**Cobham plc**
Annual Report and Accounts 2017

**Front cover image:**
Cobham is investing in the development of a next generation life support system, based on its revolutionary VigilOX™ breathing sensors, that will directly respond to changing aircraft conditions and pilot physiology. VigilOX™ monitors pilot health and cockpit conditions through a unique combination of rapid response sensors. The sensors will interact with the oxygen system to prevent the onset of physiologic events.

**Inside cover image:**
Cobham is developing the next generation of aircraft SATCOM products called the Aviator 'S' Series. This provides cockpit connectivity and enables SwiftBroadband safety services in a smaller and smarter package. It is secured by over two million lines of code, protecting customers, including Airbus, from the next two decades of aviation related cyber threats.

Cobham is a leading global technology and services innovator, respected for providing solutions for the most challenging problems, from deep space to the depths of the ocean.

We employ about 11,000 people primarily in the US, UK, Europe and Australia. We have customers and partners in more than 100 countries.

**Total revenue**

£2,052.5m

(2016: £1,943.9m)

**Free cash flow***

£140.6m

(2016: £50.7m)

**Earnings per ordinary share – underlying***

6.0p

(2016: 7.8p**)

**Earnings per ordinary share – basic***

3.5p

(2016: (45.9)p**)

## Highlights of the Year

- Revenue 6% higher, benefiting from favourable currency translation. Organic revenue growth of 1%
- Underlying operating profit of £210.3m, slightly ahead of expectations
- Progressing delivery on the onerous contracts provided for in 2016, including KC-46, although risks and challenges remain
- Strong free cash flow generation as a result of management focus, later phasing of 2016 onerous contract cash flows, lower capital expenditure and £27m of advance customer receipts
- More resilient Balance Sheet with year-end gearing ratio at 1.3x and US$545m revolving credit facilities refinanced for five years or over
- Agreed divestment of AvComm and Wireless test and measurement for US$455m in cash; transaction will increase focus, reduce risk and further strengthen Balance Sheet
- Unchanged expectations for 2018 before divestment and currency translation

* For details refer to pages 94 and 102.
** Restated for the bonus element of the June 2017 Rights Issue.

# Contents



Visit us online at **www.cobham.com**

You can also view this Annual Report and Accounts online at **www.cobhaminvestors.com**


The Company is registered in England and Wales under company number 00030470. The Company's registered office is Brook Road, Wimborne, Dorset, BH21 2BJ, England.


The Annual Report and Accounts contains certain forward looking statements with regard to the operations, performance and financial condition of the Group. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated. Nothing contained in this Annual Report and Accounts should be construed as a profit forecast.

# Cobham has four Sectors with differentiated technology and leading market positions

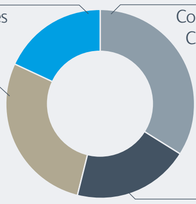
### The Group in 2017

Cobham offers technologies and services across its defence, aerospace and space markets. It has leading market positions in: air-to-air refuelling; aviation services; wireless; audio, video and data communications, including satellite communications; defence electronics; life support and mission equipment.

Cobham has four Sectors, each with differentiated technology and capabilities and leading market positions. Three Sectors design and manufacture intelligent hardware, primarily subsystems, also supplying components particularly where these can be integrated higher up the value chain. Within the Aviation Services Sector we provide often complex and customised services under long term contracts.

## Our revenue split by:

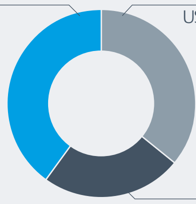
**Sector** (%)




£2,052.5m

(2016: £1,943.9m)

**Market** (%)




### Communications and Connectivity

Provides high performance equipment and solutions to enable reliable connectivity across a range of demanding environments in aerospace, avionics, satellite and radio, wireless and mobile connectivity markets.

**Main operating locations**
United States, United Kingdom, Denmark, France, South Africa, Finland and Sweden

| Revenue | Underlying operating profit |
|---|---|
| £700.7m | £69.0m |
| (2016: £690.2m) | (2016: £58.2m) |

**See page** 20 for more information

### Mission Systems

Provides safety and survival systems for extreme environments, aerial refuelling systems and wing-tip to wing-tip mission systems for fast jets, transport aircraft and rotorcraft. The primary focus is serving niche areas of the defence and security market globally, supplemented by an expanding presence in commercial aviation markets.

**Main operating locations**
United States and United Kingdom

| Revenue | Underlying operating profit |
|---|---|
| £419.0m | £55.2m |
| (2016: £386.4m) | (2016: £60.0m) |

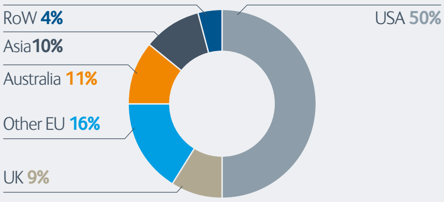
**See page** 22 for more information

For further information visit us online at
**www.cobham.com**

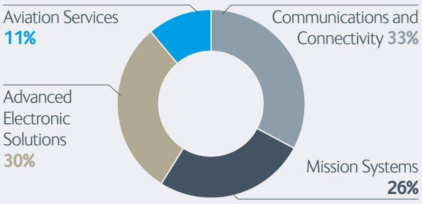
## Our underlying operating profit split by:

## Our employees worldwide:

### Geography (%)



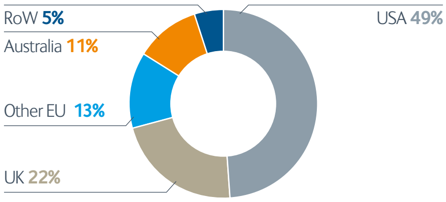

### Sector (%)




£210.3m

(2016: £225.0m)

### Geography (%)




10,813*

(2016: 10,692)

*Total permanent headcount at 31 December 2017.

## Advanced Electronic Solutions

Provides critical solutions for communication on land, sea, in the air and in space through off-the-shelf and customised products including radio frequency, microwave, and high reliability microelectronics, antenna subsystems and motion control solutions. This incorporates defence, including missile, radar and electronic warfare, X-ray imaging, medical and industrial markets.

**Main operating locations**
United States and Mexico

**Revenue**

£568.4m

(2016: £511.6m)

**Underlying operating profit**

£63.3m

(2016: £66.2m)

**See page** 24 for more information

## Aviation Services

Delivers outsourced aviation services for customers worldwide, including military training, special mission flight operations, outsourced commercial aviation, including fly-in, fly-out services to the natural resources industry and aircraft engineering.

**Main operating locations**
Australia and United Kingdom

**Revenue**

£366.6m

(2016: 357.2m)

**Underlying operating profit**

£22.8m

(2016: £40.6m)

**See page** 26 for more information

"Our products and capabilities have relevance to a global customer base

It has been a year of rebuilding and renewal and we have made encouraging progress

## Operational turnaround

2017 was extremely challenging for Cobham, being the first full year of the turnaround. It was a year of rebuilding and renewal, following a very disappointing 2016. Cobham started the year with a new Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as well as myself taking over as Chairman on 1 January 2017.

David Lockwood as CEO, and David Mellors as CFO quickly recognised the attributes of the business, including Cobham's differentiated technology, know-how and leading market positions. As I reported last year, they diagnosed what needed to be done to bring about an operational turnaround at Cobham, which would reverse the Group's negative performance trajectory. They agreed three operational priorities with our Board to give this process both clear objectives and instil a sense of momentum among employees. However, it was also recognised that the turnaround would take time as the underlying causes were in part cultural, as well as being linked to operational and execution weaknesses.

We have made encouraging progress against all these operational priorities, in line with our prior commitments, and I am pleased to say that the overall financial performance of Cobham in 2017 is slightly ahead of expectations. We have achieved a more stable operational and financial performance – including the important metric of on time delivery to the Group's customers. Having said this, it is very important not to get ahead of ourselves, as much remains to be done. While stability is a goal, it is certainly not the final destination – or anywhere near it. Our shareholders, customers and our employees deserve much more than this and the Board is absolutely clear that further significant progress needs to be made during 2018.

We have prioritised cash flow as a key measure of operational performance. This was not just because the net debt/EBITDA* gearing ratio was 3.0x at the end of 2016, but also because focusing on cash is just good business sense. As a result of the 2016 gearing level, the Group completed a Rights Issue in May 2017, raising 05£497m net of expenses.

Our net debt/EBITDA ratio at 31 December 2017 was far lower at 1.3x with the improved position due primarily to the Rights Issue. This was enhanced by the focus on our cash position, enabling us to deliver cash conversion of 103% in the year, and we will continue the focus on cash.

We also have some significant contract exposures, including on the KC-46 US tanker programme, as well as contingent liabilities that remain to be retired, and progressing these will also be a priority for 2018.

## Divestment of AvComm and Wireless

We have also made progress during the year in simplifying the portfolio, re-focusing on our traditional defence, aerospace and space markets. As announced in February 2018, we have agreed to divest the AvComm and Wireless test and measurement businesses for US$455m in cash and, with the completion of this transaction, we will have reduced portfolio risk, with a more coherent business and further resilience in the Balance Sheet.

## FCA investigation

In June 2017 we announced that the Financial Conduct Authority had appointed investigators to ascertain whether the Company had breached the Listing Rules and the Disclosure and Transparency Rules between April 2016 and February 2017, and the Market Abuse Regulations between July 2016 and February 2017. It is not possible currently to predict what the outcome of this investigation will be.

* For details on net debt/EBITDA gearing ratio and reconciliation to statutory numbers refer to note 16 to the Group Financial Statements.

## Dividend policy

I said last year that the Board would not announce a dividend in respect of the 2017 financial year. The Board recognises the importance of dividend payments to shareholders and will review the dividend policy as the turnaround progresses and the risk profile improves, seeking to resume a dividend when it is appropriate to do so.

## The Board and succession planning

Consistent with the rolling succession plan agreed with the Board, as set out in last year's Annual Report and Accounts, the Board has undergone a number of changes during the year. In implementing the plan, I have been cognisant that there is a need to balance the recruitment of experienced Non-executives with a measure of Board stability and continuity, and I have at all times tried to maintain this balance.

During the year we appointed John McAdam as Senior Independent Director, replacing Jonathan Flint who retired from the Board at the same time. René Médori and General Norton Schwartz (retired) were also appointed as Non-executive Directors. René Médori will take over as Chairman of the Audit Committee in April 2018 when Alan Semple will retire from the Board.

In addition, General Michael Hagee (retired) and Birgit Nørgaard have indicated that they will retire from the Board in April 2018. General Hagee will remain on the Cobham Advanced Electronic Solutions Sector Board, to which he was appointed in the first half of 2017.

The Board and I are extremely grateful for the service, hard work and dedication of Jonathan Flint, Alan Semple, General Hagee and Birgit Nørgaard and I thank them for their contribution to the turnaround.

I said last year that we would start the reinvigoration of our succession planning below Board level, to strengthen the quality and depth of management, although done diligently this would not be a quick task. We expect to continue progressing this through 2018. David Lockwood has made a number of senior management appointments in the year which have strengthened the management team and this has provided a foundation for our work on succession planning.

I continue to be impressed as to how hard our employees have worked to improve the Group's performance. The deep employee knowledge of our technologies, together with their capabilities and long experience, are key ingredients which will help us on the road to success.

In David Lockwood and David Mellors we have two executives who will take Cobham forward, supported by a strengthening and capable management team. I remain grateful for their dedication and commitment.

## Looking forward

2018 is another important year for Cobham as we accelerate progress on our turnaround, complete our senior recruitment goals and retire a number of remaining challenges so as to position ourselves for a strong performance thereafter.

**Michael Wareing**
Chairman
1 March 2018

> 2018 is another important year as we position ourselves for a strong performance thereafter

We have addressed the various issues that faced us and we are building the foundations of future success

### Overview

We are reporting financial results for 2017 which are slightly ahead of expectations, with Group underlying trading profit of £210.3m and organic revenue growth of 1%.

We delivered much improved cash generation in 2017, with operating cash conversion of 103%, and net debt of £383.5m at the year end. The Balance Sheet is now stronger than a year ago, reflecting the May 2017 Rights Issue and the benefit of the cash generation. The cash generation has been achieved from a combination of management focus and a benefit from some deferred cash phasing against the 2016 onerous contract charges, and lower capital expenditure. There was also some favourable working capital timing, including £27m of advance customer receipts.

During my first year, I have been impressed with the Group's technology and capabilities and its people and I have also had regular contact with many of our customers. This has reinforced my early conviction that Cobham has a number of high quality businesses with differentiated technology and know-how, and leading positions in a number of attractive markets. Taken together, this gives me confidence in the Group's medium term prospects.

### Encouraging first year of our turnaround plan

At our results announcement in March 2017, we identified a number of significant opportunities for improvement. These included improved execution, better first-pass quality, a reduction in organisational complexity and duplication, and improved capital allocation decision making. We continue to believe that these should enable Cobham to deliver underlying operating margins 2-3% higher over the medium term, all else being equal. We identified three operational priorities comprising (1) customer focus, (2) leadership and simplification and (3) control and execution. It was clear that the improvement process would be iterative and would take at least two years before we saw the benefits, with business units likely to respond at different speeds, and therefore potential for an uneven recovery.

### Operational environment

Driven by heightened security threats, we are beginning to see an increase in global defence budgets overall, although these are not without political risk. In addition, the US National Defense Strategy document, published in early 2018, makes technology modernisation one of its themes, with favourable implications for Cobham. Commercial aerospace markets continue to see volume growth, although there remain areas of commercial market weakness, including maritime and flying services in Australia. Across all markets, customers demand value-for-money, driving the need to be competitive on price; this alongside flawless execution and enhanced capability. It is to prosper in this environment that we are pursuing our turnaround strategy.

### Progress against operational priorities

We have made progress on the three operational priorities which I originally set out. These will continue to be a focus for 2018, with key achievements below:

#### Customer Focus

To enable us to grow the business, we need to understand our customers' needs, invest in our products and services, and deliver on time. We have significantly increased the level of CEO and senior management engagement with customers, supplementing the business unit level engagement. We are improving co-ordination to deliver greater customer facing collaboration and we have increased training during the year on root cause problem solving and lean manufacturing.

#### Leadership and Simplification

We will only achieve optimal results if our employees understand the Group's objectives, are motivated to achieve them and are made accountable. We are simplifying processes and procedures, which will provide more time for focus on customers, with monthly operating reviews enabling us to have a more constructive and forward looking dialogue with our business unit leaders and we are rolling out a new streamlined Group policy framework to ensure clearer governance.

We have strengthened the management team with focus on critical capability gaps. During the year, I appointed Air Marshall Greg Bagwell as Strategic Advisor and Chris Shaw as Chief Operations Officer. We have also strengthened the team by appointing Paul Kahn as President of the Communications and Connectivity Sector and Gillian Duggan as Executive Vice President Human Resources and Communications. These individuals bring strong operational track records, with considerable energy and ideas. I will continue to selectively strengthen the broader management team.

In addition, the Advanced Electronics Solutions Sector (CAES) operates under a Special Security Agreement (SSA), with the Sector Board critical to Sector governance and performance. The Board has been significantly strengthened during the year with the appointments of Admiral Steve Abbot USN (retired), General Mike Hagee USMC (retired), Cindy Moran and Scott Webster.

#### Control and Execution

Underpinning what we do is a need to improve the ability to forecast performance and enhance control. This includes strengthening supply chain management and quality management functions and making investments to improve our manufacturing performance. We have also provided definition and clarity over minimum standards of financial control for all our businesses.

In conclusion, we are beginning to see early signs of progress across the business. I am proud of how most of Cobham's employees have responded to the challenge and, in particular, their demonstration of real commitment to customers. However, while we have many improvement actions in-train and we have started to build the foundations of future success, there is much that is work-in-progress with a lot left to do.

### Update on 2016 onerous contracts

We are progressing delivery on our contracts against which we took significant charges in 2016, including on the largest of them, the KC-46 programme. KC-46 qualification is ongoing as part of the overarching US Federal Aviation Administration certification process. The work is being carried out according to the terms of the original development contract signed in 2011, which contains some significant terms including relating to delayed performance. The Centreline Drogue System qualification is nearing completion and the more complex Wing Aerial Refuelling Pod qualification will be ongoing into the second half of 2018.

We continue to support delivery of the first 18 KC-46 production aircraft to the US Air Force during 2018. A number of challenges remain, and the focus continues to be on achieving improvements in the supply chain and quality management.

On other programmes, we have taken some additional charges at the 2017 year end within Group underlying operating profit but overall our estimates for the 2016 onerous contract provisions are still appropriate. 2018 will be a critical year for delivering against these contracts.

### Balance Sheet

Our year end gearing ratio was 1.3x (31 December 2016: 3.0x). As I have previously stated, the improved position is due primarily to the May 2017 Rights Issue, which raised £497m net of expenses. This was enhanced by a greater level of focus on our cash position, enabling us to deliver cash conversion of 103% in the year. We will continue the focus on cash.

One year ago the Board set a net debt/EBITDA threshold of 1.5x in response to the immediate need to strengthen the Balance Sheet. We will review Cobham's Balance Sheet structure as the risk profile of the Group reduces, and we will set out a capital allocation policy at the end of 2018.

### Strategy

Our three operational priorities are only the first step in delivering an improvement in Cobham's fortunes. Cobham is best placed to generate value when it focuses on its defence, aerospace and space markets. We can add value where we serve markets we know with technology and capabilities, where we have real depth in skill and understanding. Accordingly we announced in February 2018 that we had agreed to divest the AvComm and Wireless test and measurement businesses for US$455m cash consideration, following an auction, with the businesses comprising approximately 8% of Group revenue in 2017. On completion of the divestment, we will have increased the coherency of the portfolio, reducing risk by exiting businesses with little commonality with the Group. Completion is subject to US anti-trust clearance and other customary conditions, and is anticipated in the first half of 2018.

Our strategy is focused on organic growth and aligned to our operational improvement priorities, as it will succeed when we combine our high value-add technology and capabilities with improved execution and delivery. Future growth will be driven by increasing the number of products and services we supply to our customers, as well as selling more of our technology and capabilities into attractive geographies. We will avoid higher risk, unrelated diversification.

### Technology investment

A technology focused company like Cobham needs to fund Private Venture (PV) investment. This keeps our products and technology fresh, by delivering the cost savings customers want and the capability enhancements they need. We are moving Cobham towards an appropriate methodology to ensure we are consistently allocating this investment for optimal returns.

### Outlook

The Group is one year into its turnaround programme. Whilst early progress is encouraging, there remains much to do in order to improve operational execution and efficiency and return the Group to strength. Risks and challenges remain in our business and the necessary actions to complete the turnaround are expected to take time and have associated costs. Overall for the Group, the Board's expectations for 2018 remain unchanged with a range of potential outcomes. Reported performance for 2018 will be affected by the timing of completion of the AvComm and Wireless test and measurement divestment, as well as foreign exchange rates impacting the translation of overseas business results. The Board has confidence in the medium term outlook for the Group.

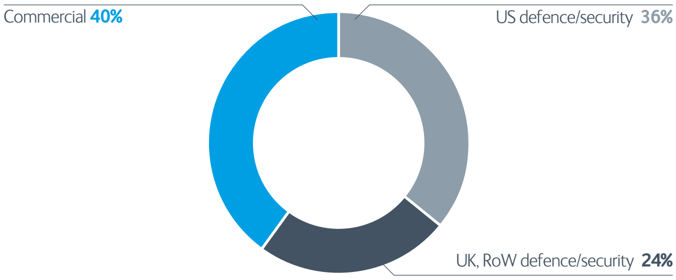
**David Lockwood**
Chief Executive Officer
1 March 2018

> It is my conviction that Cobham has high quality businesses with differentiated technology and know-how

# We have positions in three broad end-markets

Cobham's focus is on its defence, aerospace and space markets, each with attractive characteristics.

**Revenue by market** (%)




## US defence/security

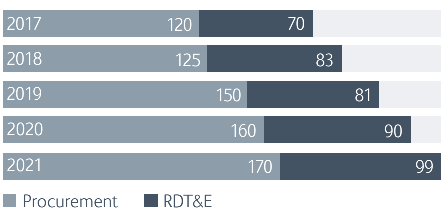
36% of Group revenue in 2017

### Our technology and capabilities position us to benefit from more favourable US market conditions.

Cobham is significantly exposed to the US Department of Defense (DoD) investment accounts, comprising the Procurement and Research, Development, Testing and Evaluation budgets. It also has some limited exposure to other DoD line items (e.g. operations) and to the Overseas Contingency Operations accounts, from which participation in regional conflicts are funded. In addition, it also has limited exposure to other US federal and state budgets including NASA, security agencies and police.

US DoD budgets are influenced by macroeconomic factors, including the state of the economy, but are also impacted by changes in global security tensions. Defence investment budgets increased in 2016 and again in 2017, after a period of year-on-year declines following the 2008-2009 financial crisis. In part, the change has been driven by regional conflicts but also by increasing tensions in the Middle East, North Eastern Asia, Eastern Europe and elsewhere. While the budget has started to increase, the actual disbursement of funds from budgets will only follow after, with a time lag between budget approval and the performance of work.

**US DoD budget** (US$bn)




Source: BAML Analyst Research, FY18 US President's Green Book

One of the primary focuses of DoD investment has been technology modernisation and this priority is set out in the National Defense Strategy published in early 2018. A priority has been high-end technologies which will protect expensive assets (e.g. ships and aircraft) and make them more capable. Cobham specialises in high-end technology, including sophisticated radar, electronic warfare, communications and life support products. In addition, there has been enhanced focus on missile defence in the face of proliferating ballistic missile strike capability, with Cobham having content on land based systems, such as THAAD and Patriot, and ship-borne systems, including Aegis and AMDR.

**Our response**

Cobham's technologies and capabilities are relevant to current US DoD priorities and it is therefore in a good position to benefit from increasing budgets.

The Group's operational priorities for 2017 and 2018 are aligned with increasing our share of markets with considerable work having been put into customer relationships and the improvement of our on time delivery. We have been simplifying the business, in part to increase accountability and focus, and we are addressing our cost base, including the supply chain, to enhance competitiveness.

## UK, RoW defence/security

24% of Group revenue in 2017

### We also seek to benefit from growing government budgets outside of the US market.

Cobham also supplies its products and services to a number of other governments around the world, in addition to the US.

In the same way that US defence spending has begun to increase, global defence spending generally has also reached an inflection point. While Asian and Middle Eastern markets in particular have continued to be strong, many European governments have started to increase budgets, after several years of decline. However, this situation is not universal, with Eastern and Northern European countries more likely to be increasing budgets strongly. In addition, the UK defence budget looks to be under budgetary pressure. However, there is increasing recognition in parts of Europe that heightened security tensions mean that defence should be allocated a growing budget.

**Indicative Growth Outlook in RoW Defence Expenditure** (US$bn)


Selected countries comprising Japan, Saudi Arabia, India, South Korea, Australia, United Arab Emirates and Kuwait.
Source: BAMLAnalyst Research, BMI Research Defence Industry Data

The continued growth in defence spending in Asia and the Middle East over recent years has been driven by existing factors, notably the combined impact of growing economies and regional security concerns. The fall in oil revenue which has been seen in recent years has typically not significantly impacted the high level of defence spending in the Middle East. For example, Saudi Arabia, which has the largest defence budget in the region, has announced a 6% increase to its budget in 2018.

Within the Aviation Services Sector in particular, Cobham also performs non-military government contracts including maritime surveillance and participation in fixed and rotary wing training and maintenance for military and non-military customers. While competitive, the long term market trends are expected to be favourable as Cobham is able to supply customers with military-like services, at a fraction of the estimated cost of a military asset, giving a cost effective solution for customer needs.

### Our response
Cobham's technologies and capabilities are relevant to military customers and governments globally and it is therefore well positioned to benefit from global growth in spending.

Not only do the Group's operational priorities for 2017 and 2018 align with increasing our share of our markets (see US defence/security on page 8) but we aim to increase our share of faster growing global defence and government markets by supplying more of our existing technology and capabilities into them. We have laid this strategy out in more detail within the Strategy section on pages 16 to 17.

Within our current exposure to platforms and programmes we are on a number of non-US platforms and programmes in development. These include the Airbus A400M and Embraer KC-390 programmes, as well as having won a significant position on the next generation South Korean (KF-X) fighter programme. These and other similar programmes should provide significant production and aftermarket revenue.

## Commercial
40% of Group revenue in 2017

### We have positions in a number of attractive markets, with the majority of revenue in aerospace, which includes space.

The bulk of our commercial positions are focused on products and services related to communications, particularly for use on the move and in harsh environments. Our markets are driven by long term global growth, including an increasing propensity to travel, leading to a requirement for access to voice, data and video communications in remote or challenging environments. In addition, our commercial markets are also favourably impacted by enhanced safety requirements, with examples of high profile commercial aircraft disasters in recent times underpinning a long term safety trend.

## Commercial
Our revenue is in a number of different end markets set out below.

**Aerospace 9%**

**Outsourced Aviation Services 8%**

**Marine SATCOM 5%**

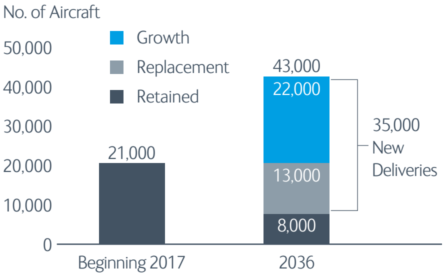
**Space 4%**

**Other* 6%**

*Other markets include: land SATCOM, medical, mining and industrial slip rings.

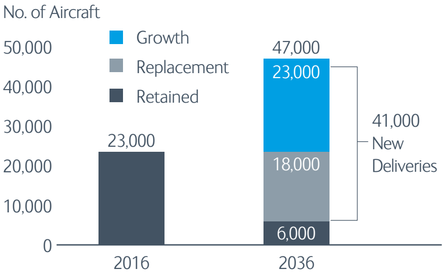
Our biggest commercial markets are in commercial aerospace where we have a number of products that are standard fit on new build large transport commercial aircraft. Within this market we expect to benefit from increased production rates in the longer term, as well as supplying products that can be retrofitted on to existing aircraft or which are linked to hours flown.

### Airbus




Source: Airbus global market forecast 2017-2036 "Growing Horizons". Includes passenger aircraft above 100 seats, freighter aircraft above 10 tonnes.

### Boeing




Source: Boeing current market outlook 2017-2036. Includes all aircraft, including freight and regional jets.

We also have positions in commercial aviation services and these include closed charter flying in Australia for natural resources customers, a market in which we face headwinds currently, as customers cut costs and production capacity, although there are some early signs of recovery. Within our other commercial markets, we also face short term headwinds from market conditions in commercial marine, where we supply SATCOM products to commercial shipping, oil and gas and leisure craft. Both these markets have good medium term prospects, once the down cycles end.

### Our response
As with our other end markets, not only do the Group's operational priorities for 2017 and 2018 align with increasing our share of our markets, but we are making significant investment in PV as a means of increasing our market share. Following on from recent wins on the Airbus A320neo aircraft, including for SATCOM products, we are continuing the development of the Aviator 'S' light SATCOM product for Airbus single aisle and long range aircraft families, as well as the new digital Radio and Audio Integrated Management System for the Airbus A320neo.

We have carried out a strategic review of our AvComm and Wireless test and measurement businesses during the year, and we announced an agreement in February 2018 to divest them, enhancing the focus on aerospace and space markets. These businesses accounted in 2017 for 8% of Group revenue and this is excluded from the end markets explanations opposite.

"Our products and capabilities have relevance to customers globally"

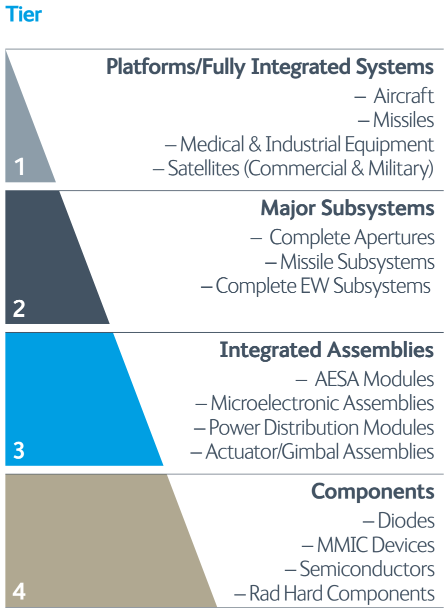
The Theater High Altitude Area Defense (THAAD) system incorporates antennas, mission computers, microcircuits and microprocessors supplied by Cobham. The THAAD interceptor is guided to its target by the TPY-2 radar, which uses waveguide, switches, time delay units and other modules also provided by Cobham. Credit: Lockheed Martin

# Our core capability is specialist intelligent hardware, with focus on our defence, aerospace and space markets

## What we do

Cobham predominantly offers subsystems (tier 2 and tier 3) and products within its markets, while also supplying components (tier 4) particularly where these can be integrated higher up the value chain.

The Group also offers tier 1 services, as not only does this result in a recurring and sustainable revenue stream through long term contracts, but it can help cross-sell our products and demonstrate their capabilities to potential customers in a live environment so enabling a 'product in a service' wrapper.




## What Cobham needs to do well to be a successful business and how this links to the Group's turnaround strategy

## Identify

### Strong customer relationships

Cobham needs to be in frequent contact with customers to understand their needs, be responsive to their requirements and deliver to their time schedules.

**Link to strategy**
- We are increasing interaction with our major customers
- We are appointing key account managers across the Group
- We are collecting and reviewing key customer data

For further details, please refer to Our Turnaround Strategy on pages 14 and 15.

### Leading market positions and reputation

Reputation and the proven ability to deliver is a key consideration in many markets, giving customers' confidence in delivery. Having a leading market position should also increase the return from technology investment.

**Link to strategy**
- We are providing greater oversight on major development programmes to maintain our market positions
- We are investing in our manufacturing facilities to improve delivery

For further details on our manufacturing investment, please refer to Mission Systems on page 22 and Advanced Electronic Solutions on page 24.

## Design and Engineer

### Knowledge and experience in our specialist markets

The ability to deliver products and services in specialist markets is dependent on deep understanding and experience. This requires the knowledge and know-how of technical specialists.

**Link to strategy**
- We invest in training and development for our employees
- We are attracting emerging talent including apprentices and graduates

For further details, please refer to CRS section on pages 40 to 43.

### Investment in PV

Cobham is a business that delivers intelligent technology and it needs to continually invest in PV to maintain technology differentiation and develop next generation products and services. It can never afford to stand still.

**Link to strategy**
- We are managing our PV investment rigorously to optimise the expected returns
- We are continuing to improve our technology capabilities through innovation

For further details, please refer to Our Turnaround Strategy on pages 14 and 15.

### Programme management expertise

Cobham often works at the leading edge of technology and needs to manage and monitor its technology developments, to ensure they are delivered on time and to budget.

**Link to strategy**
- We are providing greater oversight on major development programmes
- We are investing in training and deploying our best managers across our businesses
- We appointed a new Chief Operations Officer to integrate management of certain technical functions

For more details, please refer to the CEO's Statement on pages 6 and 7.

## Deliver

### Manage the supply chain

The supply chain is a critical factor in the ability to manufacture and deliver products on time and to the right quality.

**Link to strategy**
- Supply chain and quality management functions are being consolidated under a single leader to drive performance improvement and standardisation
- We have invested significantly in training and remediation activities
- We have seconded staff to critical suppliers

For further details, please refer to Our Turnaround Strategy on pages 14 and 15.

### Operational Excellence

Notwithstanding the Group's leading edge capabilities, customers want solutions that are delivered on time, to the required quality and which give value for money. The Group has a Continuous Improvement (CI) team, with a CI culture being embedded to enable us to deliver consistently.

**Link to strategy**
- We are reviewing our manufacturing strategy
- We are investing in our facilities to improve performance

For further detail, please refer to Our Turnaround Strategy on pages 14 and 15.

### Strong Balance Sheet

We operate in a number of long term markets, where programmes and platforms can last decades. Our customers must have confidence that we have the financial strength to continue to invest and deliver throughout the life of long term programmes.

**Link to strategy**
- We completed a Rights Issue in 2017 which reduced our gearing ratio
- Cash generation is a continual focus
- We aim to reduce working capital over time

For further details, please refer to the CFO statement on pages 28 to 33.

## What sets Cobham apart is its leading edge capabilities and know-how

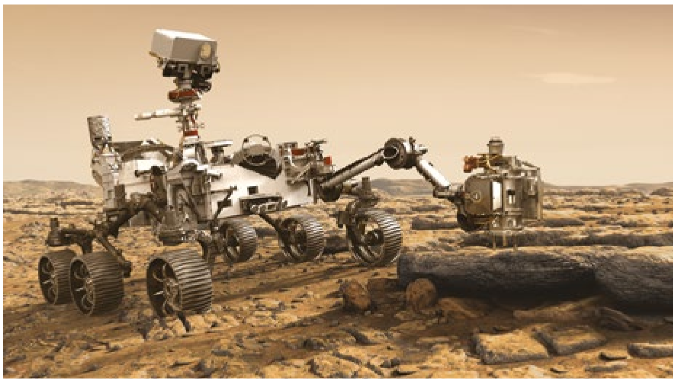
Cobham's true differentiation arises in its specialist capabilities and know-how which are often high value add, and sold to customers who have a requirement for the most demanding environments – such as on aircraft, in space or in remote or inhospitable environments. It is this ability to design, develop and manufacture high-end products, including for extremely demanding applications, that truly sets Cobham apart.

This differentiation means that the Group has often found itself at the forefront of engineering and technology and below are some examples of where its technology has helped customers achieve special results:

Cobham Mission Systems: Our Cobham oxygen products have enabled every US astronaut to breathe in space.
Credit: NASA

Cobham Aviation Services: Since 1996 Cobham has operated the largest outsourced maritime surveillance contract in the world for the Australian government. Today, aircraft converted by Cobham are used on this contract that are equipped with a suite of sophisticated sensors and electronics.
Credit: Australian Border Force

Cobham Communications and Connectivity: Every Airbus aircraft uses Cobham's equipment, including the Group's antennas and avionics, a position that will continue with Airbus' next generation of aircraft.
Credit: Airbus



Cobham Advanced Electronic Systems: Cobham provides critical actuators on a number of space exploration vehicles, including the NASA Mars 2020 programme. These are used to drive the wheels, operate the steering and deploy the sensing mast among other critical applications.
Credit: NASA

## Key factors that underpin our business model

### Culture

Developing a high performance and disciplined operational and financial culture is key to Cobham's success as it is essential to deliver products on time and to budget. The turnaround in performance that is underway is dependent upon making improvements to Cobham's culture. One major focus is Cobham's ability to attract, retain and develop talent: this is critical to execute on strategic growth plans and deliver against key programmes.

### Ethics

Cobham operates in a number of highly regulated markets, often operating with sensitive technologies and capabilities for government customers. This requires Cobham's employees to be aware of their responsibilities and to always conduct business in an ethical way, underpinned by training and processes put in place to ensure compliance with all relevant regulations. For example, Cobham has a clearly stated Anti-Bribery and Anti-Corruption Policy, and all employees are required to receive training annually.

### Health and Safety

Cobham has a robust attitude towards health and safety, having a programme which promotes continuous performance improvement, creating a safe environment for employees. Health and safety is of paramount importance and a prerequisite for the Group's success. A good health and safety performance is also linked to operational excellence, and therefore integral to our turnaround.

### Environment

Cobham recognises the importance of developing products that are smaller, lighter and which consume less power than previous generations and competitor products. In doing this, each new product iteration results in increasing environmental benefits, lowering both customer operating costs and emissions.

For more details on these enablers, please refer to CRS section on pages 40 to 43.

# Cobham's products are integral to the self-defence and potency of US aircraft carrier battle groups

Cobham content is present on every ship, aircraft and missile that makes up a modern US Navy aircraft carrier battle group.

## Aircraft Carrier

**SEWIP** (Surface Electronic Warfare Improvement Program) – protects the ship from airborne threats (aircraft and missiles) by jamming radars and sensors.

- Cobham provides SEWIP with antenna array panel assemblies and above deck electronics that focus the system's energy toward the target, and microelectronics to route and convert signals.

**Enterprise Air Surveillance Radar** – a next generation radar for future aircraft carriers which is currently in development.

**Evolved Sea Sparrow Missile (RIM-162)** – a guided missile for use against cruise missiles, helicopters and surface threats.

- Cobham provides ESSM with microelectronics.

## Missiles

- Cobham provides seeker microelectronics, fuzing and datalinks on the **Standard Missile** family (a shipborne guided missile used to defeat airborne threats including aircraft, anti-ship cruise, and ballistic missiles).
- Cobham provides microelectronics used for guiding the **AMRAAM (AIM-120)** airborne anti-aircraft missile and the **AIM-9X** airborne anti-aircraft missile.

Credit: US Department of Defense

## Guided Missile Destroyers and Cruisers

**SEWIP** (see opposite).
**AMDR** (Air and Missile Defense Radar or AN/SPY-6) – this new 3D radar will be an integral part of the AEGIS weapon/combat system when it replaces the current radar. The AEGIS system protects ships, aircraft and land based assets by detecting, tracking and targeting airborne threats with missiles and weapon systems.

- Cobham provides the AMDR digital receiver exciter and other microelectronics on the AEGIS system.
- Cobham also provides waveguide assemblies that route signals throughout the system.

**UHF antennas** – these enable communication via satellite.

## Aircraft

US Navy aircrew use a variety of Cobham safety and survival products, including oxygen and fuel inerting systems, restraints and water activated release systems.

Cobham provides a range of microelectronics for electronic warfare, radar, communication, navigation and identification – these capabilities help keep **F-18**; **E/A-18G** and **F-35** fighter crew safe, aware and able to accomplish their roles.

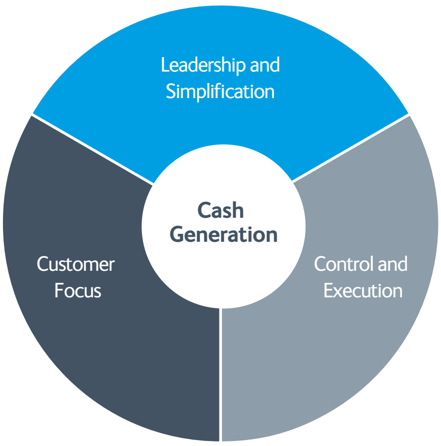
Cobham provides a variety of equipment including on the **V-22** tiltrotor multirole aircraft, **E-2** airborne early warning aircraft and **MH-60** anti-submarine helicopter including antennas, aerial refuelling systems and microelectronics.

## We have many improvement actions in train and we are beginning to see early signs of progress

The first objective of our strategy is to improve our operational performance with the aim that this is a relentless focus for every employee. Implementation of the turnaround will take time and the rate of progress across the businesses may not be uniform. However, a successful outcome will help us realise the great potential within Cobham.

We identified three operational priorities for 2017 and 2018 and success will enable us to deliver to our customers' and shareholders' expectations. Central to all of this is a laser focus on cash.

### Turnaround strategy:




### Plans for 2018

While we have many improvement actions in-train and done much to build the foundations of future success, there is much that is work-in-progress with a lot left to do. We have made progress against the three operational priorities but they will continue to be a focus for 2018. In addition, we will continue the focus on cash generation in 2018.

| | Customer Focus | |
|---|---|---|
| **Why this is important** | Cobham operates in attractive markets with good medium term opportunities. Typically, it has high value add capabilities and leading market positions, representing significant barriers to entry. There are many opportunities for the Group's businesses to increase market share, as there is a real need for its products.<br><br>In particular, customers will conduct more business with Cobham if the Group's delivery consistently meets the customers' schedule and quality requirements. | |
| **Our focus areas** | – Improving customer intelligence and building relationships<br>– Monitoring and driving customer satisfaction<br>– Focusing on improving delivery | |
| **Principal risks** | See principal risks 1, 5. | |
| **Where we started the year** | Cobham had become too internally focused over time, with centrally driven change programmes and large scale acquisition activity having consumed significant financial resources and management attention. There was a need to re-focus on customers, as the source of Cobham's prosperity.<br><br>There has been investment over the years on PV, however this substantial investment has not always yielded the expected return. This could mean Cobham's investment has not always been in the areas of greatest customer need or that the investments made have not been timely or efficiently undertaken. | |
| **Progress during 2017** | There is increasing interaction with major customers by senior management, and this is supplementing and complementing business unit level engagement.<br><br>Key customer related indicators are being collected and reviewed monthly and Cobham is actively using and reviewing customer supplied score cards to improve performance.<br><br>There is improved co-ordination between the businesses to deliver greater customer facing collaboration through the pooling of information and participation in joint presentations to customers.<br><br>There is focus on internal processes where this will result in an improved on time delivery performance. This is being supplemented by training, coaching and business-specific improvement programmes.<br><br>Greater rigour is being instilled into our PV investment processes by ensuring investment is allocated for return and the sums invested are managed rigorously. This will mean we are allocating investment to critical customer requirements and we are delivering on a timely basis. | |
| **Key Statistics and link to KPIs*** | **£1.9bn**<br>Order intake<br>(2016: £2.1bn)**<br><br>Please refer to the CFO Statement on pages 28 to 33. | **1%**<br>Organic revenue growth<br>(2016: (8)%)<br>1<br>Please refer to the CFO Statement on pages 28 to 33. |

* KPIs are identified using a numbered icon #. Please refer to pages 18 to 19 for KPI detail.
** Includes AUS$719m related to the repriced multi-year Qantas contract.

| | Leadership and Simplification | Control and Execution |
|---|---|---|
| **Why this is important** | Having a motivated and accountable work force, working to clear and understandable rules, within a more cohesive portfolio of businesses, will improve the ability to respond quickly and effectively to market developments and customer needs. This will help take advantage of opportunities as they arise. | Improved control and execution enhances the ability to consistently deliver to customers on time, so earning repeat orders and increasing content.<br><br>In addition, reduced development cost overruns, lower levels of late deliveries and improvements to first pass quality performance will also deliver significant cost and operating margin improvements over time. The focus on the supply chain and manufacturing strategy should also contribute to a lower cost base, enabling more competitive market offerings. |
| **Our focus areas** | – Instilling a common sense of purpose and motivation<br>– Reducing and simplifying internal policies<br>– Focusing on the most critical performance metrics | – Increasing visibility and accountability<br>– Increasing scrutiny over key development programmes<br>– Operational improvements |
| **Principal risks** | See principal risks 4, 10. | See principal risks 3, 5, 6, 9, 11. |
| **Where we started the year** | The Group's reporting structures, including its internal processes and the allocation of responsibilities had become overly complex and unclear and there was a broad portfolio of businesses. In a number of instances there had been examples of duplication of responsibility, reduced accountability and slow decision making, which contributed to some sustained operational and financial challenges. In addition, the Group had not always integrated its acquisitions well, which caused an additional lack of clarity. | There had been a succession of performance issues in a number of Cobham businesses which stemmed from weaknesses in management and in financial controls; contractual and commercial failures and, in a few businesses, from more challenging market conditions. However, in the main these have come from operational issues which include poorly worded contracts; late delivery against development programmes; poor financial forecasting; inadequate on time delivery to customers; and a need to improve quality levels. |
| **Progress during 2017** | The Group has been strengthened by adding a new Chief Operations Officer role and by making other significant senior appointments including a new President of the Communications and Connectivity Sector and a new Executive Vice President of Human Resources and Communications, who brings a track record of driving transformational change. The broader management team will continue to be selectively strengthened.<br><br>There is increased senior management visibility through site visits and staff meetings and increased engagement with the top 200 managers in the Group, to instil a common sense of purpose and collaboration.<br><br>Monthly business unit operational reports have been standardised with a comprehensive pack for reporting and forecasting.<br><br>Some 60 system reports and 80 data line items have been removed from the Group reporting suite and the number of non-financial key performance indicators has been cut by up to 70%.<br><br>The Group policy framework has been streamlined and there are revised delegated authorities in a single consolidated table, and this is used as an active management tool reflecting business unit performance. | The previous quarterly Sector level operational reviews are now monthly reviews at the business unit level, giving greater clarity on performance and improved accountability for delivery.<br><br>There is an increased Group level oversight over key projects and material development programmes so problems are identified earlier, when there is greater scope to resolve them. See also Customer Focus on page 14.<br><br>There has been significant investment to remediate quality management, product quality and supply chain and infrastructure failings in larger sites. There has been additional training and business unit specific remediation action taken.<br><br>The supply chain management and quality management functions are being consolidated to drive improved performance and standardisation across the Group.<br><br>We are progressing the onerous contracts on which Cobham took significant exceptional charges in 2016, including on the largest of them, the KC-46 programme. A number of challenges remain with focus on achieving improvements in the supply chain and quality management. |
| **Key statistics and link to KPIs*** | **60**<br>Number of system reports removed<br><br>**10%**<br>Voluntary staff turnover (2016: 10%)<br>6 | **711**<br>Continuous improvement training courses undertaken (2016: 504)<br><br>**87%**<br>Customer on time delivery (2016: 86%)<br>5 |

# We are looking to implement a growth strategy which is aligned to our improvement initiatives…

## Strategy

The Board has considered the Group's strategy evolution and has concluded that Cobham is best placed to generate value when it focuses on its defence, aerospace and space markets – in which it designs and delivers services, systems and products. Cobham can add value where it serves the markets it knows with technology and capabilities where there is real depth in our skill and understanding.

This strategy, which focuses the portfolio within these markets, also recognises that Cobham's positions may mitigate the risk from economic cycles. For example, within its defence/security markets, Cobham has significant positions funded out of government budgets around the world including in the US, Europe, the Middle East, Asia and Australasia. These budgets often do not move in synchronicity, which may reduce the impact from a decline in any one of them.

## 2017 Portfolio review

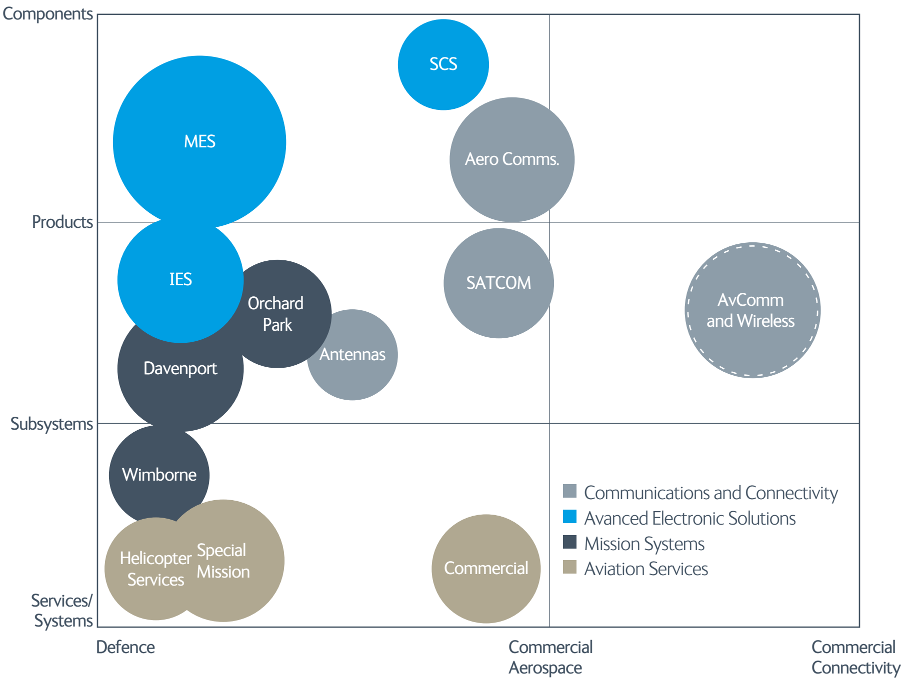
A review of the portfolio was undertaken during the year. The AvComm and Wireless businesses were placed under strategic review to investigate how best to optimise shareholder value, given their strong technology and/or market positions. The review considered a range of strategic options from better aligning the Group's operations and management to these businesses, to divesting them to an owner who is better able to add value to them.

In February 2018, the agreed divestment of the AvComm and Wireless test and measurement businesses was announced for US$455m in cash on completion, with completion expected in the first half of 2018. The businesses recorded approximately £170m of revenue during 2017, or approximately 8% of the Group. The divestment of these businesses will result in Cobham having a simplified portfolio of technologies and capabilities, with a focus on defence, aerospace and space, and a reduced risk profile, as it has exited businesses with little technology, customer or market overlap. Completion of the divestment will also further strengthen the Balance Sheet.

The portfolio review set out below showed that AvComm and Wireless were outliers within Cobham's portfolio:

> The strategy is built around Cobham's organic growth potential

### The Cobham portfolio




Bubble size is approximately proportional to revenue.

# …and takes into account our risk appetite

Given the overriding necessity to turn the performance of the businesses around, the Group's strategy is aligned to its operational improvement priorities (set out on pages 14 and 15) as it is focused on organic growth. As previously set out, Cobham's turnaround in performance and its opportunities to generate growth will be largely achieved through "self-help" measures, driven by its operational performance improvements. In particular, customers will conduct more business with Cobham, if the Group's delivery consistently meets the customers' schedule and quality requirements. This must be combined with customer desire for competitive prices and the requirement for technology and know-how to provide enhanced capabilities and operational advantage.

Future growth will be driven by increasing the number of the Group's products and capabilities sold to existing customers, as well as expanding Cobham's reach to sell more of Cobham's technology and capabilities into attractive geographies. The Group will avoid higher risk, unrelated diversification.

In summary, the approach will only succeed when high value add technologies and capabilities are combined with improved delivery to customers, in line with their needs. Successful implementation will make Cobham a trusted and valued supplier of key technologies to its customers.

The strategy for growth therefore has complementary but different directions of travel, which will underpin the delivery of the Group's revenue growth:


### Existing markets and products

Currently Cobham primarily sells to customers that are concentrated in a limited number of geographic markets.

### Product/service development

Sell more leading-edge technologies and capabilities to existing customers by offering similar capabilities that are complementary to what Cobham already supplies. The anticipated improvement in operational performance, leading to increased on time and on budget delivery, will enable the Group to expand its footprint with its existing customers, increasing our share of their spend.

### Geographic market development

Market and sell increasing amounts of existing products and services to customers across a wider range of attractive geographic markets, enabling Cobham to expand its customer base and geographic footprint.

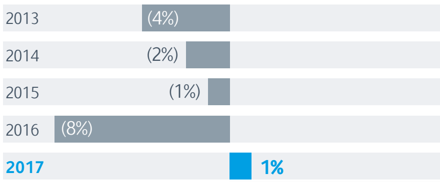
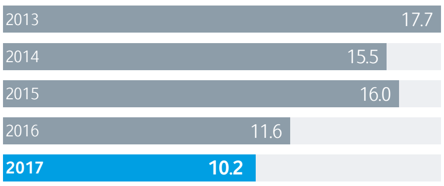
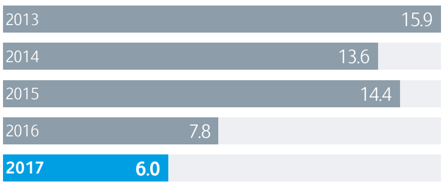
However, Cobham will avoid:

### Unrelated diversification

Diversification into new and unfamiliar markets – selling new products and capabilities to new and unfamiliar customers. Diversification is a higher risk strategy from which Cobham is less likely to deliver sustainable shareholder value.

# We are undergoing a period of change, but the way we measure our success has not fundamentally changed

In 2017, we have performed a review of our KPIs to ensure that they are still relevant to our business and aligned with our strategic objectives. Changes to the measures have been explained below.

| KPI, description and rationale | | Change to KPI and/ or target | 2017 progress and medium-term target |
|---|---|---|---|
| **1. Organic revenue** (%)<br>Organic revenue is stated at constant translation exchange rates, excluding the incremental effect of acquisitions and divestments.<br>Sustainable organic growth is an important means by which value can be created.<br>£ A |  | In today's market environment, the Group has reviewed its sustainable rate of revenue growth. | Group organic revenue growth was 1.2%, the first year of growth achieved since 2011.*<br>**Target:** Low to mid-single digit percentage organic growth. |
| **2. Underlying operating margin** (%)<br>The Group's underlying operating profit divided by its revenue in a reported period.<br>A sustainable increase in the trading margin is a key value creator for the Group.<br>A |  | This is a newly included KPI as management considers an increase in the underlying operating margin to be a major contributor to future value creation. | The underlying operating margin was 10.2%, in the first year of the Group's turnaround.<br>**Target:** 12-14% |
| **3. Underlying EPS** (pence)<br>Underlying profit after taxation less amount attributable to non-controlling interests, divided by the weighted average number of ordinary shares.<br>Earnings per Share (EPS) is an important metric used by shareholders. It is used to encapsulate the financial performance of the Group including revenue growth, operating margin progression, the cost of debt finance and the rate of underlying taxation.<br>£ A |  | The medium term EPS target is primarily driven by organic revenue growth potential and the medium term operating margin opportunity. | Underlying EPS was lower than the prior year. This reflected primarily the higher share count following the Rights Issue and lower underlying operating profit.<br>**Target:** Mid-single digit percentage growth. |

* Core business organic revenue growth in 2011.

** On time to promise (OTTP).

*** Targets are reassessed annually to ensure they drive continuous improvement.

£ Used as a measure for determining executive remuneration.

A Alternative Performance Measure.

| KPI, description and rationale | | Change to KPI and/ or target | 2017 progress and medium-term target |
|---|---|---|---|

## 4. Operating cash conversion (%)

Operating cash flow as a percentage of underlying operating profit, excluding the share of profit from joint ventures and associates.

Cash generation is a particular focus for Cobham and will aid the strengthening of the Balance Sheet and investment in the business, enabling the Group to provide returns to shareholders.

£ A


**Change to KPI and/or target:** The medium term conversion target is an increase on the previous target of >80%, demonstrating the enduring cash generation of the business. It will be on a sustainable basis primarily once Cobham has completed its onerous contracts and utilised the other provisions that it took as exceptional in 2016.

**2017 progress and medium-term target:** Operating cash conversion was driven by later phasing of 2016 onerous contract cash flow, lower capital expenditure and £27m of advance customer receipts.

**Target:** Around 90%

## 5. On time delivery** (%)

Number of complete orders delivered on time as a percentage of the total number of orders promised for delivery in the same period.

Delivering products and services in line with customer schedules, to budget and to our agreed performance and quality is essential to growing market share.

A


**Change to KPI and/or target:** KPI unchanged.

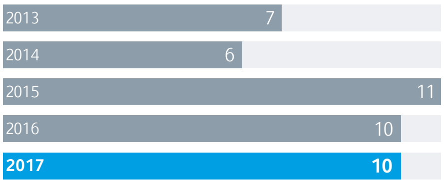
**2017 progress and medium-term target:** On time to performance stabilised following a decline in 2016, as business units respond to actions taken at different speeds.

**Target:** >90%

## 6. Voluntary staff turnover (%)

The number of voluntary leavers divided by the number of employees at the start of the period, excluding employees who became redundant, were dismissed or retired.

Retention of key staff is critical to business stability and is particularly important for a technology business needing specialist skills and capabilities.




**Change to KPI and/or target:** KPI unchanged.

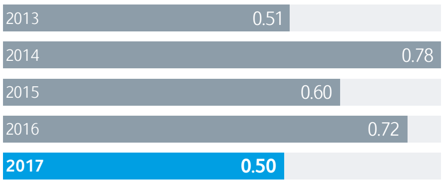
**2017 progress and medium-term target:** Voluntary staff turnover stabilised, reflecting the first year of the turnaround with the Group's structures, ways of working and culture undergoing a period of evolution.

**Target:** <10%

## 7. Lost work case incident rate

The number of lost workday injury/occupational illness cases multiplied by 200,000, divided by hours worked.

Ensuring a safe working environment for employees is an absolutely essential underpinning to our progress and fundamental to attracting and retaining talented employees. Improving health and safety is linked to the Group's operational improvement plans.




**Change to KPI and/or target:** Health and safety performance is linked to Cobham and it has used a standard metric for aerospace and defence companies, enabling it to benchmark its performance.

**2017 progress and medium-term target:** The lost work case incident rate improved on the previous year as a result of the ongoing measures taken to improve performance. These are set out in the CRS section on pages 40 to 43.

**Target:** <0.640 in 2017 ***

**2016 KPIs not included**

The Group is no longer using total PV investment and Return on Invested Capital (ROIC) as KPIs. This is because the Group is not focusing on absolute PV investment as a measure, preferring PV as an input with focus on its organic revenue and underlying operating margin performance. The 2017 KPIs are focused on achieving operational improvement, whereas the Group's ROIC measure is significantly reflective of previous M&A, most notably the 2014 acquisition of Aeroflex.

# Enabling reliable connectivity anywhere, anytime

**Provides high performance equipment and solutions to enable reliable connectivity across a range of demanding environments in aerospace, avionics, satellite and radio and mobile connectivity markets.**

Organic revenue was 3% lower, principally impacted by lower volumes in the AvComm and SATCOM business units. This was partially offset by higher organic revenue in the Antenna Systems and Wireless business units.

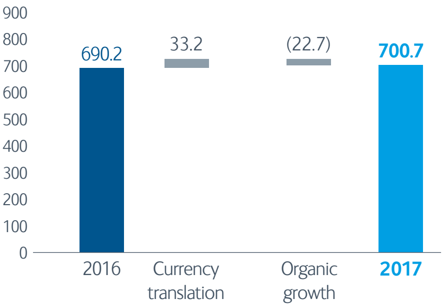
Within AvComm revenue was impacted by the previously announced transition between master distributors in the first half, albeit with a half-on-half improvement. The SATCOM business had lower revenue in its maritime markets, with the environment continuing to be challenging. Revenue in Antenna Systems was driven by increased antenna shipments on US defence/security programmes and, in Wireless, revenue reflected increased shipments of 5G related test and measurement products, including the TM/E-500 family.

In February 2018 the agreed divestment of the Sector's AvComm and Wireless test and measurement businesses to Viavi Solutions Inc. was announced for US$455m in cash, payable on completion. In 2017, the businesses recorded aggregate revenue of £169.6m and underlying operating profit of £13.6m (a £24.8m contribution before the allocation of central charges and £2.4m of restructuring costs). The transaction is expected to complete within the first half of 2018.

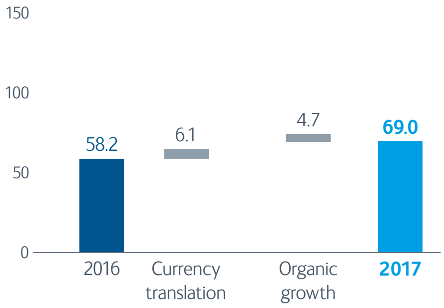
Underlying operating profit increased by £4.7m after the impact from exchange rates, reflecting improved sales volumes and a restructured cost base in the Wireless business, as well as higher sales volumes in Antenna Systems. In 2016, Wireless profit was also reduced by £9m due to accounting adjustments related to operational issues. These movements were partially offset by lower trading in the AvComm and SATCOM businesses, as well as increased PV investment in next generation aerospace SATCOM products.

The Sector has won some significant awards during the year, including the conformal antenna suite and an initial order for the anti-jam GPS system on the next generation South Korean K-FX fighter aircraft programme. In addition, the Sector has received initial orders for its Flightline radio for an upgrade of the Boeing T-38 trainer aircraft in the US, with further orders expected. Having also completed the development of its next generation panel mounted RT-7000 radio, the Sector made initial shipments in the first half, with a strong pipeline of orders for the product from government and commercial aviation customers.

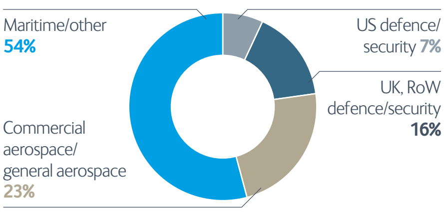
**Sector revenue** (£m)



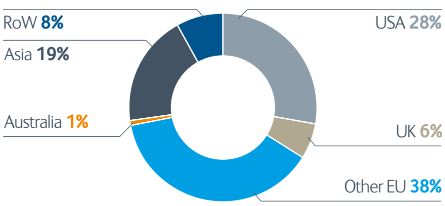

**Sector underlying operating profit** (£m)




**Revenue by market** (%)




**Revenue by geography** (%)




| Order intake | Organic revenue | Underlying operating margin | Number of employees |
|---|---|---|---|
| £715.2m | (3.1)% | 9.8% | 3,197* |
| (2016: £647.3m) | (2016: (5.1)%) | (2016: 8.4%) | (2016: 3,430) |

* Total permanent headcount at 31 December 2017.



**Main image**
Cobham's RT-7000 radio sets a new standard for airborne tactical radios. Being software defined, it has modules that can be upgraded to reflect changing operator requirements.

**Small image**
Cobham has a portfolio of land based SATCOM products, including the 935 series Tactical Direction Finder.

# Leading capabilities including aerial refuelling and survival systems for extreme environments

**Provides safety and survival systems for extreme environments, nose-to-tail aerial refuelling systems and wing-tip to wing-tip mission systems for fast jets, transport aircraft and rotorcraft. The Sector's primary focus is serving niche areas of the defence and security market globally, which is supplemented with an expanding presence in commercial aviation markets by applying its differentiated technology, particularly in pneumatic and actuation systems.**

The 6% increase in organic revenue reflected continuing growth in actuation control subsystems for air-to-ground munitions, with a significant production increase during the year. Aerial refuelling revenue increased on the KC-46 and V-22 Aerial Refuelling System development programmes, partially offset by lower Airbus A400M revenue. There were also increased shipments of the Sector's long life Air Separation Module for the Boeing 737 NG, which reduces the flammability of its fuel tanks, with a further airline customer signed in the year.

Underlying operating profit decreased by £8.8m after the impact from exchange rates and the 2016 divestment. Underlying operating profit was adversely impacted by costs incurred on additional resource to improve quality and supply chain management, as well as some additional charges taken against development programmes. However, there was a benefit from increased volumes, including from actuation control subsystems.

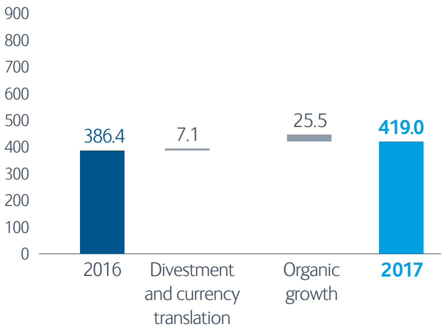
A comprehensive business change programme is underway in the Sector's Wimborne, UK facility, where a number of development programmes are moving into production. The programme, which commenced in 2017, comprises all areas of the business, including a reorganisation of the shop floor to accommodate a ramp up in production rate, a streamlining of business processes, and an investment in continuous improvement activities.

Order intake increased on the prior year in part through strong demand for actuation control subsystems for air-to-ground and laser guided munitions, with multi-year contracts secured from two major US primes for domestic and export markets.

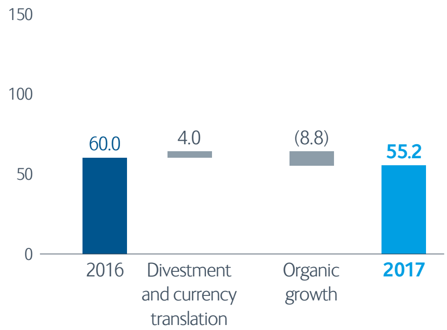
In addition, 808E Hose Drum Unit (HDU) certification flight tests were completed in December for the A400M programme. This latest series of flight tests were conducted by day and night with F/A-18 and A400M receiver aircraft. Final type approval for the HDU is continuing. The Sector has also secured customer funding to develop a Helicopter Refuelling capability for the A400M, a significant enhancement for this aircraft.

Cobham has accumulated over 15,000 CRU-123 (oxygen sensor) flight hours on the Boeing T-45 aircraft. The CRU123 records oxygen concentration and pressure and has been instrumental in supporting the US Navy's Physiologic Events (hypoxia) investigation. Furthermore, the Sector's new VigilOX (breathing sensor suite) is currently undergoing US Navy flight testing, to demonstrate its ability to enhance diagnostic capability.

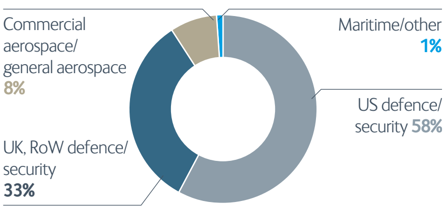
**Sector revenue** (£m)



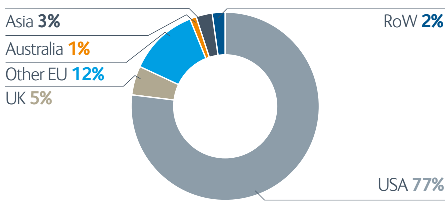

**Sector underlying operating profit** (£m)




**Revenue by market** (%)




**Revenue by geography** (%)




**Order intake**

£518.2m

(2016: £381.6m)

**Organic revenue**

6.5%

(2016: (6.6)%)

**Underlying operating margin**

13.2%

(2016: 15.5%)

**Number of employees**

1,774*

(2016: 1,618)

* Total permanent headcount at 31 December 2017.

**Main image**
Cobham designs and builds aerial refuelling systems including for the Lockheed Martin C-130 aircraft as well as a variety of external fuel tanks and special pods.

**Small image**
Cobham designs and manufactures actuation products including emergency release, inflation rocket propulsion and weapons control and ejection.

# Providing critical communication solutions on land, at sea, in the air and in space

**Provides critical solutions for communication on land, at sea, in the air and in space through off-the-shelf and customised products including radio frequency, microwave and high reliability microelectronics, antenna subsystems and motion control solutions. This addresses defence and commercial markets, including missiles, radars, electronic warfare, satellite electronics and select industrial applications.**

The Sector's 6% organic revenue performance reflected increases across a number of product areas including space related actuation, power distribution modules for satellite programmes and the Low Band Consolidation (LBC) electronic warfare programme, which passed its preliminary design review. Additionally there were increased volumes on the F-35 Joint Strike Fighter programme, with the Sector having significant electronic warfare and radar subsystem content, with further content won.

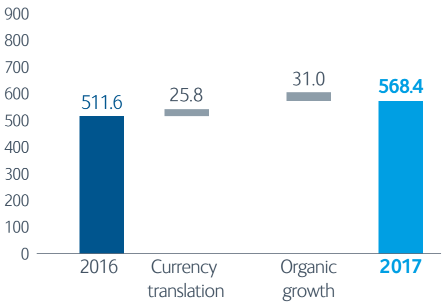
Underlying operating profit decreased by £5.9m after the impact from exchange rates. As previously reported, there was an adverse impact from investments made to strengthen the Sector's functional infrastructure and this included the build out and deployment of various IT and compliance systems.

During 2017 and 2018 a significant investment is also being made in the San Diego facility, which is currently increasing production, to improve on time delivery and quality management.

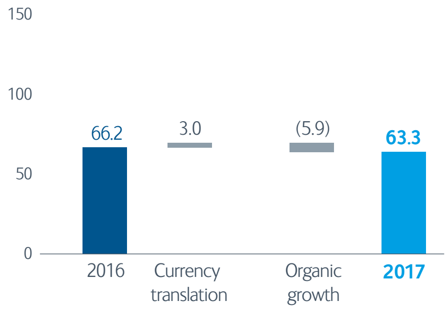
The Sector has received Low Rate Initial Production awards for air and missile defence programmes. The Advanced Off-board Electronic Warfare (AOEW) pod programme also successfully passed its preliminary design review. This is a major milestone for this long-term programme, which will provide US Navy MH-60 helicopters with enhanced electronic warfare surveillance and countermeasure capabilities against anti-ship missile threats, extending the detection range of existing ship-based electronic warfare systems. The Sector also worked with partners on the European Space Agency (ESA)'s Next Generation Microprocessor (NGMP) development to bring to market a space-qualified quad-core processor, providing faster processing power.

The Sector continues to operate under an SSA, with the Sector Board critical to Sector governance and performance. Admiral Steve Abbot USN (retired), General Mike Hagee USMC (retired), Cindy Moran and Scott Webster were appointed to the Board in the year.

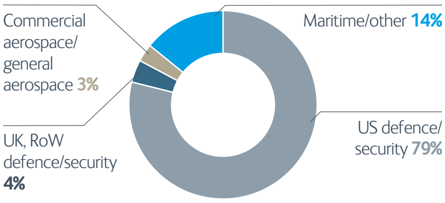
**Sector revenue** (£m)



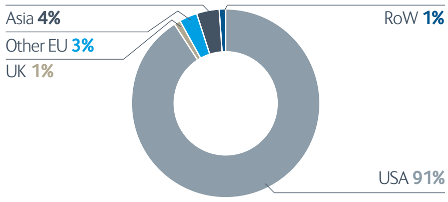

**Sector underlying operating profit** (£m)




**Revenue by market** (%)

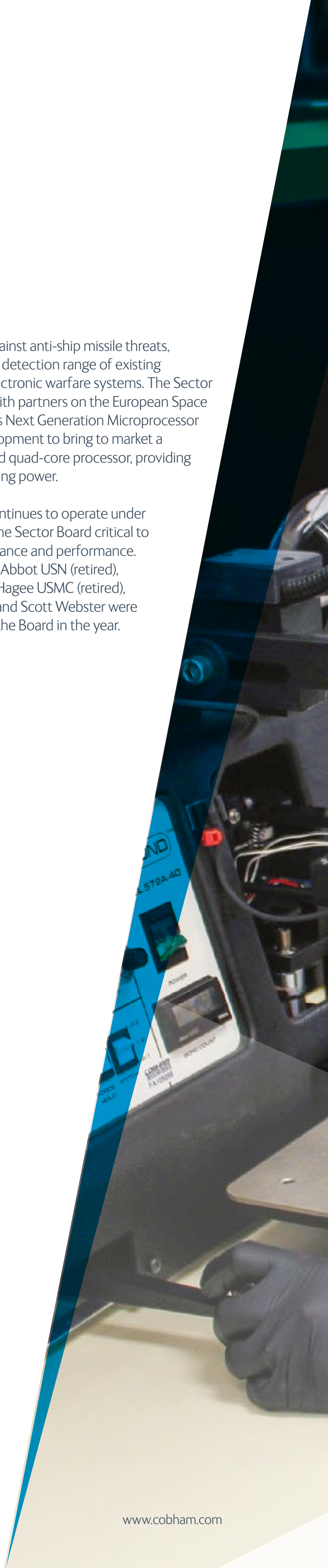



**Revenue by geography** (%)




| Order intake | Organic revenue | Underlying operating margin | Number of employees |
|---|---|---|---|
| £563.0m | 5.8% | 11.1% | 3,393* |
| (2016: £542.1m) | (2016: (8.3)%) | (2016: 12.9%) | (2016: 3,068) |

* Total permanent headcount at 31 December 2017.





**Main image**
Cobham is investing significantly in its site in San Diego, US to deliver its strong order book while improving on time delivery and enhancing the efficiency of our operations.

**Small image**
Cobham's Application Specific Integrated Circuit (ASIC) space solutions have earned the US Government's highest ratings. They offer higher size, weight, and processing benefits.

# Delivering outsourced aviation services for military and commercial customers

**Delivers outsourced aviation services for customers worldwide, including military training, special mission flight operations, outsourced commercial aviation, including fly-in fly-out services to the natural resources industry and aircraft engineering.**

Organic revenue was 2% lower, reflecting a reduction in revenue from commercial markets, attributable to lower flying activity for Australian natural resources customers and the adverse impact from the first full year of the repriced contract with Qantas. In addition, Helicopter Services revenue was lower, being impacted by the completion of certain overseas contracts, including search and rescue operations in Trinidad and Tobago and maintenance activity in Qatar. However, there was a benefit from an increase in fixed wing special mission revenue, primarily relating to the commencement of the Australian Maritime Safety Authority (AMSA) contract.

Operating profit was £19.1m lower after the impact of exchange rates. This primarily reflected the Qantas contract and also the wind-down and demobilisation of helicopter operations in Trinidad and Tobago and Qatar. The results also reflected £3.2m of non-recurring charges, relating to the settlement of legacy issues largely provided for in the first half.

In order to enhance customer focus as well as reduce overheads, the Sector is being restructured into two regionally based businesses, one based in Australia and one focused on the UK and EMEA.

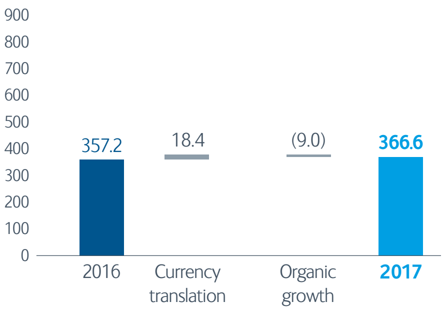
The Sector's order intake was lower than the prior year, which included receipt of the net initial order for AUS$719m relating to the multi-year Qantas contract extension.

The Australian natural resources market is showing some early signs of recovery. Significantly, the Sector also secured a five year contract extension to continue its operations for Chevron, albeit at a lower rate of flying activity.

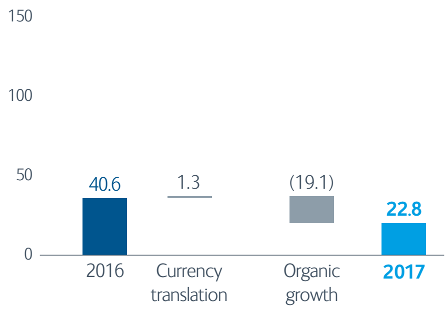
In addition, all four specially modified Bombardier Challenger CL-604 aircraft for the AMSA contract are now fully operational and after the recent establishment of the Cobham Helicopter Academy, based in Newquay, UK, a launch customer has been secured. The Academy will allow the Sector to continue helicopter training services when the UK Defence Helicopter Flying School contract finishes at the end of March 2018.

The Sector signed a teaming agreement with Draken International in the year, for jointly developing solutions for the delivery of operational readiness training under the UK Ministry of Defence (MoD) Air Support to Defence Operational Training (ASDOT) programme. ASDOT will meet the training component of UK air support from 2020, progressively replacing contracted and military service provision as these expire, including Cobham's existing operational readiness training for the UK MoD.

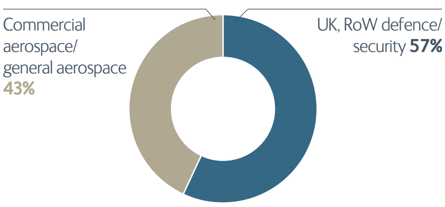
**Sector revenue** (£m)



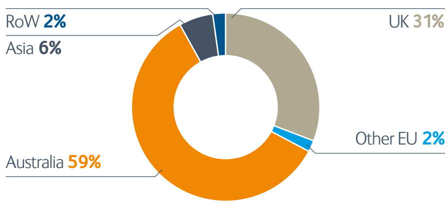

**Sector underlying operating profit** (£m)




**Revenue by market** (%)




**Revenue by geography** (%)




| Order intake | Organic revenue | Underlying operating margin | Number of employees |
|---|---|---|---|
| £122.4m | (2.4)% | 6.2% | 2,072* |
| (2016: £513.4m) | (2016: (13.9)%) | (2016: 11.4%) | (2016: 2,240) |

* Total permanent headcount at 31 December 2017.


**Main image**
Cobham operates the world's most advanced civil search-and-rescue aircraft – specially modified Challenger jets – to conduct operations for the Australian Maritime Safety Authority.

**Small image**
Cobham's Helicopter Academy delivers specialised search and rescue training with over 20 years of experience in the market.

"This first year of the turnaround has delivered a significantly more resilient Balance Sheet with a focus on cash generation

## Summary of underlying results

To assist with the understanding of earnings trends, the Group has included within its published financial statements non-GAAP alternative performance measures including underlying operating profit and underlying profit. The non-GAAP measures used are not defined terms under IFRS and therefore may not be comparable to similar measures used by other companies. They are not intended to be a substitute for, or superior to, GAAP measures.

Management uses underlying measures to assess the operating performance of the Group, having adjusted for specific items as detailed in note 2 to the Group Financial Statements on page 94. They form the basis of internal management accounts and are used for decision making including capital allocation and a subset also forms the basis of internal incentive arrangements. By using underlying measures in segmental reporting, this further ensures readers of the financial statements can recognise how incentive performance is targeted. Underlying measures are also presented in this statement because the Directors believe they provide additional useful information to shareholders on comparative trends over time. Finally, this presentation allows for separate disclosure and specific narrative to be included concerning the adjusting items; this helps to ensure performance in any one year can be more clearly understood by the user of the financial statements.

A reconciliation of statutory to underlying profit numbers is set out on page 29.

A summary of the Group's underlying results is set out below:

| £m | 2017 | 2016 |
|---|---|---|
| Revenue | **2,052.5** | 1,943.9 |
| Underlying operating profit | **210.3** | 225.0 |
| Underlying operating margin | **10.2%** | 11.6% |
| Underlying net finance expense | **(37.2)** | (49.8) |
| Underlying profit before tax | **173.1** | 175.2 |
| Underlying tax | **(39.8)** | (39.6) |
| Underlying tax rate | **23.0%** | 22.6% |
| Underlying profit after tax | **133.3** | 135.6 |
| Weighted average number of shares (millions)* | **2,231.8** | 1,732.2 |
| Underlying EPS (pence)* | **6.0** | 7.8 |

* Comparatives have been restated to reflect the bonus element of the Rights Issue completed during 2017.

Definitions of the underlying measures can be found on page 94.

## Orders

Group order intake was £1,916.6m (2016: £2,084.0m). Order intake in 2016 benefited from an initial net AUS$719m order booked relating to the significant repriced and multi-year Qantas contract in the Aviation Services Sector. Excluding this, and at constant currency, 2017 order intake was 8% higher. The Group's book-to-bill was 0.93x (2016: 1.07x); excluding Aviation Services book-to-bill was 1.06x (2016: 0.99x).

At 31 December 2017, the Group's order book was £2,700.8m (2016: £2,946.4m), a decrease of 8%. Within this, orders due for delivery in the current year are £1,370.1m (2016: £1,301.7m), an increase on the prior year of 5%, or 11% after adjusting for divestments and currency.

## Revenue

A summary of the changes to Group revenue in the year is as follows:

| £m | 2016 | FX translation | Divestments | Organic growth | 2017 |
|---|---|---|---|---|---|
| | 1,943.9 | 92.3 | (7.7) | 24.0 | **2,052.5** |

Total Group revenue increased to £2,052.5m (2016: £1,943.9m) driven by favourable currency translation and organic revenue growth of 1%.

Organic revenue was driven by growth of 6% (£25.5m) in the Mission Systems Sector and 6% (£31.0m) in the Advanced Electronic Solutions Sector, partly offset by a 3% (£22.7m) organic decline in the Communications and Connectivity Sector and a 2% (£9.0m) decline in the Aviation Services Sector.

Analysing this revenue performance by end market, organic revenue in the Group's US defence/security market, which was 36% (2016: 34%) of Group revenue, was £37.6m or 5% higher. UK, RoW defence/security organic revenue, which was 24% (2016: 25%) of Group revenue, was £1.1m or 0.2% higher. Organic revenue in the Group's commercial markets, which amounted to 40% (2016: 41%) of Group revenue, was £14.7m or 2% lower in the year.

## Statutory operating profit

The Group made a statutory operating profit of £104.1m (2016: £779.1m loss). In addition to the underlying operating profit result, statutory profit includes items which have been accounted for as specific adjusting items, consistent with prior years. The net charge arising from these specific adjusting items is lower than the prior year, principally due to the following:

## Reconciliation of underlying measures

| £m | 2017 | 2016 |
|---|---|---|
| **Operating profit/(loss)** | **104.1** | (779.1) |
| Adjusted to exclude: | | |
| Amortisation of intangible assets arising on business combinations | **138.9** | 161.2 |
| Derivative financial instruments | **(28.9)** | 39.3 |
| Impairment of goodwill and other intangible assets | **33.5** | 573.8 |
| Reversal of impairment of intangible assets | **(31.8)** | – |
| Carrying values of other assets provided at 31 December 2016 | **(1.4)** | 33.3 |
| Legal and other provisions provided at 31 December 2016 | **(8.0)** | 24.4 |
| Estimates of fixed price contract profitability provided at 31 December 2016 | **–** | 179.1 |
| Amounts related to prior periods restructuring programmes | **4.7** | (8.7) |
| Other business acquisition and divestment related items | **(0.8)** | 1.7 |
| Total operating reconciling items | **106.2** | 1,004.1 |
| **Underlying operating profit** | **210.3** | 225.0 |

| £m | 2017 | 2016 |
|---|---|---|
| **Profit/(loss) before taxation** | **66.9** | (847.9) |
| Adjusted to exclude: | | |
| Total operating reconciling items above | **106.2** | 1,004.1 |
| Non underlying finance costs | **–** | 19.0 |
| **Underlying profit before taxation** | **173.1** | 175.2 |
| Taxation charge on underlying profit | **(39.8)** | (39.6) |
| **Underlying profit after taxation** | **133.3** | 135.6 |
| | | |
| **Underlying EPS (pence)** | **6.0** | 7.8 |

– Amortisation of intangible assets arising on business combinations of £138.9m (2016: £161.2m);

Goodwill and other intangible assets arising on business combinations are recognised as a result of the purchase price allocation on acquisition of subsidiaries.

– Favourable movements in non-hedge accounted derivative financial instruments of £28.9m (2016: £39.3m adverse);

The impact of derivative financial instruments excluded from underlying results includes changes in the marking to market of non-hedge accounted derivative financial instruments. These amounts relate to foreign currency exchange contracts and would not have impacted the results had the Group chosen to comply with IAS 39 hedge accounting requirements.

– Net impairment of goodwill and other intangible assets of £1.7m (2016: £573.8m);

The Group reviews its valuation of goodwill for potential impairment at least annually. In 2017 the Group impaired its Helicopter Services Business Unit by £33.5m. In addition, following announcement of the divestment in February 2018 there was a partial reversal of £31.8m against a previous impairment of other intangible assets of the Wireless business. The reversal related to the 2016 impairment of £573.8m against goodwill and other intangible assets of the Wireless, Integrated Electronic Solutions and Semiconductor Solutions Business Units.

– Adjustments to revisions of the carrying values of other assets provided at 31 December 2016 was a credit adjustment of £1.4m (2016: £33.3m charge);

The credit adjustment, previously announced within the 2017 interims, related to a provision against receivables which was considered doubtful at 31 December 2016, but which has now been recovered. The 2016 charge relates in aggregate to inventory balances, reflecting ageing stock and lower demand forecasts; provisions against aged receivables and tangible and intangible assets no longer expected to be used.

– Adjustments to the assessment of legal and other provisions was a credit adjustment of £8.0m (2016: £24.4m charge);

The credit adjustments relate to legal, environmental, warranty and other regulatory matters that were provided for in 2016 and which have been resolved within their original cost estimates.

– Other business acquisition and divestment related items was a credit of £0.8m (2016: £1.7m charge);

The credit adjustment predominately relates to previous divestment activity being concluded within the original cost estimates.

In addition, in 2016 the Group also took aggregate charges of £179.1m against contract loss provisions, including £150.0m against the KC-46 programme.

Partially offsetting these was the following specific adjusting item:

– Amounts relating to prior periods' restructuring programmes of £4.7m (2016: £8.7m credit);

The costs relate to prior periods' restructuring programmes which have been accounted for as incremental to normal operations. The 2016 credit included a reassessment of the level of provisions required in respect of IT integration and remediation costs. There will be no further charges relating to prior periods' restructuring programmes.

### Technology investment

Included within underlying operating profit was £121.9m (2016: £123.9m) of PV investment, excluding bid costs. PV investment in the year represented 7.2% (2016: 7.8%) of revenue.

### Net finance expense and profit before tax

The Group's net finance charge was £37.2m (2016: £68.8m). In 2016 this included £19.0m of make-whole payments relating to the pay down of senior notes following the June 2016 Rights Issue. These were treated as non-underlying as they were one-off in nature and did not reflect the ongoing costs of servicing the Group's net debt.

## Cash flow

| £m | 2017 | 2016 |
|---|---|---|
| **Underlying operating profit** | **210.3** | 225.0 |
| Less: Share of post-tax results of joint ventures | **0.2** | (0.2) |
| Underlying operating profit (excluding joint ventures) | **210.5** | 224.8 |
| Depreciation and amortisation | **84.8** | 80.5 |
| Share based payments | **5.5** | 3.8 |
| Decrease in provisions | **(60.9)** | (16.3) |
| Pension contributions in excess of pension charges | **(17.3)** | (16.7) |
| Decrease/(increase) in working capital | **69.7** | (8.2) |
| Gross capital expenditure | **(79.8)** | (92.2) |
| Proceeds on disposal of property, plant and equipment | **5.1** | 6.1 |
| **Operating cash flow** | **217.6** | 181.8 |
| *Operating cash/underlying operating profit (excluding joint ventures)* | ***103%*** | *81%* |
| Net interest paid | **(34.9)** | (71.2) |
| Taxation paid | **(32.2)** | (20.1) |
| Amounts related to prior years' restructuring programmes | **(9.9)** | (39.8) |
| **Free cash flow** | **140.6** | 50.7 |
| Dividends paid | **(0.1)** | (126.1) |
| Business acquisition and divestment related costs paid | **(0.9)** | (2.5) |
| Net Rights Issue proceeds and allocation of treasury shares | **497.2** | 492.9 |
| Exchange movements | **7.9** | (236.4) |
| **Increase in net debt** | **644.7** | 178.6 |
| Opening net debt | **(1,028.2)** | (1,206.8) |
| **Closing net debt** | **(383.5)** | (1,028.2) |

Included within the underlying net finance charge was a net expense on cash and debt holdings of £34.9m (2016: £48.0m). This benefited from lower average net debt following the 2016 and 2017 Rights Issues, as well as from the Group's free cash flow generation. The non-cash finance charge from pension schemes was £2.3m (2016: £1.8m).

The Group made a statutory profit before tax of £66.9m (2016: loss of £847.9m). The Group's underlying profit before tax was £173.1m (2016: £175.2m).

### Divestments

The Group announced in February 2018 that it had agreed to divest its AvComm and Wireless test and measurement businesses for US$455m in cash payable on completion, which is anticipated within the first half of 2018. In the year ended 31 December 2017 the businesses recorded aggregate revenue of £169.6m and underlying profit of £13.6m (a £24.8m contribution, before the allocation of central charges and restructuring costs of £2.4m).

On completion, the coherency of the portfolio will be enhanced, reducing risk by exiting businesses with little commonality with the rest of the Group. The net divestment proceeds (which are subject to certain post completion adjustments and expenses) will be used to strengthen the Balance Sheet and, coupled with existing cash, will pay down approximately £440m of debt. This will include the repayment of private placement debt (senior notes), which will result in estimated accelerated interest costs (make-whole payments) of up to £30m. After the accelerated interest costs, which it is expected will be incurred in the first half of 2018, the Group's future interest expense will be reduced by approximately £18m per full year.

### IFRS 15 (Revenue Recognition) and IFRS 9 (Financial Instruments)

The Group is adopting the new revenue recognition standard, IFRS 15, from 1 January 2018. The standard impacts the timing of revenue recognition on some Group development contracts and on some US government product based contracts. It is estimated that the impact of IFRS 15 is to increase Group revenue by £41m and underlying operating profit by £3m in 2017. There is no impact on Cobham's cash generation or net debt, and it has an immaterial impact on net assets although there will be changes between amounts recoverable on contracts and receivables and payables.

The Group will also adopt IFRS 9 on 1 January 2018. As a result, the valuation of certain of Cobham's minority shareholding investments will increase by approximately £30m, reflecting a requirement to hold these at fair value, rather than at cost, with the change also increasing Group reserves. There are no other material changes arising from the adoption of IFRS 9.

### Taxation

The Group's overall tax credit was £11.9m (2016: £52.8m), in part reflecting an improvement over prior year Group profit after specific adjusting items.

The Group's underlying tax rate increased to 23.0% (2016: 22.6%) from an underlying tax charge of £39.8m (2016: £39.6m). The increased rate was primarily a result of the geographic profit mix in the year.

The Group is reviewing the implications of the US tax reform, including the Base Erosion and Anti Abuse (BEAT) provisions, and resolving certain tax issues arising from prior years. Given these and the expected geographical mix of profit, the underlying tax rate is anticipated to remain at approximately. the current level, subject to any future changes in tax legislation.

In addition, the Group previously announced it is reviewing its internal financing structures and is in the process of resolving certain tax issues from prior years, which are set out in more detail in note 6 to the Group Financial Statements on page 100.

### Earnings per share (EPS)

Basic EPS was 3.5p (2016: (45.9)p), including the restatement of the prior year figure for the 2017 Rights Issue bonus factor. In addition to the underlying operating performance, basic EPS was impacted by the specific adjusting items set out in the paragraphs on statutory operating profit above, most notably a charge relating to the amortisation of intangible assets arising on business combinations, partially offset by favourable movements in non-hedge accounted derivative financial instruments.

Underlying EPS was 6.0p, 23% lower than the prior year, primarily due to the higher share count following the 2017 Rights Issue, with underlying profit afer tax broadly flat year on year.

The Group's average share count in the year was 2,231.8m (2016: 1,506.3m or 1,732.2m restated to reflect the bonus element of the Rights Issue completed during 2017). The share count at 31 December 2017, excluding shares held in treasury, was 2,391.0m (31 December 2016: 1,707.9m).

## Cash flow

Operating cash flow, which is stated after net capital expenditure, but before interest and tax payments was £217.6m (2016: £181.8m). Operating cash conversion was 103% (2016: 81%). This was driven by a cash inflow from working capital, including improvements due to advance customer receipts of £27m. Cash conversion was also assisted by lower capital expenditure of £79.8m (2016: £92.2m) before proceeds from asset disposals of £5.1m (2016: £6.1m). Operating cash flow included £66.6m of net utilisation against the charges taken at 31 December 2016.

Free cash flow was £140.6m (2016: £50.7m). This included net interest payments of £34.9m (2016: £71.2m, including £19.0m of make whole payments on senior notes paid down). Net tax payments were £32.2m (2016: £20.1m), in part reflecting the Group's increased underlying tax rate.

Also included in free cash flow were payments relating to prior periods' restructuring programmes of £9.9m (2016: £39.8m). A significant element relates to ongoing lease payments on vacated premises provided for in previous years.

Below free cash flow, there was a net inflow of £497.2m (2016: £492.9m), primarily relating to the net proceeds of the Rights Issues completed in 2017 and 2016 respectively.

## Dividend and dividend policy

It was previously announced that the Board would not recommend a dividend in respect of the financial year 2017. The Board recognises the importance of dividend payments to shareholders and will review its dividend policy as the turnaround progresses and the risk profile improves, seeking to resume a dividend when it is appropriate to do so.

The decision on the level of any future payment will take into account a number of factors including the Group's underlying earnings, cash flows and gearing, its investment needs and the requirement to maintain an appropriate level of dividend cover.

In addition, in determining whether to pay a dividend in any one year, in accordance with its policy, the Board will also consider the level of distributable reserves and the requirements of recurring business commitments such as pension obligations and servicing debt providers.

As stated above, the Group's risk profile is also important to its dividend decision and the Board will continue to consider the Group's principal risks, which are set out on pages 36 to 39.

The Group's Parent Company operates as a holding company which primarily derives its net income from dividends paid by its subsidiary companies. At 31 December 2017 Cobham plc had significant distributable reserves, amounting to £1,180.1m, which mainly related to its retained earnings. The Parent Company Balance Sheet is shown on page 129.

The Board's decision not to recommend a dividend during 2017 was driven by consideration of all the primary factors above. The Board continues to believe that in order to retain operational flexibility, and having due regard to the Group's current risk profile and the future cash flows associated with its contract loss provisions, the payment of a dividend in 2017 was not justified.

## Treasury

The Group's treasury activities are managed centrally by the Group Treasury function, which reports to the Chief Financial Officer. The Treasury function operates within written policies and delegation levels that have been approved by the Board. It is the Group's policy that trading in financial instruments is used for financial risk management purposes only.

## Net debt, gearing and 2017 Rights Issue

The Group's net debt decreased to £383.5m (31 December 2016: £1,028.2m) at the year end, including favourable exchange rate movements of £7.9m (2016: £236.4m adverse), which were largely driven by translation of Cobham's US dollar denominated debt between the opening and closing rates.

The Group's policy was reviewed and updated during 2017 in respect of the impact of foreign currency movements on the net debt/EBITDA ratio. In addition, the proportion of the Group's net debt denominated in US dollars, which had been significantly higher than US dollar denominated profit through 2016 has been more closely aligned during 2017. This closer alignment mitigates the risk of currency related gearing volatility.

Included within net debt are cash deposits, which are primarily denominated in sterling US dollars, euros, Danish kroner and Australian dollars. At 31 December 2017, the Group held total cash and short term bank deposits, net of offsettable overdrafts and all with an original maturity of three months or less, of £451.9m (31 December 2016: £236.2m).

Cobham announced the results of its fully underwritten 2 for 5 Rights Issue on 5 May 2017. The Rights Issue raised gross proceeds of £512.4m, amounting to £496.7m after expenses. The proceeds of the Rights Issue were partially used to repay senior notes of face value US$44m in May 2017 (with no make-whole payment) and US$75m of scheduled repayment in October 2017, with the remaining proceeds after partial repayment of the Group's revolving credit facilities held on deposit at the year end.

Under the Group's borrowing agreements, the net debt number used in the net debt/EBITDA ratio calculation is based on an average foreign exchange rate. On this basis the Group's year end net debt figure was £405.3m, resulting in a ratio of 1.3x (2016: 3.0x). For the purposes of this calculation specific adjusting items are excluded from EBITDA, in addition to some smaller adjustments. Interest cover was 6.8x (2016: 5.1x).

## Debt covenants

| £m | 2017 | 2016 |
|---|---|---|
| Net debt – balance sheet | **(383.5)** | (1,028.2) |
| Net debt – average rate | **(405.3)** | (937.9) |
| EBITDA | **308.5** | 316.5 |
| **Net debt to EBITDA (not to exceed 3.5x)** | **1.3** | 3.0 |
| EBITA | **234.3** | 245.2 |
| Net interest | **34.7** | 48.0 |
| **Interest cover (not less than 3x)** | **6.8** | 5.1 |

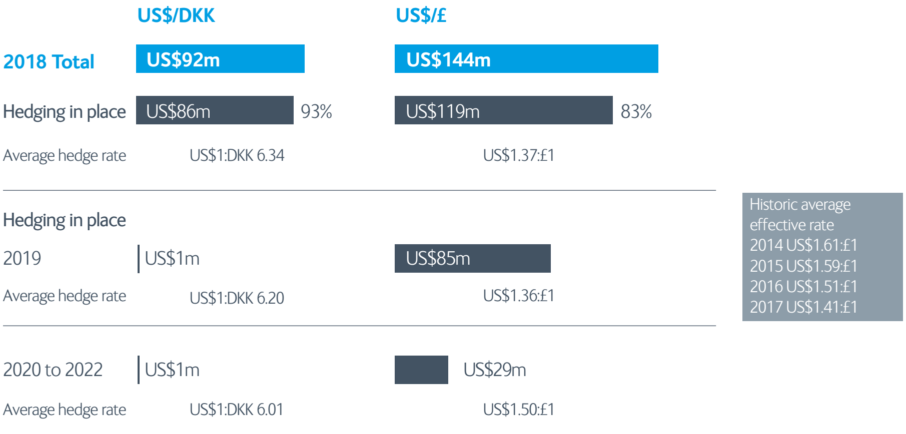
A summary of the Group's borrowings and associated maturities together with further details of the financial covenants are set out in note 16 to the Group Financial Statements on page 111.

In December 2017, the Group completed a scheduled refinancing of its revolving credit facilities maturing in October 2018, with new bank facilities totalling US$545m and maturities of five years or over at a similar cost. As a result of the refinancing three new floating rate loan agreements were signed and the four existing agreements were cancelled. Details of the new loan facilities are set out in note 16 to the Group Financial Statements on page 111.

As set out in the Divestments paragraph, the Group intends to use part of the net divestment proceeds arising from the disposal of the AvComm and Wireless test and measurement businesses coupled with existing cash to pay down approximately £440m of debt.

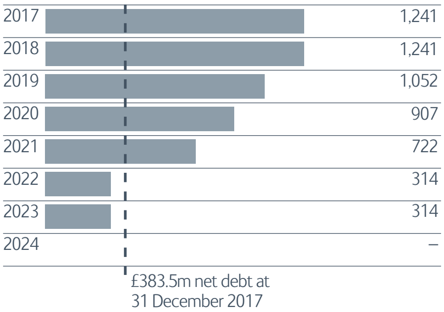
The chart (right) summarises the Group's main foreign currency transaction exposures (based on forecast revenues) and the hedging in place to mitigate it.

## Hedging transaction exposure




US dollar/euro exposure predominantly hedged for 2018 with US$48m @ 1.15

## Maturity profile of Group's outstanding debt facilities (£m)




The Group has exposure to a number of financial risks, including liquidity risk and credit risk, which are described in note 21 to the Group Financial Statements. In addition, it has exposure to the effects of changes in foreign currency exchange rates and interest rates, and these are described below.

### Foreign currency translation

The following are the average and closing rates for the four foreign currencies that have the most impact on the translation into sterling of the Group's Income Statement and Balance Sheet:

| | **2017** | 2016 |
|---|---|---|
| **Income Statement – average rate** | | |
| US$/£ | **1.29** | 1.35 |
| AUS$/£ | **1.68** | 1.83 |
| EUR/£ | **1.14** | 1.22 |
| DKK/£ | **8.49** | 9.11 |
| **Balance Sheet – closing rate** | | |
| US$/£ | **1.35** | 1.24 |
| AUS$/£ | **1.73** | 1.71 |
| EUR/£ | **1.13** | 1.17 |
| DKK/£ | **8.39** | 8.71 |

Foreign exchange translation exposure arises on the earnings of operating companies based largely in the US, Europe and Australia. These are partially offset by foreign currency denominated interest costs due to the Group's current policy of generally funding acquisitions with borrowings denominated in the same currency and also to approximately match the currency mix of EBITDA with the currency mix of net debt. The interest charge on this debt provides a partial offset against currency denominated profits.

The Group's approximate pro rata Income Statement sensitivity to currency translation is as follows, calculated as the impact of a 10 cent movement in the full year average rate against sterling:

| £m | Revenue | Underlying operating profit |
|---|---|---|
| US$ | 79 | 10 |
| AUS$ | 16 | 1 |
| EUR/DKK | 23 | 2 |
| Other currencies | 4 | 1 |
| | 122 | 14 |

### Foreign currency transaction

The Group's aim is to reduce, or eliminate whenever practical, foreign exchange transaction risk. The US dollar/sterling and the US dollar/Danish krone exchange rates are the most significant exposures, together with a number of other, smaller foreign exchange transaction exposures, including the euro/US dollar.

All foreign exchange hedging transactions are approved under delegated authority from the Board. A number of financial instruments are used to manage transactional foreign exchange exposure, such as forward rate contracts. The Group has a policy of hedging at least 80% of estimated transactional exposure for the next 12 months, a proportion of exposures between 12 and 36 months, and firm exposures on long term contracts. Details of the most significant of these instruments are described in notes 19 and 21 to the Group Financial Statements.

Some 83% of the Group's anticipated transaction exposure to the US dollar/sterling exchange rate is hedged for 2018 at an average rate of US$1.37/£1, with additional forward sales in place to partially cover anticipated exposure in subsequent years.

### Interest rates

Cobham has various borrowings at both fixed and floating rates of interest. During the year ended 31 December 2017, the Group cancelled floating to fixed interest rate swaps following repayment of the associated floating rate borrowings. The Group monitors its exposure to movements in interest rates to bring greater stability and certainty to its borrowing costs, with the policy being to assess the proportion of borrowings that are fixed and floating in the context of prevailing market conditions.

### Retirement obligations

Cobham operates a number of defined benefit pension schemes, with the largest being the Cobham Pension Plan (CPP) in the UK. At the year end the estimated deficit for all defined pension schemes for accounting purposes, which is the difference between the aggregate value of the schemes' assets and the present value of the future liabilities, was £63.2m before deferred tax (2016: £87.0m).

A reconciliation of the movements in the pension deficit in the year is shown in the table below.

| | 2017 |
|---|---|
| Pension deficit at 1 January 2017 | (87.0) |
| Service cost | (0.7) |
| Admin cost | (0.2) |
| Interest charge | (2.3) |
| Total employer contributions | 18.2 |
| Actuarial gains | 7.4 |
| Exchange differences | 1.4 |
| **Pension deficit at 31 December 2017** | **(63.2)** |

At 31 December 2017, the scheme assets were £816.3m (2016: £790.0m) and the present value of scheme obligations was £879.5m (2016: £877.0m).

Significant movements within the deficit were:
- An increase of £35m due to a reduction in the discount rate;
- A reduction due to net investment returns of £31m;
- A reduction of £11m due to changes to mortality assumptions; and
- A reduction of £18m due to employer contributions.

The CPP was closed to future accrual from 1 April 2016 and the Group's defined benefit pension schemes have been closed to new entrants since 2003, with alternative defined contribution schemes offered in all cases. Cobham remains committed to the support of the legacy defined benefit pension schemes within the Group and continues to work with the trustees of those schemes to ensure that net deficit issues are managed appropriately. The next triennial valuation of the CPP is at 1 April 2018. This exercise will take place during 2018, which may result in an updated schedule of contributions to take effect in 2019 and future years.

Further details on the Group's retirement benefit schemes in the year, including the primary assumptions, the amounts recognised in the Income Statement and the changes in value of defined benefit schemes are given in note 20 to the Group Financial Statements.

## Going concern

The Group's business activities, together with factors likely to affect its future development, performance and position, are set out in the business overview on pages 1 to 27 and the principal risks on pages 34 to 39. In addition, notes 1, 13, 19 and 21 to the Group Financial Statements include the Group's objectives, policies and processes for managing its capital, financial risk management, details of financial instruments and hedging activities, and its exposure to credit liquidity and other risks.

The Group has considerable financial resources with liquidity available on the Balance Sheet from its cash resources and it has a spread of maturities on its debt. It has a mix of shorter and longer term contracts and leading market positions with customers across different geographical areas. As a consequence, the Board believes that the Group is well placed to manage its business risks successfully. Accordingly, after making enquiries, the Directors have formed a judgement at the time of approving the financial statements that it is their expectation that the Company and the Group as a whole have adequate financial resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Group and Parent Company Financial Statements.

See also the Group's Viability Statement on page 35.

**David Mellors**
Chief Financial Officer
1 March 2018

# The Group's principal risks have been updated to reflect its operational priorities

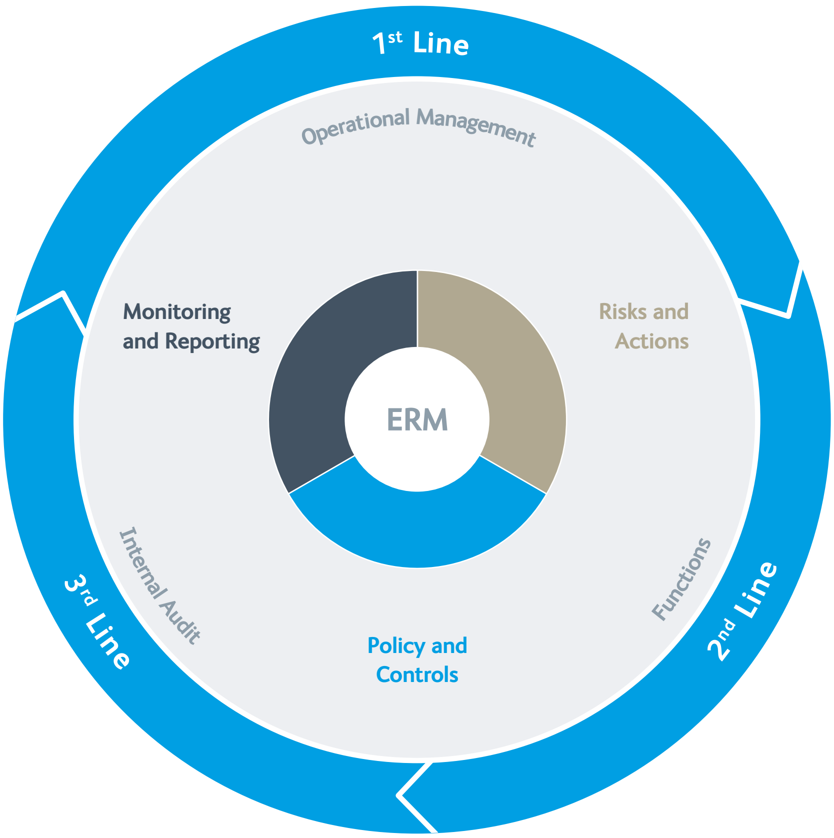
**How we manage risk**
The Board sets the policy for managing risk in the business. It recognises the importance of having effective processes and procedures for identifying, actively monitoring, mitigating and managing the financial and non-financial risks facing the Group.

By regularly reviewing the principal risks reported across the Group by businesses and functions, and satisfying itself that these risks are managed within the Group's risk appetite, the Board ensures that the Group's risk exposure remains appropriate and that this links to the effective delivery of its strategic objectives.

The Board has ultimate accountability for the execution of risk management and internal control systems, with the Group Executive responsible for overseeing execution of risk management throughout the Group. During 2017 a new Risk Committee was formed as a formal Board committee to review the risk management activities of the Group Executive.

The Board has delegated responsibility for the monitoring and reviewing of the effectiveness of the Group's risk management and internal control systems to the Audit Committee. Assurance over the effectiveness of these systems is provided through regular management reporting to the Audit Committee. For the Advanced Electronic Solutions Sector, which holds classified US Defence programmes and so operates under a US DoD SSA, specific assurances and authorised assurance reports are given by representatives of the SSA Board, which has its own Audit Committee. The Group's CEO and CFO both sit on the Board of the SSA, as described on page 51.

The process for monitoring and controlling risk, illustrated in the diagram (left), emphasises ongoing evaluation and monitoring by the management teams at each appropriate entity level: Business Unit, Sector, specialist function and at Group level. The Group's Enterprise Risk Management (ERM) framework is structured to ensure that risks are identified promptly by management teams to ensure that they are mitigated and managed appropriately in support of the delivery of the Group's strategic plan. Risks are categorised in terms of inherent risk (before mitigation) and current risk (after existing mitigation). This allows the Group to identify risks that are heavily dependent on internal mitigating controls and to allocate resources appropriately. The risks identified are documented and measured, including the ownership of individual risks. Data from this process has been aggregated and has been used as the basis for the Group's principal risk disclosure on pages 36 to 39.



As a result of this process, several changes have been made to the Group's principal risks. Following the completion of the Rights Issue and the refinancing of the Group's loans in 2017, and the divestment of the AvComm and Wireless test and measurement businesses that is expected to complete in the first half of 2018, the risk associated with breaching borrowing covenants has been retired as a specific principal risk, although it is still being tracked as part of principal risk 10 – Governance Framework. In addition, the risks arising from the execution of the Group's strategy and the realisation of integration benefits from the Aeroflex acquisition have also been retired, reflecting the completion of a strategic review in 2017, which identified new strategic objectives and the completion of Aeroflex integration activities. Finally, a new principal risk was identified associated with meeting customers' expectations, as a result of increased focus being put on this area as one of the Group's operational priorities.

The Group manages risk by operating a 'three lines of assurance' risk and control model. The first line consists of operational management implementing and maintaining effective risk management and internal control systems. They are supported by a number of Group functions which, together with performance management procedures, form the second line. Internal Audit, which forms the third line, is empowered to provide an independent assessment of the effectiveness of risk management and internal control systems, as well as identifying areas for improvement. These lines of assurance include the Group's ethics reporting system, which enables employees to raise concerns over ethics and compliance matters. The Internal Audit function reports directly to the Audit Committee to ensure its independence and objectivity.

## Risk appetite

The Board has established a risk appetite baseline through which Cobham's risks can be managed with appropriate controls and assurance measures. Risk events can be categorised under four main headings: Strategic, Operational, Financial/Reporting and Compliance. The Group has broken down these risk categories into a number of subcategories and defined its risk appetite for each. The risk appetite is articulated as low, medium or high across the various elements of the risk framework.

There is a higher appetite for areas of Strategic risk including the promotion of growth, for example in business and product portfolios, and in the strategic planning processes. There is a low appetite for Compliance risk – including zero tolerance for certain ethical issues such as bribery – with a medium appetite for Operational and Financial/Reporting risks.

The Group's controls, mitigation activities and associated assurance measures implemented reflect the risk appetite for each position.

## Viability Statement

The Board considers the Group's viability as part of their continuing programme of monitoring and managing risk. The Board has concluded that the most relevant time horizon for this review is three years, taking account of the diversity in demand characteristics of the Group's end markets. These range from relatively long cycle businesses, such as Aviation Services and US defence related businesses which both contain predominantly multi-year contracts, to the less predictable, largely commercial, shorter cycle businesses, such as SATCOM, which typically operates with an order backlog of a few months or less.

### Assessing viability

The starting point in assessing the prospects of the Group was the annual strategic planning process. The output of this process is considered to contain all of the key underlying assumptions that will provide the most appropriate information on which to assess the Group's viability.

In making its assessment, the Board has taken into account the potential impacts of the principal risk events identified in the latest risk review to consider whether these could prevent the Group from achieving its strategic objectives. These principal risks are described in detail in the Principal Risks section of this report on pages 36 to 39. The Board considers the potential financial and operational impact of plausible downside scenarios resulting from these risk events occurring individually or in combination. Consideration was also given to the occurrence of other individual events that in their own right could have a material impact on the Group's viability, including a failure to complete the AvComm and Wireless divestment. Whilst the conclusion on the viability of the Group is unchanged in most plausible downside scenarios, if the divestment were not to complete the Balance Sheet would be less resilient in the event of other material risks crystallising.

Based on the consolidated financial impact of the sensitivity analyses and associated mitigating internal controls and risk management actions that are either now in place, or could be implemented, the Board has been able to conclude that the Group will be able to maintain sufficient bank facilities to meet its funding needs over the three year period.

### Confirmation of longer term viability

Based upon the assessment of the principal risks facing the Group and robust downside sensitivity analysis, all of which are described above and on pages 36 to 39, the Board has a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to December 2020.

The Group's going concern statement is detailed on page 33.

| Element | Risks and impact | Mitigation | Risk appetite | Risk status indicator |
|---|---|---|---|---|
| **1. The Group operates within a volatile macroeconomic environment**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion | Cobham's revenues and costs are dependent on a complex mix of macroeconomic, fiscal, commercial and strategic defence and security factors, arising from the global defence/security and commercial markets within which the Group participates.<br><br>36% of the Group's revenue is derived directly or indirectly from the US Government. Due to a number of factors, including the US Government operating under a continuing resolution and the US statutory debt ceiling, US defence spending levels are difficult to predict beyond the near term.<br><br>24% of the Group's revenue is derived directly or indirectly from non-US governments. While heightened regional security tensions have led to an increase in demand for the Group's products, the general level of public deficits and indebtedness remains high, which the Group expects will act to limit growth in defence and security investment in the region.<br><br>The Group also has exposure to commercial markets which have historically been cyclical and have experienced downturns in response to weakness in commodity markets (such as oil and gas, iron and steel, and precious metals) and other factors such as interest rates and foreign exchange rates.<br><br>Government and commercial customers are increasingly focused on pricing as budgetary pressure requires them to do more with less, even where headline budgets are expected to increase, in areas such as US Defence. Protectionism by governments is also growing in response to the perceived effects of globalisation on national economies.<br><br>The Brexit vote in 2016 may lead to uncertainty in future trade arrangements between the Group's UK businesses and the various end markets which they serve, together with potential restrictions on the international movement of capital and the mobility of personnel.<br><br>If the Group does not anticipate changes in the various end markets which it serves (including deterioration in demand or a fundamental shift in how customers procure products and services), changes in input costs, and changes in other macroeconomic factors, its business, results of operations and financial condition could be adversely affected. | A review of near and long term market trends is conducted as part of the Group's annual strategic planning process to ensure that actual and anticipated impacts from macroeconomic risks are minimised and managed effectively.<br><br>Periodic reviews of externally sourced market demand data, with the re-forecasting and adjustment of internal planning in line with market demand.<br><br>A culture of continuous improvement should enable Cobham to improve operating performance, while reducing costs. This should enable Cobham to grow market share and remain competitive in the face of volume declines or price pressures, whilst retaining flexibility to adjust the cost base appropriately to changing market conditions.<br><br>The Group uses financial instruments where applicable to assist in the management of foreign exchange and interest rate risks, principally forward exchange contracts and interest rate swaps.<br><br>Emerging issues and opportunities arising as a result of the UK decision to leave the EU will be monitored. | High | **Unchanged**<br>Overall in 2017, the volatility in global macroeconomic conditions continued to affect the Group. |
| **2. The characteristics of the Group's markets and the resulting contractual environment are highly complex**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion | The various end markets served by Cobham are highly competitive. The Group relies on its ability to win business ahead of its competitors through a combination of differentiated technology, contractual terms and price. There is no assurance that the Group will be able to maintain its current market share with respect to its products or services due to the development of competing technologies, the periodic retender and renewal of existing contracts, the inability to develop existing products due to resource constraints or the emergence of new competitors.<br><br>The Group has a number of contracts which span more than one accounting period, some of which have a fixed price. If the Group fails to accurately estimate the resources and time necessary to meet contractual milestones, the Group may be subject to claims for damages for late delivery. If the costs required for the delivery of such contracts are higher than those agreed, as a result of the performance of new or developed products, schedule over-runs or other external factors (such as inflation resulting in an increase in input costs), which cannot be passed on to a customer, the profitability of a contract may be reduced, or result in a contract becoming loss making.<br><br>The timing of order receipt from customers could have a material impact on the Group's performance in a given reporting period, as the amounts payable under such contracts can be individually substantial.<br><br>The Group's existing contractual arrangements are subject to periodic renewal and retender. There can be no assurance that the Group will be able to successfully renew such contracts, for example the contract with the UK MOD for helicopter pilot training, which expires in 2018 was lost on retender in 2016. Other significant contract renewals are approaching, for example the contract with the UK MOD for provision of airborne operational readiness training which expires at the end of 2019.<br><br>Some of the Group's contracts have terms (which are not unusual in the Group's markets), that provide for unlimited liabilities for the Group or termination rights for the customer and, in some cases, damages and consequential loss exposure. Many of the Group's contracts are also across international borders, leading to increased complexity in interpretation.<br><br>The Group is reliant on third party manufacturers and key suppliers, to whom certain manufacturing and engineering functions are outsourced. This results in a reduction in control over capacity allocation and quality and may result in disputes regarding the ownership of intellectual property.<br><br>The occurrence of any or all of these factors may result in the financial performance of the Group being impaired, through reductions in revenue, increased costs or the emergence of unexpected liabilities. | The Group seeks to focus on areas within those markets in which its deep customer understanding and technical expertise provide it with an advantage in bidding, to reduce the likelihood of an emergent technology or competitor affecting the competitive position.<br><br>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.<br><br>The Group's Life Cycle Management (LCM) process is applied to significant contracts, to identify and mitigate cost and schedule over-runs or other issues.<br><br>The Group seeks to mitigate risks associated with the complex characteristics of its markets through the use of a Contract Policy which is intended to ensure that the Group enters into contracts with an appropriate balance of risk and reward.<br><br>The Group's bid and approval process and contract policy is applied to all bids, contracts and development programmes to ensure that a consistent approach is followed.<br><br>Appropriately trained personnel are embedded within the business to ensure that the contract policy is adhered to, and that delays to negotiating and agreeing contracts are minimised.<br><br>Training is conducted for key staff with responsibility for negotiating contracts.<br><br>The Group continues to review its level of exposure to individual suppliers to ensure that the level of reliance is appropriately managed. | Medium | **Unchanged**<br>In 2017, the Group remained challenged in a number of areas, in particular with regard to fixed price development contracts. The Group's markets and the resultant contracting environment continue to increase in complexity. |

| Element | Risks and impact | Mitigation | Risk appetite | Risk status indicator |
|---|---|---|---|---|
| **3. Project and Programme Management is not effective**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion<br>– On time delivery | The Group designs, develops and delivers products and services that are often customised, utilising complex technologies, outsourced supply chains and both fixed price contracts that can be long term in nature and through internally funded PV projects to exploit an identified market opportunity. Development projects can take place across a wide range of markets and technologies. The decision to outsource, and the selection of the appropriate suppliers can add additional risk to programmes if the supply chain is not properly managed.<br><br>The Group employs a system of project and programme management known as Lifecycle Management (LCM) to ensure that all such projects are managed within a common framework. The current deployment of LCM across the Group is at varying levels of maturity.<br><br>The Group is currently undertaking a number of significant development projects, notably the aerial refuelling development programmes within the Mission Systems sector and the Aviator 'S' system within the SATCOM Business Unit. Failure by the Group to execute or deliver these or other projects or programmes, and to deliver them concurrently in the same locations (for example in Wimborne, UK) gives rise to the risk of increased costs, damages, product liability claims, litigation and other financial liabilities, reduced future profitability and reputational risk. Poor operational performance could also lead to customers withholding new and existing business from the Group.<br><br>Certain programmes on which the Group has won positions are scheduled to ramp up to meet user requirements, for example the San Diego facility in the US. The growth in production required puts added pressure on quality management and therefore adds additional risk to on time delivery and contractual performance and reputation. | Lifecycle Management (LCM) ensures that the Group's key contract and programme management policies and procedures are applied consistently and appropriately across all areas of the business. The Group is currently investing in quality management to improve both in house and supply chain performance. On time delivery is a KPI for all Business Units.<br><br>A project and programme watch list has been established to ensure increased focus is given to large and technically complex projects.<br><br>Continuing professional development of project managers is undertaken against agreed standards and identified development needs. | Medium | **Unchanged**<br>The Group is in a significant phase of engineering and development activity on various programmes and platforms, which will continue in 2018. |
| **4. Shortage of appropriate skills and talent**<br><br>**Links to KPIs**<br>– Voluntary staff turnover | Key to execution of the Group's strategic plan is the recruitment, development and retention of sufficient personnel with the appropriate skills to meet the needs of the business, in engineering, technical and other specialist and managerial roles, which are amongst the most sought after skills within the labour market on a worldwide basis. This is exacerbated by nationality restrictions in certain of its markets, which prevent the Group from accessing a worldwide talent pool. Insufficient availability of personnel will generate a resource gap that will impair the Group's ability to deliver against its strategic plan.<br><br>Partly as a result of recent operational and financial challenges, the Group was required to hire new senior managers in certain of its business units, including the SATCOM, Antenna Systems and Wireless Business Units. The Group is also seeking to strengthen its central capabilities through hiring new employees within its corporate functions. Employee retention has been and may continue to be challenging, and the Group must continue to motivate employees and keep them focused on its strategies and goals.<br><br>The resulting talent gap could lead to a reduced ability to execute on growth plans and key programmes, resulting in reduced customer confidence and an adverse impact on the Group's financial position and financial outlook. | The Group undertakes workforce planning to ensure that skill gaps are identified and plans are established to close them. This includes ensuring that the Group's compensation planning and review process takes into account any key shortages and that succession planning is carried out to ensure that a pipeline of suitable candidates for key roles is maintained.<br><br>Development programmes are undertaken to ensure that internal candidates develop the skills and experience necessary to undertake more senior roles within the organisation.<br><br>See the CRS section on pages 40 to 43 for information on talent management actions. | Medium | **Increasing Risk**<br>The Group continues to experience difficulties with attracting and retaining personnel with the range of skills and experience that it requires. |
| **5. Customer expectations of service, quality and innovation are not met**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion<br>– On time delivery | It is crucial to the Group's current and future development that the expectations of its customers are fully understood and fulfilled, in areas such as the development of new products, the delivery of existing products in accordance with customer requirements and the support provided in respect of products that have already been delivered.<br><br>If the Group fails to understand the future requirements of its customers, and achieve the level of service that they expect, failure to win new contracts and difficulty in renewing existing contracts may result. In addition, the Group may suffer financial penalties and possibly the loss of existing contracts. Customer pricing pressure may also intensify where customers perceive that the Group is not providing a level of service that is commensurate with expectations. | The Group has made customer focus a key strategic objective during 2017 and this is expected to continue into the future. As a result, the level of senior engagement with key customers has been substantially increased.<br><br>Regular tracking of on time delivery has commenced across the Group. | Medium | **Increasing Risk**<br>This is a newly identified Principal Risk during 2017 and the effectiveness of mitigation actions will be assessed during 2018. |
| **6. Business change programmes are not successfully executed**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion<br>– On time delivery | Cobham is undertaking several business change programmes that are important to the Group's future prospects, in areas such as the re-organisation of its supply chain, the implementation of improved Information Technology systems across the Group, and the ramp up of production at facilities in certain Business Units.<br><br>If these programmes are not successfully executed, the Group's ability to deliver its strategic objectives will be impaired, which could lead to reputational damage, deteriorations in financial performance, loss of customer confidence and reduced success in winning new business from existing customers. | Internal project teams have been formed to deliver business change programmes against agreed objectives.<br><br>Business change programmes are being managed using the LCM process to ensure that adherence to budgets and schedules is being tracked. | Medium | **Unchanged**<br>During 2017, the number of centrally driven programmes was reduced and refocused. A smaller number of significant programmes remain in operation. |

| Element | Risks and impact | Mitigation | Risk appetite | Risk status indicator |
|---|---|---|---|---|
| **7. Value creating Mergers, Acquisitions (M&A) and Divestment activity is not identified and/or executed**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying EPS | Cobham's track record for M&A has been adversely affected by the Aeroflex acquistion in 2014. The Group's focus is currently on operational execution, which may result in the Group not being an active participant in the M&A market, except for smaller acquisitions that "bolt-on" to existing operations.<br><br>This could result in the Group failing to capitalise on time sensitive opportunities and effectively maintain a robust M&A pipeline. This could cause a failure to meet strategic targets, as well as reputational damage which could affect the success of future acquisitions.<br><br>Divestments that are conducted within confined timescales may result in optimum valuations not being achieved. Businesses that are subject to divestment processes can suffer from distraction and morale issues if staff are uncertain about their future. | Focus on operational execution to pay down debt and create scope for future M&A activity in the medium term.<br><br>Conducting divestments through a competitive process rather than through the identification of single buyers should optimise sale proceeds. | Medium | **Decreasing Risk**<br>The Group's portfolio is being managed to optimise the total performance in continued challenging markets. |
| **8. Occurrence of an event leading to a significant business interruption**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion<br>– Lost work case incident rate<br>– On time delivery | Cobham's businesses could be impacted by natural disasters or other external events affecting its operational locations, by other significant events in the supply chain or by IT systems failures (including from cyber attack), rendering critical systems or manufacturing locations unable to function. In some cases this can be exacerbated by the historic selection of key suppliers which has created significant reliance within the supply chain.<br><br>Unscheduled interruption to business activities would result in the inability to deliver products to customers in accordance with their expectations. This would result in reduced profits, loss of customer satisfaction, potential cost outlays, and reputational impact. | For the Group's larger manufacturing locations, programmes have been implemented that seek to meet or exceed best practice loss prevention guidance, and for its smaller locations effective loss prevention programmes and incident management plans have been put in place. The Group also maintains major incident/IT failure business continuity plans. Employees are trained in relevant procedures.<br><br>IT security and capability are monitored and strengthened when needed.<br><br>The Group maintains appropriate insurance cover and works with insurers and other third party experts to ensure operating infrastructure and processes include robust risk improvement activities.<br><br>See the CRS section on pages 40 to 43 for further details on mitigating actions against business interruption risk arising from environmental factors. | Medium | **Unchanged**<br>IT security threats remain significant, and continual updates and improvements are required to keep pace with their ever changing nature. |
| **9. Failure to comply with laws and regulations**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion<br>– Lost work case incident rate | Cobham operates in a highly regulated environment and is subject to the laws, regulations and restrictions of many jurisdictions, notably including those of the US and the UK as well as many other countries in which it operates.<br><br>These include but are not limited to anti-bribery provisions, import and export controls, tax, government contracting rules, human rights, environmental, and health and safety regulations. A lack of understanding of legal and regulatory restrictions in force in the jurisdictions in which it operates could lead to the Group being in contravention of applicable laws or regulations.<br><br>Sanctions for failure by the Group, its sales intermediaries, or others acting on its behalf to comply with laws, regulations and restrictions could include fines, penalties, legal claims, suspension or debarment of the Group from future government contracts for a period of time, as well as having a potentially significant impact on the Group's reputation. Such sanctions could also have an impact on the Group's financial position and future operations.<br><br>Safety is a key priority throughout the Group, particularly within the Aviation Services Sector which conducts flying operations in support of our customers. Safety is carefully managed through Group-wide processes, but the Group recognises that an accident could have a major impact on its employees, customers and other stakeholders. Such an incident could also result in legal claims, financial damage and reputational loss.<br><br>Cobham's US defence business is managed through an SSA, the terms of which are agreed with the US Government. The SSA is intended to ensure that the US defence business is not subject to the effects of FOCI (Foreign Ownership, Control or Influence). Further details of the SSA can be found on page 51. The terms of the SSA may reduce the ability for the Group to effectively manage its US defence business due to reduced visibility into the business and its performance.<br><br>The Group is currently the subject of an investigation by the UK Financial Conduct Authority (FCA) in connection with the Group's handling of inside information prior to its trading update in January 2017 and announcement of its intention to undertake its Rights Issue in 2016. The Group continues to co-operate fully with the FCA, but is unable to predict the timing, cost, or outcome of the investigation. | Cobham employs procedures to ensure it remains in compliance with all legal requirements and regulations, and continues to drive a culture that ensures that ethical, environmental, and health and safety considerations are embedded in all of the Group's activities.<br><br>Policies and procedures are included in the Group's corporate framework to ensure all of the Group's compliance requirements are met. This is regularly reviewed and audited, including procedures related to the use of sales and marketing representatives, anti-bribery and anti-corruption, gifts and hospitality, whistleblowing, and investigation of ethics and compliance concerns, along with Cobham's Code of Business Conduct.<br><br>Mandatory training is undertaken by all employees on a variety of compliance related subjects including US Government contracting and anti-bribery and corruption.<br><br>See the CRS section on pages 40 to 43 for further details on human rights, environmental, and health and safety actions. | None | **Increasing Risk**<br>The regulatory landscape in many areas, continues to develop. |

| Element | Risks and impact | Mitigation | Risk appetite | Risk status indicator |
|---|---|---|---|---|
| **10. Governance framework is poorly constructed and implemented**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion<br>– Voluntary staff turnover | The Group's organisational structure delegates some operational autonomy and responsibility to its business units, including with respect to the negotiation and performance of the Group's contracts with its customers.<br><br>The Group is implementing an enhanced internal governance framework, following the identification of certain internal control issues that affected the business primarily during 2016. There is a risk that the revised internal governance framework could misalign the level of constraint with the levels of risk appetite in different aspects of the Group's operations, leading to the over and under control of risks in different areas of the business.<br><br>This could lead to exposure to unacceptable risks in areas requiring conservatism, potentially damaging shareholder value. Conversely, it may also prevent the acceptance of risks required in order to grow the Group's business, hindering the ability to deliver an acceptable return on shareholder investment.<br><br>The Group has a capital structure that is partially funded through borrowings from banks and other financial institutions. The associated banking agreements incorporate financial covenants and other provisions, breach of which may lead to potential defaults and costs associated with obtaining temporary waivers or the requirement to reduce debt through divestment or additional capital raising. | The ongoing review of governance is being conducted in accordance with established principles to ensure that it delivers a streamlined governance framework, facilitates appropriate risk taking, and drive improvements in performance through application of effective governance principles.<br><br>A revised delegation of authorities has been issued to ensure that the degree of delegation is commensurate with the management capabilities within each business unit, Sector and specialist function.<br><br>An internal governance committee has been established to review and approve a revised set of policies and procedures being rolled out during 2017 and 2018. | Medium | **Decreasing Risk**<br>The updated delegation of authorities, and the roll out of a streamlined set of policies and procedures has improved the Group's internal governance. |
| **11. Information assurance security measures are insufficient to prevent data loss**<br><br>**Links to KPIs**<br>– Organic revenue<br>– Underlying operating margin<br>– Underlying EPS<br>– Operating cash conversion | Cobham relies upon its IT systems to store and process its data securely. Due to the nature of its business, the Group faces various security threats, including cyber security attacks from computer hackers, viruses and malicious code intended to gain access to proprietary or sensitive information, as well as threats to the physical security of its IT facilities and infrastructure.<br><br>Although various bespoke and industry standard procedures and controls are utilised to monitor and mitigate exposure to these threats, the impact of any future attack cannot be predicted with any certainty due to the evolving nature of these security threats. These could include compromising the security of intellectual property and customer and employee data and the corruption of embedded product data and data for external services.<br><br>Significant data breaches or losses could also lead to litigation and fines for breaking data privacy law and other regulations. This would result in reputational damage and potentially the loss of new and existing contracts. | IT policy compliance is assessed on a quarterly basis to ensure that processes and procedures in place are reflective of all legal and regulatory requirements.<br><br>Constant monitoring of events and vulnerabilities is conducted by both internal resources and trusted external third parties.<br><br>Primary and secondary data centres have been established to provide contingency. | Medium | **Unchanged**<br>Information security measures continue to be strengthened in response to the increasing level of threats being experienced. |
| **12. Taxation liabilities may be larger than anticipated**<br><br>**Links to KPIs**<br>– Underlying EPS | Cobham is subject to corporate and other tax rules in the jurisdictions in which it conducts its business operations. Due to changes in tax laws and regulations, changes in interpretation of taxation regulations, an increase in tax audits and challenges and the testing of interpretations through litigation, tax liabilities are being challenged and may ultimately be deemed inaccurate. Tax authorities may also pursue additional taxes based on retroactive changes to, and interpretations of tax laws.<br><br>For example, the availability of interest deductions on one of the Group's internal financing arrangements, principally as a result of various US acquisitions, has been under challenge for some time. Over the life of this financing arrangement, the aggregate tax value of the interest deductions amounted to approximately £130m, before interest. If decided adversely to the Group, this could lead to increased tax liabilities in excess of those provided in the Group's Balance Sheet and result in a substantial tax payment becoming due. The Group has taken external advice and considers that it has strong support for its position, but the timing and resolution of this issue is uncertain.<br><br>An adverse outcome could also result in potential damage to the Group's reputation. | External advisors review all major transactions.<br><br>Known risk areas such as transfer pricing are monitored by the Group.<br><br>Significant tax computations are reviewed by external advisors prior to submission.<br><br>The Group has established and published its tax policy. | Medium | **Increasing Risk**<br>Tax authorities continue to assess and challenge significant taxation judgements. |
| **13. The deficit within the Cobham Pension Plan may change**<br><br>**Links to KPIs**<br>– Underlying EPS<br>– Underlying operating margin<br>– Operating cash conversion | The Group maintains a number of defined benefit pension schemes which are closed to new entrants and future benefit accrual, the largest of which is the Cobham Pension Plan in the UK. This pension scheme is in deficit, and this deficit may change in the future in response to changes in the value of assets and liabilities.<br><br>According to the current schedule of contributions agreed with the scheme trustees, the Group expects to contribute £18.1m in 2018, £18.2m in 2019 and £8.8m in each subsequent year through to 2022. This deficit funding could change in the future, following the next triennial valuation of the Group's defined benefit pension schemes which is expected to be completed during the second half of 2018.<br><br>The Trustees view of the strength of the Company covenant is also taken into account in the setting of recovery plans to address the deficit. | The trustees of the Cobham Pension Plan seek to ensure that the scheme's assets and liabilities remain matched, the most significant element of which involves the acquisition of insurance policies that match existing liabilities. | Medium | **Unchanged** |

# Cobham has made progress against its key objectives during the year

Acting responsibly and sustainably enables Cobham to enhance its culture, manage risk and capitalise on opportunities creating long term value for the Company and stakeholders. Products and services often provide important environmental and social benefits whether through enhancing aviator survival, reducing the size and weight of products and their consequent environmental impact, or providing reliable communications in demanding environments.

Cobham takes a strategic approach to corporate responsibility and sustainability (CRS). The Group identifies and prioritises the CRS issues most relevant to it. This is completed through a mapping process that includes stakeholder research, feedback and engagement on material issues important to the Group's industry sectors and to employees, customers and investors. The table below shows the material CRS issues that have been identified as part of this process, and maps them against the Group's operational priorities to illustrate how they are being managed. The identified issues, which have been reviewed and are unchanged from 2016, have been grouped into three dimensions for ease of reporting – Economic, Social and Environmental. Further information on each dimension is set out below.

| Material issue | Customer Focus | Leadership | Simplification | Control | Execution |
|---|---|---|---|---|---|
| **Economic dimension** | | | | | |
| Business ethics | • | • | • | • | • |
| Material sourcing and supply chain management | • | • | • | • | • |
| **Social dimension** | | | | | |
| Talent attraction, development and retention | • | • | • | • | • |
| Diversity and inclusion | | • | | • | • |
| Employee health and safety | • | • | | • | • |
| Human rights | • | • | | • | |
| **Environmental dimension** | | | | | |
| Environmental sustainability | • | • | | • | |

All material disclosures are verified internally. Cobham also obtains limited external assurance on its recording of greenhouse gas (GHG) emissions. Bureau Veritas has provided assurance on the Group's 2017 GHG emissions data (see page 74 for more information).

The Group's policies and assurance statements are available at **www.cobham.com/the-group/corporate-responsibility-and-sustainability/performance-data-policies/performance-data/**.

## Economic dimension

### Business ethics

Cobham operates in specialist markets, a number of which are highly regulated. It is Group policy to comply with all applicable laws and regulations. Non-compliance with applicable laws and regulations is a Group principal risk (refer to risk 9 on page 38).

The Group is committed to sustaining an ethical culture. The Cobham Ethics and Compliance Programme (CECP) has been developed to support this culture through a range of policies, processes and activities. The implementation and effectiveness of the CECP is overseen by the Business Ethics and Compliance Committee (BECC), and ultimately the Board. The programme is underpinned by the Code of Business Conduct (COBC), which outlines the Group's core values and the behavioural standards it mandates for all its officers, employees and representatives on a range of issues, including anti-bribery and anti-corruption.

Cobham has a clearly stated zero-tolerance approach to bribery and corruption in any form. All employees are required to receive training on the COBC and other ethics and compliance training, including anti-corruption. Cobham maintains an independent Ethics Helpline and website where potential compliance violations can be reported. In 2017, it sought to improve the handling of concerns raised via the Ethics Helpline through a range of steps, including providing specialist training to a panel of newly appointed internal investigators. Further details on the Group's approach to ethics and compliance can be found at **www.cobham.com/the-group/corporate-responsibility-and-sustainability/ethics/**.

A related risk area is the use of third party intermediaries as a route to market. Failure by an intermediary to comply with laws and regulations, or the failure of the Group to complete appropriate intermediary due diligence can impact the Group's reputation as well as lead to a range of sanctions, including significant fines or debarments from government contracts and new business. Cobham's Anti-Bribery and Anti-Corruption policy requires intermediaries to undergo a comprehensive due diligence and approval process prior to engagement. In 2017 Cobham took steps to improve its intermediary risk management process. Enhancements included an increased number of counterparties subjected to additional due diligence and the use of technology to provide a continuous real time due diligence monitoring system.

Cobham measures the effectiveness of the CECP and improvements to it through a range of Key Performance Indicators (KPIs), one of which is the completion of mandatory COBC training. In 2017, 99.8% (2016: 99.5%) of Cobham employees completed COBC training.

### Material sourcing and supply chain management

Cobham is seeking to simplify its supply chain by reducing the number of suppliers used, to manage risk, reduce cost and improve quality. The Group is committed to maintaining responsible business practices across the supply chain, which it puts into effect through the Group's Responsible Supply Chain Management (RSCM) policy and Supplier Code of Conduct, details of which can be found at **www.cobham.com/the-group/suppliers/supplier-documents**.

During 2017, Group-wide supplier compliance campaigns were conducted with respect to bribery and corruption, modern slavery and human trafficking, and conflict minerals. In addition to reinforcing the Group's responsible business practices, this supported Group regulatory disclosures and customer information requests.

During 2018 Cobham will continue to focus on repeating its supplier campaigns and enhancing key supplier engagement.

Cobham is legally, and sometimes contractually, required to disclose certain information regarding its global supply chains. Compliance with applicable laws and regulations and the characteristics of its markets and the resulting complex contracting environment have been identified as principal risks (for further details refer to risks 9 and 2 on pages 38 and 36 respectively).

## Social dimension

### Attraction, development and retention of talent

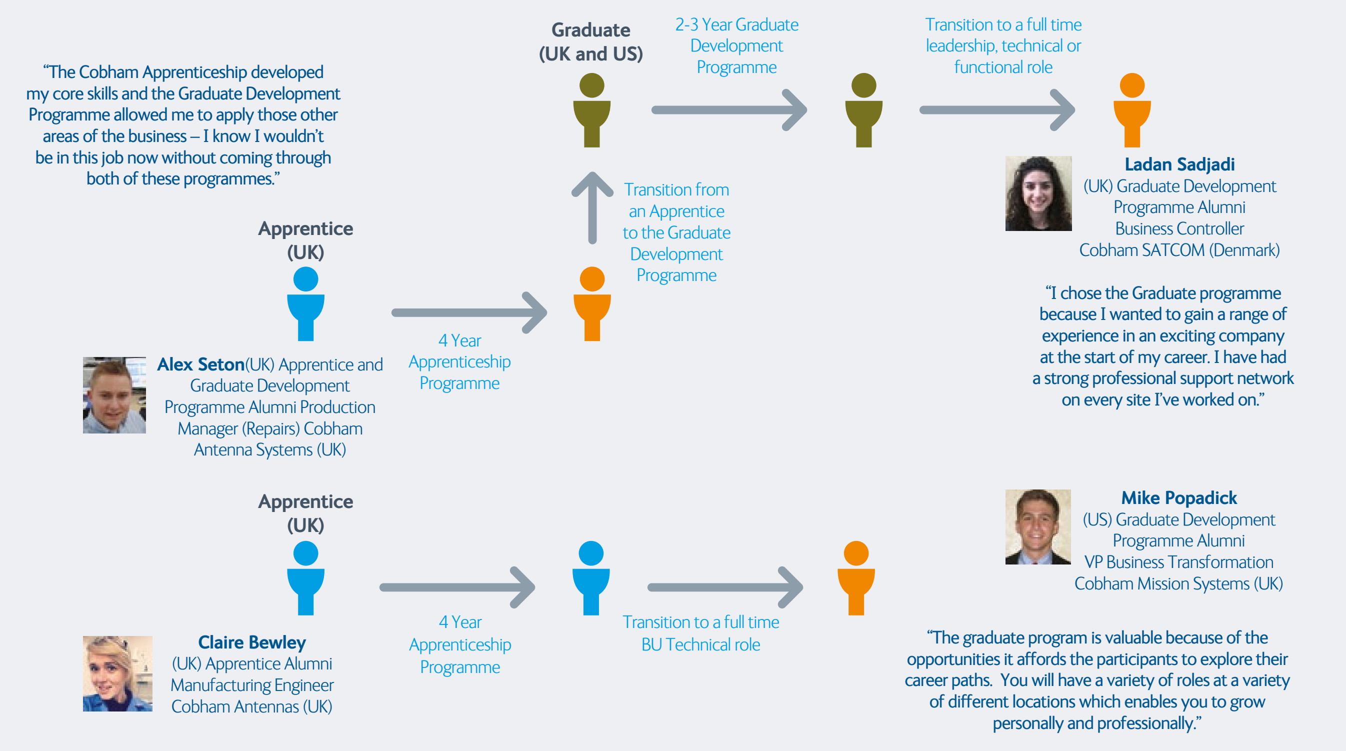
The ability to attract and retain talented and engaged employees is critical to enable Cobham to achieve its growth plans, deliver on key programmes and meet ongoing commitments. The talent strategy looks to create a talent and organisational development framework that ensures Cobham is a high performing and sustainable organisation. The shortage of appropriate skills and talent has been identified as one of the Group's principal risks (refer to risk 4 on page 37).

The Group continues to invest in emerging talent, and as a result has increased the number of places within its graduate and apprentice development programmes. The Group has also created a vocational programme to provide an additional pathway into key management and other technical roles. The graduate development programme continues to expand its geographical reach, with opportunities for graduates created in Denmark, in addition to existing opportunities in the US and the UK. Alumni from the graduate and apprentice schemes are progressing into senior roles and are increasingly featuring on succession plans, evidencing the success of the schemes. The graduate scheme continues to be accredited by the UK Institute of Mechanical Engineers and the Royal Aeronautical Society, and in 2017 the Group employed 4.5% (2016: 4.2%) of its UK workforce as apprentices, graduates or undergraduate placements, putting it on track to meet its 5% Club commitment by 2019 – for further information see: **www.5percentclub.org.uk**.

During 2017, Cobham has invested in developing leadership capability though the ongoing delivery of the Cobham Certificate in Management programme which is accredited through the Institute of Leadership and Management. In addition, development assessments were undertaken across the organisation to support the continued development of individuals in critical roles, and this activity will continue during 2018.

### The Emerging Talent Career Pathway

Cobham's apprentice and Graduate Development Programmes enable emerging talent to choose and follow multiple career pathways. Different skills, development needs and interests are accommodated and cultivated as demonstrated with the success stories below.



Development activity linked to career frameworks has been deployed across the Group in key capability areas, including delivery of Association of Project Management accredited programmes, and continuous improvement (Six Sigma) training. A mentoring programme has been commenced to support individual development and facilitate knowledge sharing across the Group.

The Group has enhanced its approach to talent for 2018, which looks to develop Cobham's pipeline of leadership and technical capability through structured development programmes. This will seek to build on the current structures and integrate external best practice to ensure that the objectives of the organisation continue to be supported.

The Group uses voluntary staff turnover to measure the effectiveness of its talent retention and employee engagement approach. In 2017, the Group's voluntary employee turnover was 10% (2016: 10%). The Group has completed the first year of its turnaround and in these circumstances it is expected that there might be a degree of staff movement, while the Group's organisation structures, ways of working and culture undergo a period of evolution. Management continue to expect that the staff turnover will decrease over time.

### Diversity and inclusion

Competition for talent is growing in the Group's markets. A combination of ageing populations and declining numbers of suitable university graduates is leading to greater competition for the same talent across industries and geographies, particularly for science, technology, engineering and mathematics disciplines on which the Group relies. Cobham must attract and retain the right skills to meet its plans. Ensuring the Group's culture supports the creation of a diverse workforce will enable the Group to attract and retain key talent from all backgrounds. Cobham is committed to developing an inclusive workplace where employee differences are valued, enabling everyone to contribute fully.

Under the UK Equality Act 2010 regulations, which apply to legal entities with at least 250 employees, Cobham is required to report gender pay gap data. Gender pay gap data for five Cobham legal entities is available at **www.cobham.com/the-group/corporate-responsibility-and-sustainability/performance-data-policies/disclosures/**.

In 2017, women were employed in 16% (2016: 17%) of all senior management roles. The Group recognises that there is a significant opportunity to increase the number of women in leadership positions and is developing plans to proactively address this issue. Ensuring that the Group is able to attract and retain a diverse workforce aligns with the Group's principal risks relating to a shortage of appropriate skills and talent as well as failure to comply with laws and regulations (refer to risks 4 and 9 on pages 37 and 38).

### Employee health and safety

Cobham endeavours to create a safe and healthy culture and framework that fosters employee engagement at all levels. The Group Safety, Health and Environment (SHE) Committee has set the objective of transforming the Group's organisational SHE culture. Failure to deliver consistently high standards of health and safety could lead to accidents or incidents which may result in employees being injured or otherwise harmed, which is totally unacceptable. In addition, accidents or incidents may result in prosecutions, fines, loss of assets, business interruption and widespread reputational damage. Health and safety aligns with the Group's principal risks relating to significant business interruption and failure to comply with laws and regulations (refer to risks 8 and 9 on page 38).

The Group's workplace SHE programme, called 'Zero Harm', promotes continuous improvement. Its objective is to minimise injuries and illnesses occurring in the workplace, improve environmental sustainability and ensure employees' wellbeing. Accountability for implementing the Group's SHE strategy is with line management. This is monitored by the Group SHE Committee, which is chaired by the CEO. Technical expertise is provided through a Group SHE Council – comprising senior business unit SHE professionals under the leadership of a dedicated Group SHE Senior Director and the VP Corporate Responsibility and Sustainability.

The Group's three year SHE strategy is to:
- Continually improve safety, health, environmental and sustainability performance;
- Drive a proactive and learning SHE culture through engaged and empowered people at all levels; and
- Derive business efficiencies through the implementation of an integrated, standardised SHE management system across the organisation.

Cobham continues to enhance its SHE programme, and has built further on the transformational work undertaken in 2016. 2017 saw the first full year of implementation of the new global SHE standards. Compliance with these standards is measured, and Cobham's businesses were expected to achieve a minimum compliance target by 2017, with the target increasing by five percentage points in 2018. Testing is through an annual self-assessment exercise, periodic peer-to-peer auditing and a biennial external audit. In 2017 all assessed sites achieved or exceeded the minimum SHE compliance target, an improvement compared to 2016 when 5 of the 47 sites assessed did not achieve the standard.

In addition, the Group Executive monitors SHE performance on a monthly basis, using a balanced scorecard of leading and lagging indicators. Leading indicators (indicators that correlate with future performance) are used to drive correct behaviours. They include safety training, risk assessments, workplace inspections, SHE Committees and reporting of safety observations. Lagging indicators (indicators that are based on historic performance) are used to measure the effectiveness of the approach, and these include the incidence of workplace injuries and illness, environmental issues and regulatory interventions. During 2017, the Group achieved 94% of its leading indicator metrics.

With regard to lagging indicators, there were no fatalities in 2017. The occupational lost time injury and illness incident rate (defined as the number of cases resulting in one or more days lost time or restricted duties) fell to its lowest level since the Aeroflex acquisition in 2014, at 0.503 incidents per 200,000 hours worked (an industry standard metric which Cobham has adopted as one of its key reporting measures in 2017), compared to 0.720 in 2016. Manual handling, minor hand injuries, and slips and trips were the most common causes of injury or illness that resulted in lost time during 2017, and this is consistent with prior years.

There was one significant regulatory intervention in the year. In May 2017, a defective 40 metre electrical lead that was used to power aircraft on the ground at the Aviation business in Adelaide, Australia was identified which led to the issuance of a prohibition notice by the government regulator for South Australia (Safework SA). All defective leads were removed from service and destroyed immediately, and a new worldwide inspection regime implemented to prevent recurrence.

### Gender Diversity in the Cobham Workforce

| Females/Total (%)[1] | 2017 | 2016 | 2015 |
|---|---|---|---|
| Board of Directors | **2/10 (20%)** | 2/9 (22%) | 2/10 (20%) |
| Senior Managers[2] | **16/112 (14%)** | 21/113 (19%) | 20/135 (15%) |
| Senior Managers[3] | **24/151 (16%)** | 24/138 (17%) | 21/144 (15%) |
| Total workforce | **2,877/11,070 (26%)** | 2,904/10,845 (27%) | 3,649/12,658 (29%) |

1 Full time equivalent employees at year end.
2 Statutory definition – Employees with responsibility for planning, directing or controlling corporate activities.
3 Cobham definition – Vice Presidents and above.

Further details on Cobham's SHE policy, management standards and performance are at **www.cobham.com/the-group/corporate-responsibility-and-sustainability/performance-data-policies/policy-downloads/**.

## Human rights

Human rights remain an important issue for the Group. There are growing requirements to comply with legislation and to respond to customer information requests on human rights issues such as modern slavery (for example the UK Modern Slavery Act 2015) and conflict minerals (for example the US Dodd-Frank Act). Compliance with applicable laws and regulations has been identified as a principal risk (refer to risk 9 on page 38).

Cobham supports the principles contained in the Universal Declaration of Human Rights and seeks to reflect these in the context of its business activities. Cobham also respects the human rights of its employees as set down in the International Labour Organisation Declaration on Fundamental Principles and Rights at Work. Cobham demonstrates its support and respect for human rights through the principles and policies contained in the COBC, the Corporate Framework and the Group's policies and processes.

In 2017, the Group issued its first annual Anti-Slavery and Human Trafficking statement in compliance with section 54 of the Modern Slavery Act. The statement outlines the Group policy and approach to managing risk in Group operations and in its supply chains. The statement can be downloaded at **www.cobham.com/the-group/corporate-responsibility-and-sustainability/performance-data-policies/disclosures/**.

Cobham believes that community issues are best addressed locally wherever possible. Individual sites are encouraged to manage their operations and activities with due consideration for the wellbeing of their neighbours and local communities. In 2017 the Group donated £275,726 (2016: £269,933) to a range of good causes including armed services, rescue and health based charities, as well as local community interests. It is Cobham's policy not to make political donations.

# Environmental dimension

## Environmental sustainability

Cobham recognises that its operations, activities, products and services have an impact on the environment. A material environmental issue is the Group's response to climate change. The table below outlines Cobham's governance, strategy, risk management, and performance measurement approach with regard to this issue.

### Task force on climate related disclosures (TFCD) – our initial response

#### Governance

The Corporate Responsibility and Sustainability Committee, chaired by the CFO, has overall accountability for CRS strategy, including climate change and carbon management. The Committee has responsibility for reviewing the effectiveness of controls in place for identifying and managing risks and opportunities, challenging Group performance, and maintaining strategic and policy oversight.

#### Strategy

Climate change affects the Group's approach to its drivers of change. Climate change regulation, taxes, international agreements such as the Paris accord, volatile energy costs and changes in weather conditions have all informed the Group's strategic decisions as Cobham adapts to changing operating environments. Investment in new technology that reduces size, weight and power consumption of products is an important differentiator in the Group's markets.

Material issues identified include:

- Greenhouse gas (GHG) emissions from aircraft fuel combustion in its Aviation Services Sector (which represents the majority of the Group's GHG emissions);
- GHG emissions from electricity and fuel used in the lighting, heating, ventilation and cooling of its facilities and supply chain Group-wide;
- The impact of the size, weight and power efficiency of Cobham products upon the fuel burn and GHG emissions of customer aerospace platforms; and
- Business interruption at its facilities, and those of its key suppliers, due to adverse weather events (e.g. flooding, wildfire).

#### Risk management

Risks and opportunities are monitored, prioritised and managed in a number of ways, including by the Group's insurance partner, in local risk registers and business unit SHE self assessments.

Failure to address environmental sustainability issues aligns with the Group's principal risks of failure to comply with laws and regulations and of significant business interruption (refer to principal risks 8 and 9 on page 38).

The Group addresses environmental sustainability issues by:

- Reducing environmental impacts from its operations wherever practicable;
- Reducing legacy aircraft fuel consumption and seeking to transition to more fuel efficient aircraft where possible;
- Reducing GHG emissions across a number of operating sites through practical energy efficiency measures, including to lighting, heating, ventilation and air conditioning;
- Investing in design to reduce the size and weight of products which reduces energy consumption with a corresponding reduction in environmental impacts;
- Reinforcing business continuity measures and effective emergency response planning, in preparation for adverse weather events and natural disasters; and
- Aligning the Group's environmental standards to ISO14001 and encouraging business units to certify to ISO14001 standards.

#### Performance measurement

The Aviation Services Sector sets an annual aviation fuel consumption per hour reduction target for the aircraft under its operational control. In 2017, the Sector achieved a reduction of 18.6 kg /hr in fuel burn intensity, which is a reduction of 3.25% compared to 2016, well in excess of the 0.5% target. This equated to a saving of 1,714 tonnes of carbon dioxide emissions. This reduction was achieved through the implementation of a number of measures, including the use of improved flight planning software with more accurate weather forecasts, a reduction in flight speeds and reduced engine usage during the taxi phase of the flight.

Facility energy intensity decreased by 8% (2016: 18% decrease) narrowly missing the target of 10%. Reductions in facility energy intensity were achieved through a number of planned energy saving initiatives, some of which were deferred and will be implemented in 2018.

Further details on the Group's GHG emissions can be found in the Other Statutory Information report on pages 73 and 74.

The Group measures and discloses its greenhouse gas emissions strategy, risks, opportunities and performance on **www.cobhamsustainability.com/environment.aspx** and through the annual CDP investor climate change and customer supply chain surveys. CDP is a not-for-profit charity that runs the global disclosure system for companies and others to manage their environmental impacts.

Cobham achieved an A- Leadership rating from CDP for a second year based on its 2016 performance, placing it among the best performers in the UK aerospace and defence sector.

## Summary of 2017 CRS KPIs

| Key Performance Indicator | Target | 2017 | 2016 | 2015 |
|---|---|---|---|---|
| % Employees trained on Code of Business Conduct | 100.0% | 99.8% | 99.5% | 100.0% |
| % Voluntary employee turnover | <10.0% | 10% | 10% | 11% |
| % Female representation in total workforce | | 26% | 27% | 29% |
| Lost Work Case Incident Rate[1, 4] | <0.64 | 0.50 | 0.72 | 0.60 |
| Recordable Incident Rate[2, 4] | <1.26 | 0.95 | 0.93 | 1.18 |
| Facility energy intensity[3] | -10% | -8% | -18% | 5% |

1 Number of lost workday injury or occupational illness cases multiplied by 200,000 divided by the hours worked.
2 Number of recordable incidents per year per 100 full time equivalent employees.
3 MWh per £1m revenue.
4 Targets are re-assessed annually to ensure that they drive continuous improvement.

# Board of Directors

## Chairman

**Michael Wareing**
**Chairman**
CMG, FCA, FCCA, MCSI

## Senior Independent Director

**John McAdam**
**Senior Independent Director**
BSc, PhD

## Executive Directors

**David Lockwood**
**Chief Executive Officer, Executive Director**
OBE, BA, FCA, RSA, FAeS

**David Mellors**
**Chief Financial Officer, Executive Director**
MA, ACA

### Changes to the Board of Directors

| | |
|---|---|
| David Mellors | David became Chief Financial Officer on 1 January 2017 |
| Michael Wareing | Michael was appointed as Non-executive Chairman on 1 January 2017 |
| (David) Jonathan Flint | Jonathan retired as Senior Independent Director and Non-executive Director on 3 August 2017 |
| John McAdam | John was appointed Senior Independent Director and Non-executive Director on 3 August 2017 |
| René Médori | René was appointed as a Non-executive Director on 1 January 2018 |
| Norton Schwartz | Norton was appointed as a Non-executive Director on 1 January 2018 |

### Corporate Governance Index

## Non-executive Directors

**Michael Hagee**
**Independent Non-executive Director**

**Birgit Nørgaard**
**Independent Non-executive Director**
MA, MBA

**Alan Semple**
**Audit Committee Chair**
BA, CA

**Alison Wood**
**Remuneration Committee Chair**
MA, MBA

### Director appointments post year end

**René Médori**
**Independent Non-executive Director**
Doctorate Degree, Masters in Finance

**Norton Schwartz**
**Independent Non-executive Director**
BSc, MA

## Chairman
**Michael Wareing**
CMG, FCA, FCCA, MCSI

**Age:** 64
**Appointed:** Director December 2010, Chairman January 2017
**Skills and experience:** Michael was, until 30 September 2017, the Senior Independent Director, Audit Committee Chair and member of the Remuneration and Nomination Committees at Intertek plc. He was previously a Non-executive Director, Audit Committee Chair and member of the Remuneration and Nomination Committees of Wolseley plc from 2009 until 2014. Prior to these Board roles, he held a number of senior executive positions, including International Chief Executive Officer at KPMG, where he worked from 1973 until 2009. He previously served as Audit Committee Chair for Cobham, and chaired not for profit organisations, including Business in the Community International, and two roles on behalf of the British Government, namely as the Prime Minister's Envoy for Reconstruction in Southern Iraq, and the Economic Development Adviser to the Government of Afghanistan.
**External appointments:** None.
**Committee membership:** Chair of the Nomination Committee and of the Board Risk Committee.

## Senior Independent Director
**John McAdam**
BSc, PhD

**Age:** 69
**Appointed:** August 2017
**Skills and experience:** John is currently Chairman at Rentokil Initial plc and United Utilities Group plc, roles he has held since 2008. Prior to this, he held a number of Non-executive Director appointments at companies including Rolls-Royce Holdings plc, J Sainsbury plc, Sara Lee Inc. and Severn Trent plc. He was also Senior Independent Director for Electra Private Equity plc, a London Stock Exchange listed investment trust, until March 2018. John previously served as the Chief Executive Officer of ICI plc, a position he held from 2003 until it was taken over by Akzo Nobel in 2008. He holds a BSc from the University of Manchester and a PhD.
**External appointments:** Chairman at Rentokil Initial plc and United Utilities Group plc.
**Committee membership:** Member of the Remuneration Committee and Nomination Committee.

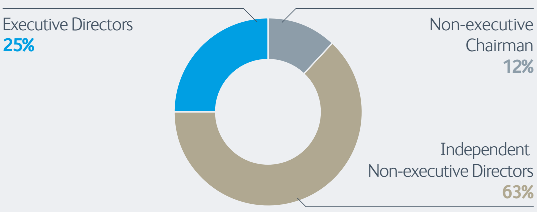
## Executive Directors
**David Lockwood**
**Chief Executive Officer, Executive Director**
OBE, BA, FCA, RSA, FAeS

**Age:** 55
**Appointed:** December 2016
**Skills and experience:** David was formerly the Chief Executive of Laird plc, the FTSE 250 global technology company, a position he held since 2012. Prior to this, he was Vice President Global Defense and Security at BT Global Services. David has also held senior management positions with Thales Group, Intense Limited and BAE Systems plc. He has held Non-executive Director and Chairman positions with WFEL Ltd, Photonix Ltd, and the Scottish Government's Technology Advisory Group, and was previously the Non-executive Chair of Knowledge Transfer Network Limited, a vehicle established to support the work of Innovate UK, the UK's innovation agency which is sponsored by the UK Government Department for Business, Energy and Industrial Strategy (BEIS). David is an accountant (FCA) by training, holding a degree in mathematics from the University of York. He is a Fellow of the Royal Society of Arts and Commerce (RSA) and in 2005 was awarded as the Scottish Entrepreneur of the Year for Technology. In the 2001 Queen's Birthday Honours, David was awarded the OBE for services to industry in Scotland.
**External appointments:** Member of the Dunedin International Advisory Board.
**Committee membership:** Chair of the Executive Directors Committee.

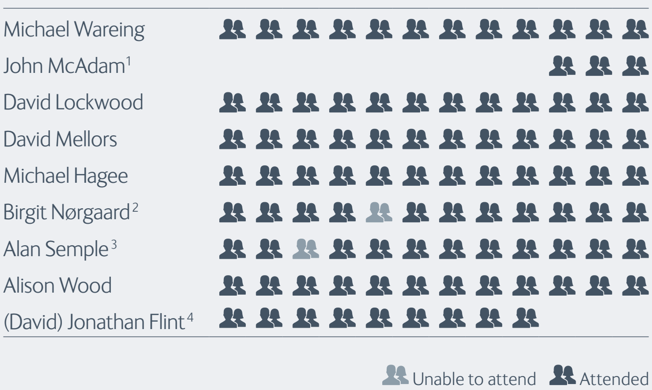
**David Mellors**
**Chief Financial Officer, Executive Director**
MA, ACA

**Age:** 49
**Appointed:** January 2017
**Skills and experience:** David was CFO of QinetiQ, the FTSE 250 science and engineering group operating primarily in the defence, security and aerospace markets, a position he held from 2008, and was interim Chief Executive for a period during 2015. Previously, he was Deputy Chief Financial Officer of Logica plc, Chief Financial Officer of Logica's international division, covering operations in North America, Australia, the Middle East and Asia, and prior to that he was the Group Financial Controller. David formerly held various roles with CMG plc, Rio Tinto plc and Price Waterhouse, now PwC. He is a Chartered Accountant, holding a degree in physics, from Oxford University.
**External appointments:** None.
**Committee membership:** Member of the Executive Directors Committee.

### Role and focus
The Board's main duties are to:
- Lead the Group with a view to the creation of strong, sustainable financial performance and long term shareholder value;
- Review and agree the Group's strategy;
- Set the Group's risk appetite and monitor the Group's risk management processes;
- Ensure necessary resources are in place;
- Monitor management performance; and
- Supervise the conduct of the Group's activities within a framework of prudent and effective internal controls.

### Board of Directors as at 31 December 2017



### Board meeting attendance for 2017
12 Board meetings were held during the year, attended as follows:




1 John McAdam joined the Board on 3 August 2017.
2 Birgit Nørgaard missed a telephone meeting due to other Board commitments.
3 Alan Semple missed a telephone meeting due to ill health.
4 (David) Jonathan Flint retired from the Board on 3 August 2017.

## Non-executive Directors

### Michael Hagee

**Independent Non-executive Director**

**Age:** 73
**Appointed:** December 2008
**Skills and experience:** Michael served in the US Marine Corps for almost 39 years ending his career in 2007 as Commandant of the Marine Corps and a member of the Joint Chiefs of Staff. His numerous military assignments included Commanding General, 1st Marine Expeditionary Force, Deputy Director of Operations at the US European Command and Executive Assistant to the Director of Central Intelligence. He also served in a number of diplomatic missions including the presidential diplomatic mission to Somalia. Michael retired from his role as Non-executive Director of Remington Outdoor Company Inc. in February 2015.
**External appointments:** President and CEO of the Admiral Nimitz Foundation in Fredericksburg, Texas, US, Co-Chairman of the Commission on Energy and Geopolitics, Non-executive Director of DynCorp International Inc. and Outside Manager on the Government Security Committee of the Special Security Agreement of TE SubCom, a TE Connectivity limited company.
**Committee membership:** Member of the Audit Committee.
Michael is retiring by rotation following the 2018 Annual General Meeting.

### Birgit Nørgaard

**Independent Non-executive Director**
MA, MBA

**Age:** 59
**Appointed:** April 2014
**Skills and experience:** Birgit, a Danish national, currently holds a number of non-executive roles in the private and public sectors. Birgit's last executive role was as both the Chief Executive Officer of Grontmij Carl Bro, the Danish engineering consultancy group as well as the Chief Operating Officer of Grontmij NV, the Dutch parent company. An economics graduate from Copenhagen Business School, Birgit has an MBA from INSEAD.
**External appointments:** Birgit is a Non-executive Director of IMI plc, WSP Global Inc, a global consulting engineering company listed in Canada, DSV A/S, an international transportation company listed on the Copenhagen Stock Exchange and NCC AB, a construction and property development company listed on Nasdaq OMX Stockholm. She also holds board positions in private companies and public sector positions.
**Committee membership:** Member of the Audit Committee and Board Risk Committee.
Birgit is retiring from the Board following the 2018 Annual General Meeting.

### Alan Semple

**Independent Non-executive Director**
BA, CA

**Age:** 58
**Appointed:** February 2015
**Skills and experience:** Alan was formerly CFO and a Director of John Wood Group plc, a role he had held since 2000 and retired from in May 2015. Prior to this, he held a number of senior finance roles in Wood Group from 1996. Alan previously served as the Group Finance Director of GRT Bus Group plc from 1994 to 1995, one of two companies which merged to form FirstGroup plc. Between 1987 and 1994, he was Finance Director at Seaforth Maritime Group Limited.
**External appointments:** Non-executive Director and member of the Audit Committee of Teekay Corporation. Non-executive Director and Chair of the Audit Committee of Cactus, Inc.
**Committee membership:** Chair of the Audit Committee and member of the Board Risk Committee and Nomination Committee.
Alan is retiring from the Board following the 2018 Annual General Meeting.

### Alison Wood

**Independent Non-executive Director**
MA, MBA

**Age:** 54
**Appointed:** July 2011
**Skills and experience:** Alison was formerly Global Director Corporate Development and Strategy for National Grid plc. Previously, she was Group Strategic Development Director for BAE Systems plc, responsible for corporate strategy, mergers and acquisitions, and strategic business development across the UK and US. She held two previous Non-executive Directorships with BTG plc and THUS plc, and was Senior Independent Director and Chair of the Remuneration Committee for e2v technologies until March 2017.
**External appointments:** Non-executive Director and Chair of the Remuneration Committee of Costain Group plc, TT Electronics plc and The British Standards Institution (a non-listed Royal Charter Company).
**Committee membership:** Chair of the Remuneration Committee and member of the Nomination Committee and Board Risk Committee.

### René Médori

**Independent Non-executive Director**
Doctorate Degree, Masters in Finance

**Age:** 60
**Appointed:** January 2018
**Skills and experience:** René was Finance Director at Anglo American plc for 12 years, having retired at its AGM in April 2017. Prior to joining Anglo American he held a number of senior financial positions, including Group Finance Director at The BOC Group plc. René holds a doctorate degree in economics and degrees in finance and economics from the Université de Paris – Dauphine, France.
**External appointments:** Since 2013 René has been on the Board of Petrofac Limited, a company listed on the London Stock Exchange, and the Chairman of their Audit Committee. Having become Senior Independent Director of Petrofac in 2017, he will become Chairman in May 2018. Before that, he was a Non-executive Director and Chairman of the Audit Committee at SSE plc.
**Committee membership:** Member of the Audit Committee and Board Risk Committee.

### Norton Schwartz

**Independent Non-executive Director**
BSc, MA

**Age:** 66
**Appointed:** January 2018
**Skills and experience:** General Schwartz retired from military service in October 2012 after serving over 39 years in the US Air Force. He was the 19th Chief of Staff of the US Air Force from 2008-2012 and a member of the US Joint Chiefs of Staff. He also held a number of other senior military positions including Commander US Transportation Command, Director for Operations and Director of the Joint Staff and Deputy Commander of US Special Operations Command.
**External appointments:** Norton sits on the Board of Wesco Aircraft Holdings, Inc, and the US Board of Directors of CAE Inc, both NYSE listed companies. He is currently the President and CEO of Business Executives for National Security (BENS) in the US, a position he has held since 2013. BENS applies best practice business solutions to improve the performance of US Government national security partners.
**Committee membership:** Member of the Remuneration Committee and Board Risk Committee.

# 2017 has seen enhancements to internal control, increased transparency, strengthening of the Balance Sheet and other governance changes

The focus during the year has been to address the Group's operational issues and to enhance controls

**Dear Shareholder**

As we noted in last year's report, the early part of 2017 was focused on the actions needed to start the operational turnaround. As I also noted last year, my fellow Board members and I spent time in the early part of the year considering the Board's strengths and, more importantly, our development areas. I have also been working on the composition of the Board and we have announced a number of new non-executive appointments, namely: the new Senior Independent Director, John McAdam in August 2017, René Médori, the Audit Committee Chair Elect, and Norton Schwartz, a Non-executive Director, both in December 2017. Biographies for the new Directors have been included on page 47.

The Chief Executive Officer and Chief Financial Officer, who joined the Board in late 2016 and early 2017 respectively, have settled into their new roles quickly and have been instrumental in formulating the focus for 2017, namely on customer focus; leadership and simplification; and control and execution. We also recognised the need to improve our succession planning, starting at Board level and then at all levels through the business. Below Board level, there have been a number of significant senior appointments in the year to enhance our management team which are identified in the CEO's Statement.

During the year we formed a Board Risk Committee, chaired by me and comprising a number of the Non-executive Directors. Meetings were also attended by our Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, VP Risk Management, Group Head of Internal Audit and Assurance and Company Secretary.

We have complied with the UK Corporate Governance Code (the Code) except in relation to the membership of our Remuneration Committee, where, due to the number of Board members being reduced, we could not comply with the Code in terms of numbers of Committee members, although we did comply with our own terms of reference and were therefore quorate. The Audit Committee membership dropped to two members between the resignation of (David) Jonathan Flint and Birgit Nørgaard being appointed to the Committee, but no formal meetings were held during that period.

The Directors present their report and the audited Group and Parent Company Financial Statements of Cobham plc for the year ended 31 December 2017.

### Statement of compliance with the provisions of the Code

The ordinary shares are listed on the London Stock Exchange. In accordance with the Listing Rules of the UK Listing Authority, the Company confirms that throughout the year ended 31 December 2017 and at the date of this Annual Report, it was compliant with the provisions of the Code subject to the committee membership point noted above; please refer to page 64 for further details.

This part of the Annual Report describes how the Company has applied, and complied with, the Code. The Code is published by the Financial Reporting Council (FRC) and is available from its website **www.frc.org.uk**.

### Responsibility statements

The statement relating to the responsibilities of the Directors is on page 75, and that relating to the auditors is on page 82.

### Share capital

Details of the share capital of the Company and the powers of the Directors in relation to allotment, issue and market purchases of shares are given on page 72.

### Financial reporting

At its February 2018 meeting, the Board reviewed and was satisfied that the Annual Report and Accounts for the 2017 financial year, taken as a whole, is fair, balanced and understandable and the Board believes that the information contained provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy. The Audit Committee, supported by management, has adopted a process to enable the Board to take this view and this process is set out in the Audit Committee Report on page 61.

The Directors have adopted the going concern basis in preparing the Annual Report and Accounts as stated in the CFO's Statement on page 33.

### Key events for 2017

- The Company completed a £512m Rights Issue (£497m raised, net of costs), strengthening the Balance Sheet and allowing the management team to focus on the business aims of: customer focus; leadership and simplification; control and execution;
- The Board has agreed a different approach to its strategic review process, including more Board time spent on matters of a strategic nature. The new approach commenced in October 2017 with a full day starting to consider strategic questions. 2018 will see time spent on reviews of each Sector to assist the Board in its understanding of the Group;
- Non-executive Board appointments during the year have included John McAdam as the new Senior Independent Director, the Audit Committee Chair Elect, René Médori and Norton Schwartz;
- In terms of increased controls, improvements have been made to the risk management process, with a focus on management of the accumulated known risk within the business and the formation of a formal Board Risk Committee, wider mandatory training (including more training at Board level), enhanced disclosure and transparency arrangements and a Corporate Framework and policy refresh, with roll out currently underway including training as necessary; and
- We announced on 27 March 2017, that the Company is the subject of an investigation by the Financial Conduct Authority (FCA). That investigation is ongoing and relates to the Company's handling of inside information prior to its trading update and announcement of its intention to undertake the 2016 Rights Issue on 26 April 2016 and subsequent trading updates during 2016 and early 2017. The Company is cooperating fully with the FCA and will update the market on the outcome in due course.

### Priorities for 2018

- Review and challenge the organisational design to support a simplified corporate structure;
- Review and challenge the strategic direction of the Group as we finalise the turnaround;
- Review the capital allocation and dividend policy; and
- Continued focus on the operational and control improvements which commenced during 2017.

**Michael Wareing**
Chairman
1 March 2018

## Corporate Governance Report

### The Board composition

The Board comprises a Non-executive Chairman (Michael Wareing), a CEO (David Lockwood), a CFO (David Mellors), a Senior Independent Director (John McAdam) and six other Non-executive Directors. All Non-executive Directors, except the Chairman, are considered to be independent and the Chairman was considered to be independent on appointment. They all held office throughout the year except John McAdam who was appointed on 3 August 2017, at which point the previous Senior Independent Director, (David) Jonathan Flint retired from the Board. René Médori and Norton Schwartz both joined the Board as additional Board members on 1 January 2018.

Biographies of the Directors, giving details of their experience and other significant commitments, are set out on pages 46 and 47. The attendance of Directors at Board meetings is set out on page 46 and attendance at principal Board Committee meetings as members of such committees during the year is set out in the reports from each committee on pages 55, 59 and 64.

The rules for the appointment and replacement of Directors are set out in the Company's Articles of Association (the Articles), copies of which can be obtained from Companies House in the UK or by contacting the Company Secretary. Changes to the Articles must be approved by shareholders passing a special resolution. The Directors and the Company (in the latter case by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director.

All the Non-executive Directors have confirmed that they have sufficient time to meet their time commitments to the Group. Copies of their appointment letters are available on request to the Company Secretary and will be available for inspection at the Annual General Meeting (AGM).

In accordance with the Code, which recommends that all Directors of FTSE 350 companies seek re-election by shareholders on an annual basis, all Directors currently in office will retire and those eligible and wishing to do so will seek re-election at the AGM. The Chairman confirms to shareholders when proposing re-appointment that the individual's performance continues to be effective and that the individual continues to demonstrate commitment to the role. Non-executive Directors are subject to Companies Act provisions relating to the removal of a Director.

The Chairman is, among other things, responsible for chairing Board meetings and leading the Board. The CEO's responsibilities include operational performance, corporate social responsibility and the development and implementation of the Group's strategy. He also focuses on long term growth and development of the Group, its people and customer relationships. The Board's policy is that the roles of Chairman and CEO should be performed by different people.

The Senior Independent Director's responsibilities include the provision of an additional channel of communication between the Chairman and the Non-executive Directors. They also provide another point of contact for shareholders if they have concerns that communication through the normal channels of Chairman, CEO or CFO has failed, or where these contacts are inappropriate.

## Board proceedings

### Board meetings

Board meetings, scheduled in accordance with the annual timetable, were held six times during the year on a face to face basis and three times by telephone. In addition, there were three short notice meetings to support Board decisions required between scheduled meetings and for approvals necessary to support the Rights Issue completed during the year. There is also contact between Board meetings to progress the Group's business as required. Meetings are held in London, Wimborne and at other UK and international operational locations.

### Site visits

In 2017, the Board visited operational sites in Wimborne in the UK, and Lyngby, Denmark. Site visits help the Board to understand the business and its strategy better, as well as the problems being faced by the business and how they (as Board members) may be able to help.

### Performance reviews

John McAdam, the Senior Independent Director, held a meeting with the other Non-executives, in the absence of the Chairman, to appraise the Chairman's performance. The Chairman also held meetings with the Non-executives in the absence of the Executive Directors, and one to one performance appraisals with each Non-executive Director and the CEO.

### Board appointments

At the start of the Board composition review process, the Chairman agreed a role specification and shortlist for the first appointment. The first role to be filled was the Senior Independent Director (SID) role, due to the seniority of this role. The Chairman undertook the initial screening of the candidates, in consultation with Egon Zehnder, following which further due diligence was undertaken which included meeting other members of the Board and reference taking. The Board approved the appointment of John McAdam to the role of the Senior Independent Director. A similar process was followed for the other two new Board appointments made, effective on 1 January 2018. All new Board appointments will be considered by the Nomination Committee.

### Board Diversity

The Board is, by necessity, a diverse group of individuals, some with business backgrounds, and others with defence specific or more general management experience. This level of diversity is needed to make sure the decisions made at this level have the right input and challenge. It is also important for the Board to try to understand and influence the culture around the business, which cannot be achieved solely from inside the boardroom.

### Matters reserved for the Board

The Board has adopted a schedule of matters reserved for its specific approval. The schedule provides the framework for those decisions that can be made by the Board and those that can be delegated. Among the key matters on which the Board alone may make decisions are the Group's strategy, its three year financial plan, its consolidated budget, Group policies, dividends, acquisitions and disposals, and all appointments to and removals from the Board. Authority is delegated to management by way of a delegation matrix in accordance with the provisions of the Group's Corporate Framework ensuring that proper management oversight exists at the appropriate level. Matters delegated in this way include, within defined parameters: the approval of bids and contracts; capital expenditure and financing arrangements.

### Other Board proceedings

The Board has adopted procedures relating to the conduct of its business, including the timely provision of information, and the Company Secretary is responsible for ensuring that these are observed and for advising the Board on corporate governance matters. The Company Secretary is appointed, and can only be removed, by the Board.

If a Director were to have a concern that cannot be resolved this would be recorded in the Board minutes. On resignation, Non-executive Directors are invited to provide a written statement to the Chairman for circulation to the Board if they have concerns. No such statements were made during 2017.

All potential situational and transactional conflicts of interest are disclosed, noted and authorised. Procedures are in place and operating effectively to keep such disclosures up to date.

## Board committees

The Board is supported in its work by a number of committees. The Company Secretary acts as secretary to all Board committees. Committee Chairs provide oral reports on the work undertaken by their committees at the following Board meeting. Information relating to the activities of each committee may be found on the pages that follow. All Board committees are provided with sufficient resources to undertake their duties.


■ = New committee established during the year

The principal Board committees include the Nomination Committee, Audit Committee and Remuneration Committees; please refer to pages 54, 56 and 62 respectively. The other principal Board committee is the Executive Directors Committee. The Executive Directors are the only members of this Committee, under the chairmanship of the CEO. The purpose is to assist the CEO in the performance of his duties and its terms of reference include:

- The discharge of obligations arising under the Company's share plans;
- The determination of the remuneration of the Non-executive Directors;
- The approval of banking facilities; and
- The approval of bids and contracts above the limits delegated to the Sectors.

This Committee met on 15 occasions during the year and, in addition, decisions were made as required to respond to business needs and market conditions. Such decisions were subsequently ratified by the Committee in formal meeting.

The Board Risk Committee was set up during 2017, providing assurance to the Board regarding the management of principal risks (as defined in the Annual Report and Accounts, see pages 36 to 39). It is this Committee's intention to formally report on its work in the 2018 Annual Report and Accounts.

As noted last year, the arrangements to manage disclosure of information to the market were strengthened in January 2017. A Disclosure Committee comprised of the Executive Directors, the Chairman and the Company Secretary has been tasked with ensuring that policies, systems and controls exist to ensure that potential share price sensitive information is escalated, considered, verified and promptly released to the market, where required. A Disclosure Panel, comprised of senior executives has been set up which reports up to the Board's Disclosure Committee. Enhanced disclosure arrangements and transparency training has been delivered through the Group during the year. This has resulted in the Panel meeting on 28 occasions throughout 2017 to consider potential price sensitive information.

## Management committees

The Group Executive Committee and the other principal management committees are shown in the table below. In addition, business reviews, focusing on financial performance for each business unit, were held on a monthly basis during 2017.

| | |
|---|---|
| Group Executive | Operational Risk |
| | Safety, Health and Environment |
| | Business Ethics and Compliance |
| | Governance |
| | Corporate Responsibility and Sustainability |
| | Disclosure Panel |

## Board and committees performance evaluation

The Board conducts an evaluation of its activities on an annual basis.

During the early months of 2017, the Chairman undertook in-depth evaluation interviews with each individual Non-executive Director to collate learning points to consider with the full Board at its April 2017 meeting. The areas covered included:

- Assessment of the challenging market conditions and other developments during 2016, including lessons learnt;
- How the Board can ensure that better execution against plan is achieved by the business;
- How the Board can assist the new Executive Directors as they settle into role; and
- To assess the performance of each individual Board member.

As a result of this exercise, a number of changes have been instigated, including:

### Board evaluation actions

| Observations | Actions |
|---|---|
| Improved strategic input from the Board | – Adopting a different approach to the Board's strategic review process, including much more Board time spent on matters of a strategic nature. October 2017 kicked off the new approach with a full day spent on starting to formulate answers to strategic questions; |
| Improved understanding of the business | – During 2018, half-day sessions will be held with each Sector for a deep dive into their business in order to support the Board in its understanding of the business and to enable deeper insight into the Group; |
| Better Board evaluation/ composition review | – Re-energising the Board Nomination Committee, reducing membership but increasing involvement in the Board skills composition review and succession planning process; and |
| Improved management of the Group's risk management processes | – The introduction of a Board Risk Committee. |

## The CAES Sector/SSA Governance

The CAES Sector participates in classified US Defense programmes. It therefore operates under a US DoD SSA as required by the US National Industrial Security Program. In order to protect US national security interests, the SSA is designed to ensure that foreign ownership, control or influence (FOCI) does not affect the way that CAES conducts its business affairs or its performance on classified contracts. There are certain areas in which CAES and the wider Group operate under an Affiliate Operations Plan (AOP), pursuant to which certain services (such as US Legal support) can be provided by the Group to the SSA, or can be shared by the Group and the SSA.

The CAES Board has undergone a process during the year, led by the CEO of the Group, to strengthen the governance and personnel and is currently made up of:

(i) the Group's CEO and CFO and General Michael Hagee (known as Inside Directors under the SSA), whose biographies can be found on pages 46 and 47;

(ii) the CAES Sector President and CFO (known as Officer Directors under the SSA); and

(iii) a number of other individuals who have no prior relationship with Cobham plc (known as Outside Directors under the SSA) approved by the US Defense Security Service (DSS), identified below:
   - Lt. General Thomas McInerney USAF (retired) – who has served in multiple high level military positions under the Secretary of Defense and the Vice President of the United States;
   - Admiral Steve Abbot USN (retired) – former Deputy Commander in Chief US European Command;
   - Cindy Moran – President and managing partner of IT consultancy, Pikes Way LLC, and former Director of Network Services, US Defense Information Systems Agency; and
   - Scott Webster – Co-founder and Executive Director of Orbital Sciences Corporation.

Outside Directors and Officer Directors, who must be US citizens with appropriate US security clearances, also make up the Government Security Committee (GSC) of the CAES Board. The SSA does not permit Inside Directors to be members of the GSC, which is responsible for maintaining independent policies and processes facilitating insulation of CAES operations as a US cleared defense contractor from the foreign parent.

The SSA restricts the level of participation that Cobham can have in certain CAES activities. For example, it limits Cobham's ability to decide matters affecting the management or operations of the US cleared defense contractor (CAES) in a manner that may result in unauthorised access to classified information.

Cobham maintains its involvement in CAES activities primarily through participation of Cobham's CEO and CFO (as Inside Directors) in the deliberations and decisions of the CAES Board and authorised committees, or interactions through a series of shared services provided pursuant to an AOP approved by the DSS.

All CAES Board Directors have a fiduciary duty to Cobham plc, as shareholder, and the Outside Directors need to perform their duties reasonably and in good faith in a manner believed to be in the best interests of the SSA but consistent with the national security concerns of the US, as set out in the SSA. Cobham plc, as shareholder, retains the right to remove/replace any member of the CAES Board, subject to the consent of the DSS in the case of an Outside Director. In addition, under the current SSA, the CAES Board cannot carry out any of the actions listed below without Cobham's express approval:

- Sell, lease or otherwise dispose of property or assets otherwise than in the usual course of business;
- Merge, consolidate, reorganise, dissolve or wind up the business; or
- Terminate the SSA itself.

The effectiveness of governance and assurance procedures between the Group and the CAES Sector are regularly reviewed.

### Investor Relations activity during 2017

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Results/ AGM/ Trading Update** | | | Preliminary Results 2016; Rights Issue announced | Annual General Meeting; Trading | Rights Issue completed | | | Interim Results 2017 | | | Trading Update | |
| **Investor meetings** | | | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ |
| **Other investor activities** | | | | Investor Site Visit | Investor Site Visit | Airshow; Investor Site Visit | | | Trade Show; Investor Site Visits | Investor Site Visit | Investor Site Visit | Investor Site Visits |

The purpose of the shareholder relations programme is to keep current and potential investors regularly informed of the Group's prospects and progress and significant developments as they occur. An effective shareholder relations strategy will keep the Company's Board regularly informed of investor views so that there is the opportunity for these to impact Board strategy and objectives. Done appropriately, this process should result in an effective two-way flow of information between a company's owners and its managers.

The year started with a new executive management team in place as well as a new Chairman. There were a number of emerging trading and other issues that were communicated up to and at the 2 March 2017 preliminary results announcement. In April, this was followed by the Annual General Meeting and a Rights Issue was announced in March and completed in May.

The year continued with further announcements, including the Financial Conduct Authority investigation and three new Cobham Non-executive Director appointments.

Within the scheduled preliminary and interim results announcements and trading updates, shareholders were informed of the early progress made so far to turn around the Group's operational performance, including progress that was being made against the Group's three operational priorities.

Given the priority to improve the Group's operational performance, the shareholder relations programme in 2017 focused on existing shareholders, with the aim of maintaining an effective two-way information flow with them through a period of change. This has taken the form of meetings with the CEO and CFO and visits to operating locations, with these trips hosted by business unit management. There have been opportunities for shareholders to view Cobham products and meet business unit based management at two trade shows attended during the year. These activities are intended to reinforce the quality of the underlying businesses and of operational management.

The Chairman has also offered to meet major shareholders during the year to discuss a range of matters including Board changes and governance and Group strategy, and he has elicited feedback from the investors met. This feedback has been communicated to the Board.

The Board is interested in the views of smaller investors, who would not ordinarily meet them. The AGM is a forum for this communication.

The focus during the year on meeting existing shareholders has meant that the aggregate number of investor meetings conducted was lower than in the previous year at 188 (2016: 273).

A project was undertaken during the year to refresh the Cobham investor website, to improve it visually and sharpen the navigation and messaging. The results of this can be found at **www.cobhaminvestors.com**.

# Compliance with the UK Corporate Governance Code

## A. Leadership

### A.1. The Board's role

The Board's role is to lead the Group with a view to the creation of strong, sustainable financial performance and long term shareholder value, to review and approve the Group's strategic plan, and to monitor management performance against plan. The Board also sets the Group's risk appetite, and oversees the Group's risk management processes. The Board has adopted a schedule of matters reserved for its specific approval, including a framework for those decisions which can be delegated to committees or otherwise. Further details can be found in the Corporate Governance Report starting on page 49.

### A.2. A clear division of responsibilities

The Board's policy is that the roles of Chairman and CEO should be performed by different people. The division of responsibilities is documented and clearly understood. The Chairman is responsible for the leadership and effectiveness of the Board and the CEO is responsible for leading the day-to-day management of the Company, formulating the strategy and delivering against the strategy when approved by the Board.

### A.3. Role of the Chairman

The Chairman is responsible for the leadership and effectiveness of the Board. He sets the agendas for meetings and manages the meeting timetable. The Chairman facilitates open and constructive dialogue between Executive and Non-executive Directors and also ensures effective communication with shareholders. The Chairman has held regular meetings with the Non-executives in the absence of Executive Directors, providing an opportunity for any concerns to be discussed.

### A.4. Role of the Non-executive Directors

The Board has appointed a Senior Independent Director to provide a sounding board for the Chairman and to serve as an intermediary for the other Directors where necessary. The Board has appointed six other Non-executive Directors whose role is primarily to constructively challenge and help the CEO formulate proposals on strategy. They also scrutinise the performance of management in meeting agreed objectives, monitor the reporting of performance and satisfy themselves on the integrity of the financial information and that financial controls and risk management processes are robust and defensible.

## B. Effectiveness

### B.1. The Board's composition

The Board currently consists of ten individuals: the Chairman, two Executive Directors and seven independent Non-executive Directors, reducing to four after the 2018 AGM. The composition of the Board is reviewed regularly by the Nomination Committee to ensure that there is an appropriate mix of skills, and a range of diverse experience. Board members' biographies are provided on pages 46 and 47 and identify the experience that each Director brings to the Board. A table identifying the skills and experience of the Board members may also be found on page 55. The Board determines, through the Nomination Committee, the independence of its members. Conflicts of interest are also monitored and updated at least annually and more frequently as and when required.

### B.2. Board appointments

The appointment of new Directors to the Board is led by the Nomination Committee. The Nomination Committee's terms of reference, as published on the Company website, document its responsibility regarding Board appointments. Further details of succession planning, including the Board's policy on diversity, including gender, can be found on page 55.

### B.3. Time commitments

The time commitments of Non-executive Directors are defined in their appointment letters and are regularly reviewed. The impact of any new role proposed by a Non-executive Director on existing time commitments is considered by the Chairman before approval is granted.

### B.4. Training and development

A structured induction programme is available to each new Board member, which is supplemented by visits to key locations and meetings with senior executives. Further training for Directors is offered when taking a new role on a committee and is otherwise available as required. Further details can be found in the Directors' professional development section on page 55.

### B.5. Provision of information and support

The Chairman, in conjunction with the Company Secretary, ensures that all Board members receive accurate and timely information. All the Directors have access to independent professional advice, at the Company's expense, when the Directors judge it necessary to discharge their responsibilities.

### B.6. Board and committee performance evaluation

An external evaluation of Board and committee performance will be held in 2018. A thorough exercise to review the working of the Board, how it could be improved and how lessons from the past could be learnt was completed by the incoming Chairman during January and February 2017, the results of which are summarised on page 51.

### B.7. Directors' re-election

All Directors were subject to shareholder vote at the AGM.

## C. Accountability

### C.1. Financial and business reporting

The Statement of Directors' Responsibility is set out on page 75, and the Independent Auditors' Report commences on page 76. The Company's business model is explained on pages 10 and 11.

### C.2. Risk management and internal control systems

The Board, through the Board Risk Committee, conducts a robust assessment of the principal risks. An annual review of the effectiveness of the Group's risk management and internal control systems is undertaken by the Audit Committee. Further details on the risk management and internal control systems can be found on page 59.

### C.3. Role and responsibilities of the Audit Committee

Details of the composition of the Audit Committee and how the Committee has discharged its responsibilities during the year are provided in the Audit Committee Report on pages 56 to 61. The terms of reference for the Audit Committee are reviewed annually and are available on the Company website.

## D. Remuneration

### D.1. Levels and components of remuneration

The Board believes that the Group's Remuneration Policy is appropriately designed to promote the long term success of the Company, while enabling the Group to attract, retain and motivate the executive talent required for the delivery of its business strategy. For further information, see the Directors' Remuneration Report on pages 62 to 71.

### D.2. Development of remuneration policy and packages

The membership of the Remuneration Committee is made up of Non-executive Directors only. The terms of reference for the Remuneration Committee are reviewed annually and are available on the Company website. The Remuneration Committee has delegated authority for setting the remuneration of Executive Directors and the Chairman. The fees payable to the Non-executive Directors are determined by the Board, on recommendation from the Executive Directors Committee.

## E. Relations with shareholders

### E.1. Shareholder engagement and dialogue

Effective communication and engagement with investors is of paramount importance to the continued success of the Company, and roadshows are held during the year between investors and the Chairman and Director of Investor Relations. The CEO and CFO have held meetings with existing shareholders through the shareholder relations programme during 2017. Further details can be found in the Corporate Governance Report on page 52.

### E.2. Constructive use of general meetings

The Board values all general meetings as an important opportunity to engage with investors. Attendees at general meetings have the opportunity to ask questions to the Board and to speak to individual Directors following the formal business of the meeting.

# The composition of the Board remains under review, with the Committee focused on the recruitment of new Board members

"The Committee focused on the recruitment process for the newly appointed Non-executive Directors and a process is underway to complete a skills review at Board level

**Dear Shareholder**
As the new Chairman, I have been identifying candidates for appointment to the Board as I committed to do as part of the Rights Issue and in following the programme of changes agreed by the Board at that time. The first role filled was that of the Senior Independent Director, due to the seniority of this role. With John McAdam's appointment secured in August, the Nomination Committee was slimmed down and now includes me, the Senior Independent Director and the Chairs of both the Audit and Remuneration Committee. The terms of reference for the Committee are being revisited to incorporate best practice.

In December 2017, the Board announced that René Médori would be joining the Board with effect from 1 January 2018. René Médori joins the Board with a wealth of financial and listed company experience. Alan Semple will retire from the Board and as the Audit Committee Chair at the 2018 Annual General Meeting and René Médori will take over from Alan Semple as the Chair of the Audit Committee.

Also in December 2017, the Board announced that General Norton Schwartz would be joining the Board with effect from 1 January 2018. Norton joins the Board with a US Military background having been Chief of Staff for the US Air Force (2008-2012). Michael Hagee will retire by rotation at the AGM in April 2018 after serving nine years on the Board.

Full due diligence was completed for all Board candidates, including meetings with Board members before their formal appointment was confirmed.

I have been very conscious that some shareholders have concerns regarding directors taking on too many non-executive roles. For those members of the Board who have more than one other Board position, I have assessed their ability to be able to meet our time commitments going forward, particularly as we go through the operational turnaround. I am satisfied that all Board members put forward for election or re-election at the AGM have the capacity to meet the time commitments we need. All Board members are required to complete their own continued professional development. As a Board we are also conscious of the need to keep up to date with current regulatory requirements and have, accordingly, built time into the 2018 work plans to receive updates from our external advisors, alongside the routine updates we receive from our Company Secretary and internal subject matter experts.

My thanks go to all of the Board members, including those who have left during 2017 and those leaving after the 2018 AGM. I would extend particular thanks to the Remuneration Committee Chair, who helped the executive management through their induction, the early part of the turnaround and in replacing senior management positions below the Board.

## Role and focus
The Nomination Committee's main duties are to:
– Review the structure, size and composition of the Board; and
– Consider succession planning for Directors.

## Key events for 2017
– Conducted a complete Board evaluation as I took up the role of Chairman;
– Reviewed the structure, size and composition of the Board;
– Reviewed Committee structure;
– Formed a new Board Risk Committee;
– Oversight of the search for the new Board members; and
– Led by John McAdam as Senior Independent Director, conducted a full review of the performance of myself as Chairman.

## Skills and experience

| | Independence | Years with Cobham | Skills and Experience: UK Corporate Governance | Engineering | Defence | Finance | US Market | UK Listings | Human Resources |
|---|---|---|---|---|---|---|---|---|---|
| Michael Wareing | | 7 | • | • | • | • | • | • | • |
| John McAdam | • | 0 | • | | • | | • | • | • |
| David Lockwood | | 1 | • | • | • | • | • | • | • |
| David Mellors | | 1 | • | | • | • | • | • | |
| Michael Hagee | • | 9 | | | • | | • | | |
| René Médori | • | 0 | • | | | • | | • | • |
| Birgit Nørgaard | • | 4 | • | • | • | • | | • | • |
| Norton Schwartz | • | 0 | | | • | | • | | |
| Alan Semple | • | 3 | • | • | | • | • | • | |
| Alison Wood | • | 6 | • | • | • | | • | • | • |

All of the Directors, Executive and Non-executive, have leadership, strategy and risk experience.

## Priorities for 2018

- Complete a Board skills review to inform the structure, size and composition of the Board and to ensure experience and competencies remain aligned with the strategic plan and are appropriately balanced;
- Complete the programme of changes to be made to the Board; and
- Oversight of a succession planning exercise for the Executive Directors.

The Committee's terms of reference, which are under review, are available on Cobham's website or by application to the Company Secretary.

## Membership and attendance

Two formal meetings were held during the year, attended as follows:

| | | |
|---|---|---|
| Michael Wareing | ● | ● |
| John McAdam[1] | | ● |
| Michael Hagee[2] | ● | |
| Birgit Nørgaard[2] | ● | |
| Alan Semple | ● | ● |
| Alison Wood | ● | ● |
| (David) Jonathan Flint[3] | ● | |

● Attended

1 John McAdam joined the Board on 3 August 2017.
2 The Committee constitution was reviewed and Birgit Nørgaard and Michael Hagee left the Committee on 24 July 2017.
3 (David) Jonathan Flint retired from the Board on 3 August 2017.

## Directors' professional development

On appointment, Directors undertake a structured induction programme in the course of which they receive information about:

- The operations and activities of the Group;
- The role of the Board and the matters reserved for its decision;
- The Group's corporate governance practices and procedures;
- Their duties, responsibilities and obligations as Directors of a listed public limited company; and
- Specific duties as a member of one of the Board committees.

This is supplemented by visits to key locations and meetings with, and presentations by, members of the senior management team.

Development for Directors is available as required and is provided mainly by means of internal briefing from senior management or advisors and external courses. In addition, Directors' knowledge of the legal and regulatory environment is updated through the provision of information by the Group's advisors and by means of regular updates from the Company Secretary and the legal team. There is also time reserved in the Board's work plan and within those of its committees to receive updates and teach-ins from advisors and subject matter experts. As mentioned on page 50, site visits are considered critical to ensure that the Directors remain close to the business of the Group.

## Diversity and inclusion

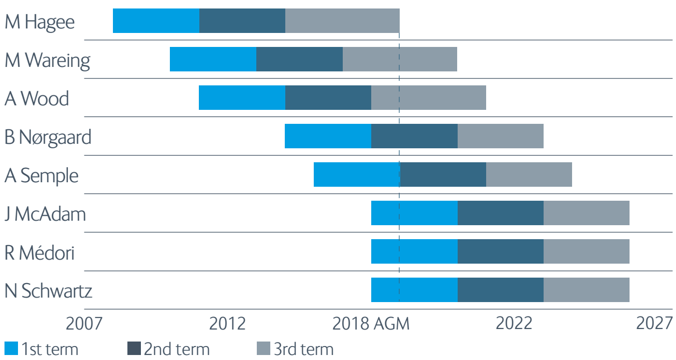
The Committee is aware of the need for diversity when considering the composition of the Board. In recruiting for Board roles, targets are generally set around ensuring a proportion of female and ethnically diverse applicants are included in the candidate pool for Non-executive Director positions. The representation of women on the Board as at December 2017 was 20%.

Please refer to page 42 for details of diversity and inclusion initiatives within the business.

## Succession planning for Board members and senior management

Succession planning takes place on a regular basis to ensure that the Group is managed by executives with the necessary skills, experience and knowledge. The Board has a role to play in overseeing the development of management resources in the Group. Specifically, the Board wants to see depth and quality in management, and robust processes are in place to help them in this task. The succession planning process is in need of review, which is a focus area for 2018.

The Nomination Committee actively manages Non-executive Director succession having regard to anticipated retirement dates for existing Directors and initiates focused searches for Non-executive Directors as positions are required.




The Board composition in relation to length of service and current term as at 31 December 2017, is shown above.

**Michael Wareing**
Nomination Committee Chair
1 March 2018

# A significant focus area for the Audit Committee during 2017 has been oversight of enhancements to the Group's control environment including assessing progress on major development contracts

**Dear Shareholder**

This has been a critical year for Cobham, given the start of the Group's turnaround, including the completion of the 2017 Rights Issue. The Audit Committee has focused on working with the CEO and CFO in their first year in the Group with an emphasis on improvements in the risk and control environment.

## Key issues for 2017

- The Audit Committee agreed the scope and reviewed the outcome of the 2016 Balance Sheet review, including key judgements and provisions, and the process undertaken to complete the exercise.
- The new CFO led the lessons learnt exercise from the 2016 Balance Sheet review and has updated the Audit Committee on progress. This exercise identified a number of control improvement actions. Implementation of these actions by the management team has progressed well with a number of further activities ongoing.
- The Committee has monitored the implementation of improvements to the control environment throughout the year. This has included:
  - An enhanced governance structure and its key components;
  - A revised, proportionate minimum standards of financial control, reporting of control standards at business unit level, and enhanced tracking and reporting of open and overdue Internal Audit recommendations; and
  - Ongoing monitoring and reporting of the usage and adequacy of provisions given the significant charges created for 2016.
- Oversight of the key development contracts and programmes has remained a priority throughout the year, and the Committee has been assisted by management enhancing the programme watchlist review process.
- Increased assurance has been provided to the Audit Committee over controls in operation within the SSA through changes to the CAES Board and Audit Committee, enhancements to the governance framework and improved reporting.
- Oversight of the response to the FRC following their review of Cobham's 2016 Annual Report and Accounts including approval of plans to improve disclosure in this report.

> The Committee has worked with management to ensure the lessons learnt from past underperformance are being addressed and support the process of improving the Group's control environment

In addition, during 2017 the Committee continued its work plan which included:

- A review of financial statements and associated reports;
- A review of the effectiveness of the Group's risk management and internal control systems;
- A review of management's readiness to adopt new accounting standards including revenue recognition (IFRS 15);
- A review of reports from management on key governance, risk and compliance activities including LCM, tax, treasury and ethics and compliance matters;
- Oversight of the enhancement of existing IT controls (including cyber security and disaster recovery), and the requirement for enhanced controls in certain areas;
- Continued review and support of the Internal Audit and Assurance Function with its increased risk based scope including the audit plan, reports and effectiveness;
- A review of all matters relating to external audit including audit scope, independence, effectiveness and fees; and
- Working with PwC to implement improvements to the documentation of the audit process identified through the FRC's Audit Quality Review (AQR).

### Priorities for 2018

- Ensuring a successful transition to the new Committee Chair and members.
- Completion of a satisfactory audit tender exercise in 2018 with a view to the new independent auditors commencing as from the 2019 year-end audit. As previously disclosed, PwC will not participate in this tender.
- Continued oversight of the implementation of improvements to risk management and internal controls systems.
- Continued oversight of the reporting of, usage and adequacy of provisions, including those created at the time of the 2016 Balance Sheet review.
- Ongoing focus on the key programme watchlist review process.
- Preparation for the new leasing accounting standard IFRS 16.

I will be stepping down from the Board at the 2018 AGM and my successor, René Médori, who joined the Board on 1 January 2018, will be appointed as the Group's Audit Committee Chair with effect from 26 April 2018. René has valuable financial and commercial experience from his career at both Anglo American plc and The BOC Group plc and his non-executive experience with both Petrofac Limited, a company listed on the London Stock Exchange, and SSE plc. I wish him well in his new role.

At the 2018 AGM, I and my fellow members of the Committee will be available to respond to any questions shareholders may wish to raise on this report or the Committee's activities.

**Alan Semple**
Audit Committee Chair
1 March 2018

## Financial reporting and significant financial judgements

The Committee reviews whether suitable accounting policies have been adopted and whether management has made appropriate judgements and estimates, and also seeks support from the independent auditors to assess these matters. The Committee identified the issues below as significant in the context of the 2017 Group Financial Statements with regard to the facts and circumstances then existing, on account of the level of materiality and the degree of judgement exercised by management.

| Area of focus | Key issue | Role of the Committee | Conclusion |
|---|---|---|---|
| Programme watchlist<br><br>Revenue/contract accounting | Changes in estimates to complete and customer schedules (Refer to notes 18 and 26 in the Group Financial Statements) | The Committee considered the estimated costs to complete, customer schedule requirements, working capital levels and profitability of material development projects and contracts. The new process of monthly business reviews has identified accounting judgements at an early stage and more readily allowed the Committee to monitor conclusions on key judgements and matters. | The judgements of management as regards estimated costs to complete, outcome of negotiations with customers and amounts recoverable and related disclosures were deemed appropriate. |
| Provisions and material disputes | Appropriateness and completeness of provisions and their utilisation (Refer to note 18 in the Group Financial Statements) | The Committee has had regular updates on the Balance Sheet review items from 2016, provisions and material disputes ahead of and during the year end process. | Whilst the final outcome of a number of matters is still uncertain, there has been control and consideration of these amounts, so that we are satisfied with their use and the year end position. |
| Inventory provisions | Valuation, obsolescence provisions and recoverability (Refer to note 12 in the Group Financial Statements) | The Committee has had regular updates on balance sheet values and the levels of provisions against these. | Inventory remains a focus for working capital management, especially linked to production ramp up on development programmes and business units with short-cycle customer demand. Adequate provision has been made for risks identified at year end. |
| Uncertain tax positions and deferred tax | Judgements on provisions for the open tax years, authority enquiries and changes in legislation (Refer to note 6 in the Group Financial Statements) | The Committee has reviewed the accounting judgements made to account for uncertain tax positions. | The Committee is satisfied that the material estimate made at the year end reflects advice that has been taken, by management, from relevant experts and specialists, while taking into account that there may be more than one route to settlement. |
| Goodwill and acquired intangible assets | Measurement of carrying values of goodwill and acquired intangibles relative to the present value of the associated cashflows (Refer to note 9 in the Group Financial Statements) | The Committee has reviewed management's computation of the present value of cash flows and has compared to goodwill and acquired intangibles in order to test for impairment. | The Committee considers the impairment charges, and reversals for 2017 to be appropriate. The change to the assessment of Cash Generating Units at the Sector level is deemed appropriate. |
| Pensions | Sensitivity to changes in various metrics (Refer to note 20 in the Group Financial Statements) | The Committee received an update from management on the changes in assumption for mortality and discount rates. | The Committee satisfied itself that all assumptions were within acceptable ranges and up to date. |
| Presentation, disclosures and new accounting standards | FRC thematic review, our own correspondence with the FRC and new accounting standards for IFRS 9, IFRS 15 and IFRS 16 (Refer to note 1 in the Group Financial Statements) | The Committee was involved in the response to the FRC following their review of the 2016 Annual Report and Accounts.<br><br>The Committee reviewed the appropriateness of judgements for IFRS 15. | Appropriate changes have been made in this Annual Report to respond to FRC comment.<br><br>The Group is ready for the adoption of IFRS 9 and IFRS 15 from 1 January 2018. |

### Objectives and responsibilities

The Committee's main objectives and responsibilities are set out in its terms of reference, which are available on the Group's website. The Committee's terms of reference are reviewed annually and were updated to take account of the allocation of responsibilities to the newly formed Board Risk Committee.

### Composition

The Committee consists of independent Non-executive Directors only. The current members, as at the date of this report, are Alan Semple, René Médori, Birgit Nørgaard and Michael Hagee. The Committee membership in 2017 included (David) Jonathan Flint, until his departure from the Board. Birgit Nørgaard joined the Committee officially on 5 December 2017.

Biographical details for all of the Committee members may be found on pages 46 and 47. The membership of the Committee has been selected with the aim of providing the range of financial, risk and business expertise necessary to meet its responsibilities, and the particular skills and experience of each member may be found on page 55.

Given Alan Semple's experience as a Chartered Accountant, and formerly as Chief Financial Officer of John Wood Group plc, the Board has designated him as the financial expert on the Committee for the purposes of the Code.

René Médori, who joined the Board on 1 January 2018, will pick up the role of Audit Committee Chair upon Alan Semple's retirement at the AGM in April 2018. René has financial and commercial experience from his executive career as Finance Director at Anglo American plc for 12 years, having retired at its AGM in April 2017. Prior to joining Anglo American he held a number of senior financial positions, including Group Finance Director at The BOC Group plc. The Board will designate René Médori as the financial expert on the Committee with effect from the 2018 AGM, for the purposes of the Code.

### Meetings

Six Audit Committee meetings were held during the year, attended as follows:

| | | | | | | |
|---|---|---|---|---|---|---|
| Alan Semple (Chair) | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| (David) Jonathan Flint[1] | ✓ | ✓ | ✓ | ✓ | ✓ | |
| Michael Hagee | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Birgit Nørgaard[2] | | | | | ✓ | ✓ |

✓ Attended

1 (David) Jonathan Flint retired from the Board on 3 August 2017.

2 Birgit Nørgaard attended the July meeting and joined the Audit Committee officially on 5 December 2017.

During the year the Committee invited the Chair of the Board, Non-executive members of the Board, CEO, CFO, Group Director of Financial Control, Group Head of Internal Audit and Assurance, the PwC lead audit partner, other representatives from PwC, and other key senior management to attend their meetings, as appropriate.

At least twice a year, immediately following a Committee meeting, the Committee meets separately with the PwC lead audit partner and the Group Head of Internal Audit and Assurance to give them the opportunity to discuss matters without executive management being present. In addition, regular contact is maintained between the Chairman and the PwC lead audit partner and the Group Head of Internal Audit and Assurance between meetings, often without the presence of management.

### Key issues and activities

Matters considered by the Committee during 2017 were:

| | Feb | Apr | Jul | Dec |
|---|---|---|---|---|
| **Financial Statements and reports** | | | | |
| Full year results | ● | | | |
| Half year results | | | ● | |
| Fair, balanced and understandable assessment | ● | | | |
| Key accounting matters | ● | | ● | ● |
| **External Audit** | | | | |
| Independence, objectivity and effectiveness of the external auditors | ● | | | |
| Appointment recommendation to the Board | ● | | | |
| Approval of non-audit fees | ● | ● | | |
| External audit scope and fees | | ● | ● | ● |
| Independent auditors' reports | ● | | ● | |
| **Internal Audit** | | | | |
| Effectiveness review of Internal Audit | | | | ● |
| Internal Audit report including performance against plan | ● | | ● | ● |
| Annual Internal Audit plan | | | | ● |
| **Governance, risk and assurance** | | | | |
| Risk management report | ● | ● | | |
| Risk management framework and internal controls | ● | ● | ● | ● |
| IT controls including cyber security | | ● | | |
| Key programme watchlist review oversight | ● | ● | ● | ● |
| Compliance, whistleblowing and fraud | | | | ● |
| **Other** | | | | |
| Updates on accounting and corporate governance developments | | | | ● |
| Audit Committee evaluation | | ● | | ● |
| Terms of reference | | | | ● |
| Meetings with senior finance management (CFO) | | | | ● |

### Risk management and internal control systems

The Board has the ultimate responsibility for risk management and internal control systems, and has delegated to the Committee the review of effectiveness of these systems in order to assist the Board in meeting this responsibility. The Board Risk Committee, which was established during 2017, is responsible for providing assurance to the Board regarding the management of principal risks.

The Committee reviews internal financial controls, that is, the systems established to identify, assess, manage and monitor financial risks. The Group Executive (GE), chaired by the CEO, retain accountability for the management of operational risks, including mitigating actions. Sector Presidents are required to ensure that appropriate processes, including the maintenance of business unit and Sector risk registers, exist to identify and manage risks and to regularly carry out formal risk assessments.

Further information on the Group's principal risks and the risk management process may be found on pages 34 to 39.

The Group operates under a system of internal controls which has been developed over time to meet the needs of the business and the risks and opportunities to which it is exposed, recognising differences in the nature and type of each of the Group's operations.

These controls include:

- The preparation and consideration of the three year plan;
- A comprehensive budgeting system with an annual budget which is approved by the Board;
- Monthly review of business and financial performance in the month and year to date and update of financial forecasts for the year;
- The monitoring of financial performance and key dependencies for the full year;
- The monitoring of project and programme management, through LCM; and
- The appropriate delegation of authorities to operational management.

Legacy control systems still exist from previous acquisition activity and other key control processes, including IT, are not fully standardised and implemented across the Group. The implementation and operation of certain key controls is decentralised in the business units. Sector, functional and central oversight activities and controls are in place to support this.

During the year we have strengthened controls over known areas of weakness. This has included strengthened financial controls through increased independent review of the most material development contracts; extended governance and regulatory training; monthly Sector and business unit reviews by the CEO and CFO; the communication of a revised delegation matrix and Letter of Representation; the enhanced tracking and reporting of open and overdue audit recommendations and the communication of revised, proportionate minimum standards of financial control and a 'hard financial close' exercise in Q4, ahead of the year end.

Delegated authorities and other controls are contained in the Corporate Framework and the Group Finance Manual. Specifically with regard to the financial reporting process and the preparation of the Group Financial Statements, the system includes a semi-annual representation letter from all Sector and business units. Included in those letters are written acknowledgements that financial reporting is based upon reliable data, that there is compliance with the Group's Minimum Standards of Financial Control and that the results are properly stated in accordance with Group policies. The Letter of Representation process has not highlighted any material weaknesses.

The Committee's review covers all material controls, including financial, operational and compliance controls and risk management systems, and is designed to give assurance that the day to day risk management and internal control systems which are embedded in the business, have operated effectively in the review period notwithstanding that management continues to implement plans to improve those systems. The three principal lines of assurance are outlined on page 34. The Committee receives assurance from the Inside Directors on the CAES Board on matters relating to CAES. It should be noted that due to the restrictions of the SSA our assessment of the control environment in CAES differs from that operated elsewhere in the Group. In order to meet the requirements of the SSA and US DSS, oversight is indirect and flows primarily through the Inside Directors. Further details on how governance procedures are maintained in the SSA may be found on page 51.

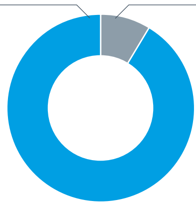
## External audit

The Committee is responsible for overseeing relations with the independent, external auditors PwC, including the approval of fees, and makes recommendations to the Board on their appointment and re-appointment. The total fees paid to PwC in the year ended 31 December 2017 equalled £2.3m, with non-audit fees of £0.2m, which included £0.2m of other assurance services, representing 9% of the total. An analysis of the fees paid to the external auditors in respect of audit and non-audit work during the year can be found in note 4 to the Group Financial Statements.

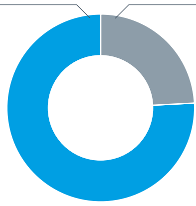
The provision of non-audit services is controlled by a policy which states that the external auditors will not be engaged to provide any element of non-audit services, without approval in advance from the CFO for fees up to £10,000, from the Chair of the Audit Committee for fees between £10,000 and £100,000 and by the Audit Committee for fees over £100,000. The Committee recognises that there may be some element of non-audit services for which the Group might wish to use the external auditors.

The work must also be permitted under relevant regulations and must not impinge on the independence of the audit firm.

**Total fees paid to the external auditors** (2017)




**Total fees paid to the external auditors** (2016)




Significant engagements included work related to the interim results announcement and 2017 Rights Issue.

PwC is expected to report to the Committee any material departures from Group accounting policies and procedures that they identify during the course of their audit work. None were found or reported in 2017. The Independent Auditors' Report to the members of the Company can be found on page 76.

PwC's presentation of their audit plan to the Committee set out the scope and objectives of the audit, together with an overview of the planned approach, an assessment of the Group's risks and controls, and proposed areas of audit focus. The Committee reviewed and approved the terms, areas of responsibility and scope of the December 2017 year-end audit.

The Committee received feedback, compiled by the Group Finance Function, from each business unit, on the performance of the external auditors through the year end process. On consideration of this feedback, the Committee confirmed that they were satisfied with the effectiveness of the external auditors.

The Committee is responsible for the development, implementation and monitoring of the Group's policies on services from external auditors, which are designed to maintain the objectivity and independence of the external auditors. These policies set out the approach to be taken when using the external auditors for non-audit work and regulate the appointment by the Group of former employees of PwC. In addition to an independence review conducted by management, PwC has provided specific assurance and the Committee has considered the arrangements and safeguards that PwC has in place to maintain its independence and objectivity. The external auditors follow regulatory requirements to maintain the objectivity of the audit process; these stipulate a five year rotation policy in relation to the senior engagement auditor. Pauline Campbell was appointed lead audit partner in 2014. The Committee continues to be satisfied that PwC remain independent and objective.

The Committee has previously stated its intention to re-tender for the 2019 audit during 2018, to coincide with the next rotation of the PwC lead audit partner. As PwC have acted as external auditors for more than 20 years, the Committee will not be inviting them to re-tender in 2018. The Committee last conducted a tender exercise in 2015 in which PwC were successful.

### Audit Quality Review

The Committee considered the findings of the FRC's AQR report into the conduct of PwC audits generally. In addition, the AQR team selected to review the audit of the Group's 2016 Financial Statements as part of its 2017 annual inspection of audit firms. The Chairman of the Committee received a copy of the findings of the AQR team and PwC has confirmed that those areas identified for improvement have been addressed during the 2017 Audit.

### Internal Audit and Assurance

In December 2017, the Committee conducted a review of the effectiveness of the Group's Internal Audit and Assurance Function, taking into account the views of Directors and senior management on matters such as independence, proficiency, resourcing, audit strategy, planning and methodology. The Committee was satisfied with the performance of the Internal Audit and Assurance Function.

The Group Head of Internal Audit and Assurance attended every Audit Committee meeting throughout 2017 where Internal Audit was on the agenda and in addition, had ongoing contact with members of the Audit Committee throughout the year with and without management present including private sessions with members of the Audit Committee.

The findings of each Internal Audit review are summarised for the Committee, which focuses its discussions on unsatisfactory findings and on the action plans in place to address them. The Internal Audit reports are also made available in full, to the Board. Particular areas of focus for Internal Audit during 2017 included continuation of financial control audits in line with the increased focus on control improvements, programme related Internal Audits in line with the programme watchlist review process, the introduction of a specialised IT audit programme and a number of risk based reviews.

In addition, Internal Audit has continued to maintain a programme of follow-up audits to assess the timely implementation of Internal Audit recommendations by the businesses and key matters from the Internal Audit reviews.

The Committee received regular updates against the 2017 Internal Audit programme throughout the year.

The Committee approved the Internal Audit plan for 2018, including the proposed audit approach, coverage and allocation of resources. The 2018 plan was prepared considering a number of factors, including the principal risks of the Group. The key points of focus in the 2018 plan include:

- Continued focus on internal financial controls assurance;
- Increased focus on non-financial areas of risk, including corporate governance and business interruption;
- Increased focus on IT controls and cyber security including compliance with new regulations; and
- Continued improvement in the Group's assurance mapping process across the three lines of assurance.

Where the operation of the SSA results in limitations of visibility when compared to other areas in the Group, the Audit Committee gains its assurance over CAES internal controls via the CAES Audit Committee of which Cobham's CFO is a member, and with Cobham plc's CEO and CFO representing Cobham on the CAES main Board, in their capacity as Inside Directors. Further details can be found in the Corporate Governance Report on page 51.

### Fair, balanced and understandable report and accounts

At the request of the Board, the Committee considered whether, in its opinion, the 2017 Annual Report and Accounts were fair, balanced and understandable. In forming its opinion, the Committee reflected on the information it had received and its discussions throughout the year. The assessment was assisted by an internal verification of the factual content by management, a review at different levels of the Group to ensure consistency and overall balance, and a comprehensive review by the senior management team and the external auditors.

Following its review, the Committee was of the opinion that the 2017 Annual Report and Accounts was representative of the year and presents a fair, balanced and understandable overview, providing the necessary information for shareholders to assess the Group's position and performance, business model and strategy.

In reporting on Alternative Performance Measures, the Group followed the FRC recommendation to consider the Guidelines on Alternative Performance Measures, as published by the European Securities and Markets Authority, and specifically addressed points raised by the FRC in its thematic review. Account has also been taken of the disclosures of our peers, and current best practice.

On 26 September 2017, the Group received a request for information from the FRC in relation to the 2016 Annual Report and Accounts. The Alternative Performance Measures used in those accounts were one of the items included in the FRC review. This review also covered 'Revenue recognition policy', 'Key judgements and estimates' and 'Customer funded research and development'.

The Audit Committee considered management's response and a number of changes have been made in response to that review, the most fundamental being to separate judgements and estimates into two distinct areas within the accounting policies.

On 22 February 2018, correspondence was received from the FRC concluding the review to their satisfaction.

The FRC's review did not benefit from detailed knowledge of our business or an understanding of the underlying transactions entered into but was conducted by staff who have an understanding of the relevant legal and accounting framework.

### Code of Business Conduct violations and fraud

The COBC, which incorporates the Group's whistleblowing policy, contains arrangements for an independent external service provider to receive, in confidence, complaints on suspected violations of the COBC for reporting to the Committee as appropriate. Details of the COBC are provided in the CRS section of this report, on page 40. The Committee regularly received reports on matters relating to the COBC.

### Evaluation of the effectiveness of the Committee

The Committee Chair initiated an internal review of the effectiveness of the Committee towards the end of 2017. The review was conducted by questionnaire, taking comments from Committee members, regular meeting attendees and the independent auditors. The results were considered and actions required are in progress.

# Remuneration outcomes align with delivery of the first year of the turnaround

Salaries for all the Executive team will remain unchanged in 2018

**Dear Shareholder**

I would like to set out how the Remuneration Committee has determined the outcome of remuneration decisions for the Executive Directors, along with how we intend to implement our Remuneration Policy in 2018.

As outlined earlier in this report, 2017 has been a critical year of transition. The Committee has, throughout 2017, been focused on the key issue of pay for performance and ensuring that the performance metrics against which our Executive Directors and senior management team are assessed, are closely aligned with our turnaround strategy and to the commitments given to our shareholders during the Rights Issue process.

During the year we have welcomed a new Board member to the Committee, John McAdam. General Norton Schwartz also joined us early in 2018.

**Remuneration Policy**

Shareholders were asked to approve a new Remuneration Policy at our AGM in April 2017. Given the degree of change in the business at the time, both in terms of key executives and business challenges, the Committee determined that it was not the right time to be undertaking a significant overhaul of pay. Instead, some minor revisions were incorporated to reflect developing best practice.

The Committee is conscious that our new executive team should have time to thoroughly embed the new strategic direction for Cobham, and that pay should then align fully with this direction. Given timings, we will continue to operate under our 2017 Policy for 2018, with the expectation that a thorough review of remuneration will be performed during 2018, with the potential for a new Policy to be presented to shareholders at the 2019 AGM.

Some modest changes which we are making to our arrangements are set out in more detail in the '2018 remuneration framework' section below.

**How company performance during the year is reflected in the remuneration outcome**

The Committee's primary focus was to ensure that the targets set for the 2017 annual bonus and LTI were fully aligned with the commitments made to shareholders at the time of the May 2017 Rights Issue. Recognising the review of the Balance Sheet and re-baselining of the financial plan by the incoming CEO and CFO at the start of 2017, the Committee gave particular scrutiny to setting these 2017 targets to ensure these were appropriately stretching.

With that backdrop, the CEO and CFO's bonus targets were set to achieve, at threshold payout, an operating profit of £200m and an operating cash flow of £100m.

In line with the reported performance of the Group, the CEO and CFO have therefore achieved a 2017 bonus award at 81.1% and 79.6% respectively of the maximum opportunity of 150%. Further details on the bonus performance measures are given later in this report.

The Committee deferred setting the LTI targets until May to ensure that the targets set fairly reflected the outcome of the Rights Issue and that the CEO and CFO would therefore receive no benefit from the short term volatility in the share price.

No salary increases for the Executive Directors or fee increases for the Chairman and Non-executive Directors have been made during 2017.

### Incoming CEO – relocation

When David Lockwood was appointed as CEO in 2016, it was agreed that he would be based at Wimborne (his predecessor had been based in London). The Board believed it was important that both the CEO and CFO be based at Wimborne to enable them to drive the necessary re-structuring and culture change and provide the visible senior leadership that the Group required.

It was agreed that the CEO would permanently relocate to Wimborne in 2017 and the Company provided an appropriate relocation package to support this. The CFO is not able to permanently relocate so the Committee agreed to provide funding to support the CFO's costs of working from Wimborne.

The Board has seen a significant improvement in senior leadership and wider employee engagement, as evidenced by a recent senior staff survey, so the Committee are satisfied these relocation expenses are justified.

### 2018 remuneration framework

As outlined above, substantial changes are not proposed to the overall remuneration framework for Executive Directors, which is considered to remain largely fit for purpose. Instead, the Committee has taken the opportunity to review whether any minor modifications are required to ensure that we continue to align pay with performance.

During internal discussion over the course of 2017, there was consensus that the performance measures under the LTI should be refined to ensure that they align with the key areas of focus communicated to the market. In particular, the Committee considers that the long term incentive framework should reflect the importance to Cobham at the current time of earnings progression, margin improvement and cash generation. As such, the 2018 LTI awards will be based on an even split of underlying EPS growth and cumulative free cash flow.

The Committee considers that EPS remains the single most important financial metric for the business, encompassing the aggregate impacts of revenue growth, operating margin progression and financing costs. Meanwhile cash flow reflects the importance of this measure to the business over the next few years.

These performance conditions are subject to a 'quality of earnings' assessment, under which awards will not vest unless the Committee is satisfied that there has been a sustained improvement in the underlying financial performance of the Company. This provides assurance that achievement of the EPS and cash flow targets does not put at risk the ability of the Company to generate sustainable future value.

We recognise that some shareholders may question the removal of relative Total Shareholder Return (TSR) from the framework. On balance though, the Committee believes that its attractions are outweighed by a number of challenges that it presents for Cobham: selecting a relevant comparator group is difficult given that Cobham has few direct peers; it can reward share price volatility, rather than the incremental growth that we are aiming to deliver; and it provides limited line-of-sight for participants. Given this, we consider that replacing it with more strategically relevant financial measures for 2018 is a positive step.

We will not be increasing Executive salaries in 2018, nor making any material change to the variable reward elements.

### Leaving arrangements for the departing CEO and CFO

In line with our disciplined approach to the principle of pay for performance, neither of the departing CEO or CFO received any payment in respect of their 2016 annual bonus, and all outstanding incentive awards lapsed on cessation of employment. Full details of the leaving arrangements are detailed on page 69.

### Key issues to be addressed by the Committee during 2018

The Committee will undertake a detailed review of remuneration strategy to address aligning reward at all levels of the Group with delivering the next phase of the turnaround.

### Comment on stakeholder engagement conducted

I will write to our top 20 shareholders in March 2018 to engage with them regarding the LTI targets for 2018 set by the Committee. We would expect greater engagement in 2018 as part of the Remuneration Policy/strategy review.

### Conclusion

Throughout 2017, as Chair of the Remuneration Committee, I have sought to ensure that we exercise rigour and discipline in all remuneration decisions and have continued the drive for transparency. The priority for 2018 will be to ensure that the remuneration structure supports the evolving strategy as the Group works through the turnaround.

**Alison Wood**
Remuneration Committee Chair
1 March 2018

## Role and focus

The Remuneration Committee's main duties are to:

- Make recommendations to the Board on the Group's policies on Executive Directors' remuneration and ensure alignment to the Group's strategic plan; and
- Determine, on the Board's behalf, the specific remuneration packages of the Chairman, Executive Directors, Group Executive and Company Secretary.

## Membership and attendance

Six Remuneration Committee meetings were held during the year, attended as follows:

| | | | | | | |
|---|---|---|---|---|---|---|
| Alison Wood | Member | Member | Member | Member | Member | Member |
| John McAdam[1] | | | | | Member | Member |
| Birgit Nørgaard[2] | Member | Member | Member | Member | Member | |
| Michael Wareing | Attendee | | Attendee | Attendee | | Attendee |

Attendee Member

[1] John McAdam joined the Committee on 3 August 2017.
[2] Birgit Nørgaard left the Committee on 5 December 2017.

Upon appointment as Chairman in January 2017, Michael Wareing ceased to be a member of the Remuneration Committee. The Committee remained quorate with two members but below the Code requirement for three independent directors. John McAdam joined the Committee on his appointment in August. In the period prior to this appointment, the Chair also consulted with the SID and other Board members on key remuneration decisions. The Committee became two members again when Birgit Nørgaard joined the Audit Committee on 5 December 2017, moving back to three members upon the appointment of Norton Schwartz on 1 January 2018.

In addition to the formal meetings, there were three written resolutions circulated during the year to approve urgent matters of business.

## Other attendees

Executive Vice President Human Resources and Communications, Senior Vice President Compensation and Benefits, Deloitte LLP and the Company Secretary. The CEO and the Chairman of the Board attend by invitation.

No individual is present in meetings relating to decisions around their own remuneration. The Committee's terms of reference are available on the Company's website or by application to the Company Secretary.

## Key issues and activities

Set out in the table below is a summary of matters considered by the Committee during 2017.

| | Feb | Mar | May | Jun* | Jul | Oct | Oct* | Nov* | Dec |
|---|---|---|---|---|---|---|---|---|---|
| **Compensation awards – previous year** | | | | | | | | | |
| Outgoing CEO/CFO | ● | ● | | | | | | | |
| **Compensation awards – current year** | | | | | | | | | |
| Buy-out awards | | ● | ● | ● | | | | | |
| LTI performance dashboards | ● | | | | | | | | |
| NED/Chairman remuneration | | | | | ● | | | | |
| GE leaver/starter awards | | | | | | ● | ● | ● | |
| **Remuneration strategy** | | | | | | | | | |
| AIP | ● | ● | | | | | | | ● |
| LTI | ● | ● | ● | | ● | | | | ● |
| **Other** | | | | | | | | | |
| Updates on corporate governance developments | | | | | | | | | ● |
| Effectiveness of the Committee | | | | | | | | | ● |
| DRR Policy and Report review | ● | | | | ● | | | | |
| Approval of LTI and Deferred Bonus Plan – new rules | ● | | | | ● | | | | |
| Committee work planning | | | | | | | | | ● |
| Gender pay reporting | | | | | | | | | ● |

* An asterisk against a month denotes that this business of the Committee was agreed by way of a written resolution.

# Our remuneration structure

## Introduction

The revised Directors' Remuneration Policy (the Policy) set out below was approved by over 93% of our shareholders at our AGM held on 27 April 2017. The full Policy is available on the Company's website. As context for the rest of this report, the main elements of the Policy, as well as how the Policy was implemented during the year, are summarised below:

| | Key elements | Key features | How it was implemented in 2017 | How it will be implemented in 2018 |
|---|---|---|---|---|
| **Fixed pay** | **Base salary** | Reviewed annually with changes typically effective from 1 March.<br><br>Maximum salary increases typically in line with the outcomes of the annual review and typically in line with the average increase for the wider workforce. | Due to the timing of the new CEO joining, he was not eligible for a 2017 pay review.<br><br>No increase was made to the CFO's base salary in 2017. | No increase will be made to base pay during 2018. |
| | **Retirement Benefits** | The Company may make a payment into a pension scheme and/or make a cash allowance payment set as a percentage of salary. | For 2017, the CEO was paid cash in lieu of 25% and the CFO, 20%. | 2018 cash in lieu payments:<br><br>CEO 25%<br><br>CFO 20% |
| **Annual Incentive**<br><br>The Annual Incentive Plan (AIP) is designed to drive and reward annual performance against financial and operational KPIs as well as individual objectives, which are directly linked to the Group's strategic plan. | **Cash bonus** | Maximum opportunity under the Policy is 150% of salary.<br><br>For target performance, 50% of maximum bonus opportunity will be received.<br><br>Measured over a one year performance period based on a combination of financial and individual metrics.<br><br>Malus and clawback provisions are in place. | 2017 awards:<br><br>CEO – 150% of base pay opportunity<br><br>CFO – 150% of base pay opportunity<br><br>Payments of £839,747 (81.1%) and £621,153 (79.6%) have been earned by the CEO and CFO respectively. | 2018 awards:<br><br>CEO – 150% of base pay opportunity<br><br>CFO – 150% of base pay opportunity |
| | **Deferred bonus** | 25% of any cash award is mandatorily deferred into Company shares for a period of three years.<br><br>Malus and clawback provisions are in place. | 25% of each of the CEO's and CFO's AIP has been put into deferred share awards with a three year vesting period. | Applicable to 2018 AIP |
| **Long term Incentive**<br><br>LTI – the Performance Share Plans (PSP) are designed to drive sustainable profitable growth and align Executive Directors' interests with shareholders' interests. | **LTI – PSP** | PSP allows for conditional share awards or nil-cost options up to 200% of base salary to be granted annually.<br><br>Threshold level of vesting is 16.7% of maximum award.<br><br>Performance assessed over more than one year, usually three years against key financial metrics.<br><br>Malus and clawback provisions are in place. | Awards of 200% of salary for the CEO were made in 2017 with performance conditions as set out on page 68.<br><br>Awards of 150% for the CFO. | Awards of 200% of salary for the CEO will be made in 2018 with performance conditions based on an even split between underlying EPS growth and cumulative free cash flow.<br><br>Awards of 150% will be made for the CFO. |
| | **Share Ownership Guidelines** | There is a requirement to retain a percentage of salary in Company shares, which must be built up from shares vesting from executive incentive plans.<br><br>A two year holding period post the end of the three year performance period for LTI awards is in place. | The CEO is required to retain 200% of annual salary, and the CFO, 100%. | As 2017, the CEO is required to retain 200% of annual salary, and the CFO, 100%. |
| **All employee share schemes** | **Save as You Earn/Share Incentive Plan** | Both of these plans are available to all employees, including both the CEO and CFO on the same basis as all other employees. | Both CEO and CFO have invested in the 2017 Save as You Earn offer to the maximum allowable under the Plan. | Not applicable |

### Aligning remuneration to deliver operational performance

We have taken a disciplined approach to ensure that our Policy supports Cobham's emerging strategy and delivery of both the long and the short term operational and financial priorities. Our incentive framework is designed to underpin the delivery of sustainable growth in earnings and shareholder value together with the generation of free cash flow.

The 2017 AIP framework supported our priorities of driving continuous improvement in operational excellence and programme execution with inclusion of operational KPIs and by directly targeting organic revenue growth in operating profit and operating cash flow. In addition, individual objectives were set as part of the 2017 AIP to specifically address the strategic development of the Group's portfolio.

In 2018, the AIP will continue to focus on delivering operational performance to meet the strategic actions. We have carried forward the same financial and performance measures from 2017 to 2018 to retain a strong focus on the key financial objectives of the Group, particularly improved cash flow generation.

The LTI is designed to support the creation of long term growth and value for the Group, by aligning shareholder expectations with that of performance.

## The annual report on remuneration

Both Executive Directors were in role throughout the year. The only change to the Board membership during 2017 was the appointment of John McAdam as Senior Independent Director and (David) Jonathan Flint, who retired on John's appointment.

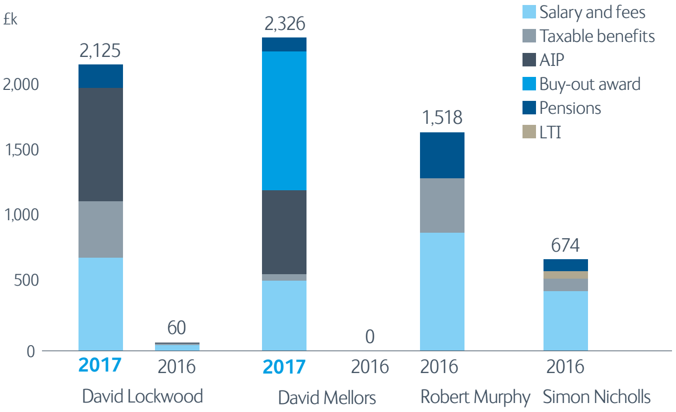
### Single total figure table

| £k | | Salary and fees | Taxable benefits | AIP | LTI | Pensions | Buy-out awards | Total |
|---|---|---|---|---|---|---|---|---|
| David Lockwood | **2017** | **690** | **422** | **840** | – | **173** | – | **2,125** |
| | 2016 | 40 | 10 | – | – | 10 | – | 60 |
| David Mellors | **2017** | **520** | **50** | **621** | – | **104** | **1,031** | **2,326** |

### Previous Executive Directors

| £k | | Salary and fees | Taxable benefits | AIP | LTI | Pensions | Buy-out awards | Total |
|---|---|---|---|---|---|---|---|---|
| Robert Murphy | 2016 | 871 | 404 | – | – | 243 | – | 1,518 |
| Simon Nicholls | 2016 | 440 | 89 | – | 57 | 88 | – | 674 |

### Single total figure of remuneration for each Executive Director (audited information)




### Additional disclosures in respect of the single total figure of remuneration (audited information)

The Company has obtained written confirmation from each Director that they have disclosed all other items in the nature of remuneration.

### Salary and fees

**2017 Approved Policy:**
Reviewed annually with changes typically effective from 1 March. Maximum salary increases typically in line with the outcomes of the annual review and typically in line with the average increase for the wider workforce.

David Lockwood joined the Company on 12 December 2016 and his base salary on joining was set at £690,000. David Mellors joined the Company on 1 January 2017 and his base salary on joining was set at £520,000. Neither Director received an increase at the 1 March 2017 pay review.

### Taxable benefits

The taxable benefit figures are as follows:

| Benefit | David Lockwood £k | David Mellors £k |
|---|---|---|
| Car and private petrol allowance | **19** | **16** |
| Private medical insurance | **2** | **2** |
| Life cover | **3** | **11** |
| Income protection | **3** | **2** |
| Allowance to cover financial/tax advice | **1** | **2** |
| Relocation | **394**[1] | **17**[2] |
| **Total** | **422** | **50** |

[1] One of the conditions within the CEO's employment contract was that he relocate to be based out of the Corporate Head Office in Wimborne, UK. A cap of £500,000 was placed on the relocation package offered to the CEO. The final figure reflects Mr Lockwood's personal circumstances at the time of his move and primarily represents the following elements:

| Element | Cost £k |
|---|---|
| Purchase costs of the house | **203** |
| Removal fees | **7** |
| Legal fees | **13** |
| Structural survey | **2** |
| Gross-up tax | **177** |
| Qualifying relocation allowance | **(8)** |
| **Total** | **394** |

[2] The Company provides support to the CFO whilst working from the corporate head office Wimborne by payment for travel and subsistence in lieu of relocation expenses.

## Annual Incentive Plan

| 2017 Approved Policy: | |
|---|---|
| Cash bonus | Maximum opportunity under the Policy is 150% of salary.<br><br>For target performance, 50% of maximum bonus opportunity will be received.<br><br>Measured over a one year performance period based on a combination of financial and individual metrics.<br><br>Malus and clawback provisions are in place. |
| Deferred bonus | 75% paid in cash and up to 25% mandatorily deferred into Company shares for a period of three years.<br><br>Malus and clawback provisions are in place. |

Awards were subject to the performance measures set out in the table below which are aligned to the key financial and strategic objectives of the Company over the previous 12 months:

| Performance measure | Weighting % |
|---|---|
| Group Operating Cash Flow | 40 |
| Group Revenue | 20 |
| Group Operating Profit | 20 |
| Key Individual Goals | 20 |

Details of the AIP measures, weightings and targets as well as performance against each of the targets is provided in the table below:

| | Full Year Targets | | | |
|---|---|---|---|---|
| Measure[1] | Threshold | Target | Maximum | Actual Performance |
| Group Operating Cash Flow (£m) | 100 | 105 | 125 | **222** |
| Group Organic Revenue Growth (%) | 0 | +1.2 | +5 | **1.2** |
| Group Operating Profit (£m) | 200 | 210 | 252 | **215** |

[1] Performance and targets are measured based on 2017 budgeted foreign exchange rates.

As a result of the actual performance in the table above, the business element of the AIP award achieved was 76.4% of the maximum opportunity.

As noted in the Chairman's Statement, the Board believe that the CEO and CFO have made good progress in 2017. Recognising that the turnaround would require the CEO and CFO to address a range of operational priorities, their Key Individual Goals (KIGs) were set to address specific priorities that the Board believed needed particular attention in 2017.

The KIG's for the two Executive Directors, and the actions taken in relation to them, were as follows:

### CEO – David Lockwood

KIG 1: Complete a full strategic portfolio review of the Group and identify non-core assets for disposal. Progress: The CEO has established a revised strategy for the Group, with its focus on restructuring and growing its core aerospace, defence and space activities. In addition, the CEO, with the support of the CFO, has successfully negotiated the disposal of the AvComm and Wireless testing businesses.

KIG 2: Drive an improved relationship with the CAES SSA Board and the Group's key US stakeholders. Progress: The CEO has established effective working relationships with the new US Outside Directors and key US Government and senior industry contacts which has contributed to the improvement in the Group's performance in relation to its SSA obligations in 2017.

### CFO – David Mellors

KIG 1: To develop and embed standardised financial processes across the Group. Progress: As noted in the Audit Committee report, the CFO has successfully implemented a series of process changes that have delivered a significant improvement in the control framework across the Group.

KIG 2: To deploy across the Group an improved monthly reporting framework and a set of standard KPIs that would focus on cash performance of the business. Progress: The reporting across the Group is now at an acceptable standard and as evidenced by the reported financial performance in 2017, the cash performance of the Group has much improved, achieving a cash conversion rate of 103%.

As a result of the personal elements of the AIP, the CEO achieved 100% of the maximum opportunity and the CFO, 92.5%.

Taken together, the business and personal elements achieved an 81.1% payout for the CEO and 79.6% for the CFO.

## Long term incentives

### 2017 Approved Policy:

PSP allows for conditional share awards or nil-cost options. Up to 200% of base salary may be granted annually.

Threshold level of vesting is 16.7% of maximum award.

Performance assessed over more than one year, usually three years, against key financial metrics.

Malus and clawback provisions are in place.

The PSP is designed to drive sustainable profitable growth in shareholder value and align Executive Directors' interests with shareholders' interests.

### PSP awards vesting in 2017

No Executive Directors hold PSP awards under the 2015-2017 cycle.

### Long term incentives awarded during the financial year (audited information)

The following table sets out the awards made under the LTI plans to Executive Directors during the year.

| | David Lockwood | David Mellors |
|---|---|---|
| Type of award | PSP | PSP |
| Basis on which award is made | 200% of base salary | 150% of base salary |
| Date of award | 24 May 2017 | 24 May 2017 |
| Face value of award (No. of shares awarded) | £1,380,000 (982,206) | £780,000 (555,160) |
| Performance period | 1 January 2017 to 31 December 2019<br><br>A further two year holding period is applicable | 1 January 2017 to 31 December 2019<br><br>A further two year holding period is applicable |

- The award has been made in accordance with the relevant plan rules.
- The face value has been calculated by multiplying the number of shares awarded by the mid-market price of those shares for the three trading days immediately preceding the date of the award.

Performance conditions for the PSP awarded in 2017 are set out in the table below:

| Metric | Weighting % | Performance | Award vesting at |
|---|---|---|---|
| TSR | 50 | Threshold (Median 50th percentile) | 16.7 |
| | | Mid-point (60th percentile) | 50 |
| | | Maximum (75th percentile) | 100 |
| EPS | 50 | Threshold | 16.7 |
| | | Mid-point | 50 |
| | | Maximum | 100 |

**TSR Peer Group**

The companies in the TSR comparator group for awards granted in 2017 were based on FTSE 250 constituents, excluding investment trust and financial services companies.

## Buy-out awards

As we disclosed last year, and in RNS announcements in May and June 2017, we granted buy-out awards to the two incoming Executive Directors who forfeited awards at their previous employer as a result of joining Cobham. These awards have been made on a comparable basis to those of the forfeited arrangements, the details of the awards are below:

| | David Lockwood[1] | David Mellors | David Mellors |
|---|---|---|---|
| Type of award | Buy-out award | Buy-out award | Buy-out award |
| Basis on which award is made | 200% of previous employer's salary | See note 3 below | See note 4 below |
| Date of award | 24 May 2017 | 24 May 2017 | 14 June 2017 |
| Face value of award (No. of shares awarded) | £1,100,000 (782,918)[2] | £391,494 (278,571)[3] | £320,850 (246,998)[4] |
| Performance period | 1 January 2017 to 31 December 2018<br><br>To match the conditions attached to forfeited awards, this award is subject to underlying EPS performance for FY2018.<br><br>A further two year holding period is applicable. | Not applicable as the awards being replaced were no longer in a performance period. | Not applicable as the awards being replaced were no longer in a performance period. |

1 As disclosed in the 2016 DRR, David Lockwood forfeited the deferred share portion of his 2015 bonus as a consequence of joining Cobham and as such will receive a restricted share award with a face value of circa £66,000. This award will be granted as soon as is practicable, and will vest in March 2019 to align with the timeframe of the forfeited award.

2 These awards will be tested against the performance conditions shown above and if satisfied will vest on 8 March 2019.

3 These awards are compensation for awards forfeited when leaving his previous employer. Part of the award vested on 25 June 2017 (141,434 shares) and part will vest on 25 June 2018 (137,137 shares). This release schedule matches that of the awards being replaced.

4 These awards are in recognition of bonus opportunity forfeited when leaving his previous employer. They are due to vest on 14 June 2018 (123,499 shares) and 14 June 2019 (123,499 shares). This release schedule matches that of his previous employer. In addition to these awards, David Mellors received £320,853 paid to him in cash in relation to the lost bonus opportunity, representing half of the total value.

- The award has been made in accordance with the relevant plan rules.
- The face value has been calculated by multiplying the number of shares awarded by the mid-market price of those shares for the three trading days immediately preceding the date of the award.

## Pensions

**2017 Approved Policy:**
The Company may make a payment into a pension scheme (e.g. a defined contribution plan) and/or make a cash allowance payment set as a percentage of salary.

David Lockwood's pension contributions are paid as a cash in lieu amount, which equates to 25% of his base salary. The amount paid during 2017 was £172,500.

David Mellors' pension contributions are paid as a cash in lieu amount, which equates to 20% of his base salary. The amount paid during 2017 was £104,000.

**Non-executive Directors (audited information)**

The 2017 remuneration and current fees of the Non-executive Directors, including the Chairman, have remained unchanged since 2008 and are stated below:

| £k | Total payable 2017 | 2016 |
|---|---|---|
| Michael Wareing (Chairman)[1] | **270**[5] | 68 |
| John McAdam[2] | **28** | – |
| Michael Hagee[3] | **65** | 66 |
| Birgit Nørgaard | **58** | 58 |
| Alan Semple[3] | **70** | 70 |
| Alison Wood | **65** | 65 |
| (David) Jonathan Flint[4] | **40** | 58 |
| John Devaney (Chairman)[5] | – | 278 |
| Mark Ronald[3, 6] | – | 22 |
| **Total** | **596** | 685 |

1 The Chairman, Michael Wareing, received taxable benefits of £3,989 during the year related to reimbursed travel expenses to the Wimborne office, which is considered to be his principal place of work.

2 John McAdam joined the Board on 3 August 2017.

3 Except as noted in 1 above, Non-executive Directors only receive fees under their service agreement and do not have any other taxable benefits, annual or long term incentives or pension arrangements provided by the Company. Messrs Hagee, Ronald and Semple received a taxable benefit in kind for financial services (tax) advice for the amounts of £1,800, £2,092 and £3,475 respectively.

4 (David) Jonathan Flint retired from the Board on 3 August 2017.

5 John Devaney retired from the Board on 31 December 2016.

6 Mark Ronald retired from the Board following the April 2016 AGM.

Non-executive Directors do not have a permanent place of work specified in their service contract. All reasonable and properly incurred expenses claimed in performance of duties as Board members are reimbursed by the Company.

Non-executive Directors are paid a fee of £2,500 per annum for Committee work and a £5,000 fee is paid for Directors travelling from continental locations. A £10,000 per annum fee is paid to each of the Chair of the Audit and Remuneration Committees and to the Senior Independent Director.

Total aggregate Directors' fees for the year, including the Executive Director fees as per the single figure table on page 66, amount to £5,047,000 (2016: £2,659,000).

## Statement of Directors' shareholding and share interests (audited information)

The interests of the Directors and their families in ordinary shares were:

| | 2017 | 2016 |
|---|---|---|
| Michael Wareing | **60,500** | 30,000 |
| John McAdam | **5,000** | N/A |
| David Lockwood | **44,578** | N/A |
| David Mellors | **74,058** | N/A |
| Michael Hagee | **10,500** | 7,500 |
| Birgit Nørgaard | **10,500** | 7,500 |
| Alan Semple | **10,500** | 7,500 |
| Alison Wood | **10,500** | 7,500 |
| (David) Jonathan Flint | **N/A** | 7,500 |
| John Devaney | **N/A** | 30,000 |

Non-executive Directors are required, within six months of election to the Board, to acquire and hold a shareholding of 5,000 ordinary shares.

All Non-executive Directors took up their rights under the Company's Rights Issue on 5 May 2017.

## Executive Directors' share interests

The interests of the Executive Directors in share awards or share options at 31 December 2017 are shown below:

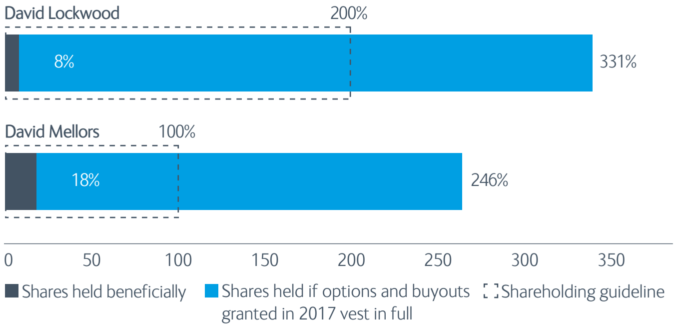
| | Award | Share awards subject to performance conditions | Share awards subject to continued employment | Unvested options subject to performance awards | All employee Sharesave Scheme |
|---|---|---|---|---|---|
| David Lockwood | **PSP 2017** | – | – | **982,206** | – |
| | **PSP 2017 Buy-out** | – | – | **782,918** | – |
| **Total** | | – | – | **1,765,124** | – |
| David Mellors | **PSP 2017** | – | – | **555,160** | – |
| | **Restricted Share Plan Buy-out** | – | **384,135** | – | – |
| **Total** | | – | **384,135** | **555,160** | – |

## Share ownership requirements

There is a requirement to retain a percentage of salary in shares, which must be built up from shares vesting from LTI plans.

Ownership guidelines require the Executive Directors to hold ordinary shares. These guidelines state that the CEO retain the value of at least two years' salary, and the CFO retain the value of at least one year's salary. In addition, the CEO and CFO are to retain a minimum of 50% of net vested PSP shares until the relevant shareholding level is met. There is no time frame over which the guidelines are required to be met and there is no requirement for Directors to hold these shares after leaving the Company.

Shares held by Executive Directors as at 31 December 2017 against share ownership




Interests at 1 March 2018, being a date no more than one month prior to the date of the Notice convening the AGM, were the same as at 31 December 2017.

The market price of the ordinary shares as at 31 December 2017 was 126.3p per share and the closing price range during the year was 96.2p to 148.0p, all prices adjusted to account for the Rights Issue adjustment.

## Dilution

The Company's share schemes are currently funded through shares purchased in the market and have been since November 2010, prior to which they were funded through new issue shares. Funding of awards through new issue shares is subject to an overall dilution limit of 10% of issued share capital in any ten year period. Of this, 5% may be used in connection with the Company's discretionary share schemes. As of 31 December 2017, 0.5m (0.02%) and 0.5m (0.02%) shares have been issued pursuant to awards made in the previous ten years in connection with all share schemes and discretionary schemes respectively. Awards that are made, but then lapse or are forfeit, are excluded from the calculations.

## Payments to past Directors and payment for loss of office (audited information)

The termination payments made to the CEO and CFO were in line with their basic entitlements under their employment contracts as outlined in the table below.

| Element | Outgoing CEO – Robert Murphy £k | Outgoing CFO – Simon Nicholls £k |
|---|---|---|
| **Salary and fees** | | |
| Contractual base pay | **861**[1] | **23** |
| **Taxable benefits** | | |
| Relocation | **184**[2] | – |
| Car and private petrol allowance | – | **3** |
| Private medical insurance, disability cover and life insurance | **25** | – |
| Legal/Financial advice | – | **36** |
| Outplacement services | – | **48** |
| Subsistence | – | **2** |
| **Annual Incentive Plan** | | |
| Deferred AIP | – | **37**[3] |
| **Pensions** | **1,014** | **4** |
| **Total** | **2,084** | **153** |

1 Upon cessation of employment, the outgoing CEO was entitled to a payment in respect of 12 months' annual base salary.
2 In accordance with terms of the outgoing CEO's contract on appointment, the Company was obliged to reimburse the reasonable cost of relocating him and his family from the UK to the US, limited to a maximum of 50% of his salary.
3 The CFO has an outstanding payment of bonus which has been withheld pending the outcome of the FCA investigation.

There were no payments made to past Directors for loss of office during the year.

## Historic CEO total remuneration

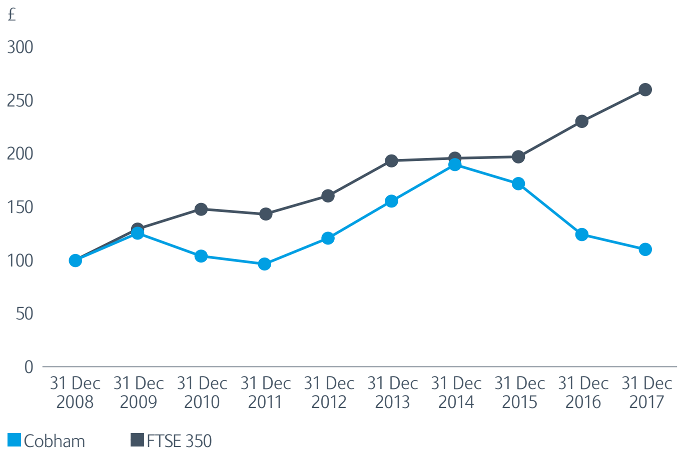
The table below shows historic CEO total remuneration, calculated on the same basis as that used in the single figure table on page 66.

| Year | CEO | CEO single figure of total remuneration (£k) | Annual bonus payout against maximum opportunity % (£k) | Long term incentive vesting rates against maximum opportunity % (£k) |
|---|---|---|---|---|
| **2017** | **CEO4 David Lockwood** | **2,125** | **81.1 (840)** | **N/A** |
| 2016 | CEO4 David Lockwood | 60 | Nil | N/A |
| 2016 | CEO3 Robert Murphy | 1,518 | Nil | N/A |
| 2015 | CEO3 Robert Murphy | 1,364 | 18.4 (209) | N/A |
| 2014 | CEO3 Robert Murphy | 1,196 | Nil | N/A |
| 2013 | CEO3 Robert Murphy | 2,058 | 34.3 (280) | N/A |
| 2012 | CEO3 Robert Murphy | 753 | 48.5 (182) | N/A |
| | CEO2 Andrew Stevens | 1,283 | 45.0 (267) | 58.0 (202) |
| 2011 | CEO2 Andrew Stevens | 1,916 | 92.5 (555) | 85.0 (546) |
| 2010 | CEO2 Andrew Stevens | 1,478 | 33.5 (201) | 87.0 (471) |
| 2009 | CEO1 Allan Cook | 1,496 | 93.0 (567) | 100.0 (238) |

## Performance graph

The graph below illustrates the TSR performance (share price growth plus dividends) of Cobham against the FTSE 350 Index over the past nine years. The graph shows the value of £100 invested over the nine year period ending 31 December 2017. The FTSE 350 Index was chosen as it is a recognised broad equity market index of which Cobham was a member during 2017 and is currently, as at 28 February 2018, ranked at 148.

### TSR performance Cobham vs FTSE 350




Source: Deloitte LLP

## Percentage change in remuneration of CEO

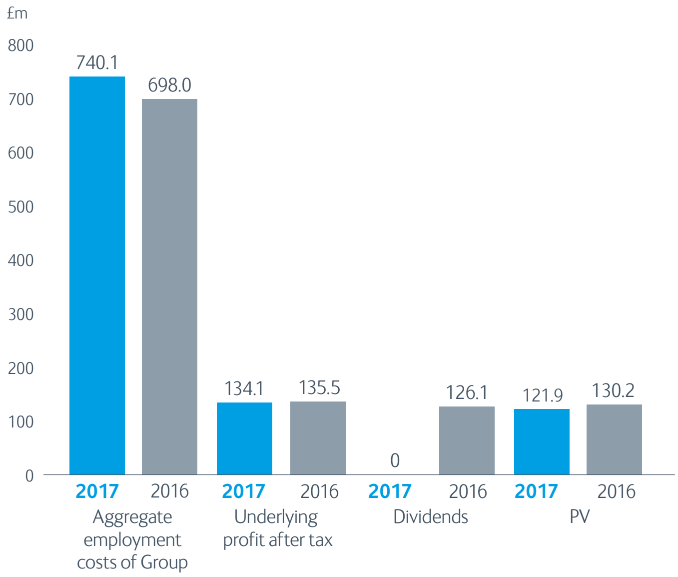
The following table shows the year on year change in respect of the three remuneration elements shown in the table for the CEO, David Lockwood, as compared to that of UK employees generally:

| Remuneration element | CEO | Average employee per capita figure |
|---|---|---|
| Salary | 0.0% | 2.0% |
| Benefits | (2.0)% | 8.8% |
| AIP | 81.1% | 17.4% |

The UK payroll has been chosen for comparison as this is the location of the head office.

## Relative importance of spend on pay

The chart below displays the relative expenditure of the Company on various matters, as required (in the case of Group employees' pay and shareholder distributions) by the relevant remuneration regulations:




The aggregate employment cost of Group employees is detailed at note 4 to the Group Financial Statements and includes employers' social security and similar costs. Group underlying profit after tax is shown above as this is the measure used by the Board to monitor financial performance, refer to note 2. No dividends have been paid in the year, refer to note 7. PV relates to the amount of profit the Group spends on research and development, refer to note 4.

## Statement of implementation of remuneration policy in the current financial year

### Base salary

The base salaries of the CEO and CFO have not been increased as part of the Company's annual salary review for 2018.

### Benefits

Both the CEO and CFO will continue to receive benefits in line with those provided for under the Remuneration Policy.

### Pension

The pension contributions for the CEO and CFO are paid as a cash in lieu amount, which equate to 25% of salary for the CEO and 20% of salary for the CFO, both of which are below the 30% maximum set under the Remuneration Policy. These amounts are unchanged from 2017.

### 2018 AIP

The maximum opportunities for the CEO and CFO will remain unchanged at 150% of base salary.

### 2018 PSP awards

PSP awards will be made to the CEO and CFO with a face value of 200% of salary and 150% of salary respectively and will be subject to an additional two year holding period following the end of the performance period.

## Advisors to the Remuneration Committee

| Advisor | Appointed by | Services provided to the Committee | Other services provided to the Company |
|---|---|---|---|
| Deloitte LLP | Remuneration Committee in November 2009, and reappointed following a tender exercise conducted in 2016 | Remuneration strategy<br>Incentive design<br>Market data | Immigration, international mobility and tax advice<br>Corporate tax advice |

The Committee received advice during the year from Deloitte LLP, who comply with the Code of Conduct of the Remuneration Consultants Group. The Committee is satisfied that the advice they have received has been objective and independent. Deloitte's performance was considered by the Committee as part of the tender process undertaken in 2016. Total fees for advice provided to the Committee during the year amounted to £64,993 (2016: £83,463) and were provided on a time/cost basis. Additional advice was received from the Executive Vice President Human Resources and Communications, Senior Vice President Compensation and Benefits, and Company Secretary.

Whilst proposals from the Committee take account of the advice received, the ultimate decision is made by the Committee and ratified by the Board in the absence of any advisors.

## 2017 voting at the Annual General Meeting

At the AGM held on 27 April 2017, shareholders approved the Directors' Remuneration Policy and voted on the Directors' Remuneration Report for the year ended 31 December 2016. Below are the results in respect of those resolutions, which required a simple majority (i.e. 50%) of the votes cast to be in favour in order for the resolution to be passed. The votes 'for' include discretionary votes given to the Chairman of the Board.

### Directors' Remuneration Policy

| Votes for | % | Votes against | % |
|---|---|---|---|
| 32,316,198 | 93.62 | 2,200,906 | 6.38 |

Votes withheld: 2,542

### Directors' Remuneration Report

| Votes for | % | Votes against | % |
|---|---|---|---|
| 34,099,321 | 98.79 | 417,666 | 1.21 |

Votes withheld: 2,661

# Other Statutory Information

## Dividends

As previously communicated to the market, no dividend is expected with the 2017 results. Given the Group is continuing to progress a turnaround and the cumulative risk around significant contract exposures and other contingent liabilities remains high, the policy on future capital allocation will be considered by the Board towards the end of 2018.

## Directors' indemnity arrangements

The Directors have the benefit of a Directors' and Officers' liability insurance policy and the Company has entered into qualifying third party indemnity arrangements with them, as permitted by the Companies Act 2006. The policy was in force through 2017, at the year end and continues in force at the date of this report. The Directors are permitted to take independent legal advice at the Company's expense within set limits in furtherance of their duties.

## Directors' interests

None of the Directors are or were materially interested in any significant contract during or at the end of the financial year, particulars of which are required to be disclosed by the Listing Rules of the UK Listing Authority. Details of Directors' share interests and of their rights to subscribe for shares are shown in the Directors' Remuneration Report on page 69.

## Share capital

The Company has one class of ordinary shares which carry no right to fixed income, representing 99.9% of the total issued share capital.

In addition, 19,700 non-redeemable 6% second cumulative preference shares have been issued, which represent 0.1% of total issued share capital.

At the AGM held on 27 April 2017, the Company was authorised to purchase up to 170,786,385 ordinary shares. This authority will expire at the conclusion of the 2018 AGM. A special resolution will be put to shareholders at the AGM to renew the authority to make market purchases of the Company's shares up to a maximum of 10% of the share capital of the Company.

The Directors have been authorised to allot and issue ordinary shares. These powers are exercised under authority of resolutions passed at the Company's AGM. The Company launched a fully underwritten 2 for 5 Rights Issue of 683,145,540 new ordinary shares at 75p per new ordinary share which closed on 5 May 2017.

Subject to applicable statutes, and to the rights conferred on the holders of any other shares, shares may be issued with such rights and restrictions as the Company may by ordinary resolution decide or (if there is no such resolution or so far as the resolution does not make specific provision) as the Board may decide. Holders of ordinary shares are entitled to attend and speak at general meetings of the Company, to appoint one or more proxies and, if they are corporations, corporate representatives, and to exercise voting rights. Holders of ordinary shares may receive a dividend and, on a liquidation, may share in the assets of the Company. Holders of ordinary shares are entitled to receive the Company's Annual Report and Accounts. Subject to meeting certain thresholds, holders of ordinary shares may requisition a general meeting of the Company or the proposal of a resolution at an AGM.

The shareholders of the 6% second cumulative preference shares are entitled to receive a fixed cumulative preference dividend at the rate of 6% per annum in priority to the payment of dividends on the ordinary shares. In addition, on a return of assets on the liquidation or otherwise of the Company, the assets available for distribution are to be applied first in repaying to the holders of the 6% second cumulative preference shares the amounts paid up on their shares.

## Voting rights and restrictions on transfer of shares

The rights and obligations attaching to the ordinary shares and 6% second cumulative preference shares of £1 each in the capital of the Company are set out in the Articles.

On a show of hands at a general meeting of the Company, every holder of shares present in person or by proxy and entitled to vote has one vote, and on a poll every member present in person or by proxy and entitled to vote has one vote for every £1 in nominal value of the shares of which they are the holder. None of the ordinary or preference shares carry any special rights with regard to control of the Company.

There are no restrictions on transfers of shares other than:

- Certain restrictions which may from time to time be imposed by laws or regulations;
- Pursuant to the Company's Dealing Code including the requirement on the Directors and designated employees to obtain approval to deal in the Company's shares; and
- Where a person with an interest in the Company's shares has been served with a disclosure notice and has failed to provide the Company with information concerning interests in those shares.

The Company is not aware of any arrangements between shareholders that may result in restrictions on the transfer of securities or voting rights.

## Significant arrangements – change of control

Individual operating companies in the Group have contractual arrangements with third parties in support of the Group's business activities which may take effect, alter or terminate upon a change of control of the Company following a takeover bid. Such contractual arrangements include supply of equipment, goods and services to third parties, including research, design and production. Such contracts and arrangements may be deemed to be essential to one or more of the operating companies but there are no contracts or arrangements considered to be essential to the operation of the business of the Group as a whole, apart from the following:

- The Company has entered into a number of credit agreements with banks, and has issued senior notes under private placements. The total amount owing under such agreements at the year end date is shown in note 16 to the Group Financial Statements. Borrowing agreements contain clauses that in the event of a change of control require either, the Company to repay the lender all amounts owing, or to notify lenders of the change of control and either simultaneously offer to repay all outstanding amounts or repay all outstanding amounts if the lenders so require. Both the offer to repay and obligation to prepay on request are subject to time limits;
- Under the Sentinel contract, entered into in March 2006, the Company must seek approval for any material change in the shareholding of the Company. There is an ancillary aircraft lease agreement under which a change of control may result in the termination of the lease if such event is likely to have a material adverse effect on the Company's ability to perform its obligations under the lease;
- Under the FSTA shareholders agreement entered into in June 2008, a change of control of the Company may result in a required sale of the Company's shares in FSTA to the other shareholders; and
- Under contracts with Airbus for the supply of radio and audio integrated management systems, announced on 2 June 2016, and satellite communications systems, announced on 23 June 2016, if a change in control reasonably appears to the purchaser to materially affect the ability of the supplier to discharge its obligations under the contract or if such change in control is in favour of a party which is strategically unacceptable to the purchaser because of existing, latent or potential conflict of interest, the purchaser shall be entitled to terminate the contract and any order in connection therewith.

## Employee share schemes – rights of control

If required to do so by the Company, the trustee of the Cobham Share Incentive Plan (SIP) will, on receipt of notice from the Company of any offer, compromise arrangement or scheme which affects shares held in the SIP, invite participants to direct the trustee on the exercise of any voting rights attaching to the shares held by the trustee on their behalf and/or direct how the trustee shall act in relation to those shares.

The trustee will not vote in respect of any shares held in the SIP in respect of which it has received no directions nor will the trustee vote in respect of any shares which are unallocated under the SIP.

The trustees of the Employee Benefit Trust which holds ordinary shares to be used for settlement of long term incentives and share option schemes, waive all rights to vote in respect of any shares they hold within the Trust.

Further information relating to change of control under the LTI arrangements appears within the Remuneration Policy available on the Company's website.

## Major interests in shares

As at 31 December 2017, the Company had been notified of the following interests in the ordinary shares:

| | Number of shares at the date of notification | Percentage at date of notification |
|---|---|---|
| Causeway Capital Management LLC | 191,303,713 | 8.001 |
| Artemis Investment Management LLP | 118,455,401 | 4.960 |
| Deutsche Bank AG | Below Threshold | Below Threshold |
| Lancaster Investment Management LLP | 66,415,381 | 2.780 |
| Massachusetts Financial Services Company | 85,343,080 | 4.997 |

Since the year end and up to 28 February 2018, being a date not more than a month prior to the date of the AGM Notice, the Company had been notified of the following interests in the ordinary shares in accordance with DTR 5:

| | Number of shares at the date of notification | Percentage at date of notification |
|---|---|---|
| Silchester International Investors LLP | 239,350,910 | 10.010 |
| Ameriprise Financial, Inc. | 244,814,042 | 10.239 |
| Causeway Capital Management LLC | 192,557,651 | 8.050 |

## Financial instruments

Notes 13, 19 and 21 to the Group Financial Statements and note 11 to the Parent Company Financial Statements contain disclosures relating to the use of financial instruments. The Group uses derivative financial instruments in its management of financial risks and does not trade in financial instruments or use complex financial instruments.

## People

Cobham has continued to meet its commitment to developing people and creating an environment that embraces diversity and inclusivity.

We have grown our investment in our people by building our Emerging Talent programmes across the Group, establishing and delivering a consistent accredited management programme and providing both leadership and functional career frameworks where employees have visibility of how they can grow and develop careers.

Strategic Workforce Planning is an activity the Group has been focused on for some time, using the business strategy to build resource plans that mitigate any risk and identify those competencies that we need in the future, which ensures that our career frameworks reflect the future needs of the business.

Our resourcing process is designed to give consistent and fair consideration to all candidates for employment. We ensure that no candidate feels disadvantaged at any time during the recruitment process or employment.

We have invested, and will continue to invest, in our resource to enable our transformation and underpin our future success.

## Research and development

The Group continues to invest in the important area of research and development, further details can be found on page 29, technology investment. During the year, the Group expended £121.9m (2016: £123.9m) on non-customer funded research and development.

## Events after the balance sheet date

As shown in note 16, the US$75m credit agreement was repaid in January 2018 following the refinancing activity completed in December 2017. The divestment of the AvComm and Wireless test and measurement businesses was announced on 2 February 2018, as disclosed in note 15.

## Political donations and expenditure

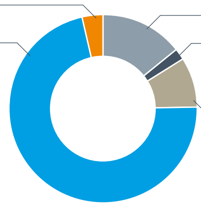
No contributions were made to political organisations during the current or prior year.

## Greenhouse gas emissions

The majority (86%) of the Group's total greenhouse gas (GHG) emissions come from its aviation activity (Figure 1). There was an overall reduction in aviation emissions in 2017 attributed to operational improvements within Aviation Services, such as Engine in Taxi out and Auxiliary Power Unit (APU) usage reduction initiatives. There was also a downturn in flight hours across Regional Services and Airline Services in Australia.

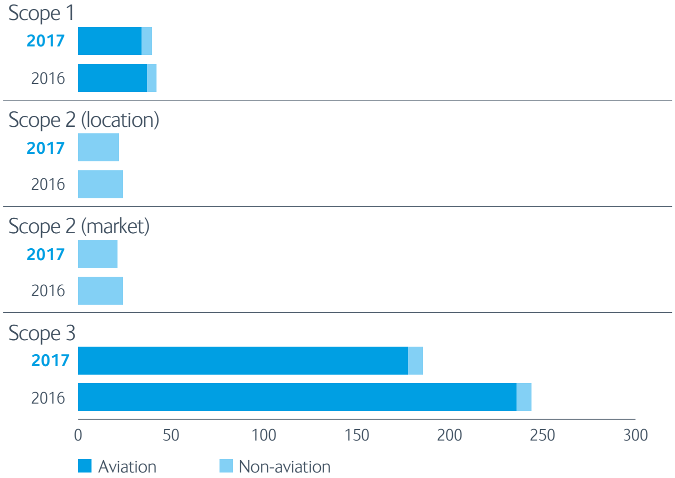
Total emissions from non-aviation activities decreased from 2016. However, there was a greater variation in ambient temperatures during the year resulting in an increase in gas use at multiple sites. Improved data gathering and management, and use of a wider range of emission factors, have improved the accuracy and robustness of GHG reporting across the Group.

**Figure 1 – 2017 GHG emissions** ($tCO_2e$ %)




| Scope | Year | Aviation | Aviation % | Non-Aviation | Non-Aviation % | % total change |
|---|---|---|---|---|---|---|
| Scope 1 | **2017** | **72,479** | **89** | **8,896** | **11** | **0** |
| | 2016 | 71,960 | 89 | 9,050 | 11 | – |
| Scope 2 (location) | **2017** | **–** | **–** | **44,388** | **100** | **(5)** |
| | 2016 | – | – | 46,775 | 100 | – |
| Scope 2 (market) | **2017** | **–** | **–** | **43,154** | **100** | **(7)** |
| | 2016 | – | – | 46,303 | 100 | – |
| Scope 3 | **2017** | **365,736** | **96** | **17,155** | **4** | **(21)** |
| | 2016 | 465,655 | 97 | 16,131 | 3 | – |
| **Total** | **2017** | **438,215** | **86** | **70,438** | **14** | **(17)** |
| | 2016 | 537,915 | 88 | 71,957 | 12 | – |

**Figure 2 – Emissions intensity** ($tCO_2e$/£m)




| Scope | Year | Aviation $tCO_2e$/£m | Non Aviation $tCO_2e$/£m | Total $tCO_2e$/£m | % total change |
|---|---|---|---|---|---|
| Scope 1 | **2017** | **35** | **4** | **39** | **(5)** |
| | 2016 | 37 | 5 | 41 | – |
| Scope 2 (location) | **2017** | **–** | **22** | **22** | **(8)** |
| | 2016 | – | 24 | 24 | – |
| Scope 2 (market) | **2017** | **–** | **21** | **21** | **(13)** |
| | 2016 | – | 24 | 24 | – |
| Scope 3 | **2017** | **178** | **8** | **186** | **(24)** |
| | 2016 | 236 | 8 | 245 | – |

Cobham's GHG emissions intensity (Figure 2) decreased for all scopes. The Group's target is to reduce facility energy intensity by 10% year on year, with the baseline year set from 2015. In 2017, energy intensity decreased by 8%, narrowly missing the annual target. The Aviation Services Sector has set a target of 0.5% reduction in aviation fuel consumption for its commercial aviation services. In 2017 it exceeded this target with a 3.25% reduction, a saving of 1,714$tCO_2$.

## Definitions

Scope 1 comprises direct emissions from Cobham owned and controlled plant and equipment, including: aviation fuel, natural gas, heating oil, non-automotive diesel, fugitive emissions, solvent emissions and automotive fuel.

Scope 2 comprises indirect emissions from purchased renewable and non-renewable electricity using a location based calculation method and indirect emissions from purchased district heating.

Scope 3 comprises indirect emissions from non-Cobham owned and controlled plant and equipment, including aviation fuel and business travel (train, air and car).

## Methodology and data verification

The Group collects data annually, as per our financial year, on GHG emissions from its wholly owned operational subsidiaries. Cobham uses the World Business Council for Sustainable Development, World Resources Institute Greenhouse Gas Protocol method as of 31 December 2014, GHG Protocol Scope 2 Guidance, the International Aerospace Environmental Group GHG Reporting Guidance for the Aerospace Industry, a supplement of the GHG Protocol and the Carbon Disclosure Standards Board to report its greenhouse gas emissions and defines its GHG emissions boundary as those under its direct operational control.

Reported data excludes joint ventures not under the Group's operational control, sites with fewer than five people, sites leased to tenants, vacant properties being disposed of, and any business units that have been closed or divested during the course of the year for which there is less than six months of reported data.

Further information is provided at **www.cobham.com/the-group/corporate-responsibility-and-sustainability**.

100% of the Group's wholly owned operations have been reviewed internally to identify omissions and significant variations from the prior year.

## Data assurance

Bureau Veritas UK has been commissioned by Cobham to provide independent limited assurance using the ISAE 3000 assurance standard over scope 1 and 2 GHG emissions and energy use for the reporting period of 1 January to 31 December 2017. The reporting boundaries cover global operations.

Having completed a verification process including site visits, documents review, testing of a selection of data points and interrogation of reporting systems, Bureau Veritas concludes that there is no evidence to suggest that the data within the scope of our work and presented here is not a fair and accurate representation of the Group's performance.

A full verification statement including methodology, limitations and exclusions and the reporting criteria can be found on the Company website **www.cobham.com/the-group/corporate-responsibility-and-sustainability/performance-data-policies/performance-data**.

## Compliance with Listing Rule 9.8.4R

The majority of the disclosures required under Listing Rules 9.8.4R are not applicable to the Company. The table below gives the location of information required to be included in the Annual Report and Accounts that are applicable.

| Listing Rule | Information | Response |
|---|---|---|
| LR 9.8.4 (12) | Details of any arrangement under which a shareholder has waived or agreed to waive any dividends. | The trustees of the Employee Benefit Trust have elected to waive dividends, except in circumstances where they may be holding shares beneficially owned by participants. Refer to page 72 for further details. |
| (13) | Details of any arrangement under which a shareholder has agreed to waive future dividends. | As noted above. |

## Annual General Meeting

The Company's AGM will be held at 10:00am on Thursday, 26 April 2018 at the Registered Offices of Allen & Overy LLP at One Bishops Square, London E1 6AD.

The Company arranges for the Notice of AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

By order of the Board

**Lyn Colloff**
Company Secretary
1 March 2018

# Statement of Directors' Responsibility

The Directors are responsible for preparing the Annual Report and Accounts, the Directors' Remuneration Report and the Group Financial Statements in accordance with applicable laws and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group Financial Statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising Financial Reporting Standard 101 (FRS 101), Reduced Disclosure Framework, and applicable law). 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 the Parent Company, and of the profit or loss of the Group and the Parent Company for that period.

In preparing those financial statements, the Directors are required to:
- Select suitable accounting policies and then apply them consistently;
- Make judgements and accounting estimates that are reasonable and prudent;
- State whether applicable IFRS, as adopted by the EU, and applicable United Kingdom Accounting Standards, comprising FRS 101, have been followed, subject to any material departures disclosed and explained in the Group and Parent Company Financial Statements respectively; and
- Prepare the Group and Parent Company Financial Statements on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Parent Company and to enable them to ensure that the Group Financial Statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the Group Financial Statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group and Parent Company's position and performance, business model and strategy.

## Directors' Responsibility Statement

Each of the Directors, whose names and functions are listed on pages 44 to 47, confirm that, to the best of their knowledge:
- The Group Financial Statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group;
- The Parent Company Financial Statements, which have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising Financial Reporting Standard 101 (FRS 101), Reduced Disclosure Framework, and applicable law), give a true and fair view of the assets, liabilities, financial position and profit of the Parent Company; and
- The Strategic Report includes a fair review of the development and performance of the business and the position of the Group and Parent Company, together with a description of the principal risks and uncertainties that the Group faces.

## Directors' declaration in relation to relevant audit information

In the case of each Director in office at the date the Directors' Report is approved, that:
- So far as the Director is aware, there is no relevant audit information of which the Group's auditors were unaware; and
- He or she has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

The Responsibility Statement was approved by the Board of Directors on 1 March 2018 and signed on its behalf by:

**David Lockwood**
Chief Executive Officer
1 March 2018

**David Mellors**
Chief Financial Officer
1 March 2018

## Report on the audit of the Financial Statements

### Opinion

In our opinion:

- Cobham plc's Group Financial Statements and Parent Company Financial Statements (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 December 2017 and of the Group's profit and cash flows for the year then ended;
- The Group Financial Statements have been properly prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union;
- The Parent Company Financial Statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101, Reduced Disclosure Framework, and applicable law); 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.

We have audited the Financial Statements, included within the Annual Report and Accounts, which comprise: the Group and Parent Company Balance Sheets as at 31 December 2017; the Group Income Statement and Statement of Comprehensive Income, the Group Statement of Cash Flows, and the Group and Parent Company Statements of Changes in Equity for the year then ended; and the Notes to the Financial Statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Financial Statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the Financial Statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company.

Other than those disclosed in note 4 to the Group Financial Statements, we have provided no non-audit services to the Group or the Parent Company in the period from 1 January 2017 to 31 December 2017.

### Our audit approach

#### Overview

Materiality
- Overall Group materiality: £8.7 million (2016: £9.8 million), based on 5% of underlying profit before tax.
- Overall Parent Company materiality: £39.7 million (2016: £35 million), based on 1% of total assets. We applied a lower materiality of £5 million (2016: £5 million) to certain line items, account balances and disclosures that were in scope for the audit of the Group Financial Statements.
- In response to the level of historical adjustments raised within inventory and contract balances, mainly affecting work in progress and sales reserves we have reduced overall materiality specifically for these two areas to £5.5 million.

Audit scope
- Cobham plc has 58 reporting units which fall into four reporting sectors. Of the 58 reporting units 15 were subject to an audit of their complete financial information due to their size.
- Specific audit procedures were performed on certain balances and transactions in respect of other units.
- We visited three out of four overseas locations to directly supervise the work of component auditors. For all locations we reviewed work papers and maintained regular dialogue.

Areas of focus
- Revenue and profit recognition on contracts – Group.
- Goodwill and acquired intangible asset impairment assessments – Group.
- Inventory provisioning – Group.
- Accounting for uncertain tax provisions and recoverability of deferred tax assets – Group.
- Utilisation or releases of provisions through non-underlying profit – Group and Parent.

#### The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the Financial Statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industry in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group and Parent Company Financial Statements, including, but not limited to: the Special Security Agreement (SSA) regulation for the Advanced Electronic Solutions sector, being the most significant regulatory framework; the Companies Act 2006; Pensions Regulator legislation; and UK and US tax legislation. Our tests included, but were not limited to: agreeing the financial statement disclosures to underlying supporting documentation; review of correspondence with and reports to the regulators; review of correspondence with legal advisors; enquiries of management; review of significant components auditors' work; and review of internal audit reports in so far as they related to the Financial Statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the Financial Statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

#### Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the Financial Statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the Financial Statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| **Revenue and profit recognition on contracts – Group**<br>*Refer to page 58 (Audit Committee Report – Programme watchlist – Revenue and contract accounting) and page 88 (Note 1, Accounting policies, management judgement and estimation uncertainty – contract risk and programme execution).*<br><br>For revenue from the sale of goods, we focused on cut-off around the year end because material revenue transactions can occur close to that date.<br><br>The Group also has a number of significant contracts that span more than one accounting period. These contracts are subject to a high level of scrutiny by management. In particular, we focused on complex development and production contracts including those on aerial refuelling programmes such as KC-46 and A400M.<br><br>The nature of much of the contracting work done by the Group means that there are reasonably frequent contractual issues, variations and renegotiations that arise in the ordinary course of business, whose resolution is uncertain. Costs incurred can significantly exceed amounts estimated as a result of material enhancements to the specifications originally assumed under the contracts. For the contracts detailed above, we focused on:<br>– The amount of revenue assumed as recoverable from customer claims which are subject to commercial negotiation;<br>– The estimation of costs to complete the contract;<br>– Whether contracts with the same customer should be accounted for as separate or linked;<br>– Whether the profit recognised on revenue in the year is appropriate;<br>– Whether associated assets held on the Balance Sheet (work in progress and accrued income) are recoverable or whether a contract loss provision should be recorded;<br>– The recognition of significant revenue milestones which often involve judgement surrounding the achievement of those milestones;<br>– Whether the additional cost contingency meets the definition for the recognition and measurement of a provision. | We tested the recognition of revenue transactions close to the period end to establish whether they were recorded in the correct period. This included agreement to external shipping evidence, shipping terms and authorised milestone documentation with customer acceptance where appropriate. No material misstatements were identified.<br><br>We assessed, through our audit of significant contracts, the basis of profit or loss recognition on the Group's significant contracts, together with whether it is appropriate to account for them as separate or linked contracts. We evaluated the accounting in the context of the Group accounting policies, contract terms and accounting standards. We found the accounting, in all material respects, to be in accordance with accounting standards and Group policies.<br><br>For significant new contracts, we read the key contract terms and for ongoing contracts, we understood any change clauses or amendments agreed in the year, considering whether any areas were subject to interpretation or dispute. We looked at the track record of customer behaviour, and any correspondence, in order to obtain evidence of how terms were being interpreted. We found the accounting, in all material respects, to be in accordance with our understanding of customer arrangements.<br><br>We challenged the reasonableness of the assumptions behind estimated costs to complete by meeting with engineering staff to enquire about project estimates, checking the basis of overhead rates used and, on a sample basis, checking purchase orders for materials. We also inspected risk registers and the process by which risk was included within the cost to complete estimate. Where there was insufficient evidence, we reviewed management's range of outcomes and prepared an independent range to understand if the estimate was materiality different from an adverse or favourable position. As part of this work performed, we check that cost contingency recorded meets the requirements of IAS 37. No material impacts were identified.<br><br>We agreed total contracted revenue to original signed customer contracts, approved change orders or to evidence of customer discussions and agreements. We evaluated the reasonableness of estimated revenue through a review of, and discussion about, customer claims submitted to recover additional costs incurred and considered correspondence with the customer. No material exceptions were found.<br><br>We assessed the recoverability of the assets held on the Balance Sheet by reference to agreements with customers regarding payment or billing profiles. No material exceptions were found.<br><br>We agreed contract loss provisions recorded through a combination of the procedures above in respect of the overall outcome anticipated on the contract. No material exceptions were found.<br><br>We read the disclosures relating to key estimates and judgements in these Financial Statements and are satisfied that the disclosures made were appropriate. |

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| **Goodwill and acquired intangible asset impairment assessments – Group**<br>*Refer to page 58 (Audit Committee Report – Goodwill and acquired intangible assets), page 88 (Note 1, Accounting policies, management judgement and estimation uncertainty – impairment of goodwill) and pages 105 to 107 (Note 9, Intangible assets).*<br><br>During 2016, an impairment charge of £573.8m was recognised against goodwill and other intangible assets. A key focus of our 2017 audit was the carrying value of the remaining assets.<br><br>Management conducts an annual impairment assessment to test whether the carrying value of goodwill and acquired intangible assets exceeds the present value of the cash flows of the Cash Generating Units (CGUs) to which they relate.<br><br>An impairment charge of £33.5m has been recognised against the Helicopter Services Business Unit. This impairment reflects lower growth expectations for 2018 onwards following major contract changes.<br><br>As a result of the 2016 impairment assessment, an impairment charge was recognised against intangible assets in the Wireless Business Unit. In the 2017 assessment, the future growth expectations of the business have improved, resulting in the reversal of this previous impairment.<br><br>Amounts relating to the Wireless and AvComm Business Units have been reclassified as 'held for sale' as at 31 December 2017.<br><br>Following completion of Aeroflex integration activities and as part of a wider strategic review, management have redefined a CGU from having been at a business unit level historically, to now being at a Sector level, as this is the level at which senior management now assess the performance of the Group. In this year of transition, management performed their assessment at a business unit level before moving to Sector level in order to ensure that necessary impairments were booked. | We assessed management's impairment testing relating to the ten CGUs with goodwill balances by obtaining the supporting model and assessing the methodology used and key assumptions made:<br>– Future cash flow forecasts: we evaluated the reasonableness of future cash flow forecasts based on management's accuracy of forecasting and our knowledge of the businesses;<br>– Discount rates: to assess the discount rates used in the model, we used an internally developed range of acceptable discount rates for valuing CGUs, which is based on our view of economic indicators. All discount rates used fell within the range expected for all territories; and<br>– Long term growth rates: we compared the rates applied in the model against our own internally developed published rates. No inconsistencies were noted.<br><br>To assess the Helicopter Services impairment charge, we:<br>– Compared the future cash flow forecasts to historic performance and considered them appropriate based on our knowledge of the business, including contract losses in Qatar and Trinidad during the year;<br>– We recalculated the impairment charge and confirmed that this had been accounted for appropriately.<br><br>For the remaining CGUs, we performed sensitivity analysis around the key assumptions in order to ascertain the extent of change in those assumptions required individually or collectively to result in an impairment of goodwill or acquired intangible assets. For those business units which were most sensitive, we discussed the basis for these cash flows with senior management, concluding that these are appropriate with no impairment required.<br><br>We obtained evidence that the reversal of the impairment charge in respect of acquired intangible fixed assets in the Wireless business is compliant with both IAS 36 and IFRS 5 and has been calculated appropriately. The disclosures in note 9 are considered appropriate.<br><br>Management have redefined a CGU to being a Sector. This is considered appropriate following the completion of Aeroflex integration activities and based on the information now being provided to, and reviewed by, senior management. This transition is compliant with IAS 36. We are satisfied with the disclosure provided explaining the change.<br><br>Management's disclosure in note 9 to the Group Financial Statements includes sensitivities at a Sector level. This is also compliant with IAS 36 which requires disclosure of possible changes in key assumptions prospectively, during which period the impairment assessment for goodwill and acquired intangible assets will be monitored at a Sector level.<br><br>Through review of the impairments booked and reversed, the disclosures made and the overall impairment assessment performed by management, we did not identify any material misstatements. |
| **Inventory provisioning – Group**<br>*Refer to page 58 (Audit Committee Report – Inventory provisions), page 88 (Note 1, Accounting policies, management judgement and estimation uncertainty – inventory provisions) and page 107 (Note 12, Inventories).*<br><br>The nature of some of the Group's business means that the products developed can become technically obsolete. There may be long lead times on the supply of materials which requires the holding of inventory to meet customer required delivery dates. It is also necessary to hold additional spare parts in order to support key customers and programmes should the products require replacement or servicing.<br><br>The Group had gross inventory of £465.4m and provisions for obsolescence of £76.0m on its Balance Sheet. Inventory holdings and aging remain a particular focus by management.<br><br>We focused on this area because inventory provisions include subjective estimates. They are influenced by assumptions concerning future realisable value and usage. Some businesses have experienced lower than expected demand and have had challenges with revenue forecasting. In addition, the methods used for this estimate vary between reporting units depending on the nature of the business and inventory. Furthermore, with the delay in some of the programmes, the spares inventory is becoming more aged and is at risk of being damaged or subject to a new level of conformity. | We assessed the process, methods and assumptions used to develop the provision for slow moving, excess or obsolete items. This included comparing management's calculations for consistency against those used in the prior year and, where forecast demands were used in the assessment, management's historical forecasting accuracy. In situations where there was evidence that management forecasts had not been achieved, we assessed whether the provision had taken account of the likelihood of failure to meet future forecasts.<br><br>We also considered whether there was any indication of management bias such as management overrides to the established methodology.<br><br>Management overrides are typically applied in respect of spares held for the servicing of products on aircraft which have a long service life or where the business has purchased 'last time buys' for components which would no longer be available for purchase. Where overrides were material, we considered the appropriateness of management's judgement based on historical usage and future usage expectations. No material misstatements were identified. |

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| **Accounting for uncertain tax provisions and recoverability of deferred tax assets. – Group**<br>*Refer to page 58 (Audit Committee Report – Uncertain tax positions), page 88 (Note 1, Accounting policies, management judgement and estimation uncertainty – taxation), pages 98 to 101 (Note 6, Taxation) and page 124 (Note 26, Contingent liabilities).*<br><br>The Group has a wide geographic footprint and is subject to tax laws in a number of jurisdictions. The Group has a number of open tax enquiries and has recognised a number of centrally held provisions against uncertain tax positions, the valuation of which is a highly judgemental area. Where tax positions are not settled with the tax authorities, the Directors take into account precedent and the advice of external experts.<br><br>The Group has material deferred tax assets, principally in respect of losses. The Directors apply judgement in establishing whether deferred tax assets are recoverable. | We discussed with management the known uncertain tax positions and read correspondence from tax authorities and external legal counsel on open tax enquiries.<br><br>We assessed the adequacy of the Directors' taxation provisions by considering factors such as the risk profile of each matter, management's appetite for settlement and whether the provision addresses possible penalties and interest.<br><br>We met with senior management and management's expert and challenged the judgements made in relation to a range of outcomes in respect of open enquiries. We assessed the risk from tax authorities by comparing management's assessment against our own views based on all available correspondence and use of specialists.<br><br>We assessed the recoverability of deferred tax assets, comparing the cash flow forecast used by the Directors in making that assessment against those used for the goodwill impairment review and viability assessment. We found that the judgements made by management were within an acceptable range.<br><br>We reviewed the disclosures made in respect of tax, in particular around estimates and uncertainties, as well as contingent liabilities and impact of restatement, and are satisfied that the disclosures made were appropriate. |
| **Utilisation or releases of provisions through non-underlying profit –Group and Parent Company.**<br>*Refer to page 58 (Audit Committee Report – Provisions and material disputes), page 88 (Note 1, Accounting policies, management judgement and estimation uncertainty – definitions) and pages 94 to 96 (Note 2, Underlying measures).*<br><br>We focused on this area because IFRS does not define which items may be excluded from underlying operating profit and it therefore requires judgement around the justification for such exclusion. Consistency in identifying and disclosing items to be excluded from underlying operating profit is important to maintain comparability of the results year on year.<br><br>In 2016, these costs related primarily to the outcome of the closing Balance Sheet review and were disclosed as exceptional and business restructuring activity, with provisions being recorded in the Balance Sheet.<br><br>In 2017, we have focused on how these costs unwind and the correct treatment of utilisation or release to ensure appropriate classification and disclosure through non-underlying or underlying profit. | We assessed the movements in provisions during the year and obtained evidence for any releases or utilised amounts.<br><br>We reviewed the disclosure made in respect of these movements and the impacts to the Income Statement, specifically distinguishing between non-underlying and underlying profit.<br><br>We performed a look back test for the adjustments made and ensured the utilisation of the provision was appropriate based on the original nature of the provision.<br><br>We challenged any significant releases made in the year and obtained evidence to support management's judgement around the basis of the release. We found the accounting, in all material respects, to be in accordance with accounting standards and Group policies. |

## How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the Financial Statements as a whole, taking into account the structure of the Group and the Parent Company, the accounting processes and controls, and the industry in which they operate.

Of the Group's 58 reporting units, we performed audits of complete financial information at 15 reporting units in the UK, Australia, Denmark and France. At 12 US reporting units, we performed audit procedures on certain balances and transactions (typically including at least revenue and inventory which are areas of audit focus) rather than an audit of their complete financial information. In addition to the above, we performed analytical procedures on the remaining 31 reporting units to understand key balances and transactions in the year and performed additional procedures on any unusual balances identified.

The Group is structured across four reported Sectors, being Advanced Electronic Solutions, Aviation Services, Communications and Connectivity and Mission Systems. The Group Financial Statements are a consolidation of the 58 reporting units within these Sectors, comprising the Group's operating businesses and centralised functions. The Advanced Electronic Solutions Sector operates under an SSA which is required to carry on business with the US Department of Defence. The SSA places certain restrictions on access to, and communication of, information outside of the US borders. We planned our audit to ensure US personnel complete the audit work within the SSA. We maintained regular dialogue throughout the audit cycle with our US team, including a face to face meeting at the planning stage to communicate, discuss and agree the audit plan. We also supervised and reviewed the work performed through regular dialogue and reviewing their work papers. We agreed the format and content of communications required. There are seven reporting units within the SSA that were included in our audit scope. The reporting units were subject to directed scope procedures, providing reporting to us on specified financial statement line items including revenue and contract work in progress, as well as specified procedures on other key areas such as manual journals and inventory counts. We also performed specific procedures relating to US taxation.

84% of the Group's revenue is accounted for by reporting units where we performed audits of their complete financial information or performed specific audit procedures over revenue. 45% of the Group's underlying profit before taxation is accounted for by the 15 reporting units where we performed audits of their complete financial information. In combination with the other work referred to above, together with additional procedures performed at Group level, including testing of significant journals posted within the Sector and Group consolidations and significant adjustments made to the Financial Statements, this gave us the evidence we needed for our opinion on the Financial Statements as a whole.

Where the work was performed by component audit teams, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate evidence had been obtained as a basis for our opinion on the Financial Statements as a whole. We have visited three territories (covering ten in scope reporting units) during the year, being France, Denmark and the US. We visited France at the planning stage and met with local management. We visited Denmark at year end to perform a review of the team's work and meet local management. We met with our US team twice, both at the planning stage to discuss and agree the audit plan, and at year end to review their working papers. We reviewed the working papers of our Australian team remotely at year end. Finally, we met regularly with the key audit partner on six other reporting units in the Communications and Connectivity Sector, who is based in the UK. We maintained regular dialogue with all component teams throughout the audit. In addition, members of the Group team lead, or form part of, a number of significant component teams on the audit, including the two key reporting units with the aerial refuelling development and production contracts. We attended clearance calls on all in scope components.

### Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the Financial Statements as a whole.

Based on our professional judgement, we determined materiality for the Financial Statements as a whole as follows:

Group Financial Statements

| | |
|---|---|
| Overall materiality | £8.7 million (2016: £9.8 million). |
| How we determined it | 5% of underlying profit before tax. |
| Rationale for benchmark applied | Underlying profit before tax is defined on page 94. We believe that underlying profit before tax represents an appropriate metric for assessing the performance of the Group and provides us with a consistent year on year basis for determining materiality. It is the amount reported by management both internally and externally to the market. We also considered our overall Group materiality in the context of the Group's revenue, noting that it represents less than 0.4%.<br><br>In response to the level of historical adjustments raised within inventory and contract balances, mainly impacting work in progress and sales reserves, we reduced materiality specifically for these two areas to £5.5m. This level of materiality was determined to reflect the level of historical adjustment for these balances in the prior year and the continued heightened risk of misstatement. |

Parent Company Financial Statements

| | |
|---|---|
| Overall materiality | £39.7 million (2016: £35.0 million). |
| How we determined it | 1% of total assets. |
| Rationale for benchmark applied | We believe that total assets are an appropriate metric for assessing the Parent Company as it holds the investments and derivative financial instruments of the Group.<br><br>We applied a lower materiality of £5m to certain line items, account balances and disclosures that were in scope for the audit of the Group Financial Statements. |

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £1 million and £5 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £200,000 (Group audit) (2016: £200,000) and £200,000 (Parent Company audit) (2016: £200,000) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

### Going concern

In accordance with ISAs (UK) we report as follows:

| Reporting obligation | Outcome |
|---|---|
| We are required to report if we have anything material to add or draw attention to in respect of the Directors' statement in the Financial Statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the Financial Statements and the Directors' identification of any material uncertainties to the Group's and the Parent Company's ability to continue as a going concern over a period of at least 12 months from the date of approval of the Financial Statements. | We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Parent Company's ability to continue as a going concern. |
| We are required to report if the Directors' statement relating to going concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit. | We have nothing to report. |

## Reporting on other information

The other information comprises all of the information in the Annual Report and Accounts other than the Financial Statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the Financial Statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the Financial Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Financial Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Financial Statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and the Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

### Strategic Report and the Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and the Directors' Report for the year ended 31 December 2017 is consistent with the Financial Statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and the Directors' Report. (CA06)

### The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

- The Directors' confirmation on page 53 of the Annual Report and Accounts that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- The disclosures in the Annual Report and Accounts that describe those risks and explain how they are being managed or mitigated;
- The Directors' explanation on page 35 of the Annual Report and Accounts as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the Code); and considering whether the statements are consistent with the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit.

### Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the Directors, on page 61, that they consider the Annual Report and Accounts taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Parent Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Parent Company obtained in the course of performing our audit;
- The section of the Annual Report and Accounts on page 57 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee;
- The Directors' statement relating to the Parent Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

### Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

## Responsibilities for the Financial Statements and the audit

### Responsibilities of the Directors for the Financial Statements

As explained more fully in the Statement of Directors' Responsibility set out on page 75, the Directors are responsible for the preparation of the Financial Statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of Financial Statements that are free from material misstatement, whether due to fraud or error.

In preparing the Financial Statements, the Directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

### Auditors' responsibilities for the audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the Financial Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Financial Statements.

A further description of our responsibilities for the audit of the Financial Statements is located on the FRC's website at: **www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditors' report.

### Use of this report

This report, including the opinions, has been prepared for and only for the Parent Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- We have not received all the information and explanations we require for our audit; or
- 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
- Certain disclosures of Directors' remuneration specified by law are not made; 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.

We have no exceptions to report arising from this responsibility.

### Appointment

Following the recommendation of the Audit Committee, we were appointed by the Directors on 1 April 1974 to audit the Financial Statements for the year ended 31 December 1974 and subsequent financial periods. The period of total uninterrupted engagement is 44 years, covering the years ended 31 December 1974 to 31 December 2017.

Pauline Campbell

**Pauline Campbell**
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
1 March 2018

# Financial Statements Index

# Consolidated Income Statement

For the year ended 31 December 2017

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| Revenue | 3 | **2,052.5** | 1,943.9 |
| Cost of sales | | **(1,457.9)** | (1,567.3) |
| **Gross profit** | | **594.6** | 376.6 |
| Operating costs | 4 | **(490.5)** | (1,155.7) |
| **Operating profit/(loss)** | | **104.1** | (779.1) |
| Finance income | 5 | **6.1** | 4.1 |
| Finance costs | 5 | **(43.3)** | (72.9) |
| **Profit/(loss) before taxation** | | **66.9** | (847.9) |
| Taxation | 6 | **11.9** | 52.8 |
| **Profit/(loss) after taxation for the year** | | **78.8** | (795.1) |
| | | | |
| Attributable to: | | | |
| Owners of the parent | | **78.6** | (795.2) |
| Non-controlling interests | | **0.2** | 0.1 |
| | | **78.8** | (795.1) |
| | | | |
| **Earnings per ordinary share** | 2 | | |
| Basic | | **3.5p** | (45.9)p |
| Diluted | | **3.5p** | (45.9)p |

EPS for the comparative period has been restated for the impact of the Rights Issue in May 2017.

# Consolidated Statement of Comprehensive Income

For the year ended 31 December 2017

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| **Profit/(loss) after taxation for the year** | | **78.8** | (795.1) |
| | | | |
| **Items that will not be reclassified subsequently to profit or loss** | | | |
| Remeasurements of defined benefit retirement benefit obligations | 20 | **7.4** | (42.6) |
| Actuarial loss on other retirement benefit obligations | 20 | – | (1.2) |
| Tax effects | 6 | **(1.4)** | 8.9 |
| | | **6.0** | (34.9) |
| | | | |
| **Items that may subsequently be reclassified to profit or loss** | | | |
| Net translation differences on investments in overseas subsidiaries | 23 | **(50.4)** | 41.3 |
| Reclassification of cash flow hedge fair values | 23 | **0.5** | 1.6 |
| Hedge accounted derivative financial instruments | 23 | **0.9** | (2.8) |
| Tax effects | 6 | **(0.1)** | 0.4 |
| | | **(49.1)** | 40.5 |
| | | | |
| **Other comprehensive (expense)/income for the year** | | **(43.1)** | 5.6 |
| | | | |
| **Total comprehensive income/(expense) for the year** | | **35.7** | (789.5) |
| | | | |
| Attributable to: | | | |
| Owners of the parent | | **35.5** | (789.6) |
| Non-controlling interests | | **0.2** | 0.1 |
| | | **35.7** | (789.5) |

# Consolidated Balance Sheet

As at 31 December 2017

| £m | Note | 2017 | 2016 (restated) |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Intangible assets | 9 | 893.8 | 1,165.9 |
| Property, plant and equipment | 10 | 380.9 | 422.9 |
| Investment properties | 11 | 2.4 | 3.6 |
| Investments in joint ventures and associates | | 3.6 | 3.6 |
| Trade and other receivables | 14 | 64.5 | 66.0 |
| Other financial assets | 13 | 6.1 | 6.1 |
| Deferred tax | 6 | 57.5 | 43.9 |
| Derivative financial instruments | 19 | 25.0 | 19.7 |
| | | 1,433.8 | 1,731.7 |
| **Current assets** | | | |
| Inventories | 12 | 389.4 | 405.3 |
| Trade and other receivables | 14 | 329.0 | 409.8 |
| Current tax receivables | 6 | 7.2 | 3.1 |
| Derivative financial instruments | 19 | 10.4 | 8.5 |
| Cash and cash equivalents | 8 | 451.9 | 236.2 |
| Assets classified as held for sale | 15 | 171.7 | – |
| | | 1,359.6 | 1,062.9 |
| **Liabilities** | | | |
| **Current liabilities** | | | |
| Borrowings | 16 | (0.1) | (60.9) |
| Trade and other payables | 17 | (448.2) | (440.3) |
| Provisions | 18 | (125.1) | (180.6) |
| Current tax liabilities | 6 | (135.8) | (141.6) |
| Derivative financial instruments | 19 | (12.2) | (42.2) |
| Liabilities associated with assets classified as held for sale | 15 | (49.1) | – |
| | | (770.5) | (865.6) |
| **Non-current liabilities** | | | |
| Borrowings | 16 | (835.3) | (1,203.5) |
| Trade and other payables | 17 | (36.1) | (31.5) |
| Provisions | 18 | (30.7) | (57.3) |
| Deferred tax | 6 | (2.1) | (27.6) |
| Derivative financial instruments | 19 | (27.2) | (32.2) |
| Retirement benefit obligations | 20 | (63.2) | (87.0) |
| | | (994.6) | (1,439.1) |
| **Net assets** | | 1,028.3 | 489.9 |
| **Equity** | | | |
| Share capital | 22 | 61.7 | 44.6 |
| Share premium | 22 | 1,257.9 | 778.3 |
| Other reserves | 23 | (8.6) | 37.9 |
| Retained earnings | | (284.0) | (372.0) |
| **Total equity attributable to owners of the parent** | | 1,027.0 | 488.8 |
| Non-controlling interests in equity | | 1.3 | 1.1 |
| **Total equity** | | 1,028.3 | 489.9 |

Details of the restatement of the 2016 Balance Sheet can be found in note 6.

The financial statements on pages 84 to 128 were approved by a duly appointed and authorised committee of the Board on 1 March 2018 and signed on its behalf by:

**David Lockwood**
Directors

**David Mellors**

# Consolidated Statement of Changes in Equity

For the year ended 31 December 2017

| £m | Share capital | Share premium | Other reserves (note 23) | Retained earnings | Total attributable to owners of the parent | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|---|
| **Total equity at 1 January 2016** | 30.4 | 301.9 | (0.3) | 576.8 | 908.8 | 0.9 | 909.7 |
| Loss for the year | – | – | – | (795.2) | (795.2) | 0.1 | (795.1) |
| Other comprehensive income/(expense) | | | | | | | |
| Items that will not be reclassified subsequently to profit or loss | – | – | – | (34.9) | (34.9) | – | (34.9) |
| Items that may subsequently be reclassified to profit or loss | – | – | 40.5 | – | 40.5 | – | 40.5 |
| Issue of shares, net of costs (note 22) | 14.2 | 476.4 | – | – | 490.6 | – | 490.6 |
| Proceeds on allocation of treasury shares | – | – | – | 2.3 | 2.3 | – | 2.3 |
| Dividends (note 7) | – | – | – | (126.1) | (126.1) | – | (126.1) |
| Share based payments (note 24) | – | – | 3.8 | – | 3.8 | – | 3.8 |
| Transfer of other reserves to retained earnings | – | – | (5.1) | 5.1 | – | – | – |
| Tax effects (note 6) | – | – | (1.2) | – | (1.2) | – | (1.2) |
| Foreign exchange adjustments | – | – | 0.2 | – | 0.2 | 0.1 | 0.3 |
| **Total equity at 31 December 2016** | 44.6 | 778.3 | 37.9 | (372.0) | 488.8 | 1.1 | 489.9 |
| Profit for the year | – | – | – | **78.6** | **78.6** | **0.2** | **78.8** |
| Other comprehensive income/(expense) | | | | | | | |
| Items that will not be reclassified subsequently to profit or loss | – | – | – | **6.0** | **6.0** | – | **6.0** |
| Items that may subsequently be reclassified to profit or loss | – | – | **(49.1)** | – | **(49.1)** | – | **(49.1)** |
| Issue of shares, net of costs (note 22) | **17.1** | **479.6** | – | – | **496.7** | – | **496.7** |
| Proceeds on allocation of treasury shares | – | – | – | **0.5** | **0.5** | – | **0.5** |
| Share based payments (note 24) | – | – | **5.5** | – | **5.5** | – | **5.5** |
| Transfer of other reserves to retained earnings | – | – | **(2.9)** | **2.9** | – | – | – |
| **Total equity at 31 December 2017** | **61.7** | **1,257.9** | **(8.6)** | **(284.0)** | **1,027.0** | **1.3** | **1,028.3** |

# Consolidated Cash Flow Statement

For the year ended 31 December 2017

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| **Cash generated from operations** | | **282.3** | 226.0 |
| Tax paid | | **(32.2)** | (20.1) |
| Interest paid | | **(41.6)** | (74.7) |
| Interest received | | **6.7** | 3.5 |
| **Net cash from operating activities** | 8 | **215.2** | 134.7 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of property, plant and equipment | | **(69.0)** | (82.8) |
| Purchase of intangible assets | | **(10.8)** | (9.1) |
| Capitalised expenditure on intangible assets | 9 | **–** | (0.3) |
| Proceeds on disposal of property, plant and equipment | | **5.1** | 6.1 |
| Acquisition of subsidiaries net of cash or debt acquired | | **(0.3)** | (1.4) |
| (Costs)/proceeds of business divestments | | **(0.5)** | 1.0 |
| **Net cash used in investing activities** | | **(75.5)** | (86.5) |
| | | | |
| **Cash flows from financing activities** | | | |
| Issue of share capital | | **496.7** | 490.6 |
| Dividends paid | 7 | **–** | (126.1) |
| Dividends paid to non-controlling interests | 7 | **(0.1)** | – |
| Proceeds on allocation of treasury shares | | **0.5** | 2.3 |
| New borrowings | 16 | **–** | 9.9 |
| Repayment of borrowings | 16 | **(359.6)** | (497.0) |
| **Net cash from/(used in) financing activities** | | **137.5** | (120.3) |
| | | | |
| **Net increase/(decrease) in cash and cash equivalents** | | **277.2** | (72.1) |
| Exchange movements | | **(61.5)** | 14.3 |
| Cash and cash equivalents at start of year | | **236.2** | 294.0 |
| **Cash and cash equivalents at end of year** | | **451.9** | 236.2 |

## Reconciliation of cash and cash equivalents and net debt

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| Cash and cash equivalents | | **451.9** | 236.2 |
| Borrowings – current liabilities | 16 | **(0.1)** | (60.9) |
| Borrowings – non-current liabilities | 16 | **(835.3)** | (1,203.5) |
| **Net debt at 31 December** | | **(383.5)** | (1,028.2) |

A reconciliation of the movements in net debt can be found in note 16.

Note 13 includes details of the offsetting of overdrafts with cash and cash equivalents and other financial instruments.

## 1. Accounting policies and related information

### 1.1 General information

These financial statements are the consolidated financial statements of Cobham plc (the Company), a public company limited by shares, registered and domiciled in England, the United Kingdom and its subsidiaries (the Group).

### 1.2 Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, interpretations of the IFRS Interpretations Committee and those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

These financial statements have been prepared on the going concern basis under the historical cost convention, unless otherwise stated.

### 1.3 Management judgement and estimation uncertainty

The preparation of financial statements in conformity with IFRS requires the use of judgements and estimates that affect the application of accounting policies and reported amounts of assets, liabilities, revenue and expenses.

These judgements and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The current economic conditions have been considered when evaluating accounting judgements and estimates, including the application of the going concern basis of preparation. Although estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

#### 1.3.1 Significant judgements in applying accounting policies

The following are the judgements, apart from those involving estimations, that the Directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements:

a. Consolidation of Cobham Advanced Electronic Solutions Sector
The Cobham Advanced Electronic Solutions Sector operates under an SSA with the US Government due to the nature of its work on classified US Department of Defense (DoD) programmes. The results of this Sector have been consolidated based on a judgement that, whilst the day to day operation of this Sector is managed by the SSA Board, the Cobham plc Board retains the right to variable returns and the ability to affect those returns. Further details can be found in the Corporate Governance section on page 51;

b. Classification of assets as held for sale
It is considered that the carrying amount of the assets and liabilities of the AvComm and Wireless test and measurement businesses will be recovered through a sale transaction rather than through continuing use, and these have therefore been classified as held for sale at 31 December 2017. Following the announcement of the divestment on 2 February 2018, the Directors believe it is highly probable that the sale will be completed within a year of the balance sheet date;

c. Revenue recognition – milestone recognition
The recognition of significant revenue milestones which often involve judgement surrounding the achievement of those milestones; and

d. Capitalisation of development costs
The Group undertakes significant levels of development work which is largely expensed to the Income Statement. Judgement is exercised in determining whether the criteria for capitalisation as described in IAS 38, Intangible Assets are met; in particular in applying the appropriate level of caution to the requirement for the product to be technically feasible and capable of generating a financial return. If these tests were met, further costs would be capitalised as an intangible asset until the intangible asset was readily available for use and would then be amortised.

#### 1.3.2 Assumptions and estimation uncertainties

Management considers that there are a number of assumptions concerning the future and other major sources of estimation uncertainty at the balance sheet date, which have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Those key assumptions and estimation uncertainties are as follows:

a. Long term contract provisions (note 18)
Recognition and measurement of onerous contract provisions includes estimates of the costs to complete the contracts, the outcome of negotiations with customers and the amounts recoverable under these contracts;

b. Impairment of goodwill and intangible assets (note 9)
Determination of the value in use of Cash Generating Units (CGUs) as assessed in relation to the annual review of goodwill and any subsequent impairment of goodwill and intangible assets, or reversal of previously impaired intangible assets;

c. Inventory provisions (note 12)
Recognition and measurement of provisions for obsolete, slow moving and defective items of inventory;

d. Uncertain tax positions (note 6)
Recognition and measurement of amounts provided in respect of uncertain tax positions included within net current tax payables in the Balance Sheet; and

e. Pension assets and liabilities (note 20)
Assumptions are made in assessing the costs and present value of the pension assets and liabilities, which include the discount rate, inflation and mortality rates.

### 1.4 Underlying measures (note 2)

Definitions and a description of the use of non-GAAP alternative performance measures can be found in note 2.

### 1.5 Operating segments (note 3)

The chief operating decision making body for the Group has been identified as the Board. It reviews the Group's internal reporting in order to assess performance and allocate resources. Details of the composition and purpose of the Board can be found on pages 44 to 53.

The Group reports four operating segments whose revenue and results are reported to the Board. These are the Communications and Connectivity, Mission Systems, Advanced Electronic Solutions and Aviation Services Sectors. All operating segments meet the definition of reportable segments as defined in IFRS 8. Costs of the corporate head office and Group functions are allocated across the operating segments. The principal activities of these segments are described on pages 20 to 27.

The Board assesses the trading performance of operating segments based on revenue and underlying operating profit as defined in note 2. Finance income, finance costs and taxation are not segmented and are reviewed by the Board on a consolidated basis. Segment net assets are disclosed voluntarily in note 3 and include intangible assets, property, plant and equipment, investment properties, inventory, trade and other receivables, trade and other payables and provisions. They do not include tax, net debt, derivative financial instruments, contingent consideration payable or retirement benefit obligations.

## 1.6 Principal accounting policies

The principal accounting policies, which have been consistently applied unless otherwise stated, are as set out below.

### 1.6.1 Basis of consolidation

The Group Financial Statements include the financial statements of the Parent Company, Cobham plc, and of all its subsidiaries.

Subsidiaries are all entities over which the Group has control, which is defined as the right to variable returns and the ability to affect those returns. Subsidiaries are fully consolidated from the date on which control is transferred to the Group until the date that control ceases. Joint ventures and associates are not consolidated but are accounted for using the equity method.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

As noted in section 1.3.1 above, the consolidation of the Cobham Advanced Electronic Solutions Sector is the subject of a significant judgement.

### 1.6.2 Foreign currencies

The presentation currency of the Group is sterling. Most Group companies, including the Parent Company, use their local currency as their functional currency. Transactions in currencies other than the functional currency are translated at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in non-functional currencies are retranslated at the exchange rate ruling at the balance sheet date and any exchange differences arising are taken to the Income Statement.

For consolidation purposes, the assets and liabilities of foreign operations are translated at closing exchange rates. Income statements of such undertakings are consolidated at average rates of exchange as an approximation for actual rates during the year. Exchange differences arising on these translations are accounted for in the translation reserve in Other Comprehensive Income (OCI). On divestment, these exchange differences are reclassified from the translation reserve to the Income Statement.

### 1.6.3 Revenue recognition

Revenue is measured at the fair value of the right to consideration, net of returns, other allowances, value added tax and other sales taxes.

Revenue from the sale of goods not under a long term contract is recognised when the significant risks and rewards of ownership and effective control of the goods have been passed to the customer in accordance with contract terms, recovery of the consideration is probable, and the amount of revenue and costs can be measured reliably. In the case of contracts with a long duration, including contracts with a funded development phase, revenue is recognised based upon the fair value of work performed to date assessed with reference to completed contract milestones which have been accepted by the customer.

Long term contract accounting as described in IAS 11, Construction Contracts is not generally applicable to the longer term contracts for sales of goods entered into by Group companies. Where long term contract accounting is applicable, revenue is recognised on a percentage of completion basis. For customer funded development programmes, revenue is usually recognised based on the value attributed to completed performance milestones, net of any amounts expected to be repaid to the customer arising from penalties or claims.
Margin is recognised based on the estimated total costs and revenues from the contract, taking into account amounts expected to be incurred and recovered on contract variations and modifications.

Revenue for services is recognised as the services are rendered with reference to the proportion of the service delivered to date. For 'cost-plus' contracts (typically with government departments and agencies), revenue is recognised to the extent of reimbursable costs incurred, plus a proportionate amount of the estimated fee earned. For contracts where revenue is determined on a unit activity basis, revenue is recognised on the basis of activity undertaken in the period.

### 1.6.4 Taxation including deferred taxation (note 6)

The tax expense is the sum of current tax and deferred tax. Tax is charged or credited to the Income Statement except when it relates to items recognised in OCI or directly in equity, in which case the tax is also dealt with in OCI or in equity respectively.

Current tax is provided at the amounts expected to be paid, using rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying values in the consolidated financial statements. It is calculated using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date and that are expected to apply to the period when the asset is realised or the liability is settled.

Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the assets to be recovered.

Deferred tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred taxes relate to the same fiscal authority.

### 1.6.5 Intangible assets (note 9)

#### Goodwill

Goodwill arises on business combinations and represents the excess of the fair value of consideration transferred over the fair value of the Group's share of the identifiable net assets acquired. Goodwill is allocated at acquisition to the CGUs that are expected to benefit from that business combination. CGUs represent the lowest level within the Group at which the goodwill is monitored for internal management purposes.

On divestment of a business the attributable amount of goodwill is included in the determination of the profit or loss on divestment.

#### Other intangible assets

Intangible assets other than goodwill which are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. These include customer relationships, technology and software, trademarks, licences and patents. The only internally generated intangible assets are development costs which are capitalised as described below and internally developed software where asset recognition criteria are met.

These intangible assets are amortised over the asset's estimated useful life on a straight-line basis as follows:

| | |
|---|---|
| Customer relationships | 5 to 15 years |
| Technology based assets | 5 to 15 years |
| Development costs | 2 to 10 years |
| Order book and trade names | 6 months to 10 years |
| Software and other | 2 to 10 years |

Useful lives are assessed for each asset on an individual basis, taking into account the specific characteristics of the asset.

### Research and development

Development costs are capitalised when it can be demonstrated that the conditions for capitalisation as described in IAS 38, Intangible Assets are met, paying particular attention to the requirements for the product to be technically feasible and capable of generating a financial return. At that point, further costs are capitalised as an intangible asset until the intangible asset is readily available for use and it is then amortised as described above. All development costs not capitalised are written off as incurred together with all research costs.

For customer funded research and development projects, costs are initially recognised within inventory as work in progress, to the extent that they are considered recoverable, until the criteria of the revenue recognition accounting policy are met.

### 1.6.6 Property, plant and equipment (note 10)

Freehold and leasehold land and buildings, plant and machinery, and fixtures, fittings, tools and equipment are held at historic cost less accumulated depreciation and any recognised impairment losses. Cost comprises the purchase price and any costs directly attributable to the asset.

All property, plant and equipment other than land and assets under construction is depreciated on a straight-line basis to the estimated residual values over the estimated useful lives. These lives are as follows:

| | |
|---|---|
| Freehold buildings | 50 years |
| Leasehold properties | Period to next break clause |
| Plant and machinery | 3 to 15 years |
| Fixtures, fittings, tools and equipment | 3 to 15 years |

Estimated residual values and the estimated useful lives are reviewed annually and adjusted where necessary. Freehold land is not depreciated, and is reviewed for impairment at least annually.

Assets under construction are held at cost and transferred to the appropriate category of property, plant and equipment once construction is complete and they enter into service. They are depreciated from this point in accordance with the policies described above.

Assets held under finance leases are depreciated over the term of the relevant lease.

Major overhaul expenditure on owned aircraft is capitalised when incurred and the resultant property, plant and equipment is depreciated over its useful economic life. Major overhaul costs that are contractually required on aircraft held under operating leases are provided for over the period between the scheduled maintenance events.

### 1.6.7 Investment properties (note 11)

Investment properties, which are properties held to earn rentals or for capital appreciation, are stated at cost in the Balance Sheet. They are depreciated on a straight-line basis to their estimated residual value over their estimated useful lives of up to 50 years.

Rental income is recognised as revenue on a straight-line basis.

### 1.6.8 Impairments

The carrying amounts of the Group's non-financial assets are reviewed at least annually to determine whether there is any indication of impairment. Where there is an indication of impairment, the asset's recoverable amount is estimated. The recoverable amount is the higher of fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

An impairment loss is recognised where the recoverable amount of an asset is lower than its carrying amount. All impairment losses are recognised in operating costs in the Income Statement.

An impairment loss, other than arising on goodwill, is reversed only after a change in the estimates used to assess the recoverable amount is identified and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. Any reversal is recognised in operating costs in the Income Statement.

### 1.6.9 Leasing (note 25)

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under operating leases are charged to the Income Statement on a straight-line basis over the term of the relevant lease. Benefits receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

### 1.6.10 Inventories (note 12)

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the first-in, first-out method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution. Provision is made where necessary for obsolete, slow moving and defective items.

### 1.6.11 Non-current assets and disposal groups held for sale (note 15)

Non-current assets and disposal groups classified as held for sale are stated at the lower of carrying amount and fair value less costs of disposal. No further depreciation is charged in respect of non-current assets classified as held for sale.

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and expected to be completed within a year of the balance sheet date. The asset or disposal group should be available for immediate sale in its present condition and actively marketed at a price that is reasonable in relation to its current fair value.

### 1.6.12 Fair values

The fair value of an asset or liability is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the balance sheet date. Fair value measurements are used on a recurring basis except where used in the measurement of net assets classified as held for sale and in the valuation of assets and liabilities in a business combination.

The fair values of derivative financial instruments have been determined by the use of valuation techniques, primarily discounted cash flows, based on assumptions that are supported by observable market prices or rates. The fair values of non-financial assets and liabilities, which includes net assets classified as held for sale, are based on observable market prices or rates. For non-financial assets, the fair value takes into account the highest and best use of the asset. These measurements all fall within Level 2 of the IAS 39 fair value hierarchy.

For financial assets and liabilities which are not held at fair value in the Balance Sheet, the carrying values of these items are assumed to approximate to fair value due to their short term nature.

There have been no changes to the valuation techniques used during the year. The Group's policy is to recognise transfers in and transfers out of fair value hierarchy levels as at the date of the event or change in circumstances that caused the transfer, although there have been no such transfers during the current or comparative periods.

### 1.6.13 Financial instruments (note 13)

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 and are initially recognised at fair value at trade date. Subsequent measurement is dependent upon the classification of the instrument which is determined at initial recognition with reference to the purpose for which the instruments were acquired and re-evaluated at each reporting date.

All financial assets and liabilities are classified as current or non-current dependent upon the maturity date of the instruments. Financial assets and liabilities are presented on an offset basis when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis.

#### Financial assets (note 13)

Assets held at fair value through profit or loss are those categorised as held for trading under IAS 39 and are subsequently carried at fair value.

Loans and receivables are non-derivative financial assets with fixed or determinable payments which are not quoted in an active market. These include trade and other receivables, and cash and cash equivalents. Subsequent to initial recognition, assets categorised as loans and receivables are carried at amortised cost using the effective interest method.

Available for sale financial assets are those non-derivative financial assets either designated by management as available for sale or not falling into any other category. Financial assets so categorised include equity instruments which do not have a quoted price in an active market and hence are measured at cost.

None of the Group's material financial assets fall into the held to maturity category of IAS 39, which are non-derivative financial assets with fixed maturity dates that the Group intends to hold to maturity.

#### Financial liabilities (note 13)

Financial liabilities are categorised as held for trading under IAS 39 and are subsequently held at fair value through profit or loss, or other liabilities, which are held at amortised cost using the effective interest method. Derivative financial instruments are categorised as held for trading unless they are designated as hedges.

#### Trade and other receivables (note 14)

Trade and other receivables are stated at their amortised cost, reduced when there is evidence that the Group may not be able to collect the amount due. All trade receivables which are more than six months overdue are provided for by reference to past default experience. The balance may be written off in full, generally where receivables are in excess of 12 months old. Impairments are charged to operating costs in the Income Statement.

#### Cash and cash equivalents

Cash and cash equivalents comprise cash balances and bank deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the Cash Flow Statement.

#### Bank borrowings (note 16)

Interest bearing bank loans and overdrafts are recorded at the amount of proceeds received, net of direct issue costs. Borrowing costs, net of amounts capitalised, are accounted for on an accruals basis and charged to the Income Statement as incurred. Premiums payable on settlement or redemption and direct issue costs are capitalised and amortised over the period of the facility. Borrowing costs that are directly attributable to relevant property, plant and equipment are capitalised as part of the cost of that asset.

#### Trade payables (note 17)

Trade payables do not carry any interest and are stated at their nominal value.

#### Derivative financial instruments and hedge accounting (note 19)

Interest rate swaps and a limited number of specific foreign exchange contracts are designated as cash flow hedges and hedge accounting is applied. The effective portion of changes in fair value is recognised in OCI through the hedge reserve and the gain or loss relating to the ineffective portion is recognised immediately in the Income Statement. Amounts accumulated in OCI are reclassified to finance income or finance costs in the Income Statement in the periods when the hedged item affects profit or loss.

The majority of foreign exchange contracts entered into to mitigate foreign exchange impacts of trading in non-functional currencies and inflation swaps entered into to mitigate inflation risks are not accounted for using hedge accounting.

Foreign currency borrowings are also used to hedge the effects of changes in the Group's net investment in foreign operations. These borrowings either provide a natural economic hedge through the use of intercompany debt or are designated as net investment hedges. Where net investment hedging applies, the borrowings are designated as fair value hedges of the foreign currency risk attributable to the foreign equity investment and the exchange differences arising are recognised in OCI and through profit and loss on disposal of the foreign operation.

The fair value of a hedging derivative is classified as a current asset or liability except when the remaining maturity of the hedged item is more than 12 months.

Where hedge accounting is not applied, the movements in fair value of the derivative instruments are included in the Income Statement within operating costs. The fair value of such derivatives is classified as a current or non-current asset or liability dependent upon the maturity date of the financial instrument.

### 1.6.14 Provisions (note 18)

A provision is required when the Group has a present legal or constructive obligation as a result of a past event and it is probable that settlement will be required and where the amount can be reliably measured. No provision is recognised where the existence of an obligation is possible but will only be confirmed by uncertain future events.

Provisions for warranty costs are recognised at the date of sale of the relevant products, at management's best estimate of the expenditure required to settle the Group's liabilities, based on past experience and industry averages for defective products.

Contract loss provisions are recognised for onerous contracts when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

Provisions for claims made against the Group and commitments made under performance guarantees are recognised at management's best estimate of the expenditure required to settle the Group's liabilities.

Aircraft maintenance provisions are established in respect of significant periodic maintenance costs, where maintenance activity is required on leased operational aircraft or engines on a cycle greater than 12 months. Costs are charged to the Income Statement on the basis of utilisation of the aircraft and are credited to the provision. The provision is then utilised by absorbing the actual costs incurred in carrying out the maintenance activity. Maintenance carried out on a cycle of 12 months or less is charged to the Income Statement as incurred.

Provisions also arise in connection with leased aircraft, where contracts contain specific conditions regarding the configuration of the aircraft on its return to the lessor at the end of the lease. The estimated cost associated with fulfilling these requirements is charged to the Income Statement on an aircraft utilisation basis. The provision is utilised on actual return of the aircraft or on incurring the expenditure required to return the aircraft to the state of maintenance required by the lease before return of the aircraft to the lessor.

Provisions are discounted at an appropriate risk free rate when the impact is material.

### 1.6.15 Retirement benefit schemes (note 20)

For defined benefit schemes, current service costs and costs related to the administration of the schemes are charged to operating profit. Gains and losses on settlements and curtailments arising on a business divestment are included in profit on divestment. Past service costs are recognised in the Income Statement. The interest on net assets or liabilities is shown within finance income and costs. Actuarial remeasurements are recognised in OCI.

Defined benefit schemes are funded, with the assets of the scheme held separately from those of the Group, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting net defined benefit asset or liability is presented separately on the Balance Sheet.

For defined contribution schemes, contributions are charged to the Income Statement as they fall due.

### 1.6.16 Treasury shares (note 22)

When ordinary share capital recognised as equity is acquired by the Company, the shares are held as treasury shares. The consideration paid, including commissions and taxes, is deducted from retained earnings and total equity. The proceeds of any treasury shares subsequently sold or re-issued, net of commission and taxes, are recognised as an increase in retained earnings and total equity.

### 1. 6.17 Share based payments (note 24)

For grants made under the Group's equity settled share based payment schemes, amounts which reflect the fair value of awards at the time of grant are charged to the Income Statement over the relevant vesting periods, taking into account management's best estimate of the number of awards expected to vest. The Group reviews and updates the vesting estimate, which includes progress against non-market related performance conditions, at each balance sheet date.

The valuation methodology for all schemes is based on the Black-Scholes model, modified where required to allow for the impact of market related performance criteria and taking into account all non-vesting conditions.

## 1.7 Current and future accounting developments

No new standards are required to be adopted from 1 January 2017.

In September 2017 the IFRS Interpretations Committee issued an agenda decision on interest and penalties related to income taxes. This decision clarified that entities do not have a policy choice between applying IAS 12, 'Income taxes' and applying IAS 37, 'Provisions, contingent liabilities and contingent assets' to interest and penalties related to income taxes. As a consequence the Group has reassessed its treatment of interest and penalties related to its global uncertain tax positions as presented in the 2016 Annual Report and Accounts. Details of the restatement arising from this change can be found in note 6.

The following amendments have been adopted with effect from 1 January 2017:

- Amendments to IAS 7, Disclosure Initiative. These amendments require disclosure of changes in liabilities arising from financing activities. As a result, the reconciliation of movements in net debt in note 16 has been enhanced;
- Amendments to IAS 12, Recognition of Deferred Tax Assets for Unrealised Losses. These amendments clarify how an entity should evaluate whether there will be sufficient taxable profits against which it can utilise a deductible temporary difference. The Group already assesses the sufficiency of future taxable profits in a manner consistent with these amendments and hence the adoption of this amendment has had no impact; and
- Annual Improvements 2014-2016 cycle have been adopted with effect from 1 January 2017. No changes to previously published accounting policies or other adjustments were required on the adoption of these amendments.

A number of new standards and amendments have been published that are mandatory for future accounting periods:

### IFRS 9, Financial Instruments

IFRS 9 is effective from 1 January 2018. In summary, it has an impact on three areas:

- Classification and measurement – the rules based approach of IAS 39 is replaced by a principles based approach which refers to the asset's cash flow characteristics and the business model in which it is held;
- Impairment of financial assets – this moves to a more forward looking expected loss model; and
- Hedge accounting – the changes align the accounting treatment with the Company's risk management activities.

As a result of the adoption of this standard, the measurement basis for most of the Group's financial assets will be unchanged, although the classification and corresponding disclosures of financial assets in the 2018 Annual Report and Accounts will be impacted. The changes to impairment and hedge accounting will not have a material impact on the results of the Group. The valuation of the Parent Company's minority shareholdings in two Air Tanker companies (as detailed in note 13) will, however, be impacted.

Cobham holds 13.3% of the equity of AirTanker Holdings Limited and 5% of AirTanker Services Limited. These shareholdings, together with the governance structure of the entities, are not considered to provide significant influence and hence the investments are currently accounted for as trade investments, categorised as available for sale. They are held at a cost of £6.1m in accordance with IAS 39, Financial Instruments. Under IFRS 9, these investments must be held at fair value, using a present value methodology.

The provisional impact on the Balance Sheet as at 1 January 2018 is to increase investments by £39m, with a potential increase in deferred tax liabilities of £7m, and a corresponding increase to reserves.

### IFRS 15, Revenue from Contracts with Customers and clarifications

The Group will adopt IFRS 15, Revenue from Contracts with Customers, from 1 January 2018. IFRS 15 introduces a five step model to be applied to all contracts with customers when determining accounting for revenue. In addition a number of new disclosures will be required. Upon adoption of IFRS 15 in 2018 comparatives will be restated using the fully retrospective approach.

Contracts related to the sale of short-cycle catalogue items, mostly seen in the Communications and Connectivity Sector will not be significantly impacted by IFRS 15 and revenue will typically continue to be recognised at a point in time based on when control of the product passes to the customer.

Most of the revenue in Aviation Services is generated from providing services to customers. Revenue is recognised over time as the services are enjoyed. This is consistent with IFRS 15 and there will not be a significant impact on this Sector on the adoption of the new standard.

Within the Mission Systems Sector there are currently a number of long-term development programmes. For these contracts revenue is recognised based upon the fair value of work performed to date assessed with reference to completed contract milestones. Under IFRS 15, revenue for these contracts will be recognised over time on a percentage of completion basis whereby a portion of the contract revenue is recognised based on contract costs incurred to date compared with total estimated costs at completion.

Mission Systems also generate revenue through the sale of products. Some of these products are customer specific and therefore may have no alternate use. For these contracts there is usually a right to payment and therefore revenue will be recognised over time. Progress in completing performance obligations will typically be measured based on cost incurred as a percentage of total expected cost.

The Group has a number of contracts with government bodies, in particular within the Advanced Electronic Solutions Sector, by which control is transferred to the customer as the product is being manufactured or as the services are being provided. For these contracts revenue will be recognised over time, typically using cost as the basis of measuring progress. For 'cost-plus' contracts (typically with government departments and agencies), revenue will continue to be recognised to the extent of reimbursable costs incurred, plus a proportionate amount of the estimated fee earned.

IFRS 15 will change revenue recognition methodologies for longer term contracts in the Advanced Electronic Solutions Sector and for products where there is no alternate use and an enforceable right to payment. Currently revenue for some of these contracts is recognised on a contractual milestone basis, or at a point in time on shipment or delivery to the customer.

A detailed review of contracts impacted by IFRS 15 has been undertaken and the provisional impact on the Balance Sheet as at 31 December 2016 is a decrease to working capital of £17m, a decrease in provisions of £21m, and a decrease in other Balance Sheet items of £4m resulting in no net impact on reserves.

The impact on 2017 revenue is an increase of approximately £41m, with an increase in operating profit of approximately £3m.

### IFRS 16, Leases

IFRS 16, effective from 1 January 2019, requires all leases to be recognised on the Balance Sheet. Broadly the Group will recognise leases currently treated as operating leases, disclosed in note 25, as a lease liability and a right-to-use asset, after adjusting for extension periods that are reasonably certain to be taken and discounting using the rate implicit in the lease or the incremental cost of borrowing.

The total operating lease cost, currently expensed to the Income Statement as incurred will be split into a financing element and an operating element. The financing element will create a front loaded expense in finance costs. Additional disclosures will be required to support the new accounting requirements.

Management are currently assessing the impact of adopting this standard, and are also considering which transitional method will be most appropriate for the Group.

### Other changes

There are also a number of amendments to existing standards including Annual Improvements and interpretations which, once endorsed by the EU, will be effective from 1 January 2018 or later years.

None of these are expected to have an impact on the Group's financial reporting.

## 2. Underlying measures, EPS and specific adjusting items

### Use of underlying measures

To assist with the understanding of earnings trends, the Group has included within its published financial statements non-GAAP alternative performance measures including underlying operating profit and underlying profit.

The non-GAAP measures used are not defined terms under IFRS and therefore may not be comparable to similar measures used by other companies. They are not intended to be a substitute for, or superior to, GAAP measures.

Management uses underlying measures to assess the operating performance of the Group, having adjusted for specific items as defined below. They form the basis of internal management accounts and are used for decision making including capital allocation and a subset also forms the basis of internal incentive arrangements. By using underlying measures in our segmental reporting, this further ensures readers of the financial statements can recognise how incentive performance is targeted. Underlying measures are also presented in this report because the Directors believe they provide additional useful information to shareholders on comparative trends over time. Finally, this presentation allows for separate disclosure and specific narrative to be included concerning the adjusting items; this helps to ensure performance in any one year can be more clearly understood by users of the financial statements.

### Definitions of underlying measures

All underlying measures include the operational results of all businesses including those held for sale until the point of sale. These definitions are applied consistently on a year to year basis.

#### Underlying operating profit

Underlying operating profit is defined as operating profit from continuing operations excluding the impacts of business acquisition and divestment related activity and prior periods' business restructuring costs as detailed below. Also excluded are changes in the marking to market of non-hedge accounted derivative financial instruments, gains and losses arising on dividend related foreign exchange contracts and other items deemed by the Directors to be of a non-operating nature including the impairment of intangible assets.

#### Underlying profit

Underlying profit before taxation is defined as underlying operating profit less net underlying finance costs, which exclude business acquisition and divestment related items and specific finance costs.

### Income Statement including underlying results

| | | | 2017 | | | 2016 | |
|---|---|---|---|---|---|---|---|
| £m | Note | Underlying | Specific adjusting items | Total | Underlying | Specific adjusting items | Total |
| Revenue | 3 | 2,052.5 | – | 2,052.5 | 1,943.9 | – | 1,943.9 |
| Cost of sales | | (1,457.9) | – | (1,457.9) | (1,358.6) | (208.7) | (1,567.3) |
| **Gross profit** | | 594.6 | – | 594.6 | 585.3 | (208.7) | 376.6 |
| Operating costs | | (384.3) | (106.2) | (490.5) | (360.3) | (795.4) | (1,155.7) |
| **Operating profit/(loss)** | | 210.3 | (106.2) | 104.1 | 225.0 | (1,004.1) | (779.1) |
| Finance income | 5 | 6.1 | – | 6.1 | 4.1 | – | 4.1 |
| Finance costs | 5 | (43.3) | – | (43.3) | (53.9) | (19.0) | (72.9) |
| **Profit/(loss) before taxation** | | 173.1 | (106.2) | 66.9 | 175.2 | (1,023.1) | (847.9) |
| Taxation | 6 | (39.8) | 51.7 | 11.9 | (39.6) | 92.4 | 52.8 |
| **Profit/(loss) after taxation for the year** | | 133.3 | (54.5) | 78.8 | 135.6 | (930.7) | (795.1) |

### Earnings per ordinary share

| | | 2017 | | | | 2016 (restated) |
|---|---|---|---|---|---|---|
| £m | Underlying | Specific adjusting items | Total | Underlying | Specific adjusting items | Total |
| Profit/(loss) after taxation for the year | 133.3 | (54.5) | 78.8 | 135.6 | (930.7) | (795.1) |
| Less amount attributable to non-controlling interests | 0.2 | – | 0.2 | 0.1 | – | 0.1 |
| Earnings attributable to owners of the parent | 133.1 | (54.5) | 78.6 | 135.5 | (930.7) | (795.2) |
| | | | | | | |
| Weighted average number of shares (million) | 2,231.8 | | 2,231.8 | 1,732.2 | | 1,732.2 |
| **Basic EPS** | 6.0p | | 3.5p | 7.8p | | (45.9)p |
| | | | | | | |
| Weighted average number of shares (million) | 2,231.8 | | 2,231.8 | 1,732.2 | | 1,732.2 |
| Effect of dilutive securities (million) | 3.5 | | 3.5 | 2.0 | | – |
| Diluted weighted average number of shares (million) | 2,235.3 | | 2,235.3 | 1,734.2 | | 1,732.2 |
| **Diluted EPS** | 6.0p | | 3.5p | 7.8p | | (45.9)p |

Potentially dilutive securities are unvested awards under the Group's share based payment schemes described in note 24. When losses are made, EPS is not impacted by any potential dilution.

Basic and diluted EPS figures for the comparative period have been restated and adjusted by the bonus factor of 1.15 to reflect the bonus element of the May 2017 Rights Issue, in accordance with IAS 33, Earnings per Share. Amounts as originally stated were (52.8)p basic and diluted EPS, and 9.0p basic and diluted underlying EPS.

## Details of specific adjusting items

The specific adjusting items excluded from underlying profit can be analysed as follows:

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| **Cost of sales** | | | |
| Revisions of the carrying values of other assets | | – | 24.1 |
| Estimates of fixed price contract profitability | | – | 179.1 |
| Assessment of legal and other provisions | | – | 5.5 |
| | | – | 208.7 |
| **Operating costs** | | | |
| Amounts related to prior periods restructuring programmes | | **4.7** | (8.7) |
| Derivative financial instruments | 19 | **(28.9)** | 39.3 |
| Business acquisition and divestment related items | | | |
| Amortisation of intangible assets arising on business combinations | 9 | **138.9** | 161.2 |
| (Profit)/loss on divestments | | **(1.1)** | 1.3 |
| Other M&A related costs | | **0.3** | 0.4 |
| Impairment of goodwill and other intangible assets | 9 | **33.5** | 573.8 |
| Reversal of impairment of intangible assets | 9 | **(31.8)** | – |
| Other items provided at 31 December 2016 | | | |
| Adjustments to revisions of the carrying values of other assets | | **(1.4)** | 9.2 |
| Adjustments to the assessment of legal and other provisions | | **(8.0)** | 18.9 |
| | | **106.2** | 795.4 |
| **Finance costs** | | | |
| Non-underlying finance costs – make whole payments | 5 | – | 19.0 |
| **Taxation** | | | |
| Tax on specific adjusting items | 6 | **(51.7)** | (92.4) |

## Explanation of specific adjusting items

### Business acquisition and divestment related items

The Group has been acquisitive over time and also divests businesses in accordance with its strategy. Accounting adjustments that arise as a result of business combinations and divestments are not considered to result from the underlying business activity and have therefore been excluded from underlying results.

These adjustments include the amortisation of intangible assets arising on business combinations, gains or losses arising on business divestments, adjustments to businesses held for sale, the writing off of the pre-acquisition profit element of inventory written up on acquisition, revaluation gains and losses arising on the original equity interests on stepped acquisitions, other direct costs associated with business combinations and terminated divestments, and adjustments to contingent consideration related to previously acquired businesses.

Amortisation of intangible assets arising as a result of the purchase price allocation on business combinations, such as customer lists, technology based assets and order book and trade names, is not included in underlying measures. Amortisation of internally generated intangible assets such as software and development costs is included within underlying measures.

Likewise impairments of goodwill and other intangible assets arising on business combinations, together with any reversal of impairment of intangible assets, are treated as specific adjusting items as these assets arose from business acquisitions in prior periods.

Other M&A related costs reflect the finalisation of costs related to acquisitions and divestments in prior years.

### Amounts related to prior periods restructuring programmes

Amounts related to prior periods restructuring programmes were deemed as incremental to normal operations. These costs relate to the integration of the Aeroflex businesses acquired in 2014, specifically in respect of the IT integration and remediation costs resulting from this acquisition. Where restructuring costs are incurred as a result of the ongoing business activity, such costs are included within operating costs and are not excluded from underlying results.

### Derivative financial instruments

The impact of derivative financial instruments excluded from underlying results includes changes in the marking to market of non-hedge accounted derivative financial instruments. These amounts relate to foreign currency exchange contracts and would not impact operating results had the Group chosen to comply with IAS 39 requirements to enable these contracts to be hedge accounted. Also included are gains and losses arising on dividend related foreign exchange contracts. As dividend cash flows do not impact operating results, the movement in the fair value of foreign exchange contracts being used to manage the currency risks arising are excluded from underlying results.

### Other items

In 2016 additional items which were excluded from underlying results due to their unusual size and incidence arose out of the January 2017 Balance Sheet review. The impact of these items was much larger than would normally be expected in any individual accounting period and they reflected commercial events that were not expected to repeat. They included revisions to the carrying value of assets, changes in estimates of fixed price contract profitability and the assessment of legal and other provisions.

Adjustments to revisions of the carrying value of other assets provided at 31 December 2016 relate to a provision against aged receivables which was considered doubtful at 31 December 2016 but which has been recovered during the first half of the year ended 31 December 2017. The release of this provision has been treated as an adjusting item consistent with the treatment of the original provision.

Adjustments to the assessment of legal and other provisions relate to provisions made at 31 December 2016 which have been reassessed during 2017. These provision releases have been treated as an adjusting item consistent with the treatment of the original provisions.

## 3. Revenue and segmental information

### Revenue

Revenue comprises income from the sale of goods and services during the year and can be analysed as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Revenue from sale of goods | **1,508.8** | 1,445.0 |
| Revenue from services | **543.7** | 498.9 |
| | **2,052.5** | 1,943.9 |

Revenue from services includes service contracts in the Aviation Services Sector together with logistics support, maintenance and repairs in other Sectors.

### Operating segments

| | Revenue | | Underlying operating profit | | Segment net assets | |
|---|---|---|---|---|---|---|
| £m | 2017 | 2016 | 2017 | 2016 (restated) | 2017 | 2016 (restated) |
| Communications and Connectivity | **700.7** | 690.2 | **69.0** | 58.2 | **523.0** | 573.7 |
| Mission Systems | **419.0** | 386.4 | **55.2** | 60.0 | **206.2** | 196.3 |
| Advanced Electronic Solutions | **568.4** | 511.6 | **63.3** | 66.2 | **583.4** | 686.1 |
| Aviation Services | **366.6** | 357.2 | **22.8** | 40.6 | **222.2** | 276.3 |
| Head office, other activities and elimination of inter-segment items | **(2.2)** | (1.5) | **–** | – | **13.8** | 37.5 |
| **Total Group** | **2,052.5** | 1,943.9 | **210.3** | 225.0 | **1,548.6** | 1,769.9 |
| Interests in joint ventures and associates | | | | | **3.6** | 3.6 |
| Unallocated liabilities | | | | | **(523.9)** | (1,283.6) |
| **Total net assets** | | | | | **1,028.3** | 489.9 |

The segmental analysis of underlying operating profit for 2016 as shown above has been restated with the effect of eliminating the net underlying operating profit previously reported as head office and other activities. The Directors consider that the revised allocation, whereby all costs of the corporate head office and Group functions are allocated across the operating segments, more fairly represents the underlying performance of the Group and its Sectors. Details of the restatement of the 2016 segment net assets can be found in note 6.

Underlying operating profit is reconciled to the profit/(loss) before taxation as follows:

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| Underlying operating profit | | **210.3** | 225.0 |
| Specific adjusting items included within | | | |
| Cost of sales | 2 | **–** | (208.7) |
| Operating costs | 2 | **(106.2)** | (795.4) |
| Net finance costs | 5 | **(37.2)** | (68.8) |
| **Profit/(loss) before taxation** | | **66.9** | (847.9) |

Depreciation of property, plant and equipment, investment properties and amortisation of internally generated intangibles included in the calculation of underlying operating profit can be analysed by segment as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Communications and Connectivity | 15.2 | 16.8 |
| Mission Systems | 6.8 | 5.9 |
| Advanced Electronic Solutions | 16.0 | 15.4 |
| Aviation Services | 37.6 | 33.5 |
| Head office and other activities | 9.4 | 8.9 |
| **Total Group** | 85.0 | 80.5 |

Details of employees analysed by operating segment can be found in note 4.

### Geographical information

Revenue from external customers analysed by their geographic location, irrespective of the origin of the goods and services, is shown below; non-current assets are analysed by the physical location of the assets and exclude financial instruments and deferred tax assets.

| | Revenue | | Non-current assets | |
|---|---|---|---|---|
| £m | 2017 | 2016 | 2017 | 2016 |
| USA | 1,028.8 | 941.9 | 647.3 | 862.0 |
| UK | 188.3 | 185.2 | 172.1 | 269.6 |
| Other EU | 337.5 | 312.1 | 294.8 | 289.6 |
| Australia | 229.5 | 213.9 | 146.2 | 151.4 |
| Rest of the world | 268.4 | 290.8 | 20.3 | 23.4 |
| | 2,052.5 | 1,943.9 | 1,280.7 | 1,596.0 |

The largest component of revenue from customers located in the rest of the world is £193.9m (2016: £195.1m) from customers in Asia including the Middle East. The balance of this geographic location includes South America, Africa, and non EU European countries. Revenue from customers in individual countries within the EU (except the UK) and the rest of the world is not considered to be individually material.

## 4. Other income statement disclosures

Costs include the following:

| £m | 2017 | 2016 |
|---|---|---|
| Materials costs within cost of sales | 645.4 | 615.1 |
| Restructuring costs included within underlying profit | 7.5 | 6.3 |
| Amounts related to prior periods restructuring programmes excluded from underlying profit (note 2) | 4.7 | (8.7) |
| Company funded research and development | 121.9 | 123.9 |

### Employment costs and employee numbers

The aggregate employment costs are as follows:

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| Wages and salaries | | 644.9 | 614.2 |
| Social security costs | | 51.6 | 44.9 |
| Pension costs | 20 | 38.1 | 35.1 |
| Share based payments | 24 | 5.5 | 3.8 |
| | | 740.1 | 698.0 |

Employee numbers, analysed by segment, are as follows:

| | Average number of employees | | As at 31 December | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Communications and Connectivity | 3,300 | 3,561 | 3,197 | 3,429 |
| Mission Systems | 1,682 | 1,588 | 1,774 | 1,618 |
| Advanced Electronic Solutions | 3,202 | 3,103 | 3,393 | 3,068 |
| Aviation Services | 2,181 | 2,316 | 2,072 | 2,240 |
| Head office and other activities | 371 | 330 | 377 | 337 |
| **Total Group** | 10,736 | 10,898 | 10,813 | 10,692 |

### Compensation of key management personnel

The remuneration of the Group Executive Committee (as referred to on page 51) during the year was as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Salaries and short term employee benefits | 7.9 | 6.3 |
| Post-employment benefits | 0.3 | 0.1 |
| Termination benefits | 1.8 | 1.5 |
| Share based payments | 1.1 | 0.5 |
| | 11.1 | 8.4 |

### Audit fees

During the year the Group obtained the following services from the Company's auditors, PricewaterhouseCoopers LLP and its associates:

| £m | 2017 | 2016 |
|---|---|---|
| Annual audit of the Parent Company and Group Financial Statements | 1.0 | 1.4 |
| Audit of the Company's subsidiaries | 1.1 | 1.1 |
| **Fees payable for audit services** | 2.1 | 2.5 |
| | | |
| Tax compliance services | – | 0.3 |
| Other tax advisory services | – | 0.2 |
| Other assurance services | 0.2 | 0.3 |
| **Fees payable for other services** | 0.2 | 0.8 |
| | | |
| **Total fees payable to the auditors** | 2.3 | 3.3 |

## 5. Finance income and costs

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| Bank interest | | 3.9 | 0.9 |
| Other finance income | | 2.2 | 3.2 |
| **Total finance income** | | 6.1 | 4.1 |
| | | | |
| Interest on bank overdrafts and loans | | (38.3) | (51.9) |
| Interest on net pension scheme liabilities | 20 | (2.3) | (1.8) |
| Other finance expense | | (2.7) | (19.2) |
| **Total finance costs** | | (43.3) | (72.9) |
| | | | |
| **Net finance costs** | | (37.2) | (68.8) |

Other finance expense for 2016 includes £19.0m of make-whole fees payable in connection with the early repayment of fixed term borrowings following the June 2016 Rights Issue. These costs are excluded from underlying earnings.

## 6. Taxation

### Tax included in Income Statement

| £m | 2017 | 2016 |
|---|---|---|
| Charge for the year | 22.0 | 45.1 |
| Adjustments to tax charge in respect of prior years | – | 4.5 |
| **Current tax** | 22.0 | 49.6 |
| | | |
| Credit for the year | (39.9) | (107.6) |
| Impact of change in tax rates | 2.7 | 5.0 |
| Adjustments to tax charge in respect of prior years | 3.3 | 0.2 |
| **Deferred tax** | (33.9) | (102.4) |
| | | |
| **Total tax credit for the year** | (11.9) | (52.8) |

Income tax is calculated on the estimated assessable profit for the year at the rates prevailing in the relevant tax jurisdiction. The total tax credit for the year includes a credit of £8.6m (2016: credit £44.3m) for the UK.

The total tax credit for the year can be reconciled to the accounting result as follows:

| £m | 2017 Underlying | 2017 Specific adjusting items | 2017 Total | 2016 Underlying | 2016 Specific adjusting items | 2016 Total |
|---|---|---|---|---|---|---|
| Profit/(loss) before tax | **173.1** | **(106.2)** | **66.9** | 175.2 | (1,023.1) | (847.9) |
| Tax thereon at the UK income tax rate of 19.25% (2016: 20%) | **33.3** | **(20.4)** | **12.9** | 35.0 | (204.6) | (169.6) |
| Goodwill impact | – | **2.7** | **2.7** | – | 106.1 | 106.1 |
| Effect of differences in overseas tax rates | **8.2** | **(15.1)** | **(6.9)** | 4.0 | (12.2) | (8.2) |
| Impact of tax treatment of divestments | – | **(11.9)** | **(11.9)** | – | 5.6 | 5.6 |
| Impact of change in tax rates | **2.7** | – | **2.7** | 5.0 | – | 5.0 |
| Expenditure qualifying for additional R&D tax relief | **(1.9)** | – | **(1.9)** | (1.3) | – | (1.3) |
| Adjustments to tax charge in respect of prior years | **3.3** | – | **3.3** | 4.7 | – | 4.7 |
| Impact of other items | **(5.8)** | **(7.0)** | **(12.8)** | (7.8) | 12.7 | 4.9 |
| **Total tax credit for the year** | **39.8** | **(51.7)** | **(11.9)** | 39.6 | (92.4) | (52.8) |
| Effective tax rate | **23.0%** | | **(17.8%)** | 22.6% | | 6.2% |

Details of specific adjusting items can be found in note 2.

Impact of other items primarily relates to non-taxable interest and movements in tax risk provisions. Adjustments to tax charge in respect of prior years arise from differences in the filed tax returns compared to the estimates made in December 2016.

## Tax included in OCI

| £m | 2017 | 2016 |
|---|---|---|
| **Items that will not be reclassified subsequently to profit or loss** | | |
| Actuarial gain/(loss) on retirement benefit obligations | **1.4** | (8.5) |
| Actuarial loss on other retirement benefit obligations | – | (0.4) |
| | **1.4** | (8.9) |
| **Items that may subsequently be reclassified to profit or loss** | | |
| Hedge accounted derivative financial instruments | **0.1** | (0.4) |

## Tax included in equity

| £m | 2017 | 2016 |
|---|---|---|
| Share based payments | – | 1.2 |

The UK corporation tax rate reduced from 20% to 19% on 1 April 2017. It will reduce further to 17% from 1 April 2020. UK deferred taxes have been calculated at 19%, or 17% where the liability is expected to crystallise after 1 April 2020.

The US corporation tax rate reduced from 35% to 21% on 1 January 2018, and US deferred taxes as at 31 December 2017 have been calculated at 21%. The reduction in tax rate did not result in a material change due to deferred tax assets arising from timing differences being offset by deferred tax liabilities on acquired intangible assets.

The Group is reviewing the implications of the US tax reform, including the Base Erosion and Anti-abuse Tax (BEAT) provisions, and resolving certain tax issues arising from prior years. Given this, and the expected geographical mix of profit, the underlying tax rate is anticipated to remain at approximately the current level, subject to any future changes in tax legislation.

## Current tax assets and liabilities

| £m | 2017 | 2016 (restated) |
|---|---|---|
| Current tax receivables | **7.2** | 3.1 |
| Current tax liabilities | **(135.8)** | (141.6) |
| | **(128.6)** | (138.5) |

In September 2017 the IFRS Interpretations Committee issued an agenda decision on interest and penalties related to income taxes. This decision clarified that entities do not have a policy choice between applying IAS 12 'Income taxes' and applying IAS 37 'Provisions, contingent liabilities' and contingent assets to interest and penalties related to income taxes. As a consequence the Group has reassessed its treatment of interest and penalties related to its global uncertain tax positions as presented in the 2016 Annual Report and Accounts. This resulted in other liabilities within trade and other payables increasing by £9.5m, current tax liabilities decreasing by £7.9m, and deferred tax assets increasing by £1.6m and 2016 balances have been restated accordingly.

### Current tax risks (key estimation uncertainty)

The Group is subject to corporate and other tax rules in the jurisdictions where it conducts its business operations. Changes in tax rates, tax reliefs and tax laws, changes in practice or interpretation of the law by the relevant tax authorities, increasing challenges by relevant tax authorities on transfer pricing and other matters, or any failure to manage tax risks adequately could result in increased charges, financial loss, penalties and reputational damage, which may materially adversely affect the Group's financial condition and results of operations.

In addition, tax enforcement has become a higher priority for many tax authorities in jurisdictions in which the Group operates, which has led to an increase in tax audits, enquiries and challenges, or the testing through litigation of the boundaries of the correct interpretation of legislation. Tax authorities may also actively pursue additional taxes based on retroactive changes to tax laws and the Group may have disagreements with tax authorities which could result in a material restatement to the tax position. For example, the availability of certain interest deductions on one of the Group's internal financing arrangements, principally as a result of various US acquisitions, has been under challenge for some time. Over the life of this internal financing arrangement, the aggregate tax value of the interest deductions amounted to approximately £130m. If decided adversely to the Group, this could lead to increased tax liabilities in excess of those provided in the Group's Balance Sheet, and result in a substantial tax payment becoming due. That payment may also be subject to an interest charge from the relevant authority. The Group has taken external advice and considers that it has strong support for its position. However, the timing and resolution of this issue is uncertain.

The European Commission (EC) has opened an investigation into the UK's controlled foreign company (CFC) rules. The CFC rules levy a charge on foreign entities controlled by the UK that are subject to a lower rate of tax, however there is currently an exemption available for 75% of this charge if the activities being undertaken by the CFC relate to financing. The EC are investigating whether this exemption is in breach of EU State Aid rules, but it is too early to assess what the conclusions of this investigation might be.

On 22 December 2017 extensive changes to the US tax system were made. A number of risks to the Group arise as a result, including Anti-base erosion, the way that interest deductions are made, foreign tax credits and tax of foreign earnings. These risks are currently being assessed as further clarity is provided by the US tax authorities.

In respect of the above risks and other uncertain tax positions in the UK, US and other tax jurisdictions, amounts totalling £126.4m (2016: £138.7m) have been accrued. Final resolutions will affect the amounts settled and the timing of any settlements. Whilst resolution remains uncertain, these amounts are included in current liabilities.

### Deferred tax assets and liabilities

| £m | 2017 | 2016 (restated) |
|---|---|---|
| Deferred tax assets | | |
| Recoverable within one year | **(53.5)** | (26.5) |
| Recoverable after one year | **(4.0)** | (17.4) |
| | **(57.5)** | (43.9) |
| Deferred tax liabilities | | |
| Falling due within one year | **0.5** | 0.5 |
| Falling due after one year | **1.6** | 27.1 |
| | **2.1** | 27.6 |
| | **(55.4)** | (16.3) |

The following are the major deferred tax assets and liabilities recognised by the Group and the movements thereon:

| £m | Intangible assets | Property, plant and equipment | Retirement benefit obligations | Tax losses | Other | Total |
|---|---|---|---|---|---|---|
| At 1 January 2016 (restated) | 175.1 | 5.0 | (11.3) | – | (79.8) | 89.0 |
| (Credit)/charge to Income Statement | (37.7) | 16.5 | 2.4 | (28.9) | (54.7) | (102.4) |
| Credit to OCI | – | – | (8.5) | – | (0.8) | (9.3) |
| Charge to reserves | – | – | – | – | 1.6 | 1.6 |
| Business divestments | (0.2) | (2.4) | – | – | – | (2.6) |
| Foreign exchange adjustments | 26.8 | 5.5 | – | – | (24.9) | 7.4 |
| At 31 December 2016 (restated) | **164.0** | **24.6** | **(17.4)** | **(28.9)** | **(158.6)** | **(16.3)** |
| (Credit)/charge to Income Statement | **(71.5)** | **(5.1)** | **2.6** | **(18.1)** | **58.2** | **(33.9)** |
| Charge to OCI | – | – | **1.4** | – | **0.1** | **1.5** |
| Charge to reserves | – | – | – | – | **0.1** | **0.1** |
| Reclassified as held for sale | **(10.7)** | **0.8** | – | – | **3.1** | **(6.8)** |
| Foreign exchange adjustments | **(9.5)** | **(1.0)** | **0.3** | **0.6** | **9.6** | – |
| **At 31 December 2017** | **72.3** | **19.3** | **(13.1)** | **(46.4)** | **(87.5)** | **(55.4)** |

Other deferred tax assets and liabilities shown above include balances arising from temporary differences in relation to provisions, accruals, deferred compensation, share based payments and derivative financial instruments.

### Tax losses (key estimation uncertainty)

Tax losses of £29.6m (2016: £28.9m) arising in the UK during the year have been recognised on the basis of UK forecasted future taxable profits, using projections prepared by management and reviewed by the Board. The recognition of these tax losses is sensitive to movement in these forecasted profits. A 33% reduction in the estimated profits would not impact the recognition of these tax losses. In addition capital losses in the US are expected to be used on completion of the divestment of the AvComm business and therefore £10.9m has been recognised as a deferred tax asset.

At the balance sheet date, the Group has further unused capital losses of £85.9m (2016: £144.4m) potentially available for offset against future capital profits in certain circumstances. No deferred tax asset has been recognised in respect of this amount because of the unpredictability of future qualifying profit streams. These losses can be carried forward indefinitely.

### Unremitted earnings

The unprovided tax on unremitted earnings as at 31 December 2017 is considered to be immaterial.

## 7. Dividends

No dividends have been paid or approved by Cobham plc during the year ended 31 December 2017. The following dividends were paid in the prior year:

| £m | 2016 |
|---|---|
| Final dividend of 7.07p per share for 2015 (restated) | 91.6 |
| Interim dividend of 1.77p per share for 2016 (restated) | 34.5 |
| | 126.1 |

Further details of Cobham plc's dividend policy can be found on page 31. Dividend per share figures above have been restated to reflect the bonus element of the May 2017 Rights Issue.

A dividend of £0.1m (2016: £nil) was paid to the holders of non-controlling interests in TEAM SA, a subsidiary of Cobham plc.

## 8. Cash flow from operations

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| **Operating profit/(loss)** | | **104.1** | (779.1) |
| Non-cash items | | | |
| Share of post-tax results of joint ventures and associates | | **0.2** | (0.2) |
| Depreciation and amortisation | | **223.9** | 248.1 |
| Impairment of goodwill and intangible assets | 9 | **33.5** | 573.8 |
| Reversal of impairment provision | | **(31.8)** | – |
| (Profit)/loss on sale of property, plant and equipment | | **(0.2)** | 4.4 |
| Business acquisition and divestment related items | | **(0.8)** | 1.7 |
| Derivative financial instruments | 19 | **(28.9)** | 39.3 |
| Adjustments to revisions of the carrying values of other assets | 2 | **(1.4)** | – |
| Adjustments to the assessment of legal and other provisions | 2 | **(8.0)** | – |
| Pension contributions in excess of pension charges | | **(17.3)** | (16.7) |
| Share based payments | 24 | **5.5** | 3.8 |
| Operating cash movements | | | |
| (Increase)/decrease in inventories | | **(26.7)** | 50.8 |
| Decrease in trade and other receivables | | **24.1** | 21.9 |
| Increase/(decrease) in trade and other payables | | **71.1** | (9.7) |
| (Decrease)/increase in provisions | | **(65.0)** | 87.9 |
| **Cash generated from operations** | | **282.3** | 226.0 |
| Tax paid | | **(32.2)** | (20.1) |
| Interest paid | | **(41.6)** | (74.7) |
| Interest received | | **6.7** | 3.5 |
| **Net cash from operating activities** | | **215.2** | 134.7 |

## Use of alternative cash flow performance measures

Free cash flow and operating cash flow are considered to provide a consistent measure of the operating cash flow of the Group's business. These alternative performance measures are used in internal management accounts and for decision making including capital allocation. In addition to underlying profit measures, underlying cash conversion is also used for internal incentive arrangements, and presenting this information allows users of the financial statements to better understand the way in which performance is targeted.

## Definitions of operating cash flow measures

### Free cash flow

Free cash flow is defined as net cash from operating activities plus dividends received from joint ventures, less cash flows related to the purchase or disposal of property, plant, equipment and intangible assets but excluding payments relating to business acquisition and divestment related activities.

### Operating cash flow

Operating cash flow is free cash flow before payment of tax, interest and restructuring costs.

## Reconciliation of operating cash flow measures

The Cash Flow Statement subtotal of net cash from operating activities is reconciled to alternative measures of cash flow, free cash flow and operating cash flow as follows:

| £m | 2017 | 2016 |
|---|---|---|
| **Net cash from operating activities per Cash Flow Statement** | **215.2** | 134.7 |
| Purchase of property, plant and equipment | **(69.0)** | (82.8) |
| Purchase of intangible assets | **(10.8)** | (9.1) |
| Capitalised expenditure on intangible assets | – | (0.3) |
| Proceeds on disposal of property, plant and equipment | **5.1** | 6.1 |
| Business acquisition and divestment related costs paid | **0.1** | 2.1 |
| **Free cash flow** | **140.6** | 50.7 |
| Amounts related to prior periods restructuring programmes | **9.9** | 39.8 |
| Tax paid | **32.2** | 20.1 |
| Underlying net finance costs paid | **34.9** | 71.2 |
| **Operating cash flow** | **217.6** | 181.8 |

The underlying cash conversion ratio is operating cash flow divided by underlying operating profit, excluding the share of results of joint ventures and associates:

| £m | 2017 | 2016 |
|---|---|---|
| Underlying operating profit excluding the share of post-tax results of joint ventures | **210.5** | 224.8 |
| Operating cash flow | **217.6** | 181.8 |
| **Underlying cash conversion** | **103%** | 81% |

## 9. Intangible assets

| £m | Goodwill | Arising on business combinations: Customer relationships | Technology based assets | Order book and trade names | Software and other | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At 1 January 2016 | 1,200.6 | 545.2 | 278.5 | 48.2 | 79.8 | 2,152.3 |
| Additions | – | – | – | – | 8.2 | 8.2 |
| Additions – internally generated | – | – | – | – | 0.3 | 0.3 |
| Business divestments | (32.3) | (1.0) | (19.1) | – | (0.5) | (52.9) |
| Derecognitions and disposals | – | – | (13.1) | (43.9) | (1.0) | (58.0) |
| Foreign exchange adjustments | 150.1 | 79.7 | 32.8 | 0.8 | 8.1 | 271.5 |
| Reclassifications | – | – | – | – | 5.0 | 5.0 |
| At 31 December 2016 | **1,318.4** | **623.9** | **279.1** | **5.1** | **99.9** | **2,326.4** |
| Additions | – | – | – | – | **10.6** | **10.6** |
| Reclassified as held for sale | **(186.0)** | **(93.5)** | **(94.9)** | – | **(1.3)** | **(375.7)** |
| Derecognitions and disposals | – | **(20.3)** | **(24.6)** | **(0.3)** | **(1.7)** | **(46.9)** |
| Foreign exchange adjustments | **(57.5)** | **(31.7)** | **(15.5)** | **(0.4)** | **(3.7)** | **(108.8)** |
| Reclassifications | – | – | – | – | **0.8** | **0.8** |
| **At 31 December 2017** | **1,074.9** | **478.4** | **144.1** | **4.4** | **104.6** | **1,806.4** |
| **Accumulated amortisation and impairment** | | | | | | |
| At 1 January 2016 | 53.4 | 193.3 | 108.3 | 40.5 | 27.3 | 422.8 |
| Amortisation charge for the year | – | 105.2 | 50.0 | 6.0 | 14.0 | 175.2 |
| Eliminated on business divestments | (32.3) | (0.8) | (18.3) | – | (0.5) | (51.9) |
| Impairment provision | 530.6 | 23.0 | 20.2 | – | – | 573.8 |
| Derecognitions | – | – | (13.1) | (43.9) | (0.8) | (57.8) |
| Foreign exchange adjustments | 41.5 | 34.2 | 13.4 | 0.4 | 5.9 | 95.4 |
| Reclassifications | – | – | – | – | 3.0 | 3.0 |
| At 31 December 2016 | **593.2** | **354.9** | **160.5** | **3.0** | **48.9** | **1,160.5** |
| Amortisation charge for the year | – | **101.5** | **36.7** | **0.7** | **10.8** | **149.7** |
| Impairment provision | **33.5** | – | – | – | – | **33.5** |
| Reversal of impairment provision | – | **(19.7)** | **(12.1)** | – | – | **(31.8)** |
| Reclassified as held for sale | **(152.9)** | **(61.3)** | **(72.3)** | – | **(1.1)** | **(287.6)** |
| Derecognitions and disposals | – | **(20.3)** | **(24.6)** | **(0.3)** | **(1.7)** | **(46.9)** |
| Foreign exchange adjustments | **(35.9)** | **(18.6)** | **(7.5)** | **(0.2)** | **(2.8)** | **(65.0)** |
| Reclassifications | – | – | – | – | **0.2** | **0.2** |
| **At 31 December 2017** | **437.9** | **336.5** | **80.7** | **3.2** | **54.3** | **912.6** |
| **Carrying amount** | | | | | | |
| **At 31 December 2017** | **637.0** | **141.9** | **63.4** | **1.2** | **50.3** | **893.8** |
| At 31 December 2016 | 725.2 | 269.0 | 118.6 | 2.1 | 51.0 | 1,165.9 |
| At 1 January 2016 | 1,147.2 | 351.9 | 170.2 | 7.7 | 52.5 | 1,729.5 |

Customer relationships represent customer lists, customer contracts and the associated benefits of customer relationships recognised on acquisition. Technology based assets represent trade secrets and processes, patented and unpatented technology, and know-how recognised on acquisition. Software and other intangible assets include both internally generated and purchased software together with purchased patents, licences, trademarks and also includes capitalised development costs with a carrying amount of £0.1m (2016: £0.4m).

Intangible assets recognised on business combinations are derecognised when they are fully amortised.

Amortisation charged during the year relating to intangible assets recognised on business combinations was £138.9m (2016: £161.2m). This amortisation, together with the impairment provision of £33.5m (2016: £573.8m plus £3.9m of amortisation of software) and reversal of impairment of £31.8m, has been excluded from underlying profit as described in note 2. All amortisation charges are included within operating costs in the Income Statement.

### Goodwill

Goodwill represents the premium paid on acquisitions in anticipation of future economic benefits from assets that are not capable of being separately identified and separately recognised, such as the value of the workforce, and is the only indefinite life intangible asset held by the Group.

Goodwill must be allocated to CGUs for the purposes of reporting and accounting. Cobham has previously defined CGUs in line with business units. However, during the year, the Group determined that following completion of all historic integration activities, the strategic review undertaken in 2017 and increasing numbers of new customer platforms using multiple Cobham products, CGUs are now more appropriately defined at the Sector level. This avoids the need to allocate goodwill on an increasingly arbitrary basis and represents the lowest level at which goodwill is now monitored by management. Prior to making the assessment of impairment at this new level, impairment reviews were performed at the business unit level. Where relevant any impairments arising are discussed below.

The carrying value of goodwill is allocated to the following Sectors:

| £m | 2017 | 2016 |
|---|---|---|
| Communications and Connectivity | 278.8 | 310.0 |
| Mission Systems | 89.8 | 92.4 |
| Advanced Electronic Solutions | 225.1 | 244.1 |
| Aviation Services | 43.3 | 78.7 |
| **Total** | **637.0** | 725.2 |

### Annual impairment review (key estimation uncertainty)

A review of the carrying value of goodwill is completed at least once a year to ensure that it is not impaired. This requires estimation of the recoverable amounts of the CGUs to which the goodwill is allocated. This is determined from value in use calculations unless specific conditions at a CGU dictate otherwise. As the Wireless and AvComm businesses are treated as held for sale then the expected sales proceeds, less costs to sell, have been used for the purposes of the impairment review.

Impairment tests on other intangible assets are undertaken if events occur which may indicate that these assets may be impaired. The carrying value of intangible assets is considered annually as part of the goodwill impairment exercise with reference to the value in use calculation of each CGU.

Estimating value in use requires the Group to make an estimate of the expected future cash flows from the CGUs and also to choose a suitable discount rate in order to calculate the present value of those cash flows. This is considered to be a source of estimation uncertainty at the balance sheet date, which may have a significant risk of causing a material adjustment to the carrying amount of intangible assets within the next financial year.

#### Key assumptions

The calculation of recoverable value for CGUs based on value in use includes the following key assumptions:

- Cash flow forecasts prepared by management and reviewed by the Board covering a three year period, updated where appropriate for more recent forecasts. These forecasts take into account the current and expected economic environment including factors such as continued uncertainty within some markets in which we operate. They also make assumptions about the demand for our products in our primary geographical markets, based on historic experience, available government spending and key current and future programme platforms. These cash flow projections do not include benefits or costs expected to arise from future restructuring or initiatives to enhance performance which have not yet commenced;
- Growth rates assumed after this period are based on long-term GDP projections of the primary market for each business. The long-term projections used are in the range 1.5% to 2.5% (2016: 1.2% to 2.5%);
- Cash flows are discounted using the Group's WACC, adjusted for country, cash flow and currency risks in the principal territories in which the CGU operates. These pre-tax discount rates are within the range 8.6% to 10.5% (2016: 8.3% to 10.1%);
- Cash flows include the impact of working capital and fixed asset requirements; and
- Cash flows include management charges which allocate central overheads to the CGUs.

In 2017 and 2016 the following impairments were made:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| £m | Goodwill | Other intangible assets | Goodwill | Other intangible assets |
| Wireless (Communications and Connectivity) | – | (31.8) | 152.9 | 43.2 |
| Helicopter Services (Aviation Services) | 33.5 | – | – | – |
| Integrated Electronic Solutions (Advanced Electronic Solutions) | – | – | 185.7 | – |
| Semiconductor Solutions (Advanced Electronic Solutions) | – | – | 192.0 | – |
| **Total** | **33.5** | **(31.8)** | 530.6 | 43.2 |

Helicopter Services goodwill arose on the acquisition of the FB Group in 2013. Projected cash flows for the next three years, with subsequent growth assumed at a rate of 2.3% were discounted at a pre-tax rate of 9.7%. The previously announced loss of the UK Defence Helicopter Flying School contract, which expires at the end of March 2018, meant this business has been more sensitive to its ability to secure extensions on its remaining portfolio of contracts and to secure new business. In 2017 the business was not able to win extensions with two key non-UK customers where local governments were reconsidering whether or not, and how, they fund training activities. Reflecting the lower level of secured income into future projections an impairment provision of £33.5m has been expensed, leaving a balance of £17.3m.

£31.8m of a previous impairment of intangible assets held in the Wireless business was reversed with reference to the expected sale proceeds less costs to sell for the AvComm and Wireless businesses, which were subsequently reclassified as held for sale in the Balance Sheet.

### Sensitivity analysis

Sensitivity analysis has been performed on the CGUs, as described below:

The largest elements of goodwill in Communications and Connectivity arose on the acquisition of Thrane & Thrane in 2012 and a number of Aerospace Communications businesses. Cash flow projections assume growth in the satellite communications market for maritime products driven by availability of satellite capacity and aerospace products from regulatory changes and passenger connectivity demands. Projected cash flows for the next three years, with subsequent growth assumed at a rate of 1.8% were discounted at a pre-tax rate of 9.7%. If cash flows reduced by 20%, the discount rate was 11.7% or if the growth rate was zero, then no impairment losses would arise.

Mission Systems goodwill primarily arose on the acquisition of Carleton Technologies in 1987, Conax in 1998 and Koch in 2005. Projected cash flows for the next three years, with subsequent growth assumed at a rate of 2.1% were discounted at a pre-tax rate of 10.3%. If cash flows reduced by 20%, the discount rate was 12.4% or if the growth rate was zero, then no impairment losses would arise.

Advanced Electronic Solutions goodwill includes part of the Aeroflex business acquired in 2014, the Trivec business acquired in 2011, the Lansdale business and the former M/A-COM businesses acquired in 2008 and the REMEC business acquired in 2005. In prior years this CGU has been impacted by the end of production on some long term programmes. Projected cash flows for the next three years, with subsequent growth assumed at a rate of 2.0% were discounted at a pre-tax rate of 10.5%. If cash flows reduced by 20%, the discount rate was 12.6% or if the growth rate was zero, then no impairment losses would arise.

Aviation Services goodwill includes that arising on the acquisition of FR Aviation together with the remaining goodwill, after the impairment charge made in the year, that arose on the acquisition of the FB Group in 2013. Projected cash flows for the next three years, with subsequent growth assumed at a rate of 2.5% were discounted at a pre-tax rate of 10.2%. If cash flows reduced by 20%, the discount rate was 12.2% or if the growth rate was zero, then impairment losses of between £5m and £8m would arise.

## 10. Property, plant and equipment

| £m | Freehold | Land and buildings: Long leases | Land and buildings: Short leases | Plant and machinery (including aircraft and vehicles) | Fixtures, fittings tools and equipment | Payments on account and assets under construction | Total |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| At 1 January 2016 | 93.7 | 32.1 | 3.9 | 645.9 | 84.2 | 62.0 | 921.8 |
| Additions | 1.8 | 1.3 | 0.1 | 50.3 | 10.7 | 17.3 | 81.5 |
| Business divestments | – | – | – | – | (2.5) | – | (2.5) |
| Disposals | (3.6) | (2.3) | (0.4) | (43.5) | (4.9) | (0.2) | (54.9) |
| Foreign exchange adjustments | 14.2 | 2.8 | 0.7 | 69.3 | 12.2 | 9.5 | 108.7 |
| Reclassifications | 3.4 | – | – | 12.5 | 4.7 | (18.5) | 2.1 |
| At 31 December 2016 | **109.5** | **33.9** | **4.3** | **734.5** | **104.4** | **70.1** | **1,056.7** |
| Additions | **3.9** | **2.6** | **0.1** | **43.3** | **5.3** | **14.2** | **69.4** |
| Disposals | **(0.6)** | – | – | **(24.5)** | **(5.0)** | **(0.6)** | **(30.7)** |
| Reclassified as held for sale | **(7.1)** | – | – | **(33.4)** | **(2.8)** | **(0.2)** | **(43.5)** |
| Foreign exchange adjustments | **(6.0)** | **(1.6)** | **(0.2)** | **(19.8)** | **(3.6)** | **(0.9)** | **(32.1)** |
| Reclassifications | **2.0** | **(0.3)** | – | **49.3** | **0.9** | **(52.7)** | **(0.8)** |
| **At 31 December 2017** | **101.7** | **34.6** | **4.2** | **749.4** | **99.2** | **29.9** | **1,019.0** |
| **Accumulated depreciation** | | | | | | | |
| At 1 January 2016 | 30.6 | 18.1 | 2.6 | 430.8 | 59.8 | – | 541.9 |
| Depreciation charge for the year | 5.6 | 1.5 | 0.5 | 54.4 | 10.2 | – | 72.2 |
| Eliminated on business divestments | – | – | – | – | (1.6) | – | (1.6) |
| Eliminated on disposals | (3.4) | (0.7) | (0.3) | (36.4) | (3.6) | – | (44.4) |
| Foreign exchange adjustments | 5.0 | 2.3 | 0.5 | 45.7 | 7.8 | – | 61.3 |
| Reclassifications | (0.1) | – | – | 4.7 | (0.2) | – | 4.4 |
| At 31 December 2016 | **37.7** | **21.2** | **3.3** | **499.2** | **72.4** | – | **633.8** |
| Depreciation charge for the year | **4.5** | **1.4** | **0.4** | **58.0** | **9.7** | – | **74.0** |
| Eliminated on disposals | **(0.5)** | – | – | **(20.8)** | **(4.9)** | – | **(26.2)** |
| Reclassified as held for sale | **(0.9)** | **0.1** | – | **(22.7)** | **(1.7)** | – | **(25.2)** |
| Foreign exchange adjustments | **(2.0)** | **(1.2)** | **(0.2)** | **(12.5)** | **(2.2)** | – | **(18.1)** |
| Reclassifications | – | – | – | – | **(0.2)** | – | **(0.2)** |
| **At 31 December 2017** | **38.8** | **21.5** | **3.5** | **501.2** | **73.1** | – | **638.1** |
| **Carrying amount** | | | | | | | |
| **At 31 December 2017** | **62.9** | **13.1** | **0.7** | **248.2** | **26.1** | **29.9** | **380.9** |
| At 31 December 2016 | 71.8 | 12.7 | 1.0 | 235.3 | 32.0 | 70.1 | 422.9 |
| At 1 January 2016 | 63.1 | 14.0 | 1.3 | 249.4 | 24.4 | 27.7 | 379.9 |

At 31 December 2017 the Group had commitments for the acquisition of property, plant and equipment of £13.8m (2016: £14.3m).

## 11. Investment properties

| £m | 2017 | 2016 |
|---|---|---|
| Carrying amount at 1 January | 3.6 | 4.3 |
| Depreciation | (0.2) | (0.7) |
| Disposals | (0.4) | – |
| Reclassified as held for sale | (0.6) | – |
| **Carrying amount at 31 December** | **2.4** | 3.6 |

The fair value of the Group's investment properties has been assessed to be £5.0m (2016: £6.2m). These values are based on management estimates using observable market data, taking into account current lease terms.

Property rental income earned by the Group from its investment properties amounted to £0.7m (2016: £0.7m), which is net of all direct costs associated with the leasing of the properties except depreciation. The buildings are leased to commercial users on operating leases with terms of 10 and 25 years which commenced in 2013 and 1998 respectively.

## 12. Inventories

| £m | 2017 | 2016 |
|---|---|---|
| Raw materials and consumables | 179.9 | 210.7 |
| Work in progress | 247.0 | 238.2 |
| Finished goods and goods for resale | 38.5 | 42.5 |
| Allowance for obsolescence | (76.0) | (86.1) |
| | 389.4 | 405.3 |

Work in progress includes £45.5m (2016: £58.4m) which relates to customer funded engineering development contracts. These amounts will be utilised or amortised as deliveries are made against customers' contractual schedules. Those schedules are subject to change and do not all fall due within 12 months.

Within the Mission Systems segment, inventory expected to be realised after more than 12 months amounts to £17.7m (2016: £29.2m). Otherwise, all inventory is expected to be realised within the normal operating cycle of the businesses.

### Obsolescence provision (key estimation uncertainty)

The nature of much of the Group's business means that inventory held can become technically obsolete. It is also necessary to hold additional spare parts in order to support key customers and programmes. Assessing the level of provision required for obsolete, slow moving and defective items of inventory is an area of estimation uncertainty which may have a significant effect on the carrying amount of inventory within the next financial year.

This allowance is reviewed by management on a regular basis and further amounts are provided or released as considered necessary. The amounts are generally determined based on factors which include ageing and known demand reflecting assumptions concerning future orders and revenue streams. Subsequent events may give rise to these estimates being revised and, consequently, to the reversal of amounts previously provided.

During the year £21.2m (2016: £36.3m) was provided, £4.5m (2016: £5.2m) was utilised and £6.2m (2016: £6.4m) of the allowance for obsolescence was reversed.

The amount provided in the year represents the outcome of the key sensitivity, being changes in forecast customer demand against which production has been planned or undertaken. A 10% deterioration in the assumed immediate forecast demand would lead to an increased provision in the order of £4m (2016: £4m).

## 13. Financial instruments

The Group's financial assets and liabilities are categorised as follows:

| £m | Note | Loans and receivables | Fair value through profit or loss | Amortised cost | Derivatives used for hedging | Total carrying amount | Fair value |
|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | |
| Trade receivables | 14 | **235.9** | – | – | – | **235.9** | **235.9** |
| Other receivables | 14 | **129.3** | – | – | – | **129.3** | **129.3** |
| Cash and cash equivalents | | **451.9** | – | – | – | **451.9** | **451.9** |
| Derivative contracts (not hedge accounted) | 19 | – | **13.2** | – | – | **13.2** | **13.2** |
| Other financial assets | | – | – | **6.1** | – | **6.1** | **6.1** |
| Financial liabilities | | | | | | | |
| Borrowings | 16 | – | – | **(835.4)** | – | **(835.4)** | **(893.1)** |
| Trade payables | 17 | – | – | **(140.7)** | – | **(140.7)** | **(140.7)** |
| Accruals | 17 | – | – | **(140.9)** | – | **(140.9)** | **(140.9)** |
| Other financial liabilities | 17 | – | – | **(55.2)** | – | **(55.2)** | **(55.2)** |
| Derivative contracts (not hedge accounted) | 19 | – | **(17.4)** | – | – | **(17.4)** | **(17.4)** |
| Hedging instruments | | | | | | | |
| Assets | 19 | – | – | – | **22.2** | **22.2** | **22.2** |
| Liabilities | 19 | – | – | – | **(22.0)** | **(22.0)** | **(22.0)** |
| **Net financial liabilities at 31 December 2017** | | | | | | **(353.0)** | **(410.7)** |
| | | | | | | | |
| Financial assets | | | | | | | |
| Trade receivables | 14 | 307.5 | – | – | – | 307.5 | 307.5 |
| Other receivables | 14 | 129.0 | – | – | – | 129.0 | 129.0 |
| Cash and cash equivalents | | 236.2 | – | – | – | 236.2 | 236.2 |
| Derivative contracts (not hedge accounted) | 19 | – | 9.3 | – | – | 9.3 | 9.3 |
| Other financial assets | | – | – | 6.1 | – | 6.1 | 6.1 |
| Financial liabilities | | | | | | | |
| Borrowings | 16 | – | – | (1,264.4) | – | (1,264.4) | (1,348.3) |
| Trade payables | 17 | – | – | (155.8) | – | (155.8) | (155.8) |
| Accruals | 17 | – | – | (129.5) | – | (129.5) | (129.5) |
| Other financial liabilities | 17 | – | – | (43.3) | – | (43.3) | (43.3) |
| Derivative contracts (not hedge accounted) | 19 | – | (54.0) | – | – | (54.0) | (54.0) |
| Hedging instruments | | | | | | | |
| Assets | 19 | – | – | – | 18.9 | 18.9 | 18.9 |
| Liabilities | 19 | – | – | – | (20.4) | (20.4) | (20.4) |
| Net financial liabilities at 31 December 2016 | | | | | | (960.4) | (1,044.3) |

Borrowings are held at amortised cost which equates to fair value except for the Group's fixed rate borrowings. At 31 December 2017 the fair value of those borrowings was £743.7m (2016: £932.8m) compared to their book value of £687.4m (2016: £848.9m). The fair value of the fixed rate borrowings and derivative financial instruments have been determined by reference to observable market prices and rates.

Other financial assets relate to Cobham plc's investments in Air Tanker Holdings Limited and Air Tanker Services Limited in connection with the Voyager (FSTA) project which are held at cost, totalling £6.1m (2016: £6.1m).

Gains and losses on derivative financial assets and liabilities held at fair value through profit or loss are shown in note 19. The total interest income and expense for financial assets and liabilities not held at fair value through profit or loss is shown in note 5.

### Offsetting financial assets and liabilities

Cash and cash equivalents as shown in the Balance Sheet include overdraft balances on currency cash pooling accounts which have been offset as the accounts will be settled on a net basis as described in note 21. Master netting agreements also cover all bank balances and derivative balances with the same counterparty. These do not meet the criteria for offsetting because the right to offset is only enforceable on the occurrence of future events such as a default and amounts presented in the Balance Sheet are therefore presented on a gross basis.

If full offsetting by counterparty were to be applied, the resulting net amounts would be as follows:

| £m | Gross amounts before set off | Amounts set off in the Balance Sheet | Amounts as presented in the Balance Sheet | Amounts not set off in the Balance Sheet | Net amount |
|---|---|---|---|---|---|
| Financial assets | | | | | |
| Cash and cash equivalents | **943.7** | **(491.8)** | **451.9** | **(3.1)** | **448.8** |
| Derivative financial assets | **35.4** | – | **35.4** | **(30.6)** | **4.8** |
| Financial liabilities | | | | | |
| Bank overdrafts | **(491.8)** | **491.8** | – | – | – |
| Derivative financial liabilities | **(39.4)** | – | **(39.4)** | **33.3** | **(6.1)** |
| **At 31 December 2017** | **447.9** | – | **447.9** | **(0.4)** | **447.5** |
| Financial assets | | | | | |
| Cash and cash equivalents | 826.8 | (590.6) | 236.2 | (3.9) | 232.3 |
| Derivative financial assets | 28.2 | – | 28.2 | (25.7) | 2.5 |
| Financial liabilities | | | | | |
| Bank overdrafts | (590.6) | 590.6 | – | – | – |
| Derivative financial liabilities | (74.4) | – | (74.4) | 29.6 | (44.8) |
| At 31 December 2016 | 190.0 | – | 190.0 | – | 190.0 |

## 14. Trade and other receivables

### Current

| £m | 2017 | 2016 |
|---|---|---|
| Trade receivables (net of provision for impairment) | **235.7** | 307.5 |
| Accrued income | **36.6** | 41.8 |
| Loans and other receivables | **28.4** | 21.2 |
| Prepayments | **28.3** | 39.3 |
| | **329.0** | 409.8 |

### Non-current

| £m | 2017 | 2016 |
|---|---|---|
| Trade receivables (net of provision for impairment) | **0.2** | – |
| Accrued income | **39.4** | 38.0 |
| Loans and other receivables | **24.9** | 28.0 |
| | **64.5** | 66.0 |

### Impairment of trade receivables

| £m | 2017 | 2016 |
|---|---|---|
| Trade receivables | **240.7** | 318.0 |
| Provision for impairment of trade receivables | **(4.8)** | (10.5) |
| **Net trade receivables** | **235.9** | 307.5 |

Movements in the provision for impairment of trade receivables during the year are as follows:

| £m | 2017 | 2016 |
|---|---|---|
| At 1 January | **10.5** | 3.3 |
| Additional provisions | **4.5** | 9.2 |
| Utilisation of provisions | **(2.8)** | (0.8) |
| Unused amounts reversed | **(5.2)** | (1.4) |
| Unused amounts reversed (specific adjusting item, see note 2) | **(1.4)** | – |
| Business divestments | – | (0.4) |
| Reclassified as held for sale | **(0.4)** | – |
| Foreign exchange adjustments | **(0.4)** | 0.6 |
| **At 31 December** | **4.8** | 10.5 |

A significant proportion of the Group's business is directly with government agencies or in respect of large government funded military programmes, where credit risk is considered to remain low. Information concerning management of credit risk is shown in note 21.

The credit quality of trade receivables can be analysed as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Amounts not yet due and not impaired | 183.1 | 242.4 |
| Amounts past due but not impaired | 49.4 | 59.2 |
| Amounts for which full or partial impairment provision has been made | 8.2 | 16.4 |
| | 240.7 | 318.0 |

Trade receivables which are past due but not considered by management to be impaired are aged as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Less than 1 month overdue | 34.0 | 42.2 |
| 1 month overdue | 8.1 | 10.6 |
| 2 months overdue | 3.6 | 2.9 |
| 3 or more months overdue | 3.7 | 3.5 |
| | 49.4 | 59.2 |

Other classes of financial assets within trade and other receivables do not include any overdue or impaired assets.

## 15. Non-current assets and disposal groups held for sale

On 2 February 2018, the divestment of the Group's AvComm and Wireless test and measurement businesses, part of the Communications and Connectivity Sector was announced. The following assets and liabilities have been classified as held for sale in the Balance Sheet as at 31 December 2017, and are measured on a non-recurring basis at fair value, taking into account the agreed selling price of US$455m. The divestment is expected to complete within the first half of 2018, subject to regulatory approval.

| £m | 2017 |
|---|---|
| Property, plant and equipment | 18.3 |
| Investment property | 0.6 |
| Intangible assets | 88.1 |
| Deferred tax | 3.8 |
| Inventories | 20.3 |
| Trade and other receivables | 40.6 |
| **Total assets classified as held for sale** | 171.7 |
| | |
| Trade payables and other liabilities | (37.5) |
| Deferred tax | (10.6) |
| Provisions | (1.0) |
| **Total liabilities associated with assets classified as held for sale** | (49.1) |
| | |
| **Total non-current assets and disposal groups held for sale** | 122.6 |

There were no non-current assets or disposal groups held for sale at 31 December 2016.

## 16. Borrowings

| £m | 2017 | 2016 |
|---|---|---|
| **Current borrowings** | | |
| Senior notes | – | 60.7 |
| Finance leases | 0.1 | 0.2 |
| | 0.1 | 60.9 |
| **Non-current borrowings** | | |
| Bank loans | 204.3 | 475.7 |
| Senior notes | 630.8 | 727.5 |
| Finance leases | 0.2 | 0.3 |
| | 835.3 | 1,203.5 |
| | | |
| **Total borrowings** | 835.4 | 1,264.4 |

## Bank loans

Bank loans comprise the following:

| £m | Agreement date | Maturity date | Amount drawn 2017 | Amount drawn 2016 | Undrawn facilities 2017 | Undrawn facilities 2016 |
|---|---|---|---|---|---|---|
| Fixed rates | | | | | | |
| US$75m credit agreement | December 2008 | December 2019 | 55.2 | 60.7 | – | – |
| Floating rates | | | | | | |
| €131m and US$40m loan agreements | May 2015 | May 2020 | 145.5 | 144.2 | – | – |
| €4m loan agreement | May 2015 | May 2022 | 3.6 | 3.4 | – | – |
| US$450m multi-currency revolving facility | December 2017 | December 2022 | – | – | 332.6 | – |
| US$45m multi-currency revolving facility | December 2017 | December 2022 | – | – | 33.3 | – |
| DKK320m multi-currency revolving facility | December 2017 | December 2022 | – | – | 38.2 | – |
| US$270m multi-currency revolving facility | October 2011 | October 2018* | – | 190.5 | – | 28.0 |
| €70m multi-currency revolving facility | June 2012 | October 2018* | – | 48.4 | – | 11.4 |
| DKK525m multi-currency revolving facility | June 2012 | October 2018* | – | – | – | 60.3 |
| AUS$90m multi-currency revolving facility | February 2014 | October 2018* | – | 28.5 | – | 24.2 |
| | | | 204.3 | 475.7 | 404.1 | 123.9 |

Floating rate bank loans accrue interest at LIBOR or other appropriate benchmark plus margin.

In December 2017 three new multi-currency floating rate borrowing agreements were signed and the four existing multi-currency agreements expiring in October 2018 (marked * in the table above) were cancelled. The US$75m credit agreement was repaid and cancelled in January 2018.

## Senior notes

At 31 December 2017, senior notes with a total principal value of US$855.0m (£630.8m) (2016: US$974.0m; £788.2m) were outstanding as set out below:

| £m | Issue date | Maturity date | 2017 | 2016 |
|---|---|---|---|---|
| US$44m fixed rate | October 2012 | October 2020** | – | 35.6 |
| US$930m fixed rate comprising: | October 2014 | | | |
| US$75m | | October 2017 | – | 60.7 |
| US$180m | | October 2019 | 132.9 | 145.7 |
| US$250m | | October 2021 | 184.4 | 202.3 |
| US$425m | | October 2024 | 313.5 | 343.9 |
| | | | 630.8 | 788.2 |

Senior notes with a principal value of US$44.0m (marked ** above) were repaid in May 2017.

## Reconciliation of movements in net debt

Net debt is defined as the net of borrowings less cash and cash equivalents at the balance sheet date.

| £m | Cash and cash equivalents | Bank overdrafts | Liabilities from financing activities: Bank loans | Senior notes | Finance leases | Net debt |
|---|---|---|---|---|---|---|
| At 1 January 2016 | 294.7 | (0.7) | (572.5) | (927.8) | (0.5) | (1,206.8) |
| Cash flows | (72.8) | 0.7 | – | – | – | (72.1) |
| New borrowings | – | – | (9.9) | – | – | (9.9) |
| Repayment of borrowings | – | – | 199.2 | 297.7 | 0.1 | 497.0 |
| Foreign exchange adjustments | 14.3 | – | (92.5) | (158.1) | (0.1) | (236.4) |
| At 31 December 2016 | 236.2 | – | (475.7) | (788.2) | (0.5) | (1,028.2) |
| Cash flows | 277.2 | – | – | – | – | 277.2 |
| Repayment of borrowings | – | – | 266.5 | 92.9 | 0.2 | 359.6 |
| Foreign exchange adjustments | (61.5) | – | 4.9 | 64.5 | – | 7.9 |
| **At 31 December 2017** | **451.9** | **–** | **(204.3)** | **(630.8)** | **(0.3)** | **(383.5)** |

### Financial covenants

The various borrowing agreements include both financial and non-financial covenants but do not contain any provisions for charges over Group assets. Terms of the financial covenants are based on adjusted IFRS results, as defined in the agreements. The financial covenant calculations as presented below are as defined in the senior note borrowing agreements and are included here to allow readers of these financial statements to better understand their interpretation:

#### Net debt to EBITDA

| £m | 2017 | 2016 |
|---|---|---|
| Net debt per Balance Sheet | (383.5) | (1,028.2) |
| Adjust to average exchange rate | (21.8) | (90.3) |
| Net debt for covenant purposes | (405.3) | (937.9) |
| | | |
| Operating profit/(loss) per Income Statement | 104.1 | (779.1) |
| Specific adjusting items as disclosed in note 2 | 106.2 | 1,004.1 |
| Depreciation and amortisation not included within specific adjusting items | 85.0 | 80.5 |
| Other adjustments | 13.2 | 11.0 |
| EBITDA for covenant purposes | 308.5 | 316.5 |
| | | |
| **Net debt to EBITDA ratio as calculated for financial covenants** | 1.3 | 3.0 |
| Covenant condition – not more than | 3.5 | 3.5 |

#### Interest cover

| £m | 2017 | 2016 |
|---|---|---|
| Operating profit/(loss) per Income Statement | 104.1 | (779.1) |
| Specific adjusting items as disclosed in note 2 | 106.2 | 1,004.1 |
| Amortisation not included within specific adjusting items | 10.8 | 10.1 |
| Other adjustments | 13.2 | 10.1 |
| EBITA for covenant purposes | 234.3 | 245.2 |
| | | |
| Net finance costs per Income Statement | (37.2) | (68.8) |
| Specific adjusting items as disclosed in note 2 | – | 19.0 |
| Other adjustments | 2.5 | 1.8 |
| Net finance costs for covenant purposes | (34.7) | (48.0) |
| | | |
| **Interest cover as calculated for financial covenants** | 6.8 | 5.1 |
| Covenant condition – not less than | 3.0 | 3.0 |

There have been no breaches of the terms of the borrowing agreements or defaults during the current or prior year.

## 17. Trade and other payables

### Current liabilities

| £m | 2017 | 2016 (restated) |
|---|---|---|
| Payments received on account | 89.4 | 67.0 |
| Trade payables | 140.7 | 155.3 |
| Other taxes and social security | 25.4 | 28.2 |
| Deferred income | 8.2 | 19.2 |
| Accruals | 134.5 | 123.5 |
| Other liabilities | 50.0 | 47.1 |
| | 448.2 | 440.3 |

Details of the restatement of the 2016 Balance Sheet can be found in note 6. Included in other liabilities is £10.6m (2016: £9.5m) related to interest on uncertain tax positions also disclosed in note 6.

### Non-current liabilities

| £m | 2017 | 2016 |
|---|---|---|
| Payments received on account | 4.1 | 2.7 |
| Trade payables | – | 0.5 |
| Deferred income | 20.4 | 16.6 |
| Accruals | 6.4 | 6.0 |
| Other liabilities | 5.2 | 5.7 |
| | 36.1 | 31.5 |

## 18. Provisions

| £m | 2017 | 2016 |
|---|---|---|
| Current liabilities | 125.1 | 180.6 |
| Non-current liabilities | 30.7 | 57.3 |
| | 155.8 | 237.9 |

Movements in provisions during the year are as follows:

| £m | Contract loss provisions | Provisions related to businesses divested | Restructuring provisions | Warranty claims | Aircraft maintenance provisions | Other | Total |
|---|---|---|---|---|---|---|---|
| At 1 January 2017 | 147.0 | 6.6 | 23.4 | 17.0 | 3.3 | 40.6 | 237.9 |
| Additional provisions in the year | 8.3 | – | – | 6.0 | 1.0 | 7.2 | 22.5 |
| Utilisation of provisions | (66.5) | (0.7) | (2.1) | (3.5) | (1.0) | (6.5) | (80.3) |
| Provisions released | (1.2) | – | (1.5) | (6.0) | (0.6) | (4.2) | (13.5) |
| Reclassified as held for sale | – | – | – | (0.7) | – | (0.3) | (1.0) |
| Other reclassifications | 5.5 | – | (1.5) | 2.2 | – | (8.5) | (2.3) |
| Foreign exchange adjustments | (3.4) | – | (0.7) | (0.2) | – | (3.2) | (7.5) |
| **At 31 December 2017** | 89.7 | 5.9 | 17.6 | 14.8 | 2.7 | 25.1 | 155.8 |

Provisions released in the year include the release of £4.3m of provisions for warranty claims and £3.7m of other provisions which have been excluded from underlying earnings as shown in note 2.

### Contract loss provisions (key estimation uncertainty)

Contract loss provisions are recognised for onerous contracts when the expected benefits to be derived by the Group are lower than the forecasted unavoidable cost of meeting the related contractual obligations. The assessment of the amount provided is a source of estimation uncertainty which may have a significant effect on the carrying amount of these provisions within the next financial year. The estimated costs to complete, the outcome of negotiations with customers, the amounts recoverable under these contracts and the risk of incurring penalties for not meeting challenging delivery schedules are all areas requiring management judgement and the Group may take account of the advice of experts in quantifying the expected costs of future adverse outcomes. Due to the inherent uncertainty associated with such matters, the timing and determination of the total costs or amount of any payments under any claims could differ from the amounts provided. These provisions are expected to be utilised within three years although where there are uncertainties surrounding the timing of utilisation, they have been disclosed as current liabilities.

There are multiple sensitivities to be considered in assessing contract loss provisions, in particular the ability to achieve development milestone dates, the accuracy of cost estimates to complete contractual work and the ability to successfully invoice and collect cash from the customer. It is not considered practical to provide sensitivities for each of these items, and potentially misleading to suggest each one can be considered separately, so this risk is disclosed as part of our contingent liabilities in note 26.

### Other categories of provisions

Provisions related to businesses divested relate to longer term warranties given on the divestments completed in 2005. Due to uncertainties surrounding the timing of settlement of these items, they have been disclosed as current liabilities.

Restructuring provisions relate to onerous lease provisions arising from the restructuring of the Aeroflex businesses, which is now complete. Amounts carried forward are not expected to be fully settled until 2025.

Provisions for warranty claims are expected to be utilised within three years.

Aircraft maintenance provisions relate to significant periodic maintenance costs as well as return conditions for leased aircraft and are anticipated to crystallise within five years.

Other provisions include amounts provided in respect of legal claims and environmental obligations and are mostly expected to be settled within one year.

## 19. Derivative financial instruments

The fair values of derivative financial instruments are as follows:

| £m | Interest rate swaps | Foreign exchange derivatives | Inflation swap | Total |
|---|---|---|---|---|
| Non-current assets | – | **25.0** | – | **25.0** |
| Current assets | – | **10.4** | – | **10.4** |
| Current liabilities | – | **(11.8)** | **(0.4)** | **(12.2)** |
| Non-current liabilities | – | **(27.2)** | – | **(27.2)** |
| **Fair value at 31 December 2017** | – | **(3.6)** | **(0.4)** | **(4.0)** |
| | | | | |
| Non-current assets | – | 19.7 | – | 19.7 |
| Current assets | – | 8.5 | – | 8.5 |
| Current liabilities | (0.6) | (40.2) | (1.4) | (42.2) |
| Non-current liabilities | (1.2) | (30.6) | (0.4) | (32.2) |
| Fair value at 31 December 2016 | (1.8) | (42.6) | (1.8) | (46.2) |

The movements in the fair values of derivative financial instruments during the year are as follows:

| £m | Interest rate swaps | Foreign exchange derivatives | Inflation swap | Total |
|---|---|---|---|---|
| At 1 January 2016 | (2.3) | (24.2) | (2.4) | (28.9) |
| (Loss)/gain through Income Statement – not hedged | – | (16.7) | 1.0 | (15.7) |
| Gain reclassified to Income Statement | 1.1 | 0.5 | – | 1.6 |
| Loss through OCI – hedged items | (0.2) | (2.2) | – | (2.4) |
| Foreign exchange adjustments | (0.4) | – | (0.4) | (0.8) |
| At 31 December 2016 | **(1.8)** | **(42.6)** | **(1.8)** | **(46.2)** |
| Gain through Income Statement – not hedged | – | **39.2** | **1.4** | **40.6** |
| Gain/(loss) reclassified to Income Statement | **0.7** | **(0.2)** | – | **0.5** |
| Ineffectiveness of net investment hedge through Income Statement | – | **0.2** | – | **0.2** |
| Gain/(loss) through OCI – hedged items | **1.1** | **(0.2)** | – | **0.9** |
| **At 31 December 2017** | – | **(3.6)** | **(0.4)** | **(4.0)** |

Floating to fixed interest rate swaps were cancelled in the year ended 31 December 2017 following the repayment of the associated floating rate borrowings. These interest rate swaps were previously designated as cash flow hedging instruments and hedge accounting was applied. In addition, a small number of specific foreign exchange derivatives with a fair value at 31 December 2017 of £0.2m (2016: £0.3m) are designated as cash flow hedging instruments or as hedging instruments for net investment hedging purposes, and hedge accounting is applied. In 2016, there was no material ineffectiveness in cash flow hedges to be reported through the Income Statement.

The majority of foreign exchange and inflation derivatives are not accounted for using hedge accounting. Movements in fair values are recorded in the Income Statement within operating costs but are excluded from underlying profit as described in note 2. Also excluded from underlying profit are losses of £11.7m (2016: loss £23.6m) arising from the movement in fair values of currency swaps which offset movements in currency balances held, and gains and losses arising on foreign exchange derivatives related to dividend flows within the Group.

Full details of the Group's financial instrument accounting policies and risk management strategies, objectives and policies are set out in the accounting policies in note 1 and in note 21, financial risk management.

## 20. Retirement benefit schemes

| £m | 2017 | 2016 |
|---|---|---|
| Defined benefit scheme assets | **816.3** | 790.0 |
| Defined benefit obligations | **(879.5)** | (877.0) |
| | **(63.2)** | (87.0) |

Pension expense included in employment costs in note 4 are as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Defined benefit schemes | **0.7** | 1.6 |
| Defined contribution schemes | **37.4** | 33.5 |
| | **38.1** | 35.1 |

£1.4m (2016: £0.7m) was outstanding in respect of defined benefit schemes but not due for payment at 31 December 2017. £1.1m (2016: £0.4m) was outstanding in respect of defined contribution schemes but not due for payment at 31 December 2017.

## Defined contribution schemes

The Group operates a number of defined contribution pension arrangements. Under a defined contribution pension arrangement the Group's contribution is fixed at a set percentage of employees' pay. The contributions are recognised as an employee benefit expense as the employee provides service to the Group. There is no legal or constructive obligation to pay any additional amounts into the funds.

## Defined benefit schemes

The Group operates a number of funded defined benefit schemes (where benefits are based on employees' length of service and average final salary), the most significant being the Cobham Pension Plan (CPP). The assets of all of these schemes are held separately from those of the Group in funds under the control of trustees. However, the Group is responsible for funding any shortfall in the obligations of the schemes to their members. All defined benefit schemes have been closed to new members since 2003 and the UK schemes were closed to future accrual from 1 April 2016.

The defined benefit schemes expose the Group to a number of risks, as described below:

- Volatility of investment returns. If the investment return is lower than the discount rate set with reference to corporate bond yields then the scheme deficit will increase;
- Inflation risk. Pensionable salaries, deferred pensions and pensions in payment are subject to inflationary increases. A higher inflation rate will lead to higher defined benefit obligations;
- Changes in bond yields. Volatility in the financial markets can have a significant impact on corporate bond yields which are used to generate a discount rate assumption. Lower corporate bond yields will lead to higher defined benefit obligations; and
- Life expectancy risk. The schemes' obligations are to provide benefits for the life of the member and therefore increases in life expectancy will lead to higher defined benefit obligations.

The trustees seek to mitigate these risks and have entered into a number of buy-in arrangements where assets are transferred to an insurance company in return for a qualifying insurance policy which provides an income stream equivalent to the obligations to pensioners covered by the arrangement. The most significant buy-in arrangement relates to pensioners of the CPP as at 1 July 2013. This eliminates all of the above risks in relation to these liabilities except for the credit risk related to the insurance provider. In addition the trustees have invested in liability driven investments that mitigate approximately 85% of the remaining bond yield and inflation risks, on a technical provision basis. This is achieved by using a portfolio of gilts and swaps supported with investment grade credit instruments. These investments introduce the risk that a call for further investment may be made if inflation decreases or the bond yield increases, which is managed by maintaining sufficient liquid investments. Leverage and counterparty risks are managed by the fund investment managers. The remaining assets include significant investment in diversified growth funds which seek to manage investment risks.

### Triennial actuarial valuations

Actuarial valuations of the present value of the defined benefit obligations for the CPP are carried out on a triennial basis by qualified independent actuaries; the most recent valuation was as at 1 April 2015. Actuarial valuations of other schemes have been carried out at regular intervals as required by the applicable country regulations. The actuarial valuations were updated by qualified independent actuaries for accounting purposes to 31 December 2017. In the UK, within 15 months of each triennial valuation, the employer and the trustees are required to agree a schedule of contributions to ensure that the Plan is fully funded over time on a suitably prudent basis. The valuation of the Plan liabilities for this triennial valuation is on a more prudent basis than that required by IAS 19 and therefore the schedule of contributions will address a higher deficit than that recorded on an IAS 19 basis. The Group expects to contribute £18.1m to its defined benefit pension schemes in 2018 and, under the current schedule of contributions, £10.7m in 2019. Thereafter the current schedules of contributions require £8.8m of contributions each year through to 2022. A new schedule of contributions is likely to be agreed prior to 1 April 2019 based on a triennial valuation as at 1 April 2018, which may change the Group's commitments after 2018.

### Assumptions (source of estimation uncertainty)

A number of assumptions are made in assessing the costs and present value of the pension assets and liabilities, which include the discount rate, inflation and mortality rates. These are considered to be major sources of estimation uncertainty as comparatively small changes in the assumptions used may have a significant effect on the Group's financial statements within the next financial year. The Group uses published indices and independent actuarial advice to select the values of critical assumptions.

The principal financial assumptions used for the purpose of the actuarial valuations were as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | **UK schemes** | **US scheme** | UK schemes | US scheme |
| RPI inflation assumption (rate of increase in pensions in payment unless overridden by specific scheme rules) | **3.35%** | **3.35%** | 3.45% | 3.45% |
| CPI inflation assumption (rate of increase in deferred pensions) | **2.35%** | **2.35%** | 2.45% | 2.45% |
| Discount rate | **2.35%** | **3.47%** | 2.65% | 3.95% |

The mortality assumptions used for the CPP are based upon actuarial tables which reflect actual recent mortality experience and also allow for future mortality improvements. The mortality tables used to estimate life expectancy are known as 'SAPS CMI 16' (2016: SAPS CMI 15). In practical terms, this is demonstrated in the table below:

| | Year of birth | Year age 65 | Life expectancy |
|---|---|---|---|
| Male | 1952 | 2017 | 88 years |
| Female | 1952 | 2017 | 89 years |
| Male | 1980 | 2045 | 90 years |
| Female | 1980 | 2045 | 91 years |

At 31 December 2017 it has been assumed that members will commute on average 25% (2016: 25%) of their pension for cash at retirement.

### Sensitivity analysis

The sensitivity of scheme liabilities to changes in certain key assumptions, after adjusting for liabilities covered by insurance contracts, is provided below:

| | Change in assumption | Change in liabilities |
|---|---|---|
| Discount rate | Increase by 1.0% | -9% |
| Inflation rate (both RPI and CPI) | Increase by 0.5% | +3% |
| Life expectancy | Increase by one year | +2% |

If the change in assumptions were in the opposite direction to that shown above, the impact would be approximately symmetrical.

### Movements in scheme assets and scheme liabilities

A summary of the movements in the net liability and the amounts recognised in the Income Statement and OCI are as follows:

| | | | 2017 | | | 2016 |
|---|---|---|---|---|---|---|
| £m | Scheme assets | Defined benefit obligations | Total | Scheme assets | Defined benefit obligations | Total |
| Current service cost included in administrative expenses | – | (0.7) | (0.7) | – | (1.6) | (1.6) |
| Scheme administration expenses | (0.2) | – | (0.2) | (0.2) | – | (0.2) |
| **Amounts recognised in operating profit** | (0.2) | (0.7) | (0.9) | (0.2) | (1.6) | (1.8) |
| Net interest | 20.8 | (23.1) | (2.3) | 25.1 | (26.9) | (1.8) |
| **Amounts credited/(charged) to other finance expense** | 20.8 | (23.1) | (2.3) | 25.1 | (26.9) | (1.8) |
| Actual return less interest income on pension scheme assets | 31.0 | – | 31.0 | 112.3 | – | 112.3 |
| Experience gains and losses arising on scheme liabilities | – | (0.1) | (0.1) | – | (1.0) | (1.0) |
| Actuarial gains and losses arising from changes in financial assumptions | – | (34.8) | (34.8) | – | (163.6) | (163.6) |
| Actuarial gains arising from changes in demographic assumptions | – | 11.3 | 11.3 | – | 9.7 | 9.7 |
| **Amounts recognised in OCI** | 31.0 | (23.6) | 7.4 | 112.3 | (154.9) | (42.6) |
| Employer contributions | 18.2 | – | 18.2 | 18.5 | – | 18.5 |
| Member contributions | – | – | – | 0.4 | (0.4) | – |
| Benefits paid | (41.8) | 41.8 | – | (33.0) | 33.0 | – |
| **Amounts included in Cash Flow Statement** | (23.6) | 41.8 | 18.2 | (14.1) | 32.6 | 18.5 |
| **Exchange differences** | (1.7) | 3.1 | 1.4 | 3.0 | (5.6) | (2.6) |
| **Net movement in the year** | 26.3 | (2.5) | 23.8 | 126.1 | (156.4) | (30.3) |
| Net liability at start of year | 790.0 | (877.0) | (87.0) | 663.9 | (720.6) | (56.7) |
| **Net liability at end of year** | 816.3 | (879.5) | (63.2) | 790.0 | (877.0) | (87.0) |
| UK schemes | 796.3 | (844.6) | (48.3) | 770.9 | (842.2) | (71.3) |
| US scheme | 20.0 | (34.9) | (14.9) | 19.1 | (34.8) | (15.7) |
| **Net liability at end of year** | 816.3 | (879.5) | (63.2) | 790.0 | (877.0) | (87.0) |

The cumulative amount of actuarial losses recognised in OCI since transition to IFRS is £241.4m (2016: £248.8m).

Of the net actuarial gain recognised in the year, the loss from changes in financial assumptions is primarily driven by the movements in the discount rate, while the gain from changes in demographic assumptions arises from the use of the latest mortality tables.

The actual return on scheme assets was £51.8m (2016: £137.4m). The weighted average duration of the scheme liabilities is estimated to be 16 years.

### Scheme assets

The fair value of major categories of scheme assets, and as a percentage of total scheme assets, is as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | £m | % | £m | % |
| UK equity instruments | 14.4 | 1.8% | 66.9 | 8.5% |
| Overseas equities | – | – | 31.2 | 3.9% |
| Emerging markets equities | – | – | 21.2 | 2.7% |
| Global equities | 92.3 | 11.3% | – | – |
| Liability driven investments | 149.5 | 18.3% | 79.0 | 10.0% |
| Corporate bonds | 87.0 | 10.7% | 85.6 | 10.8% |
| Private credit | 27.8 | 3.4% | 14.7 | 1.9% |
| Diversified growth funds | 127.8 | 15.6% | 146.1 | 18.5% |
| Insurance contracts | 313.7 | 38.4% | 318.4 | 40.3% |
| Other assets including cash | 3.7 | 0.5% | 26.9 | 3.4% |
| | 816.2 | 100.0% | 790.0 | 100.0% |

Scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, or other assets used by the Group. None of the scheme assets are quoted in an active market. The above, except for the insurance contracts assets, are pooled investment vehicles and are valued based on bid price for funds with bid/offer spreads, or single price where there are no bid/offer spreads based on valuations provided by the investment manager. Insurance contracts are valued based on the valuation of the liabilities insured.

### Other retirement benefit schemes

The assets and liabilities of other immaterial retirement benefit schemes are as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| £m | Assets | Liabilities | Assets | Liabilities |
| French indemnity schemes | – | (5.8) | – | (5.6) |
| German based schemes | 1.0 | (1.5) | 1.0 | (1.5) |
| | 1.0 | (7.3) | 1.0 | (7.1) |

The actuarial loss for these schemes in the year to 31 December 2017, recognised in OCI, was £nil (2016: £1.2m). The net liabilities are included in other liabilities in note 17. The German based scheme assets relate to insurance policies.

## 21. Financial risk management

The Group's multinational operations and debt financing expose it to a variety of financial risks which include the effects of changes in foreign currency exchange rates, interest rates, liquidity risk and credit risk. The Group has in place a risk management programme that seeks to limit the adverse effects on the financial performance of the Group by using foreign currency financial instruments, debt and other instruments, including interest rate swaps. Other derivative financial instruments may be used from time to time to manage exposures such as inflation risk. The financial risk management policies agreed by the Board have not changed during the year and are summarised below. The Group does not trade in financial instruments.

### Foreign currency risk

The Group is based in the UK, reports in sterling and has significant investment in overseas operations in the USA, Australia and other European countries. As a result, the Group's Balance Sheet, including the net debt position, can be affected by movements in these countries' exchange rates. The Group's policy is to reduce, or eliminate where practical, both structural and transactional foreign exchange risk and, consequently, the net foreign exchange gains and losses included in the Income Statement amounted to a gain of £12.1m (2016: £26.1m). The Group undertakes to manage the currency mix of debt and EBITDA so that they are broadly in line to mitigate the impact of currency fluctuations on the net debt to EBITDA financial covenant. All currency exposures are reviewed regularly and all significant foreign exchange transactions are approved by Cobham plc management.

The Group has the following exposure to foreign currency denominated monetary assets and monetary liabilities in the Balance Sheet, translated into sterling at the relevant year end exchange rates:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| £m | Monetary assets | Monetary liabilities | Monetary assets | Monetary liabilities |
| US dollars | 488.3 | (932.6) | 377.8 | (1,290.8) |
| Euros | 95.2 | (166.5) | 116.4 | (163.2) |
| Australian dollars | 48.7 | (11.6) | 40.3 | (43.8) |
| Danish kroner | 9.3 | (8.7) | 24.1 | (68.2) |
| Other currencies | 36.2 | (7.0) | 42.6 | (8.2) |
| | 677.7 | (1,126.4) | 601.2 | (1,574.2) |
| Sterling denominated monetary assets and liabilities | 167.7 | (129.2) | 110.8 | (186.7) |
| | 845.4 | (1,255.6) | 712.0 | (1,760.9) |

Foreign currency borrowings also mitigate the impact of foreign currency exchange differences arising from the Group's overseas net assets. Monetary liabilities in the table above include US dollar borrowings of £717.1m (2016: £1,061.8m) which match exposures arising from currency denominated net assets. Foreign currency derivative contracts are also used to manage exposure to currency risks.

On consolidation, the net assets of overseas subsidiaries (which include the monetary assets and liabilities shown in the table above) are translated at closing exchange rates and exchange differences arising are accounted for in OCI through the translation reserve (note 23).

The Group is exposed to foreign currency risk in the Income Statement where individual subsidiaries hold non-functional currency monetary assets and liabilities and when an operating unit makes sales and purchases in currencies other than its own functional currency. The Group undertakes a formal process to actively manage and mitigate this exposure through a combination of matching non-functional currency revenues and costs, matching non-functional currency monetary assets and liabilities and through the use of forward contracts.

Group policy is that at least 80% of the next 12 months' forecast cash flows in non-functional currencies are covered by forward foreign exchange contracts. For shorter cycle businesses, the profile of hedging is based on customer commitments which are subject to approval by the Group CFO. Where forecasted currency cash flows do not arise this will result in increased income statement exposure to foreign currency exchange differences. These are however managed at a Group level and mitigating action is taken where possible.

The sterling/US dollar and Danish krone/US dollar exchange rates are the most important for the Group. The Group has the following forward foreign currency contracts outstanding for net sales of US dollars for sterling and Danish kroner:

| | US$m amount | | Average US$:£ exchange rate | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Expiring within one year | 119.4 | 141.8 | 1.37 | 1.42 |
| Expiring within one to two years | 85.3 | 40.2 | 1.36 | 1.43 |
| Expiring after two years | 29.5 | 34.7 | 1.50 | 1.52 |
| **US$/sterling contracts outstanding at 31 December** | 234.2 | 216.7 | 1.38 | 1.43 |

| | US$m amount | | Average US$:DKK exchange rate | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Expiring within one year | 85.5 | 95.1 | 6.34 | 6.16 |
| Expiring within one to two years | 0.5 | – | 6.20 | – |
| Expiring after two years | 1.2 | 1.7 | 6.01 | 6.07 |
| **US$/DKK contracts outstanding at 31 December** | 87.2 | 96.8 | 6.34 | 6.15 |

The latest expiry date of forward foreign currency contracts for sales of US dollars is July 2022 and it is the Group's current belief that the net dollar receipts by subsidiaries will exceed the level of the outstanding commitments.

## Sensitivity analysis

Financial instruments denominated in a currency other than the functional currency in which they are measured create exposure to foreign currency exchange rate risk. These financial instruments include the monetary assets and liabilities and the forward foreign currency contracts shown in the tables above. The sensitivity arising on these financial instruments from a weakening in sterling against the respective foreign currency at the balance sheet date is set out below, with a negative number indicating a reduction in profit after taxation or total equity.

| | | 2017 | | | | 2016 |
|---|---|---|---|---|---|---|
| £m | **Sensitivity** | **Profit or loss** | **Total equity** | Sensitivity | Profit or loss | Total equity |
| US dollars to sterling | **12%** | **(23.1)** | **(23.1)** | 11% | (20.7) | (20.7) |
| US dollars to Danish kroner | **12%** | **(6.1)** | **(6.1)** | 11% | (7.0) | (7.0) |
| Euros to sterling | **12%** | **(10.6)** | **(10.6)** | 11% | (7.4) | (7.4) |

The sensitivities used represent management's assessment of the possible changes in foreign exchange rates, based on experience over the previous five years. However these potential changes are hypothetical and actual rates in future may differ significantly as a result of developments in global financial markets. This sensitivity analysis has been based on the assumption that all other variables, including interest rates, remain constant.

## Interest rate risk

The Group has borrowings with a range of maturities at both fixed and floating rates of interest. In managing its borrowing costs, the Group monitors its exposure to movements in interest rates, having regard to prevailing market conditions and, where necessary, uses interest rate swaps to manage the interest rate risk. At 31 December 2017, the Group does not have any interest rate swaps outstanding.

All floating rate borrowings have regular repricing dates.

| £m | 2017 | 2016 |
|---|---|---|
| Senior notes | **630.8** | 788.2 |
| Bank loans at fixed rate | **55.2** | 60.7 |
| Bank loans swapped to fixed rate | **–** | 22.7 |
| **Fixed rate borrowings** | **686.0** | 871.6 |
| Bank loans | **149.1** | 392.3 |
| Finance leases | **0.3** | 0.5 |
| **Floating rate borrowings** | **149.4** | 392.8 |
| **Total borrowings** | **835.4** | 1,264.4 |

Surplus funds are placed on short term fixed rate deposit and as such also give rise to interest rate exposure. There was no material sensitivity to changes in interest rates at the year end.

Floating to fixed interest rate swaps, designated as cash flow hedges, have previously been used to mitigate the interest rate exposure arising on selected floating rate debt. As the borrowings were repaid during the year, the associated interest rate swaps were cancelled and there were no interest rate swaps outstanding at 31 December 2017. Interest rate swaps outstanding at the prior year end were as follows:

| | | Period of swap contract | | | 2016 |
|---|---|---|---|---|---|
| Hedged item | Fixed rate | from | to | Currency value | £m |
| Australian dollar loans | 6.3% | May 2006 | January 2020 | AUS$33.3m | 19.5 |
| | 6.4% | January 2007 | January 2020 | AUS$5.5m | 3.2 |
| | | | | | 22.7 |

## Liquidity risk

The Group's policy on managing liquidity risk throughout the year has been to maintain a mix of short, medium and long term borrowings with lenders. Overdraft and revolving credit facilities provide short term flexibility whilst the revolving credit facilities provide longer term committed funding.

As shown in note 16, at 31 December 2017 undrawn committed borrowing facilities of £404.1m (2016: £123.9m) were available to the Group in various currencies.

At an operating level, the Group has a positive cash flow from operating activities and where practical the funds generated by business units are managed on a regional basis. In the UK and USA, most business units utilise local banking facilities within a UK or US group arrangement. This allows a balance to be maintained between continuity of funding, security and flexibility.

The table below summarises the remaining contractual maturity for the Group's borrowings and other financial liabilities. The amounts shown are the contractual undiscounted cash flows which include interest, analysed by contractual maturity. The difference between the contractual cash flows and the carrying amount of these liabilities reflects the effects of interest not included in the carrying amount and discounting applied in assessing fair value.

| £m | Within one year | 1-2 years | 2-5 years | Over 5 years | Total |
|---|---|---|---|---|---|
| **Non-derivative financial liabilities** | | | | | |
| Borrowings | **35.0** | **85.6** | **521.5** | **338.7** | **980.8** |
| Trade and other payables | **320.9** | **2.5** | **3.7** | **5.4** | **332.5** |
| **At 31 December 2017** | **355.9** | **88.1** | **525.2** | **344.1** | **1,313.3** |
| | | | | | |
| **Derivative liabilities** | | | | | |
| Foreign exchange derivatives | | | | | |
| Gross cash outflows | **381.6** | **31.5** | **31.0** | – | **444.1** |
| Gross cash inflows | **(370.2)** | **(29.0)** | **(28.4)** | – | **(427.6)** |
| Inflation swap | **0.4** | – | – | – | **0.4** |
| **At 31 December 2017** | **11.8** | **2.5** | **2.6** | – | **16.9** |
| | | | | | |
| **Non-derivative financial liabilities** | | | | | |
| Borrowings | 102.6 | 301.6 | 667.4 | 388.8 | 1,460.4 |
| Trade and other payables (restated, see notes 17 and 6) | 319.5 | 3.0 | 3.2 | 6.0 | 331.7 |
| At 31 December 2016 | 422.1 | 304.6 | 670.6 | 394.8 | 1,792.1 |
| | | | | | |
| **Derivative liabilities** | | | | | |
| Interest rate swaps | 0.9 | 0.6 | 0.3 | – | 1.8 |
| Foreign exchange derivatives | | | | | |
| Gross cash outflows | 724.9 | 66.1 | 41.5 | 6.1 | 838.6 |
| Gross cash inflows | (683.8) | (58.5) | (36.9) | (4.8) | (784.0) |
| Inflation swap | 1.4 | 0.4 | – | – | 1.8 |
| At 31 December 2016 | 43.4 | 8.6 | 4.9 | 1.3 | 58.2 |

## Credit risk

The Group's principal financial assets are bank balances, cash and trade and other receivables and there are no significant concentrations of credit risk.

The Group has a conservative policy towards the credit risk related to liquid funds and derivative financial instruments with balances currently spread across a range of reputable financial institutions. The levels of credit risk are monitored through the Group's ongoing risk management processes, which include a regular review of the banks' credit ratings. Risk in this area is limited further by setting a maximum level for term deposits with any one counterparty.

Concentrations of credit risk with respect to trade receivables are limited due to the Group having a large customer base. Customers are typically large global companies or government agencies with long term trading relationships. The Group also has in place procedures that require appropriate credit checks on potential customers before sales are made and any requests for extended credit are approved by senior management. Existing customer accounts are monitored on an ongoing basis and appropriate action is taken where necessary to minimise any credit risk. At 31 December 2016, additional provisions were made following the Balance Sheet review exercise as described in note 2. No further credit risk provision is required in excess of the provision for impaired receivables shown in note 13.

Bank term balances totalling £7.0m (2016: £7.1m) have been pledged against the residual value of leased assets under an agreement which expires in 2020.

Group management monitor debtor days and the ageing of receivables which are more than one month overdue on a regular basis. At 31 December 2017, 8.7% (2016: 9.5%) of gross trade receivables were overdue by one month or more.

The maximum exposure to credit risk at 31 December 2017 is the fair value of each class of receivable as disclosed in note 13.

The Group has master netting arrangements in respect of bank balances in the UK. In the normal course of business, these bank accounts are settled on a net basis within each currency and as such are presented net in the Balance Sheet as shown in note 13. In the event of an automatic enforcement event, the bank balances are set off against each other to achieve a net position. Derivatives can also be offset by counterparties in the event of a default; net amounts that result on this basis are also shown in note 13.

### Inflation risk

The Group's exposure to inflation is considered to be a general business risk which is mitigated through normal commercial activity. The Group has one swap contract which was designed to manage the inherent inflation risk in a specific operational contract. The fair value of this swap contract is included in derivative financial instruments shown in note 19.

### Capital risk management

Group policy continues to be to maintain a strong capital base so as to maintain stakeholder confidence and to sustain future development of the business.

Capital is defined as total equity excluding non-controlling interests and amounted to £1,027.0m at 31 December 2017 (2016: £488.8m). Within its overall policy, the Group seeks to maintain an appropriate finance structure through a mixture of debt and retained earnings. Funding needs are reviewed periodically and also each time a significant acquisition or business divestment is made. A number of factors are considered which include the net debt/EBITDA ratio, forecast trading requirements, the availability and maturity of banking facilities, future funding needs and proposed dividend levels. Group banking arrangements include financial covenants which are based on adjusted IFRS results as outlined in note 16.

As a result of these considerations it was announced in January 2017 that no dividend would be paid in respect of the year ended 31 December 2017. The Board set a net debt/EBITDA threshold of 1.5x in response to the immediate need to strengthen the Balance Sheet, and in May 2017 a Rights Issue was completed as detailed in note 22. This raised net proceeds of £496.7m which were applied to existing debt and held as bank deposits. The Board continues to review the position on a regular basis and intends to take a conservative approach to the capital structure in 2018 before setting out a revised capital allocation policy.

## 22. Share capital

| | Number of 2.5p shares | Share capital £m | Share premium £m |
|---|---|---|---|
| At 1 January 2016 | 1,214,527,625 | 30.4 | 301.9 |
| Issued in the year | 569,287,950 | 14.2 | 476.4 |
| At 31 December 2016 | **1,783,815,575** | **44.6** | **778.3** |
| Issued in the year | **683,145,540** | **17.1** | **479.6** |
| **At 31 December 2017** | **2,466,961,115** | **61.7** | **1,257.9** |

Shares were issued on 4 May 2017 as a result of a 2 for 5 fully underwritten Rights Issue at an issue price of 75p per share. Net proceeds of £496.7m were realised after costs of £15.7m. In the prior year, shares were issued following a 1 for 2 fully underwritten Rights Issue which raised net proceeds of £490.6m after costs of £16.1m.

As at 31 December 2017 88,427,023 (2016: 88,587,855) ordinary shares were held in treasury including 12,475,299 (2016: 12,636,131) shares held in the Cobham Employee Benefit Trust. At 31 December 2017 the market value of treasury shares was £111.7m (2016: £145.0m), including shares with a market value of £15.8m (2016: £20.7m) held by the Cobham Employee Benefit Trust.

During the year ended 31 December 2017 treasury shares were used to satisfy awards and options under the Group's share based payment schemes. Receipts from option exercises are included in retained earnings and total equity.

Further details of the share capital of Cobham plc can be found in the Directors' Report on page 72.

## 23. Other reserves

| £m | Note | Translation reserve | Hedge reserve | Share based payment reserve | Total other reserves |
|---|---|---|---|---|---|
| At 1 January 2016 | | (24.4) | (0.1) | 24.2 | (0.3) |
| Foreign exchange differences on translation of overseas operations | | 34.6 | – | – | 34.6 |
| Reclassification of foreign exchange on divestment of overseas operation | | 6.7 | – | – | 6.7 |
| Movements on cash flow hedges – interest rate swaps | 19 | (0.4) | (0.2) | – | (0.6) |
| Movements on cash flow hedges – foreign exchange contracts | | 0.1 | (2.3) | – | (2.2) |
| Reclassification of fair value of cash flow hedges to Income Statement | | – | 1.6 | – | 1.6 |
| Share based payments recognised in reserves | 24 | – | – | 3.8 | 3.8 |
| Transfer of share based payment reserve on exercise | | – | – | (5.1) | (5.1) |
| Tax effects | | (0.1) | 0.5 | (1.2) | (0.8) |
| Foreign exchange adjustments | | – | 0.2 | – | 0.2 |
| At 31 December 2016 | | **16.5** | **(0.3)** | **21.7** | **37.9** |
| Foreign exchange differences on translation of overseas operations | | **(50.4)** | – | – | **(50.4)** |
| Movements on cash flow hedges – interest rate swaps | 19 | – | **1.1** | – | **1.1** |
| Movements on cash flow hedges – foreign exchange contracts | | **0.5** | **(0.7)** | – | **(0.2)** |
| Reclassification of fair value of cash flow hedges to Income Statement | | – | **0.5** | – | **0.5** |
| Transfer reserves on settlement of cash flow hedge contracts | | **0.1** | **(0.1)** | – | – |
| Share based payments recognised in reserves | 24 | – | – | **5.5** | **5.5** |
| Transfer of share based payment reserve on exercise | | – | – | **(2.9)** | **(2.9)** |
| Tax effects | | – | **(0.1)** | – | **(0.1)** |
| **At 31 December 2017** | | **(33.3)** | **0.4** | **24.3** | **(8.6)** |

The translation reserve comprises all foreign exchange differences arising on the results and financial position of subsidiaries whose functional currencies differ from the Group's reporting currency together with foreign exchange movements arising on interest rate swaps and foreign exchange derivatives designated as hedge instruments.

The hedge reserve reflects movements in fair values on cash flow hedging derivatives as detailed in notes 19 and 21.

The share based payment reserve includes the cost of awards as assessed under IFRS 2 and detailed in note 24, together with related deferred tax provided under IAS 12. The appropriate proportion of this reserve is transferred to retained earnings following vesting or exercise.

## 24. Share based payments

The Group offers a number of long term incentive schemes which provide a mix of performance based incentive and retention based awards as described below and in the Directors' Remuneration Report on pages 62 to 71. All schemes are equity settled and the total amount included in the Income Statement arising from share based payment schemes is as follows:

| £m | 2017 | 2016 |
|---|---|---|
| PSP | **1.4** | 1.7 |
| RSP | **3.4** | 1.3 |
| Other schemes | **0.7** | 0.8 |
| | **5.5** | 3.8 |

The number of awards outstanding at 31 December under each scheme are as follows:

| Number of awards (thousands of shares) | 2017 | 2016 |
|---|---|---|
| PSP | **13,597** | 9,998 |
| RSP | **5,052** | 3,618 |
| ESOS | **3,484** | 3,794 |
| BCP | – | 17 |
| ShareSave | **8,372** | 7,612 |
| **At 31 December** | **30,505** | 25,039 |

### PSP

The PSP scheme is offered to senior executives across the Group and allows for annual grants of conditional shares and nil-cost options with vesting conditions based on the Group's financial performance, taking into account both market based conditions such as TSR growth and non-market based measures such as EPS growth or cash conversion. The scheme includes retention awards granted from time to time to specific personnel and buy-out awards granted to key new starters, both vesting after a maximum of three years conditional only upon continued employment within the Group.

| Number of awards (thousands of shares) | 2017 | 2016 |
|---|---|---|
| At 1 January | 9,998 | 10,026 |
| Awards granted | 8,405 | 4,100 |
| Effect of Rights Issue | 853 | 1,314 |
| Awards forfeited or cancelled | (5,487) | (3,909) |
| Exercised | (143) | (1,489) |
| Expired | (29) | (44) |
| **At 31 December** | 13,597 | 9,998 |

| | | |
|---|---|---|
| Weighted average remaining contractual life of PSP awards outstanding | 1.7 years | 1.1 years |
| Number of PSP awards exercisable at 31 December (thousands) | 26 | 23 |

Awards granted in the year under the PSP scheme were mainly granted in May 2017 with an average fair value of £1.319 (2016 awards: £1.602). Fair values are calculated using the Black-Scholes option pricing model and, where market related performance conditions apply, a Monte Carlo simulation is also used. There is no exercise price for these awards. The weighted average inputs into the models were as follows:

| | 2017 | 2016 |
|---|---|---|
| Weighted average share price | £1.381 | £1.646 |
| Expected life | 2.9 years | 2.2 years |
| Expected employee cancellation rate | 3.1% | 4.0% |
| Risk free rate | 0.3% | 0.6% |

The expected lives used in the models have been adjusted, based on management's best estimate, for the effects of non-transferability and behavioural considerations. The expected employee cancellation rates are based on assessments of historic rates of voluntary cancellations of contracts by employees. Dividend yields were nil or were not relevant to the valuation model where participants of the vested awards receive the benefit of dividend equivalent payments.

### RSP

RSP awards provide conditional shares based solely on continued employment within the Group over a maximum of four years.

| Number of awards (thousands of shares) | 2017 | 2016 |
|---|---|---|
| At 1 January | 3,618 | 1,317 |
| Awards granted | 3,200 | 2,660 |
| Effect of Rights Issue | 524 | 172 |
| Awards forfeited or cancelled | (455) | (213) |
| Exercised | (1,823) | (304) |
| Expired | (12) | (14) |
| **At 31 December** | 5,052 | 3,618 |

| | | |
|---|---|---|
| Weighted average remaining contractual life of RSP awards outstanding | 1.5 years | 1.3 years |
| Number of RSP awards exercisable at 31 December (thousands) | 4 | – |

Awards granted in the year under the RSP scheme were mainly granted in May 2017 with an average fair value of £1.375 (2016 awards: £1.617) which is then adjusted for non-vesting conditions such as expected employee cancellation using a weighted average rate of 5.1% (2016: 6.1%). Fair values are calculated using the Black-Scholes option pricing model and equate to the market price on the date of grant.

### Other schemes

Charges for other schemes relate to share options granted under the Group's ShareSave scheme, which is open to all UK employees. The fair values of ShareSave awards granted in the year are significantly lower than for PSP and RSP awards due to the effect of the exercise price which is set based upon the market value of the Company's ordinary shares around the date of grant.

In 2016, the charges for other schemes also included the final amounts charged for ESOS and BCP schemes which were last awarded in 2013 and 2014 respectively.

## 25. Operating lease arrangements

At the balance sheet date the Group had outstanding commitments for minimum lease payments due under non-cancellable operating leases as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Within one year | **28.3** | 30.3 |
| Between one and two years | **24.7** | 27.7 |
| Between two and three years | **17.5** | 25.1 |
| Between three and four years | **16.0** | 16.6 |
| Between four and five years | **13.7** | 14.0 |
| After five years | **66.9** | 45.5 |
| | **167.1** | 159.2 |

Operating lease commitments include £17.6m (2016: £23.8m) related to onerous leases which have been provided for at the balance sheet date.

Operating lease payments during the year totalled £35.7m (2016: £32.3m) including rental costs of £8.6m (2016: £7.8m) relating to operational aircraft used in the Group's service businesses; the remainder primarily relates to the rental of office and operating facilities.

## 26. Contingent liabilities

At 31 December 2017, the Company and the Group had contingent liabilities in respect of bank and contractual performance guarantees and other matters arising in the ordinary course of business. Where it is expected that a material liability will arise in respect of these matters, appropriate provision is made within the Group Financial Statements.

As announced in June 2017, Cobham was notified by the Financial Conduct Authority that it had appointed investigators to ascertain whether the Company had breached the Listing Rules and the Disclosure and Transparency Rules between April 2016 and February 2017 and the Market Abuse Regulation between July 2016 and February 2017. It is currently not possible to predict what the outcome of this investigation will be.

The Company and various of its subsidiaries are, from time to time, parties to various legal proceedings and claims and management does not anticipate that the outcome of these, either individually or in aggregate, will have a material adverse effect upon the Group's financial position.

The nature of much of the contracting work done by the Group means that there are reasonably frequent contractual issues, variations and renegotiations that arise in the ordinary course of business, whose resolution is uncertain and could materially impact the Group's future reported earnings. In particular, on fixed price development contracts, costs incurred and anticipated can significantly exceed amounts estimated as a result of material enhancements to the specifications originally agreed under the contracts. Judgement is therefore required as regards estimated costs to complete, the outcome of negotiations with customers and the amounts recoverable under these contracts. The amount recoverable may be subject to direct damages due to the customer and damages or penalties they incur from their own end users. In particular there are onerous contract terms and challenging delivery schedules on air to air refuelling development contracts. The Group may take account of the advice of experts as required in making these judgements and whether the outcome of negotiations will result in an appropriate recovery of costs.

In the case where the Group is undertaking development activity at its own cost, but has given performance undertakings to prospective customers, then a liability for losses consequent upon the failure to meet such undertakings could exist.

The Group is subject to corporate and other tax rules in the jurisdictions where it conducts its business operations. Changes in tax rates, tax reliefs and tax laws, changes in practice or interpretation of the law by the relevant tax authorities, increasing challenges by relevant tax authorities on transfer pricing and other matters, or any failure to manage tax risks adequately could result in increased charges, financial loss, penalties and reputational damage, which may materially adversely affect the Group's financial condition and results of operations.

In addition, tax enforcement has become a higher priority for many tax authorities in jurisdictions in which the Group operates, which has led to an increase in tax audits, enquiries and challenges, or the testing through litigation of the boundaries of the correct interpretation of legislation. Tax authorities may also actively pursue additional taxes based on retroactive changes to tax laws and the Group may have disagreements with tax authorities which could result in a material restatement to the tax position. For example, the availability of certain interest deductions on one of the Group's internal financing arrangements, principally as a result of various US acquisitions, has been under challenge for some time. Over the life of this internal financing arrangement, the aggregate tax value of the interest deductions amounted to approximately £130m. If decided adversely to the Group, this could lead to increased tax liabilities in excess of those provided in the Group's Balance Sheet, and result in a substantial tax payment becoming due. That payment may also be subject to an interest charge from the relevant authority. The Group has taken external advice and considers that it has strong support for its position. However, the timing and resolution of this issue is uncertain.

The European Commission (EC) has opened an investigation into the UK's controlled foreign company (CFC) rules. The CFC rules levy a charge on foreign entities controlled by the UK that are subject to a lower rate of tax, however there is currently an exemption available for 75% of this charge if the activities being undertaken by the CFC relate to financing. The EC is investigating whether this exemption is in breach of EU State Aid rules, but it is too early to assess what the conclusions of this investigation might be.

On 22 December 2017 extensive changes to the US tax system were made. A number of risks to the Group arise as a result, including anti-base erosion, the way that interest deductions are made, foreign tax credits and tax of foreign earnings. These risks are currently being assessed as further clarity is provided by the US tax authorities.

## 27. Related party transactions

During the year, £0.4m (2016: £0.9m) of goods were purchased from and £nil (2016: £0.6m) of goods were sold to joint ventures and associates. There were no other material transactions between Group entities and related parties during the current or previous year. Group policy is for all transactions with related parties to be made on an arm's length basis and no guarantees have been given to, or received from, related parties.

Details of the compensation of key management personnel can be found in note 4.

The Directors of Cobham plc had no material transactions with the Company during the year, other than as a result of service agreements. Details of Directors' remuneration are disclosed in the Directors' Remuneration Report on pages 62 to 71.

## 28. Events after the balance sheet date

As shown in note 16, the US$75m credit agreement was repaid in January 2018 following the refinancing activity completed in December 2017.

The divestment of the AvComm and Wireless test and measurement businesses was announced on 2 February 2018, as disclosed in note 15.

## 29. Subsidiaries and other related undertakings

The Group operates through a number of subsidiary undertakings and a full listing of these as at 31 December 2017 is provided below. The Group owns 100% of the share capital of all subsidiaries with the exception of TEAM SA (98.7% owned).

The Group also has interests in a small number of joint ventures and one associated undertaking which are included in the list below. The joint ventures and associates all have share capital consisting solely of ordinary shares, which are indirectly held, and the country of incorporation or registration is also their principal place of operation. No further disclosures are provided concerning the assets and results of the joint ventures or associated undertaking on the basis of materiality.

| Name of undertaking | Address of registered office or equivalent |
|---|---|
| Aedion Investments Unit Trust | 26 New Street, St Helier, Jersey JE2 3RA |
| Aeroflex Asia Ltd. | Unit 7-8, 13/F, Progress Commerical Building, 9 Irving Street, Causeway Bay, Hong Kong |
| Aeroflex Colorado Springs, Inc. | Wilmington, USA |
| Aeroflex Control Components, Inc. | CSC-Lawyers Incorporating Service (Company), 601 Abbot Road, East Lansing, MI 48823, USA |
| Aeroflex France SAS | 31 avenue de la Baltique, 91140 Villebon sur Yvette, France |
| Aeroflex GmbH | Gutenbergstr. 2–4, 85737 Ismaning, Germany |
| Aeroflex Holding Corp. | Wilmington, USA |
| Aeroflex Incorporated | Wilmington, USA |
| Aeroflex Innovations (Shanghai) Co. Ltd. | 1008-1009, No 76, Pujian Road, 10F, You You International Plaza, Shanghai 200127, PRC |
| Aeroflex Ireland Limited | Adelphi Plaza (Ground Floor) George's Street Upper, Dún Laoghaire, Co. Dublin, Ireland |
| Aeroflex Japan KK | 16F Fukoku Seimei Bldg., 2-2-2 Uchisaiwai-cho, Chiyoda-ku, Tokyo 100-0011, Japan |
| Aeroflex Limited | Stevenage, England |
| Aeroflex Microelectronic Solutions, Inc. | CSC-Lawyers Incorporating Service (Company), 601 Abbot Road, East Lansing, MI 48823, USA |
| Aeroflex Plainview, Inc. | Wilmington, USA |
| Aeroflex RAD Europe Limited | Stevenage, England |
| Aeroflex RAD, Inc. | Corporation Service Company, 80 State Street, Albany, New York 12207-2543, USA |
| Aeroflex Singapore Pte. Ltd. | 21 Media Circle, Infinite Studios, #06-04 & #05-01, Singapore 138562, Singapore |
| Aeroflex Systems Private Limited | 602, 6th Floor, Raheja Paramount, Residency Road, Bangalore – 560025, Karnataka, India |
| Aeroflex Technology Service (Beijing) Co. Ltd. | CircleNo. 38 Taikang Building Block 1, Unit 1501-03, & 1507, Chaoyang District, Beijing, PRC |
| Aeroflex Test Solutions Limited | Wimborne, England |
| Aeroflex Wichita, Inc. | Wilmington, USA |
| AFI Flight Inspection GmbH | Hermann-Blenk-Straße 8a, 38108 Braunschweig, Germany |
| AFI Holdings GmbH | Hermann-Blenk-Straße 8a, 38108 Braunschweig, Germany |
| Air Précision SAS | 5 avenue Denis Papin, BP 36, 92353 Le Plessis Robinson, France |
| Asia Pacific Airlines (Papua New Guinea) Pty Limited | Blake Dawson, 4th Floor, Mogoru Motor Building, Champion Parade, Port Moresby, National Capital District, Papua New Guinea |
| Asia Pacific Airlines Pty Limited | Adelaide, Australia |
| Atlantic Microwave Corporation | Wilmington, USA |
| Avenue 64 Limited | Wimborne, England |
| Aviation Défense Service SA (45% joint venture)[1] | Zone Aéroportuaire Nîmes Arles Camargue, 30800 Saint Gilles, France |
| A-xell Wireless AB | Torhamnsgatan 30F, 164 40 Kista, Sweden |
| Axell Wireless Asia Pte Limited | 21 Media Circle, Infinite Studios, #06-04 & #05-01, Singapore 138562, Singapore |
| Axell Wireless Israel Limited | 6 Bareket St., Petah-Tikva 49002, Israel |
| Axell Wireless Limited | Wimborne, England |
| Axell Wireless, Inc. | Wilmington, USA |
| Carleton Life Support Systems, Inc | Wilmington, USA |

| Name of undertaking | Address of registered office or equivalent |
|---|---|
| Carleton Technologies, Inc | Wilmington, USA |
| Chelton Antennas SA | 7 chemin de Vaubesnard, 91410 Dourdan, France |
| Chelton Avionics, Inc | Wilmington, USA |
| Chelton Limited | Wimborne, England |
| Chelton Technologies Canada Limited | PO Box 10424, Pacific Centre, 1300-777 Dunsmuir Street, Vancouver V7Y 1K2, Canada |
| Chelton Telecom and Microwave SAS | 31 avenue de la Baltique, 91140 Villebon sur Yvette, France |
| Chelton, Inc | Corporation Service Company d/b/a CSC-Lawyers Inco, 211 E. 7th Street, Suite 620, Austin, TX 78701, USA |
| Cob Finance LLC | Wilmington, USA |
| Cobham Advanced Electronic Solutions Mexico, S.A. de C.V. | Baker & McKenzie Abogados, S.C., Pedregal 24, Lomas Virreyes, 11040 Ciudad de México, D.F., Mexico |
| Cobham Advanced Electronic Solutions, Inc. | Wilmington, USA |
| Cobham AES Holdings Inc. | Wilmington, USA |
| Cobham Aviation Services Engineering Pty Limited | Adelaide, Australia |
| Cobham Aviation Services International Limited | Wimborne, England |
| Cobham CTS Limited | Wimborne, England |
| Cobham Defence Communications Limited | Wimborne, England |
| Cobham Defense Products, Inc. | Wilmington, USA |
| Cobham Flight Inspection Limited | Wimborne, England |
| Cobham Gaisler AB | Kungsgatan 12, SE-411, 19 Göteborg, Sweden |
| Cobham Holdings (US) Inc. | Wilmington, USA |
| Cobham Holdings Inc. | Wilmington, USA |
| Cobham India Private Limited | 4th Floor, Statesman House, Barakhamba Road, New Delhi – 110001, India |
| Cobham Leasing Limited | Wimborne, England |
| Cobham Management Services Inc. | Wilmington, USA |
| Cobham Mission Equipment Inc. | Wilmington, USA |
| Cobham Properties Inc. | Wilmington, USA |
| Cobham SAR Services Pty Limited | Adelaide, Australia |
| Cobham Slip Rings Naples Inc. | Wilmington, USA |
| Comant Industries, Incorporated | CSC Lawyers Incorporating Service, 2710 Gateway Oaks Drive, Suite 150N, Sacramento, CA 95833, USA |
| Continental Microwave and Tool Co, Inc. | Corporation Service Company, 84 State Street, Boston, MA 02109, USA |
| FB Heliservices Kenya Limited | PO Box 764, 00606, Nairobi, Kenya |
| FB Heliservices Limited | Wimborne, England |
| FB Leasing Limited | Wimborne, England |
| FBH Cyprus Limited | 12 Kennedy Avenue, Kennedy Business Centre, 2nd Floor, Office 203, P.C. 1087, Nicosia, Cyprus |
| FBS Limited | Wimborne, England |
| Fleet Support Pty Limited | Adelaide, Australia |
| Flight Refuelling Limited[2] | Wimborne, England |
| FR Aviation Group Limited | Wimborne, England |
| FR Aviation Limited | Wimborne, England |
| FR Aviation Services Limited | Wimborne, England |
| FR Investments Inc. | Wilmington, USA |
| Glyndale Pty Limited | Adelaide, Australia |
| Groupement Troyen d'Electronique | Rue Catherine et William Booth, 10000 Troyes, France |
| Hyper-Technologies SAS | 28 rue des Dames, 78340 Les Clayes sous Bois, France |
| IFR Finance Inc. | 10200 West York Street, Wichita, KS 67215-8999, USA |
| IFR Finance Limited Partnership[3] | Stevenage, England |
| IFR Systems, Inc. | Wilmington, USA |
| Jet Systems Pty Limited | Adelaide, Australia |
| Label SAS | 10 allée de Montréal, 74108 Annemasse, France |
| Lock Financing Limited | Suite 6, Rineanna House, Shannon Free Zone, Co. Clare, Ireland |
| Lockman Denmark Financing S.à r.l | 20 rue des Peupliers, L-2328, Luxembourg |
| Lockman Denmark Holdings A/S | Lundtoftegårdsvej 93 D, DK-2800 Kongens Lyngby, Denmark |
| Lockman Electronic Holdings Limited | Wimborne, England |
| Lockman Financing S.à r.l | 20 rue des Peupliers, L-2328, Luxembourg |
| Lockman Investments Limited | Wimborne, England |
| Lockman Properties Limited | Wimborne, England |
| Lockwash Investments LLC | Wilmington, USA |

| Name of undertaking | Address of registered office or equivalent |
|---|---|
| Lockwash US Limited | Wimborne, England |
| Manlock Investments Limited | Wimborne, England |
| Mastsystem International Oy | Muovilaaksontie 8, 82110 Heinävaara, Joensuu, Finland |
| Micro-Mesh SARL | 35 rue de Montlhéry, BP 20191, 94563 Rungis, France |
| NAS Services Pty Limited | Adelaide, Australia |
| NAT Seattle Inc. | Wilmington, USA |
| National Air Support Pty Limited | Adelaide, Australia |
| National Investments Asia Pacific Pty Limited | Adelaide, Australia |
| National Jet Express Pty Limited | Adelaide, Australia |
| National Jet Operations Services Pty Limited | Adelaide, Australia |
| National Jet Systems Ground Handling Pty Limited | Adelaide, Australia |
| National Jet Systems Pty Limited | Adelaide, Australia |
| Northern Airborne Technology Limited | PO Box 10424, Pacific Centre, 1300-777 Dunsmuir Street, Vancouver V7Y 1K2, Canada |
| Northrop Grumman Cobham Intercoms LLC (50% joint venture) | CT Corporation System, 1209 Orange Street, Wilmington, DE 19801, USA |
| Omnipless Manufacturing (Pty) Limited | Westlake Drive, Westlake Business Park, Westlake 7945, South Africa |
| Philtech Co., Ltd (associate owned 30%) | Sujeong-gu, Seongnam-si, Gyeonggi-do, South Korea |
| Precision Aviation Industries SARL | 5 avenue Denis Papin, BP 36, 92353 Le Plessis Robinson, France |
| Sargent Fletcher Inc. | Wilmington, USA |
| Satori Air Services Inc | 4105 Cousens Street, Saint-Laurent, Quebec H4S 1V6, Canada |
| Sea Tel, Inc | CSC Lawyers Incorporating Service, 2710 Gateway Oaks Drive, Suite 150N, Sacramento, CA 95833, USA |
| Sivers Lab AB | Torhamnsgatan 30F, 164 40 Kista, Sweden |
| Société de Marquage et Signalisation SAS | 174-178 Quai de Jemmapes, 75010 Paris, France |
| Surveillance Australia Pty Limited | Adelaide, Australia |
| TEAM SA | 35 rue de Montlhéry, BP 20191, 94563 Rungis, France |
| Thrane & Thrane A/S | Lundtoftegårdsvej 93 D, DK-2800 Kongens Lyngby, Denmark |
| Thrane & Thrane Aalborg A/S | Industrivej 30, DK-9490 Pandrup, Denmark |
| Thrane & Thrane Inc. | CT Corporation System, 4701 Cox Road, Suite 285, Glen Allen, VA 23060, USA |
| Thrane & Thrane Norge A/S | Cort Adelers gate 16, 0254 Oslo, Norway |
| Trivec-Avant Corporation | CSC Lawyers Incorporating Service, 2710 Gateway Oaks Drive, Suite 150N, Sacramento, CA 95833, USA |
| Vector Fields Incorporated | Wilmington, USA |

**Dormant entities**

| | |
|---|---|
| Aeroflex Asia Pacific Limited | Stevenage, England |
| Aeroflex Bloomingdale, Inc. | Corporation Service Company, 80 State Street, Albany, New York 12207-2543, USA |
| Aeroflex Burnham Limited | Stevenage, England |
| Aeroflex Cambridge Limited | Stevenage, England |
| Aeroflex Milan SRL | Via Comaggia 10, c/o Studio Legale Tributario, Milan 20123, Italy |
| Aeroflex Tech., SA | Europa Empresarial, Calle Rozabella 6, Edificio Paris, 28230 Laz Rosas, Madrid, Spain |
| Aeroflex Test Solutions India Pvt Limited | 602, 6th Floor, Raheja Paramount, 138 Residency Road, Bangalore, Karnataka-560025, India |
| Chelton Aviation Corporation | Corporation Service Company d/b/a CSC-Lawyers INCO, 211 E. 7th Street, Suite 620, Austin, TX 78701, USA |
| Chelton Satcom, Inc. | Wilmington, USA |
| Cobham Aviation SDN BHD | Level 8 Symphony House, Block D13 Pusat Dagangan Dana 1, Jalan PJU 1A/46, 47301 Petaling Jaya, Selangor, Malaysia |
| Cobham Comms Limited (formerly Cobham Communications and Connectivity Limited) | Wimborne, England |
| Cobham Communications and Connectivity Limited (formerly Wallop Holdings Limited) | Wimborne, England |
| Cobham Group Limited | Wimborne, England |
| Cobham Helicopter Services Trinidad | 5-7 Sweet Briar Road, St Clair, Port of Spain, Trinidad and Tobago |
| Cobham Mission Systems Limited | Wimborne, England |
| Cobham Whiteley Limited | Wimborne, England |
| Credowan Limited | Wimborne, England |
| CTS Patents Limited | Wimborne, England |
| European Antennas Limited | Wimborne, England |
| Falcon Special Air Services SDN BHD | Level 8 Symphony House, Block D13 Pusat Dagangan Dana 1, Jalan PJU 1A/46, 47301 Petaling Jaya, Selangor, Malaysia |
| FB Heliservices Curacao N.V. | Kaya W.F.G. (Jombi), Mensing 36, Curacao |
| Grenedere Limited | Wimborne, England |

| Name of undertaking | Address of registered office or equivalent |
|---|---|
| Lockman Finance Limited | Wimborne, England |
| Lockman Financing Limited | Wimborne, England |
| ML Aviation Limited | Wimborne, England |
| Multiphase Pumping Systems Limited | Wimborne, England |
| National Jet Regional Services Pty Limited | Adelaide, Australia |
| Racal Antennas Limited | Wimborne, England |
| Strabor (Aircraft) Limited | Wimborne, England |
| Strabor Investments Limited | Wimborne, England |
| W.E.S. (Manufacturing) Limited | Wimborne, England |
| W.E.S. Investments Limited | Wimborne, England |

Full registered office addresses are:

| | |
|---|---|
| Wimborne, England | Brook Road, Wimborne, Dorset BH21 2BJ, England |
| Stevenage, England | Longacres House, Six Hills Way, Stevenage, Hertfordshire SG1 2AN, England |
| Wilmington, USA | Corporation Service Company, 2711 Centerville Road, Suite 400, Wilmington, DE 19808, USA |
| Adelaide, Australia | National Drive, Adelaide Airport SA 5950, Australia |

[1] The 45% investment in Aviation Défense Service SA is treated as a joint venture because the governance structure means that the Group has joint control with its partner.
[2] Issued shares in Flight Refuelling Limited are held by Cobham plc. Otherwise shares are held by, or by a nominee for, a subsidiary of Cobham plc.
[3] Advantage has been taken of the exemption conferred by regulation 7 of the Partnership Accounts Regulations 2008 from the requirements to prepare and publish audited accounts for IFR Finance Limited Partnership.

# Parent Company Balance Sheet

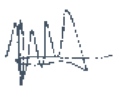
As at 31 December 2017

| £m | Note | 2017 | 2016 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Investments in Group and other undertakings | 6 | 1,013.5 | 787.3 |
| Other investments | 6 | 6.1 | 6.1 |
| Derivative financial instruments | 11 | 33.1 | 35.0 |
| Other receivables | 7 | 18.7 | 18.3 |
| | | 1,071.4 | 846.7 |
| **Current assets** | | | |
| Derivative financial instruments | 11 | 15.6 | 35.2 |
| Trade and other receivables | 7 | 2,474.3 | 2,645.8 |
| Cash and cash equivalents | | 409.1 | 204.7 |
| | | 2,899.0 | 2,885.7 |
| **Liabilities** | | | |
| **Current liabilities** | | | |
| Borrowings | 8 | – | (60.7) |
| Trade and other payables | 9 | (511.4) | (510.5) |
| Provisions | 10 | (6.3) | (8.0) |
| Derivative financial instruments | 11 | (18.5) | (46.4) |
| | | (536.2) | (625.6) |
| **Non-current liabilities** | | | |
| Borrowings | 8 | (835.1) | (1,203.2) |
| Derivative financial instruments | 11 | (29.7) | (33.3) |
| Retirement benefit obligations | 12 | (25.8) | (36.8) |
| | | (890.6) | (1,273.3) |
| **Net assets** | | 2,543.6 | 1,833.5 |
| **Equity** | | | |
| Share capital | 13 | 61.7 | 44.6 |
| Share premium | | 1,257.9 | 778.3 |
| Other reserves | | 17.2 | 13.5 |
| Retained earnings | | 1,206.8 | 997.1 |
| **Total equity** | | 2,543.6 | 1,833.5 |

## Profit for the financial year

In accordance with the concession granted under Section 408 of the Companies Act 2006, the Income Statement of Cobham plc has not been separately presented in these financial statements. The Company's profit for the year ended 31 December 2017 was £203.8m (2016: £304.6m).

The financial statements on pages 129 to 135 were approved by a duly appointed and authorised committee of the Board on 1 March 2018 and signed on its behalf by:



**David Lockwood** **David Mellors**
Directors

# Parent Company Statement of Changes in Equity

For the year ended 31 December 2017

| £m | Share capital | Share premium | Other reserves: Hedge reserve | Other reserves: Share based payment reserve | Retained earnings | Total equity |
|---|---|---|---|---|---|---|
| **Total equity at 1 January 2016** | 30.4 | 301.9 | (2.3) | 15.6 | 829.1 | 1,174.7 |
| Profit for the year | – | – | – | – | 304.6 | 304.6 |
| Other comprehensive income/(expense) | | | | | | |
| Items that will not be reclassified subsequently to profit or loss | – | – | – | – | (17.9) | (17.9) |
| Items that may subsequently be reclassified to profit or loss | – | – | 1.5 | – | – | 1.5 |
| Issue of shares, net of costs (note 13) | 14.2 | 476.4 | – | – | – | 490.6 |
| Proceeds on allocation of treasury shares | – | – | – | – | 2.3 | 2.3 |
| Dividends (note 2) | – | – | – | – | (126.1) | (126.1) |
| Share based payments (note 5) | – | – | – | 3.8 | – | 3.8 |
| Transfer of share based payment reserve | – | – | – | (5.1) | 5.1 | – |
| **Total equity at 31 December 2016** | 44.6 | 778.3 | (0.8) | 14.3 | 997.1 | 1,833.5 |
| Profit for the year | **–** | **–** | **–** | **–** | **203.8** | **203.8** |
| Other comprehensive income | | | | | | |
| Items that will not be reclassified subsequently to profit or loss | **–** | **–** | **–** | **–** | **2.5** | **2.5** |
| Items that may subsequently be reclassified to profit or loss | **–** | **–** | **1.1** | **–** | **–** | **1.1** |
| Issue of shares, net of costs (note 13) | **17.1** | **479.6** | **–** | **–** | **–** | **496.7** |
| Proceeds on allocation of treasury shares | **–** | **–** | **–** | **–** | **0.5** | **0.5** |
| Share based payments (note 5) | **–** | **–** | **–** | **5.5** | **–** | **5.5** |
| Transfer of share based payment reserve | **–** | **–** | **–** | **(2.9)** | **2.9** | **–** |
| **Total equity at 31 December 2017** | **61.7** | **1,257.9** | **0.3** | **16.9** | **1,206.8** | **2,543.6** |

The share based payment reserve includes the cost of awards granted to employees of the Company and Group as assessed under IFRS 2. Where awards which gave rise to charges under IFRS 2 have vested or been exercised, the appropriate proportion of the reserve is transferred to retained earnings.

Distributable reserves at 31 December 2017 amounted to £1,180.1m (2016: £967.8m).

# Notes to the Parent Company Financial Statements

## 1. Parent Company accounting policies

These financial statements are the financial statements for Cobham plc, the Parent Company of the Cobham plc Group, which operates as a group holding company.

### Accounting convention

The financial statements have been prepared in accordance with Financial Reporting Standard 101, Reduced Disclosure Framework (FRS 101).

The financial statements have been prepared on the going concern basis, under the historical cost convention as modified to include the revaluation of derivative financial assets and liabilities measured at fair value through profit or loss and in accordance with the Companies Act 2006.

The Company has taken advantage of the following disclosure exemptions under FRS 101:

- A cash flow statement and related notes (IAS 7, Statement of Cash Flows and paragraph 10(d) of IAS 1, Presentation of Financial Statements);
- Comparative period reconciliations of the number of shares outstanding (Paragraph 38 of IAS 1, Presentation of Financial Statements in respect of paragraph 79(a)(iv) of IAS 1);
- Capital management disclosures required by paragraphs 134 to 136 of IAS 1;
- The requirements of paragraphs 30 and 31 of IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors concerning the effects of new but not yet effective IFRSs;
- Details of compensation of key management personnel required by paragraph 17 of IAS 24, Related Party Disclosures; and
- The requirements in IAS 24 to disclose related party transactions entered into between two or more members of a group.

In addition, as the consolidated financial statements of Cobham plc include the equivalent disclosures, the following exemptions under FRS 101 have also been taken:

- Share based payment disclosures under paragraphs 45(b) and 46-52 of IFRS 2, Share Based Payment in respect of group settled share based payments; and
- Financial instrument information required by IFRS 7, Financial Instruments: Disclosures and paragraphs 91 to 99 of IFRS 13, Fair Value Measurement.

### Management judgement and estimation uncertainty

The preparation of financial statements in conformity with Financial Reporting Standards requires the use of judgements and estimates that affect the application of accounting policies and reported amounts of assets, liabilities, revenue and expenses.

These judgements and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The current economic conditions have been considered when evaluating accounting judgements and estimates, including the application of the going concern basis of preparation. Although estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

#### Significant judgements in applying accounting policies

There were no significant judgements, apart from those involving estimations, that the Directors made in the process of applying the Group's accounting policies which require separate disclosure in these financial statements.

#### Assumptions and estimation uncertainties

Management consider that there are a number of assumptions concerning the future and other major sources of estimation uncertainty at the balance sheet date, which have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Information concerning these assumptions and estimation uncertainties is provided as follows:

a. Carrying value of investments (note 6)
   A review of the carrying value of investments is completed as required to ensure that it is not impaired. This requires an estimate of the expected future cash flows from subsidiary undertakings and also a suitable discount rate in order to calculate the present value of those cash flows. This is considered to be a source of estimation uncertainty at the balance sheet date, which may have a significant risk of causing a material adjustment to the carrying amount of investments within the next financial year.

b. Pension assets and liabilities (note 12)
   Assumptions are made in assessing the costs and present value of the pension assets and liabilities, which include the discount rate, inflation and mortality rates.

The principal accounting policies, which have been consistently applied, are as set out below.

### Dividends

Dividends payable are recognised as a liability in the period in which they are fully authorised. Dividend income is recognised when the shareholders' right to receive payment has been established.

### Retirement benefit obligations

The Company operates and participates in the Cobham Pension Plan (CPP) and the Cobham Executive Pension Plan (CEPP). The plans are funded defined benefit schemes and assets are held in separate trustee administered funds. The assets and liabilities of the CPP have been allocated to the contributing companies based on the proportional number of members. The Company also operates and contributes to a defined contribution scheme.

For the defined benefit schemes, current service costs and costs related to the administration of the schemes are charged to operating profit. Past service costs are recognised in the Income Statement. The interest on net assets or liabilities is shown within finance income and costs. Actuarial remeasurements are recognised in Other Comprehensive Income (OCI).

Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting net defined benefit asset or liability is presented separately on the Balance Sheet.

For the defined contribution scheme, the amount charged to the Income Statement in respect of pension costs and other post-retirement benefits are the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are recorded as either accruals or prepayments in the Balance Sheet.

### Current and deferred taxation
Current tax is provided at the amounts expected to be paid using rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. It is calculated at the tax rates that are expected to apply in the periods in which the asset is realised or liability is settled, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on an undiscounted basis and deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Tax is charged or credited to the Income Statement except when it relates to items recognised in OCI or directly in equity respectively, in which case the tax is also recognised in OCI or directly in equity respectively. Tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred taxes relate to the same fiscal authority.

### Investments in Group and other undertakings
Investments in subsidiary undertakings are stated at cost less any provision for impairment in value and include the fair value at the date of grant of share based payment awards to employees of subsidiary undertakings, net of amounts recovered as management charges.

Other investments are stated at cost less any provision for impairment in value.

### Provisions
A provision is recognised when the Company has a present legal or constructive obligation as a result of a past event and it is probable that settlement will be required of an amount that can be reliably estimated.

### Share capital
Ordinary share capital is classified as equity.

Preference share capital is classified as a liability if it is redeemable on a specific date or at the option of the preference shareholders or if dividend payments are not discretionary. Dividends on preference share capital classified as liabilities are recognised in the Income Statement as interest expense.

### Foreign currencies
The functional currency of the Company is sterling.

Transactions in currencies other than sterling are translated at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in non-functional currencies are retranslated at the exchange rate ruling at the balance sheet date. Non-monetary items (such as investments) that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency (such as some derivative financial instruments) are translated using the exchange rates at the date when the fair value was determined.

All exchange differences arising are taken to the Income Statement.

### Financial instruments
The policies disclosed in note 1 to the Group Financial Statements on page 88 for the recognition, measurement and presentation of financial instruments are applicable to the Parent Company Financial Statements.

Amounts receivable from and owed to subsidiaries are recognised at amortised cost using the effective interest method and are reduced by appropriate allowances for estimated irrecoverable amounts.

Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs and subsequently held at amortised cost. Interest is accounted for on an accruals basis in the Income Statement. Premiums payable on settlement or redemption and direct issue costs are capitalised and amortised over the period to which the facility relates.

### Share based payments
For grants made to employees of Cobham plc under the Group's equity share based payment schemes, amounts which reflect the fair value of awards as at the time of grant are charged to the Income Statement over the vesting period, taking into account management's best estimate of the number of awards expected to vest. The vesting estimate, which includes progress against non-market related performance conditions, is reviewed and updated at each balance sheet date. The fair value of awards made to employees of subsidiary undertakings, net of amounts recovered as management charges, is recognised as a capital contribution and recorded in investments.

## 2. Dividends
No dividends were paid or approved during the year ended 31 December 2017. The following dividends were paid in the prior year:

| £m | 2016 |
|---|---|
| Final dividend of 7.07p per share for 2015 (restated) | 91.6 |
| Interim dividend of 1.77p per share for 2016 (restated) | 34.5 |
| | 126.1 |

Dividend per share figures above have been restated to reflect the bonus element of the May 2017 Rights Issue.

## 3. Employees
The average number of employees, including Directors, during the year was 162 (2016: 162). All staff were employed in administrative functions. Costs for these employees were as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Wages and salaries | 13.2 | 12.9 |
| Social security costs | 1.1 | 1.0 |
| Pension costs | 9.4 | 9.6 |
| Share based payments | 1.3 | 0.7 |
| | 25.0 | 24.2 |

Disclosures in respect of the emoluments of Directors and key management personnel can be found in the Directors' Remuneration Report on pages 62 to 71 and in note 4 to the Group Financial Statements respectively.

## 4. Audit fees
The audit fee in respect of the Parent Company Financial Statements was £44,000 (2016: £47,000).

## 5. Share based payments
Employees of Cobham plc participate in equity settled share based payment schemes which are operated by the Group for senior executives and also in the Group's ShareSave scheme which is open to all UK employees.

At 31 December, the following awards were outstanding under each scheme:

| Number of awards (thousands of shares) | 2017 | 2016 |
|---|---|---|
| PSP | 3,942 | 3,242 |
| RSP | 1,082 | 388 |
| ESOS | 84 | 180 |
| BCP | – | 17 |
| ShareSave | 818 | 696 |
| | 5,926 | 4,523 |

Options outstanding under the ESOS scheme had a weighted average remaining contractual life of 1.3 years (2016: 1.7 years) and exercise prices which range from £1.36 to £1.72 (2016: £1.36 to £1.71 as adjusted for the bonus impact of the 2017 Rights Issue). Options outstanding under the ShareSave scheme had a weighted average remaining contractual life of 3.0 years (2016: 3.1 years) and exercise prices which range from £1.10 to £1.78 (2016: £1.09 to £1.78 as adjusted).

Exercises of awards under the ESOS and ShareSave schemes were made at various times throughout the year. The average share price in that period was £1.241 (2016: £1.842).

Further details of these schemes can be found in the Directors' Remuneration Report on pages 62 to 71 and in note 24 to the Group Financial Statements.

## 6. Investments in Group and other undertakings

| £m | Shares | Share based payments | Total |
|---|---|---|---|
| **Cost and net book amount** | | | |
| At 1 January 2017 | **773.3** | **14.0** | **787.3** |
| Additions in the year | **225.0** | **–** | **225.0** |
| Share based payment awards granted to employees of Group undertakings net of recoveries | **–** | **1.2** | **1.2** |
| **At 31 December 2017** | **998.3** | **15.2** | **1,013.5** |

During the year, the Company subscribed for additional shares in two of its subsidiary undertakings at a total cost of £225.0m with no changes to the proportion of shares held.

In the opinion of the Directors the value of investments in subsidiary undertakings is not less than the aggregate amount at which they are shown above.

A list of all subsidiaries is provided in note 29 to the Group Financial Statements. The market capitalisation of the Group as a whole is given in the Group Financial Record on page 136.

The Company has minority shareholdings in two companies in connection with the FSTA programme. The total amount invested is £6.1m (2016: £6.1m) and this is held as a trade investment.

## 7. Trade and other receivables

### Current assets

| £m | 2017 | 2016 |
|---|---|---|
| Amounts owed by Group undertakings | **2,456.1** | 2,621.4 |
| Deferred tax | **7.4** | 15.2 |
| Prepayments and accrued income | **10.8** | 9.2 |
| | **2,474.3** | 2,645.8 |

Amounts owed by Group undertakings are unsecured and repayable on demand. All such balances, excluding trading balances, are interest bearing.

The net deferred tax asset can be analysed as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Derivative financial instruments | **1.9** | 7.5 |
| Retirement benefit obligations | **5.3** | 7.4 |
| Share based payments | **0.2** | 0.2 |
| Accelerated capital allowances | **–** | 0.1 |
| | **7.4** | 15.2 |

Movements in the net deferred tax asset are as follows:

| £m | 2017 |
|---|---|
| At 1 January 2017 | **15.2** |
| Charge to reserves | **(0.8)** |
| Charge to Income Statement | **(7.0)** |
| **At 31 December 2017** | **7.4** |

### Non-current assets

| £m | 2017 | 2016 |
|---|---|---|
| Loan notes | **18.7** | 18.3 |

The loan notes relate to the FSTA programme, are interest bearing and due for repayment in 2035.

## 8. Borrowings

### Current liabilities

| £m | 2017 | 2016 |
|---|---|---|
| Senior notes | **–** | 60.7 |

### Non-current liabilities

| £m | 2017 | 2016 |
|---|---|---|
| Bank loans | **204.3** | 475.7 |
| Senior notes | **630.8** | 727.5 |
| | **835.1** | 1,203.2 |

Further details of the Company's principal borrowing facilities are disclosed in notes 13 and 16 to the Group Financial Statements.

The loans falling due after more than one year are due for repayment as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Between one and two years | **55.4** | 267.4 |
| Between two and five years | **148.9** | 204.9 |
| After five years | **–** | 3.4 |
| | **204.3** | 475.7 |

Senior notes falling due after more than one year mature as follows:

| £m | 2017 | 2016 |
|---|---|---|
| Between two and five years | **317.3** | 383.6 |
| After five years, maturing in 2024 (2016: between 2021 and 2024) | **313.5** | 343.9 |
| | **630.8** | 727.5 |

## 9. Trade and other payables

| £m | 2017 | 2016 |
|---|---|---|
| Trade payables | **2.6** | 2.4 |
| Amounts owed to Group undertakings | **484.5** | 488.2 |
| Corporation tax payable | **6.5** | 3.3 |
| Other tax and social security | **1.0** | 1.3 |
| Accruals and deferred income | **16.9** | 15.3 |
| | **511.4** | 510.5 |

Amounts owed to Group undertakings include £86.8m (2016: £85.6m) on which interest is charged at rates of between 0.4% and 9% (2016: 0.25% and 9%). The remaining amount owed by Group undertakings is interest free. All amounts are unsecured and are repayable on demand.

## 10. Provisions

| £m | Legal claims | Other provisions | Total |
|---|---|---|---|
| At 1 January 2017 | **1.4** | **6.6** | **8.0** |
| Additional provisions in the year | **0.8** | – | **0.8** |
| Utilisation of provisions | **(1.0)** | **(0.7)** | **(1.7)** |
| Provisions released | **(0.8)** | – | **(0.8)** |
| **At 31 December 2017** | **0.4** | **5.9** | **6.3** |

Other provisions of £5.9m (2016: £6.6m) relate to longer term warranties given on divestments completed in 2005. All amounts have been determined based on the Directors' current estimates of likely outcomes and the timing of any claims remains uncertain.

## 11. Derivative financial instruments

The Company's activities expose it to the financial risks of changes in foreign currency exchange rates and interest rates. The Company uses foreign exchange contracts and interest rate swap contracts to reduce these exposures and does not use derivative financial instruments for speculative purposes. Other derivative financial instruments may be used from time to time to manage exposures such as inflation risk.

The fair values of derivative financial instruments are as follows, these are financial assets measured at fair value through profit or loss, or financial liabilities categorised as held for trading:

| £m | Interest rate swaps | Foreign exchange derivatives | Inflation swap | Total |
|---|---|---|---|---|
| Non-current assets | – | **33.1** | – | **33.1** |
| Current assets | – | **15.2** | **0.4** | **15.6** |
| Current liabilities | – | **(18.1)** | **(0.4)** | **(18.5)** |
| Non-current liabilities | – | **(29.7)** | – | **(29.7)** |
| **At 31 December 2017** | – | **0.5** | – | **0.5** |
| | | | | |
| Non-current assets | – | 34.6 | 0.4 | 35.0 |
| Current assets | – | 33.8 | 1.4 | 35.2 |
| Current liabilities | (0.6) | (44.4) | (1.4) | (46.4) |
| Non-current liabilities | (1.2) | (31.7) | (0.4) | (33.3) |
| At 31 December 2016 | (1.8) | (7.7) | – | (9.5) |

The movements in the fair values of derivative financial instruments during the year are as follows:

| £m | Interest rate swaps | Foreign exchange derivatives | Inflation swap | Total |
|---|---|---|---|---|
| At 1 January 2016 | (2.3) | (15.8) | – | (18.1) |
| Gain through Income Statement – not hedged | – | 7.1 | – | 7.1 |
| Gain reclassified to Income Statement | 1.1 | 0.4 | – | 1.5 |
| (Loss)/gain through OCI – hedged items | (0.2) | 0.6 | – | 0.4 |
| Foreign exchange adjustments | (0.4) | – | – | (0.4) |
| At 31 December 2016 | **(1.8)** | **(7.7)** | – | **(9.5)** |
| Gain through Income Statement – not hedged | – | **8.0** | – | **8.0** |
| Gain/(loss) reclassified to Income Statement | **0.7** | **(0.1)** | – | **0.6** |
| Ineffectiveness of net investment hedge through Income Statement | – | **0.2** | – | **0.2** |
| Gain through OCI – hedged items | **1.1** | **0.1** | – | **1.2** |
| **At 31 December 2017** | – | **0.5** | – | **0.5** |

Floating to fixed interest rate swaps were cancelled in the year ended 31 December 2017 following the repayment of the associated floating rate borrowings. These interest rate swaps were previously designated as cash flow hedging instruments and hedge accounting was applied. In addition, a small number of specific foreign exchange derivatives with a fair value at 31 December 2017 of £0.1m (2016: £18.5m) are designated as cash flow hedging instruments and hedge accounting is applied. In 2016, there was no material ineffectiveness in cash flow hedges to be reported through the Income Statement.

The majority of foreign exchange and inflation derivatives are not accounted for using hedge accounting and movements in fair values are recorded in the Income Statement.

The most significant assumptions in valuing the derivatives are the exchange rates for GBP: US$, GBP: DKK and GBP: EUR.

## 12. Retirement benefit obligations

Retirement benefit obligations in the Balance Sheet comprise:

| £m | 2017 | 2016 |
|---|---|---|
| Defined benefit scheme assets | **431.4** | 415.7 |
| Defined benefit obligations | **(457.2)** | (452.5) |
| | **(25.8)** | (36.8) |

### Defined benefit pension schemes

The Company operates and participates in the Cobham Pension Plan (CPP) and the Cobham Executive Pension Plan (CEPP). The plans are funded defined benefit schemes (where benefits are based on employees' length of service and average final salary) and assets are held in separate trustee administered funds. The plans have been closed to new members since 2003 and have been closed to future accrual from 1 April 2016.

Details of actuarial valuation processes and risks, assumptions and sensitivities relating to the CPP and CEPP are not significantly different to those disclosed in note 20 to the Group Financial Statements.

The Company expects to contribute £8.5m to its defined benefit pension schemes in 2018 and £4.8m in 2019. At 31 December 2017, £0.7m (2016: £nil) of contributions were outstanding.

Changes in the fair value of scheme assets are as follows:

| £m | 2017 | 2016 |
|---|---|---|
| At 1 January | 415.7 | 349.0 |
| Interest | 10.9 | 13.1 |
| Actuarial gains | 18.0 | 62.3 |
| Employer contributions | 8.7 | 8.7 |
| Benefits paid | (21.9) | (17.4) |
| **At 31 December** | 431.4 | 415.7 |

Changes in the present value of the defined benefit obligations are as follows:

| £m | 2017 | 2016 |
|---|---|---|
| At 1 January | 452.5 | 371.4 |
| Interest cost | 11.7 | 13.8 |
| Actuarial losses arising from changes in financial assumptions | 20.7 | 89.7 |
| Actuarial gains arising from changes in demographic assumptions | (5.8) | (5.0) |
| Benefits paid | (21.9) | (17.4) |
| **At 31 December** | 457.2 | 452.5 |

The actual return on scheme assets was £28.9m (2016: £75.4m). The weighted average duration of the scheme liabilities is estimated to be 16 years.

The fair value of major categories of scheme assets, and as a percentage of total scheme assets, is as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | £m | % | £m | % |
| UK equity instruments | – | – | 27.7 | 6.7% |
| Overseas equities | – | – | 16.1 | 3.9% |
| Emerging markets equities | – | – | 11.0 | 2.6% |
| Global equities | 48.1 | 11.1% | – | – |
| Liability driven investments | 77.9 | 18.1% | 40.8 | 9.8% |
| Corporate bonds | 42.5 | 9.9% | 41.3 | 9.9% |
| Private credit | 14.5 | 3.3% | 7.6 | 1.8% |
| Insurance contracts | 180.8 | 41.9% | 181.9 | 43.8% |
| Diversified growth funds | 66.5 | 15.4% | 75.4 | 18.2% |
| Other assets | 1.1 | 0.3% | 13.9 | 3.3% |
| | 431.4 | 100.0% | 415.7 | 100.0% |

Scheme assets do not include any of the Company's own financial instruments, nor any property occupied by, or other assets used by, the Company.

### Defined contribution pension schemes

The Company also operates and participates in the Cobham Personal Pension Plan, a defined contribution scheme. The assets of the scheme are held separately from those of the Company in independently administered funds. The pension cost charged represents contributions payable by the Company to the funds and amounted to £0.8m (2016: £1.0m). No contributions were outstanding at the end of 2017 or 2016.

## 13. Share capital

| £m | 2017 | 2016 |
|---|---|---|
| **Allotted, issued and fully paid** | | |
| **Equity** | | |
| 2,466,961,115 (2016: 1,783,815,575) 2.5p ordinary shares | 61.7 | 44.6 |
| **Non-equity** | | |
| 19,700 (2016: 19,700) 6% second cumulative preference shares of £1 | – | – |

Preference shares with a value of £19,700 are classified as borrowings.

Following a 2 for 5 fully underwritten Rights Issue, 683,145,540 ordinary shares of 2.5p each were issued on 4 May 2017 at an issue price of 75p per share. Net proceeds of £496.7m were realised, net of costs of £15.7m.

Further details of the share capital of Cobham plc, including changes resulting from treasury shares, can be found on page 72 and in note 22 to the Group Financial Statements.

## 14. Contingent liabilities and commitments

The Company has contingent liabilities in respect of bank and contractual performance guarantees and other matters arising in the ordinary course of business entered into for, or on behalf of, certain Group undertakings.

Further details of contingent liabilities related to the Company, including risks related to uncertain tax positions and the nature of contract risks supported by performance guarantees, can be found in note 26 to the Group Financial Statements.

The Company had no capital commitments at 31 December 2017 (2016: £nil).

## 15. Related party transactions

During the year the Company entered into transactions, in the ordinary course of business, with related parties that are part of the Cobham plc Group or investees of the Group. The Company has taken advantage of the exemption under paragraph 8(k) of FRS 101 from disclosing related party transactions with its wholly owned subsidiary undertakings. The only transactions with non-wholly owned subsidiaries relate to the receipt of management and brand charges totalling £1.4m (2016: £1.3m) from TEAM SA which is 98.7% owned. No amounts were outstanding at the current or prior year end.

There were no material transactions with the Directors, their close family members or other connected parties to be reported during the year other than arising from Directors' service agreements. Details of Directors' remuneration are disclosed in the Directors' Remuneration Report on pages 62 to 71.

# Group Financial Record

| £m | 2013 | 2014 | 2015 | 2016 | **2017** |
|---|---|---|---|---|---|
| Revenue | 1,789.7 | 1,851.7 | 2,072.0 | 1,943.9 | **2,052.5** |
| Underlying operating profit | 316.7 | 286.7 | 332.2 | 225.0 | **210.3** |
| Underlying profit before taxation | 288.0 | 257.0 | 280.4 | 175.2 | **173.1** |
| Underlying earnings attributable to owners of the parent | 230.8 | 204.8 | 220.1 | 135.5 | **133.1** |
| Profit/(loss) before taxation | 126.6 | 24.3 | (39.8) | (847.9) | **66.9** |
| Taxation | (12.1) | 4.7 | 2.1 | 52.8 | **11.9** |
| Profit/(loss) after taxation for the year | 114.5 | 29.0 | (37.7) | (795.1) | **78.8** |
| Working capital | 247.5 | 374.2 | 424.8 | 409.3 | **298.6** |
| Net debt | (453.4) | (1,222.7) | (1,206.8) | (1,028.2) | **(383.5)** |
| Retirement benefit obligations | (87.3) | (102.0) | (56.7) | (87.0) | **(63.2)** |
| Net assets | 1,044.2 | 1,112.3 | 909.7 | 489.9 | **1,028.3** |
| Operating cash flow | 268.5 | 207.9 | 234.6 | 181.8 | **217.6** |
| Operating cash conversion | 85% | 73% | 71% | 81% | **103%** |
| Free cash flow | 155.0 | 114.4 | 105.5 | 50.7 | **140.6** |
| Net debt/EBITDA (for covenant purposes) | 1.2 | 2.6 | 2.9 | 3.0 | **1.3** |
| Average number of employees | 10,090 | 10,941 | 12,527 | 10,898 | **10,736** |

| pence | | | | | |
|---|---|---|---|---|---|
| Dividend paid per ordinary share | 6.66 | 7.33 | 7.96 | 7.76 | – |
| Earnings per ordinary share – underlying | 15.9 | 13.7 | 14.3 | 7.8 | **6.0** |
| Earnings per ordinary share – basic | 7.9 | 1.9 | (2.4) | (45.9) | **3.5** |
| Earnings per ordinary share – diluted | 7.9 | 1.9 | (2.4) | (45.9) | **3.5** |

EPS figures for prior years have been restated to reflect the bonus element of the Rights Issues, in accordance with IAS 33, Earnings per Share. The dividend paid per ordinary share has also been restated for all comparative periods presented above.

| £m | | | | | |
|---|---|---|---|---|---|
| Market capitalisation as at 31 December | 3,169 | 3,934 | 3,440 | 2,920 | **3,116** |

# Shareholder Information

## Analysis of shareholders

Analysis of ordinary shareholders on the register at 31 December 2017:

| Size of holding (number of ordinary shares held) | Number of registered holders | Percentage of registered holders | Number of ordinary shares held | Percentage of ordinary shares |
|---|---|---|---|---|
| Up to 1,000 | 1,201 | 26.05% | 547,309 | 0.02% |
| 1,001-10,000 | 2,189 | 47.47% | 8,182,546 | 0.33% |
| 10,001-50,000 | 722 | 15.66% | 14,807,130 | 0.60% |
| 50,001-250,000 | 251 | 5.44% | 31,914,524 | 1.29% |
| 250,001-1,000,000 | 126 | 2.73% | 65.494.311 | 2.66% |
| 1,000,001 and above | 122 | 2.65% | 2,346,015,295 | 95.10% |
| **Total** | **4,611** | **100.00%** | **2,466,961,115** | **100.00%** |

Source: Equiniti Group plc

At 31 December 2017, there were 4,611 ordinary shareholders on the register, compared with 4,803 at 31 December 2016. The total includes 75,951,724 shares held in treasury.

## Registrars

Enquiries concerning shareholdings or dividends should, in the first instance, be addressed to the Company's registrars, Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA (telephone: 0371 384 2163* or +44 (0) 121 415 7047 if calling from outside the UK). Shareholders should promptly notify the registrars of any change of address or other particulars.

The registrars provide a range of shareholders' services online. The portfolio service provides access to information on investments including balance movements, indicative share prices and information on dividends and also enables address and mandate details to be amended online. For further information and practical help on transferring shares or updating your details, please visit **www.shareview.co.uk**. The share dealing service enables shares to be sold by UK shareholders by telephone, post or over the internet. For telephone sales please call 0345 603 7037 between 8:00am and 4:30pm, Monday to Friday. For postal sales, please send your completed documentation to the address above. For internet sales, please visit **www.shareview.co.uk/dealing**.

## Individual Savings Accounts (ISAs)

The registrars also offer an ISA for Cobham shareholders. Further information may be obtained by visiting **www.shareview.co.uk**, or telephone 0345 300 0430 (or +44 (0) 121 415 0105 if calling from outside the UK).

You should bear in mind that investments, both their value and the income they provide, can go down as well as up and you might not get back what you originally invested.

## Capital gains tax

For the information of shareholders who held Cobham plc ordinary shares on 31 March 1982, the market value, adjusted for capitalisation and Rights Issues, of the Company's ordinary shares on that date for capital gains tax purposes, unadjusted for the share sub-division of July 2005, was 86.02p.

## ShareGift

Do you have a small shareholding which is uneconomical to sell? You may want to consider donating it to ShareGift (registered charity no. 1052686), a charity that specialises in the donation of small, unwanted shareholdings to good causes. You can find out more by visiting **www.sharegift.org** or calling +44 (0) 20 7930 3737.

## Shareholder Security

Shareholders are advised to be wary of any unsolicited advice, offers to buy shares, or offers of free reports about the Company. Details of any share dealing facilities that the Company endorses will be included in Company mailings or on our website. If you receive any unsolicited advice, make sure you get the correct name of the person and organisation and check that they are appropriately authorised by the FCA by visiting **www.fca.org.uk**. You can also call the FCA Consumer Helpline on 0800 111 6768 (or +44 (0) 20 7066 1000 if calling from outside the UK).

* Lines are open Monday to Friday 8:30am to 5:30pm; excluding Public Holidays in England and Wales.

## Financial calendar

| | |
|---|---|
| AGM | 26 April 2018 |
| Interim results | 1 August 2018 |

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## Cautionary Statements

This publication contains 'forward looking statements' with respect to the financial condition, results of operations and business of the Cobham Group and to certain of Cobham's objectives with respect to these items.

Forward looking statements are sometimes but not always identified by the use of a date in the future or such words as 'anticipates', 'aims', 'due', 'could', 'may', 'should', 'expects', 'believes', 'intends', 'plans', 'targets', 'goal', or 'estimates' (or the negative thereof). By their very nature forward looking statements are inherently unpredictable, speculative and involve risk and uncertainty because they relate to events and depend on circumstances that may or will occur in the future.

There are various factors that could cause actual results and developments to differ materially from those expressed or implied by these forward looking statements. These factors include, but are not limited to, changes in economies, political situations and markets in which the Group operates; changes in government priorities due to programme reviews or revisions to strategic objectives; changes in regulatory or competition frameworks in which the Group operates; the impact of legal or other proceedings against or which affect the Group; changes to or delays in programmes in which the Group is involved; the completion of acquisitions and divestitures and changes in commodity prices, inflation or exchange rates.

All written or verbal forward looking statements, made in this publication or made subsequently, which are attributable to Cobham or any other member of the Group or persons acting on their behalf, are expressly qualified in their entirety by the factors referred to above. Neither Cobham nor any other person intends to update these forward looking statements.

No statement in this publication is intended as a profit forecast or should be interpreted to mean that underlying operating profit for the current or future financial years would necessarily be above a minimum level, or match or exceed the historical published operating profits or set a minimum level of operating profit.

# The most important thing we build is trust

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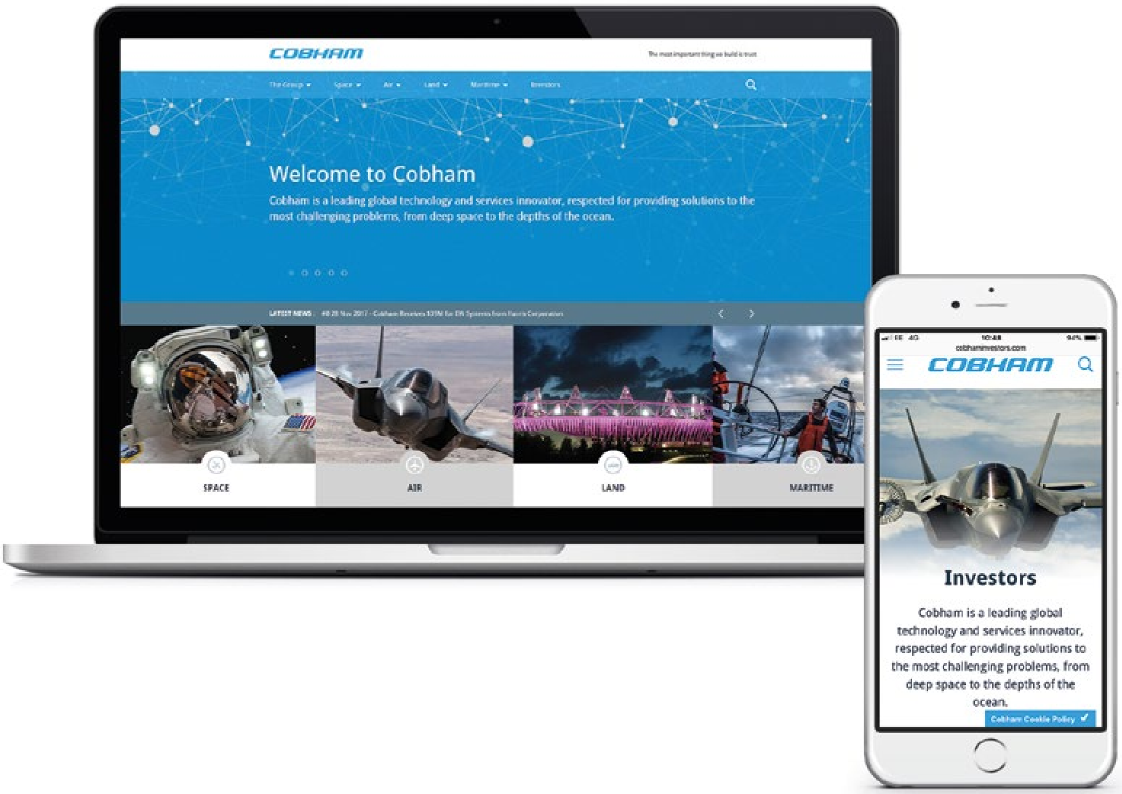


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