is an ITIL (Information Technology Infrastructure Library) Foundation Certification Training provider, with two certified instructors. US employee service and accomplishments are recognised through a variety of bonus programmes.



The 5% Club – Investing in a generation

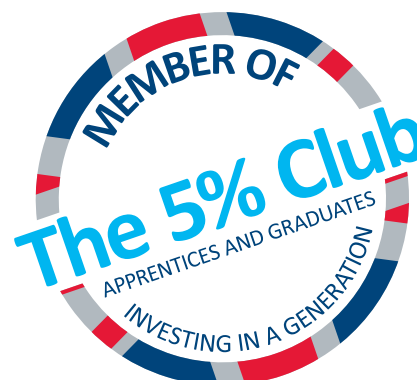
The 5% Club was launched in October 2013. Spearheaded by QinetiQ and supported by five founding members, this industry-led campaign aims to transform the fortunes of young people in the UK. This initiative already has the support of 32 companies, large and small, from a range of sectors, including engineering, construction, defence, retail, law and IT. Developing our young people is both a business and a social imperative. It is good for the economy, as skills enhancement leads to innovation, innovation leads to growth, and growth leads to prosperity. We believe 'what gets measured gets done', so The 5% Club involves formalising what an organisation does in terms of apprentice and graduate programmes and making the public commitment that these will comprise 5% of the UK workforce within the next five years. At QinetiQ we have set this UK goal by March 2015 (our current figure is shown below). A People Network has been set up to ensure that the achievement of this target is sustainable and the first meeting was held in March 2014.

| The 5% Club | Number |
|-----------------------------------|--------------|
| Number of apprentices | 121 |
| Number of graduates | 106 |
| Number of sponsored students | 17 |
| Percentage of UK workforce | 4.78% |

Our communities

QinetiQ is committed to being a good neighbour in the communities in which we operate. One way in which employees contribute to this is by volunteering their time and professional skills, such as via the UK Employee Volunteering Scheme. Our flagship initiative is our STEM outreach programme with the aim of inspiring the next generation of scientists and engineers. QinetiQ STEM Ambassadors have organised STEM events for school children such as the annual powerboat and robo-olympics challenges, and have hosted Cyber Security Challenge UK. We are delighted that one of our STEM Ambassadors, Lauren Hill, won the accolade of Most Inspirational Apprentice at STEMNET's national Annual Awards. Our non-STEM employees also use their skills through programmes such as Young Enterprise. The 'giving something back' score in our 2014 employee survey rose by 3% compared with 2013, indicating that employees recognise and value the continued focus on community programmes.

In the US we support educational enrichment through the National Guard Youth Foundation, World Affairs Council, Naval Historical Foundation and various robotics education programmes. There is also a particular focus on supporting wounded military and their families by contributions to a range of specialist organisations.



Name: Chris Clinton [far right]
Role: Cyber Security Consultant



A graduate in electronic engineering and computer sciences who joined QinetiQ in 2011, cyber security consultant Chris Clinton is passionate about his job – and his extra workload as a Technical Lead for Cyber Security Challenge UK. With the threat landscape growing and only one-fifth of attacks reported, the not-for-profit challenge seeks to address the serious shortfall in cyber defence professionals:

"There's a huge shortage of expertise, and of young people coming into the industry, yet the threat is massive and growing," Chris says. "That's why initiatives like The 5% Club and the Challenge are vital, to promote science and engineering, and energise people to get involved. We can help government, military and businesses globally to understand that cyber security isn't an overhead – it's actually a business enabler. We have an amazing capability at QinetiQ, with cyber security's leading minds ready and able to help people counter attacks."

Corporate responsibility continued

This year we created a new UK Volunteer of the Year award, presented at our leadership conference, which recognised the achievement of an employee who has made an outstanding contribution in the community through the Employee Volunteering Scheme.

QinetiQ in the UK continues to support three corporate charities voted for by employees (Cancer Research UK, Help for Heroes and RNLI) by providing matched funding for any employee fundraising activities. Employees can also choose to give to their chosen charity pre-tax through payroll giving.



Environment

2014 highlights and 2015 priorities

2014 highlights

- **Launched Energy Matters in the UK**
- **MOD Silver Otter conservation award**

2015 priorities

- Reduce greenhouse gas emissions due to UK energy use by 17% by 2020 from a baseline of 2013
- Consolidate the proportion of UK waste going to landfill at less than 10%
- Set a number of UK site-specific targets to reduce current waste-to-landfill levels
- Promote prevention of UK waste via enhanced re-use of assets

Our environmental impact

Environmental stewardship

QinetiQ is committed to strong, effective and innovative environmental management. The UK Environmental Management System is certified to ISO 14001 and applies to our own estate and the sites we manage on behalf of the MOD. We are also reinforcing our management review arrangements. We recruited a dedicated Energy Manager to strengthen our specialist team with responsibility to develop strategy, provide clear direction and drive improvement programmes. We have delivered further reductions in the proportion of waste-to-landfill and established partnerships with key service providers, from utilities to waste.

We have also delivered initiatives to deal with the specific, complex challenges associated with our work and footprint. These have included: the development of our Sustainability Appraisal processes and training; holding a Climate Change Workshop, with MOD, enabling the identification of potential impacts and priorities; and enhanced conservation and sustainability programmes on many sites.

Many of the MOD sites contain designated conservation areas of national and international importance, such as Cardigan Bay, a Special Area of Conservation, situated next to the MOD Aberporth site. As a result, Sustainability Appraisals are regularly carried out to identify and mitigate any impact to the flora and fauna before we undertake our delivery of test, evaluation and training support services. In 2014 we won the MOD's Silver Otter conservation award for our work at MOD Aberporth (see case study on page 41). We also manage Eelmore Marsh, a Site of Special Scientific Interest at our Head Office in Farnborough. Through our partnership with Marwell Wildlife and the long-term commitment to restoration of this lowland heath system, Natural England has now classed all three of the habitat units at Eelmore Marsh as 'favourable' condition status.

Greenhouse gas emissions

We have continued our focus on reducing our carbon footprint; we again submitted voluntarily to the CDP Climate Change Programme (scoring 73 and Band C) and we are registered for the Carbon Reduction Commitment (CRC) scheme. As part of our annual UK Environment Week, we launched a major new campaign called Energy Matters. The aim is to encourage everyone to get involved in reducing our energy usage. A network of Energy Champions supports the business in identifying areas where energy consumption could be reduced.



Energy Matters has resulted in a reinvigorated programme with improvements in data quality and our ability to prioritise, so we have decided to re-set our target to focus on carbon emissions from energy use (gas, oil and electricity) associated with buildings and our operations in the UK. Our new target is to reduce these emissions by 17% by 2020 from a baseline of 2013, where our emissions were 51,976 tonnes of carbon dioxide equivalent (tCO₂e). Our emissions due to energy use in 2014 were 49,368 tCO₂e – a reduction of 5%.

We have put in place the process to capture and report our greenhouse gas (GHG) emissions across the Group to reflect the requirements of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. The GHG emissions statement below provides a summary of the Group's emissions from 1 April 2013 to 31 March 2014, giving a summary of Scope 1 (fuel combustion and operation of facilities) and Scope 2 (purchased electricity) emissions and an intensity ratio (per £m of revenue). We have adopted a financial control approach and have used the UK Government's Conversion Factors for Company Reporting 2013 and Defra reporting guidance (October 2013).

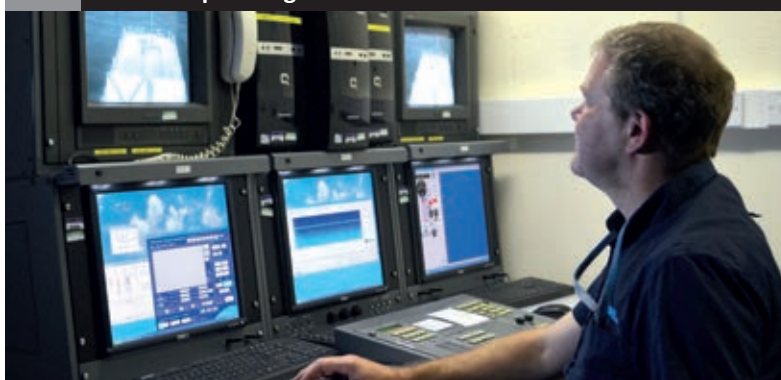
| Group GHG emissions | Year end 31 March 2014 |
|--|------------------------------|
| Total Scope 1 emissions (tCO ₂ e) | 26,042 |
| Total Scope 2 emissions (tCO ₂ e) | 37,613 |
| Total Scope 1 and 2 emissions (tCO ₂ e) | 63,655 |
| Intensity ratio (tCO ₂ e per £m of revenue) | 53.4 |

UK waste management

Robust capture and effective reporting of data is an ongoing priority, enabling our improvement programmes to be targeted. Our aim in 2014 was to encourage reduction in waste, increase re-use of assets, and enhance segregation of waste streams. Overall waste levels increased compared with last year (5,626 tonnes, including 112 tonnes of hazardous waste, compared with 4,904 tonnes in 2013) due to significant site clearance, and development work, but the proportion of UK waste going directly to landfill ran at less than 10%, reflecting our focus to promote effective segregation and recycling. Our aim for 2015 is to consolidate the proportion going to landfill at less than 10% and to set a number of site-specific targets to reduce current waste-to-landfill levels. We also plan to promote prevention of waste by improving the re-use of assets.



Name: Martin Pope
Role: Weapons Engineer



Paul Rowley, QinetiQ Trials Safety Manager at the MOD Aberporth coastal range in Wales, instigated and championed an award-winning conservation project to protect bottlenose dolphins from sea trials. Passive Acoustic Monitoring (PAM) provides the tools to give additional protection for marine mammals. "I conducted a study and recognised certain activities posed a greater risk, requiring a focused solution. This was an opportunity to not only protect wildlife but also expand our business, conducting test and evaluation activities that were previously thought too risky to marine life." Paul persuaded senior managers to support the project, eventually gaining support from a customer project. Engineer Martin Pope made PAM a reality: "I've always been considered a good 'ideas person', and my formal training in electronics, oceanography, biology and sustainability helped. I believe in minimising risk to the marine environment, and PAM shows QinetiQ takes environmental issues seriously." PAM received the MOD's Sanctuary Environmental Award and prestigious Silver Otter conservation award.

BALANCE SHEET STRENGTH ACHIEVED



Key highlights

- Strong performance from EMEA Services with 11% increase in orders and 3% organic revenue growth
- Further strengthening of the balance sheet with net cash of £170.5m at 31 March 2014 (2013: £74.0m)
- Re-basing of the dividend, with full year dividend of 4.6p, 21% growth on prior year
- Agreed sale of the US Services division, announced post year end on 22 April 2014, for an initial gross cash consideration of \$165m plus a potential earnout of up to \$50m in cash; together with a proposed pay-down of private placement debt; £6m contribution to the pension scheme; and £150m share buyback

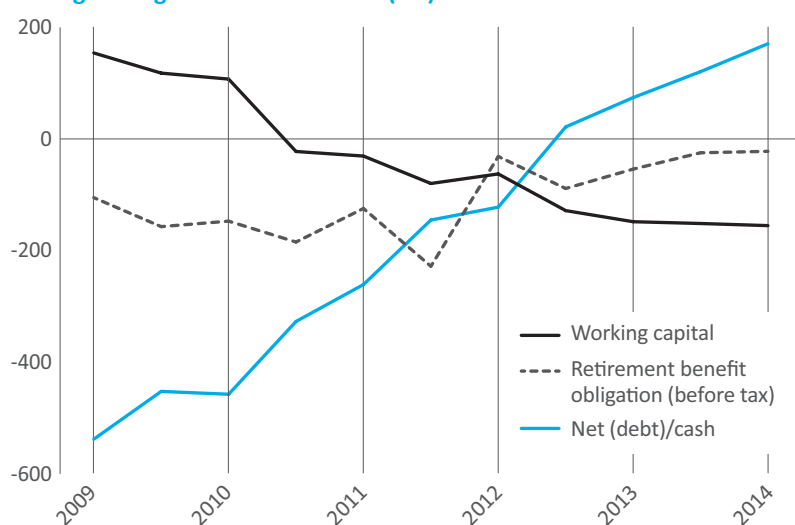
Group revenue was £1,191.4m (2013: £1,327.8m), down 10% on an organic basis at constant currency, excluding a £3.7m decrease due to the strengthening of the Australian dollar and US dollar. The performance of US Services was impacted by continued uncertainty in the US federal services market. In Global Products, there was a decrease in US conflict-related sales against the very strong prior year levels of Q-Net® deliveries.

EMEA Services (formerly UK Services) performed well throughout the year in an environment where the UK Government remains focused on financial stability and defence transformation. Revenue was £607.0m (2013: 594.6m[^]), an increase of 3% on an organic basis at constant currency, excluding a £2.9m decrease due to the strengthening of the Australian dollar.

US Services revenue was £408.8m (2013: £463.8m[^]), a 12% decrease on an organic basis at constant currency, impacted by continued uncertainties in the US federal services market, despite a deal on the US defence budget being signed into law in December 2013, providing a more gradual path to lower defence spending than was previously mandated. Revenue was also impacted by some long-term contracts ending in the period and the switching of some work to small-business set-aside contracts.

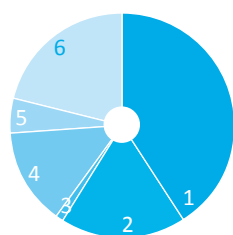
[continued on page 44]

Strengthening of the balance sheet (£m)



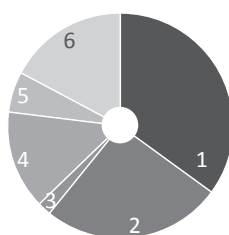


Revenue by customer 2014: £1,191.4m



| | |
|------------------------------------|-----|
| 1. MOD | 41% |
| 2. DoD | 18% |
| 3. DHS | 1% |
| 4. NASA | 14% |
| 5. Commercial Defence | 5% |
| 6. Civil/Other government agencies | 21% |

Revenue by customer 2013: £1,327.8m



| | |
|------------------------------------|-----|
| 1. MOD | 35% |
| 2. DoD | 26% |
| 3. DHS | 2% |
| 4. NASA | 10% |
| 5. Commercial Defence | 6% |
| 6. Civil/Other government agencies | 21% |

Group summary

| | 2014 | 2013 [^] |
|--|---------|-------------------|
| Revenue (£m) | 1,191.4 | 1,327.8 |
| Organic change at constant currency | (10)% | (10)% |
| Underlying operating profit* (£m) | 132.7 | 168.7 |
| Underlying operating margin* | 11.1% | 12.7% |
| Underlying profit before tax* (£m) | 119.4 | 152.1 |
| Underlying net finance expense (£m) | (13.3) | (16.6) |
| Underlying effective tax rate* | 12.9% | 19.2% |
| Total Group operating profit/(loss) (£m) | 24.0 | (121.4) |
| Total Group profit/(loss) before tax (£m) | 4.1 | (137.0) |
| Total Group net finance expense (£m) | (15.0) | (17.9) |
| Basic earnings per share | (1.9)p | (20.5)p |
| Underlying earnings per share* | 16.0p | 18.9p |
| Dividend per share | 4.6p | 3.8p |
| Underlying net cash from operations (post capex)* (£m) | 136.5 | 175.9 |
| Underlying operating cash conversion* | 103% | 104% |
| Net cash (£m) | 170.5 | 74.0 |
| Average US\$/£ exchange rate | 1.59 | 1.58 |
| Closing US\$/£ exchange rate | 1.67 | 1.52 |

Underlying operating profit*

| | 2014 £m | 2013 [^] £m |
|------------------------------|--------------|-------------------------|
| EMEA Services | 86.7 | 84.8 |
| US Services | 19.0 | 23.7 |
| Global Products | 27.0 | 60.2 |
| Total | 132.7 | 168.7 |
| Underlying operating margin* | 11.1% | 12.7% |

[^] Restated to reflect the reclassification of product sales from EMEA Services to Global Products and the reclassification of the Cyveillance® business from US Services to EMEA Services.

* Definitions of underlying performance measures can be found in the glossary on page 150.

Chief Financial Officer's review continued

The US services division was sold to The SI Organization, Inc. post year end. The Cyveillance® business, which provides cyber intelligence, did not form part of the strategic review and is not part of the disposal transaction. This business was previously reported under the US Services division but in the second half of 2014 was established as a standalone commercial entity reported as part of the EMEA Services division. The divisional comparatives have been restated accordingly.

Global Products revenue was £175.6m (2013: £269.4m^), a 35% decrease on an organic basis at constant currency. The performance of Global Products was impacted by the reduction in demand for US conflict-related products against a very strong prior year that included \$120m of Q-Net® systems and spares revenues (\$20m this year).

EMEA Services delivered a positive performance with underlying operating profit* increasing by 2% to £86.7m (2013: £84.8m^). The resulting underlying margin* remained flat at 14.3% (2013: 14.3%^) reflecting continued productivity improvements and better project execution embedded during the self-help phase, enhanced by the contribution of certain international projects.

Global Products underlying operating profit* fell by 55% to £27.0m (2013: £60.2m^), with the underlying margin declining to 15.4% (2013: 22.3%^). This performance was primarily the result of a significant decline in demand for conflict-related products (e.g. Q-Nets®), partially offset by a £6m benefit from a favourable legal ruling on an historic contract.

US Services underlying operating profit* was £19.0m (2013: £23.7m^) and the underlying margin* fell from 5.1%^ to 4.6%.

Excluding US Services, revenue for 2014 was £782.6m (2013: £864.0m^), down 4% on an organic basis at constant currency.

The overall Group underlying operating margin* decreased from 12.7% to 11.1%.

Specific adjusting items*

Initial gross cash consideration from the US Services disposal will be \$165m plus a potential earnout of up to \$50m in cash, based on the gross profit performance of the US Services division in the year to 31 March 2015. The net cash proceeds, are expected to be circa \$175m (£105m at year end rate) including an estimate of the contingent, deferred consideration based on the 2015 budget assumptions. Following completion of the disposal the Group will make a one-off cash payment of £6m into the UK defined benefit pension scheme and will make repayment of its remaining private placement debt. The full impact of the disposal, including remaining transaction costs, estimated warranty/indemnity liabilities, change in control payments and deferred foreign exchange gains/losses recycled from reserves will be shown in the year ending 31 March 2015.

Goodwill in respect of the US Services division has been impaired, with a change in valuation from a 'value in use' basis to a 'fair value' basis crystallising an £84.0m impairment loss (2013 impairment of US Services division of £255.8m).

Specific adjusting items*

The performance of the Group after allowing for specific adjusting items is shown below:

| | 2014 £m | 2013 £m |
|--|---------------|----------------|
| Underlying profit for the year attributable to equity shareholders of the parent company | 104.0 | 122.9 |
| Impairment of goodwill – US Services | (84.0) | (255.8) |
| Impairment of goodwill – US Global Products | (41.9) | – |
| US Services transaction costs | (6.0) | – |
| Amortisation of intangible assets arising from acquisitions | (11.0) | (14.0) |
| Charges in respect of the 2013 US restructuring | (0.3) | (16.3) |
| Reduction in pension liabilities on closure to future accrual | 31.1 | – |
| Pension closure mitigation costs | (4.0) | – |
| Pension net finance expense | (1.7) | (1.3) |
| Impairment reversal/(charge) in respect of property | 1.4 | (4.0) |
| Gain on business divestments and disposals of investments | 1.1 | 2.9 |
| Impairment of investments | – | (0.6) |
| Tax impact of items above | (1.4) | 33.0 |
| Loss for the year attributable to equity shareholders of the parent company | (12.7) | (133.2) |



There was an impairment of the acquired goodwill in the Global Products division of £41.9m reflecting the drawdown from Afghanistan, and its impact on the delivery of conflict-related products.

There was a reduction in pension liabilities on closure to future accrual of £31.1m and an associated £4.0m cash cost in respect of compensation to affected employees.

An impairment reversal of £1.4m (2013: £4.0m charge) relates to obtaining new tenants for vacant, previously impaired, properties.

The gain on business divestment of £1.1m is in respect of the receipt of deferred consideration from the 2009 disposal of the Calibration business.

Finance costs

Net finance costs were £15.0m (2013: £17.9m). The underlying net finance costs* were £13.3m (2013: £16.6m), with an additional £1.7m (2013: £1.3m) in respect of the pension net finance expense reported within specific adjusting items. The reduction in underlying net finance costs* reflects the lower level of private placement debt in place during 2014.

Taxation

The Group's underlying effective tax rate* was 12.9% (2013: 19.2%). The rate is primarily dependent on the geographic split of profits between the UK and US businesses and the availability of R&D relief.

The effective tax rate continues to be below the statutory rate in the UK, primarily as a result of the benefit of R&D relief in the UK. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to the impact of any tax legislation changes and the geographic mix of profits. The Finance Act 2013 allows the continued super-deduction approach for R&D expenditure until April 2016, when mandatory R&D Expenditure Credit ('RDEC') treatment is introduced, which could increase the Group's effective tax rate over time to a blend of the US and UK corporation tax rates.

At 31 March 2014 the Group has unused tax losses of £191.4m (2013: £202.7m) that are potentially available to offset against future profits.

The resulting statutory loss after tax was £12.7m (2013: £133.2m loss).

Earnings per share

Underlying earnings per share* was 16.0p compared with 18.9p for the year ended 31 March 2013. The decline is primarily the result of the operating performance of the US businesses outlined above, partially offset by a decrease in net finance costs. Basic earnings per share was a loss of 1.9p (2013: 20.5p loss).

Dividend

The Board proposes a final dividend of 3.20p per share for the year ended 31 March 2014 (2013: 2.70p). Subject to approval at the AGM, the final dividend will be paid on 5 September 2014 to shareholders on the register at 8 August 2014.

Other financials

Cash flow

The Group's cash flow from operations before net restructuring recoveries/costs but after capital expenditure was £136.5m (2013: £175.9m). Underlying operating cash conversion* remained strong at 103% (2013: 104%).

The net cash outflow in the year on restructuring was £10.3m (£63.1m cash inflow). This relates to the restructuring costs recorded in 2013 in the Group's US businesses.

At 31 March 2014 net cash was £170.5m (2013: £74.0m), reflecting continued strong operating cash performance.

Total committed facilities available to the Group at year end amounted to £416.8m (2013: £446.3m); this is made up of US private placement debt of £148.9m (2013: £163.5m) and a revolving credit facility of £267.9m (2013: £282.8m), which is currently undrawn – the movement as a result of foreign exchange.

Following completion of the disposal of US Services, the Group will make repayment of its remaining private placement debt of \$248m (£148.9m at year end rate), with associated accelerated interest costs of approximately £28.5m, subject to market rates on date of payment. The Group will retain its revolving credit facilities.

[^] Restated to reflect the reclassification of product sales from EMEA Services to Global Products and the reclassification of the Cyveillance® business from US Services to EMEA Services.

* Definitions of underlying performance measures can be found in the glossary on page 150.

Chief Financial Officer's review continued

Sensitivity of key pension assumptions

| Assumption | Change in assumption | Indicative effect on scheme liabilities (before deferred tax) |
|-----------------|---------------------------|---|
| Discount rate | Increase/decrease by 0.1% | Decrease/increase by £25m |
| Inflation | Increase/decrease by 0.1% | Increase/decrease by £25m |
| Life expectancy | Increase by 1 year | Increase by £31m |

Pensions

The net pension deficit under IAS 19 (revised), after deducting deferred tax, was £20.9m (2013: £40.4m). The decrease in net pension deficit is primarily a result of the closure of the scheme to future accrual. This generated a reduction in scheme liabilities of £31.1m. Additional movement is driven by macro-economic factors.

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

| Assumption | 2014 | 2013 |
|--|------|------|
| Discount rate | 4.2% | 4.4% |
| Inflation | 2.6% | 2.7% |
| Life expectancy – male (currently aged 40) | 90 | 90 |
| Life expectancy – female (currently aged 40) | 92 | 92 |

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

The market value of the assets at 31 March 2014 was £1,304.6m (2013: £1,256.5m) and the present value of scheme liabilities was £1,326.8m (2013: £1,310.6m).

The most recent full actuarial valuation of the defined benefit section of the QinetiQ Pension Scheme was undertaken as at 30 June 2011 and resulted in an actuarially assessed deficit of £74.7m. The next scheduled triennial valuation will be performed as at 30 June 2014. The funding basis of calculating scheme funding requirements differs from IAS 19 in that it does not use corporate bonds as a basis for the discount rate but instead uses the risk free rate from UK gilts, prudently adjusted for long-term expected returns for pre-retirees. Given the current extremely low gilt yields, perhaps exacerbated by quantitative easing, a funding valuation of the scheme would probably have resulted in a bigger deficit than the IAS 19 methodology if performed at the period end.

Capital risk

The Group funds its operations through a mixture of equity funding and debt financing, including bank and capital market borrowings. At 31 March 2014 the Group's total equity was £378.1m (2013: £438.5m). Net cash as defined by the Group was £170.5m (2013: net cash £74.0m).

The Group's target is to maintain a strong balance sheet, keeping its gearing ratio below 2xEBITDA.

Treasury policy

The Group treasury department works within a framework of policies and procedures approved by the Audit Committee. As part of these policies and procedures, there is strict control on the use of financial instruments. Speculative trading in financial instruments is not permitted. The policies are established to manage and control risk in the treasury environment and to align the treasury goals, objectives and philosophy of the Group.

Funding and debt portfolio management

The Group seeks to obtain certainty of access to funding in the amounts and maturities required to support the Group's medium to long-term forecast financing requirements. Group borrowings are arranged by the Group treasury function.

Interest risk management

The Group seeks to reduce the volatility in its interest charge caused by rate fluctuations. A significant portion of the Group's borrowings are fixed in the short to medium term through fixed-rate debt.

Foreign exchange risk management

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

| | 2014 | 2013 |
|-----------------------|------|------|
| £/US\$ – average rate | 1.59 | 1.58 |
| £/US\$ – closing rate | 1.67 | 1.52 |
| £/US\$ – opening rate | 1.52 | 1.60 |



The Group's income and expenditure is largely settled in the functional currency of the relevant Group entity, mainly sterling or US dollar. The Group has a policy in place to hedge all material transaction exposure at the point of commitment to the underlying transaction.

Uncommitted future transactions are not routinely hedged. The Group continues its practice of not hedging income statement translation exposure. To minimise the impact of currency depreciation of the net assets on its overseas subsidiaries, the Group seeks to borrow in the currencies of those subsidiaries, but only to the extent that its gearing covenant within its loan documentation, as well as its facility headroom, are likely to remain comfortably within limits.

Tax risk management

QinetiQ's tax strategy is to ensure compliance with all relevant tax legislation, wherever we do business, whilst managing our effective and cash tax rates. Tax is managed in alignment with our corporate responsibility strategy in that we strive to be responsible in all our business dealings. These principles are applied in a consistent and transparent manner in pursuing the Group's tax strategy and in all dealings with tax authorities around the world.

Credit risk

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

Insurance

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

Employees

Year end employee numbers have decreased by 6% to 8,937 at 31 March 2014 (2013: 9,498). The decline primarily reflects headcount reductions in the US to maintain competitiveness in the challenging market. The headcount of the US Services division, which the Group agreed to sell post year end, was 2,704 at 31 March 2014.

Accounting standards

As a UK-listed company, the Group is required to adopt EU endorsed IFRSs and comply with the Companies Act 2006. The effect of changes to financial reporting standards in the year is disclosed in note 1 to the financial statements.

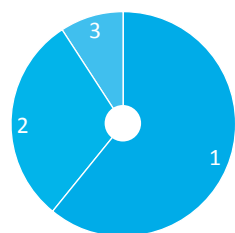
Critical accounting estimates and judgments in applying accounting policies

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

By order of the Board

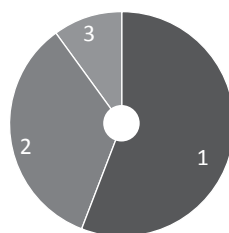
David Mellors
Chief Financial Officer
22 May 2014

Employees by sector 2014: 8,937



| | |
|--------------------|-----|
| 1. EMEA Services | 61% |
| 2. US Services | 30% |
| 3. Global Products | 9% |

Employees by sector 2013: 9,498[^]



| | |
|--------------------|-----|
| 1. EMEA Services | 56% |
| 2. US Services | 34% |
| 3. Global Products | 10% |

[^] Restated to reflect the reclassification of product sales from EMEA Services to Global Products and the reclassification of the Cyveillance® business from US Services to EMEA Services.

Chairman's introduction to governance

COMMITTED TO GOOD GOVERNANCE

In this section

| | |
|---|----|
| Relations with shareholders | 50 |
| Leadership | 51 |
| Board objectives | 51 |
| Roles and responsibilities | 51 |
| Committees | 53 |
| Directors' biographies | 55 |
| Effectiveness | 56 |
| Composition of the Board | 56 |
| Board meetings and attendance | 56 |
| Performance of the Board | 57 |
| Report of the Nominations Committee | 58 |
| Accountability | 59 |
| Risk management and internal control | 59 |
| Management and control of US subsidiaries | 61 |
| Report of the Audit Committee | 62 |
| Report of the Risk & CSR Committee | 66 |
| Report of the Security Committee | 68 |
| Directors' remuneration report | 69 |
| Annual statement | 69 |
| Report of the Remuneration Committee | 69 |
| Remuneration Policy | 73 |
| Annual Report on Remuneration | 84 |
| Directors' report | 93 |
| Directors' responsibility statements | 96 |
| Independent auditor's report | 97 |

The Board continues to consider good governance to be a key element in its stewardship of the Group, providing a foundation from which to build value and promote the long-term success of the Company within a framework of prudent and effective systems of internal control.

The Board's role in the oversight of strategy and leadership was pivotal during the year. At the end of 2013, the executive leadership team was refreshed with the formation of the Operating Committee, which includes the leaders from the UK and EMEA businesses. The presentations by Operating Committee members at the Board strategy meeting in October 2013 provided a valuable opportunity for Board members to review and discuss the objectives and goals of those businesses directly with the business leaders. In addition, the strategic review of the US Services division has been a key focus of the Board, both in terms of agreeing the strategic aims of the Group and its general direction of travel, in overseeing the progress of the review and the changes which will take place as a result; and in ensuring that the re-configured Group will have the appropriate

strategy, structures and processes in place to ensure good governance and stewardship, and to facilitate future growth.

The Group's risk management processes were further strengthened during the year with the establishment of the Governance Committee. This is an executive committee responsible for oversight of all risks, and of the risk management process, including the identification, monitoring and mitigation of risk, which reports, via the Chief Executive Officer, to the Risk & CSR Committee. Further details can be found on page 66.

Progress has been made with succession planning as detailed in the report of the Nominations Committee on page 58. At the end of January 2014, Colin Balmer stepped down as a Director after over ten years on the Board of QinetiQ. Colin's in-depth experience of government and knowledge of the Company's business was an invaluable resource during a period of great transition for QinetiQ. In March 2014, Susan Searle was appointed as an additional Non-executive Director and her experience of commercialising new technologies will provide a fresh perspective on the Company's strategy and stewardship.

During the year, changes in regulation have led to considerable work by the Board and the Remuneration and Audit Committees. The work of the Remuneration Committee in relation to changes in remuneration regulation has been detailed by the Chair of that Committee in the Directors' remuneration report on page 69. The Board has considered the new reporting requirement of 'fair, balanced and understandable' and asked the Audit Committee to give assurance that the relevant systems and processes are in place to support that requirement. Details can be found in the Audit Committee report on pages 62 to 65.

During this period of change, the Board continues to maintain a dialogue with key investors and to make itself available to shareholders at the Annual General Meeting.

The governance process will continue to evolve as the Group takes shape, and to take account of future changes in regulation and best practice.

Mark Elliott
Chairman
22 May 2014



Compliance

QinetiQ is subject to the provisions of the 2010 and 2012 versions of the Financial Reporting Council's UK Corporate Governance Code (the 'UK Code'). The UK Code and associated guidance are publicly available on the Corporate Governance page of the Financial Reporting Council's website, www.frc.org.uk/corporate.

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

The Board considers that QinetiQ has complied with the provisions of both versions of the UK Code throughout the last financial year. This statement provides details of the way the principles of the UK Code have been applied during the year.

Corporate Governance Statement

Relations with shareholders

Responsibility for maintaining regular communications with shareholders rests with the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), assisted by the Investor Relations Director.

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

The following information is included in these reports:

- financial calendar and draft material;
- share price performance;
- the composition of the shareholder register;
- feedback from investor meetings, including key questions;
- covering sell-side analysts, their recommendations and expectations; and
- peer group news.

The Company attaches significant importance to the effectiveness of its communications with shareholders and sets itself the target of providing information that is timely, clear and concise. Investor activity during the last financial year included:

- telephone briefings for analysts and investors in conjunction with key financial announcements;
- face-to-face presentations of full-year and half-year results where the Chairman and Directors were available for discussions with investors;
- live and post-event webcasts of key presentations;
- investor 'road shows' held in the UK and the US at least twice during the year;
- investor days, briefings and ad hoc meetings on request, where calendar and regulatory requirements allow;
- re-launched web-based investor centre incorporating best practice and optimised for mobile devices; and
- the Annual General Meeting.

During the year, new executive incentive arrangements were proposed and a consultation was undertaken with the Group's largest 20 investors, holding approximately 70% of the issued share capital. Further details can be found in the Directors' Remuneration Report on pages 69 to 92.

The Chairman proactively offers to attend meetings with key shareholders on a regular basis and the Chairman, the Senior Independent Director and Non-executive Directors routinely attend key financial calendar events and make themselves available to meet shareholders as required.

"There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place."

UK Corporate Governance Code

Annual General Meeting

The UK Code notes that the Board should use the Annual General Meeting (AGM) to communicate with investors and encourage their participation. Holders of ordinary shares are invited to attend the Company's AGM each year and to ask questions. The Chairs of the Audit, Remuneration, Nominations, Risk & CSR and Security Committees are available at that meeting to answer any questions on the work of the Committees. During the year under review, the AGM was held in July 2013 and each member of the Board attended and was available to take questions.

In respect of the 2014 AGM, the Company confirms that it will send the Notice of Meeting and relevant documentation to all shareholders at least 20 working days before the date of the AGM. For those shareholders who have elected to receive communications electronically, notice is given of the availability of documents in the 'Investors' section of the Group's website. All shareholders will be entitled to vote on the resolutions put to the AGM and, to ensure that all votes are counted, a poll will be taken on all of the resolutions in the Notice of Meeting. The results of the votes on the resolutions will be published on the Company's website, www.QinetiQ.com, in the 'Investors' section.

Website information

All shareholders and potential shareholders can gain access to the Annual Report, presentations to investors, AGM documentation, key financial information, regulatory news, financial calendar, share and dividend data and other significant information about QinetiQ in the 'Investors' section of the Company's website, www.QinetiQ.com. The site also provides contact details for any investor-related queries, by telephone and by email.

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

Details of the Company's share capital, which are required to be disclosed in accordance with rule 7.2.6 of the Financial Conduct Authority (FCA's) Disclosure and Transparency Rules, and the Directors' powers in relation to issuing and buying back shares can be found on pages 93 and 95 in the Directors' report section of this Annual Report.

Leadership

The Board of Directors has identified key objectives and responsibilities in respect of its stewardship of the Group as a whole.

Board objectives

To demonstrate the highest standards of corporate governance in accordance with the UK Code to:

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

Roles and responsibilities

The Board of Directors:

- is responsible for overseeing the Executive Directors' management of operations and, in this capacity, determines the Group's strategic and investment policies;
- monitors the performance of the Group's senior management team and organises its business to have regular interaction with key members of senior management; and
- is responsible for overseeing the management of the business of the Group. Its powers are subject to the Articles of Association and any applicable legislation and regulation.

Operation of the Board

For each meeting, the Board receives a written report from the CEO and CFO, together with a separate report on investor relations which is prepared in consultation with QinetiQ's brokers, and a report produced by the Company Secretary on key legal and regulatory issues that affect the Group. The CEO's and CFO's Executive report addresses the key strategic initiatives which have had an impact on the Group since the previous Board meeting, with particular focus on the progress of each of the businesses. Other key areas of focus include health, safety and environmental matters; employee and organisational issues; corporate responsibility; the status of key account management/customer relationship initiatives; the pipeline of potential bids, acquisitions, disposals and investments; and the post-acquisition performance of recently acquired businesses. The Board also receives updates from key functional areas on an 'as needed' basis, on issues such as HR, treasury, corporate responsibility, real estate, security, trade controls and pensions.

"Every company should be headed by an effective board which is collectively responsible for the long-term success of the company... There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business."

UK Corporate Governance Code

Key issues considered by the Board in the past year include:

- a) the strategic review of the US Services division;
- b) strategy for the Group as a whole;
- c) succession planning; and
- d) the closure of the Company's UK defined benefit pension scheme.

Further details are set out below.

a) US Services strategic review

The US Services strategic review has been one of the main items of Board consideration during the course of the year, from the announcement of the review in May 2013 to the announcement of the outcome in April 2014, and will continue to be an area of focus for the Board. Details of the activity in respect of the strategic review and the outcomes from it can be found in the strategic report on pages 2 to 47. The Board oversaw this process by way of regular updates from the Group Strategy Director, the CFO and key external advisors and also by way of a Board sub-committee which met regularly to oversee the developments and drive the progress of the review.

Corporate Governance Statement continued

b) Group strategy

The Board views strategic growth as a key priority. During the year, the Board held its annual two-day strategy meeting at an off-site location where the strategy for the Group as a whole was reviewed. The Managing Directors from each business attended the two-day meeting and gave presentations on their respective business areas. The Board was able to meet both formally and informally with business leaders, to assess potential future leaders and to understand the key drivers and risks (including their mitigation) for their business areas. Further details can be found in the strategic report on pages 2 to 47.

During the course of the year, reporting on the progress of the business units with their strategies is detailed in the Executive Directors' report contained in each Board pack. In addition, the Group Strategy Director attends Board meetings to provide an update on progress against Group strategy, including an interim report to the Board on each business unit's performance against its material strategic goals.

c) Succession planning

Succession planning, both at Executive and Non-executive level, remains a key focus for the Board. The Group HR Director gave presentations to the Board during the year on succession planning, including the tabling of succession planning charts for key senior executive roles, on the development of the Group's diversity policy and to agree the methodology for establishing metrics for measuring diversity across the Group. The policy has been approved and the metrics will be established in 2015 for measuring progress against the policy. Further details on diversity can be found in the corporate responsibility and sustainability review on pages 36 to 41.

At a Non-executive level, the Board agreed details of the key competencies required to enhance the composition of the Board and those competencies have been used in the search for new Non-executive Directors.

d) Pension scheme changes

During the year, the Board was kept informed of developments in the review of the pension scheme arrangements which ultimately led to the closure of the defined benefit scheme, by way of presentations from the Group HR Director and the CFO. Further details can be found in note 28 on page 139 in the notes to the accounts.

Matters reserved to the Board

The Board operates through a comprehensive set of processes, which define the schedule of matters to be considered by the Board and its Committees during the annual business cycle. This includes the level of delegated authorities (both financial and non-financial) available to Executive Directors and other layers of management in the business, QinetiQ's business ethics, risk management, and health, safety and environmental processes.

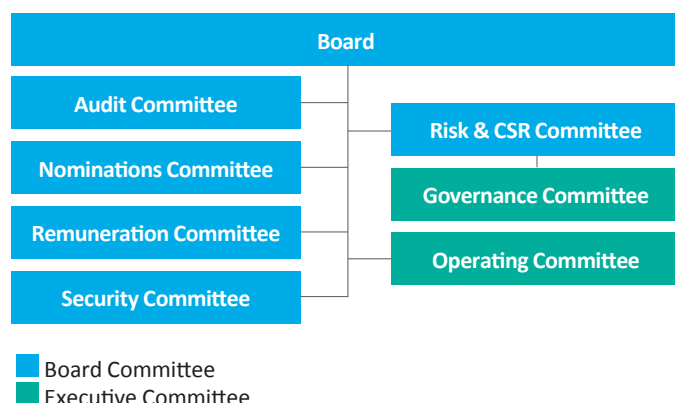
The Board devotes one entire meeting each year to consider strategy and planning issues that have an impact on the Group, from which the corporate plan is generated. It is also regularly kept up to date on strategic issues throughout the year.

The Board has a clearly articulated set of matters which are specifically reserved to it for consideration. These include:

- reviewing the annual budgets;
- raising indebtedness;
- granting security over Group assets;
- approving Group strategy and the corporate plan;
- approving the Annual and Interim Report and Accounts;
- approving significant investment, bid, acquisition and divestment transactions;
- approving HR policies (including pension arrangements);
- reviewing material litigation; and
- monitoring the overall system of internal control, including risk management.

Committees

QinetiQ operates by way of two key Executive Committees and five principal Board Committees.



Executive Committees

During the year, the Operating Committee was responsible for the day-to-day management of the Group's activities, with the exception of QinetiQ's US operations (which were managed through the Proxy Board, as described in the section on page 61 headed 'Management and control of US subsidiaries'). The Operating Committee had a specific focus on the achievement of the Group's strategic goals in respect of growth and operational excellence. The Committee membership comprised the Group CEO, Group CFO, UK Divisional MDs, HR, Business Development and Operations Directors. From December 2013, the Group Strategy Director and the Group General Counsel were added as members of the Committee. The Committee met on a monthly basis, and received weekly updates on key operational issues by way of pre-scheduled conference calls.

The Governance Committee was responsible for oversight of the risk management process and its implementation by the divisions and covers matters such as non-financial corporate objectives, targets and key performance indicators, approval of Operating Framework policy documents and the review of business risk registers and the Group Risk Register. It reported via the CEO to the Risk & CSR Committee. The Committee membership comprised the Group CEO, four UK Divisional MDs, the HR, Safety, Assurance, and Sustainability Engineering and Technical Directors and the Group General Counsel. The Committee is scheduled to meet on a quarterly basis.

Board Committees

The Board has established five principal Committees: the Audit Committee, the Nominations Committee, the Remuneration Committee, the Risk & CSR Committee and the Security Committee. Each operates within written terms of reference approved by the Board. The full terms of reference can be found in the Governance section of the QinetiQ website at www.qinetiq.com/responsibility/corporate-governance/Pages/default.aspx. Where a Committee is not attended by the full Board, details of the key issues discussed, and decisions taken, are circulated to all members of the Board after the relevant Committee meeting.

Given the size of the Board, and in the interests of full Board participation and transparency, the Board maintains a policy of all-Director membership of Committees, other than where prohibited by the UK Code, statutory or Security Committee requirements. A report in respect of each of these Committees is contained in pages 58 to 68. The details of each Committee member's attendance at Committee meetings are set out in the table contained within each Committee report. Details of the Group's reward and remuneration policies and payments, together with the report of the Remuneration Committee, can be found in the Directors' remuneration report on pages 69 to 92 which is incorporated into this governance statement by reference.

Board of Directors

THE RIGHT MIX OF SKILLS AND EXPERIENCE



Board statistics

Board experience

| | | |
|-------|---------------|------------------|
| 100% | Finance | 2 female, 6 male |
| 87.5% | Operational | 2 female, 5 male |
| 87.5% | International | 2 female, 5 male |
| 87.5% | Other plc | 2 female, 5 male |

Board composition

| | | |
|-----|---------------|------------------|
| 25% | Executive | 2 male |
| 75% | Non-executive | 2 female, 4 male |
| 75% | Male | 6 male |
| 25% | Female | 2 female |

Board tenure

| | | |
|-------|-----------|----------|
| 12.5% | 0–2 years | 1 female |
| 25% | 2–4 years | 2 male |
| 50% | 4–6 years | 4 male |
| 12.5% | 6–9 years | 1 female |

Committee membership

| Name | Audit Committee | Nominations Committee | Remuneration Committee | Risk & CSR Committee | Security Committee |
|-------------------------------------|-----------------|-----------------------|------------------------|----------------------|--------------------|
| 1. Mark Elliott | | ▲ | ● | ● | |
| 2. Leo Quinn | | ● | | ● | ● |
| 3. David Mellors | | | | ● | ● |
| 4. Michael Harper | ● | ● | ● | ● | ● |
| 5. Noreen Doyle | ● | ● | ▲ | ● | |
| 6. Admiral Sir James Burnell-Nugent | ● | ● | ● | ▲ | ▲ |
| 7. Paul Murray | ▲ | ● | ● | ● | ● |
| 8. Susan Searle | ● | ● | ● | ● | ● |
| 9. Jon Messent | | | | | |

▲ Chairman

● Member

**1 Mark Elliott****Non-executive Chairman****Appointment to the Board**

Appointed Non-executive Chairman in March 2010; Non-executive Director between June 2009 and February 2010.

Skills and experience

Mark is a Non-executive Director of G4S plc and Chairman of Kodak Alaris Holdings Limited. He was a Non-executive Director of Reed Elsevier Group plc (and also Chairman of its Remuneration Committee) and Reed Elsevier NV from April 2003 until April 2013.

He was previously General Manager of IBM Europe, Middle East and Africa and was a member of IBM's Worldwide Management Council.

The Board considers that Mark's extensive experience in the technology services sector, in the US and Europe, together with his exposure to a variety of industry sectors on the boards of FTSE listed companies, is a valuable asset to the Group in terms of leadership and of addressing the strategic issues that affect the Group.

2 Leo Quinn**Chief Executive Officer****Appointment to the Board**

Appointed Chief Executive Officer in November 2009.

Skills and experience

Leo was Chief Executive Officer of De La Rue plc between 2005 and 2009. He was previously Chief Operating Officer of Invensys plc's Production Management Division and before that spent 16 years with Honeywell Inc. in a variety of senior management roles in the US, Europe, the Middle East and Africa. He is a Non-executive Director of Betfair Group plc and was formerly a Non-executive Director of Tomkins plc.

3 David Mellors**Chief Financial Officer****Appointment to the Board**

Appointed Chief Financial Officer in August 2008.

Skills and experience

David was previously deputy Chief Financial Officer of Logica plc. He was also Chief Financial Officer of Logica's international division, covering operations in North America, Australia, the Middle East and Asia and, before that, was the Group Financial Controller. His earlier experience includes various roles with CMG plc, Rio Tinto plc and Price Waterhouse. He is a member of the Institute of Chartered Accountants in England and Wales.

4 Michael Harper**Deputy Chairman and Senior Independent Non-executive Director****Appointment to the Board**

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

Skills and experience

Michael is Chairman of Ricardo plc and has announced his intention to retire from that company's Board with effect from the end of the AGM in November 2014. He was Chairman of BBA Aviation plc from June 2007 until May 2014, having joined the Board in 2005, and also Chairman of Vitec Group plc from 2004 to 2012. He was previously a Director of Williams plc where, at the time of the demerger in 2000, he became CEO of Kidde plc.

The Board considers that Michael's wealth of operational and corporate experience enables him to make a significant contribution to the Board.

5 Noreen Doyle**Non-executive Director****Appointment to the Board**

Appointed Non-executive Director in October 2005.

Skills and experience

Noreen is a member of the Board of Credit Suisse Group (Zurich) and Chair of its UK regulated subsidiaries. She is a Non-executive Director of Newmont Mining Corporation (Denver), where she is Chair of the Audit Committee. From 2005 through 2012 she served on the Board of Rexam plc, where she was Chair of the Finance Committee. She was First Vice President of the European Bank for Reconstruction and Development (EBRD). Before EBRD, she worked in corporate finance and leveraged financing at Bankers Trust Company (now Deutsche Bank).

The Board considers that Noreen's extensive international business experience, particularly in corporate finance, risk management and banking, is of significant benefit to the Board.

6 Admiral Sir James Burnell-Nugent**Non-executive Director****Appointment to the Board**

Appointed Non-executive Director in April 2010.

Skills and experience

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

The Board considers that Sir James' expertise in the government contracting domain, particularly with the UK MOD and HM Treasury, is highly beneficial in the context of QinetiQ's government-sourced operations.

7 Paul Murray**Non-executive Director****Appointment to the Board**

Appointed Non-executive Director in October 2010.

Skills and experience

Paul is currently a Non-executive Director and Chair of the Audit & Risk Committee at Royal Mail Group plc. He is also a Director of Independent Oil and Gas plc, Ventive limited and Naked Energy Ltd and a Trustee of Pilotlight. He was previously a Director of Knowledge Peers plc, Senior Independent Director of Taylor Nelson Sofres plc, a Non-executive Director of Thomson SA and Tangent Communications plc, and has also been Group Finance Director of Carlton Communications plc and LASMO plc.

The Board considers that Paul brings a broad range of experience in finance and corporate governance from a cross-section of industries, all of which leverage technology.

8 Susan Searle**Non-executive Director****Appointment**

Appointed Non-executive Director in March 2014.

Skills and experience

Susan is a Non-executive Director and Chair of the Remuneration Committee of Benchmark Holdings plc. She is also a member of the international advisory board of PTT, an advisor to the Technology Strategy Board and a Trustee of Fight for Sight.

Susan was a founder of Imperial Innovations Group, leading it as CEO from 2002 to July 2013, and has served on a variety of private company boards in engineering, healthcare and materials.

The Board considers Susan's strong experience of commercialising new technologies and intellectual property of particular relevance to QinetiQ as it pursues its Organic-Plus strategy.

9 Jon Messent**Company Secretary and Group General Counsel****Appointment**

Appointed as Company Secretary and Group General Counsel in January 2011.

Skills and experience

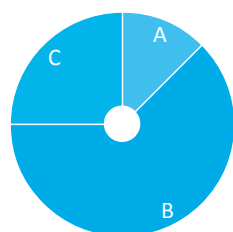
Jon joined QinetiQ from Chloride Group plc where he held a similar role. He has a background in legal private practice as well as general counsel and company secretarial experience in other FTSE250 companies.

Corporate Governance Statement continued

Effectiveness

Composition of the Board

The Board currently has eight members: the Non-executive Chairman; five other Non-executive Directors; and two Executive Directors – the CEO and the CFO. During the year, Colin Balmer resigned as a Non-executive Director, having served on the Board for more than ten years, and Susan Searle was appointed.



| | |
|----------------------------|---|
| A. Non-executive Chairman | 1 |
| B. Non-executive Directors | 5 |
| C. Executive Directors | 2 |

The Board considers its overall size and composition to be appropriate, having regard in particular to the independence of character and integrity of all the Directors and the experience and skills that they bring to their duties, which prevents any individual or small group from dominating its decision making. The Board has due regard to the benefits of diversity (including gender diversity) when considering its composition. It considers that the skills and experience of its individual members, particularly in the areas of UK/US defence and security, the commercialisation of innovative technologies, corporate finance, mergers and acquisitions, and risk management, have been fundamental in the pursuit of QinetiQ's strategic initiatives (as described in the CEO's strategic review on pages 4 to 13 of this report) in the past year. In addition, the quoted company experience of members of the Board in a variety of industry sectors and international markets has also been invaluable to the Group as it seeks to consolidate its position in its core markets and geographic territories.

“The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.”

UK Corporate Governance Code

Board meetings and attendance

The Board has regular scheduled meetings. Seven scheduled Board meetings and one further Board meeting (in respect of the strategic review of the US Services division) were held in the last financial year. Members of the Board were also invited to attend a dinner on the occasion of each scheduled Board meeting, to assist with the process of relationship building and to ensure that key strategic initiatives were discussed thoroughly.

During the year, the Chairman and the Non-executive Directors met without Executive Directors present after each Board meeting.

The table below details the number of meetings of the Board and its principal Committees held during the last financial year and attendance by the Directors.

Board and Committee meeting attendance

| Members | Committee | | | | |
|----------------------------------|-----------|-------|-------------|--------------|------------|
| | Board | Audit | Nominations | Remuneration | Risk & CSR |
| Mark Elliott | 8/8 | – | 2/2 | 6/6 | 4/4 |
| Colin Balmer [#] | 7/7 | 4/4 | 2/2 | 5/5 | 4/4 |
| Admiral Sir James Burnell-Nugent | 8/8 | 5/5 | 2/2 | 6/6 | 4/4 |
| Noreen Doyle [~] | 7/8 | 4/5 | 2/2 | 5/6 | 4/4 |
| Michael Harper [~] | 8/8 | 5/5 | 2/2 | 5/6 | 4/4 |
| David Mellors | 8/8 | – | – | – | 4/4 |
| Paul Murray | 8/8 | 5/5 | 2/2 | 6/6 | 4/4 |
| Leo Quinn | 8/8 | – | 2/2 | – | 4/4 |
| Susan Searle [*] | 1/1 | 1/1 | – | 1/1 | – |

[#] Colin Balmer retired at the end of January 2014 and therefore had left the Board prior to the meetings in March 2014.

[~] Noreen Doyle and Michael Harper were each unable to attend a meeting due to long-standing prior commitments.

^{*} Susan Searle joined the Board in March 2014 and therefore was only able to attend the March Board and Committee meetings.



Independence of Non-executive Directors

Of the current Directors of the Company, the Board considers all the Non-executive Directors to be independent of QinetiQ's executive management and free from any business or other relationships that could materially interfere with the exercise of their independent judgment. Prior to his departure, and notwithstanding that Colin Balmer had served on the Board for more than ten years, the Board considered that he had remained independent in character and judgment and the Board found no information or circumstances to lead it to conclude otherwise. The Board considers that more than half its members were independent Non-executive Directors throughout the last financial year.

“The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.”

UK Corporate Governance Code

Performance of the Board

QinetiQ continues each year to evaluate the performance of the Board and its Committees.

The most recent external evaluation of the Board's effectiveness was carried out by Independent Audit Limited in 2012 and reported in that year's Annual Report and Accounts. In 2013, the Board's effectiveness was assessed internally by way of a questionnaire completed by Board members and individual performance reviews carried out by the Chairman and the Senior Independent Director. The actions arising from those reviews have largely been completed and resulted in the following:

- the setting up of the Risk & CSR Committee to provide greater oversight of non-financial risk management and risk strategy;
- improvements in the way that information was provided to members of the Board;
- the provision of a schedule of training and development options for Non-executive Directors; and
- the facilitation of site visits and access to senior management by way of the provision of a schedule of QinetiQ sites from which Non-executive Directors are able to select site visits which are then arranged by the Company Secretariat.

In the year under review, a process similar to that followed in 2013 was followed, which included individual performance evaluations assessed by the Chairman, coupled with a Board effectiveness questionnaire which was circulated to the members of the Board for completion and the results evaluated by the Chairman. The questionnaire covered the following areas:

- the role of the Board and its skills mix;
- clarity of decision-making processes and of information provided to the Board;
- risk appetite and the overview of Group risks; and
- engagement with management and other stakeholders.

The principal actions agreed in respect of the outcome of the review included the following:

- further improvement in the quality of supporting documentation presented to the Board;
- provision of more opportunities for engagement with management; and
- more reporting from management in respect of key outcomes and targets that flow directly from the Group strategy.

The overall conclusion of the review was that the Board continues to be effective in its fulfilment of its governance responsibilities.

Re-election of Directors

Rules concerning the appointment and replacement of Directors of the Company are contained in the Articles of Association. Changes to the Articles must be submitted to shareholders for approval. According to the Articles of Association, all Directors are subject to election by shareholders at the first AGM following their appointment, and to re-election thereafter at intervals of no more than three years. In line with best practice reflected in the UK Code, however, the Company requires each serving member of the Board to be put forward for election or re-election on an annual basis at each AGM.

Corporate Governance Statement continued

Report of the Nominations Committee



Diversity remained a key theme in the work of the Nominations Committee during the year under review and was a key element in both the search for candidates to refresh the Non-executive element of the Board and the progression of the objectives under the Board Diversity Policy which was adopted in 2013. Good progress has been made, culminating in the appointment of an additional Non-executive Director in 2014.

Mark Elliott
Chair

Membership and attendance during the year

| Member | Attendance |
|----------------------------------|------------|
| Mark Elliott (Committee Chair) | 2/2 |
| Colin Balmer | 2/2 |
| Admiral Sir James Burnell-Nugent | 2/2 |
| Noreen Doyle | 2/2 |
| Michael Harper | 2/2 |
| Paul Murray | 2/2 |
| Leo Quinn | 2/2 |
| Susan Searle* | N/A |

* Susan Searle became a member of the Committee in March 2014 and will attend future meetings.

Main responsibilities

The role of the Committee is to ensure that the composition of the Board and Committees has the optimum balance of skills, knowledge and experience, and to oversee succession planning for the Board and senior management. It considers diversity, including skills mix, international industry experience and gender, when seeking to appoint a new Director to the Board. The Committee meets as necessary and when called by its Chair. During the financial year ended 31 March 2014, the Committee met on two occasions.

Overview

Key areas of focus during the year were:

- the review of the size and composition of the Board and its Committees;
- the review and preparation of a memorandum setting out the role and capabilities required to refresh the Board membership; and
- the review of succession planning processes at Executive Director, Non-executive Director and senior management levels.

Succession planning

The Committee continued with the succession planning process which had begun in 2013 and was detailed in the report of the Committee contained in the 2013 Annual Report. Pending the outcome of the US Services division strategic review, it was agreed to focus on the search in the UK for potential Non-executive Director candidates, which was being undertaken by the Zygos Partnership. The firm is a signatory to the Voluntary Code of Conduct for Executive Search Firms, which requires them to ensure that at least 30% of the candidates are women, and it has no other connections with the Company. We are delighted with the appointment of Susan Searle to the Board in March and look forward to her contribution to the work of the Board and its Committees.

Board Diversity Policy

During 2013 the Nominations Committee recommended, and the Board approved, a Board Diversity Policy. The key statement and objectives of that policy (the full text of which is available on the Group's website) are as follows:

Statement:

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

Objectives:

- The Board should ensure an appropriate mix of skills and experience to ensure an optimum Board and efficient stewardship.
- The Board should ensure that it comprises Directors who are sufficiently experienced and independent in character and judgment.
- The Board aims to increase the proportion of women on the Board to 25% by 2015. Thereafter, the Board aims to maintain a minimum Board composition of 25% women, such percentage to be reviewed annually.

Progress against the policy:

QinetiQ continues to make progress against this policy. A Company-wide diversity policy has been issued and details can be found in the Corporate Responsibility and Sustainability Review on pages 36 to 41. In terms of Board diversity, the appointment of Susan Searle brings the current proportion of women on the Board to 25%, which is in line with our objective. Any future appointments will always be made on merit and will continue to take into account diversity, not only in terms of gender, but also in terms of the appropriate mix of skills and experience.

Accountability**Directors' responsibilities**

Statements explaining the Directors' responsibilities for preparing the Group's Annual Report and financial statements and the auditor's responsibilities for reporting on those statements are on page 96.

Going concern

The Group's activities, combined with the factors that are likely to affect its future development and performance, are set out in the CEO's strategic review on pages 4 to 13. The CFO's review on pages 42 to 47 sets out details of the financial position of the Group, the cash flows, committed borrowing facilities, liquidity, and the Group's policies and processes for managing its capital and financial risks. Note 24 to the financial statements also provides details of the Group's hedging activities, financial instruments, and its exposure to liquidity and credit risk. 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 the 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 the appropriate enquiries, including a review of the latest two-year budget, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Consequently, the Annual Report and Accounts have been prepared on a going concern basis.

"The board should present a fair, balanced and understandable assessment of the company's position and prospects... The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives."

UK Corporate Governance Code

Risk management and internal control

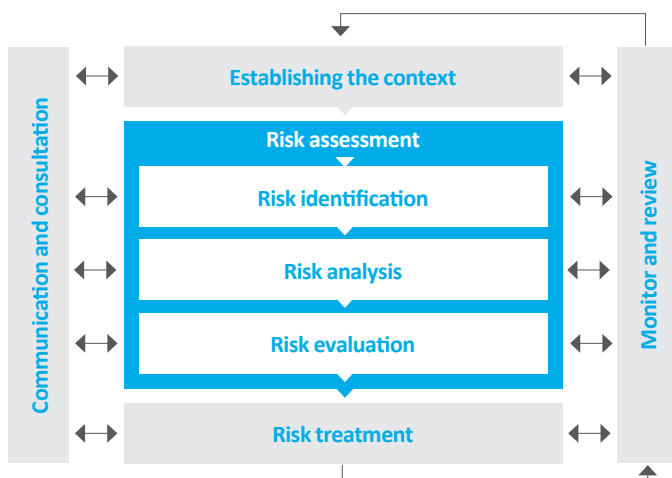
The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness in safeguarding shareholders' interests and the Company's assets. The system is designed to manage and mitigate, rather than eliminate, the risk of failure to achieve business objectives, and can provide only reasonable and not absolute assurance against material misstatement or loss.

Identification and review of risks

QinetiQ managers are responsible for the identification and evaluation of significant risks applicable to their areas of business, together with the design and operation of suitable internal controls to ensure effective mitigation. These risks, which are related to the achievement of business objectives, are assessed on a continual basis and may be associated with a variety of internal and external events, including control breakdowns, competition, disruption, regulatory requirements, and natural and other catastrophes. The Board, the Audit Committee and the Risk & CSR Committee regularly review significant risks to the business.

Corporate Governance Statement continued

QinetiQ's risk management processes are defined in the Group's Operating Framework and mirror the Institute of Risk Management's guidance as detailed in the figure below.



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

Risk assurance activity conforms to the three lines of defence model detailed below and is performed by the businesses, oversight functions and Internal Audit, reporting to the Governance Committee and the Board's Risk & CSR Committee.

Details of key risks can be found in the risks and uncertainties section of this Annual Report on page 22 to 27.

Risk assurance activity during 2014 has covered the following areas:

- Agreement, and continued implementation of, the Group Risk Appetite.
- Creation of the Governance Committee as the executive review body for risk governance.
- Quarterly updates in respect of the divisional risk register and moderation to form the Group Risk Register, such that the Group Risk Register now lives as a dynamic document with regular risk ratings changes, additions and retirement of risks.
- Challenge to risk identification by business divisions and functions.
- Embedding use of the Operating Framework and Business Assurance Tool to ensure effective internal control against regulatory and operational risks.
- Regularly requiring risk owners to report their activity to the Risk & CSR Committee (see page 66).

Self-certification process

An annual process of hierarchical self-certification, which provides a documented and auditable trail of accountability for the operation of the system of internal control, has been established. This self-certification process is informed by a rigorous and structured self-assessment that addresses compliance with Group policy. It provides for successive assurances to be given at increasingly higher levels of management and, finally, to the Board.

Internal control

Our businesses are responsible for ensuring that a robust risk and control environment is in place as part of their day-to-day operations. Business assurance managers oversee this process and a clear set of delegated authorities is in place, covering financial and non-financial activities, and is consistent with effective operational control and risk management. The business is guided by two key documents which are managed by our Safety, Assurance and Sustainability team:

- 'The Way We Work' is applicable to all staff and covers three key pillars of the way we operate: Organisation, Risk Management and Assurance, and Key Business Processes. It is underpinned by key business policies, the Operating Framework (referred to below) and our culture, values and brand; and
- The Operating Framework (Business Management System), which contains the policies, procedures and codes of practice which are expected to be complied with across the business.

The internal audit function, which is independent of the business and has a direct reporting line to the Audit Committee, provides assurance to the Board and its Committees over the effectiveness of the internal control environment. The programme of work undertaken by Internal Audit is approved in advance by the Audit Committee and is prioritised according to risks identified by the Group through its risk management processes.

A similar process is undertaken within the Group's QinetiQ North America business, thereby providing assurance on the adequacy and efficacy of internal controls in this business. The risk management process and the system of internal control necessary to manage risks are managed by the Audit Committee (financial risks) and the Risk & CSR Committee (non-financial risks) and each Committee presents its findings to the Board. The internal audit function independently reviews the risk identification and control processes implemented by management and reports to the respective Committee.

The Audit Committee and the Risk & CSR Committee also review the assurance process, ensuring that an appropriate mix of techniques is used to obtain the level of assurance required by the Board. Each Committee presents its findings to the Board on a regular basis. The Board reviewed the effectiveness of the system of internal control that was in operation during the financial year ended 31 March 2014. The Board also routinely challenges management to ensure that the



systems of internal control are constantly improving to maintain their effectiveness. The internal control and risk management systems described above, as well as finance policy and codes of practice, apply to the Company's process of financial reporting and the preparation of consolidated accounts. A structured approach to the review and challenge of financial information is also an essential element of the process.

Anti-bribery and the prevention of corruption

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

International Business Risk Assessment

The International Business Risk Assessment Procedure and the Commercial Intermediaries Procedure both contain comprehensive processes to support the Group's commercial and legal objectives when undertaking business in overseas jurisdictions.

Compliance is managed through a risk-based approach. As part of this process, a country risk table has been developed which segregates countries using a traffic-light code:

- Green for countries with whom we are willing to trade (subject always to trade control and security clearances;
- Amber for countries with some risk, and which require careful consideration; and
- Red for countries with high risks which require independent review by the Red Review Panel – a group of experts who assist with the assessment of the risk of activities associated with 'red' countries.

The risk table is compiled on the basis of information received in respect of specified areas such as security advice, trade controls, insurance and measures in respect of bribery and corruption, using a combination of internal expertise and external, internationally recognised organisations, such as TRACE, international law firms and other expert service providers, who also conduct anti-corruption due diligence reviews of all third-party commercial intermediaries used by QinetiQ's divisions.

During the year, a process of quarterly reporting to the Board was instigated in respect of payments to agents, and signed overseas contracts, in excess of £10m, in a standard form report. In addition, the Board's approval is required for certain types of contract proposals in 'amber' and 'red' jurisdictions.

Whistleblowing

The Company has in place a whistleblowing process which is detailed on the Company's intranet. If an individual does not feel that they can resolve any concerns with the Company directly, either through discussions with their line manager, or with the Company Secretary or Group Internal Audit Manager, they can use the whistleblowing hotline – an externally provided confidential internet and telephone reporting system. All concerns are passed by the external third party to the Group Internal Audit Manager who will ensure that they are held in strict confidence and are properly investigated.

Ethics

The Company provides employees with guidance to assist them in making informed ethical decisions on a day-to-day basis, including the Company's Code of Conduct, annual ethics training for all employees and links to the country risk table and Red Review Panel processes detailed above.

Further details regarding activity in respect of corporate responsibility, including in respect of business ethics and anti-bribery risk management, can be found in the Corporate Responsibility and Sustainability Review on pages 36 to 41.

Management and control of US subsidiaries

QinetiQ's principal US subsidiaries are required by the US National Industrial Security Program to maintain facility security clearances and to be insulated from foreign ownership, control or influence. This is achieved by way of proxy arrangement, as detailed below.

Following the announcement of the sale of the US Services division, the main operating companies within the retained US business have been placed under a new proxy arrangement, and a new Proxy Board comprising US individuals has been appointed to manage that business. The Board will review the robustness of the new governance arrangements once the current restructuring has been completed.

Pending completion of the sale of the US Services division, to comply with the proxy requirements, QNA, a wholly-owned subsidiary of QinetiQ in the US and the holding company for the substantive part of QinetiQ's US operations (until completion of the US Services disposal), and the US Department of Defense (DoD) are parties to a proxy agreement that regulates the management and operation of these companies. Pursuant to this Proxy agreement, QinetiQ appointed four US citizens who hold the requisite US security clearances (Peter Marino, Riley Mixson, John Currier and Vince Vitto) as proxy holders to exercise the voting rights in QNA. The proxy holders are also Directors of the relevant US subsidiaries and, in addition to their powers as Directors, have power under the proxy arrangements to exercise all prerogatives of share ownership of QNA. The proxy holders have a fiduciary duty, and agree, to perform their role in the best interests of shareholders (including the legitimate economic interest), and in a manner consistent with the national security interests of the US. QinetiQ Group plc does not have any representation on the Boards of the subsidiaries covered by the Proxy agreement. QinetiQ Group plc may not remove the proxy holders other than for acts of gross negligence or wilful misconduct or for breach of the proxy agreement (with the consent of the US Defense Security Service).

Corporate Governance Statement continued

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

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

Unlike minority interest holders with protective veto rights, QinetiQ can unilaterally require the above to be carried out and these are, therefore, considered to be significant participative features.

In addition, QinetiQ can require the payment of dividends, and the pay-down of parent company loans, from QNA.

In the interests of transparency and good governance, during the year the Company sought to maintain its involvement in QNA's activities through the conduct of business meetings and communications at the CEO, CFO, HR and Legal levels. QNA senior management presented on key commercial and governance activities in respect of the US business to the Company's Board and its Committees twice during the year, at six-monthly intervals, and QNA activities were reported on during the intervening meetings by way of executive reports and updates via teleconference.

This activity is subject always to the confines of the proxy regime to ensure that it meets the requirement that QNA must conduct its business affairs without external control or influence, and the requirements necessary to protect the US national security interest. The challenges that this creates for the Board are dealt with in the Audit Committee report on page 63.

Report of the Audit Committee



The principal responsibility of the Committee remains the review of controls around the preparation of the full and half-year financial statements including significant judgments taken in their preparation and reporting.

2014 is the first full year in which the Committee has operated separately from the Risk & CSR Committee and therefore been able to focus specifically on the effectiveness of the management of financial risks.

In both of these areas, I aim to encourage an open but challenging dialogue between the Committee, management, and internal and external auditors.

In addition, the Committee has worked with US colleagues to achieve, where possible, consistency between the US and the UK in respect of the assessment and reporting of internal controls, risks and governance arrangements generally. This activity is challenging, remains ongoing and, with the adjustment of the US Group following the outcome of the US Services strategic review, further work will be undertaken by the Committee to improve the consistency of approach across the re-shaped Group.

Paul Murray
Chair

Membership and attendance during the year

| Member | Attendance |
|----------------------------------|------------|
| Paul Murray (Committee Chair) | 5/5 |
| Colin Balmer [#] | 4/4 |
| Admiral Sir James Burnell-Nugent | 5/5 |
| Noreen Doyle ^{>} | 4/5 |
| Michael Harper | 5/5 |
| Susan Searle [*] | 1/1 |

[#] Colin Balmer retired at the end of January 2014 and therefore had left the Board prior to the Committee's meeting in March 2014.

[>] Noreen Doyle was unable to attend one Committee meeting due to a long-standing prior commitment.

^{*} Susan Searle joined the Board in March 2014 and therefore was only able to attend the March Committee meeting.

The Audit Committee is chaired by Paul Murray. The Board considers him to have recent and relevant financial experience, given his former roles as Group Finance Director of Carlton Communications plc and LASMO plc, and through his current role as Audit & Risk Committee Chairman at Royal Mail Group plc.

The Board considers the members of the Committee to be independent. They bring extensive experience of corporate management in senior executive positions to the Company. Details of their background and experience can be found on page 55.

The CEO, CFO, Group Financial Controller, Group Internal Audit Manager and representatives of the external auditor normally attend Audit Committee meetings.

Main responsibilities

The Audit Committee monitors the Group's integrity in financial reporting and reviews the effectiveness of the financial risk management framework. The Committee has an annual calendar of activities, in addition to which it identifies particular areas of focus during the year. The Audit Committee meets as necessary and at least four times a year. During the financial year ended 31 March 2014, the Committee met on five occasions. The external auditor has the right to request that a meeting of the Audit Committee be convened. During the past financial year, and in accordance with its terms of reference, the Committee met with QinetiQ's external auditor on two separate occasions, without Executive Directors present, to discuss the audit process. The Committee also met with the Group Internal Audit Manager on two separate occasions, without Executive Directors present.

Overview

Key areas of focus during the year were:

- QNA risks, issues and mitigating actions;
- the effectiveness of internal controls;
- the effectiveness of governance arrangements;
- the effectiveness of external audit;
- the review of the audit process for the full-year and half-year results; and

- the review of the 'fair, balanced and understandable' requirement in respect of future Annual Reports.

Further details are set out below.

a) QNA risks, issues and mitigating actions

As detailed on page 61 concerning 'Management and control of US subsidiaries', during the year the Company's holding of its QNA assets was regulated by a Proxy agreement. This arrangement, whose purpose is to insulate QNA from foreign ownership control or influence, directly impacts the way in which the Company's Board is able to gain comfort on the effectiveness of QNA's systems of internal control. As a result, the Audit Committee places significant reliance on the effectiveness of the QNA Audit Committee and independent assurance from QNA's external auditor.

QNA is subject to external audit by the same auditor as for the Company, KPMG. The Company has the opportunity to meet with QNA's external auditor independently. Further, the Company is able to review in detail, with the Chair of the QNA Audit Committee and the QNA Internal Audit Manager, the audit work within QNA, and to gain an understanding of the systems of internal control and their effectiveness. Minutes of the QNA Audit Committee meetings were reviewed by the Committee, along with QNA Internal Audit reports.

During the year under review, the Committee held two of its meetings in the US (jointly with the Risk & CSR Committee). The meetings were attended by the QNA Internal Audit Manager, QNA proxy holders and a QNA Director, thereby facilitating a more detailed review of matters affecting QNA, covering areas such as the QNA internal control environment, its risk register and business risk appetite.

b) Review of internal controls

The Audit Committee continually reviews the effectiveness of the systems of internal control to gain assurance that an effective control framework is maintained. Reports on the effective operation of the control framework are received from management and reviewed by the Committee along with key policies and processes, including whistleblowing arrangements. Regular reports on the operation of internal controls and risk management processes are also received from the internal audit function. Particular attention is given to the timely and effective implementation of remedial actions, either identified by the business directly, or by Internal Audit. The Committee also regularly reviews the effectiveness of the financial risk management framework, including reviewing key financial risks and assessing the effectiveness of management's remedial action plans.

The process in respect of QNA is adjusted to take into account the proxy arrangements referred to in (a) above, and the Committee meets regularly with the Chair of the QNA Audit Committee and the QNA Internal Audit Manager to gain assurance on the effectiveness of the QNA internal control framework. In addition, the Committee, on behalf of the Board, undertakes an annual assessment of the control environment and the QNA Audit Committee reports to the Group Audit Committee regarding QNA controls effectiveness.

Corporate Governance Statement continued

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

c) Governance reviews

The Committee's September meeting had considered the processes to be followed for the various governance reviews.

An external review of the effectiveness of the UK internal audit function was undertaken during the second half of the year by the Chartered Institute of Internal Auditors. The results of the review were reported to the March Audit Committee. The independence and effectiveness of the function were noted as well as an updated continuous improvement programme incorporating the review findings. This programme will be monitored at regular intervals by the Audit Committee.

In terms of the effectiveness of the Committee itself, an evaluation was carried out by way of a questionnaire which was circulated to Committee members and key executives for completion. The Committee Chairman had evaluated the results and reported on them at the Committee's May 2014 meeting.

The role of the Committee, its skills mix and oversight of financial risk management, reporting and audit was considered to remain effective. The following actions were noted:

- it was necessary to remain focused on the management of risk oversight by either the Audit or Risk & CSR Committees, to ensure that all matters are covered; and
- further progress would be necessary in respect of oversight of the US governance arrangements following completion of the US corporate restructuring.

d) External audit effectiveness review

The Committee's September meeting had considered the approach for monitoring the effectiveness and independence of the external audit process in the light of the requirements of the UK Code and FRC guidance.

At this meeting, it was agreed that an effectiveness review would be undertaken by the internal audit function. The views of the Audit Committee and key finance stakeholders were sought regarding the effectiveness of the external audit process using a questionnaire compiled using available best practice guidance.

The review covered a range of topics, including:

- the audit partner and the audit team;
- the audit approach – planning and execution;
- the role of management;
- communication with the Audit Committee;
- supporting the work of the Audit Committee;
- insights and adding value;
- independence and objectivity; and
- formal reporting.

The outcome of the review was considered at the March Committee meeting and the following were noted and reported to the Board:

- the external auditor's independence and objectivity were strongly affirmed;
- the external auditor was in a strong position to challenge management on its approach to key judgments;
- appropriate discussions were held with the Audit Committee during the audit planning process; and
- within the business there is a general perception of high quality execution and service.

e) Financial statements

The Committee reviews whether suitable accounting policies have been adopted, whether management has made appropriate estimates and judgments, and also seeks support from the external auditors to assess them. The Committee reviewed the following main issues for the year ended 31 March 2014:

- The basis of and key assumptions relating to management's assessment of the carrying value of the goodwill associated with the US Services and US Global Products divisions.
- The basis for and judgments made by management in determining the liabilities recorded for litigation, potential claims and other disputes.
- The accounting for long-term contracts.
- The key assumptions and their sources used in accounting for the Group's defined benefit retirement obligations.
- Provisions for ITAR compliance.
- The provisions for Income tax and deferred tax.
- The disclosures in the Preliminary Announcement and Annual Report and Accounts, in particular those relating to risk, goodwill, specific overlying items and the operation of the proxy regime in the US.

Based upon the business assurance process and discussions with management and the external auditors, the Committee was satisfied that the disclosures and assumptions were reasonable and appropriate for a business of the Group's size and complexity, that the auditors had fulfilled their responsibilities in scrutinising the financial statements for any material misstatements and that the disclosures were satisfactory.

f) Review of the 'fair, balanced and understandable' requirement in respect of Annual Reports

The Audit Committee considered during the year how to adapt, if necessary, the Group's procedures to provide advice to the Board to meet with the requirements of the UK Code on whether the Annual Report and Accounts, taken as a whole, provide a fair, balanced and understandable assessment of the Company's financial position and future prospects and provide all information necessary to a shareholder to assess the Group's performance, business model and strategy.

As part of the review process, the Committee took guidance from the external auditor and from the Group accounting and internal audit functions. The following were noted:

- The Group has a clear strategy, which is presented to the Board for review each year by business leaders, with interim updates during the year.
- Quarterly business reviews are undertaken by senior management which include monitoring business progress against budget.
- Business performance is monitored by the Board as detailed on page 51.
- Key individuals from appropriate business divisions and functions contribute to, or are involved in the verification of, the content of the Annual Report.
- The Company has an Annual Report working group, comprising individuals from the Finance, Investor Relations, Assurance, HR, Group Strategy, Company Secretariat and Marketing/Communications functions, which adheres to a timetable of actions for the production and review of the Annual Report.
- The Annual Report working group was made aware of the fair, balanced and understandable requirements early in the process and tasked with ensuring that the Annual Report would take account of those requirements.
- A checklist of considerations to ensure the requirements were met was produced and completed by the working group in order to provide assurance to the Committee (and to the Board).
- More time was allocated to the Annual Report process to allow for additional checks for consistency of reporting across the narrative and financial sections in respect of the strategy and performance of the business as a whole.

Auditor reappointment

KPMG has been the auditor of the QinetiQ Group since its formation in 2001 as the result of a competitive tender, and the Company's auditor since its incorporation in 2002. During that time, there have been periodic changes in audit partners in accordance with professional and regulatory standards to protect independence and objectivity. A rotation of KPMG's lead audit partner was last undertaken during 2012, at which time the second audit partner was appointed since the Company's flotation in 2006.

Given the work undertaken during the year under review in respect of the US Services division, and the resulting ongoing changes within the Group, the Committee considers that a continuity of approach with the external auditor is valuable and, having reviewed the effectiveness and the independence of the external auditor during the year, as detailed on page 64, the Committee does not consider it appropriate to conduct a tender process for the appointment of its auditor at the present time.

It is the Company's current intention to align the process for putting the external audit contract out to tender with the conclusion in 2017 of the five-year tenure of the audit partner. The Committee will continue, however, with the annual review of the performance of the external auditor and act accordingly.

The members of the Committee have declared themselves satisfied with the performance of KPMG as the Company's auditor in the last financial year and therefore the Committee has recommended to the Board that KPMG be reappointed for the financial year ending 31 March 2015.

External auditor independence: non-audit services

The Company views it as essential that the external auditor is both independent of any conflict of interest and perceived to be so. To safeguard auditor independence and objectivity, the Company has a Code of Practice within its Operating Framework which sets out the principles for regulating the award of non-audit work to the external auditor. The policy clearly articulates the non-audit services which are prohibited, the non-audit services which can be purchased and the key approval requirements for non-audit work.

Pursuant to the policy, the Committee ensures that any other advisory and/or consulting services provided by the external auditor do not conflict with its statutory audit responsibilities and are conducted through entirely separate working teams; such advisory and/or consulting services generally only cover regulatory reporting, tax, and mergers and acquisitions work. The cost and nature of non-audit work undertaken by the auditor is regularly reviewed by the Committee during the financial year and is included at regular intervals in its annual schedule as a standing item. This process enables the Committee to take corrective action if it believes that there is a risk of the auditor's independence being undermined through the award of such work.

It is also QinetiQ's policy that no KPMG employee may be appointed to a senior position within the QinetiQ Group without the prior approval of the CFO. Any non-audit services conducted by the auditor require the consent of the CFO or the Chairman of the Audit Committee before being initiated; any services exceeding £50,000 in value require the consent of the Audit Committee as a whole.

The Committee reviewed the Code of Practice relating to the principles for regulating the award of non-audit work to the external auditor during the year and considered that it remained appropriate.

In the last financial year, there have been non-audit services conducted by KPMG that exceeded £50,000 in value. The Committee concluded, prior to engaging KPMG for the provision of these services (in relation to the strategic review of the US Services business), that there had not been any conflict of interest that might compromise the independence of KPMG's audit work.

Corporate Governance Statement continued

Report of the Risk & CSR Committee



I am delighted to have been appointed Chair of the Risk & CSR Committee following the retirement of Colin Balmer at the end of January and would like to thank Colin for his hard work and diligence during his tenure as Chair of this Committee, including overseeing its evolution from the Compliance Committee to its current status as the Risk & CSR Committee.

During the year, the Committee continued to carry out its core functions and the development of the executive Governance Committee will enhance the process of risk management and oversight within the Group. The annual calendar of activity, together with the in-depth review of red risks and 'deep dives' into key risk areas, has provided a firm basis on which the Committee is able to oversee the operation of the non-financial risk management processes within the Group.

The work of the Committee continues to evolve, both in the light of the corporate restructuring of the QinetiQ Group and also in respect of changes in governance regulation and guidance.

Admiral Sir James Burnell-Nugent
Chair

Membership and attendance during the year

| Member | Attendance |
|--|------------|
| Admiral Sir James Burnell-Nugent (Committee Chair) | 4/4 |
| Colin Balmer [#] | 4/4 |
| Noreen Doyle ^{>} | 3/4 |
| Mark Elliott | 4/4 |
| Michael Harper | 4/4 |
| David Mellors | 4/4 |
| Paul Murray | 4/4 |
| Leo Quinn | 4/4 |
| Susan Searle [*] | N/A |

[#] Colin Balmer ceased to be Chairman of the Committee when he retired at the end of January 2014.

[>] Noreen Doyle was unable to attend one Committee meeting due to a long-standing prior commitment.

^{*} Susan Searle became a member of the Committee in March 2014 and will attend future meetings.

Main responsibilities

The Committee has three primary functions:

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

The Committee has an annual calendar of activities and meets as necessary, although normally not less than four times a year. During the financial year ended 31 March 2014, the Committee met on four occasions, excluding the two joint meetings held with the Audit Committee in the US, as noted on page 63.

As detailed in the section on Executive Committees on page 53, during the year, a Governance Committee was established to monitor non-financial strategies and their implementation by the businesses. The Governance Committee comprises senior executives and reports to the Risk & CSR Committee, with the Director of Safety, Assurance and Sustainability playing a pivotal role in this respect. During the year, matters which have been dealt with by the Governance Committee and reported to the Risk & CSR Committee have covered areas such as the inclusion or retirement of risks from the Risk Register which were then presented to the Committee and the Audit Committee.



Overview

During the year, the Committee continued to carry out its core functions by way of regular reporting in accordance with its annual calendar. The Committee continued to oversee health, safety and environment, trade controls, corporate responsibility, ethics and security through quarterly reports from the heads of those functions in the business. A summary of the key focus and activities of the health, safety and environment and ethics functions is set out in the corporate responsibility and sustainability review on pages 36 to 41.

Key areas of focus during the year were:

- a) risk management within the operation of the QNA proxy regime;
- b) the operation of the generic MOD compliance system;
- c) a review of the Group's risk management processes;
- d) a review of the Group Risk Register in accordance with FRC recommendations; and
- e) a review of the Group's risk appetite and providing clarity to executive management on acceptable levels of risk.

Further details are set out below. Details of the principal risks and uncertainties can be found in the 'risks and uncertainties' section on pages 22 to 27 of the strategic report.

Effectiveness review

The Committee evaluated the effectiveness of its performance during the year under review by way of a questionnaire which had been circulated to Committee members and key executives. The Chairman had reviewed the responses. It had been noted that there was a good level of satisfaction with the process of reviewing the management of financial risks and non-financial risks through the Audit Committee and the Risk & CSR Committee respectively. A key action arising from the review was to establish with the US Audit Committee an annual reporting timetable on items where reporting up to Board level was necessary to gain a greater understanding of non-financial risk management.

a) Risk management within the operation of the QNA proxy regime

As detailed on page 61 concerning 'Management and control of US subsidiaries', during the year the Company's holding of its QNA assets was regulated by a Proxy agreement. In conjunction with the Board and the Audit Committee, the Committee has worked with senior executives from QNA to establish, where possible, a consistency of approach with regard to areas such as risk appetite, the risk register and internal control. Work has taken place to produce an annual reporting timetable in respect of the US items where reporting is necessary to gain a greater understanding of non-financial risk management. In terms of crisis management, a revised and more complete crisis response process and committee is being set up across the Group.

The processes with regard to the US will continue to evolve as a result of the disposal of the US Services division and consequent corporate restructuring.

b) Generic compliance system

The Committee continues to monitor the generic compliance system, which is designed to give the MOD customer confidence that QinetiQ is able to provide impartial advice during any competitive evaluation of a procurement where the Group wishes to operate on both the 'buy' and the 'supply' sides. The aim is to achieve a balance between meeting the needs of the procurement customers in the MOD (principally Defence Equipment & Support) and the need to allow QinetiQ the flexibility to exploit research into the supply chain and pursue its planned commercial activities, without compromising the defence or security interests of the UK. Oversight of the operation of the system is provided by the Committee. The Board nominates two senior executives to act as Compliance Implementation Director and Compliance Audit Director. It receives a bi-annual report on the compliance areas that it monitors from the internal audit function. The Committee addresses any issues that would arise if QinetiQ were to fail to comply with the requirements of the generic compliance system.

No breaches were noted during the year. The Group will continue with rigorous management of potential conflicts of interest while ensuring that proportionate governance is maintained by the Board.

c) A review of the Group's risk management processes

The Committee receives a report at each meeting from the Safety, Assurance and Sustainability Director with regard to key areas of risk management activity, such as health and safety, international trade controls and proxy regime compliance. In addition, a series of 'deep dives' are scheduled for the course of the year, to facilitate an in-depth review and discussion of key risks. The following are examples of deep dive reviews carried out during the year:

- The review of ITAR-related risks, and the steps taken to deal with them, the continued growth of awareness across the business and the 'tone from the top' in respect of such risks. Aspects of the review included a presentation from the executive responsible for that function, a report by the internal audit function and subsequent updates on progress with actions taken to ensure delivery of a sound system.
- The review of cyber risk and the Company's resilience to cyber threats. The review included a presentation from the executive responsible for that area of risk management. It was noted that the Group's resilience to cyber threats was considered to be good, according to government agencies. The presentation gave details of actions which had been put in place for driving improvement and it was agreed that a quarterly report on the mitigation of cyber risks would be presented at each Committee meeting.

Corporate Governance Statement continued

d) A review of the risk register in accordance with FRC recommendations

The review of the Risk Register is a standing item on the Committee's agenda, with amendments being made to reflect changes in the Group's business. Further details can be found on in the 'understanding and managing our risks' section pages 22 to 27 of the strategic report. 'Red' risks are made the subject of a report to the Committee or become the subject of a 'deep dive' review as part of the Company's risk management processes. As an example, the Engineering and Technical Director updated the Committee on the work being undertaken to improve the Company's exposure to engineering and technical risk, focusing on the key risks and how they were being mitigated. The areas covered included technical assurance, facility safety assurance reviews, the QinetiQ Flying Organisation and the technical and engineering strategy.

e) A review of the Group's risk appetite and providing clarity to executive management on acceptable levels of risk

During the year the Committee reviewed the amount of investment and control necessary to mitigate the level of risk that the Board was willing to seek or accept in the pursuit of its key strategic goals, whilst also providing, by way of delegations, clear boundaries, operational flexibility and guidance for executive and business leaders to safeguard the Group's fundamental principle of trust.

The review was carried out by way of the discussion of a presentation by the Safety, Assurance and Sustainability Director, which subsequently led to the issuing of guidance to senior management.

The Security Committee



Membership and attendance during the year

| Member | Attendance |
|--|------------|
| Admiral Sir James Burnell-Nugent (Committee Chair) | N/A |
| Colin Balmer [#] | N/A |
| Michael Harper | N/A |
| David Mellors | N/A |
| Paul Murray | N/A |
| Leo Quinn | N/A |
| Susan Searle [*] | N/A |

[#] Colin Balmer ceased to be Chairman of the Committee when he retired at the end of January 2014.

^{*} Susan Searle became a member of the Committee in March 2014 and will attend future meetings.

Main responsibilities

The Committee was established in June 2009 to enable UK nationals on the Board to consider matters of a UK national security dimension that have an impact on QinetiQ's UK business.

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

Directors' Remuneration report

Report from the Remuneration Committee



On behalf of the Board, I am pleased to present the Remuneration Committee's report of the Directors' Remuneration for the year ended 31 March 2014 for which we will be seeking approval at the AGM on 22 July 2014.

Noreen Doyle
Chair

Remuneration Committee membership and attendance during year ended 31 March 2014

| Member | Attendance |
|---|------------|
| Noreen Doyle (Committee Chair) | 5/6 |
| Mark Elliott (Group Chairman) | 6/6 |
| Colin Balmer (resigned 31 January 2014) | 5/5 |
| Admiral Sir James Burnell-Nugent | 6/6 |
| Michael Harper | 5/6 |
| Paul Murray | 6/6 |
| Susan Searle (appointed 14 March 2014) | 1/1 |

Dear shareholder

On behalf of the Board, I am pleased to present the Remuneration Committee's report of the Directors' Remuneration for the year ended 31 March 2014 for which we will be seeking approval at the Annual General Meeting (AGM) on 22 July 2014.

I have set out in my statement the following information:

- The overall Remuneration Policy principles for the Company;
- The link between the Company strategy and the Company Remuneration Policy;
- The main decisions made by the Remuneration Committee (the 'Committee') during the year;
- Key activities of the Committee during the year; and
- A forward look at the main focus for the Committee in the upcoming year.

As required by the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, the rest of this Remuneration Report is divided into two parts:

- The Directors' Remuneration Policy sets out the Company's proposed policy on Director remuneration and the key factors that were taken into account in setting the policy. We will be applying the revised policy from 1 April 2014 subject to an affirmative shareholder vote at this AGM and after that at least every third year.
- The Annual Report on Remuneration sets out payments and awards made to the Directors and details the link between Company performance and remuneration for the 2014 financial year. The Annual Report on Remuneration is subject to an advisory shareholder vote at the AGM of the Company on 22 July 2014.

Remuneration Policy objectives

The primary objectives of our Remuneration Policy are to:

- Attract and retain top talent;
- Incentivise key executives and managers;
- Ensure an approach which values the diversity of our workforce;
- Drive superior performance in both the short and long term; and
- Align with the interests of shareholders.

The key purpose of the Committee is to ensure that the remuneration structure supports the Company strategy and that we are able to attract, retain and motivate high calibre executives by rewarding the creation of long-term sustainable value.

Directors' Remuneration report continued

2014 Group strategy and KPIs

Our strategy is to grow the business through the Organic-Plus programme. Progress is measured through a range of financial and non-financial KPIs to monitor Group and divisional performance. Financial measures such as order intake, organic sales growth, profitability and cash conversion track performance. Measurements of health and safety, productivity, customer satisfaction and employee engagement contribute to sustainability.

The Group's strategy is underpinned by focusing on a number of KPIs. These include a range of financial and non-financial indicators to monitor Group and divisional performance.

[Link to Remuneration Strategy](#)

Annual Bonus

Annual Bonus is determined by Group performance against targets for:

- Underlying operating profit;
- Underlying operating cash flow*; and
- Underlying earnings per share (EPS).

It is the Committee's opinion that these three headline KPIs encompass the performance of the Group and therefore encourage the Executive Directors to focus on the effective delivery of the Group's strategy on an annual basis.

Deferral of bonus in shares (DAB)

The deferral of bonus in shares has provided an ongoing exposure to the performance of the Group to ensure the annual performance delivered is viewed as sustainable by shareholders.

Performance Share Plan (PSP)

PSP awards are contingent on meeting pre-determined performance criteria based on measures that are both absolute and compare us to our peers. Awards are earned based on an equal weighting of absolute underlying EPS growth and relative Total Shareholder Return (TSR) performance against our peers.

It is the Committee's view that long-term EPS growth is the key financial measure in evaluating the sustainable performance of the Group and, therefore, is a crucial measure to include in the long-term remuneration of the Executive Directors.

The Committee views comparative TSR as an appropriate external measure of whether the implementation of the Group's strategy has led to above average levels of return for investors. Relative TSR measures the success of management in delivering on Group KPIs consistently over the longer term.

The Committee may not directly include qualitative non-financial KPIs in the performance conditions for Annual Bonus or PSP awards. However, the Committee views these KPIs as underlying and supporting the financial KPIs and may make compensation adjustments where the Committee believes that financial performance may have been delivered at the expense of meeting these non-financial KPIs.

Note: See definitions and more detail in the Strategy Report on pages 2-47.

Note: Definitions of underlying performance can be found in the glossary on page 150.

*Adjusted to exclude LTPA capital expenditure.

The Committee is grateful for all the support it has received from investors and their representative bodies over the course of the year while consulting on the proposed changes to the Remuneration Policy. The Notice of AGM sets out the details of the main change which is the proposed short-term incentive arrangement – the QinetiQ Group plc 2014 Bonus Banking Plan which, if approved by shareholders, will replace the Group's current Annual Bonus Plan, Deferred Bonus Plan and matching share arrangements.

Activities

The Committee meets as necessary, although normally at least four times a year. During the financial year ended 31 March 2014, it met on six occasions.

| Month | Main agenda Items |
|----------|--|
| May | <ul style="list-style-type: none"> • 2013 Annual Cash Bonus Plan results • Revised PSP rules prior to shareholder approval |
| July | <ul style="list-style-type: none"> • Share plan allocations and nominations • Share plan performance and vesting |
| October | <ul style="list-style-type: none"> • Executive Director recruitment policy • Executive Director payment for loss of office policy • Annual bonus and long-term incentive policy |
| November | <ul style="list-style-type: none"> • Government reforms • Committee programme for the year • Review of Executive shareholding • Reward and retention – all employees |
| January | <ul style="list-style-type: none"> • Executive pay trends • Executive incentive arrangements • Changes to the Directors' Remuneration Report |
| March | <ul style="list-style-type: none"> • Projected share plan vesting • Executive team salary review • Executive team Annual Bonus Plan design • Share plan allocations |

The Committee sets remuneration and incentives for Executive Directors and approves and monitors remuneration and incentives for senior executives of the Group. No Executive Director or employee of QinetiQ is permitted to be present or participate in the Committee's discussions about their own remuneration.

Effectiveness review

The Committee evaluated the effectiveness of its performance during the year under review by way of a questionnaire which had been circulated to Committee members and key executives. There was a good level of satisfaction with the independence and qualification of Committee members and of their willingness to challenge processes and reports where appropriate. It was noted that there was a formal and transparent procedure for developing policy on executive remuneration and for setting the remuneration packages of individual directors.

Principal areas where there was a good, but lower, level of satisfaction and therefore where improvement is possible, were noted as:

- a requirement for greater oversight of the remuneration processes for senior US Executives;
- a greater level of executive involvement in remuneration strategy;
- further continuous improvement in the provision of Committee materials;

- greater account to be taken of risk issues when considering the alignment of remuneration policies and practices with corporate objectives and business strategy; and
- the provision of greater development opportunities for Committee members to enable them to keep abreast of changes in remuneration policy and practice.

These areas for improvement are being addressed.

Looking forward for 2015

The Committee conducted an extensive review during the year of the Directors' Remuneration Policy, taking into account the following factors:

- the future suitability of the current incentive arrangements for the Company;
- the revision of strategy for the business and the requirement for any incentive to be aligned to the new strategy;
- the new BIS Regulations which require the Company to seek shareholder approval of the Remuneration Policy through a binding vote at the 2014 AGM; and
- the increasing strength of shareholder views against the operation of both a leveraged matching share plan and PSP, both of which measured performance against underlying EPS.

The key objectives of the new policy are:

- simplicity;
- retention of Executives;
- appropriate levels of fixed remuneration;
- an incentive programme which provides:
 - assurance that earned incentives materially contribute to the build-up of long-term equity holdings by the Management Team;
 - flexibility to allow the Committee to set relevant targets each year against a background of continual change and transformation of the business and sector over the next period;
 - material value if the incentive is earned; and
 - an element of annual bonus deferred into shares.

Conclusion

We have provided an 'At a glance' summary of 2014 remuneration immediately after this letter. The Annual Report on Remuneration provides further details and the Directors' Remuneration Policy sets out how we are building the strategy for the future.

I hope that we can rely on your vote in favour of the Annual Report on Remuneration and our Directors' Remuneration Policy for future years.

Noreen Doyle

Chair of the Remuneration Committee
May 2014

Directors' Remuneration report continued

At a glance

In this section we highlight the performance and remuneration outcomes for year ended 31 March 2014. More detail can be found in the Annual Report on Remuneration.

Performance against 2014 key incentive targets:

| Bonus KPIs | Target performance | Stretch performance | Actual performance | % of maximum reward achieved |
|---|--------------------|---------------------|--------------------|------------------------------|
| Underlying operating profit ¹ | £125.0m | £145.0m | £132.7m | 69.25% |
| Underlying operating cash flow ^{1,2} | £116.0m | £135.0m | £144.9m | 100.00% |
| Underlying EPS ¹ | 14.7p | 17.1p | 16.0p | 77.08% |

| LTIP vesting | Threshold performance | Stretch performance | Actual performance | % of maximum reward achieved |
|---|-----------------------|---------------------|--------------------|------------------------------|
| 2011 Value Sharing Plan (VSP) – profit before tax (PBT) | £1,087m | £1,938m | £1,026.2m | 0.00% |
| 2011 Value Sharing Plan (VSP) – TSR | £851m | £1,702m | £1,085.9m | 27.60% |
| 2011 Deferred Annual Bonus (DAB) – EPS | 15.9p | 19.8p | 16.0p | 26.47% |

Single total figure of remuneration for Executive Directors for 2013 and 2014:

| | 2014 Salary/Fee | 2014 taxable benefits | 2014 Annual Bonus | 2014 Long Term Incentive | 2014 pension | 2014 total | 2013 total |
|-----|-----------------|-----------------------|-------------------|--------------------------|--------------|------------|------------|
| CEO | £610,844 | £59,524 | £710,393 | £644,270 | £152,711 | £2,177,742 | £3,992,001 |
| CFO | £388,550 | £23,188 | £451,871 | £295,282 | £77,710 | £1,236,601 | £1,643,687 |

Proposed changes to Remuneration Policy:

| Policy element | Operation of element | Maximum potential value | Performance metrics used |
|------------------------------|--|---|--------------------------|
| Base salary | No change | | N/A |
| Benefits | No change | | N/A |
| Annual Bonus | Bonus Banking Plan replacing the Annual Bonus, Deferred and Matching Share Plans | Details are contained in the Notice of AGM (maximum 225% of salary) | |
| Performance Share Plan (PSP) | No change | No change (maximum 200% of salary) | |
| Pension | No change | No change | N/A |

¹ Definition of underlying measures and performance can be found in the glossary on page 150.

² Adjusted to exclude LTPA capital expenditure.

Remuneration Policy

Introduction

This section of the Remuneration Report contains the general principles operated by the Group in respect of the Group's Directors' Remuneration Policy which will underpin the Group's future remuneration payments. The Committee aims to maintain a Remuneration Policy, consistent with the Group business strategy and objectives, which:

- attracts, retains and motivates individuals of high calibre;
- is responsive to both Group and personal performance; and
- is competitive within relevant employment markets.

This Remuneration Policy covers the three-year period commencing 1 April 2014. The policy set out below complies with the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 ('the Regulations').

The Remuneration Policy is built on the following philosophy:

- remuneration packages are structured to support business strategy and conform to current best practice;
- appropriate rewards are given for meeting specific target objectives set at the beginning of each year;
- congruence with pay and employment conditions elsewhere in the Group;
- incremental compensation is achieved for attaining stretch performance targets;
- objectives are measured on metrics designed to be consistent with sustainable long-term business performance;
- promotion of long-term alignment with shareholders through satisfaction of incentives in shares and required employee shareholding; and
- all decisions are made taking into account the diversity of our people.

The total remuneration levels of the Executive Directors are reviewed annually by the Committee, with due consideration for:

- composition of the reward package;
- performance of the Executive against specific targets set at the beginning of each year;
- competitive market practice and remuneration levels based on a consistent competitor group reviewed annually; and
- the general economic environment, particularly in the defence sector.

The Executive Directors' remuneration package is made up of the following components:



Directors' Remuneration report continued

These main elements of remuneration, how they are linked to, and support, the Group business strategy are summarised in the following policy table:

Policy for Executive Directors

| Component | Purpose and link to strategy |
|--------------------------|---|
| Base salary | To attract and retain the talent needed to lead our business. |
| Bonus Banking Plan – NEW | Enabling the successful implementation of Group strategy through setting relevant targets to measure Executive Director performance. Aligns the interests of Executives with shareholders and contributes to the retention of key individuals by ensuring that Executives take part of their annual bonus in shares rather than cash. |

Operation and performance measures

Reviewed annually, with any change effective from 1 September.

Reference is made to the market data provided by the advisors to the Committee which covers all aspects of reward.

Each year, the packages are benchmarked independently by our advisors, currently PwC, using two comparator groups: one group is based on company size, measured by market capitalisation, and the second group is sector specific.

The first group is used as the primary reference with cross-checking against the second group to capture any industry specific features; there are approximately 20 companies in each group. The lower quartile, mid-market and upper quartile reference points are captured and the packages of the CEO and CFO benchmarked against these to ensure that they remain competitive at the mid-market level. Other factors taken into account when considering whether or not to award a base salary increase include:

- the business environment for the year ahead;
- the salary increase budget for all employees for the coming year;
- all other aspects of remuneration (the reward mix);
- the critical nature of the appointment with respect to delivering business results;
- the performance of the Executive over the previous 12 months;
- the Executive's position in terms of career development, potential and experience; and
- retention risk.

Maximum payment and payment at threshold

Aim to pay base salaries in line with the market median against defined comparator groups.

Typically, the base salaries of Executive Directors in post at the start of the policy period and who remain in the same role throughout the policy period will be increased by a similar percentage to the average annual percentage increase in salaries of all other employees in the Group. The exceptions to this rule may be where:

- an individual is below market level and a decision is taken to increase base pay to reflect proven competence in role; or
- there is a material increase in scope or responsibility to the Executive Director's role.

Annual performance conditions and targets are set at the beginning of the plan year. As well as determining the performance conditions, targets and relative weighting, the Committee will also determine, within the approved range, the level of target bonus at the beginning of the plan year. Upon assessment of performance by the Committee, a contribution will be made by the Company into the participant's plan account and 50% of the cumulative balance will be paid in cash. Any remaining balance will be converted into shares.

100% of the balance in year 4 will be paid in shares to the participant. During the four-year plan period, 50% of the retained balance is at risk of forfeiture based on a minimum level of performance determined annually by the Committee.

Discretion by the Committee to adjust targets may be made in exceptional circumstances, for example:

- acquisitions and disposals;
- restructuring costs;
- business structure changes;
- restated corporate allocations;
- Board approved budget adjustments;
- final IAS 19 pensions finance cost.

However, where such targets are altered, the Committee will adjust the performance targets so that the revised target is not materially less challenging than the target as originally set.

Maximum = 225% of salary

Target = 90%–135% of salary

Threshold = 0% of salary

Directors' Remuneration report continued

| Component | Purpose and link to strategy |
|--|--|
| Performance Share Plan (PSP) awards made from 31 March 2012 onwards | <p>To align Executive Directors' reward with returns to shareholders by a focus on increasing shareholder value over the medium to long term and ensuring long-term commitment to strategic objectives.</p> <p>The PSP focuses Executives on key measures which determine the sustainable performance of the Company and also ensures that the implementation of the Company's strategy is leading to above market levels of return for investors.</p> |
| Pension | To ensure that Executive Directors' total remuneration remains attractive and competitive. |
| Other benefits | To ensure that Executive Directors' total remuneration remains attractive and competitive. |
| Personal Shareholding Policy | To align Executive Directors' interests with those of shareholders through the build-up and retention of a personal holding in QinetiQ shares. |
| Provisions of previous policy that will continue to apply – Deferred Annual Bonus matching (DAB), Value Share Plan (VSP) | To align Executive Directors' interests with those of shareholders. No further awards are made under these plans. |

Operation and performance measures

Awards are earned based on an equal weighting of absolute underlying EPS growth and relative TSR performance. The performance period runs for three years from the start of the financial year in which the award is granted.

The Committee has discretion to vary the weighting of performance metrics over the life of this Remuneration Policy to ensure alignment with business strategy.

If events occur which cause the Committee to consider that the performance targets are no longer an appropriate measure of Group performance, the Committee may alter the terms of performance targets as it considers appropriate, but so that the revised target is not materially less challenging than the target as originally set.

To guard against misconduct, a claw back facility will apply under which part, or all, of the award can be recovered for the following reasons (but not limited to these):

- a material misstatement of the Group's financial results has occurred;
- the Board has found that the participant has engaged in misconduct (as determined by the Board) in the period between the date of grant and vesting.

The Group's policy is to offer all UK employees membership in the QinetiQ Group Personal Pension (GPP) plan which is a defined contribution scheme. Executives whose benefits are likely to exceed the Lifetime Allowance may opt out of the GPP. In such cases, or if the annual allowance would be exceeded, the individual will be paid an allowance in lieu of pension contributions. This supplement will be a non-consolidated allowance and will not impact any incentive calculations.

Benefits include car allowance, health insurance, life assurance, income protection and membership of the Group's employee Share Incentive Plan which is open to all UK employees.

Executives have five years to accumulate the required shareholding.

Deferred shares held as part of the DAB will count towards this total (excluding unvested matching shares).

Unvested awards do not count towards the required shareholding.

Once the required level of shareholding has been achieved to satisfy the policy, the Director/Executive will be expected to maintain that level of shareholding irrespective of whether the share price increases or decreases. Accordingly, they will be considered to have satisfied the test in future years even if the share price decreases.

The outstanding awards under the previous DAB and VSP will continue to form part of the Remuneration Policy until vesting. Details on how these plans operate can be found in the Directors' Remuneration Report for the year of grant.

These plans vest on terms set out in the plan rules which have previously been approved by shareholders.

Maximum payment and payment at threshold

Individual participants' award levels are determined by the Committee annually.

For the Executive Directors:

Normal grant level = 150% of salary

Maximum grant level = 200% of salary

The percentages of the award which vest at threshold performance are 25% for EPS growth and 30% for relative TSR rising on a linear basis to 100% vesting at stretch performance.

Maximum pension contribution or salary supplement = 25% of base salary for CEO, 20% of base salary for CFO.

Benefit values vary year on year depending on premiums and the maximum potential value is the cost of the provision of these benefits.

The CEO and CFO are required to hold QinetiQ shares with a value equivalent to 100% of their base salary. Other defined members of the senior leadership team are required to hold shares with a value equivalent to 50% of base salary.

DAB – maximum 100% of deferred bonus.

VSP – pre-defined number of shares for each £1m of additional shareholder value created based on PBT and TSR.

The Annual Report on Remuneration will disclose achievements under these plans in the year performance is completed.

Directors' Remuneration report continued

Notes to the policy tables

Performance measures and targets in 2015

The performance targets are determined annually. The Committee selected the performance conditions, as detailed on page 95, for the Bonus Banking Plan because these are central to the Group's overall strategy and are the key metrics used by the Executive Directors to oversee the operation of the business. Further details are included in the Notice of AGM.

The Committee is of the opinion that the specific performance targets for the Bonus Banking Plan are commercially sensitive in respect of the Company and that it would be detrimental to the interests of the Company to disclose them. The targets will be disclosed after the end of the relevant financial year in that year's Remuneration Report.

The Performance Share Plan performance conditions, as defined on page 95, complement the performance conditions described in the Bonus Banking Plan, supporting sustainable performance.

Changes to remuneration policy from that operating in 2014

The Committee conducted an extensive review of the Remuneration Policy taking into account the following factors:

- the current suitability of the incentive arrangements for the Group;
- the change in strategy for the business and the requirement to be aligned to the revised strategy;
- the new BIS Regulations which require the Company to seek shareholder approval of the Remuneration Policy through a binding vote at the 2014 AGM;
- the increasing strength of shareholder views against the operation of a leveraged matching share plan and PSP, both of which measured performance against underlying EPS.

This has resulted in the Committee proposing to introduce the Bonus Banking Plan which if approved by shareholders will replace the Company's current Annual Bonus plan, DAB Plan and matching share arrangements.

Remuneration Policy for all employees

All employees of QinetiQ are entitled to base salary, benefits and pension. UK and Australia based employees are entitled to participate in the QinetiQ Share Incentive Plan. The maximum opportunity available is based on the seniority and responsibility of the role. Participation in the PSP is available to Executive Directors; senior managers and selected employees throughout the organisation are also invited to participate.

Illustrations of application of Remuneration Policy

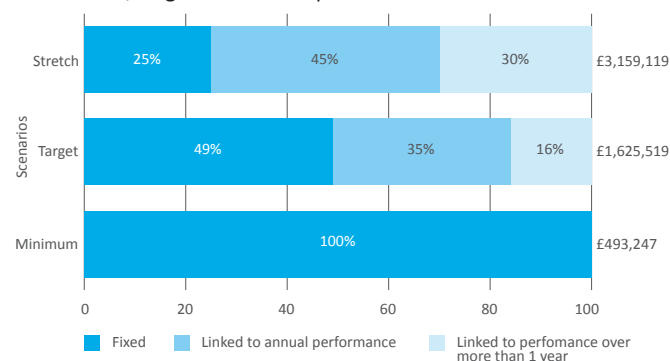
The tables below are for illustrative purposes and represent the minimum, target and maximum remuneration opportunity for both the CEO and CFO based on the following assumptions:

Fixed Pay: Estimated base salary for the year ending 31 March 2015 plus car allowance plus pension contribution.

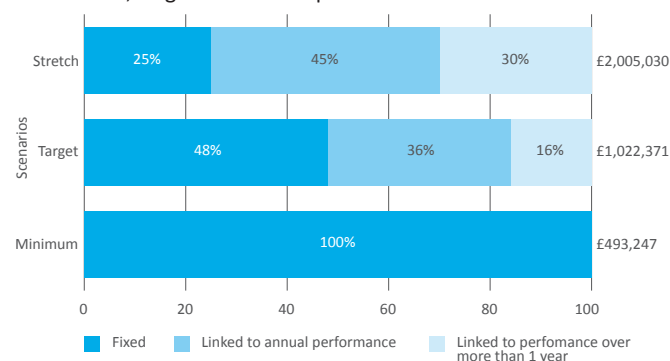
Remuneration linked to annual performance: 40% of maximum opportunity will pay out at target performance and 100% at stretch performance.

Remuneration linked to long-term performance: 27.5% of maximum opportunity will pay out at target performance and 100% at stretch performance.

The table below sets out the potential remuneration for the CEO at minimum, target and stretch performance levels:



The table below sets out the potential remuneration for the CFO at minimum, target and stretch performance levels:



Approach to recruitment remuneration

When recruiting Executive Directors, the Committee applies the following recruitment philosophy:

| Components | Policy |
|---|---|
| General | The Committee's approach to recruitment remuneration is to pay competitively to attract the appropriate high calibre candidate to the role. We expect that the pay of any new recruit would be assessed following the same principles as for the Executive Directors. |
| Base salary and benefits | The base salary will be set taking into account the responsibilities of the individual and the salaries paid to similar roles in comparable companies as per our base salary policy. The Executive Director will be eligible to receive benefits in line with QinetiQ's benefits policy as set out in the policy table. |
| Pension | The Executive Director will be eligible to receive pension benefits in line with QinetiQ's Pension Policy as set out in the policy table. |
| Bonus Banking Plan | The Executive Director will be eligible to participate in the Bonus Banking Plan to the declared maximum potential as set out in the policy table. |
| Long Term Incentives | The Executive Director will be eligible to participate in the LTIPs to the declared maximum potential as set out in the policy table. |
| Share buy-outs/ replacement awards | Awards may be granted to replace those forfeited by the Executive Director on taking up the appointment where considered by the Committee to be appropriate. The Committee will seek to structure any replacement awards such that overall they are no more generous in terms of quantum or vesting period than the awards due to be forfeited. In determining quantum and structure of these commitments, the Committee will seek to replicate the fair value and, as far as practicable, the timing and performance requirements of remuneration foregone. |
| Sign-on payments/ recruitment awards | The Committee's policy is not to provide sign-on compensation. However, in exceptional circumstances where the Committee decides to provide this type of compensation it will endeavour to provide the compensation in equity, subject to a holding period during which cessation of employment will generally result in forfeiture and subject to the satisfaction of performance targets. In addition, where practical the Committee will endeavour to consult with its key shareholders prior to entering into any commitment. The maximum value of this one-off compensation will be proportionate to the overall remuneration offered by the Company and in all circumstances is limited to 150% of salary which will only be provided in exceptional circumstances. |
| Relocation policies | In instances where the new Executive Director is required to relocate or spend significant time away from their normal residence, the Company may provide one-off compensation to reflect the cost of relocation for the Executive Director. The level of the relocation package will be assessed on a case by case basis but will take into consideration any cost of living differences/housing allowance and schooling. |

Where an existing employee is promoted to the Board, the policy set out above would apply from the date of promotion but there would be no retrospective application of the policy in relation to subsisting incentive awards or remuneration arrangements. Accordingly, prevailing elements of the remuneration package for an existing employee would be honoured and form part of the ongoing remuneration of the person concerned. These would be disclosed to shareholders in the Annual Remuneration Report for the relevant financial year.

Service contracts

Copies of Directors' service contracts and letters of appointment are available for inspection at the Company's registered office, and available at the AGM.

Executive Directors' service agreements are of indefinite duration, terminable at any time by either party giving 12 month prior notice. It is the Company's policy not to provide notice periods greater than 12 months.

Under each of the Executive Directors' service agreements, QinetiQ has the right to make a payment in lieu of notice of termination, the amount of that payment being base salary and benefits that would have accrued to the Executive Director during the contractual notice period. In addition, the Committee reserves the right to allow continued participation in the annual bonus during the notice period provided that the individual is being required to work their notice period. It should be noted that the Company expects Executive Directors to mitigate.

Non-executive Directors' letters of appointment are renewed on a rolling 12-month basis subject to reappointment at the AGM. There are no provisions for compensation on early termination.

Directors' Remuneration report continued

Policy on payment for loss of office

When considering compensation for loss of office, the Committee will always seek to minimise the cost to the Company whilst applying the following philosophy:

| Components | Policy |
|---------------------------------|--|
| General | The Committee will honour Executive Directors' contractual entitlements. Service contracts do not contain liquidated damages clauses. If a contract is to be terminated, the Committee will determine such mitigation as it considers fair and reasonable in each case. There are no contractual arrangements that would guarantee a pension with limited or no abatement on severance or early retirement. There is no agreement between the Company and its Directors or employees, providing for compensation for loss of office or employment that occurs because of a takeover bid. The Committee reserves the right to make additional payments where such payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation); or by way of settlement or compromise of any claim arising in connection with the termination of an Executive Director's office or employment. |
| Base salary and benefits | In the event of termination instigated by either the Company or Executive Director, the Executive Director may be entitled to receive compensation equivalent to salary and benefits they would have received if still in employment for their 12-month notice period. |
| Pension | In the event of termination instigated by either the Company or Executive Director, the Executive Director may be entitled to receive compensation equivalent to their Company pension contributions, or cash allowance, they would have received if still in employment for their 12-month notice period. |
| Bonus Banking | <p>In the event of termination instigated by either the Company or Executive Director, the Executive Director may be considered a good leaver and accrue service under the Bonus Banking Plan until the date they cease to hold employment if their reason for ceasing to hold employment is for the following reasons:</p> <ul style="list-style-type: none"> • death; • injury, ill-health or disability; • redundancy; • retirement with the Board's agreement; • the employing Company ceasing to be a member of the Group; • the business or part of the business to which the Participant's employment relates is transferred to a person who is not a member of the Group; or • any other reason (other than for dishonesty, fraud, misconduct, or any other circumstances justifying summary dismissal) as the Committee in its absolute discretion so permits in any particular case. The Committee will only use its general discretion to determine that an Executive Director is a good leaver in exceptional circumstances and will provide a full explanation to shareholders, if possible in advance, of the basis for its determination. <p>In addition, all balances in the participants' plan account will be paid.</p> <p>In normal good leaver circumstances, the bonus will be based on the normal performance period and paid on the normal payment date. However, the Board has discretion to accelerate the payment of bonus to an earlier date, subject to satisfaction of the performance conditions at that time.</p> <p>In the event that an Executive director is not a good leaver they will have no entitlement to a payment under the plan for the year of their cessation of employment and all balances in their plans will be forfeited.</p> |

| Components | Policy |
|--|--|
| Long Term Incentives (including matching awards under the DAB) | <p>An award which has not vested will lapse on the date the participant ceases to hold employment unless the reason for ceasing to hold employment is for one of the following reasons:</p> <ul style="list-style-type: none"> • death; • injury, ill-health or disability; • redundancy; • retirement with the agreement of the employing Company; It is the Committees Policy time; • the employing Company ceasing to be a member of the Group; • the business or part of the business to which the Participant's employment relates is transferred to a person who is not a member of the Group; or • any other reason (other than for dishonesty, fraud, misconduct, or any other circumstances justifying summary dismissal) as the Remuneration Committee in its absolute discretion so permits in any particular case. <p>The Committee will only use its general discretion to determine that an Executive Director is a good leaver in exceptional circumstances and provide a full explanation to shareholders, if possible in advance, of the basis for determination.</p> <p>Awards vest on the normal vesting date, subject to the performance conditions being satisfied. However, the Committee has discretion to accelerate the vesting of awards to an earlier date, subject to satisfaction of the performance conditions at that time. In either case, unless the Committee decides otherwise, awards are pro-rated to reflect the period in which the participant was not employed during the performance period.</p> <p>The Committee reserves the right to pay cash in lieu of shares if deemed appropriate.</p> |

Directors' Remuneration report continued

Policy for Non-executive Directors

The Remuneration Policy for Non-executive Directors is summarised in the table below:

| Component | Purpose & link to strategy |
|-----------|---|
| Fees | To attract and retain Non-executive Directors of the calibre required to assist the Company in setting and delivering its strategy. |

Other Remuneration Committee discretions

Under the various reward plans, the Committee may apply its discretion in the event of the following:

- variation of the share capital of the Company;
- demerger or disposal of a substantial part of the Group's business;
- significant acquisition or disposal;
- change of control of the Company.

Bonus Banking Plan

The Participant will receive an award in cash immediately prior to the date of the change of control (and conditional on the change of control actually occurring) based on the level of satisfaction of the performance conditions at this date pro-rated to the amount of the Plan Year completed on the change of control subject to the Committee's discretion to waive or partially waive pro-rating. It is the Committee's policy in normal circumstances to pro-rate to time; however, in exceptional circumstances where the nature of the transaction produces exceptional value for shareholders and provided the performance targets are met, the Committee will consider whether pro-rating is equitable. All balances in Participants' Plan Accounts will vest in full on a change of control.

Performance Share Plan

In the event of a change of control of the Company it is the Committee's normal expectation that any outstanding awards will vest subject to the satisfaction of the Performance Targets and pro-rated to time. However, in exceptional circumstances, the Committee will consider whether pro-rating is equitable particularly where the nature of the transaction produces exceptional value for shareholders and, provided the Performance Targets are met, may waive some or the entire pro-rating requirement.

Alternatively in the event of a change of control of the Company any outstanding allocations shall, with the Remuneration Committee's consent, continue to subsist, but subject to such adjustments to the performance target as the Remuneration Committee shall determine.

The Committee may make adjustments to awards as it may determine to be appropriate under the DAB plan, Bonus Banking Plan and PSP, in accordance with the plan rules.

The Committee has discretion in several areas of policy as set out in this report. The Committee may also exercise operational and administrative discretions under relevant plan rules approved by shareholders as set out in those rules. In addition, the Committee has the discretion to amend policy with regard to minor or administrative matters where it would be, in the opinion of the Committee, disproportionate to seek or await shareholder approval. It is the Committee's intention that commitments made in line with its policies prior to the date of the 2014 AGM will be honoured, even if satisfaction of such commitments is made post the AGM and may be inconsistent with the remuneration policies.

Consideration of employment conditions elsewhere in the Group

The Committee gains an overview of the reward and retention of the whole employee population annually when the Human Resources Director is invited to present on the proposals for salary increase for the employee population generally, and on any other changes to Remuneration Policy within the Group. The information presented is taken into consideration when setting the pay levels of the Executive population.

The Committee also oversees arrangements for share-based reward in respect of managers and the wider workforce.

Operation

The Group Chairman reviews annually the fees of the Non-executive Directors, other than the Group Chairman's, and makes recommendations to the Board.

The Senior Independent Non-executive Director reviews the Group Chairman's fees and makes recommendations to the Board.

Non-executive Directors are paid a basic fee plus additional fees for chairing committees to take account of the additional responsibilities of the role.

Fees are neither performance-related nor pensionable. Non-executive Directors are not eligible to participate in bonus, profit sharing or employee share schemes.

Excluding the Group Chairman, an additional fee is payable to those Non-executive Directors attending meetings outside of their country of residence.

All Non-executive Directors are reimbursed for any travel and other business expenses incurred.

An annual accommodation allowance may be payable to the Group Chairman and as deemed appropriate for individuals who are not UK resident.

Maximum

Non-executive Director fee policy aims to pay at median level, when considering the same comparator group used for Executive Directors, and increases will generally be in line with that of employees.

Remuneration of employees in QinetiQ North America (QNA) is governed, according to the Proxy agreement, by their Compensation Committee. The chairs of the QNA Compensation and QinetiQ Group plc Remuneration Committee meet on a regular basis to exchange information. In addition the Remuneration Committee receive quarterly reporting on the QNA senior leaders' remuneration and any material changes.

Employee plans

The Share Incentive Plan is operated in the UK and Australia in the form of a share purchase award with a matching Company contribution to encourage employee ownership and engagement in the business.

Executive plans

In addition to the VSP and PSP, the Group operates the following executive share plans:

- QinetiQ Share Option Scheme (QSOS) – This plan expired in 2013
- Stock Award Plan – Restricted Stock Units (RSU) – RSU awards are allocated in QNA to retain and motivate senior managers. The RSU awards vest in four equal tranches over a four-year period. Grants are subject to a vesting schedule which is 50% time-based and 50% based on the achievement of profit growth targets.

Awards are granted based on business performance, balanced with the need to attract, retain and motivate high calibre employees.

Executive Directors do not participate in the two plans above.

The Company does not invite employees to comment on the Directors' Remuneration Policy. The Company does not use remuneration comparison measurements.

Consideration of shareholder views

The Chair of the Committee and the Chair of the Company consult with key shareholders on remuneration matters from time to time, and particularly where changes to share arrangements are under consideration. The Chair reports any concerns expressed by shareholders to the Committee and these are taken into account as the Committee develops and implements its policy. Any comments received from shareholders outside these consultation exercises are also reported to the Committee, and the Committee takes account of general views on remuneration expressed by shareholders or representative bodies such as the ABI.

The Committee consulted with its principal shareholders in relation to the proposal to introduce the 2014 Bonus Banking Plan and took into account views expressed during the consultation when agreeing the final design. The Remuneration Committee is grateful for shareholders' comments and engagement during the consultation process. At the end of this process, the Remuneration Committee was pleased that the majority of the shareholders consulted expressed support for the Bonus Banking Plan.

Directors' Remuneration report continued

Annual Report on Remuneration

Introduction

The following section of this report details how the Remuneration Policies have been implemented for the year ended 31 March 2014 and provides an overview on planned policy implementation for the year ending 31 March 2015.

Executive Director single figure remuneration

The auditors are required to report on the information in this table. Executive Director remuneration is shown as a single figure to provide an annual comparison between the actual remuneration for the performance year ended 31 March 2014 and the preceding year.

| Executive Director | Salary/Fees ¹ | | Taxable benefits ² | | Annual Bonus ³ | | Long Term Incentive ⁴ | | Pensions ⁵ | | Single figure | |
|--------------------|--------------------------|----------|-------------------------------|---------|---------------------------|----------|----------------------------------|------------|-----------------------|----------|---------------|------------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| CEO | £610,844 | £593,050 | £59,524 | £52,106 | £710,393 | £896,100 | £644,270 | £2,302,483 | £152,711 | £148,262 | £2,177,742 | £3,992,001 |
| CFO | £388,550 | £377,500 | £23,188 | £21,183 | £451,871 | £570,000 | £295,282 | £599,504 | £77,710 | £75,500 | £1,236,601 | £1,643,687 |

¹ Base salary is presented prior to adjustments for salary sacrifice pensions. For further details see Additional supporting information below.

² Taxable benefits comprise of car allowance, private medical insurance, life assurance and income protection.

³ Annual Bonus figure comprises of the value of both cash and shares (excluding DAB matching) awarded under the DAB plan. Performance measures are Group Underlying Operating Profit, Group Underlying Cash Flow and Underlying EPS for both performance years. For the performance year ended 31 March 2014 all measures exceeded target performance resulting in a payout of 76.97% of maximum bonus opportunity. Additional supporting information below provides a detailed breakdown of calculations. For the performance year ended 31 March 2013 all performance measures exceeded the stretch performance thresholds and the scheme therefore paid out at maximum.

⁴ Long Term Incentive figures for FY14 comprise of the 2011 VSP and the 2011 DAB matching plan. For the 2011 VSP only TSR exceeded target performance resulting in an overall payout equivalent to 13.80% of maximum. The EPS performance measure in the 2011 DAB matching plan exceeded threshold resulting in a payout equivalent to 26.47% of maximum. Additional supporting information below provides a breakdown of calculations. Long Term Incentive figures for 2013 comprise of the performance for the 2010 VSP for both the CEO and the CFO. In addition the 2013 Long Term Incentive Plan figure for the CEO also comprises of the performance of the 2009 Mirror PSP and 2009 Matching PSP. Long Term Incentive figures include dividend payments for both 2014 and 2013.

⁵ CEO pension figure represents cash in lieu of pension equating to 25% of base salary for both performance years. CFO pension figure represents £38,344 into GPP and £39,366 cash in lieu of pension equating to 20% of base salary for year ended 31 March 2014 and £38,675 into GPP and £36,825 cash in lieu of pension equating to 20% of base salary for year ended 31 March 2013.

Additional supporting information for each Executive Director

To support the single figure, this section documents each element of remuneration and how the figure was calculated for performance year ended 31 March 2014.

Base salary

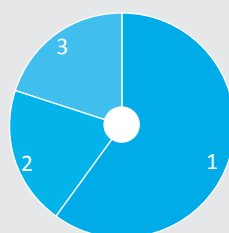
| Executive Director | From 1 July 2013 (a) | From 1 July 2012 | Prorated single figure |
|--------------------|----------------------|------------------|------------------------|
| CEO | £615,325 | £597,400 | £610,844 |
| CFO | £391,400 | £380,000 | £388,550 |

a) Following market review, the CEO's and CFO's salaries increased by 3% (£17,925 per annum and £11,400 per annum respectively) effective from 1 July 2013, based on performance and their compensation levels.

Annual Bonus

The Annual Bonus potential for both CEO and CFO remained unchanged from year ending 31 March 2013 with achievement of on-target performance providing a payment equal to 75% of base salary, rising on a linear scale to 150% of base salary for achievement of stretch performance. The scheme begins to pay out once threshold performance measures have been achieved.

Both the CEO and CFO were measured against Group targets as shown below:



1. Group underlying operating profit 60%
2. Group underlying operating cash flow 20%
3. Underlying EPS 20%

Achievements against these Annual Bonus metrics and the amounts payable are as follows:

| Performance measure | Threshold (0% payable) | Target (50% payable) | Stretch (100% payable) | Actual | % of maximum performance achieved | CEO payment | CFO payment |
|---|------------------------|----------------------|------------------------|---------|-----------------------------------|-------------|-------------|
| Underlying ¹ operating profit | £120m | £125m | £145m | £132.7m | 69.25% | £383,501 | £243,940 |
| Underlying operating cash flow ^{1,2} | £111m | £116m | £135m | £144.9m | 100.00% | £184,598 | £117,420 |
| Underlying EPS ¹ | 14.1p | 14.7p | 17.1p | 16.0p | 77.08% | £142,294 | £90,511 |
| Overall results | | | | | 76.97% | £710,393 | £451,871 |
| 50% paid in cash | | | | | 38.48% | £355,196 | £225,935 |
| 50% paid in shares | | | | | 38.49% | £355,197 | £225,936 |

¹ Definition of underlying measurements of performance can be found in the glossary on page 150.

² Adjusted to exclude LTPA capital expenditure.

For the year ended 31 March 2014, no discretion was applied to the calculated results; therefore, £710,393 and £451,871 have been reported in the single figure calculation.

For the year ended 31 March 2013, stretch financial targets were exceeded providing a payment of 150% of base salary for both the CEO and CFO as detailed in the single figure table (50% of which was deferred into shares which will vest in June 2016). No discretion was applied to these payments.

Long Term Incentive summary

The auditors are required to report on the information in this table. The following table collates all Long Term Incentives (2011 VSP and 2011 DAB matching plan) results for the performance period ended 31 March 2014. Plan details are provided in the paragraphs immediately following this table.

| | Plan | Shares granted | Shares vesting | Percentage shares vesting | Shares value (a) | Accrued dividends (c) | Reported single value figure |
|-----|-------------------------------------|----------------|----------------|---------------------------|------------------|-----------------------|------------------------------|
| CEO | 2011 Value Sharing Plan | 1,531,800 | 211,388 | 13.80% (b) | £478,161 | £24,521 | £502,682 |
| | 2011 Deferred Annual Bonus Matching | 226,777 | 60,021 | 26.47% | £135,766 | £5,822 | £141,588 |
| | Total | 1,758,577 | 271,409 | 15.43% | £613,927 | £30,343 | £644,270 |
| CFO | 2011 Value Sharing Plan | 765,900 | 105,694 | 13.80% (b) | £239,080 | £12,261 | £251,341 |
| | 2011 Deferred Annual Bonus Matching | 70,379 | 18,627 | 26.47% | £42,134 | £1,807 | £43,941 |
| | Total | 836,279 | 124,321 | 14.87% | £281,214 | £14,068 | £295,282 |

a) Share price used in calculation equals £2.262; three month average 1 January 2014 – 31 March 2014.

b) Vesting is based on value created via TSR and PBT. TSR performance is based on a QinetiQ result of 84.5% compared with the comparator group TSR of 56.9%. PBT is based on a QinetiQ result of £119.4m at the end of the performance period compared to £105.5m at the beginning of the performance period. Detailed calculations can be found on pages 86 and 87.

c) Cash equivalent dividends are earned during the performance period and any period when shares are held in trust.

For the year ended 31 March 2014, no discretion was applied to the calculated results; therefore, £644,270 and £295,282 have been reported in the single figure calculation.

Directors' Remuneration report continued

Deferred Annual Bonus matching

In 2011, the CEO deferred 50% (£290,000) and the CFO deferred 30% (£90,000) of their annual cash bonus into the DAB Plan, allocating them 226,777 and 70,379 shares respectively. These shares were subject to a three-year vesting period (vesting due 1 July 2014) and were matched up to 100% based on EPS performance detailed below:

| Underlying EPS Compound annual growth rate (CAGR) over three years | Percentage of shares vesting |
|--|-------------------------------|
| <7% | 0% |
| 7% | 25% |
| Between 7% and 15% | Between 25% and 100% (linear) |
| >15% | 100% |

Actual performance and vesting levels are presented below:

| EPS at start of performance period (1 April 2011) (p) | EPS at threshold performance level (p) | EPS at maximum performance level (p) | Actual EPS at end of performance period (31 March 2014) (p) | Vesting level (% of maximum) |
|---|--|--------------------------------------|---|------------------------------|
| 13.0 | 15.9 | 19.8 | 16.0 | 26.47 |

The resulting outcomes for the performance year ended 31 March 2014 are CEO: £141,588; and CFO: £43,941. These values are used for single figure reporting. Deferred shares have been transferred to the CEO and CFO.

For the year ended 31 March 2014, no discretion was applied to the calculated results.

Value Sharing Plan

On 26 May 2011, the CEO, CFO and a small number of senior executives were awarded shares under the VSP based on a defined number of shares for every £1m of value created using PBT and TSR, over and above three-year performance hurdles ending 31 March 2014.

Both performance measures were equally weighted with the CEO awarded 1,800 shares per £1m of calculated Additional Shareholder Value (ASV) and the CFO was awarded 900 shares per £1m of ASV. 2011 VSP performance has been assessed as follows:

2011 VSP – TSR

50% of the shares were awarded for a TSR measure of growth in market capitalisation plus net equity cash flows to shareholders over and above the equivalent return from investing in the FTSE 250 index (excluding investment trusts).

The CEO was awarded 900 shares per £1m TSR ASV.

The CFO was awarded 450 shares per £1m TSR ASV.

QinetiQ's TSR over the period was 84.5% and the TSR for the FTSE 250 Index was 56.9%, therefore QinetiQ outperformed the market by 27.6%.

The additional shareholder value was £234.9m being 27.6% of £851m (the average market capitalisation over the three months to 31 March 2011).

Consequently the CEO was eligible for 211,388 (900*234.9) shares.

The CFO was eligible for 105,694 (450*234.9) shares.

50% of the awarded shares vested in May 2014 and the remaining 50% will vest in May 2015 (provided the Executive Director remains in service).

For the year ended 31 March 2014, no discretion was applied to the calculated results.

2011 VSP – PBT

50% of the shares were awarded for growth in value based on PBT (times a fixed multiple, plus net equity cash flows to shareholders) over and above a hurdle return rate of 8.5% per annum. The fixed multiple was calculated from the average market cap in the PBT measure of growth in market capitalisation plus net equity cash flows to shareholders over and above the equivalent return from investing in the FTSE 250 index (excluding investment trusts).

The CEO was awarded 900 shares per £1m PBT ASV.

The CFO was awarded 450 shares per £1m PBT ASV.

QinetiQ's average market cap over the three months to 31 March 2011 was £851m.

Group adjusted PBT for the financial year ended 31 March 2011 was £105.5m.

Market cap as a (fixed) multiple of PBT for 2011 VSP awards is therefore 8.07 (= £851 / £105.5m), Group adjusted PBT for the financial year ending 31 March 2014 is £119.4m, and dividends to shareholders over the three-year period amount to £63.1m.

Additional shareholder value is £977.8m being:

- £914.7m (PBT in FY 2014 of £119.4m multiplied by the fixed multiple of 8.07) plus £63.1m (paid dividends).
- which is less than hurdle rate of £1,087m (= £851m x (1+8.5%)³).

Consequently the CEO and CFO were both eligible for 0 shares.

For the year ending 31 March 2014, no discretion was applied to the calculated results.

The resulting outcomes for the performance year ended 31 March 2014 are:

| Performance measure | Grant date | Vested shares | Value for single figure reporting(a) |
|--------------------------------|------------|------------------------------|--------------------------------------|
| Profit Before Tax (PBT) | 26 May 11 | CEO: 0 CFO: 0 | CEO: £0 CFO: £0 |
| Total Shareholder Return (TSR) | 26 May 11 | CEO: 211,388 CFO: 105,694 | CEO: £502,682 CFO: £251,341 |

a) Figures exclude dividend payments and are calculated using share price of £2.262 (three month average from 1 January 2014 – 31 March 2014).

Total pension entitlements

No Directors participate in the QinetiQ Pension Scheme.

Scheme interests awarded during the financial year ended 31 March 2014

The auditors are required to report on the information in this table. The following awards were made to Executive Directors.

| | Plan name | Performance measure | Grant date | Award as percentage of salary | Face value of award | Share price at date of grant | No. of shares granted | Performance period from – to | Percentage of award vesting at threshold |
|-----|--------------------|---------------------|------------|-------------------------------|---------------------|------------------------------|-----------------------|------------------------------|--|
| CEO | PSP 2013 | EPS | 28 Jun 13 | 71.2(a) | £425,412 | £1.804 | 235,816 | 1 Apr 13 to 31 Mar 2016 | 25 |
| | | TSR | 28 Jun 13 | 71.2(a) | £425,412 | £1.804 | 235,815 | 1 Apr 13 to 31 Mar 2016 | 30 |
| | DAB match 2013 (c) | EPS | 28 Jun 13 | 74.6(b) | £448,050 | £1.813 | 247,129 | 1 Apr 13 to 31 Mar 2016 | 25 |
| CFO | PSP 2013 | EPS | 28 Jun 13 | 71.2(a) | £270,600 | £1.804 | 150,000 | 1 Apr 13 to 31 Mar 2016 | 25 |
| | | TSR | 28 Jun 13 | 71.2(a) | £270,600 | £1.804 | 150,000 | 1 Apr 13 to 31 Mar 2016 | 30 |
| | DAB match 2013 (c) | EPS | 28 Jun 13 | 74.6(b) | £285,000 | £1.813 | 157,196 | 1 Apr 13 to 31 Mar 2016 | 25 |

a) The Committee signed off an award equivalent to 150% of salary for the PSP (75% for each performance measure). Between date of sign-off and grant date the share price decreased resulting in a revised face value equivalent to 142.4% of salary (71.2% for each performance measure).

b) Figure represents award following deduction of stamp duty payable on the deferred shares (equivalent to 0.4% of award).

c) DAB match 2013 is 50% of bonus earned in respect of year ended 31 March 2013.

Directors' Remuneration report continued

Payments to past Directors

The auditors are required to report on this information. No payments were made to past directors.

Payments for loss of office

The auditors are required to report on this information. No payments were made for loss of office.

Single figure remuneration for each Non-executive Director

The auditors are required to report on the information in this table. Non-executive Director remuneration is shown as a single figure to provide an annual comparison between the actual remuneration awarded during the performance year ended 31 March 2014 and the preceding year.

| Non-executive Director | Salary/Fees | | Taxable benefits | | Committee Chair fees | | US attendance fee | | Single figure | |
|----------------------------------|-----------------|----------|--------------------|-------------|----------------------|---------|-------------------|--------|-----------------|----------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| Mark Elliott | £228,750 | £225,000 | £75,000 (a) | £75,000 (a) | – | – | – | – | £303,750 | £300,000 |
| Colin Balmer [#] | £35,833 | £42,000 | – | – | £7,500 | £8,333 | £2,500 | £5,000 | £45,833 | £55,333 |
| Noreen Doyle | £43,000 | £42,000 | – | – | £9,000 | £8,333 | £5,000 | £5,000 | £57,000 | £55,333 |
| Admiral Sir James Burnell-Nugent | £43,000 | £42,000 | – | – | £1,500 | – | £5,000 | £5,000 | £49,500 | £47,000 |
| Paul Murray | £43,000 | £42,000 | – | – | £9,000 | £8,333 | £5,000 | £5,000 | £57,000 | £55,333 |
| Michael Harper | £43,000 | £42,000 | – | – | £10,000 | £10,000 | £5,000 | £5,000 | £58,000 | £57,000 |

[#] Colin Balmer retired 31 January 2014.

a) Accommodation allowance of £75,000 as Mark Elliott is a US resident.

Statement of Directors' shareholding and share interests

The auditors are required to report on the information in this table. Below sets out the Directors' shareholdings as at 31 March 2014. As detailed on page 77, the Company requires Executive Directors to hold shares equivalent to 100% of base salary.

The CEO has a current holding equivalent to 611% of base salary using a share price of £2.262 (three month average to 31 March 2014).

The CFO has a current holding equivalent to 217% of base salary using a share price of £2.262 (three month average to 31 March 2014).

Both Executive Directors have therefore met the minimum shareholding requirement.

| | Shares beneficially owned(a) | Shares subject to performance conditions | Shares not subject to performance conditions | Total shares held at 22 May 2014 |
|----------------------------------|------------------------------|--|--|----------------------------------|
| Leo Quinn | 958,403 | 3,576,099 | 703,502 | 5,238,004 |
| David Mellors | 31,268 | 1,921,449 | 344,748 | 2,297,465 |
| Mark Elliott | 125,000 | – | – | 125,000 |
| Noreen Doyle | 24,662 | – | – | 24,662 |
| Admiral Sir James Burnell-Nugent | 11,419 | – | – | 11,419 |
| Paul Murray | 56,077 | – | – | 56,077 |
| Michael Harper | 20,000 | – | – | 20,000 |
| Susan Searle | 5,000 | – | – | 5,000 |

a) Shares beneficially owned comprise of awards exercised under the VSP 2010 and PSP 2009, Shares held under the Share Incentive Plan (including matched shares) and shares owned by the Executive Director and any connected persons.

b) Shares subject to performance conditions comprise of awards made under the DAB (matching) for 2013, 2012 and 2011, PSP for 2013 and 2012, VSP for 2011 and 2010.

c) Shares not subject to performance conditions comprise of deferred shares under the DAB plan for 2013, 2012 and 2011.

Total scheme interests summary

The auditors are required to report on the information in this table. Total scheme interests, including those awarded during the financial year ending 31 March 2014, are as follows.

| | Plan name | Date of grant | Number at 1 April 2013 | Granted in year (maximum potential of awards) | Exercised/ vested in year | Lapsed in year | Number at 31 March 2014 | Market price on date of grant | Earliest vest date | Latest vest date |
|-----------|--------------------|---------------|------------------------|---|---------------------------|------------------|-------------------------|-------------------------------|--------------------|------------------|
| Leo Quinn | PSP Mirror 2009(b) | 16 Dec 09 | 420,900 | – | 210,450 | 210,450 | – | 165.0(a) | 01 Jun 13 | 01 Jun 13 |
| | Matching 2009(b) | 16 Dec 09 | 725,689 | – | 362,844 | 362,845 | – | 165.0(a) | 01 Jun 13 | 01 Jun 13 |
| | VSP 2010 | 29 Jul 10 | 1,812,000 | – | 309,102 | 1,193,796 | 309,102 | 124.9 | 29 Jul 13 | 29 Jul 13 |
| | VSP 2011 | 26 May 11 | 1,531,800 | – | – | – | 1,531,800 | 112.3 | 26 May 14 | 26 May 14 |
| | DAB Match 2011 | 01 Jul 11 | 226,777 | – | – | – | 226,777 | 129.1 | 01 Jul 14 | 01 Jul 14 |
| | DAB Match 2012 | 29 Jun 12 | 229,596 | – | – | – | 229,596 | 157.1 | 29 Jun 15 | 29 Jun 15 |
| | PSP 2012 | 09 Aug 12 | 560,064 | – | – | – | 560,064 | 166.0 | 09 Aug 15 | 09 Aug 15 |
| | PSP 2013 | 28 Jun 13 | – | 471,631 | – | – | 471,631 | 180.4 | 28 Jun 16 | 28 Jun 16 |
| | DAB Match 2013 | 28 Jun 13 | – | 247,129 | – | – | 247,129 | 180.4 | 28 Jun 16 | 28 Jun 16 |
| | | | 5,506,826 | 718,760 | 882,396 | 1,767,091 | 3,576,099 | | | |

| | Plan name | Date of grant | Number at 1 April 2013 | Granted in year (maximum potential of awards) | Exercised/ vested in year | Lapsed in year | Number at 31 March 2014 | Market price on date of grant | Earliest vest date | Latest vest date |
|---------------|----------------|---------------|------------------------|---|---------------------------|----------------|-------------------------|-------------------------------|--------------------|------------------|
| David Mellors | VSP 2010 | 29 Jul 10 | 906,000 | – | 154,551 | 596,898 | 154,551 | 124.9 | 29 Jul 13 | 29 Jul 13 |
| | VSP 2011 | 26 May 11 | 765,900 | – | – | – | 765,900 | 112.3 | 26 May 14 | 26 May 14 |
| | DAB Match 2011 | 01 Jul 11 | 70,379 | – | – | – | 70,379 | 129.1 | 01 Jul 14 | 01 Jul 14 |
| | DAB Match 2012 | 29 Jun 12 | 117,173 | – | – | – | 117,173 | 157.1 | 29 Jun 15 | 29 Jun 15 |
| | PSP 2012 | 09 Aug 12 | 356,250 | – | – | – | 356,250 | 166.0 | 09 Aug 15 | 09 Aug 15 |
| | PSP 2013 | 28 Jun 13 | – | 300,000 | – | – | 300,000 | 180.4 | 28 Jun 16 | 28 Jun 16 |
| | DAB Match 2013 | 28 Jun 13 | – | 157,196 | – | – | 157,196 | 180.4 | 28 Jun 16 | 28 Jun 16 |
| | | | 2,215,702 | 457,196 | 154,551 | 596,898 | 1,921,449 | | | |

a) Shares awarded to CEO in 2009 were based on an average market price of 138.0 representing the average price taken over the ten days before joining.

b) On appointment the CEO was granted a mirror PSP award, subject to the same EPS and TSR performance conditions as above. In addition, the CEO invested c £1m in QinetiQ shares, for which he received an additional matching PSP award, subject to the same EPS and TSR performance conditions. The exercise price was 189.25p.

The awards in the table above are subject to the performance conditions described on pages 76-77. The price of a QinetiQ share at 31 March 2014 was 225.9p. The highest and lowest prices of a QinetiQ share during the year ended 31 March 2014 were 236.7p and 179.5p.

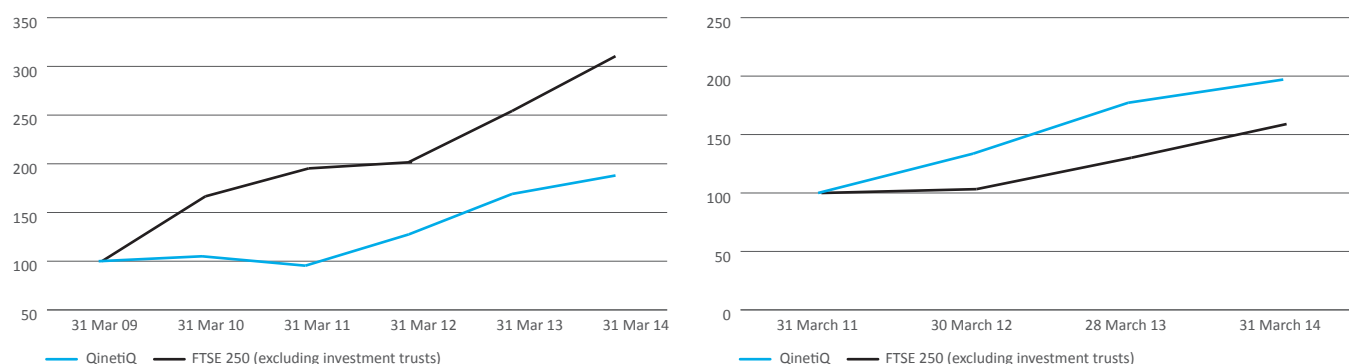
There have been no changes to the interests shown above between 31 March 2014 and 22 May 2014.

The exercise price for the VSP 2010 award was 186.15p.

Directors' Remuneration report continued

Performance review

The graph shows the Company's TSR over the period from 31 March 2009 to 31 March 2014 and 31 March 2011 to 31 March 2014 compared with the FTSE 250 (excluding investment trusts) over the same period based on spot values. The Committee has chosen to demonstrate the Company's performance against this index as it is an appropriate sector comparison within the index in which the Company is listed. This comparator group is also used to measure TSR performance in the PSP.



Incentive plans

Performance table

The table below shows the CEO remuneration over the same performance period (31 March 2009 to 31 March 2014):

| Year | Salary/Fees | Single figure | Annual Bonus (% of maximum) | Long Term Incentives (% of maximum vesting) |
|----------|-------------|---------------|--------------------------------|---|
| 2014 | £610,844 | £2,177,742 | 76.97 | 15.43 |
| 2013 | £593,050 | £3,992,001 | 100.00 | 40.27 |
| 2012 | £580,000 | £1,495,284 | 100.00 | 0.00 |
| 2011 | £580,000 | £1,327,156 | 100.00 | 0.00 |
| 2010 (a) | £217,872 | £886,564 | 0.00 | 0.00 |
| 2010 (b) | £266,667 | £1,246,320 | 0.00 | 38.70 |

a) Leo Quinn joined the Company on 16 November 2009. He was awarded £600,000 in lieu of compensation for monies earned from a third party.

b) Graham Love left the Company on 30 November 2009. His single figure comprises of earnings up to and including his leaving date and incorporates compensation for loss of office and accelerated share vests.

Percentage change in CEO remuneration

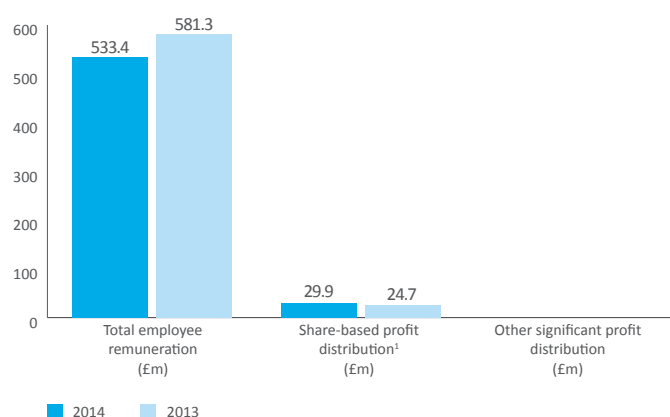
The following table compares change in CEO remuneration with an employee comparator group (averaged per capita):

| | 2013 | 2014 | % change | Comparison group (a) | | |
|------------------|----------|----------|----------|----------------------|---------|----------|
| | | | | 2013 | 2014 | % change |
| Base salary | £593,050 | £610,844 | 3.0% | £34,906 | £36,434 | 4.4% |
| Taxable benefits | £52,106 | £59,524 | 14.2% | £707 | £1,031 | 45.8% |
| Annual Bonus | £896,100 | £710,393 | -20.7% | £921 | £721 | -21.7% |

a) The comparison group (4,000 employees) represents the UK principal businesses in service between 1 April 2012 and 31 March 2014.

Relative importance of spend on pay

The graph below shows actual spend on all employee remuneration, shareholder dividends and buybacks and any other significant use of profit and cash within the previous two financial years:



¹ Includes final 2014 dividend due to be paid September 2014.

Implementation of Policy for the year ending 31 March 2015

Salary/Fees

Executive Director salaries and Non-executive Director fees were last reviewed on 1 July 2013. The Chairman's fees were increased in December 2013. Salaries and fees will be reviewed in line with policy with the exception of the Chairman where no review is planned. In March 2014, the Committee changed the Executive Directors' salary review date to 1 September in line with the rest of the employee population.

Executive Directors are permitted to accept one external Non-executive Director position with the Board's approval. Any fees received in respect of these appointments may be retained by the Executive Director. The CEO was appointed a Non-executive Director for Betfair Group plc on 5 March 2014 and subsequently appointed Chairman of the Remuneration Committee on 31 March 2014. Non-executive Director fees, as reported in the Betfair Group plc Annual Report dated 30 April 2013, were £50,000 per annum plus £10,000 per annum for chairing a committee.

Salary/Fees
effective as at
1 April 2014

| | |
|---|----------|
| Chief Executive Officer | £615,325 |
| Chief Financial Officer | £391,400 |
| Non-executive Chairman | £236,250 |
| Accommodation allowance for Group Chairman | £75,000 |
| Basic fee for UK Non-executive Director | £43,000 |
| Additional fee for chairing a Committee | £9,000 |
| Additional fee to Deputy Chairman/Senior Independent Non-executive Director | £10,000 |
| Additional fee for attendance at Board meeting held in US by UK resident Non-executive Director | £2,500 |

Incentives for Executives

Below shows the measures and relative weighting for the 2015 Bonus Banking Plan:

| | Performance measure | Relative weighting (%) |
|--|---|------------------------|
| Bonus Banking Plan (target performance 90% base salary, stretch performance 225% of base salary) | Group underlying operating profit | 30 |
| | Group underlying operating cash flow ¹ | 30 |
| | Group underlying profit after tax | 20 |
| | Qualitative measures based on Company KPIs | 20 |

¹ Adjusted to exclude LTPA and MSCA capital expenditure.

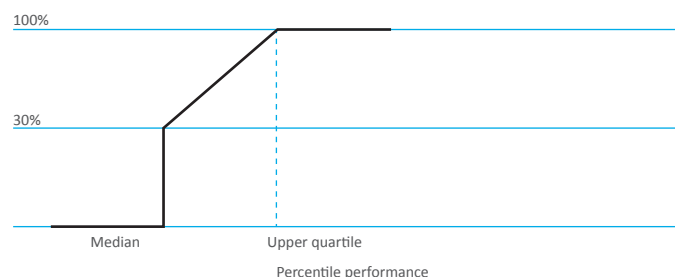
Details of specific performance targets for the Bonus Banking Plan have not been provided as they are deemed commercially sensitive. They will be disclosed retrospectively in next year's Annual Report on Remuneration.

Directors' Remuneration report continued

In 2015 PSP awards to Executive Directors are equal to 150% of base salary. The graph below shows the targets against which the performance will be measured and the vesting mechanics:

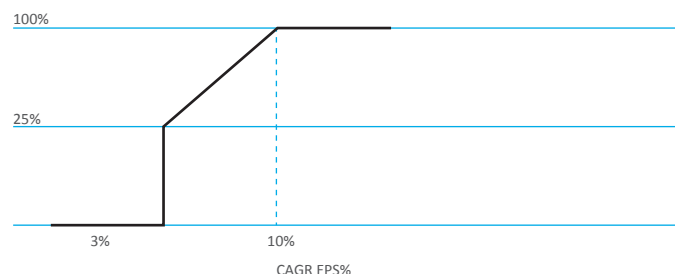
TSR performance vs FTSE 250 (excl. investment trusts) – 50% of award

Award vesting



EPS performance – 50% of award

% award vesting



Consideration by the Directors of matters relating to Directors' remuneration

Members of the Committee are appointed by the Board. The Committee comprises at least three members (not counting the Group Chairman of the Board), all of whom are independent Non-executive Directors. The Group Chairman of the Board also serves on the Committee as an additional member if he or she was considered independent on appointment as Chairman.

Only members of the Committee have the right to attend Committee meetings. However, other individuals such as the Chief Executive, the Group Human Resources Director and external advisors are invited to attend for all or part of any meeting, as and when appropriate.

The Board appoints the Committee Chairman who is an independent, Non-executive Director. In the absence of the Committee Chairman and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting who would qualify under these terms of reference to be appointed to that position by the Board. The Chairman of the Board is not permitted to be Chairman of the Committee.

The full terms of reference of the Committee can be found on the QinetiQ website (www.QinetiQ.com).

Up to and including 30 September 2013 the Committee received advice from Towers Watson, an independent firm of remuneration consultants, appointed by the Committee after consultation with the Board. Towers Watson also provided market data and advised on the comparator group's TSR so that the Committee could determine whether share plan performance targets had been met. Total fees paid during this period were £26,232.

On 1 October 2013, following a tender exercise and consultation with the Board, the Committee appointed PwC, an independent firm of remuneration consultants, to provide advice on market practice, corporate governance and institutional stakeholder views. Total fees paid during the period were £143,000 which included advice relating to the Bonus Banking Plan and advice relating to the new legislation on Directors' remuneration.

PwC provided the following additional services during the year:

- consultancy and advice to Group Tax, including tax support for the strategic review of the US Services division; and
- consultancy and advice to Group Reward for the review of global mobility services and advice in relation to Group pensions.

The Committee is satisfied the scale and nature of this work does not impact on the objectivity and independence of the advice it receives from PwC.

The Group Chief Executive, Group HR Director and Group Reward Director also provided information and advice to the Committee.

Statement of voting

| | Date of vote | For | % | Against | % | Abstained |
|---|--------------|----------------------|-------|------------|-------|-----------|
| Remuneration Report for previous financial year | 25 July 2013 | 451,287,128 | 89.78 | 51,390,043 | 10.22 | 7,421,072 |
| Remuneration Policy for year ahead (a) | | Not voted on in 2013 | | | | |

a) To be voted for first time at 2014 AGM.

The Remuneration Report detailed on pages 69 to 93 was approved by the Board on 22 May 2014 and signed on its behalf by:

Noreen Doyle
Chair of the Remuneration Committee
 May 2014

Directors' report

Statutory information contained elsewhere in the Annual Report

Information required to be part of this Directors' report can be found elsewhere in the Annual Report as indicated in the table below and is incorporated into this report by reference:

| Information | Location in Annual Report |
|--|---------------------------|
| Greenhouse gas emissions | Page 41 |
| Employees | Page 37 |
| Results and dividends | Page 2 |
| Post balance sheet events | Page 144 |
| Likely future developments in the business of the Company or its subsidiaries | Pages 2 to 35 |
| Financial instruments: Information on the Group's financial risk management objectives and policies, and its exposure to credit risk, liquidity risk, interest rate risk and foreign currency risk | Note 24 on page 126 |
| Corporate Governance Statement | Pages 48 to 68 |
| Directors' details | Pages 54 to 55 |

Research and development

One of the Group's principal business streams is the provision of funded research and development (R&D) for customers. The Group also invests in the commercialisation of promising technologies across all areas of business.

The majority of R&D-related expenditure is incurred on behalf of customers as part of specific funded research contracts. R&D costs are included in the income statement and R&D income is reflected within revenue. In the financial year, the Group recorded £315.7m (2013: £335.6m) of total R&D-related expenditure, of which £288.9m (2013: £311.0m) was customer-funded work and £26.8m (2013: £24.6m) was internally funded. Additionally, £2.1m (2013: £0.3m) of late-stage development costs was capitalised and £0.3m (2013: £0.9m) of capitalised development costs was amortised in the year.

Political contributions

QinetiQ does not make political donations to parties as that term would be commonly recognised. The legal definition of that term is, however, quite broad and may have the effect of covering a number of normal business activities that would not commonly be perceived to be political donations, such as sponsorship of events.

These may include legitimate interactions in making MPs and others in the political world aware of key industry issues and matters that affect QinetiQ, and that make an important contribution to their understanding of QinetiQ, the markets in which it operates and the work of their constituents.

Share capital

As at 31 March 2014, the Company had allotted and fully paid up share capital of 660,476,373 ordinary shares of 1p each with an aggregate nominal value of £6.6m (including shares held by employee share trusts) and one Special Share with a nominal value of £1.

Details of the shares in issue during the financial year are shown in note 26 on page 135.

The rights of ordinary shareholders are set out in the Articles of Association. The holders of ordinary shares are entitled to receive the Company's Reports and Accounts, to attend and speak at general meetings of the Company, to exercise voting rights in person or by appointing a proxy, and to receive a dividend where declared or paid out of profits available for that purpose.

The Special Share is held by HM Government through the Secretary of State for Defence and it confers certain rights under the Articles of Association which are detailed in note 26 on page 135.

These include the right to require certain persons with a material interest in QinetiQ to dispose of some or all of their ordinary shares on the grounds of national security or conflict of interest. The Special Share may only be held by and transferred to HM Government. At any time the Special Shareholder may require QinetiQ to redeem the share at par and, if wound up, the Special Shareholder would be entitled to be repaid capital before other shareholders. Any variation of the rights attaching to the Special Share requires the written approval of the MOD.

Directors' report continued

Conflicts of interest

The Company requires Directors to disclose proposed outside business interests before they are entered into. This enables prior assessment of any conflict, or potential conflict, of interest and any impact on time commitment. An annual review of all external interests is carried out by the Board.

Directors' interests in contracts

At the date of this report, there is no contract or arrangement with the Company or any of its subsidiaries that is significant in relation to the business of the Group as a whole in which a Director of the Company is materially interested.

Indemnities

The Directors of QinetiQ Pension Scheme Trustee Limited, a Group company and the Trustee of the QinetiQ Pension Scheme (the Scheme), benefit from an indemnity contained in the rules of the Scheme. The indemnity would be provided out of the Scheme assets.

Change of control – significant agreements

The following significant agreements contain provisions entitling the counterparties to require prior approval, exercise termination, alteration or other similar rights in the event of a change of control of the Company, or if the Company ceases to be a UK company:

- The Combined Aerial Target Service contract is a 20-year contract awarded to QinetiQ by the MOD on 14 December 2006. The terms of this contract require QinetiQ Limited to remain a UK company which is incorporated under the laws of any part of the UK, or an overseas company registered in the UK, and that at least 50% of the Board of Directors are UK nationals. The terms also contain change of control conditions and restricted share transfer conditions which require prior approval from HM Government if there is a material change in the ownership of QinetiQ Limited's share capital, unless the change relates to shares listed on a regulated market – 'material' is defined as being 10% or more of the share capital. In addition, there are restrictions on transfers of shares to persons from countries appearing on the restricted list as issued by HM Government;
- The Long-Term Partnering Agreement (LTPA) is a 25-year contract, which QinetiQ Limited signed on 28 February 2003, to provide test, evaluation and training services to the MOD. This contract contains conditions under which the prior approval of HM Government is required if the contractor, QinetiQ Limited, ceases to be a subsidiary of the QinetiQ Group, except where such change in control is permitted under the Shareholders Agreement to which the MOD is a party.

The Company is party to a multi-currency revolving credit facility, with a US\$250m tranche and a £118m tranche, provided by the Group's six global relationship banks, that expires on 4 February 2016. Under the terms of the facility, if there is a change of control of the Company, any lender may request, by not less than 60 days' notice to the Company, that its commitment be cancelled and all outstanding amounts be repaid to that lender at the expiry of such notice period.

On 6 December 2006, QinetiQ US Holdings, Inc., formerly known as QinetiQ North America, Inc. (as Borrower) and the Company (as Guarantor) entered into a Note Purchase Agreement to issue US\$125m 5.50% Senior Notes due 6 December 2016. \$77m has been repaid early and the remaining debt outstanding as at 31 March 2014 was \$48m. Under the terms of the agreement, if either (1) the MOD ceases to retain in its capacity as Special Shareholder its Special Shareholder's Rights; or (2) there is a change of control of the Company, the Notes must be offered for prepayment by the Company within 21 days of the change of control. The prepayment date would be no later than 45 days after the offer of prepayment by the Company.

On 5 February 2009, QinetiQ US Holdings, Inc. (as Borrower) and the Company (as Guarantor) entered into a Note Purchase Agreement to issue US\$62m 7.13% Senior Notes due 5 February 2016 and US\$238m 7.62% Senior Notes due 5 February 2019. \$100m has been repaid early and the remaining debt outstanding as at 31 March 2014 was \$43m of 7.13% Senior Notes and \$157m of 7.62% Senior Notes. Under the terms of the agreement, if either (1) the MOD ceases to retain in its capacity as Special Shareholder its Special Shareholder's Rights; or (2) there is a change of control of the Company, the Notes must be offered for prepayment within 21 days of the change of control. The prepayment date would be no later than 45 days after the offer of prepayment by the Company.

Branches

The Company and its subsidiaries have established branches in a number of different countries in which they operate; their results are, however, not material to the Group's financial results.

Major shareholders

At 31 March 2014, the Group had been notified of the following shareholdings under Chapter 5 of the Disclosure Rules and Transparency Rules:

| Shareholder | Number of ordinary shares | % of issued share capital |
|--------------------------------|---------------------------|---------------------------|
| Ruane, Cuniff & Goldfarb, Inc. | 64,117,000 | 9.71 |
| Artisan Partners | 36,320,010 | 5.50 |
| Schroders | 35,429,785 | 5.36 |
| Investec | 33,160,928 | 5.02 |
| Norges Bank | 26,310,597 | 3.98 |

At 20 May 2014, being the latest practicable date prior to the issue of this report, the Company had received a notification from Artisan Partners that their shareholding had fallen below 5% and that therefore they ceased to have a notifiable interest in the Company's shares. The Company had received no other notification of any further interests or of any changes in the interests detailed above.

Allotment/purchase of own shares

At the Company's AGM held in July 2013, the shareholders passed resolutions which authorised the Directors to allot relevant securities up to an aggregate nominal value of £4,403,174 (£2,201,587 pursuant only to a rights issue), to disapply pre-emption rights (up to 5% of the issued ordinary share capital) and for the Company to purchase ordinary shares (up to 10% of its ordinary share capital).

At the general meeting of the Company held on 13 May 2014, shareholder approval was given for the Directors to purchase ordinary shares up to 14.99% of the issued ordinary share capital. The Company intends to use this authority to effect a £150m return of capital to shareholders by way of an on-market share buyback, subject to prevailing equity market conditions.

Equivalent resolutions in respect of the allotment of relevant securities and the disapplication of pre-emption rights will be laid before the 2014 AGM.

During the year, the Company provided funding to the QinetiQ Group plc Employee Benefit Trust (the 'Trust'), which holds shares in connection with its employee share schemes, to make market purchases of the Company's ordinary shares to cover future obligations under outstanding share option and other share-based awards. Further details are disclosed in note 26 on page 135. As at 31 March 2014, the Trust held 7,811,861 ordinary shares of 1p each (the 'Trust Shares'). The Trustees of the Trust have agreed to waive their entitlement to dividends payable on the Trust Shares. The Trust holds further ordinary shares in respect of deferred shares held on behalf of participants in the Company's Deferred Annual Bonus Plan. Dividends received by the Trust in respect of the deferred shares are paid direct to the plan participants on receipt and are not retained in the Trust.

Restrictions on the transfer of shares

As outlined in note 26 on page 135, the Special Share confers certain rights under the Company's Articles of Association to require certain persons with an interest in QinetiQ's shares that exceed certain prescribed thresholds to dispose of some or all of their ordinary shares on the grounds of national security or conflict of interest.

Articles of Association

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

Employee share scheme

Equiniti Share Plan Trustees Limited acts as Trustee in respect of all ordinary shares held by employees under the QinetiQ Group plc Share Incentive Plan (the 'Plan'). Equiniti Share Plan Trustees Limited will send a Form of Direction to all employees who hold shares under the Plan, and will vote on all resolutions proposed at general meetings in accordance with the instructions received. In circumstances where ordinary shares are held by the corporate sponsored nominee service, Equiniti Corporate Nominees Limited will send a Proxy Form to all shareholders using such corporate nominee service, and will vote on all resolutions proposed at general meetings in accordance with the instructions received.

Annual General Meeting

The Company's AGM will be held on Tuesday, 22 July 2014 at 11.00am, at Pennyhill Park Hotel, London Road, Bagshot, Surrey, GU19 5EU. Details of the business to be proposed and voted on at the meeting are contained in the Notice of AGM, which is sent to all shareholders and is also published on the Company's website, www.QinetiQ.com in the 'Investors' section.

Auditor

KPMG LLP has expressed its willingness to continue in office as auditor and a resolution to re-appoint them will be proposed at the AGM.

Directors' report continued

Statement of Directors' responsibilities in respect of the Annual Report and financial statements

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

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

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the Directors are required to:

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic report, Directors' report, Directors' remuneration report and Corporate Governance Statement that comply with that law and those regulations.

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

Statement of disclosure of information to the auditor

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

Responsibility statement of the Directors in respect of the Annual Report

The Directors in office as at the date of this report confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company, and the undertakings included in the consolidation taken as a whole; and
- the Directors' report includes a fair review of the development and performance of the business, and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

In addition, all Directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy. In this context, the coordination and review of the Group-wide input into the Annual Report is a vital part of the control process upon which the Directors rely and is an exercise which spans a period wider than the timetable for compiling the Annual Report itself. Critically these processes include the controls the business operates throughout the year to identify key financial and operational issues. Further details can be found in the report of the Audit Committee on pages 64 to 65 of the Corporate Governance Statement.

By order of the Board

Jon Messent
Company Secretary

Cody Technology Park
Ively Road
Farnborough
Hampshire GU14 0LX

22 May 2014

Independent auditor's report to the members of QinetiQ Group plc only

Opinions and conclusions arising from our audit

1 Our opinion on the financial statements is unmodified

We have audited the financial statements of QinetiQ Group plc for the year ended 31 March 2014 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity, the Consolidated Balance Sheet, the Consolidated Cash Flow statement, the parent company Balance Sheet and the related notes.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2014 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent company financial statements have been properly prepared in accordance with UK Accounting Standards; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

2 Our assessment of risks of material misstatement

In arriving at our audit opinion above on the Group financial statements, the risks of material misstatement that had the greatest effect on our Group audit were as follows:

• **Carrying value of goodwill - £ 141.3 million**

Refer to page 64 (Audit Committee report), page 110 (accounting policy note) and page 117 (financial disclosures)

The risk: The carrying value of goodwill is assessed for impairment at least annually and whenever there is an indication that the asset may be impaired. In the period an impairment has been recognised to the goodwill associated with:

- a) the US SSG Cash-Generating Unit, and
- b) the US TSG Cash-Generating Unit.

The impairment calculations are based on an estimate of the fair value less costs to sell of the US SSG business and the discounted projected cash flows of the US TSG business. The fair value less costs to sell of the US SSG business reflects the expected sale proceeds which include an element of contingent consideration based on its future performance, which therefore requires estimation. There is also inherent uncertainty involved in forecasting and discounting the future cash flows used for the purposes of the US TSG impairment calculations due to the lumpy revenue profile of this business which declined in 2014 due to a significant reduction in demand for conflict related products.

Our response: Our audit procedures included in respect of the US SSG Cash-generating unit included, among others, testing the principles and mathematical integrity of the Group's estimated contingent consideration calculation. In respect of the US TSG Cash-generating unit, our audit procedures included, among others, testing the principles and mathematical integrity of the Group's discounted cash flow model and comparing the Group's assumptions to externally derived data and key inputs such as projected economic growth and discount rates. We tested the sensitivity of the impairment calculation to changes in the judgments and assumptions used by the directors. We also assessed whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions properly reflected the risks inherent in the valuation of goodwill.

• **Recognition of revenues and profits on long-term contracts – £1,069.3 million**

Refer to page 64 (Audit Committee report), page 110 (accounting policy note) and page 111 (financial disclosures)

The risk: A significant proportion of the Group's revenues and profits are derived from long-term contracts. These contracts can include complex technological and commercial risks and often specify performance milestones to be achieved throughout the contract period. This results in estimates and assumptions having to be made to forecast the margin on each contract after making appropriate allowances for these technical and commercial risks related to performance milestones yet to be achieved. The risk of misstatement is that the accounting for the Group's significant contracts does not accurately reflect the status and the associated cost to complete of the relevant contract.

Our response: Our audit procedures included, amongst others, testing the design and operating effectiveness of controls in place to manage the commercial, technical and financial aspects of the Group's long-term contracts. For all significant contracts, determined on the basis of technical and commercial complexity and profitability of the contract, we also obtained an understanding of the status of the contract through discussions with contract project teams and Directors at a Group and division level, attendance at project teams' contract review meetings, and examining externally available evidence, such as customer correspondence. We examined the assumptions behind estimated costs to complete, challenging the reasonableness of these in light of supporting evidence including past experience of the contracts and the extent of technical or commercial risk identified. We also assessed whether the Group's disclosures (see notes 3 and 30) around segmental information and material contingent liabilities properly reflected the evidence obtained.

Independent auditor's report to the members of QinetiQ Group plc only continued

- **Provisions and contingent liabilities – £24.1 million**

Refer to page 64 (Audit Committee report), page 110 (accounting policy note) and pages 123 and 143 (financial disclosures)

The risk: Provisions are held in respect of restructuring costs, environmental issues and other matters. The financial statements also disclose contingent liabilities in respect of legal claims which have not been provided for on the basis that they are not considered to qualify for recognition as provisions. The application of accounting standards to determine whether a provision should be recorded and, if so, the amount, is inherently subjective as it relates to uncertain future events.

Our response: Our audit procedures included, among others, a critical assessment of the extent to which the Directors' estimates take into account a balanced assessment of the latest available information and the accuracy and reliability of the sources of that information. We corroborated the appropriateness of the assumptions including by reference to third-party confirmations and legal advice, where available, and considered whether our understanding of the business gained throughout the audit process corroborated the provisions recorded, or indicated that further challenge was warranted. We considered the adequacy of the Group's disclosures in respect of provisions and contingent liabilities. We also assessed whether the Group's disclosures about provisions and the treatment of movements on provisions in the income statement for the year were appropriate.

- **Tax liabilities – current tax payable £4.6 million, deferred tax liability £15.0 million, deferred tax asset £18.1 million**

Refer to page 64 (Audit Committee report), page 110 (accounting policy note) and pages 115 and 121 (financial disclosures)

The risk: The Group is subject to income taxes in the UK, USA and a number of other overseas jurisdictions. The level of current tax and deferred tax recognised requires judgments as to the likely outcome of decisions to be made by the tax authorities, including those related to specific tax allowances such as the UK Research and Development tax credit. There is a risk that the judgments on which the provisions are based do not take into account or do not properly reflect the latest available, reliable information or an appropriate application of relevant tax legislation, and are either under or overstated as a result.

Our response: Our audit procedures included, among others, challenging the appropriateness of the Directors' assumptions and estimates in relation to tax assets and liabilities, by critically assessing the range of possible amounts that may be assessed under tax laws, likely settlements based on the latest correspondence with the relevant tax authorities and the complexity of the relevant tax legislation. We involved our tax specialist in analysing and challenging the assumptions used to determine tax provisions based on our knowledge and experience of the application of the legislation by the relevant authorities and courts. We also assessed whether the Group's tax disclosures (see note 16) are appropriate and in accordance with relevant accounting standards.

- **The effect of the proposed disposal of the US Services Solutions Group (SSG) division**

Refer to page 64 (Audit Committee report), page 110 (accounting policy note) and page 117 and 144 (financial disclosures)

The risk: The Group has not classified the US SSG business as held for sale and consequently has not classified it as a discontinued operation as at 31 March 2014. The classification as held for sale involves judgment as it requires consideration of whether specific criteria set out in accounting standards are present at the year end, in particular, whether the transaction was highly probable at the balance sheet date with reference to the facts and circumstances at the time.

Our response: Our audit procedures in this area included, among others: assessing the available documentation relating to the proposed disposal and making a critical assessment as to the appropriateness of not classifying the US SSG business as held for sale applying the facts and circumstances present at the year end to the criteria set out in accounting standards and assessing the carrying value of the US SSG business based on a fair value less cost to sales equivalent to the likely sale price. We also considered the adequacy of the disclosures in the financial statements.

- **Consolidation of US subsidiaries**

Refer to page 63 (Audit Committee report) and page 110 (accounting policy note)

The risk: As detailed on page 61 concerning 'Management and control of US subsidiaries', the Group's holding of its QNA assets is regulated by a Proxy agreement whose purpose is to insulate QNA from foreign ownership control or influence, the effects of which have to be considered when assessing whether it should be consolidated in accordance with the requirements of the relevant accounting standard (IAS 27). Judgment is required in assessing whether the Proxy agreement restricts the Group's ability to control QNA's operating and financial policies to an extent that it would be inappropriate to consolidate it and, if so, what the alternative accounting treatment should be.

Our response: Our audit procedures included, among others, challenging the appropriateness of the directors' judgment, by critically assessing the available evidence as to the operation of the Proxy agreement in the context of the relevant accounting standard. We reviewed the relevant documentation including the Proxy agreement to assess the respective rights of the QinetiQ and the proxy board over QNA's financial and operating policies. We also assessed whether the Group's disclosures are appropriate and in accordance with relevant accounting standards.

3 Our application of materiality and an overview of the scope of our audit

The materiality for the Group financial statements as a whole was set at £5.4 million. This has been determined with reference to a benchmark of Group underlying profit before taxation (of which it represents 4.5%), which we consider to be one of the principal considerations for members of the Company in assessing the financial performance of the Group.

We agreed with the Audit Committee to report to it all corrected and uncorrected misstatements we identified through our audit with a value in excess of £0.3 million, in addition to other audit misstatements below that threshold that we believe warranted reporting on qualitative grounds.

Audits for group reporting purposes were performed by component auditors at the key reporting components in the USA and by the group audit team in the UK. These group procedures covered 93% of total group revenue; 102% of group underlying profit before tax, as reporting units with a total net loss before tax of £1.8 million were outside the scope of group reporting activities; 89% of group specific adjusting items; and 92% of total Group assets. The disclosures in note 2 set out the individual significance of a specific country.

The audits undertaken for group reporting purposes at the key reporting components of the group were all performed to materiality levels set by, or agreed with, the group audit team. These materiality levels were set individually for each component and ranged from £3.8 million to £4.5 million.

Detailed audit instructions were sent to the component auditors. These instructions covered the significant audit areas that should be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to the Group audit team. The Group audit team visited the US. Telephone meetings were also held with the auditors at these locations and other locations that were not physically visited.

4 Our opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

5 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Independent auditor's report to the members of QinetiQ Group plc only continued

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 59, in relation to going concern; and
- the part of the Corporate Governance Statement on pages 48 – 68 relating to the Company's compliance with the nine provisions of the 2010 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope of report and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 96, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of accounts is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the Company's members as a body and subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2013a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions

Anthony Sykes (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

London, E14 5GL

May 2014

Consolidated income statement

for the year ended 31 March

| all figures in £ million | Note | 2014 | | | 2013 | | |
|--|-------|----------------|---------------------------|----------------|----------------|---------------------------|----------------|
| | | Underlying | Specific adjusting items* | Total | Underlying | Specific adjusting items* | Total |
| Revenue | 2, 3 | 1,191.4 | – | 1,191.4 | 1,327.8 | – | 1,327.8 |
| Operating costs excluding depreciation, amortisation and impairment | | (1,040.7) | 26.8 | (1,013.9) | (1,132.9) | (16.3) | (1,149.2) |
| Other income | 2 | 7.0 | – | 7.0 | 5.8 | – | 5.8 |
| EBITDA (earnings before interest, tax, depreciation and amortisation) | | 157.7 | 26.8 | 184.5 | 200.7 | (16.3) | 184.4 |
| Depreciation and impairment of property, plant and equipment | 3, 14 | (24.0) | 1.4 | (22.6) | (28.0) | (4.0) | (32.0) |
| Impairment of goodwill | 12 | – | (125.9) | (125.9) | – | (255.8) | (255.8) |
| Amortisation of intangible assets | 3, 13 | (1.0) | (11.0) | (12.0) | (4.0) | (14.0) | (18.0) |
| Group operating profit/(loss) | 3 | 132.7 | (108.7) | 24.0 | 168.7 | (290.1) | (121.4) |
| Net (loss)/gain on disposal/impairment of businesses and investments | 5 | – | (4.9) | (4.9) | – | 2.3 | 2.3 |
| Finance income | 6 | 1.9 | – | 1.9 | 1.7 | – | 1.7 |
| Finance expense | 6 | (15.2) | (1.7) | (16.9) | (18.3) | (1.3) | (19.6) |
| Profit/(loss) before tax | 4 | 119.4 | (115.3) | 4.1 | 152.1 | (289.1) | (137.0) |
| Taxation (expense)/income | 7 | (15.4) | (1.4) | (16.8) | (29.2) | 33.0 | 3.8 |
| Profit/(loss) for the year attributable to equity shareholders | | 104.0 | (116.7) | (12.7) | 122.9 | (256.1) | (133.2) |
| Earnings per share | | | | | | | |
| Basic | 11 | 16.0p | | (1.9)p | 18.9p | | (20.5)p |
| Diluted | 11 | 15.8p | | (1.9)p | 18.7p | | (20.5)p |

*For details of 'specific adjusting items' refer to note 4 to the financial statements.

Consolidated statement of comprehensive income

for the year ended 31 March

| all figures in £ million | 2014 | 2013 |
|--|---------------|----------------|
| Loss for the year | (12.7) | (133.2) |
| <i>Items that will not be reclassified to profit or loss:</i> | | |
| Actuarial loss recognised in defined benefit pension schemes | (5.6) | (42.1) |
| Tax on items that will not be reclassified to profit and loss | 1.3 | 10.1 |
| Total items that will not be reclassified to profit or loss | (4.3) | (32.0) |
| <i>Items that may be reclassified subsequently to profit or loss:</i> | | |
| Foreign currency translation differences for foreign operations | (21.2) | 24.6 |
| Increase/(decrease) in fair value of hedging derivatives | 0.4 | (0.1) |
| Reclassification of hedging derivatives to the income statement | (0.2) | – |
| Impairment loss on revalued investments | – | (4.1) |
| Fair value gains on available-for-sale investments | 0.9 | 0.3 |
| Tax on items that may be reclassified to profit or loss | (0.1) | – |
| Total items that may be reclassified subsequently to profit or loss | (20.2) | 20.7 |
| Other comprehensive expense for the year, net of tax | (24.5) | (11.3) |
| Total comprehensive expense for the year | (37.2) | (144.5) |

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 2013 | 6.6 | 39.9 | 147.6 | – | 44.3 | 200.0 | 438.4 | 0.1 | 438.5 |
| Loss for the year | – | – | – | – | – | (12.7) | (12.7) | – | (12.7) |
| Other comprehensive income/(expense) for the year, net of tax | – | – | – | 0.1 | (21.2) | (3.4) | (24.5) | – | (24.5) |
| Purchase of own shares | – | – | – | – | – | (0.5) | (0.5) | – | (0.5) |
| Share-based payments settlement | – | – | – | – | – | 0.9 | 0.9 | – | 0.9 |
| Share-based payments | – | – | – | – | – | 3.2 | 3.2 | – | 3.2 |
| Dividends | – | – | – | – | – | (26.8) | (26.8) | – | (26.8) |
| At 31 March 2014 | 6.6 | 39.9 | 147.6 | 0.1 | 23.1 | 160.7 | 378.0 | 0.1 | 378.1 |
| At 1 April 2012 | 6.6 | 39.9 | 147.6 | 0.1 | 19.7 | 385.4 | 599.3 | 0.1 | 599.4 |
| Loss for the year | – | – | – | – | – | (133.2) | (133.2) | – | (133.2) |
| Other comprehensive income/(expense) for the year, net of tax | – | – | – | (0.1) | 24.6 | (35.8) | (11.3) | – | (11.3) |
| Purchase of own shares | – | – | – | – | – | (0.4) | (0.4) | – | (0.4) |
| Share-based payments settlement | – | – | – | – | – | 0.7 | 0.7 | – | 0.7 |
| Share-based payments | – | – | – | – | – | 3.4 | 3.4 | – | 3.4 |
| Dividends | – | – | – | – | – | (20.1) | (20.1) | – | (20.1) |
| At 31 March 2013 | 6.6 | 39.9 | 147.6 | – | 44.3 | 200.0 | 438.4 | 0.1 | 438.5 |

Consolidated balance sheet

as at 31 March

| all figures in £ million | Note | 2014 | 2013 |
|--|------|----------------|----------------|
| Non-current assets | | | |
| Goodwill | 12 | 141.3 | 290.4 |
| Intangible assets | 13 | 44.2 | 57.8 |
| Property, plant and equipment | 14 | 233.8 | 241.4 |
| Other financial assets | 22 | 1.5 | 4.3 |
| Investments | 15 | 0.5 | 0.4 |
| Deferred tax | 16 | 18.1 | 32.4 |
| | | 439.4 | 626.7 |
| Current assets | | | |
| Inventories | 17 | 19.8 | 25.5 |
| Other financial assets | 22 | 3.1 | 2.6 |
| Trade and other receivables | 19 | 250.5 | 284.2 |
| Investments | 18 | 2.1 | 1.4 |
| Cash and cash equivalents | 22 | 322.2 | 240.4 |
| | | 597.7 | 554.1 |
| Total assets | | 1,037.1 | 1,180.8 |
| Current liabilities | | | |
| Trade and other payables | 20 | (425.6) | (458.0) |
| Current tax | | (4.6) | (14.2) |
| Provisions | 21 | (4.8) | (12.4) |
| Other financial liabilities | 22 | (2.2) | (2.0) |
| | | (437.2) | (486.6) |
| Non-current liabilities | | | |
| Retirement benefit obligation | 28 | (22.2) | (54.1) |
| Deferred tax | 16 | (15.0) | – |
| Provisions | 21 | (19.3) | (22.7) |
| Other financial liabilities | 22 | (154.1) | (171.3) |
| Other payables | 20 | (11.2) | (7.6) |
| | | (221.8) | (255.7) |
| Total liabilities | | (659.0) | (742.3) |
| Net assets | | 378.1 | 438.5 |
| Capital and reserves | | | |
| Ordinary shares | 26 | 6.6 | 6.6 |
| Capital redemption reserve | | 39.9 | 39.9 |
| Share premium account | | 147.6 | 147.6 |
| Hedging and translation reserve | | 23.2 | 44.3 |
| Retained earnings | | 160.7 | 200.0 |
| Capital and reserves attributable to shareholders of the parent company | | 378.0 | 438.4 |
| Non-controlling interest | | 0.1 | 0.1 |
| Total shareholders' funds | | 378.1 | 438.5 |

The financial statements were approved by the Board of Directors and authorised for issue on 22 May 2014 and were signed on its behalf by:

Mark Elliott
Chairman

Leo Quinn
Chief Executive Officer

David Mellors
Chief Financial Officer

Consolidated cash flow statement

for the year ended 31 March

| all figures in £ million | Note | 2014 | 2013 |
|---|------|---------------|---------------|
| Net cash inflow from operations before restructuring costs | 25 | 157.3 | 194.4 |
| Net cash (outflow)/inflow relating to restructuring | | (10.3) | 63.1 |
| Net cash outflow relating to pension scheme closure costs | | (4.0) | – |
| Cash inflow from operations | | 143.0 | 257.5 |
| Tax received/(paid) | | 2.1 | (1.6) |
| Interest received | | 1.0 | 0.8 |
| Interest paid | | (12.3) | (35.8) |
| Net cash inflow from operating activities | | 133.8 | 220.9 |
| Purchases of intangible assets | | (2.6) | (0.6) |
| Purchases of property, plant and equipment | | (24.2) | (27.1) |
| Proceeds from sale of property, plant and equipment | | 6.0 | 9.2 |
| Proceeds from sale of investments | | – | 3.8 |
| Net cash outflow from investing activities | | (20.8) | (14.7) |
| Repayment of bank borrowings | | – | (63.0) |
| Settlement of forward contracts | | – | (1.3) |
| Purchase of own shares | | (0.5) | (0.4) |
| Dividends paid to shareholders | | (26.8) | (20.1) |
| Capital element of finance lease rental payments | | (2.8) | (2.8) |
| Capital element of finance lease rental receipts | | 3.0 | 3.0 |
| Net cash outflow from financing activities | | (27.1) | (84.6) |
| Increase in cash and cash equivalents | | 85.9 | 121.6 |
| Effect of foreign exchange changes on cash and cash equivalents | | (4.1) | 1.0 |
| Cash and cash equivalents at beginning of year | | 240.4 | 117.8 |
| Cash and cash equivalents at end of year | 22 | 322.2 | 240.4 |

Reconciliation of movement in net cash

for the year ended 31 March

| all figures in £ million | Note | 2014 | 2013 |
|---|------|--------------|--------------|
| Increase in cash and cash equivalents in the year | | 85.9 | 121.6 |
| Add back net cash flows not impacting net debt | | (0.2) | 64.1 |
| Change in net cash resulting from cash flows | 22 | 85.7 | 185.7 |
| Other movements including foreign exchange | 22 | 10.8 | 10.5 |
| Movement in net cash in the year | 22 | 96.5 | 196.2 |
| Net cash/(debt) at beginning of year | 22 | 74.0 | (122.2) |
| Net cash at end of year | 22 | 170.5 | 74.0 |

Notes to the financial statements

1. Significant accounting policies

Accounting policies

The following accounting policies have been applied consistently to all periods presented in dealing with items that are considered material in relation to the Group's financial statements. In the income statement, the Group presents specific adjusting items separately. In the judgment 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.

Specific adjusting items include:

- amortisation of intangibles arising from acquisitions;
- pension curtailment gains/losses;
- pension gain on closure to future accrual and associated Scheme-closure mitigation costs;
- pension net finance expense;
- gains/losses on business divestments and disposal of investments;
- restructuring costs;
- gains/losses on disposal of property;
- impairment of property;
- impairment of goodwill and other intangible assets; and
- tax on the above items.

Basis of preparation

The Group's financial statements, approved by the Directors, have been prepared on a going concern basis as discussed in the Directors' Report on page 59 and in accordance with International Financial Reporting Standards as adopted by the EU ('IFRS') and the Companies Act 2006 applicable to companies reporting under IFRS. The Company has elected to prepare its parent company financial statements in accordance with UK GAAP; these are presented on page 147. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and other relevant financial assets and liabilities. Non-current assets held for sale are held at the lower of carrying amount and fair value less costs to sell. The Group's reporting currency is sterling and unless otherwise stated the financial statements are rounded to the nearest £100,000.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings to 31 March 2014. The purchase method of accounting has been adopted. Those subsidiary undertakings acquired or disposed of in the period are included in the consolidated income statement from the date control is obtained to the date that control is lost (usually on acquisition and disposal respectively). A subsidiary is an entity over which the Group has the power to govern financial and operating policies in order to obtain benefits. Potential voting rights that are currently exercisable or convertible are considered when determining control.

The Group comprises certain entities that are operated under the management of a Proxy Board. Details of the Proxy Board arrangements and the powers of the proxy holders and QinetiQ management are set out in the Corporate Governance section of this Annual Report. IAS 27 is the accounting standard currently applicable in respect of consolidation of entities. This does not specifically deal with proxy situations. However, having considered the terms of the Proxy agreement, the Directors consider that the Group has control over the operating and financial policies of such affected entities and, therefore, consolidates these entities in the consolidated accounts.

An associate is an undertaking over which the Group exercises significant influence, usually from 20%–50% of the equity voting rights, in respect of financial and operating policy. A joint venture is an undertaking over which the Group exercises joint control. Associates and joint ventures are accounted for using the equity method from the date of acquisition to the date of disposal. The Group's investments in associates and joint ventures are held at cost including goodwill on acquisition and any post-acquisition changes in the Group's share of the net assets of the associate less any impairment to the recoverable amount. Where an associate or joint venture has net liabilities, full provision is made for the Group's share of liabilities where there is a constructive or legal obligation to provide additional funding to the associate or joint venture.

The financial statements of subsidiaries, joint ventures and associates are adjusted where necessary to ensure compliance with Group accounting policies.

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

Revenue

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

Service contracts

The Group's service contract arrangements are accounted for under IAS 18 'Revenue'. Revenue is recognised once the Group has obtained the right to consideration in exchange for its performance. No profit is recognised on contracts until the outcome of the contract can be reliably estimated. When the outcome of a contract can be reliably estimated, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is normally measured by the proportion of contract costs incurred for work performed to date compared with the estimated total contract costs after making suitable allowances for technical and other risks related to performance milestones yet to be achieved. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense. The Group generally does not undertake construction contracts.

Notes to the financial statements continued

1. Significant accounting policies continued

Goods sold

Sales of goods are recognised in the income statement on delivery of the product or when the significant risks and rewards of ownership have been transferred to the customer and revenue and costs can be reliably measured.

Royalties and intellectual property

Royalty revenue is recognised over the period to which the royalty relates. Intellectual property revenue can be attributed either to perpetual licences or to limited licences. Limited licences are granted for a specified period and revenue is recognised over the period of the licence. Perpetual licences are granted for unlimited time frames and revenue is recognised when the risks and rewards of ownership are transferred to the customer.

Segmental information

Segmental information is presented according to the Group's internal management reporting structure and the markets in which it operates. Segmental results represent the contribution of the different segments to the profit of the Group. Corporate expenses are allocated to the corresponding segments. Unallocated items mainly comprise specific adjusting items. Specific adjusting items are referred to in note 4. Eliminations represent inter-company trading between the different segments.

Segmental assets and liabilities information is not regularly provided to the chief operating decision maker.

Research and development expenditure

R&D costs incurred on behalf of a customer as part of a specific project are directly chargeable to the customer on whose behalf the work is undertaken. These costs are recognised within operating costs and revenue is recognised in respect of the R&D services performed. Internally funded development expenditure is capitalised in the balance sheet where there is a clearly defined project, the expenditures are separately identifiable, the project is technically and commercially feasible, all costs are recoverable by future revenue and the resources are committed to complete the project. Such capitalised costs are amortised over the forecast period of sales resulting from the development. All other R&D costs are expensed to the income statement in the period in which they are incurred. If the research phase cannot be clearly distinguished from the development phase, the respective project-related costs are treated as if they were incurred in the research phase only and expensed.

Financing

Financing represents the financial expense on borrowings accounted for using the effective rate method and the financial income earned on funds invested. Exchange differences on financial assets and liabilities and the income or expense from interest hedging instruments that are recognised in the income statement are included within finance income and finance expense. Financing also includes the net finance expense in respect of defined benefit pension schemes.

Taxation

The taxation charge is based on the taxable profit for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes. Current tax and deferred tax are charged or credited to the income statement, except where they relate to items charged or credited to equity, in which case the relevant tax is charged or credited to equity. Deferred taxation is the tax attributable to the temporary differences that appear when taxation authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated financial statements. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using rates enacted or substantively enacted at the balance sheet date.

Any changes in the tax rates are recognised in the income statement unless related to items directly recognised in equity. Deferred tax liabilities are recognised on all taxable temporary differences excluding non-deductible goodwill. Deferred tax assets are recognised on all deductible temporary differences provided that it is probable that future taxable income will be available against which the asset can be utilised. Deferred tax assets and liabilities are offset only where there is a legally enforceable right to offset and there is an intention to settle balances on a net basis.

Discontinued operation

A discontinued operation is a component of the Group's business, the operations and cash flows of which can be clearly distinguished from the rest of the Group and which:

- represents a separate major line of business or geographical area of operations;
- is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to re-sale.

Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held for sale. When an operation is classified as a discontinued operation, the comparative statement of profit and loss and other comprehensive income is re-presented as if the operation had been discontinued from the start of the comparative year.

Goodwill

Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of joint ventures and associates is included in the carrying value of equity accounted investments. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill related to the entity sold.

Intangible assets

Intangible assets arising from business combinations are recognised at fair value and are amortised over their expected useful lives, typically between one and nine years. Internally generated intangible assets are recorded at cost, including labour, directly attributable costs and any third-party expenses. Purchased intangible assets are recognised at cost less amortisation. Intangible assets are amortised over their respective useful lives on a straight-line basis as follows:

| | |
|------------------------------|-----------|
| Intellectual property rights | 2–8 years |
| Development costs | 1–4 years |
| Other | 1–9 years |

Property, plant and equipment

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

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

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

The useful lives, depreciation methods and residual values applied to property, plant and equipment are reviewed annually and, if appropriate, adjusted accordingly.

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

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

Investments in debt and equity securities

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

The fair value of quoted financial instruments is their bid price at the balance sheet date. The fair value of unquoted equity investments is based on the price of the most recent investment by the Group or a third party, if available, or derived from the present value of forecast future cash flows.

Inventories

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

Bid costs

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

Trade and other receivables

Trade and other receivables are stated net of provisions for doubtful debts. Amounts recoverable on contracts are included in trade and other receivables and represent revenue recognised in excess of amounts invoiced. Payments received on account are included in trade and other payables and represent amounts invoiced in excess of revenue recognised.

Notes to the financial statements continued

1. Significant accounting policies continued

Cash and cash equivalents

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

Current and non-current liabilities

Current liabilities include amounts due within the normal operating cycle of the Group. Interest-bearing current and non-current liabilities are initially recognised at fair value and then stated at amortised cost with any difference between the cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis. Costs associated with the arrangement of bank facilities or the issue of loans are held net of the associated liability presented in the balance sheet. Capitalised issue costs are released over the estimated life of the facility or instrument to which they relate using the effective interest rate method. If it becomes clear that the facility or instrument will be redeemed early, the amortisation of the issue costs will be accelerated.

Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event which can be reliably estimated, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where appropriate, provisions are determined by discounting the expected cash flows at an appropriate discount rate reflecting the level of risk and the time value of money.

Financial instruments

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

Derivative financial instruments

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

Fair value hedging

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

Cash flow hedging

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

Leased assets

Leases are classified as finance leases when substantially all the risks and rewards of ownership are held by the lessee. Assets held under finance leases are capitalised and included in property, plant and equipment at the lower of the present value of minimum lease payments and fair value at the inception of the lease. Assets are then depreciated over the shorter of their useful economic lives or the lease term. Obligations relating to finance leases, net of finance charges arising in future periods, are included under financial liabilities.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the lease.

Foreign currencies

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

The individual financial statements of each Group company are presented in its functional currency. On consolidation, assets and liabilities of overseas subsidiaries, associated undertakings and joint ventures, including any related goodwill, are translated to sterling at the rate of exchange at the balance sheet date. The results and cash flows of overseas subsidiaries, associated undertakings and joint ventures are translated to sterling using the average rates of exchange during the period. Exchange adjustments arising from the re-translation of the opening net investment and the results for the period to the period-end rate are taken directly to equity and reported in the statement of comprehensive income.

Post-retirement benefits

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

For defined benefit plans, the cost charged to the income statement consists of current service cost, net interest cost, and past service cost. The finance element of the pension charge is shown in finance expense and the remaining service cost element is charged as a component of employee costs in the income statement. Actuarial gains and losses and re-measurement gains and losses are recognised immediately in full through the statement of comprehensive income. Contributions to defined contribution plans are charged to the income statement as incurred.

Share-based payments

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

Share capital

Ordinary share capital of the Company is recorded as the proceeds received, less issue costs. Company shares held by the employee benefit trusts are held at the consideration paid. They are classified as own shares within equity. Any gain or loss on the purchase, sale or issue of Company shares is recorded in equity.

Recent accounting developments

Developments adopted by the Group in 2014 with no material impact on the financial statements

The following EU-endorsed amendments, improvements and interpretations of published standards are effective for accounting periods beginning on or after 1 April 2013 and have been adopted with no material impact on the Group's financial statements. Note that QinetiQ adopted IAS19 (revised) in the prior year:

IFRS 13 'Fair Value Measurement' – new standard replacing existing guidance on fair value measurement in different IFRSs with a single definition of fair value.

IAS 1 'Presentation of Financial Statements' – amendments revising the way both other comprehensive income and comparative information are presented.

IFRS 1 'First Time Adoption of IFRS' – amendments relating to government grants, hyperinflation and fixed dates.

IFRS 7 'Financial Instruments' – amendments relating to asset and liability offsetting.

Annual improvements 2011 – annual improvements cycle including amendments to IAS 16, IAS 32 and IAS 34.

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

FRS 100, 101 and 102: FRS 100, 101 and 102 all fall under the new UK GAAP regime. FRS 100 sets out the application of financial reporting requirements in the UK and Republic of Ireland and FRS 101, known as 'IFRS with reduced disclosures', outlines the reduced disclosure framework available for use by qualifying entities choosing to follow the principles of IFRS but under the umbrella of UK GAAP. FRS 102 is applicable in the UK and Republic of Ireland and is known as the 'new UK GAAP'. FRS 102 follows more closely the principles of existing UK GAAP with some exceptions. The mandatory effective date for the new framework of reporting is for accounting periods beginning on or after 1 January 2015. The Group can choose to apply either full IFRS, or a choice of either FRS 101 or FRS 102 to the Company and to its subsidiary entities. The two latter options both fall under UK GAAP and either may therefore be applied to Group companies on an entity by entity basis. If full IFRS is selected, this must be applied to all Group companies consistently. The Group is likely to choose the UK GAAP option and is currently undertaking a full analysis on an individual company basis as to whether FRS 101 or FRS 102 is appropriate.

Revenue from Contracts with Customers: The Group awaits the final publication of the new IFRS standard 'Revenue from Contracts with Customers' which is expected to be published imminently. The new standard will replace IAS 18 'Revenue' and IAS 11 'Construction Contracts'. It will become effective for accounting periods on or after 1 January 2017 at the earliest and will therefore be applied for the first time to the Group accounts in 2018; the IASB has indicated that early adoption will not be permitted. The Group has begun a systematic review of all existing major contracts to ensure that the impact and effect of the new standard is fully understood and any changes to current accounting procedures are highlighted and acted upon well in advance of the effective date.

Leases: During 2014 the IASB and FASB discussed fundamental aspects of their lease accounting proposals published in 2013, covering both lessee and lessor accounting, and potential simplifications to the accounting models. Although both accounting bodies remain committed to on-balance sheet recognition of leases by lessees, the IASB and FASB could not agree on key aspects of the proposals.

IFRS 10 'Consolidated Financial Statements': Refer to the 'Critical accounting estimates' section on page 110.

Developments expected in future periods with no material impact on the Group's financial statements

The Directors anticipate that the adoption of the following new, revised, amended and improved published standards and interpretations, which were in issue at the date of authorisation of these financial statements, will have no material impact on the financial statements of the Group when they become applicable in future periods:

- IFRS 11 'Joint Arrangements'; IFRS 12 'Disclosure of Interests in Other Entities'; IFRS 14 'Regulatory Deferral Accounts';
- IAS 27 'Separate Financial Statements'; IAS 28 'Investments in Associates'; and
- Amendments to new standards IFRS 10, 11, 12 and 27; Amendments to IAS 36 and 39.

Notes to the financial statements continued

1. Significant accounting policies continued

Critical accounting estimates and judgments in applying accounting policies

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

Assets/businesses held for sale

Post year end, on 22 April 2014, the Group entered into an agreement, subject to shareholder approval and normal closing conditions, to sell the US Services business. Whether or not to classify this business as held for sale as at 31 March 2014 is a matter of judgment and has a significant impact on the presentation of the financial statements. The Directors are of the opinion that completion of the disposal transaction was not 'highly probable' as at 31 March 2014 and the criteria of IFRS 5 'Non-current Assets Held for Sale and Discontinued Activities' had not been met. Accordingly, the US Services business has not been reported as an asset held for sale. Additional financial information in respect of this business is disclosed in note 33 'Post balance sheet events'.

Revenue and profit recognition

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

Business combinations

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

The Group tests annually whether goodwill has suffered any impairment. This process relies on the use of estimates of the future profitability and cash flows of its CGUs which may differ from the actual results delivered. In addition, the Group reviews whether identified intangible assets have suffered any impairment. Further details on the sensitivity of the carrying value of goodwill to changes in the key assumptions are set out in note 12.

Consolidation of US subsidiaries

As described on page 61, the Group and the US Department of Defense (DoD) have entered into a Proxy agreement that regulates the ownership, management and operation of certain Group subsidiaries. Having considered the terms of the Proxy agreement, the Directors consider that the Group has control over the operating and financial policies of such entities and, therefore, consolidates the subsidiaries in the consolidated accounts. The key principle of the new standard IFRS10, effective in future periods, is that control exists, and consolidation is required, only if the investor (i) possesses power over the investee, (ii) has exposure to variable returns from its involvement with the investee and (iii) has the ability to use its power over the investee to affect its returns. The impact of this new standard on future reporting periods is being assessed.

Tax

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

Post-retirement benefits

The Group's defined benefit pension obligations and net income statement costs are based on key assumptions, including discount rates, mortality, inflation and future salary and pension increases. Management exercises its best judgment, in consultation with actuarial advisors, in selecting the values for these assumptions that are the most appropriate to the Group. Small changes in these assumptions at the balance sheet date, individually or collectively, may result in significant changes in the size of the deficit or the net income statement costs. Any change in these assumptions would have an impact on the retirement benefit obligation recognised. Further details of these assumptions are set out in note 28.

2. Revenue and other income

Revenue and other income is analysed as follows:

Revenue by category

For the year ended 31 March

| | 2014 | 2013 |
|---|----------------|----------------|
| Sales of goods | 115.7 | 201.7 |
| Services | 1,069.3 | 1,118.7 |
| Royalties and licences | 6.4 | 7.4 |
| Revenue | 1,191.4 | 1,327.8 |
| Share of joint ventures' and associates' profit after tax | 0.1 | 0.1 |
| Other income | 6.9 | 5.7 |
| Total other income | 7.0 | 5.8 |

Revenue and profit after tax of joint ventures and associates was £6.5m and £0.3m respectively (2013: £17.0m and £0.3m respectively). The figures in the table above represent the Group share of this profit after tax.

Other income is in respect of property rentals and the recovery of other related property costs.

Revenue by customer geographic location

For the year ended 31 March

| | | |
|--------------------------|----------------|----------------|
| all figures in £ million | 2014 | 2013 |
| United Kingdom | 578.8 | 560.4 |
| US | 503.9 | 672.7 |
| Other | 108.7 | 94.7 |
| Total | 1,191.4 | 1,327.8 |

Revenue by major customer type

For the year ended 31 March

| | | |
|--------------------------|----------------|----------------|
| all figures in £ million | 2014 | 2013 |
| UK Government | 503.9 | 480.3 |
| US Government | 472.1 | 620.8 |
| Other | 215.4 | 226.7 |
| Total | 1,191.4 | 1,327.8 |

Revenue from the UK Government was generated by the EMEA Services and Global Products operating segments. Revenue from the US Government was generated by the US Services and Global Products operating segments.

Notes to the financial statements continued

3. Segmental analysis

Operating segments

For the year ended 31 March

all figures in £ million

| all figures in £ million | Note | 2014 | 2013 |
|---|------|----------------|-------------------|
| | | Revenue | Operating profit^ |
| | | Revenue^ | Operating profit^ |
| EMEA Services | | 607.0 | 86.7 |
| US Services | | 408.8 | 19.0 |
| Global Products | | 175.6 | 27.0 |
| Total operating segments | | 1,191.4 | 132.7 |
| Operating profit before specific adjusting items¹ – underlying operating profit | | | 132.7 |
| Specific adjusting items before amortisation, depreciation and impairment | 4 | | 26.8 |
| Property impairment reversal/(charge) | | | 1.4 |
| Impairment of goodwill | 12 | | (125.9) |
| Amortisation of intangible assets arising from acquisitions | | | (11.0) |
| Operating profit/(loss) | | | 24.0 |
| (Loss)/gain on business divestments | | | |
| and disposal and impairment of investments | 5 | | (4.9) |
| Net finance expense | 6 | | (15.0) |
| Profit/(loss) before tax | | | 4.1 |
| Taxation (expense)/income | 7 | | (16.8) |
| Loss for the year | | | (12.7) |

¹ The measure of profit presented to the chief operating decision maker is underlying operating profit (as defined in glossary on page 150).

No measure of segmental assets and liabilities has been disclosed as this information is not regularly provided to the chief operating decision maker.

Depreciation and amortisation by business segment – excluding specific adjusting items

For the year ended 31 March 2014

| all figures in £ million | EMEA Services | US Services | Global Products | Total |
|---|---------------|-------------|-----------------|-------------|
| Depreciation of property, plant and equipment | 19.7 | 2.2 | 2.1 | 24.0 |
| Amortisation of purchased or internally developed intangible assets | 0.6 | 0.3 | 0.1 | 1.0 |
| | 20.3 | 2.5 | 2.2 | 25.0 |

For the year ended 31 March 2013

| all figures in £ million | EMEA Services^ | US Services^ | Global Products | Total |
|---|----------------|--------------|-----------------|-------------|
| Depreciation of property, plant and equipment | 22.0 | 2.2 | 3.8 | 28.0 |
| Amortisation of purchased or internally developed intangible assets | 3.6 | 0.2 | 0.2 | 4.0 |
| | 25.6 | 2.4 | 4.0 | 32.0 |

Excludes specific adjusting items not included within the measure of operating profit reported to the chief operating decision maker.

Non-current assets (excluding deferred tax) by geographic location

all figures in £ million

| | UK | Rest of World | Total |
|---------------------------------|--------------|---------------|--------------|
| Year ended 31 March 2014 | 258.4 | 162.9 | 421.3 |
| | UK | Rest of World | Total |
| Year ended 31 March 2013 | 262.6 | 331.7 | 594.3 |

^ Restated to reflect the reclassification of products businesses from EMEA Services to Global Products and the reclassification of Cyveillance® from US Services to EMEA Services.

4. Profit/loss before tax

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

| all figures in £ million | 2014 | 2013 |
|---|------------|------------|
| Fees payable to the auditor and its associates: | | |
| Audit of the Group's annual accounts | 0.6 | 0.6 |
| Audit of the accounts of subsidiaries of the Company and its associated pension scheme* | 0.5 | 0.2 |
| Audit-related assurance services | 0.1 | 0.1 |
| Other assurance services | 0.2 | – |
| Corporate finance services – due diligence support | 1.3 | – |
| All other non-audit services | – | – |
| Total auditor's remuneration | 2.7 | 0.9 |

* Included within this amount is £0.3 million in respect of the audit of prior year US Services division financial statements.

The fees payable to auditors were significantly greater in 2014 than 2013 due to the fact that KPMG were engaged to perform work in connection with the strategic review and preparation for the proposed sale of the US Services division. This included audit of prior year US Services division financial statements and acting as reporting accountant for the Class 1 circular.

| all figures in £ million | 2014 | 2013 |
|---|----------------|----------------|
| Depreciation of property, plant and equipment: | | |
| Owned assets: before impairment | (24.0) | (28.0) |
| Owned assets: Property impairment reversal/(charge) | 1.4 | (4.0) |
| Foreign exchange (loss)/gain | (1.1) | 1.0 |
| Research and development expenditure – customer funded contracts | (288.9) | (311.0) |
| Research and development expenditure – Group funded | (26.8) | (24.6) |

The following specific adjusting items have been (charged)/credited in arriving at profit/loss before tax:

| all figures in £ million | Note | 2014 | 2013 |
|---|----------|----------------|----------------|
| Restructuring costs in respect of 2013 US restructuring | | (0.3) | (16.3) |
| Reduction in pension liabilities on closure to future accrual | | 31.1 | – |
| Pension scheme closure mitigation costs | | (4.0) | – |
| Specific adjusting items before amortisation, depreciation and impairment | | 26.8 | (16.3) |
| Impairment of goodwill | 12 | (125.9) | (255.8) |
| Property impairment reversal/(charge) | 14 | 1.4 | (4.0) |
| Intangible impairment and acquisition amortisation | 13 | (11.0) | (14.0) |
| Specific adjusting items operating loss | | (108.7) | (290.1) |
| Gain on business divestments and disposal of investments | 5 | 1.1 | 2.9 |
| US Services transaction costs | 5 | (6.0) | – |
| Unrealised impairment of investments | 5 | – | (0.6) |
| (Loss)/gain on business divestments and disposal/impairment of investments | 5 | (4.9) | 2.3 |
| Defined benefit pension scheme net finance expense | | (1.7) | (1.3) |
| Total specific adjusting items loss before tax | | (115.3) | (289.1) |

Notes to the financial statements continued

5. Net gain/loss on disposal/impairment of businesses and investments

For the year ended 31 March

all figures in £ million

| | 2014 | 2013 |
|---|--------------|------------|
| Gain on business divestments | 1.1 | – |
| US Services transaction costs | (6.0) | – |
| Gain on disposal of investments | – | 2.9 |
| Unrealised impairment of investments | – | (0.6) |
| Net (loss)/gain on disposal/impairment of businesses and investments | (4.9) | 2.3 |

The gain on business divestments relates to deferred consideration received in respect of the disposal of the Calibration business in 2009. The US Services transaction costs relate to costs incurred in the current year in relation to the planned disposal of the US Services business. The disposal itself is a non-adjusting post balance sheet event (see note 33).

The prior year gain on disposal of investments relates to the disposal of QinetiQ's investment in InfoSciTex Inc.

6. Finance income and expense

For the year ended 31 March

all figures in £ million

| | 2014 | 2013 |
|--|---------------|---------------|
| Receivable on bank deposits | 1.4 | 1.0 |
| Finance lease income | 0.5 | 0.7 |
| Finance income | 1.9 | 1.7 |
| Amortisation of recapitalisation fee | (0.6) | (0.6) |
| Payable on bank loans and overdrafts | (2.1) | (1.4) |
| Payable on US dollar private placement debt | (11.3) | (14.2) |
| Finance lease expense | (0.4) | (0.6) |
| Unwinding of discount on financial liabilities | (0.8) | (1.5) |
| Finance expense before specific adjusting items | (15.2) | (18.3) |
| Specific adjusting items: | | |
| Defined benefit pension scheme net finance expense | (1.7) | (1.3) |
| Total finance expense | (16.9) | (19.6) |
| Net finance expense | (15.0) | (17.9) |

7. Taxation

| all figures in £ million | 2014 | | | 2013 | | |
|---|----------------------------------|---------------------------|-----------------|----------------------------------|---------------------------|---------------|
| | Before specific adjusting items* | Specific adjusting items* | Total | Before specific adjusting items* | Specific adjusting items* | Total |
| Analysis of charge | | | | | | |
| Current UK tax (income)/expense | (4.2) | (0.9) | (5.1) | 0.8 | (0.2) | 0.6 |
| Overseas corporation tax | | | | | | |
| Current year | (6.3) | (4.3) | (10.6) | (0.2) | 1.5 | 1.3 |
| Adjustment for prior year | – | – | – | – | 0.4 | 0.4 |
| Current tax (income)/expense | (10.5) | (5.2) | (15.7) | 0.6 | 1.7 | 2.3 |
| Deferred tax expense/(income) | 25.0 | 7.8 | 32.8 | 28.0 | (34.4) | (6.4) |
| Deferred tax impact of change in rates | 0.9 | – | 0.9 | 0.6 | (0.9) | (0.3) |
| Deferred tax in respect of prior years | – | (1.2) | (1.2) | – | 0.6 | 0.6 |
| Taxation expense/(income) | 15.4 | 1.4 | 16.8 | 29.2 | (33.0) | (3.8) |
| Factors affecting tax charge/(credit) in year | | | | | | |
| Principal factors reducing the Group's current year tax charge below the UK statutory rate are explained below: | | | | | | |
| Profit/(loss) before tax | 119.4 | (115.3) | 4.1 | 152.1 | (289.1) | (137.0) |
| Tax on profit/(loss) before tax at 23% (2013: 24%) | 27.5 | (26.5) | 1.0 | 36.5 | (69.4) | (32.9) |
| Effect of: | | | | | | |
| Expenses not deductible for tax purposes, research and development relief and non-taxable items | (9.9) | 29.7 | 19.8 | (12.4) | 49.0 | 36.6 |
| Current tax losses for which no deferred tax asset was recognised | (1.0) | – | (1.0) | (2.2) | – | (2.2) |
| Deferred tax impact of change in rates | 0.9 | – | 0.9 | 0.7 | (0.1) | 0.6 |
| Deferred tax in respect of prior years | 0.2 | – | 0.2 | 0.1 | – | 0.1 |
| Effect of different rates in overseas jurisdictions | (2.3) | (1.8) | (4.1) | 6.5 | (12.5) | (6.0) |
| Taxation expense/(income) | 15.4 | 1.4 | 16.8 | 29.2 | (33.0) | (3.8) |
| Effective tax rate | 12.9% | | >100% | 19.2% | | 2.8% |

*Definitions of underlying measures of performance and specific adjusting items can be found in the glossary on page 150.

Factors affecting future tax charges

The effective tax rate continues to be below the statutory rate in the UK, primarily as a result of the benefit of research and development relief in the UK. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to the impact of any tax legislation changes and the geographic mix of profits. The Finance Act 2013 allows the continued recognition of R&D tax credits as a super deduction in the tax line until April 2016, when R&D Expenditure Credit treatment becomes mandatory, which could increase the Group's effective tax rate over time to a blend of the US and UK corporation tax rates.

Previously, the UK Government announced reductions to the UK corporation tax rate to 21% on 1 April 2014 and to 20% on 1 April 2015 and these were substantively enacted on 2 July 2013. Deferred tax has been calculated at 21% being the tax rate effective for the financial year to 31 March 2015. The subsequent change to 20% will reduce the Group's future tax charge accordingly. It has not yet been possible to quantify the full anticipated effect of the announced rate reduction to 20% in 2015, although this will further reduce the Group's future tax charge and reduce the Group's deferred tax accordingly.

At 31 March 2014 the Group had unused tax losses of £191.4m (2013: £202.7m) potentially available for offset against future profits.

Notes to the financial statements continued

8. Dividends

An analysis of the dividends paid and proposed in respect of the years ended 31 March 2014 and 2013 is provided below:

| | Pence per share | £m | Date paid/ payable |
|---|--------------------|-------------|-----------------------|
| Interim 2014 | 1.40 | 9.2 | Feb 2014 |
| Final 2014 (proposed) | 3.20 | 20.8 | Sept 2014 |
| Total for the year ended 31 March 2014 | 4.60 | 30.0 | |
| Interim 2013 | 1.10 | 7.1 | Feb 2013 |
| Final 2013 | 2.70 | 17.6 | Sept 2013 |
| Total for the year ended 31 March 2013 | 3.80 | 24.7 | |

The Directors propose a final dividend of 3.20p (2013: 2.70p) per share. The dividend, which is subject to shareholder approval, will be paid on 5 September 2014. The ex-dividend date is 6 August 2014 and the record date is 8 August 2014.

9. Analysis of employee costs and numbers

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

| | As at 31 March | | Monthly average | |
|-----------------|----------------|-----------------------------|-----------------|-----------------------------|
| | 2014 Number | 2013 Number [^] | 2014 Number | 2013 Number [^] |
| EMEA Services | 5,399 | 5,352 | 5,292 | 5,146 |
| US Services | 2,704 | 3,219 | 3,014 | 3,602 |
| Global Products | 834 | 927 | 828 | 1,024 |
| Total | 8,937 | 9,498 | 9,134 | 9,772 |

[^] Restated to reflect the reclassification of products businesses from EMEA Services to Global Products and the reclassification of Cyveillance® from US Services to EMEA Services.

The aggregate payroll costs of these persons were as follows:

| all figures in £ million | Note | 2014 | 2013 |
|---|------|--------------|--------------|
| Wages and salaries | | 450.3 | 496.0 |
| Social security costs | | 38.3 | 38.8 |
| Pension costs | | 40.8 | 41.0 |
| Share-based payments costs | 27 | 4.5 | 5.5 |
| Employee costs before US restructuring costs and UK pension closure mitigation costs | | 533.9 | 581.3 |
| US restructuring costs | | – | 7.3 |
| UK pension scheme closure mitigation costs | | 4.0 | – |
| Total employee costs | | 537.9 | 588.6 |

On closure of the UK defined benefit pension scheme to future accrual, affected employees were transferred to a defined contribution pension scheme. Additional one-off employer contribution payments were made by the Company into the new schemes during the year.

10. Directors and other senior management personnel

The Directors and other senior management personnel of the Group during the year to 31 March 2014 comprise the Board of Directors and the Operations Committee. The remuneration and benefits provided to Directors and the Operations Committee are summarised below:

| all figures in £ million | 2014 | 2013 |
|---|------------|-------------|
| Short-term employee remuneration including benefits | 6.7 | 6.7 |
| Post-employment benefits | 0.2 | 0.2 |
| Share-based payments costs | 1.9 | 2.3 |
| Termination benefits | 0.8 | 0.9 |
| Total | 9.6 | 10.1 |

Short-term employee remuneration and benefits include salary, bonus, and benefits. Post-employment benefits relate to pension amounts.

11. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the year. The weighted average number of shares used excludes those shares bought by the Group and held as own shares (see note 26). 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. Underlying basic earnings per share figures are presented below, in addition to the basic and diluted earnings per share, because the Directors consider this gives a more relevant indication of underlying business performance and reflects the adjustments to basic earnings per share for the impact of specific adjusting items (see note 4) and tax thereon.

| For the year ended 31 March | | 2014 | 2013 |
|---|-----------|--------------|---------------|
| Basic EPS | | | |
| Loss attributable to equity shareholders | £ million | (12.7) | (133.2) |
| Weighted average number of shares | Million | 651.7 | 648.7 |
| Basic EPS | Pence | (1.9) | (20.5) |
| Diluted EPS | | | |
| Loss attributable to equity shareholders | £ million | (12.7) | (133.2) |
| Weighted average number of shares | Million | 651.7 | 648.7 |
| Effect of dilutive securities ¹ | Million | — | — |
| Diluted number of shares | Million | 651.7 | 648.7 |
| Diluted EPS | Pence | (1.9) | (20.5) |
| Underlying basic EPS | | | |
| Loss attributable to equity shareholders | £ million | (12.7) | (133.2) |
| Loss after tax in respect of specific adjusting items | £ million | 116.7 | 256.1 |
| Underlying profit after taxation | £ million | 104.0 | 122.9 |
| Weighted average number of shares | Million | 651.7 | 648.7 |
| Underlying basic EPS | Pence | 16.0 | 18.9 |
| Underlying diluted EPS | | | |
| Loss attributable to equity shareholders | £ million | (12.7) | (133.2) |
| Loss after tax in respect of specific adjusting items | £ million | 116.7 | 256.1 |
| Underlying profit after taxation | £ million | 104.0 | 122.9 |
| Weighted average number of shares | Million | 651.7 | 648.7 |
| Effect of dilutive securities | Million | 5.1 | 7.1 |
| Diluted number of shares | Million | 656.8 | 655.8 |
| Underlying diluted EPS | Pence | 15.8 | 18.7 |

¹ The loss attributable to equity shareholders results in the effect of dilutive securities on the weighted average number of shares being nil.

12. Goodwill

| all figures in £ million | 2014 | 2013 |
|-----------------------------------|----------------|----------------|
| Cost | | |
| At 1 April | 593.0 | 564.2 |
| Foreign exchange | (51.6) | 28.8 |
| At 31 March | 541.4 | 593.0 |
| Impairment | | |
| At 1 April | (302.6) | (44.9) |
| Impairment | (125.9) | (255.8) |
| Foreign exchange | 28.4 | (1.9) |
| At 31 March | (400.1) | (302.6) |
| Net book value at 31 March | 141.3 | 290.4 |

Notes to the financial statements continued

12. Goodwill continued

Goodwill as at 31 March 2014 was allocated across various CGUs in the following segments: EMEA Services (three), Global Products (two) and US Services (one).

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

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

US Services CGU

A strategic review was announced in May 2013 to determine the route to maximise the performance and value of US Services. This concluded with the decision to dispose of the CGU and a sale was agreed post year end (see note 33). As at 31 March 2014 the Group intended to realise value from US Services via sale rather than use. An impairment loss has been recognised at year end based on a comparison of the US Services goodwill with its recoverable amount, being fair value less costs to sell. Fair value has been determined by taking the initial cash consideration for the disposal of \$165m together with a potential earn out of up to \$50m in cash. The earn out is scheduled to be payable no earlier than 1 April 2015 on a sliding scale between zero and \$50m based on gross profit generated by the US Services division between \$100m and \$132m in the financial year ending 31 March 2015. Management estimates have been used to determine the value of the likely earn out. The re-measurement to fair value less costs to sell resulted in an impairment loss of £84.0m. The carrying value of goodwill for this CGU as at 31 March 2014, after impairment, was £41.4m and its net operating assets excluding goodwill were £55.6m.

The Cyveillance® business, which previously formed part of US Services, was excluded from the strategic review and was separated out from US Services during 2014. Goodwill of £4.6m was allocated to this new CGU and it has significant headroom as at 31 March 2014. An increase in the discount rate or a decrease in the terminal growth rate by 1% would not cause the net operating assets to exceed their recoverable amount. The CGU sits within EMEA Services.

Key assumptions for other CGUs

Cash flows

The value-in-use calculations generally use discounted future cash flows based on financial plans approved by the Board covering a two-year period. Discounted cash flows for the US Global Products CGU were based on a Board-approved three-year plan, reflecting increases in revenue from new product lines. Cash flows for periods beyond these periods are extrapolated based on the last year of the plans, with a terminal growth-rate assumption applied.

Terminal growth rates

The specific plans for each of the CGUs have been extrapolated using a terminal growth rate of 2.0% – 3.0% (2013: 2.0% – 3.0%). Growth rates are based on management's estimates which take into consideration the long-term nature of the industry in which the CGUs operate and external forecasts as to the likely growth of the industry in the longer term.

Discount rates

The Group's weighted average cost of capital was used as a basis in determining the discount rate to be applied adjusted for risks specific to the market characteristics of CGUs as appropriate on a pre-tax basis. This is considered to appropriately estimate a market participant discount rate. The pre-tax discount rates applied for the three EMEA Services CGUs were 11.5%, 15.6% and 18.3% and for the Global Products CGUs 10.1% and 11.4%.

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.

The performance of Global Products was impacted by the drawdown of overseas US military forces. The value in use of the US Global Products CGU, calculated using the key assumptions discussed above, was lower than the carrying value of the CGU's net operating assets which resulted in an impairment of £41.9m. Sensitivity analysis shows that a 33% decrease in the terminal year cash flow would result in an increase in the impairment charge of £24.4m. Sensitivity analysis also shows that a decrease or increase of 1% in the discount rate assumption would result in an impairment of £25.6m or £53.3m respectively. Sensitivity analysis also shows that a decrease or increase of 1% in the terminal growth rate would result in an impairment of £52.5m or £27.9m. The carrying value of goodwill for this CGU as at 31 March 2014, after impairment, was £60.0m and its net operating assets excluding goodwill were £12.8m.

The UK Global Products CGU and the individual CGUs within EMEA Services all have significant headroom. An increase in the discount rate or a decrease in the terminal growth rate by 1% would not cause the net operating assets to exceed their recoverable amount. The carrying value of goodwill for the UK Global Products CGU as at 31 March was £5.5m. The carrying values of goodwill for the three EMEA Services CGUs as at 31 March were £27.5m, £2.3m and £4.6m. The Directors have not identified any other likely changes in other significant assumptions between 31 March 2014 and the signing of the financial statements that would cause the carrying value of the recognised goodwill to exceed its recoverable amount.

13. Intangible assets

Year ended 31 March 2014

| all figures in £ million | Acquired intangible assets | | | Development costs | Other intangible assets | Total |
|--|----------------------------|-----------------------|-------------|-------------------|-------------------------|--------------|
| | Customer relationships | Intellectual property | Brand names | | | |
| Cost | | | | | | |
| At 1 April 2013 | 155.2 | 57.3 | 10.1 | 14.8 | 36.5 | 273.9 |
| Additions – internally developed | – | – | – | 2.1 | – | 2.1 |
| Additions – purchased | – | – | – | – | 0.5 | 0.5 |
| Disposals | – | – | – | – | (1.0) | (1.0) |
| Transfers | – | – | – | 0.1 | 0.2 | 0.3 |
| Foreign exchange | (13.8) | (3.8) | (0.9) | – | (0.4) | (18.9) |
| At 31 March 2014 | 141.4 | 53.5 | 9.2 | 17.0 | 35.8 | 256.9 |
| Amortisation and impairment | | | | | | |
| At 1 April 2013 | 107.8 | 51.0 | 7.8 | 14.2 | 35.3 | 216.1 |
| Amortisation charge for year | 7.5 | 2.4 | 1.1 | 0.3 | 0.7 | 12.0 |
| Disposals | – | – | – | – | (0.9) | (0.9) |
| Foreign exchange | (9.8) | (3.5) | (0.8) | – | (0.4) | (14.5) |
| At 31 March 2014 | 105.5 | 49.9 | 8.1 | 14.5 | 34.7 | 212.7 |
| Net book value at 31 March 2014 | 35.9 | 3.6 | 1.1 | 2.5 | 1.1 | 44.2 |

Year ended 31 March 2013

| all figures in £ million | Acquired intangible assets | | | Development costs | Other intangible assets | Total |
|--|----------------------------|-----------------------|-------------|-------------------|-------------------------|--------------|
| | Customer relationships | Intellectual property | Brand names | | | |
| Cost | | | | | | |
| At 1 April 2012 | 147.7 | 55.2 | 9.6 | 14.4 | 36.6 | 263.5 |
| Additions – internally developed | – | – | – | 0.3 | – | 0.3 |
| Additions – purchased | – | – | – | – | 0.3 | 0.3 |
| Disposals | – | – | – | – | (1.2) | (1.2) |
| Transfers | – | – | – | 0.1 | 0.5 | 0.6 |
| Foreign exchange | 7.5 | 2.1 | 0.5 | – | 0.3 | 10.4 |
| At 31 March 2013 | 155.2 | 57.3 | 10.1 | 14.8 | 36.5 | 273.9 |
| Amortisation and impairment | | | | | | |
| At 1 April 2012 | 92.8 | 46.5 | 6.0 | 13.3 | 33.1 | 191.7 |
| Amortisation charge for year | 10.0 | 2.6 | 1.4 | 0.9 | 3.1 | 18.0 |
| Disposals | – | – | – | – | (1.2) | (1.2) |
| Foreign exchange | 5.0 | 1.9 | 0.4 | – | 0.3 | 7.6 |
| At 31 March 2013 | 107.8 | 51.0 | 7.8 | 14.2 | 35.3 | 216.1 |
| Net book value at 31 March 2013 | 47.4 | 6.3 | 2.3 | 0.6 | 1.2 | 57.8 |

Notes to the financial statements continued

14. Property, plant and equipment

Year ended 31 March 2014

| all figures in £ million | Land and buildings | Plant, machinery and vehicles | Computers and office equipment | Assets under construction | Total |
|--|--------------------|-------------------------------|--------------------------------|---------------------------|--------------|
| Cost | | | | | |
| At 1 April 2013 | 320.0 | 163.1 | 53.1 | 17.8 | 554.0 |
| Additions | 0.1 | 1.4 | 1.1 | 21.6 | 24.2 |
| Disposals | (2.7) | (1.8) | (4.9) | (6.4) | (15.8) |
| Transfers | 1.5 | 3.5 | 2.9 | (8.1) | (0.2) |
| Foreign exchange | (1.3) | (1.7) | (2.2) | – | (5.2) |
| At 31 March 2014 | 317.6 | 164.5 | 50.0 | 24.9 | 557.0 |
| Depreciation | | | | | |
| At 1 April 2013 | 140.5 | 130.8 | 41.3 | – | 312.6 |
| Charge for year | 9.8 | 9.8 | 4.4 | – | 24.0 |
| Impairment reversal | (1.4) | – | – | – | (1.4) |
| Disposals | (2.2) | (1.7) | (4.5) | – | (8.4) |
| Foreign exchange | (0.8) | (1.4) | (1.4) | – | (3.6) |
| At 31 March 2014 | 145.9 | 137.5 | 39.8 | – | 323.2 |
| Net book value at 31 March 2014 | 171.7 | 27.0 | 10.2 | 24.9 | 233.8 |

The prior year impairment charge of £4.0m has been reversed by £1.4m in the current year reflecting the fact that new tenancies have been signed for previously vacant owned properties.

Year ended 31 March 2013

| all figures in £ million | Land and buildings | Plant, machinery and vehicles | Computers and office equipment | Assets under construction | Total |
|--|--------------------|-------------------------------|--------------------------------|---------------------------|--------------|
| Cost | | | | | |
| At 1 April 2012 | 307.8 | 153.6 | 48.6 | 18.4 | 528.4 |
| Additions | 0.3 | 1.5 | 0.6 | 24.7 | 27.1 |
| Disposals | (1.1) | (3.1) | (2.8) | (4.9) | (11.9) |
| Transfers | 4.0 | 10.2 | 5.7 | (20.5) | (0.6) |
| Transfer from 'assets classified as held for sale' | 8.4 | – | – | – | 8.4 |
| Foreign exchange | 0.6 | 0.9 | 1.0 | 0.1 | 2.6 |
| At 31 March 2013 | 320.0 | 163.1 | 53.1 | 17.8 | 554.0 |
| Depreciation | | | | | |
| At 1 April 2012 | 121.6 | 121.3 | 38.9 | – | 281.8 |
| Charge for year | 11.8 | 11.8 | 4.4 | – | 28.0 |
| Impairment | 4.0 | – | – | – | 4.0 |
| Disposals | (0.8) | (2.9) | (2.6) | – | (6.3) |
| Transfers | 0.1 | – | (0.1) | – | – |
| Transfer from 'assets classified as held for sale' | 3.3 | – | – | – | 3.3 |
| Foreign exchange | 0.5 | 0.6 | 0.7 | – | 1.8 |
| At 31 March 2013 | 140.5 | 130.8 | 41.3 | – | 312.6 |
| Net book value at 31 March 2013 | 179.5 | 32.3 | 11.8 | 17.8 | 241.4 |

Under the terms of the Business Transfer Agreement with the MOD, certain restrictions have been placed on freehold land and buildings, and certain plant and machinery related to them. These restrictions are detailed in note 29.

15. Non-current investments

As at 31 March

| | 2014 | | 2013 | |
|--|--|--|--|--|
| | Joint venture and associates financial results | Group net share of joint ventures and associates | Joint venture and associates financial results | Group net share of joint ventures and associates |
| all figures in £ million | | | | |
| Non-current assets | 0.3 | 0.1 | 0.3 | 0.1 |
| Current assets | 4.2 | 2.0 | 2.3 | 1.1 |
| | 4.5 | 2.1 | 2.6 | 1.2 |
| Current liabilities | (3.4) | (1.6) | (2.0) | (0.9) |
| Non-current liabilities | (0.3) | (0.1) | – | – |
| | (3.7) | (1.7) | (2.0) | (0.9) |
| Net assets of joint ventures and associates | 0.8 | 0.4 | 0.6 | 0.3 |
| Other non-current investments | – | 0.1 | – | 0.1 |
| Total | 0.8 | 0.5 | 0.6 | 0.4 |

During the year ended 31 March 2014, there were sales to associates of £3.3m (2013: £nil). At the year end there were outstanding receivables from associates of £0.1m (2013: £nil).

16. Deferred tax

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

Movements in the deferred tax assets and liabilities are shown below:

Year ended 31 March 2014

Deferred tax asset

| | Pension liability | Hedging | Short-term timing differences | Total |
|--|-------------------|--------------|-------------------------------|-------------|
| all figures in £ million | | | | |
| At 1 April 2013 | 13.7 | – | 29.9 | 43.6 |
| Released through income statement | (13.0) | – | (4.7) | (17.7) |
| Created through equity | 1.2 | (0.1) | – | 1.1 |
| Prior-year adjustment | 0.1 | – | 1.4 | 1.5 |
| Foreign exchange | – | – | (2.8) | (2.8) |
| Transfer to current tax | – | – | 3.8 | 3.8 |
| Deferred tax impact of change in rates | (0.7) | – | – | (0.7) |
| Gross deferred tax asset at 31 March 2014 | 1.3 | (0.1) | 27.6 | 28.8 |
| Less: liability available for offset | | | | (10.7) |
| Net deferred tax asset at 31 March 2014 | | | | 18.1 |

Deferred tax liability

| | Accelerated capital allowances | Amortisation | Total |
|--|--------------------------------|--------------|---------------|
| all figures in £ million | | | |
| At 1 April 2013 | 0.6 | (11.8) | (11.2) |
| (Released)/created through the income statement | (17.7) | 2.6 | (15.1) |
| Prior year adjustment | (0.3) | – | (0.3) |
| Foreign exchange | 0.1 | 1.0 | 1.1 |
| Deferred tax impact of change in rates | (0.2) | – | (0.2) |
| Gross deferred tax liability at 31 March 2014 | (17.5) | (8.2) | (25.7) |
| Less: asset available for offset | | | 10.7 |
| Net deferred tax liability at 31 March 2014 | | | (15.0) |

At the balance sheet date the Group had unused tax losses of £191.4m (2013: £202.7m) potentially available for offset against future profits. No deferred tax asset has been recognised in respect of this amount because of uncertainty over the timing of its utilisation. These losses can be carried forward indefinitely.

Notes to the financial statements continued

16. Deferred tax continued

Year ended 31 March 2013

Deferred tax asset

| all figures in £ million | Pension liability | Accelerated capital allowances | Short-term timing differences | Total |
|--|-------------------|--------------------------------|-------------------------------|-------------|
| At 1 April 2012 | 13.3 | 3.1 | 34.2 | 50.6 |
| Released through income statement | (9.2) | (2.3) | (5.9) | (17.4) |
| Created through equity | 10.1 | – | – | 10.1 |
| Prior-year adjustment | – | (0.1) | 0.3 | 0.2 |
| Foreign exchange | – | – | 1.9 | 1.9 |
| Transfer to current tax | – | – | (0.6) | (0.6) |
| Deferred tax impact of change in rates | (0.5) | (0.1) | – | (0.6) |
| Gross deferred tax asset at 31 March 2013 | 13.7 | 0.6 | 29.9 | 44.2 |
| Less: liability available for offset | | | | (11.8) |
| Net deferred tax asset at 31 March 2013 | | | | 32.4 |

Deferred tax liability

| all figures in £ million | Amortisation | Total |
|--|---------------|---------------|
| At 1 April 2012 | (33.6) | (33.6) |
| Created through the income statement | 23.8 | 23.8 |
| Foreign exchange | (2.0) | (2.0) |
| Gross deferred tax liability at 31 March 2013 | (11.8) | (11.8) |
| Less: asset available for offset | | 11.8 |
| Net deferred tax liability at 31 March 2013 | | – |

17. Inventories

As at 31 March

| all figures in £ million | 2014 | 2013 |
|--------------------------|-------------|-------------|
| Raw materials | 11.4 | 16.5 |
| Work in progress | 4.8 | 4.7 |
| Finished goods | 3.6 | 4.3 |
| | 19.8 | 25.5 |

18. Current asset investments

As at 31 March

| all figures in £ million | 2014 | 2013 |
|--------------------------------------|------------|------------|
| Available-for-sale investment | 2.1 | 1.4 |

At 31 March 2014 the Group held a 4.9% shareholding in pSivida Limited (31 March 2013: 4.9%), a company listed on NASDAQ and the Australian and Frankfurt Stock Exchanges. The investment is held at fair value of £2.1m (2013: £1.4m) using the closing share price at 31 March 2014 of AUS\$4.32 per share (31 March 2013: AUS\$2.22 per share).

19. Trade and other receivables

As at 31 March

| all figures in £ million | 2014 | 2013 |
|-------------------------------------|--------------|--------------|
| Trade receivables | 136.3 | 143.4 |
| Amounts recoverable under contracts | 90.0 | 112.2 |
| Other receivables | 12.5 | 15.2 |
| Prepayments | 11.7 | 13.4 |
| | 250.5 | 284.2 |

In determining the recoverability of trade receivables, the Group considers any changes in the credit quality of the trade receivable from the date credit was granted to the reporting date. Credit risk is limited as a result of the high percentage of revenue derived from UK and US defence and other government agencies. Accordingly, the Directors believe that no credit provision in excess of the allowance for doubtful debts is required. As at 31 March 2014 the Group carried a provision for doubtful debts of £2.9m (2013: £1.9m).

Ageing of past due but not impaired receivables

| all figures in £ million | 2014 | 2013 |
|--------------------------|-------------|-------------|
| Up to three months | 43.7 | 37.1 |
| Over three months | 3.7 | 3.4 |
| | 47.4 | 40.5 |

Movements in the doubtful debt provision

| all figures in £ million | 2014 | 2013 |
|--------------------------|------------|------------|
| At 1 April | 1.9 | 4.0 |
| Created | 1.9 | 0.7 |
| Released | (0.9) | (1.9) |
| Utilised | – | (0.9) |
| At 31 March | 2.9 | 1.9 |

The maximum exposure to credit risk in relation to trade receivables at the reporting date is the fair value of trade receivables. The Group does not hold any collateral as security.

20. Trade and other payables

| As at 31 March | 2014 | 2013 |
|---|--------------|--------------|
| all figures in £ million | | |
| Trade payables | 42.6 | 43.7 |
| Other tax and social security | 30.1 | 25.9 |
| Other payables | 11.8 | 16.9 |
| Accruals and deferred income | 341.1 | 371.5 |
| Total current trade and other payables | 425.6 | 458.0 |
| Payments received on account | 8.3 | 7.0 |
| Other payables | 2.9 | 0.6 |
| Total non-current trade and other payables | 11.2 | 7.6 |
| Total trade and other payables | 436.8 | 465.6 |

21. Provisions

Year ended 31 March 2014

| all figures in £ million | Restructuring | Property | Other | Total |
|--------------------------|---------------|-------------|------------|-------------|
| At 1 April 2013 | 15.3 | 13.6 | 6.2 | 35.1 |
| Created in year | 0.9 | 1.5 | 1.9 | 4.3 |
| Released in year | – | (1.2) | (1.4) | (2.6) |
| Unwind of discount | – | 0.4 | – | 0.4 |
| Utilised in year | (10.3) | (1.7) | (0.2) | (12.2) |
| Foreign exchange | (0.9) | – | – | (0.9) |
| At 31 March 2014 | 5.0 | 12.6 | 6.5 | 24.1 |
| Current liability | 1.6 | 3.0 | 0.2 | 4.8 |
| Non-current liability | 3.4 | 9.6 | 6.3 | 19.3 |
| At 31 March 2014 | 5.0 | 12.6 | 6.5 | 24.1 |

Restructuring provisions relate mainly to cost reduction initiatives in the US and include redundancy and vacant property provisions. Redundancy provisions are expected to be utilised within 12 months and provisions in respect of vacant property will be utilised in line with the remaining lease period. Lease periods extend out to 2019.

Property provisions, other than those relating to restructuring discussed above, relate to under-utilised properties in the UK. The extent of the provision is affected by the timing of when properties can be sub-let and the proportion of space that can be sub-let. Based on current assessment the provision will be utilised within 12 years.

Other provisions relate to environmental and other liabilities, the magnitude and timing of utilisation of which are determined by a variety of factors.

Notes to the financial statements continued

22. Net cash/debt

As at 31 March

| all figures in £ million | 2014 | | | 2013 | | |
|---|--------------|----------------|----------------|--------------|----------------|----------------|
| | Assets | Liabilities | Net | Assets | Liabilities | Net |
| Current financial assets/(liabilities) | | | | | | |
| Deferred financing costs | – | 0.5 | 0.5 | – | 0.6 | 0.6 |
| Borrowings | – | 0.5 | 0.5 | – | 0.6 | 0.6 |
| Derivative financial instruments | 0.3 | (0.1) | 0.2 | 0.1 | (0.2) | (0.1) |
| Finance lease debtor/(creditor) | 2.8 | (2.6) | 0.2 | 2.5 | (2.4) | 0.1 |
| Total current financial assets/(liabilities) | 3.1 | (2.2) | 0.9 | 2.6 | (2.0) | 0.6 |
| Non-current assets/(liabilities) | | | | | | |
| US\$ private placement notes – 7.13% | – | (26.6) | (26.6) | – | (29.2) | (29.2) |
| US\$ private placement notes – 5.50% | – | (29.2) | (29.2) | – | (32.1) | (32.1) |
| US\$ private placement notes – 7.62% | – | (96.9) | (96.9) | – | (106.4) | (106.4) |
| Deferred financing costs | – | – | – | – | 0.5 | 0.5 |
| Borrowings | – | (152.7) | (152.7) | – | (167.2) | (167.2) |
| Derivative financial instruments | 0.1 | – | 0.1 | – | (0.1) | (0.1) |
| Finance lease debtor/(creditor) | 1.4 | (1.4) | – | 4.3 | (4.0) | 0.3 |
| Total non-current financial assets/(liabilities) | 1.5 | (154.1) | (152.6) | 4.3 | (171.3) | (167.0) |
| Cash | 53.7 | – | 53.7 | 32.6 | – | 32.6 |
| Cash equivalents | 268.5 | – | 268.5 | 207.8 | – | 207.8 |
| Total cash and cash equivalents | 322.2 | – | 322.2 | 240.4 | – | 240.4 |
| Total net cash as defined by the Group | | | 170.5 | | | 74.0 |

At 31 March 2014 £2.2m (2013: £2.7m) of cash was held by the Group's captive insurance subsidiary, including £0.1m (2013: £0.2m) that was restricted in its use.

All US\$ private placement notes have been issued as fixed-rate bonds and have not been converted to floating-rate. Further analysis of the terms and maturity dates for financial liabilities are set out in note 24.

Reconciliation of net cash flow to movement in net cash/debt

| all figures in £ million | 2014 | 2013 |
|--|--------------|--------------|
| Increase in cash and cash equivalents in the year | 85.9 | 121.6 |
| Repayment of US\$ private placement notes | – | 63.0 |
| Settlement of forward contracts | – | 1.3 |
| Capital element of finance lease payments | 2.8 | 2.8 |
| Capital element of finance lease receipts | (3.0) | (3.0) |
| Change in net cash/debt resulting from cash flows | 85.7 | 185.7 |
| Amortisation of deferred financing costs | (0.6) | (0.5) |
| Finance lease receivables | 0.4 | 0.7 |
| Finance lease payables | (0.4) | (0.6) |
| Foreign exchange and other non-cash movements | 11.4 | 10.9 |
| Movement in net cash/debt in year | 96.5 | 196.2 |
| Net cash/(debt) at beginning of year | 74.0 | (122.2) |
| Net cash at 31 March | 170.5 | 74.0 |

Finance leases

Group as a lessor

The minimum lease receivables under finance leases fall as follows:

| all figures in £ million | Minimum lease payments | | Present value of minimum lease payments | |
|--|------------------------|------------|---|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Amounts receivable under finance leases | | | | |
| Within one year | 3.0 | 3.0 | 2.8 | 2.5 |
| In the second to fifth years inclusive | 1.5 | 4.5 | 1.4 | 4.3 |
| | 4.5 | 7.5 | 4.2 | 6.8 |
| Less: unearned finance income | (0.3) | (0.7) | – | – |
| Present value of minimum lease payments | 4.2 | 6.8 | 4.2 | 6.8 |

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

Group as a lessee

The minimum lease payments under finance leases fall due as follows:

| all figures in £ million | Minimum lease payments | | Present value of minimum lease payments | |
|--|------------------------|------------|---|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Amounts payable under finance leases | | | | |
| Within one year | 2.8 | 2.8 | 2.6 | 2.4 |
| In the second to fifth years inclusive | 1.4 | 4.2 | 1.4 | 4.0 |
| | 4.2 | 7.0 | 4.0 | 6.4 |
| Less future finance charges | (0.2) | (0.6) | – | – |
| Present value of minimum lease payments | 4.0 | 6.4 | 4.0 | 6.4 |
| Classified as follows: | | | | |
| Financial liability – current | | | 2.6 | 2.4 |
| Financial liability – non-current | | | 1.4 | 4.0 |
| | | | 4.0 | 6.4 |

The Group utilises certain buildings under finance leases. Average lease terms are typically between two and ten years (31 March 2013: between two and ten years).

23. Operating leases

Group as a lessor

The Group receives rental income on certain properties. Primarily these are properties partially occupied by Group companies, with vacant space sub-let to third-party tenants. The Group had contracted with tenants for the following future minimum lease payments:

| all figures in £ million | 2014 | 2013 |
|--|-------------|-------------|
| Within one year | 8.3 | 7.8 |
| In the second to fifth years inclusive | 22.0 | 23.8 |
| Greater than five years | 6.6 | 3.4 |
| | 36.9 | 35.0 |

Group as a lessee

| all figures in £ million | 2014 | 2013 |
|---|-------------|-------------|
| Lease and sub-lease income statement expense – minimum lease payments | 18.9 | 23.1 |

The Group had the following total future minimum lease payment commitments:

| all figures in £ million | 2014 | 2013 |
|--|-------------|--------------|
| Within one year | 17.8 | 21.4 |
| In the second to fifth years inclusive | 44.1 | 58.1 |
| Greater than five years | 18.2 | 20.5 |
| | 80.1 | 100.0 |

Operating lease payments represent rentals payable by the Group on certain property, plant and equipment. Principal operating leases are negotiated for a term of approximately ten years.

Notes to the financial statements continued

24. Financial risk management

The Group's international operations and debt financing expose it to financial risks that include the effects of changes in foreign exchange rates, interest rates, credit risks and liquidity risks.

Treasury and risk management policies, which are set by the Board, specify guidelines on financial risks and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives and interest rate derivatives. Group treasury monitors financial risks and compliance with risk management policies. There have been no changes in any risk management policies since the year end.

A) Fair values of financial instruments

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

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

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

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

The following table presents the Group's assets and liabilities that are measured at fair value at 31 March 2014:

| all figures in £ million | Note | Level 1 | Level 2 | Level 3 | Total |
|--|------|------------|------------|------------|------------|
| Assets | | | | | |
| Current other investments | 18 | 2.1 | – | – | 2.1 |
| Current derivative financial instruments | 22 | – | 0.3 | – | 0.3 |
| Non-current other investments | | – | – | 0.1 | 0.1 |
| Non-current derivative financial instruments | 22 | – | 0.1 | – | 0.1 |
| Liabilities | | | | | |
| Current derivative financial instruments | 22 | – | (0.1) | – | (0.1) |
| Total | | 2.1 | 0.3 | 0.1 | 2.5 |

The following table presents the Group's assets and liabilities that are measured at fair value at 31 March 2013:

| all figures in £ million | Note | Level 1 | Level 2 | Level 3 | Total |
|--|------|------------|--------------|------------|------------|
| Assets | | | | | |
| Current other investments | 18 | 1.4 | – | – | 1.4 |
| Current derivative financial instruments | 22 | – | 0.1 | – | 0.1 |
| Non-current other investments | | – | – | 0.1 | 0.1 |
| Liabilities | | | | | |
| Current derivative financial instruments | 22 | – | (0.2) | – | (0.2) |
| Non-current derivative financial instruments | 22 | – | (0.1) | – | (0.1) |
| Total | | 1.4 | (0.2) | 0.1 | 1.3 |

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.

The following table presents the fair value of the Group's assets and liabilities that have a fair value that is different from the carrying value at 31 March 2014:

| all figures in £ million | Level 1 | Level 2 | Level 3 | Total |
|---------------------------------------|----------|----------------|----------|----------------|
| Assets | | | | |
| Finance leases | – | 4.4 | – | 4.4 |
| Liabilities | | | | |
| Finance leases | – | (4.2) | – | (4.2) |
| Non-current bank and other borrowings | – | (175.5) | – | (175.5) |
| Total | – | (175.3) | – | (175.3) |

The following table presents the fair value of the Group's assets and liabilities that have a fair value that is different from the carrying value at 31 March 2013:

| all figures in £ million | Level 1 | Level 2 | Level 3 | Total |
|---------------------------------------|----------|----------------|----------|----------------|
| Assets | | | | |
| Finance leases | – | 7.4 | – | 7.4 |
| Liabilities | | | | |
| Finance leases | – | (7.0) | – | (7.0) |
| Non-current bank and other borrowings | – | (197.7) | – | (197.7) |
| Total | – | (197.3) | – | (197.3) |

All financial assets and liabilities have a fair value that is identical to book value at 31 March 2014 and 31 March 2013 except where noted below:

As at 31 March 2014

| all figures in £ million | Note | Available for sale | Loans and receivables | Financial liabilities at amortised cost | Derivatives used as hedges | Total carrying value | Total fair value |
|------------------------------------|------|-----------------------|--------------------------|--|----------------------------------|----------------------------|------------------------|
| Financial assets | | | | | | | |
| Non-current | | | | | | | |
| Finance leases | 22 | – | 1.4 | – | – | 1.4 | 1.5 |
| Derivative financial instruments | 22 | – | – | – | 0.1 | 0.1 | 0.1 |
| Other investments | 15 | 0.1 | – | – | – | 0.1 | 0.1 |
| Current | | | | | | | |
| Finance leases | 22 | – | 2.8 | – | – | 2.8 | 2.9 |
| Trade and other receivables | 19 | – | 250.5 | – | – | 250.5 | 250.5 |
| Derivative financial instruments | 22 | – | – | – | 0.3 | 0.3 | 0.3 |
| Current asset investments | 18 | 2.1 | – | – | – | 2.1 | 2.1 |
| Cash and cash equivalents | 22 | – | 322.2 | – | – | 322.2 | 322.2 |
| Total financial assets | | 2.2 | 576.9 | – | 0.4 | 579.5 | 579.7 |
| Financial liabilities | | | | | | | |
| Non-current | | | | | | | |
| Trade and other payables | 20 | – | – | (11.2) | – | (11.2) | (11.2) |
| Bank and other borrowings | 22 | – | – | (152.7) | – | (152.7) | (175.5) |
| Finance leases | 22 | – | – | (1.4) | – | (1.4) | (1.4) |
| Current | | | | | | | |
| Trade and other payables | 20 | – | – | (425.6) | – | (425.6) | (425.6) |
| Derivative financial instruments | 22 | – | – | – | (0.1) | (0.1) | (0.1) |
| Finance leases | 22 | – | – | (2.6) | – | (2.6) | (2.8) |
| Deferred financing costs | 22 | – | – | 0.5 | – | 0.5 | 0.5 |
| Total financial liabilities | | – | – | (593.0) | (0.1) | (593.1) | (616.1) |
| Total | | 2.2 | 576.9 | (593.0) | 0.3 | (13.6) | (36.4) |

Notes to the financial statements continued

24. Financial risk management continued

As at 31 March 2013

| all figures in £ million | Note | Available for sale | Loans and receivables | Financial liabilities at amortised cost | Derivatives used as hedges | Total carrying value | Total fair value |
|------------------------------------|------|-----------------------|--------------------------|--|----------------------------------|----------------------------|------------------------|
| Financial assets | | | | | | | |
| Non-current | | | | | | | |
| Finance leases | 22 | – | 4.3 | – | – | 4.3 | 4.4 |
| Other investments | 15 | 0.1 | – | – | – | 0.1 | 0.1 |
| Current | | | | | | | |
| Finance leases | 22 | – | 2.5 | – | – | 2.5 | 3.0 |
| Trade and other receivables | 19 | – | 284.2 | – | – | 284.2 | 284.2 |
| Derivative financial instruments | 22 | – | – | – | 0.1 | 0.1 | 0.1 |
| Current asset investments | 18 | 1.4 | – | – | – | 1.4 | 1.4 |
| Cash and cash equivalents | 22 | – | 240.4 | – | – | 240.4 | 240.4 |
| Total financial assets | | 1.5 | 531.4 | – | 0.1 | 533.0 | 533.6 |
| Financial liabilities | | | | | | | |
| Non-current | | | | | | | |
| Trade and other payables | 20 | – | – | (7.6) | – | (7.6) | (7.6) |
| Bank and other borrowings | 22 | – | – | (167.2) | – | (167.2) | (197.7) |
| Finance leases | 22 | – | – | (4.0) | – | (4.0) | (4.2) |
| Derivative financial instruments | 22 | – | – | – | (0.1) | (0.1) | (0.1) |
| Current | | | | | | | |
| Trade and other payables | 20 | – | – | (458.0) | – | (458.0) | (458.0) |
| Derivative financial instruments | 22 | – | – | – | (0.2) | (0.2) | (0.2) |
| Finance leases | 22 | – | – | (2.4) | – | (2.4) | (2.8) |
| Deferred financing costs | 22 | – | – | 0.6 | – | 0.6 | 0.6 |
| Total financial liabilities | | – | – | (638.6) | (0.3) | (638.9) | (670.0) |
| Total | | 1.5 | 531.4 | (638.6) | (0.2) | (105.9) | (136.4) |

B) Interest rate risk

The Group operates an interest rate policy designed to optimise interest costs and to reduce volatility in reported earnings. The Group's current policy is to require rates to be fixed for 30%–80% of the level of borrowings, which is achieved primarily through fixed-rate borrowings. Where there are significant changes in the level and/or structure of debt, policy permits borrowings to be 100% fixed, with regular Board reviews of the appropriateness of this fixed percentage. At 31 March 2014 100% (2013: 100%) of the Group's borrowings were at fixed rates with no adjustment for interest rate swaps.

Financial assets/(liabilities)

As at 31 March 2014

| all figures in £ million | Financial asset | | | Financial liability | | |
|--------------------------|-----------------|--------------|----------------------|---------------------|----------|----------------------|
| | Fixed or capped | Floating | Non-interest bearing | Fixed or capped | Floating | Non-interest bearing |
| Sterling | 4.2 | 280.1 | 0.4 | (4.0) | – | (0.1) |
| US dollar | – | 30.5 | 0.1 | (152.7) | – | – |
| Euro | – | 2.3 | – | – | – | – |
| Australian dollar | – | 8.4 | 2.1 | – | – | – |
| Other | – | 0.9 | – | – | – | – |
| | 4.2 | 322.2 | 2.6 | (156.7) | – | (0.1) |

As at 31 March 2013

| all figures in £ million | Financial asset | | | Financial liability | | |
|--------------------------|-----------------|--------------|----------------------|---------------------|----------|----------------------|
| | Fixed or capped | Floating | Non-interest bearing | Fixed or capped | Floating | Non-interest bearing |
| Sterling | 6.8 | 219.6 | 0.1 | (6.4) | – | (0.3) |
| US dollar | – | 9.2 | 0.1 | (167.7) | – | – |
| Euro | – | 0.9 | – | – | – | – |
| Australian dollar | – | 8.2 | 1.4 | – | – | – |
| Other | – | 2.5 | – | – | – | – |
| | 6.8 | 240.4 | 1.6 | (174.1) | – | (0.3) |

Floating-rate financial assets attract interest based on the relevant national LIBID equivalent. Floating-rate financial liabilities bear interest at the relevant national LIBOR equivalent. Trade and other receivables/payables and deferred finance costs are excluded from this analysis.

For the fixed or capped-rate financial assets and liabilities, the average interest rates (including the relevant marginal cost of borrowing) and the average period for which the rates are fixed are:

| | 2014 | | | 2013 | | |
|------------------------------------|-----------------------|--|---------------------------------------|-----------------------|--|---------------------------------------|
| | Fixed or capped £m | Weighted average interest rate % | Weighted average years to maturity | Fixed or capped £m | Weighted average interest rate % | Weighted average years to maturity |
| Financial assets: | | | | | | |
| Sterling | 4.2 | 13.4 | 1.5 | 6.8 | 13.4 | 2.5 |
| Financial liabilities: | | | | | | |
| Sterling | (4.0) | 12.1 | 1.5 | (6.4) | 12.1 | 2.5 |
| US dollar | (152.7) | 7.1 | 3.9 | (167.7) | 7.1 | 4.9 |
| Total financial liabilities | (156.7) | 7.3 | 3.8 | (174.1) | 7.3 | 4.8 |

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

Interest rate risk management

The Group private placement borrowings are fixed-rate, while the revolving credit facility is floating-rate and undrawn as at 31 March 2014.

Notes to the financial statements continued

24. Financial risk management continued

C) Currency risk

Transactional currency exposure

The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that when such a sale or purchase is certain, the net foreign exchange exposure is hedged using forward foreign exchange contracts. Hedge accounting documentation and effectiveness testing are undertaken for all the Group's transactional hedge contracts.

The table below shows the Group's currency exposures, being exposures on currency transactions that give rise to net currency gains and losses recognised in the income statement. Such exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating company involved.

Functional currency of the operating company

| all figures in £ millions | Net foreign currency monetary assets/(liabilities) | | | | |
|---------------------------------|--|--------------|------------|------------|---------------|
| | US\$ | Euro | AUS\$ | Other | Total |
| 31 March 2014 – sterling | (18.1) | (2.2) | 2.1 | 0.6 | (17.6) |
| 31 March 2013 – sterling | 0.9 | (2.5) | 1.5 | 1.9 | 1.8 |

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

The Group enters into forward foreign currency contracts to hedge the currency exposures that arise on sales and purchases denominated in foreign currencies, as the transaction occurs. The principal contract amounts of the outstanding forward currency contracts as at 31 March 2014 against sterling are net US dollars sold £17.0m (US\$28.3m) and net euros sold £8.3m (€10.1m).

Translational currency exposure

The Group has significant investments in overseas operations, particularly in the US. As a result, the sterling value of the Group's balance sheet can be significantly affected by movement in exchange rates. The Group seeks to mitigate the effect of these translational exposures by matching the net investment in overseas operations with borrowings denominated in their functional currencies unless the cost of such hedging activity is uneconomic. This is achieved by borrowing in the local currency or, in some cases, indirectly through the use of forward foreign exchange contracts.

D) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by a Board-approved policy of only selecting counterparties with a strong investment grade long-term credit rating for cash deposits. In the normal course of business the Group operates notional cash pooling systems, where a legal right of set-off applies.

The maximum credit-risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables, totals £329.0m (2013: £248.8m). The Group held cash and cash equivalents of £322.2m at 31 March 2014 (2013: £240.4m), which represents the maximum credit exposure on these assets. The cash and cash equivalents were held with different financial institutions which were rated single A or better, although £218.5m (2013: £207.8m) was invested in AAA-rated money funds at the year end and £50m was invested in deposits collateralised by security, where the security was gilts.

E) Liquidity risk

Borrowing facilities

As at 31 March 2014 the Group had a revolving credit facility (RCF) of US\$250m and £118m (2013: US\$250m and £118m).

The RCF is contracted until 2016 and is un-utilised as shown in the table below:

| | Interest rate: LIBOR plus | Total £m | Drawn £m | Undrawn £m |
|--|------------------------------|-------------|-------------|---------------|
| Committed facilities 31 March 2014 | 1.20% | 267.9 | – | 267.9 |
| Freely available cash and cash equivalents | | | | 322.1 |
| Available funds 31 March 2014 | | | | 590.0 |
| Committed facilities 31 March 2013 | 1.20% | 282.8 | – | 282.8 |
| Freely available cash and cash equivalents | | | | 240.2 |
| Available funds 31 March 2013 | | | | 523.0 |

Gross contractual cash flows for borrowings and other financial liabilities

The following are the contractual maturities of financial liabilities, including interest payments. The cash flows associated with derivatives that are cash flow hedges are expected to have an impact on profit or loss in the periods shown.

As at 31 March 2014

| all figures in £ million | Book value | Contractual cash flows | 1 year or less | 1–2 years | 2–5 years | More than 5 years |
|---|----------------|------------------------|----------------|---------------|----------------|-------------------|
| Non-derivative financial liabilities | | | | | | |
| Trade and other payables | (436.8) | (436.8) | (425.6) | (11.2) | – | – |
| US private placement debt | (152.7) | (195.8) | (10.6) | (37.0) | (148.2) | – |
| Recapitalisation fee | 0.5 | – | – | – | – | – |
| Finance leases | (4.0) | (4.2) | (2.8) | (1.4) | – | – |
| Derivative financial liabilities | | | | | | |
| Forward foreign currency contracts – cash flow hedges | (0.1) | (0.1) | (0.1) | – | – | – |
| | (593.1) | (636.9) | (439.1) | (49.6) | (148.2) | – |

As at 31 March 2013

| all figures in £ million | Book value | Contractual cash flows | 1 year or less | 1–2 years | 2–5 years | More than 5 years |
|---|----------------|------------------------|----------------|---------------|---------------|-------------------|
| Non-derivative financial liabilities | | | | | | |
| Trade and other payables | (465.6) | (465.6) | (458.0) | (7.6) | – | – |
| US private placement debt | (167.7) | (226.8) | (11.6) | (11.6) | (89.8) | (113.8) |
| Recapitalisation fee | 1.1 | – | – | – | – | – |
| Finance leases | (6.4) | (7.0) | (2.8) | (2.8) | (1.4) | – |
| Derivative financial liabilities | | | | | | |
| Forward foreign currency contracts – cash flow hedges | (0.3) | (0.3) | (0.2) | (0.1) | – | – |
| | (638.9) | (699.7) | (472.6) | (22.1) | (91.2) | (113.8) |

F) Derivative financial instruments

As at 31 March

| all figures in £ million | 2014 | | | 2013 | | |
|---|-------------|------------------|------------|-------------|------------------|--------------|
| | Asset gains | Liability losses | Net | Asset gains | Liability losses | Net |
| Forward foreign currency contracts – cash flow hedges | 0.4 | (0.1) | 0.3 | 0.1 | (0.3) | (0.2) |
| Derivative assets/(liabilities) at the end of the year | 0.4 | (0.1) | 0.3 | 0.1 | (0.3) | (0.2) |

As at 31 March

| all figures in £ million | 2014 | | | 2013 | | |
|---|-------------|------------------|------------|-------------|------------------|--------------|
| | Asset gains | Liability losses | Net | Asset gains | Liability losses | Net |
| Expected to be recognised: | | | | | | |
| In one year or less | 0.3 | (0.1) | 0.2 | 0.1 | (0.2) | (0.1) |
| Between one and two years | 0.1 | – | 0.1 | – | (0.1) | (0.1) |
| Derivative assets/(liabilities) at the end of the year | 0.4 | (0.1) | 0.3 | 0.1 | (0.3) | (0.2) |

Notes to the financial statements continued

24. Financial risk management continued

G) Maturity of financial liabilities

As at 31 March 2014

| all figures in £ million | Trade and other payables | Bank borrowings and loan notes | Finance leases and derivative financial instruments | Total |
|---|--------------------------|--------------------------------|---|--------------|
| Due in one year or less | 425.6 | (0.5) | 2.7 | 427.8 |
| Due in more than one year but not more than two years | 11.2 | 26.6 | 1.4 | 39.2 |
| Due in more than two years but not more than five years | – | 126.1 | – | 126.1 |
| Due in more than five years | – | – | – | – |
| | 436.8 | 152.2 | 4.1 | 593.1 |

As at 31 March 2013

| all figures in £ million | Trade and other payables | Bank borrowings and loan notes | Finance leases and derivative financial instruments | Total |
|---|--------------------------|--------------------------------|---|--------------|
| Due in one year or less | 458.0 | (0.6) | 2.6 | 460.0 |
| Due in more than one year but not more than two years | 7.6 | (0.5) | 2.8 | 9.9 |
| Due in more than two years but not more than five years | – | 61.3 | 1.3 | 62.6 |
| Due in more than five years | – | 106.4 | – | 106.4 |
| | 465.6 | 166.6 | 6.7 | 638.9 |

H) Sensitivity analysis

The Group's sensitivity to changes in foreign exchange rates and interest rates on financial assets and liabilities as at 31 March 2014 is set out in the following table. The impact of a weakening in sterling on the Group's financial assets and liabilities would be more than offset in equity and income by its impact on the Group's overseas net assets and earnings respectively. Sensitivity on Group assets other than financial assets and liabilities is not included in this analysis.

The amounts generated from the sensitivity analysis are forward-looking estimates of market risk assuming that certain market conditions occur. Actual results in the future may differ materially from those projected as a result of developments in the global financial markets that may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the following table, which should not, therefore, be considered to be a projection of likely future events and losses.

The estimated changes for interest rate movements are based on an instantaneous decrease or increase of 1% (100 basis points) in the specific rate of interest applicable to each class of financial instruments from the levels effective at 31 March 2014, with all other variables remaining constant. The estimated changes for foreign exchange rates are based on an instantaneous 10% weakening or strengthening in sterling against all other currencies from the levels applicable at 31 March 2014, with all other variables remaining constant. Such analysis is for illustrative purposes only – in practice market rates rarely change in isolation. The figures shown in the table relate primarily to the translational impact on the Group's US\$ debt. This debt is held in the US so there is no transactional impact. The impact of transactional risk on the Group's monetary assets/liabilities that are not held in the functional currency of the entity holding those assets/liabilities is minimal. A 10% weakening in sterling would result in a £0.1m increase in profit before tax.

As at 31 March 2014

| | 1% decrease in interest rates | | 10% weakening in sterling | |
|--------------------------|-------------------------------|-------------------|---------------------------|-------------------|
| all figures in £ million | Equity ¹ | Profit before tax | Equity | Profit before tax |
| Sterling | – | (2.8) | – | – |
| US dollar | – | (0.3) | (13.6) | (1.2) |
| Other | – | (0.1) | 1.5 | – |

| | 1% increase in interest rates | | 10% strengthening in sterling | |
|--------------------------|-------------------------------|-------------------|-------------------------------|-------------------|
| all figures in £ million | Equity ¹ | Profit before tax | Equity | Profit before tax |
| Sterling | – | 2.8 | – | – |
| US dollar | – | 0.3 | 11.1 | 1.0 |
| Other | – | 0.1 | (1.3) | – |

As at 31 March 2013

| | 1% decrease in interest rates | | 10% weakening in sterling | |
|--------------------------|-------------------------------|-------------------|---------------------------|-------------------|
| all figures in £ million | Equity ¹ | Profit before tax | Equity | Profit before tax |
| Sterling | – | (2.2) | – | – |
| US dollar | – | (0.1) | (17.6) | (1.3) |
| Other | – | (0.1) | 1.4 | – |

| | 1% increase in interest rates | | 10% strengthening in sterling | |
|--------------------------|-------------------------------|-------------------|-------------------------------|-------------------|
| all figures in £ million | Equity ¹ | Profit before tax | Equity | Profit before tax |
| Sterling | – | 2.2 | – | – |
| US dollar | – | 0.1 | 14.4 | 1.1 |
| Other | – | 0.1 | (1.2) | – |

¹ This relates to the impact on items charged directly to equity and excludes the impact on profit/loss for the year flowing into equity.

Notes to the financial statements continued

25. Cash flows from operations

For the year ended 31 March

all figures in £ million

| | 2014 | 2013 |
|---|---------------|----------------|
| Loss after tax for the year | (12.7) | (133.2) |
| Adjustments for: | | |
| Taxation expense/(income) | 16.8 | (3.8) |
| Net finance costs | 15.0 | 17.9 |
| Loss/(gain) on business divestments and disposal of investments | 4.9 | (2.9) |
| Impairment of investments | – | 0.6 |
| Amortisation of purchased or internally developed intangible assets | 1.0 | 4.0 |
| Amortisation of intangible assets arising from acquisitions and impairments | 11.0 | 14.0 |
| Impairment of goodwill | 125.9 | 255.8 |
| Depreciation and impairment of property, plant and equipment | 22.6 | 32.0 |
| Loss on disposal of property, plant and equipment | 1.4 | 0.8 |
| Share of post-tax profit of equity accounted entities | (0.1) | (0.1) |
| Share-based payments charge | 4.5 | 5.5 |
| Changes in retirement benefit obligations | (8.1) | (20.1) |
| Pension curtailment gain | (31.1) | (0.7) |
| Net movement in provisions | (10.5) | 17.7 |
| | 140.6 | 187.5 |
| Decrease in inventories | 4.4 | 6.6 |
| Decrease in receivables | 21.7 | 124.1 |
| Decrease in payables | (23.7) | (60.7) |
| Changes in working capital | 2.4 | 70.0 |
| Cash generated from operations | 143.0 | 257.5 |
| Add back: cash outflow/(inflow) relating to restructuring | 10.3 | (63.1) |
| Add back: cash outflow relating to pension scheme closure costs | 4.0 | – |
| Net cash flow from operations before restructuring costs | 157.3 | 194.4 |

26. Share capital and other reserves

Shares allotted, called up and fully paid:

| | Ordinary shares of 1p each (equity) | | Special Share of £1 (non-equity) | | Total | |
|-------------------------|-------------------------------------|--------------------|----------------------------------|----------|------------------|--------------------|
| | £ | Number | £ | Number | £ | Number |
| At 1 April 2012 | 6,604,764 | 660,476,373 | 1 | 1 | 6,604,765 | 660,476,374 |
| Issued in the year | — | — | — | — | — | — |
| At 31 March 2013 | 6,604,764 | 660,476,373 | 1 | 1 | 6,604,765 | 660,476,374 |
| Issued in the year | — | — | — | — | — | — |
| At 31 March 2014 | 6,604,764 | 660,476,373 | 1 | 1 | 6,604,765 | 660,476,374 |

Except as noted below all shares in issue at 31 March 2014 rank pari passu in all respects.

Rights attaching to the Special Share

QinetiQ carries out activities which are important to UK defence and security interests. To protect these interests in the context of the ongoing commercial relationship between the MOD and QinetiQ, and to promote and reinforce the Compliance Principles, the MOD holds a Special Share in QinetiQ. QinetiQ obtained MOD consent to changes in its Special Shareholder rights, which were approved by shareholders at the 2012 AGM. The changes to the Special Share were disclosed in the 2012 Annual Report. Subsequent to the changes approved at the 2012 AGM the Special Share confers certain rights on the holder:

- to require the Group to implement and maintain the Compliance System (as defined in the Articles of Association) so as to make at all times effective its and each member of QinetiQ Controlled Group's application of the Compliance Principles, in a manner acceptable to the Special Shareholder;
- to refer matters to the Board for its consideration in relation to the application of the Compliance Principles;
- to require the Board to obtain Special Shareholder's consent:
 - if at any time when the chairman is not a British Citizen, it is proposed to appoint any person to the office of chief executive, who is not a British Citizen; and
 - if at any time when the chief executive is not a British Citizen, it is proposed to appoint any person to the office of chairman, who is not a British Citizen;
- to require the Board to take action to rectify any omission in the application of the Compliance Principles, if the Special Shareholder is of the opinion that such steps are necessary to protect the defence or security interests of the United Kingdom; and
- to demand a poll at any of QinetiQ's meetings (even though it may have no voting rights except those specifically set out in the Articles).

The Special Shareholder has an option to purchase defined Strategic Assets of the Group in certain circumstances. The Special Shareholder has, inter alia, the right to purchase any Strategic Assets which the Group wishes to sell. Strategic Assets are normally testing and research facilities (see note 29 for further details).

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

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

The Special Share entitles the Special Shareholder to require certain persons who hold (together with any person acting in concert with them) a material interest in QinetiQ to dispose of some or all of their ordinary shares in certain prescribed circumstances on the grounds of national security or conflict of interest.

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

Other reserves

The translation reserve includes the cumulative foreign exchange difference arising on translation since the Group transitioned to IFRS. Movements on hedge instruments, where the hedge is effective, are recorded in the hedge reserve until the hedge ceases.

The capital redemption reserve, which was created following the redemption of preference share capital and the bonus issue of shares, cannot be distributed.

Own shares

Own shares represent shares in the Company that are held by independent trusts and include treasury shares and shares held by the employee share ownership plan. Included in retained earnings at 31 March 2014 are 7,811,861 shares (2013: 11,238,669 shares).

Notes to the financial statements continued

27. Share-based payments

The Group operates a number of share-based payment plans for employees. The total share-based payment expense in the year was £4.5m, of which £3.4m related to equity-settled schemes and £1.1m related to cash settled schemes (year to 31 March 2013: £5.5m, of which £3.8m related to equity-settled schemes and £1.7m to cash settled schemes).

2003 Employee share option scheme (2003 ESOS)

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

| | 2014 | | 2013 | |
|-----------------------------------|-----------|---------------------------------|----------------|---------------------------------|
| | Number | Weighted average exercise price | Number | Weighted average exercise price |
| Outstanding at start of year | 352,314 | 2.3p | 461,242 | 2.3p |
| Exercised during year | (335,294) | 2.3p | (68,080) | 2.3p |
| Forfeited during year | (17,020) | 2.3p | (40,848) | 2.3p |
| Outstanding at end of year | – | 2.3p | 352,314 | 2.3p |

The 2003 ESOS are equity-settled awards; those outstanding at 31 March 2014 had an average remaining life of nil years (2013: 0.3 years). In respect of the share options exercised during the year, the average share price on the date of exercise was 189.7p (2013: 178.2p). The exercise price of the outstanding options was 2.3p. Of the outstanding awards at the year end none were exercisable (2013: 352,314).

Performance Share Plan (PSP)

In the year, the Group made awards of conditional shares to certain UK senior employees under the PSP. The awards vest after three years with 50% of the awards subject to TSR conditions and 50% subject to EPS conditions as detailed in the Report from the Remuneration Committee.

| | 2014 Number of shares | 2013 Number of shares |
|-----------------------------------|--------------------------|--------------------------|
| Outstanding at start of year | 7,351,207 | 3,684,486 |
| Granted during year | 3,489,504 | 4,857,004 |
| Exercised during the year | (907,312) | – |
| Forfeited/lapsed during year | (1,843,139) | (1,190,283) |
| Outstanding at end of year | 8,090,260 | 7,351,207 |

PSP awards are equity-settled awards and those outstanding at 31 March 2014 had an average remaining life of 1.5 years (2013: 1.8 years). There is no exercise price for these PSP awards. Monte Carlo modelling was used to fair value the TSR element of the awards at grant date. Assumptions used in the models included 26% (2013: 29%) for the average share price volatility of the FTSE comparator group and 52% (2013: 47%) for the average correlation to the comparator group. The weighted average fair value of grants made during the year was £1.88 (2013: £1.35). The weighted average share price at date of exercise was £1.84. Of the options outstanding at the end of the year nil were exercisable (2013: nil).

Restricted Stock Units (RSU)

In the year the Group granted RSU awards to certain senior US employees under the RSU plan. The awards vest over one, two, three and four years. Of the 2014 awards, and the awards granted before 2012, half are dependent on achieving QNA organic profit growth targets and half on a time-based criterion. The time-based criterion requires the employee to have been in continual service up to the date of vesting. QNA organic profit growth is measured over the most recent financial year compared with the previous financial year, with 125% of this element awarded at a QNA organic profit growth rate above 15%, 100% awarded at 12.5%, 75% awarded at 10% and 25% awarded at 5%. The 2012 grants are entirely dependent on achieving QNA organic profit growth targets. 67.5% of the 2013 grants are dependent on achieving QNA organic profit growth targets and 32.5% are dependent on a time-based criterion.

| | 2014 Number of shares | 2013 Number of shares |
|-----------------------------------|--------------------------|--------------------------|
| Outstanding at start of year | 5,249,861 | 5,458,526 |
| Granted during year | 2,500,000 | 2,379,877 |
| Exercised during year | (354,362) | (694,197) |
| Forfeited/lapsed during year | (3,576,498) | (1,894,345) |
| Outstanding at end of year | 3,819,001 | 5,249,861 |

RSUs are equity-settled awards; those outstanding at 31 March 2014 had an average remaining life of 1.1 years (2013: 1.4 years). There is no exercise price for these RSU awards. The weighted average share price at date of exercise was £1.91 (2013: £1.47). The weighted average fair value of grants made during the year was £1.88 (2013: £1.73). Of the awards outstanding at the end of the year none were exercisable (2013: 24,031).

Value Sharing Plan (VSP)

In 2012 and 2011, the Group granted VSP awards to certain senior UK employees under the VSP. The awards vest over a three-year performance period: 50% of the 2012 awards and 70% of the 2011 awards (which vested in 2014) are/were dependent on creating additional shareholder value, measured as net cash returns to investors and the increase in PBT over an 8.5% hurdle; 50% of the 2012 awards and 30% of the 2011 awards are/were dependent on TSR against a comparator group of FTSE 250 listed companies (less investment trusts) over a three-year performance period. Half the awards vest three years from the date of grant; the remaining half of the awards vest four years from the date of grant. Further details of the vesting conditions of the scheme are in the Report from the Remuneration Committee on pages 86 and 87.

| | 2014 Number of shares | 2013 Number of shares |
|-----------------------------------|-----------------------------|-----------------------------|
| Outstanding at start of year | 10,850,040 | 11,105,340 |
| Granted during year | — | — |
| Exercised during year | (979,853) | — |
| Forfeited/lapsed during year | (4,851,899) | (255,300) |
| Outstanding at end of year | 5,018,288 | 10,850,040 |

VSP awards are equity-settled awards; those outstanding at 31 March 2014 had an average remaining life of 0.6 years (2013: 0.7 years). There is no exercise price for these VSP awards. The weighted average share price at date of exercise was £1.92. Of the awards outstanding at the end of the year nil were exercisable (2013: nil).

Group Share Incentive Plan (SIP)

Under the QinetiQ SIP the Group offers UK employees the opportunity of purchasing up to £125 worth of shares a month at the prevailing market rate. The Group will make a matching share award of a third of the employee's payment. The Group's matching shares may be forfeited if the employee ceases to be employed by QinetiQ within three years of the award of the shares. There is no exercise price for these SIP awards.

| | 2014 Number of matching shares | 2013 Number of matching shares |
|-----------------------------------|---|---|
| Outstanding at start of year | 1,009,663 | 1,319,468 |
| Awarded during year | 228,066 | 217,899 |
| Exercised during year | (467,228) | (450,015) |
| Forfeited during year | (44,597) | (77,689) |
| Outstanding at end of year | 725,904 | 1,009,663 |

SIP matching shares are equity-settled awards; those outstanding at 31 March 2014 had an average remaining life of 1.5 years (2013: 1.5 years). There is no exercise price for these SIP awards. Of the shares outstanding at the end of the year nil were exercisable (2013: nil).

Notes to the financial statements continued

27. Share-based payments continued

Group Deferred Annual Bonus Plan (DAB)

Under the QinetiQ DAB Plan the Group requires certain senior executives to defer part of their annual bonus as shares and be entitled to matching awards to a maximum of 1:1 based on EPS performance. The number that will vest is dependent on the growth of EPS over the measurement period of three years as detailed in the Report from the Remuneration Committee.

| | 2014 Number of matching shares | 2013 Number of matching shares |
|-----------------------------------|---|---|
| Outstanding at start of year | 914,621 | 448,682 |
| Granted during year | 502,060 | 470,119 |
| Forfeited during year | (253,785) | (4,180) |
| Outstanding at end of year | 1,162,896 | 914,621 |

DAB matching shares are equity-settled awards; those outstanding at 31 March 2014 had an average remaining life of 1.4 years (2013: 1.8 years). There is no exercise price for these DAB awards. Of the shares outstanding at the end of the year nil were exercisable (2013: nil).

Cash Alternative Units (CAUs)

In prior years, the Group granted CAU awards to certain employees in the UK and US.

| | 2014 Number of shares | 2013 Number of shares |
|-----------------------------------|-----------------------------|-----------------------------|
| Outstanding at start of year | 2,246,979 | 1,309,000 |
| Awarded during year | – | 1,407,729 |
| Exercised during the year | (274,188) | (298,500) |
| Forfeited during year | (743,250) | (171,250) |
| Outstanding at end of year | 1,229,541 | 2,246,979 |

CAUs are cash-settled awards which vest over one, two, three and four years from the date of grant. The CAUs have no performance criteria attached, other than the requirement that the employee remains in employment with the Group. Those awards outstanding at 31 March 2014 had an average remaining life of 1.8 years (2013: 1.7 years). There is no exercise price for these awards. The fair value of the grants at 31 March 2014 was £2.26 (2013: £2.07) being the Group's closing share price on that day. The weighted average share price on the date of exercise was £1.90 (2013: £1.67). The carrying amount of the liability of the grants at the balance sheet date was £1.7m (2013: £1.8m). Of the awards outstanding at the end of the year nil were exercisable.

Share-based award pricing – other

Share-based awards that vest based on non-market performance conditions, including certain PSP, RSUs and DAB awards, have been valued at the share price at grant, less attrition. For the 2003 ESOS, there was a pre-bonus issue weighted average share price of £1 and a weighted average exercise price of £1 based on third-party transactions in the Company's shares in the period immediately before the issue of the share options. Before the IPO in February 2006, there was no active market for the Company's shares and expected volatility was, therefore, determined using the average volatility for a comparable selection of businesses. Since the Group had no established pattern of dividend payments at this time, no dividends were assumed in this model.

28. Post-retirement benefits

Defined contribution plans

In the UK the Group operates two Group Personal Pension Plans (GPPs) for the majority of its UK employees. These are defined contribution schemes managed by Zurich. A defined contribution plan is a pension plan under which the Group and employees pay fixed contributions to a third-party financial provider. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Defined benefit pension plans

In the UK the Group operates the QinetiQ Pension Scheme (the 'Scheme') for a significant proportion of its UK employees. The Scheme closed to future accrual on 31 October 2013. After this date, defined benefit members transferred to a defined contribution scheme. On closure, the Group realised a reduction in scheme liabilities of £31.1m and a one-off cost of £4.0m arising from associated contributions to affected members' defined contribution plans following the closure of the scheme. The Scheme is a final salary plan, which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on the members' length of service and their salary in the final years leading up to retirement. In the Scheme, pensions in payment are generally updated in line with the Consumer Price Index (CPI). The benefit payments are made from Trustee-administered funds. Plan assets held in trusts are governed by UK regulations as is the nature of the relationship between the Group and the Trustees and their composition. Responsibility for the governance of the Scheme – including investment decisions and contribution schedules – lies jointly with the Company and the Board of Trustees. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the Scheme's regulations.

A defined benefit plan is a pension plan that is not a defined contribution plan. Typically, defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and final pensionable earnings.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated bi-annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation. In countries where there is no deep market in such bonds, the market rates on government bonds are used.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past-service costs are recognised immediately in income.

The expected employer cash contribution to the Scheme for the year ending 31 March 2015 is £17.1m (2014: £20.6m), including a £6.0m one-off contribution following the disposal of US Services. The Group has no further payment obligations once the contributions have been paid. Following the closure to future accrual, future reporting periods will no longer include an expense in respect of defined benefit pension service costs.

Triennial funding valuation

The most recent full actuarial valuation of the Scheme was undertaken as at 30 June 2011 and resulted in an actuarially assessed deficit of £74.7m. On the basis of this full valuation, the Trustees of the Scheme and the Company agreed the employer contribution rate of 12.7% from 30 June 2011, past service deficit recovery payments of £10.5m a year for a six-year period from 1 April 2013 and an immediate one-off contribution of £40m into the Scheme. As part of a package of measures to provide stability to the Scheme, the Company has also contributed an asset in the form of an interest through a Scottish limited partnership (see below) in a future income stream of approximately £2.5m per annum, increasing in line with the CPI, for 20 years secured on certain properties owned by the Group.

The next scheduled triennial valuation will be performed as at 30 June 2014. The funding basis of calculating Scheme funding requirements differs from IAS 19 in that it does not use corporate bonds as a basis for the discount rate but instead uses the risk free rate from UK gilts, prudently adjusted for long-term expected returns for pre-retirees. Given the current extremely low gilt yields, perhaps exacerbated by quantitative easing, a funding valuation of the Scheme would probably have resulted in a bigger deficit than the IAS 19 methodology if it had been performed at the year end.

Notes to the financial statements continued

28. Post-retirement benefits continued

QinetiQ's Pension Funding Partnership Structure

Following the 30 June 2011 valuation, a package of pension changes has been agreed with the Trustees to provide stability to the Scheme. As part of the package of proposals, on 26 March 2013 QinetiQ established the QinetiQ PFP Limited Partnership (the 'Partnership') with the Scheme. Under this arrangement, properties to the capitalised value of £32.3m were transferred to the Partnership. The transfers were affected through a 20-year sale and leaseback agreement. The Scheme's interest in the Partnership entitles it to an annual distribution of approximately £2.5m for 20 years; indexed with reference to CPI. These contributions replaced part of the regular contributions made under the past deficit recovery payments plan. The Scheme's interest in the Partnership will revert back to QinetiQ Limited in 2032.

The Partnership is controlled by QinetiQ and its results are consolidated by the Group. Under IAS 19, the interest held by the Scheme in the Partnership does not qualify as a plan asset for the purposes of the Group's consolidated financial statements and is therefore not included within the fair value of plan assets. As a result, the Group's consolidated financial statements are unchanged by the Partnership. In addition, the value of the property transferred to the Partnership and leased back to QinetiQ remains on the balance sheet. QinetiQ retains the operational flexibility to substitute properties of equivalent value within the Partnership and has the option to settle outstanding amounts due under the interest before 2032 if it so chooses.

Other UK schemes

In the UK the Group has a small number of employees for whom benefits are secured through the Prudential Platinum Scheme. The net pension deficits of this scheme at 31 March 2014 amounted to £nil (2013: £nil). QinetiQ also offers employees access to a Group Self Invested Personal Pension Plan, but no Company contributions are paid to this arrangement.

QinetiQ Pension Scheme net pension liability

The fair value of the QinetiQ Pension Scheme assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the Scheme's liabilities, which are derived from cash flow projections over long periods, and thus inherently uncertain, were:

| all figures in £ million | 2014 | 2013 | 2012 | 2011 | 2010 |
|--|----------------|----------------|----------------|----------------|----------------|
| Equities | 434.4 | 487.3 | 583.2 | 564.1 | 714.6 |
| LDI investment* | 273.6 | 205.9 | — | — | — |
| Corporate bonds | 279.9 | 276.8 | 194.6 | 158.7 | 69.5 |
| Alternative bonds** | 183.0 | 174.8 | — | — | — |
| Government bonds | — | — | 183.5 | 165.3 | 69.6 |
| Property | 94.0 | 81.3 | 82.4 | 78.0 | 53.4 |
| Other | 39.7 | 30.4 | 64.2 | 15.0 | 8.8 |
| Total market value of assets | 1,304.6 | 1,256.5 | 1,107.9 | 981.1 | 915.9 |
| Present value of Scheme liabilities | (1,326.8) | (1,310.6) | (1,139.4) | (1,105.7) | (1,063.2) |
| Net pension liability before deferred tax | (22.2) | (54.1) | (31.5) | (124.6) | (147.3) |
| Deferred tax asset | 1.3 | 13.7 | 13.3 | 32.4 | 41.2 |
| Net pension liability | (20.9) | (40.4) | (18.2) | (92.2) | (106.1) |

* The Scheme has assets invested in a Liability Driven Investment portfolio. As at 31 March 2014 this hedges against approximately 22% of the interest rate and 20% of the inflation rate risk, as measured on the Trustees' gilt-funding basis.

** Includes allocations to high-yield bonds, secured loans and emerging market debt.

Changes to the fair value of Scheme assets

| all figures in £ million | 2014 | 2013 |
|--|----------------|----------------|
| Opening fair value of Scheme assets | 1,256.5 | 1,107.9 |
| Interest income on Scheme assets | 54.9 | 53.3 |
| Re-measurement gain on Scheme assets | 2.6 | 78.4 |
| Contributions by the employer | 20.6 | 40.8 |
| Contributions by plan participants | – | 0.1 |
| Net benefits paid out and transfers | (28.8) | (22.0) |
| Administrative expenses | (1.2) | (2.0) |
| Closing fair value of Scheme assets | 1,304.6 | 1,256.5 |

Changes to the present value of the defined benefit obligation

| all figures in £ million | 2014 | 2013 |
|---|----------------|----------------|
| Opening defined benefit obligation | 1,310.6 | 1,139.4 |
| Current service cost | 11.3 | 18.7 |
| Interest cost | 56.6 | 54.6 |
| Contributions by plan participants | – | 0.1 |
| Actuarial loss/(gain) on Scheme liabilities based on: | | |
| Change in financial assumptions | 39.2 | 103.8 |
| Experience losses/(gains) | (31.0) | 16.7 |
| Curtailment gain | (31.1) | (0.7) |
| Net benefits paid out and transfers | (28.8) | (22.0) |
| Closing defined benefit obligation | 1,326.8 | 1,310.6 |

Total income/expense recognised in the income statement

| all figures in £ million | 2014 | 2013 |
|--|---------------|-------------|
| Pension costs charged to the income statement: | | |
| Current service cost | 11.3 | 18.7 |
| Past service gain (including curtailments) | (31.1) | (0.7) |
| Net interest on the net defined benefit liability | 1.7 | 1.3 |
| Administrative expenses | 1.2 | 2.0 |
| Total (income)/expense recognised in the income statement (gross of deferred tax) | (16.9) | 21.3 |

Notes to the financial statements continued

28. Post-retirement benefits continued

Assumptions

The major assumptions (weighted to reflect individual Scheme differences) were:

| | 2014 | 2013 |
|--|------|------|
| Discount rate applied to Scheme liabilities | 4.2% | 4.4% |
| CPI inflation assumption | 2.6% | 2.7% |
| Assumed life expectancies in years: | | |
| Future male pensioners (currently aged 60) | 88 | 88 |
| Future female pensioners (currently aged 60) | 90 | 90 |
| Future male pensioners (currently aged 40) | 90 | 90 |
| Future female pensioners (currently aged 40) | 92 | 92 |

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, because of the timescale covered, may not necessarily be borne out in practice. It is important to note that these assumptions are long term and, in the case of the discount rate and the inflation rate, are measured by external market indicators. The mortality assumptions as at 31 March 2014 were 90% of S1PMA for males and 100% of S1PFA for females, based on year of birth making allowance for improvements in mortality in line with CMI_2011 Core Projections and a long-term rate of improvement of 1.25% per annum. These assumptions are the same as in the prior year.

The balance sheet net pension liability is a snapshot view which can be significantly influenced by short-term market factors. The calculation of the surplus or deficit depends, therefore, on factors which are beyond the control of the Group – principally the value at the balance sheet date of equity shares in which the Scheme has invested and long-term interest rates which are used to discount future liabilities. The funding of the Scheme is based on long-term trends and assumptions relating to market growth, as advised by qualified actuaries and investment advisors.

The weighted average duration of the defined benefit obligation is approximately 20 years.

Sensitivity analysis of the principal assumptions used to measure Scheme liabilities

| Assumption | Change in assumption | Indicative impact on Scheme liabilities (before deferred tax) |
|-------------------|---------------------------|---|
| Discount rate | Increase/decrease by 0.1% | Decrease/increase by £25m |
| Rate of inflation | Increase/decrease by 0.1% | Increase/decrease by £25m |
| Rate of mortality | Increase by one year | Increase by £31m |

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

Risks

Through its defined benefit pension plans, the Group is exposed to a number of risks, the most significant of which are detailed below:

| | |
|----------------------------------|--|
| Volatility in market conditions | Results under IAS 19 can change dramatically depending on market conditions. The defined benefit obligation is linked to yields on AA-rated corporate bonds, while many of the assets of the Scheme are invested in other assets. Changing markets in conjunction with discount rate volatility will lead to volatility in the net pension liability on the Group's balance sheet and in other comprehensive income. To a lesser extent this will also lead to volatility in the IAS 19 pension expense in the Group's income statement. |
| Choice of accounting assumptions | The calculation of the defined benefit obligation (DBO) involves projecting future cash flows from the Scheme many years into the future. This means that the assumptions used can have a material impact on the balance sheet position and profit and loss charge. In practice future experience within the Scheme may not be in line with the assumptions adopted. For example, members could live longer than foreseen or inflation could be higher or lower than allowed for in the DBO calculation. |
| Inflation rate risk | The majority of the plan's benefit obligations are linked to inflation, and higher inflation will lead to higher liabilities. |

The accounting assumptions noted above are used to calculate the year end net pension liability in accordance with the relevant accounting standard, IAS 19 (revised) 'Employee benefits'. Changes in these assumptions have no impact on the Group's cash payments into the Scheme. The payments into the Scheme are reassessed after every triennial valuation. The triennial valuations are calculated on a funding basis and use a different set of assumptions, as agreed with the pension Trustees. Given the current extremely low gilt yields, perhaps exacerbated by quantitative easing, a funding valuation of the Scheme would probably have resulted in a bigger deficit than the IAS 19 methodology if it had been performed at the year end.

29. Transactions with the MOD

The MOD continues to own its Special Share in QinetiQ which conveys certain rights as set out in note 26. Transactions between the Group and the MOD are disclosed as follows:

Freehold land and buildings and surplus properties

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

i) Restrictions on transfer of title

The title deeds of those properties with strategic assets (see below) include a clause that prevents their transfer without the approval of the MOD. The MOD also has the right to purchase any strategic assets in certain circumstances.

ii) Property claw-back agreement

During the 12 years from 1 July 2001, following a 'trigger event', the MOD was entitled to claw-back a proportion of the gain on each individual property transaction in excess of a 30% gain on a July 2001 professional valuation. This agreement expired in the year to 31 March 2014.

MOD's generic compliance regime

Adherence to the generic compliance system is monitored by the Risk & CSR Committee. Refer to the Corporate Governance Report on page 67.

Strategic assets

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

- i) dispose of or destroy all or any part of a strategic asset; or
- ii) voluntarily undertake any closure of, or cease to provide a strategic capability by means of, all or any part of a strategic asset.

The net book value of assets identified as being strategic assets as at 31 March 2014 was £1.3m (2013: £1.4m).

Long-Term Partnering Agreement

On 27 February 2003 QinetiQ Limited entered into a Long-Term Partnering Agreement to provide Test and Evaluation (T&E) facilities and training support services to the MOD. This is a 25-year contract with a total revenue value of up to £5.6bn, dependent on the level of usage by the MOD, under which QinetiQ Limited is committed to providing T&E services with increasing efficiencies through cost saving and innovative service delivery.

30. Contingent liabilities and assets

Subsidiary undertakings within the Group have given unsecured guarantees of £40.3m at 31 March 2014 (2013: £54.3m) 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. 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 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 not probable.

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

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

Notes to the financial statements continued

31. Capital commitments

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

| all figures in £ million | 2014 | 2013 |
|--------------------------|-------------|-------------|
| Contracted | 38.7 | 18.0 |

Capital commitments at 31 March 2014 include £37.8m (2013: £15.8m) in relation to property, plant and equipment that will be wholly funded by a third-party customer under long-term contract arrangements.

32. Subsidiaries

The companies listed below are those which were part of the Group at 31 March 2014 and which, in the opinion of the Directors, significantly affected the Group's results and net assets during the year. The Directors consider that those companies not listed are not significant in relation to the Group as a whole. A comprehensive list of all subsidiaries will be disclosed as an appendix to the Group's annual return.

| Name of company | Principal area of operation | Country of incorporation |
|---|-----------------------------|--------------------------|
| Subsidiaries^{1,2} | | |
| QinetiQ Group Holdings Limited ³ | UK | England & Wales |
| QinetiQ Holdings Limited | UK | England & Wales |
| QinetiQ Limited | UK | England & Wales |
| QinetiQ Overseas Holdings Limited | UK | England & Wales |
| QinetiQ North America, Inc. ⁴ | US | US |
| QinetiQ US Holdings, Inc. | US | US |
| Analex Corporation ⁴ | US | US |
| Apogen Technologies, Inc. ⁴ | US | US |
| Foster-Miller, Inc. | US | US |
| Westar Aerospace & Defence Group, Inc. ⁴ | US | US |

¹ Accounting reference date is 31 March. All principal subsidiary undertakings listed above have financial year ends of 31 March and 100% of the ordinary shares are owned by the Group.

² QinetiQ Group Holdings Limited is a direct subsidiary of QinetiQ Group plc. All other subsidiaries are held indirectly by other subsidiaries of QinetiQ Group plc.

³ QinetiQ Group Holdings Limited changed its name from QinetiQ Middle East Limited on 3 December 2013.

⁴ Sale agreed post year end. See note 33.

33. Post balance sheet events

On 22 April 2014, the Group agreed to sell the US Services division, comprising QinetiQ North America Inc. and its subsidiaries, for an initial cash consideration of \$165m plus potential deferred consideration of up to \$50m. As at 31 March 2014 negotiations to conclude the transaction were still ongoing, with significant terms still unresolved. As such the Directors are of the opinion that the successful conclusion to the transaction was not 'highly probable' as at 31 March 2014. The financial reporting implications of which are that the US Services division cannot be presented as an 'asset held for sale' as at the balance sheet date, and the results of US Services are not reported as a 'discontinued operation' within the income statement.

At 31 March 2014, the Group had the intention to realise value from US Services via sale rather than use and an impairment loss (to goodwill) has been recognised in 2014 following valuation at 'fair value less costs to sell'. The full impact of the disposal, including the remaining transaction costs, estimated warranty/indemnity liabilities, completion bonuses/change of control payments, and deferred foreign exchange gains/losses recycled from reserves, will be shown in the accounts for the year ending 31 March 2015, subject to transaction completion.

The income statement of the US Services division is as follows:

| all figures in £ million | 2014 | 2013 |
|--|---------------|----------------|
| Revenue | 408.8 | 463.8 |
| Operating costs excluding depreciation, amortisation and impairment | (387.3) | (438.4) |
| EBITDA (earnings before interest, tax, depreciation and amortisation) | 21.5 | 25.4 |
| Depreciation and impairment of property, plant and equipment | (2.3) | (1.6) |
| Amortisation of intangible assets | (0.2) | (0.1) |
| Underlying operating profit | 19.0 | 23.7 |
| Impairment of goodwill | (84.0) | (246.7) |
| Other specific adjusting items | (8.1) | (17.7) |
| Operating loss before tax | (73.1) | (240.7) |
| Finance expense | (0.8) | – |
| Loss before tax | (73.9) | (240.7) |
| Taxation (expense)/income | (3.0) | 17.6 |
| Loss for the year | (76.9) | (223.1) |

Net assets of the disposed business as at 31 March 2014 are set out below.

| | 2014 |
|--|---------------|
| Assets | |
| Non-current assets | |
| Goodwill | 41.4 |
| Intangible assets | 33.6 |
| Property, plant and equipment | 6.1 |
| Deferred tax asset | 7.3 |
| | 88.4 |
| Current assets | |
| Inventory | 0.7 |
| Trade and other receivables | 75.8 |
| | 76.5 |
| Total assets | 164.9 |
| Liabilities | |
| Current liabilities | |
| Trade and other payables | (52.5) |
| Provisions | (1.4) |
| Current tax liabilities | (1.7) |
| | (55.6) |
| Non-current liabilities | |
| Other payables | (3.0) |
| Provisions for other liabilities and charges | (2.0) |
| | (5.0) |
| Total liabilities | (60.6) |
| Net assets | 104.3 |

Company balance sheet

as at 31 March

| all figures in £ million | Note | 2014 | 2013 |
|--|------|--------------|---------------|
| Fixed assets | | | |
| Investments in subsidiary undertaking | 2 | 454.8 | 451.4 |
| | | 454.8 | 451.4 |
| Current assets | | | |
| Debtors | 3 | 79.5 | 77.7 |
| | | 79.5 | 77.7 |
| Current liabilities | | | |
| Creditors amounts falling due within one year | 4 | (64.6) | (140.1) |
| Net current assets/(liabilities) | | 14.9 | (62.4) |
| Total assets less current liabilities | | 469.7 | 389.0 |
| Net assets | | 469.7 | 389.0 |
| Capital and reserves | | | |
| Equity share capital | 6 | 6.6 | 6.6 |
| Capital redemption reserve | 6 | 39.9 | 39.9 |
| Share premium account | 6 | 147.6 | 147.6 |
| Profit and loss account | 6 | 275.6 | 194.9 |
| Capital and reserves attributable to shareholders | | 469.7 | 389.0 |

There are no other recognised gains and losses.

The financial statements of QinetiQ Group plc (company number 4586941) were approved by the Board of Directors and authorised for issue on 22 May 2014 and were signed on its behalf by:

Mark Elliott
Chairman

Leo Quinn
Chief Executive Officer

David Mellors
Chief Financial Officer

Notes to the Company financial statements

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable UK Accounting Standards. As permitted by section 408(4) of the Companies Act 2006, a separate profit and loss account dealing with the results of the Company has not been presented.

Investments

In the Company's financial statements, investments in subsidiary undertakings are stated at cost less any impairment in value.

Share-based payments

The fair value of equity-settled awards for share-based payments is determined on grant and expensed straight line over the period from grant to the date of earliest unconditional exercise. The fair value of cash-settled awards for share-based payments is determined at each period end until they are exercised or lapse. The value is expensed straight line over the period from grant to the date of earliest unconditional exercise. The charges for both equity and cash-settled share-based payments are updated annually for non-market-based vesting conditions. Further details of the Group's share-based payment charge are disclosed in note 27 to the Group financial statements. The cost of share-based payments is charged to subsidiary undertakings.

2. Investment in subsidiary undertaking

As at 31 March

| all figures in £ million | 2014 | 2013 |
|---|--------------|--------------|
| Subsidiary undertaking – 100% of ordinary share capital of QinetiQ Holdings Limited | – | 424.3 |
| Subsidiary undertaking – 100% of ordinary share capital of QinetiQ Group Holdings Limited | 424.3 | – |
| Capital contributions arising from share-based payments to employees of subsidiaries | 30.5 | 27.1 |
| | 454.8 | 451.4 |

During the year the company transferred its investment in QinetiQ Holdings Limited to QinetiQ Group Holdings Limited in return for 100% of the share capital of the company.

A list of all principal subsidiary undertakings of QinetiQ Group plc is disclosed in note 32 to the Group financial statements.

3. Debtors

As at 31 March

| all figures in £ million | 2014 | 2013 |
|---|-------------|-------------|
| Amounts owed by Group undertakings | 79.5 | 77.7 |

4. Creditors

As at 31 March

| all figures in £ million | 2014 | 2013 |
|---|-------------|--------------|
| Amounts owed to Group undertakings | 64.6 | 140.1 |

5. Share capital

The Company's share capital is disclosed in note 26 to the Group financial statements.

Notes to the Company financial statements continued

6. Reserves

| all figures in £ million | Issued share capital | Capital redemption reserve | Share premium | Profit and loss | Total equity |
|-----------------------------------|----------------------|----------------------------|---------------|-----------------|--------------|
| At 1 April 2013 | 6.6 | 39.9 | 147.6 | 194.9 | 389.0 |
| Profit | — | — | — | 103.7 | 103.7 |
| Purchase of own shares | — | — | — | (0.5) | (0.5) |
| Share-based payments – settlement | — | — | — | 0.9 | 0.9 |
| Dividend paid | — | — | — | (26.8) | (26.8) |
| Share-based payments | — | — | — | 3.4 | 3.4 |
| At 31 March 2014 | 6.6 | 39.9 | 147.6 | 275.6 | 469.7 |
| At 1 April 2012 | 6.6 | 39.9 | 147.6 | 135.2 | 329.3 |
| Profit | — | — | — | 75.7 | 75.7 |
| Purchase of own shares | — | — | — | (0.4) | (0.4) |
| Share-based payments – settlement | — | — | — | 0.7 | 0.7 |
| Dividend paid | — | — | — | (20.1) | (20.1) |
| Share-based payments | — | — | — | 3.8 | 3.8 |
| At 31 March 2013 | 6.6 | 39.9 | 147.6 | 194.9 | 389.0 |

The capital redemption reserve is not distributable and was created following redemption of preference share capital.

7. Share-based payments

The Company's share-based payment arrangements are set out in note 27 to the Group financial statements.

8. Other information

Directors' emoluments, excluding Company pension contributions, were £3.1m (2013: £3.3m). These emoluments were all in relation to services provided on behalf of the QinetiQ Group with no amount specifically relating to their work for the Company. Details of the Directors' emoluments, share schemes and entitlements under money purchase pension schemes are disclosed in the Remuneration Report.

The remuneration of the Company's auditor for the year to 31 March 2014 was £146,000 (2013: £146,000), which was for audit of the Group's annual accounts and audit related assurance services. No other services were provided by the auditor to the Company.

Five-year record for the years ended 31 March (unaudited)

| all figures in £ million | | 2014 | 2013 ⁵ | 2012 ⁴ | 2011 ^{3,4} | |
|---|-----------|----------------|-------------------|-------------------|---------------------|---------|
| EMEA Services (formerly UK Services) | £m | 607.0 | 594.6 | 610.1 | 652.7 | |
| US Services | £m | 408.8 | 463.8 | 534.5 | 607.3 | |
| Global Products | £m | 175.6 | 269.4 | 325.0 | 442.6 | |
| Revenue | £m | 1,191.4 | 1,327.8 | 1,469.6 | 1,702.6 | |
| | | | | | | |
| EMEA Services (formerly UK Services) | £m | 86.7 | 84.8 | 61.3 | 45.7 | |
| US Services | £m | 19.0 | 23.7 | 32.1 | 45.9 | |
| Global Products | £m | 27.0 | 60.2 | 66.2 | 52.1 | |
| Underlying operating profit¹ | £m | 132.7 | 168.7 | 159.6 | 143.7 | |
| | | | | | | |
| | | | | | 2010 ² | |
| QinetiQ North America | £m | | | | 800.1 | |
| EMEA | £m | | | | 818.8 | |
| Ventures | £m | | | | 6.5 | |
| Revenue | £m | | | | 1,625.4 | |
| | | | | | | |
| QinetiQ North America | £m | | | | 67.7 | |
| EMEA | £m | | | | 61.1 | |
| Ventures | £m | | | | (8.5) | |
| Underlying operating profit¹ | £m | | | | 120.3 | |
| | | | | | | |
| Underlying operating margin ¹ | % | 11.1 | 12.7 | 10.9 | 8.4 | 7.4 |
| Underlying profit before tax ¹ | £m | 119.4 | 152.1 | 110.2 | 103.8 | 85.7 |
| Profit/(loss) before tax | £m | 4.1 | (137.0) | 316.3 | 7.9 | (66.1) |
| (Loss)/profit after tax | £m | (12.7) | (133.2) | 246.3 | (8.8) | (63.3) |
| Underlying basic EPS ¹ | Pence | 16.0 | 18.9 | 13.6 | 13.0 | 11.1 |
| Basic EPS | Pence | (1.9) | (20.5) | 37.9 | (1.3) | (9.7) |
| Diluted EPS | Pence | (1.9) | (20.5) | 37.6 | (1.3) | (9.7) |
| Dividend per share | Pence | 4.60 | 3.80 | 2.90 | 1.60 | 1.58 |
| | | | | | | |
| Underlying net cash from operations (post capex) ¹ | £m | 136.5 | 175.9 | 235.4 | 265.8 | 169.2 |
| Net cash/(debt) | £m | 170.5 | 74.0 | (122.2) | (260.9) | (457.4) |
| Average number of employees | | 9,134 | 9,772 | 10,637 | 12,033 | 13,604 |
| Orders | £m | 972.4 | 1,076.8 | 1,226.3 | 1,559.7 | 1,400.9 |

¹ Underlying measures are stated before specific adjusting items. Definitions of underlying measures of performance are in the glossary on page 150. Underlying financial measures are presented because the Board believes these provide a better representation of the Group's long-term performance trend.

² The Group's management structure changed with effect from 1 April 2010. Segmental data for 2010 has been retained on the old structure as reported in previous financial statements.

³ The 2011 figures have been restated to reflect the transfer of businesses from Global Products to UK Services and US Services at the beginning of the 2013 financial year.

⁴ IAS 19 (revised) 'Employee Benefits' was adopted for 2013 and the 2012 and 2011 comparatives have been restated accordingly.

⁵ The 2013 figures have been restated to reflect the reclassification of product sales from UK Services to Global Products and the reclassification of Cyveillance® from US Services to EMEA Services.

Glossary

| | | | |
|---------------|---|--|---|
| ABI | Association of British Insurers | OHSAS | Occupational Health and Safety Advisory Services |
| AGM | Annual General Meeting | Organic growth | The level of year-on-year growth, expressed as a percentage, calculated at constant foreign exchange rates, adjusting comparatives to incorporate the results of acquired entities but excluding the results for any disposals or discontinued operations for the same duration of ownership as the current period |
| BIS | Department for Business, Innovation and Skills | | |
| CAGR | Compound Annual Growth Rate | | |
| C4ISR | Command, control, communications, computers, intelligence, surveillance and reconnaissance | | |
| CPI | Consumer Price Index | PBT | Profit before tax |
| CR | Corporate Responsibility | PSP | Performance Share Plan |
| CSR | Corporate Social Responsibility | QNA | QinetiQ North America |
| | | QSOS | QinetiQ Share Option Scheme |
| DAB | Deferred Annual Bonus | | |
| DE&S | MOD's Defence, Equipment and Support organisation | R&D | Research and development |
| DHS | US Department of Homeland Security | RSU | Restricted Stock Unit |
| DoD | US Department of Defense | | |
| | | Specific adjusting items | Amortisation of intangible assets arising from acquisitions; net restructuring charges/recoveries; net pension finance expense; pension curtailment gains; pension past service gains; net pension gain on closure to future accrual; impairment of property; impairment of goodwill and intangible assets; gain/loss on business combinations and divestments; gain/loss on disposal of investments; and tax thereon |
| EBITDA | Earnings before interest, tax, depreciation and amortisation | | |
| EMEA | Europe, Middle East and Australasia | | |
| EPS | Earnings per share | | |
| Gearing ratio | This is the ratio of net debt to adjusted EBITDA in accordance with the Group's credit-facility ratios. EBITDA is adjusted to exclude charges for share-based payments. Net debt is adjusted to reflect the same exchange rates as used for EBITDA and to reflect other requirements of the debt-holders' covenant calculations | TSR | Total shareholder return |
| | | UK Corporate Governance Code | Guidelines of the Financial Reporting Council to address the principal aspects of corporate governance |
| IAS | International Accounting Standards | UK GAAP | UK Generally Accepted Accounting Practice |
| IFRS | International Financial Reporting Standards | Underlying basic earnings per share | Basic earnings per share as adjusted to exclude 'specific adjusting items' |
| IP | Intellectual property | 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 |
| IPO | Initial Public Offering | | |
| | | Underlying net cash from operations (post capex) | Net cash inflow from operations before cash flows of specific adjusting items, less net cash outflow on purchase/sale of intangible assets and property, plant and equipment |
| KPI | Key Performance Indicator | Underlying net finance costs | Net finance costs excluding net pension finance costs |
| LIBID | London inter-bank bid rate | Underlying operating cash conversion | The ratio of underlying net cash from operations (post capex) to underlying operating profit excluding share of post-tax result of equity-accounted joint ventures and associates |
| LIBOR | London inter-bank offered rate | | |
| LTPA | Long-Term Partnering Agreement – 25-year contract established in 2003 to manage the MOD's test and evaluation ranges | Underlying operating margin | Underlying operating profit expressed as a percentage of revenue |
| | | Underlying operating profit | Operating profit as adjusted to exclude 'specific adjusting items' |
| MOD | UK Ministry of Defence | Underlying profit before tax | Profit before tax as adjusted to exclude 'specific adjusting items' |
| MSCA | Maritime Strategic Capability Agreement | | |
| | | VSP | Value Sharing Plan |
| NASA | National Aeronautics and Space Administration (US) | Yellow Book | Single-source pricing regulations used by MOD |

Shareholder information

Share administration

The Company's registrar is Equiniti. If you have any queries regarding your shareholding, including dividend payments and change of address notifications, please contact Equiniti, either in writing at the address shown on the next page, by telephone on 0871 384 2021* or online at <https://help.shareview.co.uk> – from here, if you need further assistance, you will be able to email Equiniti securely. Equiniti also offers Shareview, a free of charge service enabling you to access and maintain your shareholding online. Through Shareview you can register for electronic communications, see details of balance movements and complete certain amendments online, such as changes to dividend mandate instructions. To take advantage of Shareview, register online at www.shareview.co.uk, click on 'Register' and follow the steps.

* Lines are open 8.30am to 5.30pm, Monday to Friday, excluding Bank Holidays. Calls to 0871 numbers are charged at 8p per minute plus network extras.

Direct dividend payments

If you would like to have your dividend paid directly into a UK bank or building society account, please contact Equiniti or complete the dividend mandate attached to your dividend cheque. The associated tax voucher will still be sent to your registered address. If you live outside the UK, Equiniti offers a global payments service which is available in certain countries and could enable you to receive your dividends direct into your bank account in your local currency. Further details can be obtained direct from Equiniti or online at www.shareview.co.uk.

Consolidated tax vouchers

Shareholders who have dividends paid direct into a bank or building society account receive a consolidated tax voucher which details all dividends paid for the year. Under this process, a shareholder's dividend is paid direct to their bank account each time a dividend is paid and once a year they receive a tax voucher detailing all dividends paid for that year. Shareholders who prefer to continue receiving tax vouchers with each dividend payment can contact Equiniti Registrars to request this.

Electronic communications

The Company offers shareholders the option to receive documentation and communications electronically, via the Company's website. The wider use of electronic communications enables fast receipt of documents, reduces the Company's printing, paper and postal costs and reduces the Company's environmental impact. Shareholders can register for electronic communications at www.shareview.co.uk and may also cast their vote for the 2014 AGM online quickly and easily using the Sharevote service by visiting www.sharevote.co.uk.

Donating shares to charity

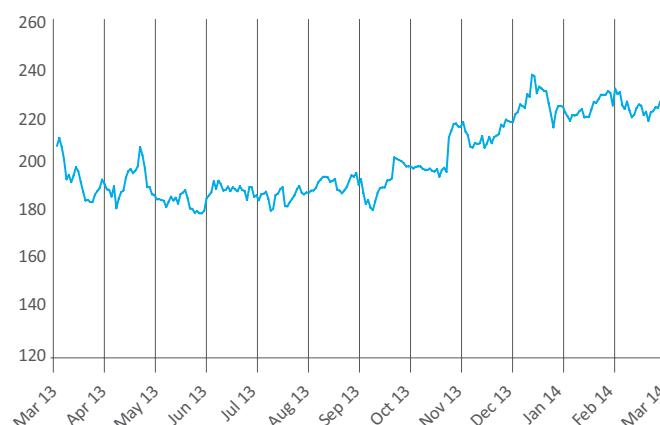
Shareholders with small numbers of shares which may be uneconomic to sell may wish to consider donating them to the charity ShareGift (registered charity no. 1052686). Details are available at www.sharegift.org.uk or by telephone on 020 7930 3737.

Unsolicited telephone calls or correspondence

We are aware that some shareholders might have received unsolicited telephone calls or correspondence concerning investment matters. These are typically from fraudsters who use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shareholders shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment. If you receive any unsolicited investment advice, check that the firm is properly authorised by the Financial Conduct Authority (FCA) by visiting www.fca.gov.uk and selecting Financial Services Register, or report the matter to the FCA by calling 0800 111 6768. If the calls persist, hang up. If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme.

Share price

Details of current and historical share prices can be found on the Company's website at www.QinetiQ.com/investors. The graph below shows the share price trend during the year ended 31 March 2014:



The share prices used in the graph above are the mid-market closing prices as derived from the London Stock Exchange Daily Official List.

Analysis of Share Register at 31 March 2014

| | | Number of holdings | % of total holdings | Shares held | % of share capital |
|--------------------|-------------------------|--------------------|---------------------|--------------------|--------------------|
| By type of holder | Individuals | 6,109 | 87.06% | 6,709,352 | 1.02% |
| | Institutions and others | 908 | 12.94% | 653,767,021 | 98.98% |
| | Total | 7,017 | 100.00% | 660,476,373 | 100.00% |
| By size of holding | 1–500 | 4,456 | 63.50% | 910,914 | 0.14% |
| | 501–1,000 | 662 | 9.43% | 533,981 | 0.08% |
| | 1,001–5,000 | 1,208 | 17.22% | 2,984,926 | 0.45% |
| | 5,001–10,000 | 218 | 3.11% | 1,639,803 | 0.25% |
| | 10,001–100,000 | 247 | 3.52% | 8,231,325 | 1.25% |
| | Over 100,000 | 226 | 3.22% | 646,175,424 | 97.83% |
| | Total | 7,017 | 100.00% | 660,476,373 | 100.00% |

Additional information

Key dates

22 July 2014

22 July 2014

6 August 2014

8 August 2014

5 September 2014

30 September 2014

20 November 2014

February 2015

31 March 2015

May 2015

Interim management statement

Annual General Meeting

Ordinary shares marked ex-dividend

Final 2014 dividend record date

Final 2014 dividend payment date

Half-year financial period end

Half-year results announcement

Interim management statement (provisional date)

Financial year end

Preliminary results announcement (provisional date)

Company information

Registered office

Cody Technology Park

Ively Road

Farnborough

Hampshire

GU14 0LX

Tel: +44 (0) 1252 392000

Company Registration Number 4586941

Auditor

KPMG LLP

Chartered Accountants

15 Canada Square

London

E14 5GL

Registrar

Equiniti

Aspect House

Spencer Road

Lancing

West Sussex

BN99 6DA

Advisors

Corporate brokers

J.P.Morgan

25 Bank Street

London

E14 5JP

UBS Investment Bank

1 Finsbury Avenue

London

EC2M 2PP

Principal legal advisor

Ashurst LLP

Broadwalk House

5 Appold Street

London

EC2A 2HA

GO ONLINE TO FIND OUT MORE...

This report is complemented by a range of online information and resources: www.QinetiQ.com/investors



The QinetiQ Annual Report 2014 can be viewed at www.QinetiQ.com/Investors together with shareholder information and information on the Company, its performance, the Annual General Meeting and latest presentations.

What you find in each section: Overview

- Latest and historic share prices
- Financial calendar
- Regulatory (RNS) news
- Corporate governance

Shareholder services

- Register online via Shareview
- Common questions
- Dividend history

Financial reports

- Financial results and trading updates
- Company results
- Company presentations

Contacts

- Investor contacts

Corporate responsibility

- Further details of our corporate responsibility policy can be found at www.QinetiQ.com/cr

Investor Relations App

The QinetiQ Annual Report 2014 can also be viewed on our Investor Relations App for the iPad, downloadable from the App Store.

People Who Know How

Additional information is also available online on the case studies and QinetiQ employees featured in this report.

OptaSense®



www.QinetiQ.com/investors

Inspiring a generation



www.QinetiQ.com/investors

Australia



www.QinetiQ.com/investors

Maritime



www.QinetiQ.com/investors

Stay connected



Designed by luminous.co.uk

Registered office
Cody Technology Park
Ively Road, Farnborough
Hampshire GU14 0LX
United Kingdom

Tel: +44 (0) 1252 392000
www.QinetiQ.com

Company Registration Number
4586941

©QinetiQ Group plc