IQE PLC | Report and Annual Accounts 2016

Overview of 2016

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BUILDING ON STRONG FOUNDATIONS

Chairman's report to shareholders

Celebrating success

It is my great pleasure to introduce our 2016 annual report and financial statements, providing details of the Group's strong operational and financial performance in what I can confidently describe as a highly successful year during which we delivered on our strategy to diversify our revenues and grow our intellectual property (IP) portfolio.

I am pleased to report that our strategy has delivered strong revenue growth, earnings growth and cash generation.

REVENUE UP BY 16%

Revenue increased by 16% to £132.7m (2015: £114.0m). Adjusted operating profit increased by 18% to £22.1m (2015: £18.9m). Adjusted, fully diluted earnings per share rose by more than 15% to 3.0p (2015: 2.6p).

This encouraging financial performance reflects the strength of our powerful portfolio of IP, which is delivering continued growth and opportunities across a diverse range of applications and markets, coupled with an advantageous currency tailwind in the second half.

EPS * UP BY 15%

We fully settled our deferred consideration relating to previous acquisitions and our capital investment increased during the year to enable us to address the emerging growth opportunities.

Building on strong foundations

Over the last few years we have laid out our strategic roadmap with the vision and ambition to develop an unparalleled depth and breadth in advanced materials technology.

We reshaped the Group to strengthen IQE's position in each of our primary markets: Wireless, Photonics, Infrared, Advanced Solar, Power, and CMOS++ (advanced electronics). The clear focus on execution of our strategy is paying off: in 2016, our strong financial performance results from achievements in diversifying our technology and product portfolio.

Our key industry differentiation comes from our superior technology capabilities, scale of operation and breadth of products and services giving us the ability to continue to deliver at the leading edge of semiconductor technology.

The Group has continued to drive progress through innovation. We have built our portfolio of pioneering, world-class materials technologies including cREO, which offers a unique approach to the manufacture of a wide range of innovative Compound Semiconductor on Silicon products and GaN on Si, which is playing an increasingly important role in RF Power markets.

Above all, our broad range of photonics capabilities, including the world's first 6" VCSEL technology, is making major waves in a range of new applications and has significantly contributed to IQE's revenue growth during 2016.

A fast moving marketplace

Technology is a meaningful part of our lives; it affects the way we live, work, socialise and communicate. As end-users, we want our battery powered handheld and wearable devices to last longer, our connectivity to be faster and our technology to be smarter.

Your current smartphone, the device in your pocket, is more powerful than the most advanced supercomputers at the end of the 20th Century. With further rapid technological advances, particularly in materials technologies, imagine how the world will look in the next few decades.

To meet consumers' increasing expectations of what is possible, enabling technologies are becoming increasingly more complex and innovation is become the key differentiator.

IQE's materials are at the very heart of many of today's advanced electronic products and with emerging technology breakthroughs in fields such as artificial intelligence, the Internet of Things, and 3D sensing, the possibilities are seemingly limitless. Technology is evolving at an amazing rate and IQE will play an increasingly important role in transforming and shaping the world in which we live.

** the measures presented above are all adjusted. See Notes 4 and 10 of the Financial Statements for reported measures*

IQE at the epicenter ….

Innovation has always been a key element in fostering economic growth: it contributes to improved competitiveness, creates value, increases employment opportunities and helps to address major societal challenges.

The last two years have ushered in a period of greater understanding of the impact that compound semiconductors will have in transforming the 21st century.

In the UK alone, we have seen significant investments in compound semiconductor technology by government agencies and academic institutions aimed at developing world-class capabilities. To date, more than £300M of UK public funding has been committed to a number of initiatives, largely focussed around Wales and South West England – the home of IQE's corporate headquarters.

Initiatives include the Cardiff University's Institute for Compound Semiconductors, EPSRC's Compound Semiconductor Hub, The Compound Semiconductor Applications Catapult and the Compound Semiconductor Centre, the unique joint venture between IQE and Cardiff University to establish a prototyping and commercialisation facility for compound semiconductor materials technologies.

It is expected that the fruits of the initiatives announced during 2015 and 2016 will begin to be realised during 2017 and 2018.

By putting innovation at the heart of its strategy, IQE has laid the foundations for a very exciting future.

Strategy and delivery

IQE manufactures and supplies compound semiconductor wafer products that offer high performance electrical and photonic properties, operating at speeds more than 100 times faster than silicon. Compound semiconductors are the material of choice for today's ever increasing demands on electronic materials technology.

Our products help to create a smarter, more advanced and more connected world that, every day, enriches people's lives in many ways. We have a passion and a drive for innovation that constantly challenges conventional and incumbent technologies to achieve the higher performance levels demanded across multiple markets such as communications, healthcare, aerospace, automotive, safety & security, the Internet of Things and efficient energy generation and usage.

Our strategy is clear: to use our technology leadership and scale to deliver the performance, cost points and security of supply required for mass market adoption of compound semiconductor materials in a demanding, highly technical, leading edge industry sector.

IQE has been at the forefront of the compound semiconductor industry since 1988 and has developed an unparalleled depth and breadth of intellectual property and technical capabilities to establish itself as a clear global leader in its chosen field.

IQE is the undisputed global leader in the supply of advanced wireless materials and is very soon set to replicate this success in its other primary markets, particularly the rapidly growing photonics sector where the Group's products enable a wide range of optical-fibre communications networks and increasingly in consumer devices in the form of sensor technologies.

The Group leverages its technology leadership and scale to deliver the performance, cost points and security of supply to support increasing mass market adoption across a significant number of high volume market verticals.

The Group has established the platform for delivering this strategy:

- Global footprint spanning US, Europe and Asia
- Breadth and depth of advanced semiconductor materials IP
- Talented, committed and experienced team
- Proven credibility and reputation
- Secure multi-site supply
- Scale and cost leadership
- Largest capacity in the industry

During 2016 we reinforced our strategy by:

- Continued expansion of our technology leadership by developing a broad IP portfolio through both internal development and recent strategic transactions.
- Using our previous investment in IP to grow revenues and profits
- Further sharpening our strategic diversification in our markets by seizing major opportunities in the rapidly growing sensor technology markets that are enabled by compound semiconductors.
- Improving operational performance

Advanced wafers for wireless communications applications continue to represent a key part of IQE's core business, growing 15% to £91.3m (2015: £79.5m) with further growth expected ahead of the next wave of innovation in smartphone and related communications technologies. The group continues to maintain its key wireless customer base and is pursuing a number of initiatives to grow market share with a number of new product qualifications in the pipeline.

Our fastest growth area was our photonics market, exhibiting 42% growth to £22.8m (2015: £16.0m) with further significant growth anticipated during 2017. Infrared products also demonstrated solid growth, increasing by 19% to £10.6m (2015: £8.9m).

As in 2015, we delivered increased underlying profitability, earnings and cash-generation, and settled all the deferred consideration relating to previous acquisitions.

We strongly anticipate the wireless sector to remain a major part of the Group's future business, which will only be enhanced with the adoption of numerous photonics devices in next generation handsets.

We expect significant upside potential to this growth in the medium term due to: innovation in smartphone hardware, including the adoptions of advanced sensors (including 3D sensing); the adoption of GaN on Silicon technology for base stations; the transition to 5G communications, which will require more advanced materials; and the combination of silicon with compound semiconductors using cREO for other wireless communication chips.

Operational highlights

A diverse range of growth drivers and end markets resulted in a 19% growth in wafer sales, reflecting organic growth in all markets, supplemented by a currency tailwind

During the year, the Group strengthened its direct engagement with multiple Tier 1 original equipment manufacturers (OEMs), reflecting IQE's strong IP position and the increasing importance of epitaxial IP as a key enabling technology in electronic systems.

A number of major milestones were achieved in 2016, enabled by IQE's growing portfolio of leading edge IP, and these provide a good lead indicator of significant growth opportunities ahead. Key achievements included:

- Key milestones delivered on several major photonics programmes during H2 2016, providing significant growth opportunities for 2017 and beyond;
- Excellent progress with our new cREO technology had delivered some early wins, including delivering a step change in GaN on Silicon technology (the elimination of "parasitic channel"), and active engagement in development programmes for advanced RF filter applications;
- A key customer is engaged in end market qualification using IQE's GaN on Silicon material, signifying that this technology is close to commercialisation
- Significant contract wins in InfraRed, and progress in a number of development programmes continue the growth of this business unit, and progress towards new high volume applications.
- Positive market dynamics, including increasing mergers and acquisition activity and sector investment, reflect the increasing focus on compound semiconductors as a critical enabling technology to major growth themes, including high speed communication, the "internet of things", big data, advanced medical technology, energy efficiency, and autonomous vehicles.
- Good progress by IQE's Joint Ventures in the UK and Singapore mark key milestones in their developing as centres of excellence in driving innovation and commercialisation of advanced CS technologies. The UK Joint Venture was a catalyst to securing c.£300m of funding towards the continued development of a UK CS Cluster, and the Singapore JV has been selected as a partner in a major programme for CS on silicon technology.

Other operational highlights during 2016 included continued organisational development, improvements in operational efficiencies and market diversification.

Organisation development

The Group continued with its Organisational Development Programme. This has involved transferring production between sites to improve operational efficiency, enabling the Group to reduce its operating costs and achieve its cost reduction targets.

The organisation also continued to focus on six key business units with a priority on those market sectors such as photonics and power, with the highest near term growth potential.

Improvements in operational efficiencies

Continuous improvement is an ongoing process across IQE's global operations, with numerous programmes under way at any given time.

A key feature of IQE's global footprint is the ability to develop and adopt best practice across multiple platforms, multiple products and multiple market sectors.

Market diversification

The Group has established six Business Units along market lines, to address its primary and emerging markets.

Each Business Unit has a clear product and customer focus, but continues to benefit from the production and technology synergies of the whole Group. Our manufacturing sites monitor production efficiencies, delivery performance and quality, aligned to the overall Group objectives.

Also, as part of its strategy for diversification, IQE has engaged with major industry players across multiple market sectors with the aim of establishing high-tech supply chains or "clusters" based on compound semiconductor technologies.

IQE has engaged with a number of stakeholders including government agencies and academic institutions to drive the economic agenda to prioritise and promote the formation of technology clusters focused on compound semiconductors.

Seizing the opportunity

As I look ahead, I couldn't be more excited about our position and the growth prospects for our industry and it is clear that the opportunities ahead are even brighter. IQE's performance over the course of 2016 demonstrated successful execution of a strategy that provides solid foundation for the future success.

IQE's position in the supply chain does not provide us with the status of being a household name amongst consumers. However, it never ceases to amaze me at the high-esteem held for IQE within our industry and across our supply chains, which include a number of major multinational blue-chip companies.

We are restricted by non-disclosure agreements across the supply chain which means that we are unable to name our customers, but the feedback from major international events is testament to the professionalism, expertise and integrity of our teams. I would like to thank all the management and staff of IQE for the success of the past year and their part in its achievement.

Our employees represent the cornerstone of our business. We start the year extremely well positioned to continue delivering strong results and to take advantage of new, high-growth opportunities. I express my thanks for the dedication and professional expertise of our directors, staff, and the whole workforce for their commitment and dedication; they continue to be the foundation of our achievements.

I would also like to take this opportunity to extend a warm welcome to Phil Smith, who joins our Board as a Non-Executive Director. Phil brings with him strong credentials and a wealth of experience gained across the technology sector. I also offer congratulations to fellow Board Member Sir David Grant on the award of his knighthood.

Finally, as always, I would like to thank you, my fellow shareholders, for your support. I trust that you share our excitement about the role we are destined to play in what promises to be an exciting future for IQE and for our industry.

Business review

This section provides an update on activities across our business.

Wireless

Wireless sales accounted for 69% of the Group's sales in 2016, slightly down from 70% in 2015. The wireless market covers electronic devices that communicate wirelessly. This includes but is not limited to mobile phones, smartphones, mobile networks, WiFi, smart metering, satellite navigation, and a plethora of other connected devices.

The wireless communications market has grown rapidly in recent years reflecting the increasing adoption of wireless technology, coupled with the need for an increased compound semiconductor content to support greater sophistication of mobile devices.

According to industry analyst, IDC, smartphone shipments in 2016 increased by 2.8% to 1.47 billion units (2015: 1.43 billion units). Sales were bolstered by a significant upturn in Q4 following Apple's launch of the iPhone 7 and iPhone 7+.

Whilst handset replacement cycles have slowed in recent years, expected innovations in areas such as wearable devices and 3D sensing are expected to reignite the desire to upgrade connected devices such as smartphones.

The ongoing evolution of our connected world in the form of the Internet of Things (IoT) is forecast to see 50 billion connected devices by 2020. In addition, the overall wireless market is expected to continue to grow with the global roll out of LTE, 4G, 5G and the evolution of WiFi.

High-speed connectivity and added functionality drive the requirement for the advanced properties offered by compound semiconductor epiwafers. The global roll-out of wireless broadband networks such as 4G/LTE devices increasingly rely on compound semiconductor content with 5G expected to demand a quantum leap in speed, power and efficiency with operating frequencies expected to operate above 60GHz compared with less than 3GHz protocols for existing 4G networks.

The migration to new WiFi standards is another major driver for RF components.

The 802.11ac WiFi standard operates at 5GHz rather than the 2.6GHz currently used. The higher frequency which greatly increases the range and reliability of WiFi networks will further raise the demand for compound semiconductor based RF devices.

Growth in the compound semiconductor content in smartphones will be driven by the need for more radio frequency functionality and greater complexity in wireless circuitry but will be partly mitigated by improved yields, production efficiencies and reduced materials "real-estate" from the ongoing drive towards smaller component sizes.

Photonics

The proportion of sales generated from photonics products continued its upward trajectory, accounting for 17% of the Group's sales in 2016, up from 14% in 2015.

Photonics represents applications which emit and detect light. We segment this market into emitters and detectors, infra-red, solar and lighting.

Emitters and detectors

This encompasses a wide range of applications including optical interconnects, laser projectors, optical storage, cosmetic applications, gesture recognition, finger navigation and a wide range of other sensing applications.

Optical interconnects

Currently, wired data transmission in the home, the office and in data centres is largely undertaken using copper cables. However, data traffic is growing at an explosive rate due to technologies such as high definition imaging, video streaming, the Internet of Things (IoT) and cloud computing. This phenomenon is necessitating a switch from copper wires to optical communication. This is a natural evolution which mirrors the transformation that has already taken place in the telecoms infrastructure.

Optical interconnects offer significantly higher-speed data transfers over much longer distances than their copper counterparts, and are much more efficient. Data centres have become major consumers of electrical energy, rivalling traditional heavy industries in terms of the power requirements needed to keep large warehouses full of servers operating and cooled. It is therefore of little surprise that enterprises such as data centres are amongst the first adopters, where optical technology now offers both higher performance and lower overall operating cost compared with copper.

Compound semiconductor technology that enable optical interconnects include Vertical Cavity Surface Emitting Lasers (VCSELs). VCSELs are an advanced laser technology geared to mass production and low cost. IQE is the market and technology leader for VCSEL products, with world record data speeds in excess of 64 Gb/s already demonstrated.

3D sensing

There is little doubt that sensing technologies will represent a major growth area in the near term and extending into the future.

Initially, consumer devices are likely to be the early adopters of 3D sensing technologies. In fact, laser (VCSEL)/detector pairs are already being deployed to enable "environment awareness" features in a number of smartphone and wearable applications and "time-of-flight" laser technology is being adopted for high speed auto-focus functionality in camera applications.

3D sensing is an essential feature for devices that need detailed and accurate information about their environment for applications such as augmented reality.

Future applications for 3D sensing will extend into autonomous vehicles for sensing features in the environment in order to make safety judgements.

Gesture recognition

Closely related to 3D sensing, gesture recognition represents the ability of electronic devices to recognise hand and body gestures and movements in order to control any device. The advanced properties of compound semiconductor epiwafers are a key component in gesture recognition devices which are expected to appear in many new product launches over the coming years.

The potential applications for this technology extend far beyond gaming, from medical applications, disability aids, remote controls, to sign language recognition, and more. In fact, the use of this technology is only limited by human imagination, and has far reaching implications for how we will interface with technology in the near future. It is anticipated that many household appliances will be controlled by gesture.

Laser projection

Conventional projection technologies use incandescent or halogen lamps as their light sources. Such devices are power hungry, physically bulky, have relatively short lifetimes and require focusing optics which can limit the image quality and flexibility.

The emergence of lasers in each of the primary colours (red, green and blue) enables a low cost, high quality laser projection solution which can be miniaturised and does not require focusing optics. This technology is called pico-projection.

Solid state lighting (LEDs)

Light emitting diodes (LEDs) are a high performance, low cost, green alternative to incandescent light bulbs.

Global concerns about climate change and the Earth's dwindling natural resources continue to be a priority for governments worldwide. Significant new policies and legislation continue to be introduced in the direction of renewable and highly efficient energy devices.

Already, many governments around the world have introduced wide-ranging legislation to progressively ban incandescent lighting. Alternative low energy, compact fluorescent lighting is unpopular because of perceptions of low quality lighting and on-going issues with heavy metal content including mercury.

Solar

Technologies which convert sunlight into electricity are also called PhotoVoltaics (or "PV"). The prevalent solar technology is based on silicon material, which typically achieves a conversion of between 15%-18% of the suns energy into electricity. IQE has been at the centre of developing solar materials using compound semiconductors, which can deliver much higher levels of efficiency. This technology, which is also known as Concentrating Photovoltaics, or "CPV", can already deliver efficiencies in excess of 44%, and has a route map to much higher levels of efficiency. Although this offers a lower overall cost of energy generation in sunny territories, the challenge in mass adoption is in reducing the end system install costs, which has been hampered by global macroeconomics as the cost of oil has plummeted.

The terrestrial market remains an exciting market opportunity, but as a result of the shifting macroeconomics, focus has shifted to the space market, where these advanced materials are used to power satellites where the higher efficiency has a dramatic cost benefit on payload. Product qualifications are underway with leading satellite manufacturers, paving the way for commercial revenues.

Infrared

IQE is a global leader in the supply of indium antimonide and gallium antimonide wafers for advanced infrared applications. We are the technology leader with the launch of the industry's first 150mm indium antimonide wafers, a major milestone in reducing the overall cost of chips to drive increasing adoption. This success was followed up with a number of significant contract wins for the division. In addition, there has been significant work in developing these materials for consumer sensing applications, which will drive much higher volumes of wafers in the future.

We expect this market to growth at a rate of approximately 5-10% for the near future.

CMOS++

Advanced technologies

IQE has developed a powerful range of advanced, engineered wafers such as germanium-on-insulator (GeOI), germanium-on-silicon (GeOSi) and silicon-on-sapphire (SOS), which offer a high performance and low cost solution for next generation microprocessors, ultra- high speed/high density flash memory and MEMS devices such as motion sensors.

IQE's cent's unique 'cREO™' technology provides a significant new platform to drive our business into several new large volume areas. Our cREO™ technology offers a unique approach to the manufacture of a wide range of innovative Compound Semiconductor on Silicon products, including gallium nitride (GaN) on silicon (Si) for the burgeoning Power switching and RF technologies markets. The technology is protected by a wide ranging IP portfolio.

IQE has established a powerful position in these advanced technologies, working with some of the biggest names in the industry, which is reflected in a number of joint patents awarded in conjunction with Intel for the production of compound semiconductor materials on silicon substrates.

We believe that our intellectual property in this field has the potential to revolutionise the semiconductor world, and in so doing will create significant long-term value to IQE shareholders.

Power Control

Gallium nitride (GaN) is a compound semiconductor that offers a diverse range of RF, photonic and electronic properties.

Of particular interest is the material's ability to cope with high voltages, high temperature, and high power which makes it an ideal candidate for power control systems which are growing in demand driven by alternative energy sources such as solar, wind and wave power, and also the adoption of electric vehicles.

It is estimated that, globally, more than 10% of all electricity is ultimately "lost" due to conversion inefficiencies, as energy is switched from generation, to grid, and through to consumption. The scale of this loss exceeds the world's entire supply of renewable energy generation.

The power adapters that we use for our electronic devices, such as laptop power supplies, provide a vivid example of this phenomenon by virtue of the electrical energy that is lost in the form of heat generated through the conversion process.

GaN offers superior performance and efficiency that are orders of magnitude better than the silicon technologies that dominate power switching devices today. Indeed, this technology has the potential to eliminate up to 90% of the energy lost through switching.

Our power business has made strong progress through 2016, achieving several key technical milestones and establishing and building commercial partnerships.

Research, development and innovation

R&D activity

Technology leadership lies at the heart of IQE's strategy. This is supported by a culture of innovation and constant improvement.

The Group is engaged in a number of research and development programmes in collaboration with customers, academia, research organisations and government agencies. These programmes are funded through a combination of internal cash generation, customer funding, and government support.

Development programmes are geared towards next generation applications as well as process improvements leading to greater throughput, higher-quality products, better manufacturing yield, increased production uptime and new product development.

Whilst many R&D programmes are subject to non-disclosure agreements and confidentiality, there are some programmes in the public domain, examples of which include:

- Integration of III-V with Si
- Sb-based materials
- Quantum Technologies
- Quantum Dot VCSELs
- Dilute nitrides for lasers and SWIR detectors
- Multi junction CPV solar cells
- Mixed nitride-antimonide-based detectors
- High power InP-based quantum cascade lasers
- Graphene for RF electronics

A list of technical publications is available within the research pages of the IQE website at www.iqep.com.

Industry events

IQE actively participates in major industry events and frequently chairs, hosts and presents technical papers at international conferences.

Open Innovation

IQE is classified by the Welsh Government as an "Anchor Company" in acknowledgement of its status as an exemplar in terms of its global leadership.

As an Anchor Company, IQE was invited by the Welsh Government to run an Open Innovation pilot programme which has been highly successful in establishing new technology networks to identify long-term opportunities.

IQE's open innovation programme, 'OpenIQE' is actively helping to boost regional economies by collaborating with industrial and academic partners to identify supply chain opportunities within Wales and across Europe.

Further details about IQE's open innovation programme can be found on a dedicated website:

www.openiqe.com

CoInnovate

As part of IQE's open innovation programme, a key "CoInnovate" conference was held in Cardiff, UK in 2015 and again in 2016. The conference was jointly sponsored by the Welsh Government, academic partners as well as IQE and industrial partners including Airbus, GE Healthcare and General Dynamics. After its first two successful years, CoInnovate 2017 is scheduled to run in June 2017.

The CoInnovate conference website is at: www.coinnovate.co.uk

Outlook

Year of opportunity

The Group's technology and market leadership, and its strong pipeline of high growth opportunities positions it well to continue its growth profile over the coming years.

The current financial year has started well and trading is in line with expectations. The outlook for the full year remains very positive, with good upside potential. The Board remains confident that the group is on track to achieve expectations for the full year, and anticipates that the group will continue to benefit from strong cash flows.

Strategic report

Celebrating success

The Group is committed to generating shareholder value by delivering increased revenues and profitability from continued investment in IP as well as through the development of new products and services for our global markets and delivering long-term sustainable revenues at high margins.

our vision

To be the global number one provider of advanced semiconductor materials

our strategy

To use our technology leadership and scale to deliver the performance, cost points and security of supply required for mass market adoption of advanced semiconductor materials

our delivery

Number one provider of compound semiconductor wafer products by market share and scale - clear technology leader with an unparalleled breadth of technology. Leading the advancement of new materials

Business overview

Outsourcing pioneer

In the early days of the industrial revolution it became absolutely necessary for manufacturers to be vertically integrated since there were no alternative sources of specialised goods and services.

Only towards the middle of the 20th century did specialisation become a competitive advantage.

However, in new and emerging technologies, the early adopters were in a similar position to their industrial revolution forefathers in that the development of new processes and technologies required the early pioneers to establish all key parts of their supply chain.

Smart specialisation

Early silicon chip manufacturers found it necessary to set up complete vertically integrated supply chains to source each part of the production process from raw materials through to a final packaged product.

As silicon technology matured, the industry saw the emergence of businesses specialising in different parts of the process to the extent that there now exist a large number of "fabless" companies who outsource the entire production process to large specialists such as TSMC and Global Foundries.

Pioneering specialisation within the compound semiconductor industry

The compound semiconductor industry shares similar attributes with the silicon chip industry. Some of the processes such as epitaxy require large scale investment, complex infrastructure support in the form of cleanrooms, environmental controls and most importantly, highly specialised skills and expertise.

In 1988, IQE, then EPI, became the first compound semiconductor materials company to recognise the potential value in offering specialised outsourcing of compound semiconductor wafers and has witnessed an increasing trend towards this model over its twenty-nine year history.

By specialising in the complex epitaxy process, IQE offers its customers economies of scale, access to leading edge technology at the same time as leaving them with the ability to do what they do best: design and refine their products.

The high level of investment means that IQE's business is highly operationally geared which facilitates significant scope for profitability once sales contribution exceeds fixed costs.

The last decade has demonstrated an unprecedented number of key industry suppliers selecting outsourcing as a key business advantage.

Our competitive advantage

Global footprint

IQE's operations span the US, Asia and Europe which reflects the geographical diversity of our customer base. This allows IQE to be positioned close to its customers and to build and maintain strong, long-term relationships and partnerships.

Breadth of technology

As a pioneer of compound semiconductor technology, IQE has developed an unparalleled and comprehensive breadth of technology and advanced production platforms.

Technology leadership

Through organic development and through acquisition, IQE has established clear technology leadership and created a virtuous circle, which continues to attract the brightest and best talent in our industry.

Intellectual property

IQE has and continues to develop a world leading IP portfolio through a combination of innovative development programmes as well as by acquisition.

Our IP is becoming increasingly attractive to customers wishing to access IQE's vast technical experience and expertise to develop and exploit new opportunities in new and emerging markets.

Our IP continues to add significant value to our product and service offering for both existing customers and the large number of new entrants to global technology markets.

Cost leadership

In the electronics industry, cost leadership is achieved through advanced technology and scale. IQE has developed leadership in both.

Security of supply

Confidence in a secure supply is critical to the supply chains in which IQE operates. IQE offers its customers identical supply from multiple locations for all its core technologies, allowing it to be a primary and trusted supplier to its customers.

Our markets

The Group has established six Business Units along market lines, to address its primary and emerging markets: Wireless, Photonics, Infrared, Solar, Power and CMOS++.

We report our wireless, photonics, infrared and CMOS++ revenues and Adjusted Operating Profit within our segmental analysis whilst the emerging markets of power control and solar are not yet significant enough to be separated in our segmental reporting.

Wireless

Wireless sales accounted for 69% of the Group's sales in 2016, slightly down from 70% in 2015. The wireless market covers electronic devices that communicate wirelessly. This includes but is not limited to mobile phones, smartphones, mobile networks, WiFi, smart metering, satellite navigation, and a plethora of other connected devices.

Photonics

The proportion of sales generated from photonics products continued its upward trajectory, accounting for 17% of the Group's sales in 2016, up from 14% in 2015. The photonics market covers applications that either emit or detect light. We segment the photonics market into:

- Emitters and detectors
- Solar (CPV)
- Lighting

Infrared

Infrared sales accounted for 8% of the Group's sales in 2016. The Infrared market uses indium antimonide (InSb) and gallium antimonide (GaSb) engineered materials that enable high resolution Infrared systems. Whilst key markets are currently limited to defence applications, there are likely to be major future opportunities in commercial markets in areas such as sensing and for autonomous and driverless vehicles.

CMOS++

The CMOS++ market combines the advanced properties of compound semiconductors with the low cost of silicon.

We further segment the CMOS++ market into:

- Power control
- Advanced materials

The key advantages of compound semiconductors are that they:

- are much more efficient at emitting and processing high-speed wireless signals
- are much more efficient at emitting and sensing light
- operate at much higher speeds and lower power consumption

It is these advanced properties which determine the top level high margin markets for our materials.

License Income

Licensing income reflects a new revenue stream from the commercialisation of our IP portfolio accounting for 5% of the Group's sales in 2016, down from the previous year's peak at 7% of revenues. IQE has developed a powerful IP portfolio which we are now able to monetise from both product sales and licensing of the IP.

Further details on the performance of each market sector are shown in the business review section of this annual report.

Our KPIs are highlighted on page 37 of this report.

Our business

Epitaxy 101

The elements

Everything in the universe is made of 118 known elements. The periodic table, first published in 1869 by Dmitri Mendeleev, shows the elements arranged in groups or columns according to their properties.

In terms of electrical properties, the elements up to and including those in group III are in general, known as metals and tend to be good conductors of electricity, whilst those from group V and above are generally non-metals and tend to be poor conductors of electricity.

Between the metals and non-metals, (and generally in group IV), are elements whose electrical properties are somewhere between conducting and non-conducting (insulating). These elements, which include silicon and germanium, are known as semiconductors.

The behaviour of semiconducting elements was discovered during the 19th century and it later became known through experimentation that their electrical properties could be altered by adding very small amounts of different impurities and that by placing together two pieces of material with different impurities, an electrical current could be controlled by allowing it to flow in one direction but not the other.

The semiconductor age is born

It was in 1947 that William Shockley, John Bardeen and Walter Brattain, working at Bell Labs, built the World's first transistor using the element germanium.

During the two decades that followed, the ability to control electrical currents using semiconductors allowed engineers to develop a range of new electronic technologies.

The evolution of silicon

Whilst germanium is a very efficient semiconductor material, the ready availability of silicon (basically sand) made for a compelling low-cost alternative and hence a new industry was born that has, for the last five-decades, transformed our lives in so many ways.

Silicon has been the backbone of the electronics revolution from the 1960s, largely by virtue of continuous miniaturisation which has led to an exponential increase in technological performance - a concept notably observed by one of the founders of Intel, Gordon Moore, and known as "Moore's Law".


IQE

Bring on the compound semiconductors

Impressive as the impact of silicon has been on our lives, being a single element, it has a very basic and limited set of properties that restricts its application in many new and emerging technology areas that demand ultra-high performance levels along with sensing and other capabilities.

By atomically engineering crystal structures that combine elements either side of those in group IV of the periodic table (eg groups III and V), a set of new semiconductor materials has emerged whose enhanced properties offer significant capability and performance improvements over those of silicon alone.

These compound semiconductors enable high speed processing in excess of 100 times that of silicon, as well as an array of other properties including the ability to emit and sense light, all the way from the infrared, through the visible and into the ultra-violet part of the spectrum.

Compound semiconductors have already complimented silicon in areas such as wireless communications, where chips made from material combinations such as gallium and arsenic (gallium arsenide, or GaAs) are found in virtually every smartphone where they enable high speed, high efficiency wireless communications in cellular and WiFi networks.

Other properties offered by compound semiconductor materials include the ability to emit and sense light in the form of general lighting (LEDs) and communications (lasers and receivers for fibre-optics).

The photonic and power efficiency properties offered by compound semiconductors that could not be achieved with silicon alone, will enable technologies essential in areas such as safety and security systems, healthcare technologies, aerospace and automotive applications including electrically powered and autonomous vehicles.

It is our ability to harness the advanced properties of the full range of semiconducting materials that will drive the digital revolution for generations to come.

Welcome to the world of advanced, compound semiconductors.

Compound semiconductors are the DNA of next generation technologies.

Epitaxy

IQE's core business is the manufacture of compound semiconductor wafers or "epiwafers" using a process called epitaxy.

The epitaxial growth process is a nanotechnology whereby complex atomic structures are produced under strictly controlled conditions. The end product is a pure, crystalline, semiconductor wafer upon which complex structures comprising many individual atomic layers are grown.

These epitaxial layers uniquely define the wireless, photonic and electronic performance of our epiwafers which are then processed by our customers to produce the "chips" that are found in virtually all of today's technology devices and gadgets.

Epitaxy is the first key stage in the process of manufacturing the critical components in a wide range of devices from mobile handsets to solar cells, lasers and LEDs, and it requires high specification cleanrooms, sophisticated production tools and high levels of process knowhow and intellectual property.

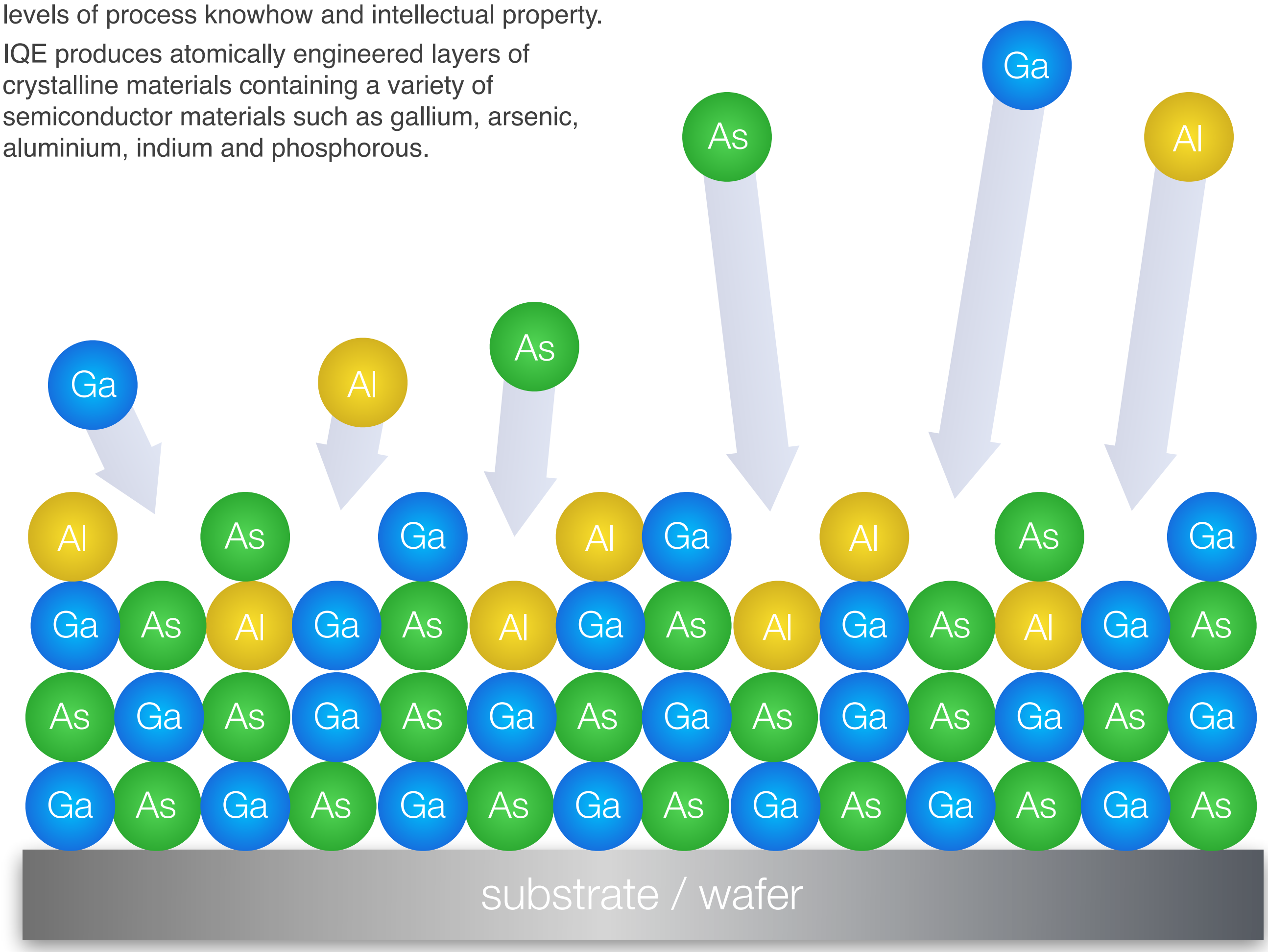
IQE produces atomically engineered layers of crystalline materials containing a variety of semiconductor materials such as gallium, arsenic, aluminium, indium and phosphorous.

The layers are grown onto a crystal substrate or wafer and the finished product containing the wafer and its atomically modified surface is known as an epiwafer.

It is the number of layers, their atomic composition and the order in which they are grown that determines the precise physical, electronic and optical properties of the material.

An epiwafer can include hundreds of individual layers, each of which may be as thin as two or three atoms.

IQE's IP and process know-how is the science and technology behind the materials and the way in which the atomic structures can be manufactured to yield the wide range of wireless, photonic and electronic properties that are essential in today's electronically enabled age.



The stage is set

Change is a constant in our world. The inexorable drive for electronic devices to continue to achieve higher levels of functionality, speed, performance and efficiency will unquestionably necessitate the increasing use of more sophisticated semiconductor materials. These advanced semiconductors are enabling a range of new mass market applications such as gesture recognition and short range optical communication, and at the same time disrupting some existing large markets such as solar energy and power switching. We expect that this rate of change will continue to accelerate.

We have established a global manufacturing platform and a breadth of IP and know how relating to the design and manufacture of advanced materials that is second to none. We have been unwavering in our vision and have developed a robust strategy which gives us confidence over the growth prospects of the business and our ability to create shareholder value.

Enabling new and emerging technologies

Semiconductors in the form of both silicon and compound semiconductors, form the heart of many of today's technologies. Without semiconductors, many devices and applications that we rely on simply would not exist, yet these atomically engineered materials go largely unnoticed amongst the end user brands with which we are so familiar.

Semiconductors are a key enabling technology that feed into multiple supply chains feeding a wide range of market sectors including: aerospace, healthcare technologies, aerospace, safety & security, big data and the Internet of Things (IoT), energy efficiency (generation and consumption), robotics and automotive products.

Global presence

Innovation through collaboration

Building high-tech clusters

Intellectual property relating to advanced materials is playing an increasingly important role in the evolution of the semiconductor industry. It is widely accepted that advanced materials are needed to overcome the challenges and realise the opportunities facing the electronics industry. This was evident from the level of M&A activity in the CS space during 2016, including the formation of a JV by Qualcomm and TDK, the acquisitions by II-VI Inc of Epiworks and Anadigics, and the attempted acquisitions of GCS and Aixtron. The multiples being paid in these deals reflect the increasing value being placed on compound semiconductor technology.

IQE has been at the forefront of advanced semiconductor technology for over a quarter of a century. It has built a reputation within the CS industry for the breadth and depth of its materials technologies and capabilities. This is now becoming increasingly recognised outside the CS industry, where IQE is becoming recognised as the 'go to' advanced materials innovator and provider. Indeed, IQE is now engaged directly with a number of Tier 1 OEMs, bypassing the normal "materials – chip - OEM" model.

There are many examples in history which reflect that collaboration is a powerful tool in accelerating innovation. The benefits are even greater when whole ecosystems "cluster" in the same location, breaking down the barriers created by geography and time zones. Indeed, Silicon Valley in California is a prime example of how the benefit of clustering can propel an industry to a global platform.

It is the benefits of collaboration and clustering that underpin IQE's strategic rationale for the joint venture partnerships in the UK and Singapore, and its highly successful Open Innovation programme (openiqe.com)

The silicon supply chain is no stranger to the benefits of clustering. Indeed, there are 4 clusters within Europe which are centred around the development and commercialisation of Silicon technology. These are strongholds of innovation and value creation, with over 800 companies and 150,000 employees.

IQE's vision is to be at the epicentre of the world's first compound semiconductor cluster, based in the UK. There was significant progress during 2016, and momentum continues to build :

- Cardiff University is investing c.£75m in the formation of the Institute of Compound Semiconductors as part its £300m innovation campus;
- IQE and Cardiff University invested £24m in the formation of the Compound Semiconductor Centre;
- The UK government has committed £50m funding for a Compound Semiconductor Catapult in Cardiff, which will leverage a further £100m funding from Innovate UK and Industry;
- The Cardiff City Region Deal has identified the emerging CS cluster in Cardiff as one of its 5 headline goals.
- EPSRC's £10m investment to create a CS Manufacturing Hub in Cardiff, led by Cardiff University and partnered by UCL, the University of Manchester and the University of Sheffield.

This level of investment is recognition of the increasing significance of compound semiconductor technology in the electronics industry, and the UK's ambitions to build on its existing academic and industrial strengths in to a world class end-to-end supply chain for compound semiconductor technologies in the UK.

As a key industry player, IQE has been actively driving the establishment of the UK compound semiconductor cluster launched in March 2017 as CS-connected (www.csconnected.com).

Environmental and CSR

Code of business conduct, ethics and anti-corruption

Our business conduct policy sets out the values and standards of behaviour expected from all employees. It addresses expectations relating to the day-to-day conduct of business as representatives of IQE. The policy also deals with how employees can report any concerns that may arise.

The policy actively promotes corporate social responsibility across our organisation. It addresses local, national and international initiatives and how we work with a wide range of third party organisations in areas such as ethical employment policies, educational and community work.

It sets out the responsibilities of employees in ensuring that they carry out their business activities in a manner aligned with IQE's values and business principles and which attract the respect of colleagues and business partners. All staff are required to ensure that they comply with all relevant laws and regulations of the countries in which we operate and do business. The policy also clarifies behaviours that are unacceptable, and which could bring IQE's reputation into disrepute.

The policy contains guidance on avoiding conflicts of interest, confidentiality, adherence to export controls, our approach to gifts and hospitality, bribery and corruption and managing relationships with third parties.

Upholding the policy is the responsibility of all IQE employees. We encourage everyone to report any behaviour which may be in breach of the Code, is unethical or illegal. This is achieved by fostering a culture of openness and accountability, and by providing a clear procedure that enables any individual to raise breaches of policy or malpractice directly at the highest level.

All those working for or on behalf of IQE are required to confirm that they have read and understood the business conduct policy, and a copy of the policy is readily available to all employees on the Group's intranet.

Commercial business practices

We are committed to acting professionally, fairly and with integrity in all our business dealings and relationships.

Every effort is made to ensure we adopt best business practice, which includes:

In our dealings with customers:

- Being open and honest about our products and services and communicating with customers all appropriate information they need to make informed decisions;
- Ensuring that any issues or problems are dealt with efficiently, with fairness and in a timely manner;
- Working closely with customers and potential customers to help us improve the value of the products and services we offer them;
- Ensuring that we benchmark and evaluate what we do in order to constantly improve products and services in the marketplace.

In our dealings with suppliers

- Identifying and selecting suppliers using fair and reasonable methodologies;
- Identifying and using suppliers who operate to ethical business standards;
- Identifying and using local suppliers where possible;
- Working closely with suppliers to help us improve the value of the products and services we offer customers to the benefit of the supply chain.

In our relationships with employees and other stakeholders

- Ensuring employment practices throughout the Group are fair and in full compliance with employment legislation;
- Working with and supporting local and national charities;
- Encouraging volunteer work in community activities;
- Supporting local academic establishments; and
- Participating in voluntary business advisory services via professional bodies.

As a company trading on AIM, a market operated by The London Stock Exchange plc, IQE is not eligible to participate in the London Stock Exchange FTSE4 Good programme, but nevertheless maintains standards and applies the principles of this index. The Group also actively engages with a number of industry groups, educational bodies and charities to promote science and technology and to help contribute to community causes.

Confidentiality

Our business conduct policy emphasises the essential need for confidentiality in all of our dealings. Maintaining confidentiality is engrained in our culture. Our policy and practice ensures that all staff fully understand what constitutes confidential information and restricts internal access on a need to know basis. Information relating to third parties is not disclosed without the third parties' written consent.

Bribery Act

We implement and enforce effective systems to uphold our zero tolerance approach to bribery and corruption. To ensure we only work with third parties whose standards are consistent with our own, all agents and third parties who act on behalf of the Group are obliged by written agreement to comply with the standards set out in the Code. A programme of supplier audits exists to ensure suppliers adhere to IQE's standards.

Human rights

IQE is committed to respecting the human rights of all those working with or for us. We do not accept any form of child or forced labour and we will not do business with anyone who fails to uphold these standards.

Modern Slavery

The Modern Slavery Act addresses the role of businesses in preventing modern slavery within their organisation and in their supply chains.

The Company has a zero-tolerance approach to modern slavery and is committed to acting ethically and with integrity in all of its business dealings and relationships and to implementing and enforcing effective systems and controls to ensure modern slavery is not taking place anywhere in its business or in any of its supply chains.

The company has developed and implemented policies to comply with the requirements of the UK's Modern Slavery Act. Reference to the policy may be found on the corporate website at www.iqep.com.

How we invest in our people and our communities

Our success depends on our people. The Group recognises the importance of its employees and in effective teamwork in enabling us to achieve our corporate goals.

Our values

IQE has grown organically and through a number of successful acquisitions, which has bought together the "best of the best" in our industry. We believe that our teamwork and collaboration is a powerful competitive advantage which keeps us at the cutting edge of technology and drives constant improvement throughout our organisation.

At the foundation of our organisation is teamwork and our common shared values. Our values define who we are, and how we operate. They clearly underpin the expectations we have of all employees and in everything we do:

- Integrity - behaving ethically, safely, honestly and lawfully
- Accountability - working to clear and mutually accepted responsibilities; hands on management and decision making
- Excellence - striving for excellence in all we do; focus on continuous improvement
- Valuing People - treating people with respect and dignity; communicating with clarity and honesty; providing opportunities for people to reach their potential
- Teamwork - working collaboratively towards common goals

We strive to make IQE a "great place to work" where our values are not just words but the behaviours that we live by each day, every day. This is aimed at providing an environment of mutual respect, where we are all valued for our contribution and everyone is proud to be part of "Team IQE".

We pursue equality of opportunity in all employment practices, policies and procedures regardless of race, nationality, gender, age, marital status, sexual orientation, disability and religious or political beliefs. As part of our policies we set out our approach to diversity.

Bonus plan

All employees participate in our bonus plan, which is designed to reward high levels of performance. The plan rewards the achievement of clearly defined objectives. These objectives are agreed up front based on the Key Strategic Objectives set by the Board and create clarity for all staff of the "cause and effect" of their achievements with their reward.

Spot awards

'Spot awards' are modest awards issued monthly to any member of staff who has gone "above and beyond" their duties for the benefit of the company. They represent a means of providing timely recognition and a "thank you" to promote a culture of "going the extra mile" to get the job done and achieve excellence. Any member of staff can recommend a colleague for a spot award. These recommendations are moderated to ensure fairness and consistency of approach. During 2016, across the group, 28 spot awards were issued.

Teamphoria©

Teamphoria© is a software solution which promotes staff engagement within the group. This software provides a quick and easy communications forum for our employees to share feedback, share ideas and promote teamwork. For example, it allows any member of staff to recognise a job well done by a colleague, raise questions, share frustrations, or make a suggestion for improvement, and all in real-time. It promotes an open culture and encourages timely communication across functions and from top-to-bottom with the organisation.

This has been a useful tool in promoting open communication and teamwork, and in reinforcing our culture and values.

Share options

The company operates a share incentive scheme which is open to all employees. The IQE Plc Share Option Scheme allows the company to grant options over up to 15% of the issued share capital. Periodically the Remuneration Committee approves the award of options to employees within the rules of the share option scheme. These options are subject to performance conditions.

Personal and professional development and performance management

We aim to support all employees to develop to their full potential and enjoy a rewarding and fulfilling career at IQE. We are committed to recognising, encouraging and developing talent across all aspects of our organisation. We value and encourage self-development and life-long learning. We believe in matching the right people to the right roles and in ensuring that they are appropriately trained and supported. We aim to provide personal and professional development opportunities for all staff throughout their employment.

In delivering the Group's strategy, the Board and Executive Committee set clear Key Strategic Objectives for the group. These objectives underpin clear roles and responsibilities, reporting lines, and detailed action plans which form part of our employees personal and company performance objectives. This ensures that each employee has clear objectives and understands how they contribute to the overall success of the team and the Group.

We believe in providing fair, balanced and constructive feedback in real-time. Through this we aim to bring personal development "to life" and promote a culture of learning and development. This is supported by an annual appraisal process, which provides the opportunity to take stock, recognise success and support areas for development. To ensure the effectiveness of our annual appraisals, we provide regular training to both reviewees and reviewers in their respective roles and responsibilities, and we are building a "training library" of easily accessible training solutions covering a variety of self-help, internal training and external development solutions.

We recognise that our continuing commercial success is dependent upon our ability to attract, retain, motivate and nurture the best talent in our industry. As the foundation for this, we are committed to promoting an environment and culture which provides for life-long learning and

Young Engineer of the Year Award

IQE's Dr. Andrew Griffiths was presented with the title "*Young Engineer of the Year*" at the 2016 ESTNet Awards at a Gala ceremony in Cardiff. Andrew, who joined IQE after completing his Ph.D, is currently working at the company's facility in Bethlehem, Pennsylvania. Andrew was the second IQE employee to clinch the award after another IQE engineer, Jason Good, was awarded the title in 2015.

Community engagement

IQE actively engages with local communities at each of its facilities from sponsoring charitable events to providing sports kits to schools.

IQE's staff are encouraged to participate in various events from volunteering work such as Massachusetts volunteer programmes including "Necessities of Life" to activities including marathon running and a 5,000 mile bicycle ride "Heart Across America" raising money and awareness for heart disease and stroke.

Education engagement

IQE actively engages with a number of schools, colleges and universities around the World and is actively promoting and encouraging the take up of science, technology, engineering and maths (STEM) subjects through a number of initiatives. In the UK, IQE is engaged with STEMNET, where IQE STEM Ambassadors participate in a variety of educational events with a particular emphasis on addressing the gender imbalance in engineering disciplines.

IQE's Cardiff facility is participating in a three year "Business Class" Programme comprising a number of schools and businesses in a partnership cluster to form strong links between schools and local businesses.

Cluster activities

CS connected

IQE has established a reputation for collaboration with supply chain partners, academics and government agencies and is actively driving the formation of technology clusters.

CS connected is an evolving Compound Semiconductor cluster based in and around South Wales. Visit www.csconnected.com for more information.

IQE supporting skills and careers events


IQE CEO Dr Drew Nelson chairing CS International Conference

IQE actively participating at international compound semiconductor events


Wales First Minister, Carwyn Jones AM visits IQE's PA site during visit to USA

Strategic report

Principal risks and uncertainties

The Group has an established process for the identification and management of risk as part of the governance framework. Management of risk is the responsibility of the Board of Directors. In managing risk a comprehensive and robust system of controls and risk management processes have been developed and implemented by the board.

The Board's role in risk management includes:

promoting a culture that emphasises integrity at all levels of business operations;

- embedding risk management within the core processes of the business;
- approving appetite for risk;
- determining the principal risks;
- ensuring that these are communicated effectively across the businesses; and,
- setting the overall policies for risk management and control.

The principal risks affecting the Group are identified by the Group Executive team within their functional areas of responsibility and reviewed by the Board.

Risk management within the business involves:

- Identification and assessment of individual risks
- Design of controls and operational processes to mitigate the risks
- Testing of controls through internal review and audits
- Conclusion on the effectiveness of the control environment in place

In identifying risks we analyse risks across four key areas:

- strategic risk;
- commercial risk;
- operational risk; and,
- financial risk.

The principal risks identified are listed in order of severity. Mitigation, where possible, is shown by each identified risk area.

Principal risk: COMPETITION

BUSINESS RISK

Loss of share with a significant customer.

Price erosion due to predatory pricing from a competitor

MITIGATION

Focus on quality, value and customer service

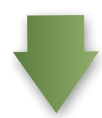
Develop and maintain close relationships with customers to become the "materials partner of choice", by forming multilevel partnerships from material design, to pilot and volume production.

Continue to invest in product development to ensure competitive advantage.

Qualification timescales can be long but once a product and relationship is established, it creates significant barriers to entry for competitors.

In some cases, customers seek second source supply arrangements to meet their own business continuity planning policies, our multiple site capabilities provide some mitigation against this risk.

Y-o-Y CHANGE IN LIKELIHOOD



Potential Impact:

High

Effect:

Sales volumes and profitability

Principal risk: TECHNOLOGICAL CHANGE

BUSINESS RISK

A disruptive technological change has not been anticipated as a result of a lack of investment in new products and materials.

We do not adequately identify and protect our IP

MITIGATION

IQE actively engages with customers, educational institutions and government agencies on a range of research and development ("R&D") programmes.

Where appropriate IQE has protected IP through patents. It is not always appropriate to protect "process know how" through patents. Rigorous controls over segregation of duties, data protection, and access controls are implemented to secure our "trade secrets".

Y-o-Y CHANGE IN LIKELIHOOD

Potential Impact:

High

Effect:

Sales volumes and profitability

Principal risk: FINANCIAL LIQUIDITY

BUSINESS RISK

The business does not maintain sufficient funding and liquidity to meet its obligations as they fall due.

MITIGATION

The Group prepares regular financial forecasts to evaluate its funding and liquidity requirements for the foreseeable future.

These forecasts are reviewed and approved by the Board.

Based on these forecasts appropriate funding and liquidity solutions are put in place to ensure that appropriate headroom is maintained.

At the year-end 31 December 2016 we have £65.5m of committed facilities against which there was net debt of £39.5m.

Y-o-Y CHANGE IN LIKELIHOOD

Potential Impact:

High

Effect:

Financial loss & reputational damage

Principal risk: NATURAL DISASTERS

BUSINESS RISK

Natural disaster disrupts production capability, supply of materials or customer demand.

MITIGATION

IQE operates multiple global manufacturing facilities which mitigates against the impact of natural disasters on IQE.

Our active programme to second source or dual site sources for all critical supplies mitigates supplier risk. Similarly our larger customers have multi-site production to mitigate their risk.

IQE maintains appropriate business interruption insurance.

Y-o-Y CHANGE IN LIKELIHOOD

Potential Impact:

Medium/High

Effect:

Costs, Sales and profitability

Principal risk: RETENTION OF KEY EMPLOYEES

BUSINESS RISK

Loss of key people and critical skills

Insufficient skilled employees

Poor engagement and morale

MITIGATION

Retention and development of its workforce is critical to the long term success of the Group.

IQE's people are the heart of the business and in order to promote the development and retention of its staff IQE offers career progression, personal development and a range of benefits and incentives to its staff.

This is reflected in low staff turnover, with many employees who have been with the company since it was formed over twenty years ago.

In addition, IQE operates a highly effective, robust, and fully documented quality management system across all of its operations. These systems ensure that all key data and procedures are fully documented, reflecting IQE's "learning organisation" philosophy. These rigorous systems provide IQE and its customers with a high level of confidence in terms of process reproducibility and product traceability, and minimise the potential impact of losing key personnel.

Y-o-Y CHANGE IN LIKELIHOOD

Potential Impact: Medium

Effect:

Quality issues and increased cost

Principal risk: BUSINESS INTERRUPTION - SUPPLY CHAIN

BUSINESS RISK

Dependency on sole supplier

Availability of qualified raw materials

MITIGATION

The raw materials which sustain IQE's products are not scarce resources.

Active programme to maintain cross qualified second sources.

Rigorous supplier quality management processes.

Maintain close relationships with its key suppliers in order to keep well informed about potential supply issues.

Y-o-Y CHANGE IN LIKELIHOOD

Potential Impact:

Medium

Effect:

Quality issues and cost pressure

Principal risk: CUSTOMER CONCENTRATION

BUSINESS RISK

Dependency on low number of customers could result in significant impact from a loss of share from a customer.

The group has two customers which individually account for more than 10% of the group sales.

MITIGATION

The wireless sector is highly concentrated with the top 5 RF Chip companies accounting for the vast majority of the wireless market.

IQE's strategy is to embed itself as a significant supplier of advanced semiconductor materials with all of the major RF chip companies in order to reduce the potential impact of swings in market share between these companies.

The customer qualification times and high quality standards creates significant barriers to entry for competitors.

Maintain and advance our technological advantage to deliver value and retain a competitive position.

Focus on quality, value and customer service.

Y-o-Y CHANGE IN LIKELIHOOD

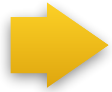
Potential Impact:

Medium/Low

Effect:

Costs, Sales and profitability

Principal risk: LEGISLATIVE COMPLIANCE

BUSINESS RISK	MITIGATION	Y-o-Y CHANGE IN LIKELIHOOD
Failure to comply with applicable legislation, such as: Export Control, International Traffic In Arms (ITAR), Bribery Act, Employment legislation and company legislation.	Regular reporting of export and ITAR compliance and detailed internal control processes and procedures Continuing education of the team on the legislative developments and requirements. Internal reviews and external audits	 **Potential Impact:** Medium/Low **Effect:** Financial loss & reputational damage

Employee wellness

As part of our employee welfare responsibilities we aim to promote wellbeing, and provide practical wellness support for our staff. In 2016 we initiated an employee education programme to support our staff making healthy lifestyle choices. This programme offers healthy lifestyle support and advice, and encourages better health and wellbeing for all employees.

Our wellness programme aims to support individuals in making small sustainable changes to improve wellbeing. We aim to improve sustainability by working in groups and making events fun. A great example in 2016 was our 'Walking Works Challenge', which was won by Brian Ruchert from our Spokane facility, who walked 796 miles (over 1,587,609 steps) in a 12 week period. Well done Brian!

To assist our employees to be proactive about their health we also provide regular health checks, and offer access to medical assistance through a number of programmes.

Communities and Charity

As a significant employer in some of the locations in which we operate, we recognise the opportunity we have to make a positive contribution to our local communities. Therefore, we seek to contribute to the economic, social and environmental sustainability of our local communities through a range of activities and initiatives.

We encourage this to be driven "bottom-up", to ensure that our efforts are relevant to our employees and what is important to the local communities in which they operate. Through this approach we are seeking to support our staff in their efforts to give something back to their communities.

IQE are committed to developing future talent, promoting STEM subjects within education and preparing young adults for the world of work. To this aim we participate in numerous careers fairs with local schools and FE facilities.

Employment policies

It is the group's policy that there should be no discrimination in considering applications for employment including those from disabled persons. All employees, including the disabled, are given equal opportunities in terms of career development and promotion. Appropriate training is arranged for disabled persons, including retraining for alternative work of employees who become disabled, to promote their career development within the organisation.

Internal communication

We believe that effective and timely communication is an essential part of positive employee engagement.

We strive to ensure that our internal communication meets our needs as a diverse global business operating throughout the UK, US and Asia. To achieve this we have developed a communication framework, which sets out our expectations and standards for internal communication. Through this we seek to achieve a clear and common understanding of our strategy, priorities, business performance and how we are doing against our action plans. For example, this includes regular "town hall" meetings hosted by senior executives, informal meetings for small groups of staff to meet with site management, all staff updates by email, video, Teamphoria©, and a group newsletter.

We also encourage employees to communicate and provide constructive feedback. We offer a variety of opportunities for this, including face-to-face meetings, 360 feedback, various employee surveys, and Teamphoria©. This is done in an open environment which is independent of hierarchy, where a new joiner can speak freely with peers and senior executives alike.

Part of the communication framework is our employee feedback survey. This annual feedback survey gives employees the opportunity to give anonymous feedback to management, which is assessed and used to guide our improvement plans. The survey helps to ensure that we listen to our employees and strive for continuing improvement.

We hold an annual Strategy Conference in which the Executives and Senior Management take stock of our markets, the competitive landscape, and how we can adapt our organisation to meet changing needs. This culminates in a common understanding of our strategy, the key goals that we need to achieve over the coming year, and our respective roles in the delivery of those plans. The Non-Executives Directors attend some of these sessions.

Our Chairman has a rolling programme of factory visits which enable him to engage directly with local management and employees and to review with them their successes and to hear at first hand the issues and challenges they face.

Health and Safety

IQE pays a great deal of attention to ensuring the health and safety of everyone involved in the business.

All employees are encouraged to take an active role in ensuring that our working environment is a safe place to work and visit by actively reporting all safety observations and incidents, being involved in safety audits, risk assessments and regular awareness training sessions.

The environment, health & safety (EHS) group, has detailed ongoing continued professional development plan including training and accreditation of competent persons, appointment of safety coordinators whose role is to minimise risks of injury at work; ensure legislative compliance; and assist in creating and monitoring safety practices to be followed at each site.

The structure also included the designation of safety advisors, with the appropriate expertise to support in specific areas of activity such as LEV and pressure systems.

The EHS group is actively involved in industry-wide initiatives, working with industry associations and proactively registering under new regulatory directives such as REACH and GHS-based Hazard Communication.

The EHS group has also recently completed an audit and review of chemical control processes to ensure continued compliance with HazComm regulations.

Safety and Environmental Teams & Reporting

The EHS Group is organised to effectively promote and increase the awareness of Safety and Environmental issues, directives and legal obligations, advising each group subsidiary and the Board accordingly.

Daily EHS activities and reporting at local sites are managed by coordinators, feeding into general site management for effective control. Regular analysis and discussion is an agenda item at site periodic Management meetings.

EHS Regional Managers oversee the trend analysis produced at each site and undertake regular conference calls to discuss major issues and site developments. Regional face-to-face meetings and data collation culminate in quarterly Board Reports, demonstrating major trends in EHS activities and comparisons with industry best-practice and National Average statistics.

Regional Managers and the Director responsible for EHS drive strategic initiatives through each organisation to promote best-practice, ensuring that the Group conforms to all global, regional and local regulations and directives. Initiatives are designed to ensure that the Group's objectives of maintaining at or beyond state-of-the-art EHS Management are met.

A full and comprehensive presentation of occupational trends, accidents, safety and environmental incidents, together with compliance with all regulatory requirements, Group and local objectives are published in the Annual Board Report.

The environment

IQE is committed to protecting both the local and global environments in which we operate. We endeavour to ensure that our activities, including our manufacturing operations, are conducted in an environmentally responsible manner.

We are committed to minimising the impact of our operations on the environment and encourage all employees to think about ways of modifying their behaviour to reduce the impact on the environment by for example, reducing waste, restricting unnecessary travel, saving water and by reducing energy usage.

IQE policy for conducting business in an environmentally responsible manner states:

- We fully integrate environmental considerations into the business planning and decision making processes.
- Compliance obligations are identified and our operations must be conducted in accordance with these obligations.
- We validate our fulfilment of compliance obligations by means of documented periodic review.
- We employ best practice to reduce the environmental impact of our operations, prevent pollution, minimise waste and maximise the efficient use of energy and resources to protect the environment.
- We continually improve our environmental management system and its performance by setting measurable objectives and reviewing them on a regular basis.
- We provide suitable information and training to all employees, and interested parties to ensure that the aims of the environmental management system are achieved.

In addition, each of our sites will supplement this policy to meet local requirements.


IQE

Recycling

At each of our sites across the globe we operate constant improvement programmes to reduce waste. In addition, we recycle and re-use wherever practicable. Currently, at each site we recycle: plastics, steel, aluminium, paper, cardboard and process by-products where the opportunity to do so exists.

Environmental concerns

We have experienced no external environmental incidents or concerns throughout 2016 at any of our locations.

Energy

We closely monitor the consumption of electricity, gas and water at all facilities and have targeted environmental improvement programs as part of ISO14001 to reduce carbon dioxide emissions and the depletion of natural resources.

Environmental Management

ISO 14001 is a global standard for environmental management which was developed to help organisations reduce their environmental impact. It provides a framework for organisations to demonstrate their commitment to preserving and protecting the environment by:

Reducing harmful effects on the environment

Providing evidence of continual improvement of environmental management

In 2016, IQE's facilities in Cardiff (IQE-Europe), North Carolina and Taiwan were subject to independent third party audit of our compliance with ISO 14001. These audits were very successful with no material deficiencies recorded.

All our high-volume epitaxy manufacturing facilities are ISO 14001 certified, clearly demonstrating IQE's commitment to reducing waste and recycling materials where appropriate. This is complementary to our commercial objectives of reducing costs and improving operational efficiency.

Environmental Legislation

Compliance with environmental legislation is critical to our businesses throughout the UK, the US and Asia. To manage our compliance we employ appropriately qualified and competent managers, who report directly to our Chief Operating Officer. These managers have access to third party professional advisors as needed.

We also maintain membership of a number of professional bodies, which provide another good source of reference and support, which enables us to keep up-to-date on the continually evolving legislation. This includes regular updates from: British Safety Council, British Standards Institution, Institute of Environmental Management and Assessment in the UK, the US National Safety Council, the US National Fire Protection Agency and the US Federal Register.

As a Company trading on AIM, a market operated by The London Stock Exchange plc, the Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013, which relates to the disclosure of greenhouse gas emissions and other environmental matters does not apply to IQE.

Financial review

In order to provide a fuller understanding of the Group's underlying performance, we have included a number of adjusted profit measures as supplementary information. As detailed in note 4, the adjusted measures eliminate the impact of certain non-cash charges and non-recurring items.

Revenues of £132.7m were up 16% on 2015 (£114.0m). Revenues from wafer sales were up 19% reflecting strong growth in each of IQE's primary markets : Photonics revenues were up 43%; wireless revenues up 15% and InfraRed revenues up 19%. Growth in underlying demand was accompanied by a currency tailwind, with the US dollar strengthening 11% against sterling in H2 primarily due to the Brexit vote in June. License revenue of £6.7m was better than expected, albeit down from £8.0m in the prior year, which as flagged benefited from a significant element of up front income.

Adjusted gross profit increased from £32.4m to £36.4m largely driven by the increase in revenue. As a percentage of sales, adjusted gross margins reduced from 28% to 27% reflecting the impact of sales mix. In particular, high margin license income reduced from 2015 which included a significant element of upfront income. Adjusted gross margins on wafer sales increased from 23% to 24% driven by increasing efficiencies. Reported gross profit increased from £30.7m to £34.7m, with percentage margin reducing from 27% to 26%.

Other income increased from £0.8m to £2.3m. This relates to gains on the reduction of the estimated remaining balance of contingent deferred consideration payable in respect of a previous acquisition. The balance under this contingent deferred consideration arrangement have now been settled in full. These gains, which do not relate to underlying trade, have been excluded from the adjusted profit measure.

Adjusted selling, general and administration expenses (SG&A) increased from £13.5m to £14.2m, which primarily reflects the impact of currency movements. Reported SG&A increased from £15.5m to £16.4m.

The **profit on disposal of fixed assets** of £5.2m in the prior year primarily reflected a gain of £4.8m on the establishment of the UK Joint Venture, in which the Group contributed equipment in return for a 50% equity share in the JV. There was a loss on disposal of fixed assets in the ordinary course of business of less than £0.1m (2015: profit £0.4m).

Adjusted operating profit increased by 17% from £18.9m to £22.1m, despite the reduction in high margin license income, reflecting the benefit of higher sales and operational efficiencies. Reported operating profit decreased from £21.2m to £20.7m, primarily reflecting that the prior year included a profit on disposal of fixed assets of £5.2m.

Interest costs increased from £1.4m to £1.5m, largely due to the impact of foreign exchange.

There was a **net tax credit** of £0.8m on underlying profits compared to £0.5m. In addition there was a £0.4m tax charge relating to exceptional items compared with a tax credit of £0.3m on exceptional items in 2015. The Group has sufficient tax losses available to shield future tax payable of circa £39.9m.

Adjusted profit after tax increased by 19% from £18.1m to £21.4m, and reported profit after tax decreased £20.1m to £19.4m. The adjusted fully diluted earnings per share was 3.00p, up 15% from 2.60p in the prior year. Reported diluted earnings per share was 2.71p, down from 2.90p in 2015. The Board will not be recommending the payment of a dividend.

Cash inflow from operations increased 7% from £20.9m to £22.5m, representing a 102% conversion of adjusted operating profit into cash (2015: 111%).

Capital investment of £19.1m represents a £9.1m increase over the prior year to address growth opportunities, principally in photonics, GaN and cREO. Investment in capital equipment was up £7.1m, and investment in intangibles was up £1.9m.

Balance sheet leverage was down 2% from £40.4m to £39.5m, as gearing reduced from 22% to 17%. Deferred consideration relating to previous acquisitions was reduced by £17.1m in the year and has now been settled in full. Net debt increased by £16.3m from £23.2m to £39.5m, although c.£7m of this increase represents a presentational foreign currency impact.

Impact of foreign currency

IQE revenues are denominated in a range of currencies, but primarily they are billed in US dollars. Therefore, given that revenues are reported in sterling there is a foreign currency translation benefit, particularly with the dramatic devaluation of sterling in the second half of 2016 following the Brexit referendum on 23rd June 2016. This is estimated to account for approximately 10% of the Group's revenue growth (being the movement in the average exchange rate).

Similarly, IQE's costs are denominated in a range of currencies, but primarily billed in US dollars. As a result, the impact of foreign currency movements on the Group's results presented in sterling is largely presentational because of this underlying natural hedge.

There is also a presentational effect on the Group's balance sheet, as both non-sterling assets and liabilities will be translated at the year-end spot rate. This is estimated to account for an increase in asset and liabilities of approximately 17% (being the movement in the year end spot rates). Therefore, although the balance sheet leverage has reduced by 2%, the underlying increase is approximately 19%.

Strategic Report

In addition to the information provided in the Chairman's Report and this Strategic Report, the directors use a number of key performance indicators to manage the business, disclosed in the financial review on page 36. Non financial KPIs are not disclosed.

Signed on behalf of the Board of Directors

P J Rasmussen

Dr A W Nelson

KPIs (dash-board)

Sales (£M)

Operating profit (£M)
(before exceptional items)

Cash from operations (£M)
(before exceptional cash flows)

FD EPS (pence)
(before exceptional items)

Leverage (£M)

Gearing (%)

Leverage and gearing: restated FY12 to include balances from acquisition on 15 Jan 2013

Five year summary

	2016 £'000	2015 £'000	2014 £'000	2013 £'000	2012 £'000
Revenue	132,707	114,024	112,011	126,774	87,961
EBITDA (see below)	31,730	29,001	27,009	24,920	16,437
Operating profit					
- **Adjusted***	22,119	18,977	17,618	14,556	9,202
- **Reported**	20,665	21,166	7,167	7,346	7,014
Profit after tax					
- **Adjusted***	21,440	18,066	16,701	14,202	8,401
- **Reported**	19,440	20,149	1,996	6,126	6,631
Net cash flow from operations					
- **Before exceptional cash flows**	24,281	22,575	19,614	16,173	4,679
- **Reported**	22,463	20,971	14,861	12,762	4,109
Free cash flow**					
- **Before exceptional cash flows**	4,382	12,114	11,446	5,389	(1,569)
- **Reported**	2,564	10,510	6,693	1,978	(2,139)
Net debt	(39,549)	(23,223)	(31,251)	(34,351)	(15,483)
Equity shareholders' funds	191,287	144,601	119,056	110,498	90,189
Basic EPS – adjusted*	3.17p	2.68p	2.51p	2.09p	1.47p
Basic EPS – unadjusted	2.87p	3.00p	0.25p	0.93p	1.16p
Diluted EPS – adjusted*	3.00p	2.60p	2.42p	2.00p	1.40p
Diluted EPS – unadjusted	2.71p	2.90p	0.24p	0.89p	1.10p

* The adjusted performance measures are reconciled in note 4 on page 86.

** Free cash flow is defined as net cash flow before acquisitions, financing and net interest paid.

	2016 £'000	2015 £'000	2014 £'000	2013 £'000	2012 £'000
Profit after tax	19,440	20,149	1,996	6,126	6,631
Tax	(408)	(773)	3,247	(934)	(503)
Interest	1,633	1,790	1,924	2,154	886
Share based payments	2,042	2,001	1,458	1,415	1,360
Profit & loss on disposal	47	(5,187)	15	-	-
Exceptional items	(1,962)	(211)	7,877	5,065	570
Depreciation	5,561	6,192	6,590	8,503	5,998
Amortisation of intangible assets	5,377	5,040	3,902	2,591	1,495
EBITDA	**31,730**	**29,001**	**27,009**	**24,920**	**16,437**

Compliance/Governance Statements

Statement of compliance with UK Corporate Governance Guidance

The Board of Directors believes in high standards of corporate governance, and is accountable to shareholders for the Group's performance in this area.

Although IQE, as a company trading on AIM, a market operated by The London Stock Exchange plc, is not required to comply with the UK Corporate Governance Code, the directors have decided to provide corporate governance disclosures similar to those that would be required of a fully listed company.

This statement describes how throughout the year ended 31 December 2016, the Group has continued to apply the principles of the UK Corporate Governance Code (the "Code") and adopt the spirit of the Code. The Code is available on the website of the Financial Reporting Council (FRC) at: www.frc.org.uk .

This statement addresses the main subject areas of the Code namely leadership, effectiveness, accountability and relations with shareholders. Remuneration is dealt with in the Remuneration Report on pages 52 to 65.

The Company is a smaller company for the purposes of the Code, and as a consequence certain provisions of the Code either do not apply to the Company or may be judged to be disproportionate or less relevant in its case.

The Board considers that throughout 2016, IQE has sought to comply with the Code and has identified the following main areas of non-compliance:

- The Chairman of the Audit Committee is not deemed independent by virtue of his length of service. Further explanation of this and the planned changes are set out below and in the Audit Committee report.
- Whilst the performance of the Directors, the Chairman and of the Board are assessed on an ongoing basis, the Code requires a formal annual review process to be completed and documented, which was not completed during 2016. However, following the appointment of the new Senior Independent Non-Executive Director in December 2016, a formal review is scheduled for 2017.

The Board views maintaining high standards in its governance and management of the affairs of the Group, as a fundamental part of discharging its stewardship responsibilities. Accordingly, both the Board and the Audit Committee continue to keep under review the Group's whole system of internal control, which comprises not only financial controls but also operational controls, compliance and risk management. This process was in place throughout the 2016 financial year and accords with the Revised Guidance for Directors on Internal Control (formerly called the Turnbull Guidance).

The Board

The Board comprises the Non-Executive Chairman Dr Godfrey Ainsworth, the Chief Executive Officer Dr Drew Nelson, two executive directors and three non-executive directors.

The fees of the non-executive directors are paid in cash and/or shares.

The Board consider Sir David Grant and Mr Phil Smith, who have held office for less than nine years, to be independent in accordance with the Code, and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.

The terms and conditions of appointment of the non-executive directors are available for inspection upon request to the Company Secretary.

Following the Annual General Meeting, Sir David Grant was appointed as Chairman of the Remuneration Committee and the Nominations Committee. There has been one change to the membership of the Board during the year. Mr Phillip Smith joined the board on 19 December 2016 and is taking over the role of Senior Independent Director.

The Senior Independent Director is recognised as the independent Board member who acts as an independent sounding board for the Chairman and serves as an intermediary for the other directors if needed.

Furthermore, the Senior Independent Director is available to discuss any concerns of shareholders and/or employees which have not adequately been resolved by the executive directors or Chairman, or for which such contact is inappropriate, such as concerns of any suspected impropriety. These concerns can be conveyed in private and investigated as required by the Code.

Rules concerning the appointment and replacement of Directors of the Company are contained in the Articles of Association ("Articles"). Amendments to the Articles must be approved by a special resolution of shareholders.

Under the Articles, all Directors are subject to election by shareholders at the first Annual General Meeting following their appointment, and to re-election thereafter at intervals of no more than three years.

The Board has considered the FRC's guidance to companies outside the FTSE 350 to consider the annual re-election of all Directors, and consider that this would be overly burdensome for the current nature of the group.

Biographies of the Directors are set out on pages 66 and 67. These show the range of business and financial experience upon which the Board is able to call.

The Boards goal is to ensure that its membership should be balanced between executives and non-executives and have the appropriate skills and experience and knowledge of the business.

The Board recognise the special position and role of the Chairman under the Code, and has approved the formal division of responsibilities between the Chairman and Chief Executive.

The Chairman is responsible for the leadership of the Board and ensuring its effectiveness, and the Chief Executive manages the Group and has the prime role, with the assistance of the Board, of developing and implementing business strategy.

One of the roles of the Non-Executive Directors under the leadership of the Chairman is to undertake detailed examination and discussion of the strategies proposed by the Executive Directors, so as to ensure that decisions are in the best long-term interests of shareholders and take proper account of the interests of the Group's other stakeholders. The Chairman ensures that meetings of Non-Executive Directors without the Executive Directors are held.

How the board operates

The Board meets regularly through the year, and is provided with appropriate strategic, operational and financial information prior to each meeting together with monthly reports to enable it to monitor the performance of the group.

At Board meetings, the Chairman ensures that all Directors are able to make an effective contribution throughout meetings and every Director is encouraged to participate and provide their perspective and opinions. The Chairman always seeks to achieve unanimous decisions of the Board following due discussion of agenda items.

All directors have direct access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures are followed, and are allowed to take independent professional advice if necessary at the company's expense.

The Board has a formal schedule of matters referred to it for decision, this list includes appropriate strategic, financial, organisational and compliance issues, including the approval of high level announcements, circulars and the report and accounts and certain strategic and management issues.

Examples of such items include but are not limited to:

- The approval of interim and annual results,
- the approval of the annual budget,
- approval of acquisitions or disposals,
- approval of major items of capital expenditure,
- approval of changes to corporate or capital structure, and
- financial issues, including changes in accounting policy, the approval of dividends, bank facilities and guarantees.
- the approval of significant contracts

Committees of the Board

The Board has four sub committees, the Executive Committee, the Remuneration Committee, the Nominations Committee and the Audit Committee.

The Board has delegated specific responsibilities to these committees as follows:

(a) Executive Committee

The Executive Committee consists of the executive directors under the chairmanship of Dr Drew Nelson and is responsible for the development of strategy, annual budgets and operating plans linked to the management and control of the day-to-day operations of the group.

The Executive Committee is also responsible for monitoring key research and development programmes and for ensuring that the Board policies are carried out on a group-wide basis.

(b) Audit Committee

The Audit Committee consists of the non-executive directors, Dr Godfrey Ainsworth, Prof. Simon Gibson, Mr Phil Smith and Sir David Grant. The Committee meets at least twice a year under the chairmanship of Dr Godfrey Ainsworth.

The Audit Committee has specific written terms of reference which deal with its authority and responsibilities and these are available for inspection from the Company Secretary. Its duties include monitoring internal controls throughout the group, approving the group's accounting policies, and reviewing the group's interim results and full year financial statements before submission to the full Board. The Audit Committee also reviews and approves the scope and content of the group's annual risk assessment programme and the annual audit, and monitors the independence of the external auditors.

The Group does not have an independent Internal Audit function, however the Group operates internal audit on a peer review basis, with a scope of evaluating and testing the group's financial control procedures. The internal audit reviews are reported directly to the Chairman of the Audit Committee, and shared with the external auditors as appropriate.

The Chief Financial Officer, senior finance managers and the external auditors attend meetings of the Audit Committee by invitation. The Committee also holds separate meetings with the external auditors, as appropriate.

(c) Remuneration Committee

The Remuneration Committee consists of two non-executive directors, Sir David Grant and Dr Godfrey Ainsworth. During the year Prof. Simon Gibson resigned from the Committee and Sir David Grant was appointed Chairman of the Committee. The Committee meets at least twice a year.

The Chief Executive attends meetings of the Remuneration Committee by invitation to respond to questions raised by the Committee, but he is excluded from any matter concerning the details of his own remuneration.

The Remuneration Committee has specific terms of reference which deal with its authority and duties and these are available for inspection from the Company Secretary.

The Remuneration Committee is responsible for setting salaries, incentives and other benefit arrangements of executive directors and senior executives and overseeing the group's employee share schemes.

The group's policy on directors' remuneration has been in line with the Code provisions throughout the year, full details of which are given in the Remuneration report. Members of the remuneration committee do not participate in decisions concerning their own remuneration.

(d) Nominations Committee

Following the AGM in June 2016, the Board established a separate Nominations Committee which consists of Dr Godfrey Ainsworth and is chaired by Sir David Grant.

The Board has delegated responsibility for nominations to this Committee. The activities of the Nominations Committee have been set out in the Nominations Committee Report on page 44.

Attendance at meetings

The number of meetings held during 2016 by the Board, the Audit Committee, the Nominations Committee and the Remuneration Committee are as shown below. The number of meetings attended by the executive and non-executive directors is also shown below:

	BOARD	AUDIT COMMITTEE	REMUNERATION COMMITTEE	NOMINATION COMMITTEE
Number of meetings in 2016	7	3	4	3
Attendance:				
Executive				
Dr A W Nelson	6	n/a	n/a	n/a
P J Rasmussen	7	n/a	n/a	n/a
Dr H R Williams	6	n/a	n/a	n/a
Non-executive				
Dr G H H Ainsworth	7	3	4	3
Professor S J Gibson	7	3	3	n/a
Sir D Grant	6	3	4	3
P Smith *(appointed 19 Dec 2016)*	n/a	n/a	n/a	n/a

Shareholder Relations

The Board regard regular communications with shareholders as one of its key responsibilities. During 2016, the Chief Executive Officer and Chief Financial Officer met with institutional investors on a regular basis to discuss the group's performance, the shareholder's views, and to ensure that the strategies and objectives of the group are well understood.

The Chief Executive Officer keeps the Board fully informed of any significant matters discussed with shareholders and of shareholders' views. Furthermore all members of the Board receive copies of analysts' reports of which the Company is made aware.

The Chairman and Senior Independent Director make themselves available to meet with major institutional shareholders as needed through the year. During 2016, they met with major institutional shareholders on a number of occasions, primarily to consult on corporate governance matters and to provide an independent view of the position and prospects of the Group.

The Non-Executive Directors, having considered the Code, are of the view that this approach to shareholder communication remains appropriate for the Group. However, should shareholders have concerns which they feel cannot be resolved through normal shareholder meetings, the Chairman, the Senior Independent Director and the remaining Non-Executive Directors may be contacted through the Company Secretary.

The company employs an Investor Relations Manager who supports the Chief Executive Officer and Chief Financial Officer with day-to-day investor relations. Together, they respond to investor enquiries throughout the year. In addition, all shareholders attending the AGM are given a presentation on the business and are invited to ask the Directors questions about the business.

The Investor Relations Manager also maintains the group's web site, which provides details of the group's business including its strategy, technologies, operations and products. The web site has a separate investor relations section which provides the group's news flow, share price information, and financial reports including the annual and interim reports. Hard copies of these financial reports are also available by request. The web site can be found at www.iqep.com.

In accordance with the recommendations of the Code, the Company will advise shareholders' attending the AGM of the number of proxy votes lodged in respect of each resolution, analysed between 'For', 'Against', 'at the Chairman's discretion' and abstentions. These are advised after the resolutions have been dealt with on a show of hands, providing that a poll has not been called for or required.

Audit and accountability

The Code requires that Directors review the effectiveness of the Group's system of internal controls on a continuing basis. The scope of the review covers all key controls including financial, operational and compliance controls as well as risk management.

The Board has put in place a framework of internal controls to manage the risks faced by the Group, and the Audit Committee has responsibility to review, monitor and make policy recommendations to the Board upon all such matters.

The Directors acknowledge their responsibility for the Group's system of internal control. The Board, through the Audit Committee, keeps this system under continuous review and formally considers its content and its effectiveness on a bi-annual basis.

In completing their review of the effectiveness of the Group's system of internal controls the Audit Committee has taken account of any material developments up to the date of the signing of the financial statements. In addition, recognition is given to the external audit findings, which help to inform the Audit Committee's views of areas of increased risk.

The system of internal control comprises those controls established in order to provide assurance that the assets of the group are safeguarded against unauthorised use or disposal, and to ensure the maintenance of proper accounting records and the reliability of financial information used within the business or for publication.

Any system of internal control can only provide reasonable, but not absolute, assurance against material misstatement or loss, as it is designed to manage rather than to eliminate the risk of failing to achieve the business objectives of the group.

The directors acknowledge their responsibility for preparing the Annual Report and Accounts. As set out in the Audit Committee Report on pages 46 to 49, the Committee reviews the Group's reporting processes with the aim of ensuring that the financial reporting ,when taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

Risk management

The Board reviews and approves an Annual Business Plan prior to the start of each financial year. The Annual Business Plan sets out the key strategic, operational and financial objectives for the year, together with a detailed financial budget. This is provided in the context of a Three Year Plan.

The Executive Committee is accountable to the Board for delivery of the Annual Business Plan. The Executives report performance against the plan on a monthly basis, which includes detailed analysis of budgetary variances and updated financial projections.

Each Executive Director is responsible for identifying and managing the risks relating to their respective areas of responsibility, including the risks relating to strategy, the Annual Business Plan, and day-to-day business.

To provide a framework for the delivery the group's strategy and plans, the Executive Committee has developed an organisational structure with clear roles and responsibilities, and clear lines of reporting. This includes a Management Board, which is made up of the heads of each business function.

The Management Board is responsible for the development and delivery of the detailed actions plans which underpin the group's Annual Business Plan. This team meets formally with the Executive Directors on a monthly basis to assess progress against their plans, and to put in place any countermeasures necessary to keep the business plan on track.

In addition to day-to-day risk management, the executive directors formally assess the major business risks and evaluate their potential impact on the Group. These risks and the reporting of the risk assessment is included in the strategic report on pages 28 to 31.

Performance evaluation

The Chief Executive reviews the performance of the executive directors on a periodic basis and reports to the Remuneration Committee.

Whilst the performance of the Directors, the Chairman and of the Board are assessed on an ongoing basis, the Code requires a formal annual review process to be completed and documented, which was not completed during 2016. However, following the appointment of the new Senior Independent Non-Executive Director in December 2016, a formal review is scheduled for 2017.

Going concern

The Directors, after making enquiries, and considering the available resources, the financial forecast together with available cash and committed borrowing facilities, have formed a judgement that there is a reasonable expectation that the Company and the Group have adequate resources to continue operating for the foreseeable future and therefore the going concern basis has been adopted in preparing these financial statements.

In reaching this conclusion, the Board has considered the magnitude of potential impacts resulting from uncertain future events or changes in conditions, the likelihood of their occurrence and the likely effectiveness of mitigating actions that the Directors would consider undertaking.

Long term viability statement

The Directors have considered the viability of the Group over a three year period to December 2019, taking account of the Group's current position and the potential impact of the principal risks and uncertainties documented in the Strategic Report.

In making this statement the Directors have considered the resilience of the Group, taking account of its current position, the principal risks facing the business in severe but reasonable scenarios, and the effectiveness of any mitigating actions.

The Directors have determined that the three-year period to December 2019 is an appropriate period over which to provide its viability statement. In making their assessment, the Directors have taken account of the Group's current funding headroom (see note 19), its ability to raise new finance in most market conditions and other potential mitigating actions.

Based on this assessment, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to December 2019.

Board committees

Terms of reference for the Remuneration Committee, Nominations Committee and Audit Committee are available on the corporate website (www.iqep.com).

Nominations Committee Report

The Nominations Committee reviews the Board structure, leads the process for Board appointments and makes recommendations to the Board, including on Board succession planning. The Chief Executive attends meetings of the Nomination Committee by invite.

The Nominations Committee evaluates the balance of skills, knowledge and experience on the Board and, in the light of this evaluation, prepares a description of the role for new appointments. In identifying potential candidates for positions as Non-Executive Directors, the Committee has full regard to the principles of the Code regarding the independence of Non-Executive Directors.

The Committee met twice during the year and was instrumental in determining the requirement and process for the identification and subsequent appointment of additional non-executive directors.

All Directors are appointed by the Board following a rigorous selection process and recommendation by the Committee. Board appointments are made on merit, against criteria identified by the Committee having regard to the benefits of diversity on the Board, including gender.

The Nominations Committee is responsible for the Board's policy on diversity. The Board recognises the benefits of diversity. Diversity of skills, background, knowledge, international and industry experience, and gender, are amongst many other factors taken into consideration when seeking to appoint new Directors to the Board. Notwithstanding the foregoing, all Board appointments will always be made on merit.

Main responsibilities

The main responsibilities of the Committee are as follows:

- To lead the process for identifying and nominating candidates for the approval of the Board, to fill Board vacancies as and when they arise
- To put in place plans for succession
- To regularly review the Board's structure, size and composition taking into account the challenges and opportunities facing the Group and the balance of skills, knowledge and experience needed by the Board and make recommendations to the Board with regard to any changes
- The Committee's terms of reference are available on request from the Company Secretary.

Recent appointments to the Board

During the year, the Committee recommended to the Board that Mr Phil Smith be appointment of as Non-Executive Director and Senior Independent Director.

The Committee initiated the recruitment process following the AGM in June 2016, at which Prof Simon Gibson and Dr Godfrey Ainsworth indicated that they did not intend to stand for re-election at the end of their current three year term.

The Committee engaged an independent external consultant, Ms Kirsten Bodley, to complete a preliminary evaluation and provide a list of potential candidates with the necessary skills and experience. Ms Bodley has no other connection with the Company and is an independent provider of services to the Company.

In scoping the search for candidates, each Board member was consulted in order to agree the necessary skills and experience of candidates to be considered for appointment. Based on these criteria a list of potential candidates was developed, which was filtered to a short-list of candidates for interview by the Nominations Committee.

On the recommendation of the Nominations Committee, the Board approved the appointment of Mr Phil Smith with effect from 19 December 2016.

The Nominations Committee remains engaged in a search for an additional independent non-executive director with appropriate financial experience and qualifications to support the Board and Audit Committee, noting that the incumbent Audit Committee Chairman is not deemed independent by virtue of the length of his tenure.

Audit Committee Report

The Audit Committee is currently chaired by Dr Godfrey Ainsworth FCA, a Chartered Accountant and is considered by the Board and Audit Committee to have current relevant financial knowledge, qualifications and experience for this role.

Dr Ainsworth is not considered independent by virtue of the length of his tenure on the IQE Board which, taken in conjunction with his role as Chairman of both the Board and Audit Committee, represents an area of non-compliance with the current UK Corporate Governance Code.

Given the knowledge, experience and skills of Dr Ainsworth the Board has asked that he remains as Chairman of the Audit Committee until a suitable independent non-executive director with appropriate financial experience is appointed.

Main responsibilities

- Reviewing the effectiveness of the Company's financial reporting, internal control policies and procedures for the identification, assessment and reporting of risk
- Reviewing significant financial reporting issues and judgements
- Monitoring the integrity of the Company's financial statements
- Keeping the relationship with the auditors under review, including their terms of engagement, fees and independence
- Monitoring the role and effectiveness of internal audit
- Advising the Board on whether the Committee believes the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy

Activities during the year

The Audit Committee met three times during the year. The meetings were also attended by the Chief Financial Officer, other senior members of the finance team , and representatives of the Group's external auditors by invitation.

At meetings attended by the external auditors time is allowed for the Audit Committee to discuss issues with the external auditors without the Chief Financial Officer and management being present.

As part of the review and audit process, the Chairman of the Audit Committee and the Chief Financial Officer visit each of the group's major subsidiaries to review and challenge local management on their draft financial results, and financial controls. The Chairman reports his observations from these visits to the Audit Committee and the Board as part of the process for approving of the Annual Report and Accounts.

The Committee operates under formal terms of reference and these are reviewed annually. An annual rolling agenda is used to ensure that all matters within the Audit Committee's Terms of Reference during the year are appropriately covered. The Committee considers that it has discharged its responsibilities as set out in its terms of reference to the extent appropriate during the year.

Financial reporting

During the year, the Audit Committee reviewed the appropriateness of the Group's interim and full year financial statements, including the consideration of significant financial reporting judgments made by management taking into account reports from management and from the external auditors. The main areas of focus considered by the Committee during 2016 were as follows:

- Review of judgemental areas, and specifically the level of accounting provisions. Following review of reports from management and the external auditors, the Committee concurred that the provisioning policy had been applied consistently and the level of provisions remains appropriate.
- Review for the potential impairment of goodwill and other intangible assets. Following review of reports from management and the external auditors, the Committee concurred that the expected future cash flows of the group support the carrying value of goodwill, and that there were no triggering events which suggested any potential impairment of other intangible assets.
- Review of product development costs capitalised. Following review of reports from management and the auditors, and discussion with the Group Technology Development Director, the Committee concurred that the product development costs were capital in nature, and that the treatment was in accordance with IAS 38.
- The presentation of the financial statements, including the presentation of adjusted performance measures. Following review of reports from management and the external auditors, the Committee concurred that the presentation was appropriate and balanced.
- Accounting for current and deferred tax. Following review of reports from management and the external auditors, the Committee concurred that the tax accounting was appropriate.
- The Committee assessed the appropriateness of the going concern assumption. In doing this the committee reviewed the resources available to the Group, taking account of the Group's trading and cash flow forecast together with available funding headroom. Based on this as disclosed on page 44 the committee concluded that the Going Concern principle was appropriate.
- At the request of the Board, the Committee considered whether the 2016 annual report was fair, balanced and understandable and whether it provided the necessary information for shareholders to assess the Company's performance, business model and strategy. Having taken account of the other information provided to the Board throughout the year, the Committee was satisfied that, taken as a whole, the annual report was fair, balanced and understandable.

The Committee was satisfied that based on its review, challenge and debate of the draft financial statements and the key accounting items, that the assumptions made, the judgements applied and the accounting and disclosures were appropriate.

The Committee reviewed and recommended the approval of the narrative reporting statements on corporate governance, internal control and risk management in the annual report and the half year and trading statements.

External auditors

The Audit Committee has developed a formal Auditor Independence Policy. In accordance with this policy, the Committee oversees the relationship with the external auditors and monitors all services provided by them and all fees payable to them. This is to ensure that potential conflicts of interest are considered, and that an independent, objective and professional relationship is maintained.

PricewaterhouseCoopers LLP ("PwC") has been the Company's external auditors for over 10 years. Therefore the Committee considers the reappointment of the external auditor and their independence on an annual basis and confirmed the continuing appointment of PwC.

The Audit Committee are satisfied that PwC remain independent and objective. This assessment reflects the control procedures that PwC has put in place to maintain its independence, including the regular rotation of the audit partner and key staff. The current audit partner has reported on IQE for two years.

The provision of external audit and tax compliance are separated where possible. Tax advice is provided by Bevan Buckland in the UK, and EY and KPMG in the US and Asia. The one exception is in Taiwan where PwC provide Audit and local Tax compliance services as this is standard local compliance practice.

The Audit Committee also monitors the effectiveness of the annual audit. Before the end of the financial year, the Committee receives a detailed audit plan from the auditors which identifies the auditors assessment of the key risks and their intended areas of focus. This is agreed with the Committee to ensure that the scope and coverage of audit work is appropriate.

IQE's management also provide the Committee with feedback on the effectiveness of the audit. In connection with 2016 IQE's management was satisfied that there had been appropriate focus and challenge on the primary areas of audit risk and they assessed the quality of the audit process as good. The Committee concurred with the view of management.

The Committee also regularly reviews the nature, extent, objectivity and cost of non-audit services provided by the external auditors. In doing this the Committee does not approve the contract for additional services from them which would compromise their audit independence. Under this policy, the award to the group's auditors of audit-related services, tax consulting services or other non-audit related services in excess of £10,000 must first be approved by both the Chairman of the Audit Committee and the Senior Independent Director. The policy also establishes guidelines for the recruitment of employees or former employees of the external auditor.

In addition, the group's auditors are required to make a formal report to the Audit Committee annually on the safeguards that are in place to maintain their independence and the internal safeguards in place to ensure their objectivity.

To ensure compliance with this policy the Audit Committee reviewed and approved the remuneration received by PwC for audit services, audit-related services and non-audit work.

The nature of the services provided by the auditors and the amounts paid to them are as detailed below:

	Total 2016 £'000	Total 2015 £'000
PricewaterhouseCoopers LLP (group auditors)		
Fees payable to company's auditor and its associates for the audit of parent company and consolidated financial statements	19	19
Fees payable to company's auditor and its associates for other services:		
- The audit of company's subsidiaries	90	88
- Audit-related assurance services	11	11
- Financial due diligence service	-	-
- Tax advisory	5	8
- Tax compliance service	-	5
Total PricewaterhouseCoopers LLP (group auditors)	**125**	**131**
Ernst and Young (auditors of MBE Technology Pte Limited)		
- Subsidiary company's audit	9	6
- Tax services	3	4
Total Ernst and Young (auditors of MBE Technology Pte Limited)	**12**	**10**
Total	**137**	**141**

Internal control

The Audit Committee reviews the effectiveness of the Group's system of internal controls and risk management activities bi-annually as part of the half year end full year public reporting.

The key procedures that the directors have established with a view to providing effective internal control include the following:

- a clearly defined organisational structure and limits of authority;
- corporate policies and procedures for financial reporting and control, project appraisal, human resources, quality control, health and safety, information security and corporate governance;
- the preparation of annual budgets and regular forecasts which require approval from both the Group Executive Committee and the Board;
- the monitoring of performance against budget and forecasts and the reporting of any variances in a timely manner to the Board;
- regular review and self-assessment of the risks to which the group is exposed, taking steps to monitor and mitigate these wherever possible;
- where appropriate, taking out insurance cover; and approval by the Audit Committee of audit plans and, on behalf of the Board, receipt of reports on the group's accounting and financial reporting practices and its internal controls together with reports from the external auditors as part of their normal audit work.
- Internal audit reviews are periodically conducted to evaluate and test the Group's financial control procedures, reporting directly to the Chairman of the Audit Committee. This involves the monitoring and reviewing of the effectiveness of internal audit activities.

Internal Audit

The group currently operates a system of "peer review" for its internal audit, which the Committee considers remains appropriate for the size and geographical spread of the Group.

In addition, site financial controllers and plant managers are obliged to positively confirm, on a monthly basis, that the agreed procedures are in place and are being adhered to, with specific reference to key controls such as bank and control account reconciliations.

This process remained in operation for the year under review, and up to the date of approval of the Annual Report and Financial Statements. It has been reviewed by the Committee, and they remain satisfied with the arrangements. No significant failings or weaknesses were identified by the internal audit process but several minor improvements were identified and implemented.

As part of its work, and in line with its terms of reference, the Committee also considers the discharge of the Board's responsibilities in the areas of corporate governance, financial reporting and internal control, including the internal management of risk, as identified in the FRC's revised guidance on Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

Risk management activities are dealt with in more detail in the Strategic Report on pages 28 to 31.

Director’s Report

The directors present their annual report and the audited consolidated financial statements for the year ended 31 December 2016.

Activities

The principal activity of the group during the year was the development, manufacture and sale of advanced semiconductor materials. The principal activity of the company is that of a holding company for the group, the provision of services to subsidiary companies, and the research, development and provision of engineering consultancy services to the compound semiconductor industry.

Business review

A review of the group’s trading during the year and its position at the year end is provided on pages 9 to 13 and 36 to 38. The review includes key performance indicators as detailed in the Five Year Financial Summary. The principal risks and uncertainties facing the group are set out on pages 28 to 31. The future outlook for the Group is set out on page 14.

Dividends

The directors do not recommend the payment of a dividend (2015: £nil).

Directors

The directors in office at 31 December 2016 and throughout the year and their beneficial interests in the company’s issued ordinary share capital and share options are set out in the remuneration report on pages 52 to 65.

Substantial interests in shares

As at 28 February 2017 the company had been notified pursuant to the Companies Act of the following substantial interests in the shares of the company as defined by the Listing Rules in addition to those disclosed for the directors:

T Rowe Price International	10.18%
AXA Investment Mgrs	9.65%
Barclays Wealth	5.81%
Hargreaves Lansdown Asset Mgt	5.66%
Dr Andrew W Nelson	5.22%
Herald Investment Mgt	4.65%
Miton Asset Mgt	4.06%
TD Direct Investing	3.64%

shareholder analysis by Canaccord Genuity

Research and development

The group incurred costs in respect of research and development during the year of £8,358,000 (2015: £5,117,000) of which £7,599,000 (2015: £4,979,000) has been capitalised in accordance with IAS 38 (“Intangible assets”). The remaining research and development costs totalling £143,000 (2015: £138,000) have been charged to the income statement (net of grant funding).

Payment terms

The group seeks to agree favourable credit terms with its suppliers where possible, and adhere to the agreed terms. The group’s average number of days’ purchases outstanding in respect of trade creditors at 31 December 2016 was 90 days (2015: 61 days).

Employment policies

A review of the group’s employment policies is provided on pages 24 to 35.

Going concern

The directors, after making enquiries, and considering financial forecast to enable them to consider the future prospects of the group and have a reasonable expectation that it will have adequate resources to continue operating for the foreseeable future and therefore the going concern basis has been adopted in preparing these financial statements.

Principal risks and uncertainties

Details of the principal risks and uncertainties impacting the group have been included in the strategic report on pages 28 to 31.

Treasury

IQE operates a central treasury function which acts in accordance with specific board policies. Speculative transactions are not permitted. The significant treasury policies relate to Interest rates, foreign currency and liquidity are detailed in note 19.

Insurance and Indemnities

We have purchased and maintain appropriate insurance cover in respect of directors’ and officers’ liabilities. The Company has also entered into qualifying third party indemnity arrangements for the benefit of all its Directors in a form and scope which comply with the requirements of the Act. These indemnities were in force throughout the year and up to the date of this Report and Annual Accounts.

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

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 International Financial Reporting Standards (IFRSs) as adopted by the European Union and company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. 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 company and of the profit or loss of the group and company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed for the group financial statements and IFRSs as adopted by the European Union have been followed for the company financial statements, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group and company's transactions and disclose with reasonable accuracy at any time the financial position of the group and company and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

The directors are also responsible for safeguarding the assets of the group and company 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 company'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 company's performance, business model and strategy.

Each of the directors, whose names and functions are listed in Directors' report confirm that, to the best of their knowledge:

- the company financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and loss of the company;
- the group financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the group; and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the group and company, together with a description of the principal risks and uncertainties that it faces.

Provision of information to auditors

So far as the directors are aware, there is no relevant audit information of which the company's auditors are unaware. The directors have taken all the steps that ought to have been taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Independent Auditors

A resolution to reappoint PricewaterhouseCoopers LLP will be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors and signed on behalf by:

Phillip Rasmussen
Chief Financial Officer
21 March 2017

Remuneration Statements

Directors' Report on Remuneration

Chairman's statement

Dear Shareholders,

On behalf of the Board, I am pleased to present the Remuneration Committee's report of the Directors' remuneration for the year ended 31 December 2016 for which we will be seeking shareholder approval at the Annual General Meeting on 13 June 2017. As an AIM-listed company, IQE is not required to submit a remuneration policy to a shareholder vote. However, in light of the feedback received from shareholders on directors' remuneration around last year's AGM, we have voluntarily decided to do so. During the year we appointed Kepler, a brand of Mercer Ltd., to undertake a review of IQE's remuneration arrangements and this report contains IQE's proposed remuneration policy for the next 3 years, which will be put to a shareholder vote at the 2017 AGM, as well as the annual report for 2016 remuneration.

The review covered all elements of directors' pay and proposed a number of changes, including:

- Limiting the increase in executive directors' salaries to the average % increase across the UK workforce of 2.4% effective 1 January.
- Leaving pension contributions unchanged.
- Discontinuing the car allowance (from 2016 onwards).
- Formalising the annual bonus structure, which will be based primarily on IQE's financial performance, and targets will be published at the end of the year.
- Incorporating Total Shareholder Return into the long-term incentive. The normal maximum LTIP opportunity will remain at 100% of salary. Executive directors' will have the opportunity to double this if and only if they at least double shareholder value, i.e. deliver a TSR of 100% or more (>26% p.a.) over the three year performance period.
- Leaving NED and Chairman fees unchanged for 2017.

David Grant

Sir David Grant CBE,
Remuneration Committee Chairman

Directors' Remuneration Policy

IQE aims to attract, retain and motivate high calibre executives, whilst recognising the need to be cost effective, and to incentivise significant industry out-performance. The Committee is proposing a remuneration policy that balances these factors, taking account of investor feedback and prevailing best practice.

This section of the directors' remuneration report sets out the Policy for Executive Director remuneration which will be put to a shareholder vote at the 2017 AGM.

Policy table

Function	Operation	Opportunity	Performance metrics
Base salary To recognise the individual's skills and experience and to provide a competitive total package.	Base salaries are reviewed annually, with reference to market levels, individual contribution, the experience of each Executive and increases across the Group. Any adjustments become effective on 1 January.	Any base salary increases are applied in line with the outcome of the Committee's review. In respect of existing executive directors, it is anticipated that salary increases will generally be in line with those of salaried employees as a whole. In exceptional circumstances (including, but not limited to, a material increase in job size or complexity, material market misalignment) the Committee has discretion to make appropriate adjustments to salary levels to ensure they remain appropriate.	n/a
Pension To provide an opportunity for executives to build up income on retirement.	All Executives are members of the Group pension scheme and/or receive a cash pension allowance. Salary is the only element of remuneration that is pensionable.	Executive Directors receive a pension contribution of 10% of salary or an equivalent cash allowance.	n/a
Benefits To provide non-cash benefits which are competitive in the market in which the executive is employed.	Executives receive benefits which consist primarily of health cover, private medical insurance, life assurance, long-term disability insurance and reimbursement for fuel, although may include other benefits that the Committee deems appropriate in the circumstances.	Benefits may vary according to role and individual circumstances. Eligibility to benefits and the cost of benefits are reviewed periodically. The Committee retains discretion to approve a higher cost in exceptional circumstances (e.g. relocation or expatriation) or in circumstances where market rates have changed (e.g. cost of insurance cover).	n/a

Policy table (continued)

Function	Operation	Opportunity	Performance metrics
Annual Bonus To incentivise and reward strong performance against financial and personal annual targets, thus delivering value to shareholders and being consistent with the delivery of the strategic plan.	Performance measures, targets and weightings are set at the start of the year. The scheme is based on a combination of financial performance and personal objectives. At the end of the year the Remuneration Committee determines the extent to which targets have been achieved. Bonus payments are delivered in cash. Clawback (of any bonus paid) may be applied during employment or for 2 years post-termination in the event of gross misconduct, material financial misstatement, error in calculation of outcomes or in any other circumstance that the Committee considers appropriate.	For Executive Directors, the maximum annual bonus opportunity is 100% of base salary. The bonus will pay 0% at Threshold, 50% at Target and 100% at Maximum, with straight-line vesting between these levels, and no vesting below Threshold.	Performance is assessed on an annual basis against financial and personal / strategic objectives set at the start of each year. Financial measures will be weighted appropriately each year according to business priorities, and will represent no less than 70% of the annual bonus. Performance vs targeted levels will be measured at budgeted FX rates. Personal/strategic objectives will represent no more than 30% of the bonus and will be set annually to capture expected individual contributions to IQE's strategic plan. The personal element shall not pay out unless financial performance is at least at Threshold. The committee has discretion to adjust formulaic bonus outcomes to ensure fairness for shareholders and participants, to ensure pay aligns underlying company performance, and to avoid unintended outcomes. These adjustments can be either upwards (within plan limits) or downwards (including down to zero). The committee may consider measures outside of the bonus framework to ensure there is no reward for failure. Further details of the measures, weightings and targets applicable are provided on page 64 in the Annual Report on Remuneration

Policy table (continued)

Function	Operation	Opportunity	Performance metrics
LTIP To drive sustained long-term performance that supports the creation of shareholder value.	Under the long-term incentive plan (LTIP) annual awards of shares or nil-cost options may be made to participants. Award levels and performance conditions are reviewed before each award cycle to ensure they remain appropriate. The Committee has the discretion to authorise a payment, in cash or shares, equal to the value of dividends which would have accrued on vested shares during the vesting period. Malus (of any unvested LTIP) and clawback (of any vested LTIP) may be applied during employment or for 2 years post-termination in the event of gross misconduct, material financial misstatement, error in calculation of outcomes or in any other circumstance that the Committee considers appropriate.	The LTIP provides for normal awards of up to 100% of salary. A multiplier of up to 2x may apply to the normal level of vesting in case of truly exceptional performance. In exceptional circumstances, including but not limited to recruitment, normal awards may be made up to 200% of salary to secure the right individual. Up to 25% of the LTIP will be paid for achieving Threshold performance, increasing on a straight-line basis to full vesting for achieving Stretch performance.	Vesting of LTIP awards is subject to achieving performance conditions and continued employment. The Committee has the discretion to change the performance measures for new cycles to ensure that they continue to be linked to the delivery of the Company's strategy. Any significant change would be subject to prior shareholder consultation. For 2017, the performance condition for the normal award will continue to be based on EPS growth +6% to +12% p.a. over 3 years. To further reinforce IQE's ambitious growth strategy, awards can be doubled if absolute TSR growth over the 3-year performance period is 100% or more. If no entitlement has been earned at the end of the relevant performance period, awards lapse. The Committee has discretion to adjust the EPS outcome to ensure it fairly reflects underlying performance. The Committee also considers environmental, social, governance and health and safety criteria, to ensure there is no reward for failure. Details of the targets to be used in future LTIP grants are included on page 64 in the Annual Report on Remuneration.

Notes to the policy table

Performance measure selection and approach to target setting

The measures used under the annual bonus plan are selected annually to reflect IQE's main objectives for the year and reflect both financial performance and personal contributions to the strategic plan.

The Committee considers EPS to be a key measure of IQE's long-term bottom line performance. TSR is a measure which strongly aligns management and shareholder interests.

Targets applying to the bonus and LTIP are reviewed annually, based on a number of internal and external reference points. Performance targets are intended to be stretching and achievable, and reflect IQE's strategic priorities and its market opportunities.

Notes to the policy table (continued)

Remuneration policy for other employees

All employees are eligible to participate in a discretionary annual bonus and our HMRC-approved share option scheme. At present, only executive directors participate in the Group's LTIP.

Shareholding guidelines

The Committee wishes to encourage Executive Directors to build up a significant shareholding in the Company. Shareholding guidelines will therefore be put in place to require Executive Directors to acquire a shareholding (excluding shares held conditionally pursuant to LTIP performance) equivalent to 200% of base salary. Until the relevant shareholding levels are achieved, 50% of any shares vesting (post-tax) under the new LTIP are required to be held. Executive Directors are expected to build up the required shareholding within five years of appointment to the Board. Details of the Executive Directors' current shareholdings are provided in the Annual Report on Remuneration. All Executive Directors held shares equivalent to a number in excess of 200% of salary as at 31 December 2016.

Non-Executive Director remuneration

Subject to annual re-election by shareholders, Non-Executive Directors are appointed for an initial term of 3 years. Subsequent terms may be offered. The appointment and re-appointment and the remuneration of Non-Executive Directors are matters reserved for the full Board.

The Non-Executive Directors are not eligible to participate in the Company's performance related bonus plan, long-term incentive plans or pension arrangements.

Full terms and conditions for each of the Non-Executive Directors are available at the company's registered office during normal business hours and will be available at the AGM for 15 minutes prior to the meeting and during the meeting.

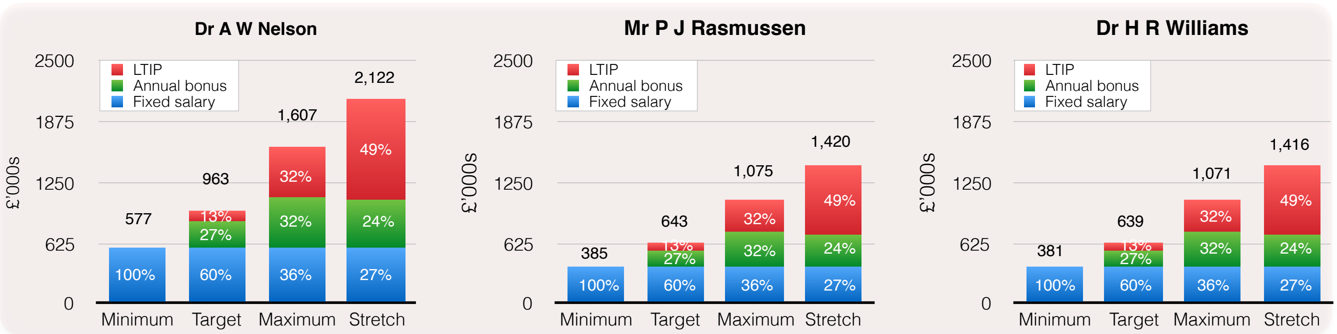
NED	Date of appointment letter
Dr Godfrey Ainsworth	16 June 2016
Sir David Grant	1 September 2012
Prof Simon Gibson	20 June 2016
Phil Smith	30 November 2016

Details of the policy on fees paid to the company's Non-Executive Directors are set out in the table below:

Function	Operation	Opportunity	Perfomance metrics
Fees To attract and retain Non-Executive Directors of the highest calibre with broad commercial and other experience relevant to the Company.	The fees paid to the Chairman are determined by the Committee, whilst the fees of the Non-Executive Directors are determined by the Board (excluding the NED or group of NEDs whose remuneration is being discussed). Fee levels are benchmarked against similar roles at comparable companies. Time commitment and responsibility are taken into account when reviewing fee levels.	Fee levels are reviewed annually, with any adjustments effective 1 January in the year following review. It is expected that increases to non-executive director fee levels will normally be in line with salaried employees over the life of this policy. However, in the event there is a material misalignment with market or a material change in the time commitment required to fulfil a non-executive director role, the Board has the power to make an appropriate adjustment to the fee level	n/a

Pay scenarios

The charts below provide an illustration of the potential future reward opportunities for the Executive Directors, and the split between the different elements of remuneration under three different performance scenarios: 'Minimum', 'On-target' and 'Maximum'. the Remuneration Committee may make use of all the existing components of remuneration, as follows:



The 'minimum' scenario comprises just fixed remuneration, i.e. base salary, pension and benefits which are the elements of the remuneration package not linked to performance. The figures for base salary and pension (10% of salary) are as of 1 January, while those for taxable benefits are based on the single figure table for 2016.

The 'on-target' scenario reflects fixed remuneration as above, plus a target bonus payout of 50% of maximum and threshold vesting for the LTIP of 25% of maximum.

The 'maximum' scenario reflects fixed remuneration, plus full payout of the annual bonus (100% of salary) plus full vesting of the normal LTIP of 100% of salary.

The 'stretch-maximum' scenario reflects fixed remuneration, plus full payout of the annual bonus at 100% of salary, plus the normal LTIP of 100% of salary with a 2x multiplier applied for doubling shareholder value over 3 years.

Approach to recruitment remuneration

External appointments

In the cases of hiring or appointing a new Executive Director from outside the Company,

the Remuneration Committee may make use of all the existing components of remuneration, as follows:

Component	Approach	Maximum annual grant value
Base salary	The base salaries of new appointees will be determined by reference to relevant market data, experience and skills of the individual, internal relativities and current basic salary. Where new appointees have initial basic salaries set below market, any shortfall may be managed with phased increases over multiple years subject to the individual's development in the role.	
Pension	New appointees will receive pension contributions or an equivalent cash supplement in line with existing policy.	
Benefits	New appointees will be eligible to receive benefits which may include (but are not limited to) those outlined in the policy table.	
Annual Bonus	The structure described in the policy table will apply to new appointees with the relevant maximum being pro-rated to reflect the proportion of employment over the year. Targets for the personal element will be tailored to each executive.	100% of salary
LTIP	New appointees will be granted awards under the LTIP on the same terms as other executives, as described in the policy table.	Up to 200% of salary on appointment; normally 100% of salary thereafter

In determining the appropriate remuneration for a new executive director appointee, the Remuneration Committee will take into consideration all relevant factors (including nature and quantum of each component of remuneration and the jurisdiction from which the candidate was recruited) to ensure that arrangements are in the best interests of IQE and its shareholders. The Committee may make an award in respect of a new appointment to 'buy out' remuneration arrangements forfeited on leaving a previous employer on a like-for-like basis, which may be awarded in addition to the ongoing remuneration elements outlined in the table above. In doing so, the Committee will consider relevant factors, including time to vesting, performance conditions attached to awards, and the likelihood of these conditions being met. Any 'buy-out' awards will typically be made under the existing annual bonus and LTIP schemes, although in exceptional circumstances the Committee may exercise the discretion available under Listing Rule 9.4.2 R to make awards using a different structure. Any 'buy-out' awards would have a fair value no higher than the awards forfeited.

Internal appointments

In the case an internal promotion to the Board, the Remuneration Committee will use the same policy as detailed above, although there will be no opportunity for a buyout. However, where an individual has contractual commitments made prior to their promotion to Executive Director level, the Company will continue to honour these arrangements.

Non-Executive Directors

In recruiting a new Non-Executive Director, the Remuneration Committee will utilise the policy as set out in the table on pages 44 to 45.

Service contracts and treatment for leavers and change of control

Executive Director service contracts, including arrangements for early termination, are carefully considered by the Committee. Each of the Executive Directors has a rolling service contract requiring 6 months' notice of termination on either side. Such contracts contain no specific provision for compensation for loss of office, other than an obligation to pay for any notice period waived by the Company, where pay refers to salary, benefits and pension only. Executive Director's service contracts are available to view at the Company's registered office.

Executive director	Date of appointment letter
Dr Andrew Nelson	1 June 2016
Phillip Rasmussen	7 January 2007
Dr Howard Williams	1 June 2016

When considering exit payments, the Committee reviews all potential incentive outcomes to ensure they are fair to both shareholders and participants. The table below summarises how the awards under the annual bonus and LTIP are typically treated in different circumstances, with the final treatment remaining subject to the Committee's discretion:

Reason for leaving	Calculation of vesting / payment
Annual bonus	
Resignation	No annual bonus payable.
'Good leaver'[1]	Cash bonuses will typically be paid to the extent that performance objectives have been met. Any resulting bonus will typically be prorated for time worked. The Committee retains discretion to vary this treatment in individual circumstances.
Change of control	
LTIP	
Resignation	Outstanding awards lapse
'Good leaver'[1] and change of control	The Committee determines whether and to what extent outstanding awards vest based on the extent to which performance conditions have been achieved and the proportion of the vesting period worked. The Committee retains discretion to vary this treatment in individual circumstances. The determination of vesting will be made as soon as reasonably practical following the end of the performance period or such earlier date as the Committee may agree (within 12 months in the event of death). In the event of a change of control, awards may alternatively be exchanged for new equivalent awards in the acquirer where appropriate.

1 'Good leaver' is defined as a participant ceasing to be employed by the Group by reason of death, disability, ill health, retirement or any other reason that the Committee determines in its absolute discretion.

External appointments

With the approval of the Board in each case, and subject to the overriding requirements of the Group, Executive Directors may accept external appointments as Non-Executive Directors of other companies and retain any fees received. None of the executive directors received any remuneration from external directorships.

Consideration of conditions elsewhere in the company

When making decisions on changes to Executive Director remuneration, the Committee considers changes to pay and conditions across the Group. To this end, the HR Manager provides the Committee with a summary of the proposed level of average increase for employees prior to the annual salary review. For Executive Directors, the Remuneration Committee does not formally consult with employees on the executive remuneration policy and implementation.

Consideration of shareholder views

The Remuneration Committee maintains a regular dialogue with the company's major shareholders. Following the 2016 AGM, we consulted with shareholders regarding the concerns raised regarding last year's remuneration report. Subsequently, we appointed Kepler as the company's independent consultant to assist the Committee and help us review our approach to executive remuneration, monitor trends and developments in corporate governance, market practice and shareholder views, and reporting in the DRR.

Annual Report on Remuneration

Remuneration Committee role, membership and advice

The primary role of the Committee is to determine and agree with the Board fair and reasonable remuneration arrangements for the Chairman and Executive Directors. The main activities of the Remuneration Committee during the year were as follows:

- Reviewed shareholder feedback from AGM.
- Appointed Kepler, a brand of Mercer as independent advisors to the Committee.
- Reviewed the remuneration policy.
- Benchmarked remuneration of executive directors.
- Determined annual bonuses payable to executive directors for 2016.
- Reviewed and approved vesting of LTIP awards.
- Reviewed and approved the executive directors' salaries for 2017.
- Determined performance targets for the executive directors' 2017 annual bonus and LTIP awards in line with the Company's strategic plan.
- Drafted the Directors Remuneration Report.

The Committee's terms of reference are set out on the Company's website at www.iqep.com.

During the year, the Committee comprised 3 Non-Executive Directors:

- Sir David Grant, Senior Independent Non-Executive Director and Remuneration Committee Chairman since 23rd June 2016, attended 4 out of 4 meetings during the year
- Simon Gibson was Remuneration Committee Chairman until the AGM on 23rd June 2016, following which he stepped off the Committee, he attended 3 out of 3 meetings during this period
- Dr Godfrey Ainsworth, Company Chairman, attended 4 out of 4 meetings during the year

The Board undertakes an annual evaluation of the Committee's performance to ensure its continued ability to independently and objectively review executive director remuneration at the Group.

The following individuals may be invited to attend Committee on certain occasion to provide advice and to help the Committee to make informed decisions. No individuals are involved in decisions relating to their own remuneration.

- Dr Andrew Nelson, Chief Executive Officer
- Jason Howells, Company Secretary and Secretary to the Remuneration Committee
- Kepler, a brand of Mercer Ltd, independent advisors to the Committee

During the year, the Committee appointed Kepler, a brand of Mercer (Kepler), to provide independent advice to the Committee. Kepler is a signatory to the Code of Conduct for Remuneration Consultants in the UK, operated by the Remuneration Consultants Group, and which requires all advice to be objective and independent (see www.remunerationconsultantsgroup.com for more information). Services provided by Kepler included advice on remuneration packages for executives, assistance with a review of incentive arrangements and support on drafting this DRR, as well as other ad-hoc advice on remuneration. No fees were paid to Kepler in 2016 as they began their appointment in December. The Committee is comfortable that Kepler is independent, does not have any connections with IQE that may impair their independence, and does not provide any services to the Group other than its advice on remuneration.

Single total figure of remuneration for Executive Directors (audited)

The table below sets out a single figure for the total remuneration received by each Director for the year ended 31 December 2016 and the prior year:

	Dr A W Nelson		P Rasmussen		Dr H R Williams	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Salary	503	480	337	322	337	322
Benefits[1]	10	73	5	51	1	45
Annual bonus[2]	503	-	337	-	337	-
Long-term incentive[3]	-	298	-	270	-	364
Pension[4]	50	-	36	28	36	28
Total	1,066	851	715	671	711	759

1. Taxable benefits for 2016 consist of health cover, private medical insurance, life assurance, long-term disability insurance, fuel and car repairs. In 2015 Dr Andrew Nelson received a car allowance of £66k and Phillip Rasmussen and Dr Howard Williams received a car allowance of £44k, these were discontinued in 2016.
2. Annual bonus payments for performance during 2016 were 100% of salary, no annual bonus was paid for 2015. Details are included below in "Incentive outcomes for year ending 31 December 2016 and 31 December 2015".
3. LTIP awards granted on 26 April 2013 vested in full based on EPS growth between 1 January 2013 to 31 December 2015. The value of these awards are included in the 2015 single figure of remuneration above, based on the share price of 20.25p on date of vest, 26 April 2016.
No LTIP awards were due to vest in 2016, as 2014 awards were delayed until 2016 and, as such, will vest based on performance to 1 January 2019.
4. Executive directors participate in a defined contribution scheme, in relation to which the Company contributed 10% of salary. Dr Andrew Nelson did not receive a pension contribution in 2015.

Incentive outcomes for year ending 31 December 2016 and 31 December 2015

Annual Bonus

For 2016 and 2015 annual bonus payments were at the discretion of the Remuneration Committee. No annual bonuses were paid to executive directors for 2015, In 2016 financial objectives were met in full and the maximum bonus of 100% of salary was paid. Going forward, the bonus will be more structured, capturing both financial performance, e.g. profit and cash, and personal/strategic objectives, as described below and on page 64.

Long-term incentive plan

LTIP awards granted on 26 April 2013 were subject to 3-year real EPS growth from 1 January 2013 to 31 December 2015, with nil vesting below RPI plus 4% at which point 25% vesting occurs, increasing on a straight-line basis to full vesting for RPI plus 10%. Actual EPS growth was 20.2% in excess of 2013 RPI of 2.7% and, as such, the 2013 LTIP awards vested in full.

No LTIP awards were due to vest in 2016, as 2014 awards were delayed until 2016 and, as such, will vest based on performance to 1 January 2019.

Percentage change in CEO remuneration

The table below shows the percentage change in CEO remuneration from the prior year compared to the average percentage change in remuneration for other employees. The CEO's annual remuneration includes base salary, taxable benefits and annual bonus. The % change in annual remuneration for other employees is calculated using the increase in the earnings of all employees who were employed in the UK throughout 2015 and 2016. The Committee considers the UK employee population to be the most appropriate comparison for CEO vs. other employee pay, as all executive directors are currently employed in the UK, our UK employee population includes employees at all levels of the organisation, and pay inflation in our other geographies is affected by local market factors.

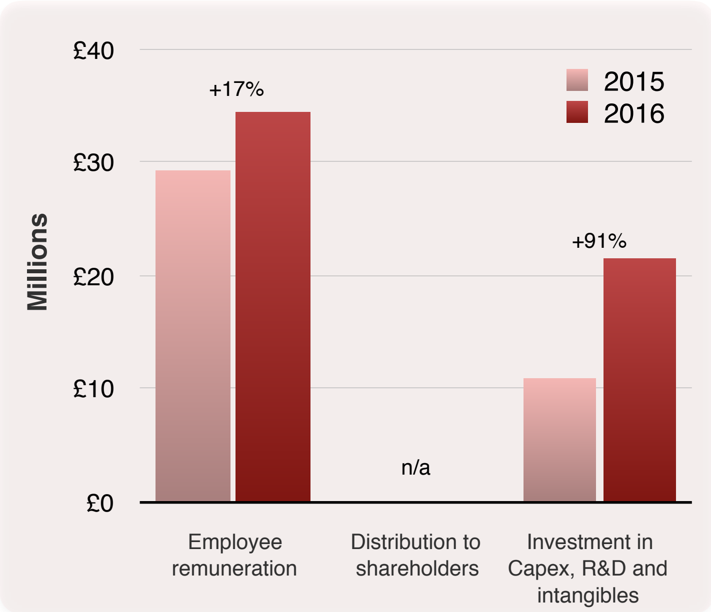
	% change 2015-2016	
	CEO	All UK employees
Base salary	5%[1]	2.4%
Taxable benefits	(86%)[1]	0.3%
Annual bonus	n/a[2]	9.7%

1. The Committee rebalanced the CEO's fixed pay from taxable benefits to salary as it discontinued the car allowance in 2016.
2. No annual bonus was paid to the CEO in 2015, the annual bonus paid for 2016 was equivalent to 100% of salary.

Directors' report

Relative importance of spend on pay

The graph on the right shows shareholder distributions (i.e. dividends and share buybacks) and total employee pay expenditure for the financial years ended 31 December 2015 and 31 December 2016, along with the percentage change.

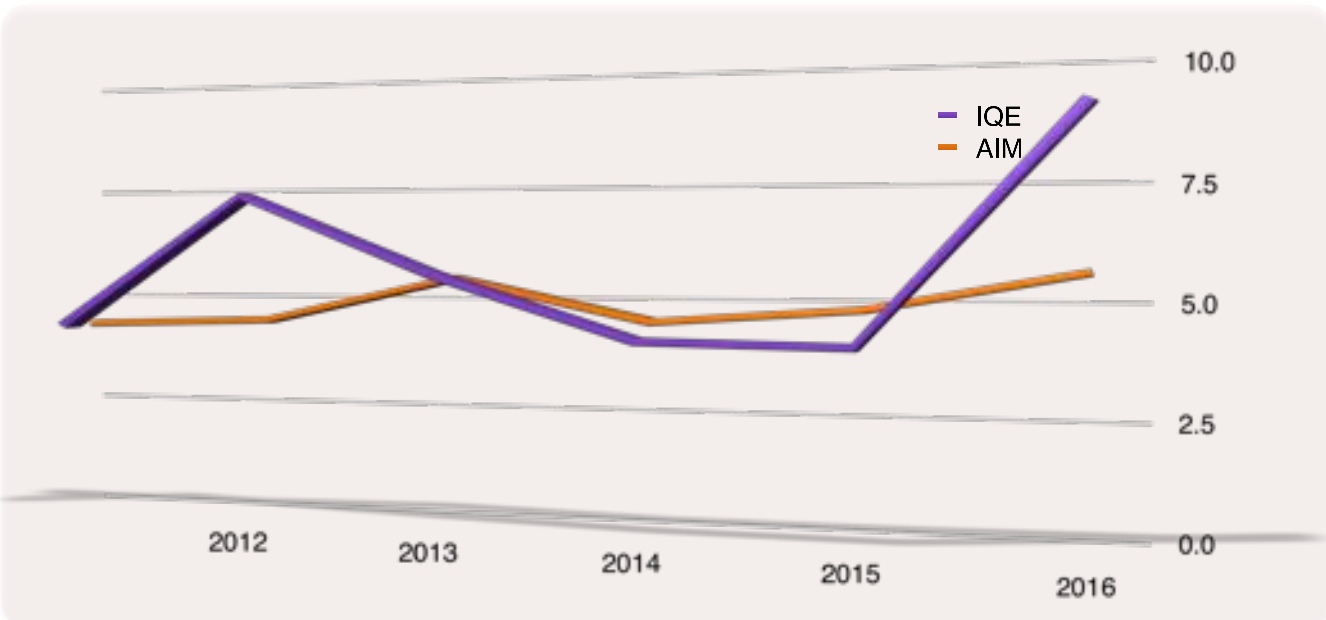


Review of past performance

The following graph charts the TSR of the Company and the FTSE AIM Index (to which IQE is a member) over the period from 1 January 2012 to 31 December 2016.

The table below details the Chief Executive's "single figure" remuneration over the same period.

Historical TSR performance



Historical CEO remuneration

	2012	2013	2014	2015	2016
CEO single figure of remuneration (£000)	780	1,266	889	851	1,066
STI award as a % of maximum opportunity	0%	0%	0%	0%	100%
LTI award as a % of maximum opportunity	100%	100%	83%	100%	n/a

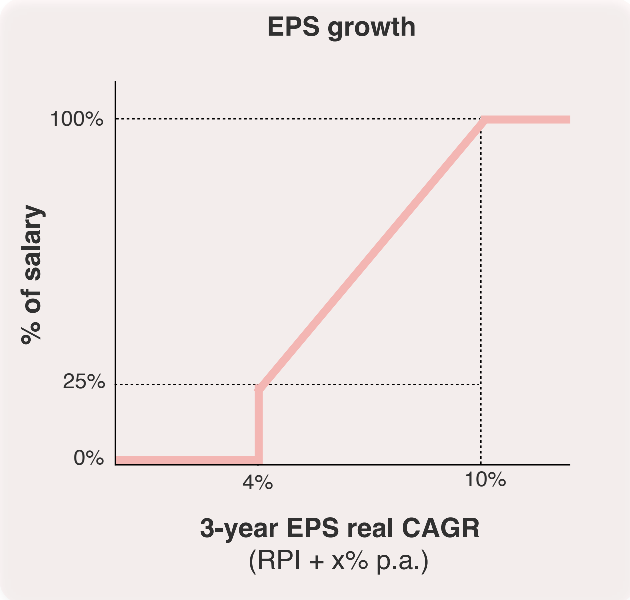
Scheme interests awarded in 2016

Executive director	Award type	Date of award	Shares awarded	Face value	End of performance period
Dr Andrew Nelson	Nil-cost option	7 Jan 2016	7,532,962	£1,506,592	31 Dec 2018
Phillip Rasmussen	Nil-cost option	7 Jan 2016	5,046,300	£1,009,260	31 Dec 2018
Dr Howard Williams	Nil-cost option	7 Jan 2016	5,046,300	£1,009,260	31 Dec 2018

As described in last year's report, the LTIP awards made on 7 January 2016 comprised the 2016 grant and the delayed 2014 and 2015 grants. Each grant was based on the directors' salary and average share price at the time that it would ordinarily have been granted. The face value of shares was based on the share price at date of award of 20p.

Vesting of these awards is subject to EPS growth in excess of RPI as illustrated in the chart on the right, where EPS is measured over the period from 1 January 2016 to 1 January 2019. All awards will vest on the third anniversary of the date of grant on 7 January 2019.

In respect of the delayed 2014 and 2015 LTIP awards, the Committee will also take into account the EPS growth in the period to 2016 and 2017, respectively, consistent with the performance periods that would have applied in respect of those grants.



Exit payments made in the year

No exit payments were paid to any director during the year.

Payments to past directors

No payments were made to past directors during the year.

Single total figure of remuneration for Non-Executive Directors

The table on the right sets out a single figure for the total remuneration received by each Non-Executive Director for the year ended 31 December 2016 and the prior year:

	NED fees 2016 £'000	NED fees 2015 £'000
Dr Godfrey Ainsworth	125	125
Sir David Grant	50	50
Prof Simon Gibson	50	50
Phil Smith[1]	n/a	n/a

1. Phil Smith was appointed to the Board as an independent director on 19 December 2016.

Implementation of remuneration policy for 2017

Base salary

The Committee approved the following base salary increases, in line with the average increase for all employee:

Pension

Executive Directors are entitles to a pension contribution of 10% of salary or equivalent cash allowance.

Executive director	Annual base salary at 1 Jan 2016	Annual base salary at 1 Jan 2017	Percentage increase
Dr Andrew Nelson	£503,000	£515,000	2.4%
Phillip Rasmussen	£337,000	£345,000	2.4%
Dr Howard Williams	£337,000	£345,000	2.4%

Annual bonus

For 2017 the Committee intends to approve the following annual bonus opportunities for Executive Directors, subject to approval of the new remuneration policy, as outlined in the Policy Table.

The Committee considers annual bonus targets for 2017 to be commercially sensitive at this time but will disclose them retrospectively once they are no longer commercially sensitive.

Payment of the personal element is also subject to IQE achieving Threshold EBITDA performance.

EBITDA (% weighting)	Cashflow (% weighting)	Personal/strategic objectives (% weighting)	Maximum annual bonus opportunity (% salary)
60%	20%	20%	100%

LTIP

It is proposed that for 2017, normal LTIP awards of up to 100% of salary may be made to executive directors, subject to approval of the new remuneration policy, as outlined in the Policy Table. For all participants, awards will vest after three years in accordance with the performance conditions outlined in the table on the right. No award will vest below Threshold performance, and vesting will increase on a straight-line basis between Threshold and Stretch.

UK high street retail prices are not particularly relevant to IQE global semiconductor revenues or the way we drive business performance internally, so we have converted the EPS scale from real growth of 4-10% p.a. to nominal growth of 6-12% p.a. (which assumes a long-run UK RPI of 2% p.a. for equivalence).

Vesting Schedule	Compound annual growth rate in EPS from 1 Jan 2017 to 31 Dec 2019	
	3-year EPS growth	% of normal maximum
Threshold	+6%	25%
Stretch	12%	100%

For truly exceptional absolute TSR growth, at or above 100% growth over the three-year performance period, the level of vesting under the normal award will be subject to a 2x multiplier.

Chairman and Non-Executive Director Fees

The Committee reviewed the Group's Chairman's fee and decided to make no change for 2017. It will therefore remain at £125k p.a. NEDs will continue to receive a fee of £50k p.a. with no additional fees for chairing a Board Committee or for fulfilling the role of Senior Independent Director.

Directors' interests (audited)

A table setting out the beneficial interests of the Directors and their families in the share capital of the Company as at 31 December 2016 is set out below.

Since 31 December 2016 there have been no changes in the Directors' interests in shares.

Details of Directors' share options are set out in the tables below.

	Shares owned outright as at 1 Jan 2016	Shares owned outright as at 31 Dec 2016	Shareholding requirement % salary/fee	Current shareholding % salary/fee	Requirement Met?
Dr Andrew Nelson	35,259,218	35,259,218	200%	2664%	✓
Phillip Rasmussen	3,473,357	3,473,357	200%	392%	✓
Dr Howard Williams	4,292,965	4,292,965	200%	484%	✓
Dr Godfrey Ainsworth	3,274,155	3,154,197	n/a	959%	n/a
Sir David Grant	215,000	215,000		163%	
Simon Gibson	301,855	301,855		229%	
Phil Smith[1]	n/a	n/a		n/a	

The table above includes shares which are the subject of the repurchase obligation by Dr Nelson entered into in October 2014.

	Options					
	Unvested and subject to continued performance	Unvested and subject to continued employment	Vested but unexercised	Vested during year	Lapsed during year	Exercised during year
Dr Andrew Nelson	7,817,203	-	2,861,192	-	-	-
Phillip Rasmussen	5,226,108	-	2,211,444	-	-	-
Dr Howard Williams	5,226,108	-	3,089,907	-	-	-
Dr Godfrey Ainsworth	n/a					
Sir David Grant						
Simon Gibson						
Phil Smith[1]						

1. Phil Smith was appointed on 19 December 2016.

Summary of shareholder voting at the 2016 AGM

Results of the vote on the remuneration report at the IQE's AGM on 23 June 2016 are as below:

	Total number of votes	% of votes cast
For (including discretionary)	94,384,040	31%
Against	205,278,487	67%
Total votes cast (excluding withheld	299,662,527	
Votes withheld	9,196,528	3%
Total votes cast (including withheld	308,859,055	

In responding to the outcome from our last AGM vote on the remuneration report we are proposing a number of changes to our remuneration which should help mitigate any concerns from our shareholders. These include:

- Appointing Kepler, a brand of Mercer, as the Committee's independent advisors.
- Formalising the structure of the bonus scheme.
- Incorporated TSR into the LTIP.
- Reviewing all elements of pay against companies of similar size and sector, alongside a review of our NED and Chairman fees.

Director’s biographies

Dr Godfrey H H Ainsworth FCA (61)
Chairman, Non-Executive Director, Chairman of the Audit Committee
Following a Ph.D at Cardiff University, Dr Godfrey Ainsworth qualified as a Chartered Accountant and was employed by Coopers & Lybrand before becoming an audit partner and then corporate finance partner with Spicer & Oppenheim. He founded Gambit Corporate Finance in 1992, a practice specialising in the provision of corporate finance services where he was Managing Partner until his retirement from the firm in November 2009. He has held several Non-Executive Directorship appointments, including assignments for 3i plc, The Business Growth Fund and the Welsh Development Agency. He was appointed to the Board of EPI (prior to its merger with QED Inc to form IQE plc) in 1997. He was appointed to the Board of IQE Plc in April 1999, and was appointed Chairman in February 2002.
Current directorships: Omniport Holdings Limited, Seren Photonics Limited, Cardiff Partnership Fund.

Professor Simon J Gibson OBE (59)
Non-Executive Director
Professor Simon Gibson is Chief Executive of Wesley Clover Corporation. Wesley Clover is an investment vehicle and holding company. He has broad management experience in high-technology industries in both North America and Europe. Before joining Wesley Clover, he was co-founder, President and CEO of Ubiquity Software Corporation. Ubiquity was acquired by Avaya Inc in 2007. Prior to Ubiquity he held senior management roles at Newbridge Networks and Mitel.
He is the Chairman and founder of the Alacrity Foundation, a graduate entrepreneurship program which operates in the UK and Canada. The Foundation provides young people with post graduate education, opportunity alignment and access to capital; with the objective of creating new companies. He was appointed to the Board of IQE in January 2002.
Current Directorships: Wesley Clover Wales Limited, Celtic Manor Resort Limited, Alacrity Foundation.

Sir David Grant CBE (69)
Senior Independent Director, Chairman of the Remuneration and Nomination Committees
Sir David Grant has a background in engineering and technology and was appointed to the Board of IQE Plc in September 2012. He was Vice- Chancellor of Cardiff University from 2001 to 2012. Previously he held leadership positions in a number of international businesses including United Technologies Corp., Dowty Group plc and GEC plc. He has been a Vice-President of the IET, and was a Vice-President of the Royal Academy of Engineering from 2007 to 2012. He was awarded the IEE's Mensforth Gold Medal in 1996 and in 1997 he was made a CBE for his contribution to the UK's Foresight Programme. He has a PhD in Engineering Science from the University of Durham.
Current directorships: Renishaw plc, DSTI, STEMNET, NPL.

Phil Smith (59)
Non-executive Director
Phil Smith BSc, Hon LLD, DUniv. FIET, became Chairman of Cisco for the UK and Ireland in August 2016, after eight years as Chief Executive. Mr Smith is also the Chairman of Innovate UK and Chairman of the Tech Partnership. Additionally, he sits on the Board of the National Centre for Universities and Business (NCUB). Mr Smith has a thirty-five year track record in the technology industry in leading companies including Philips Electronics and IBM. In September 2014 he was awarded an Honorary Doctorate by Birmingham City University, cited for his outstanding contribution to the IT industry, a “leader among leaders”. In March 2015 Mr Smith was awarded an Honorary Degree of Doctor of Laws by the University of Warwick and in 2016 an Honorary Degree of Doctor of Science by his alma mater, Glasgow University.
Current directorships: Cisco UK Ltd, INNOVATE UK.

Dr Drew Nelson OBE (62)
President and Chief Executive Officer
Dr Drew Nelson has over 30 years' experience in the semiconductor industry in a variety of research and managerial positions. Following a PhD in Semiconductor Physics, he joined BT Research Laboratories in 1981, leading the group responsible for the development of advanced optoelectronic devices for optical fibre communications. He subsequently managed the technology transfer from BT to Agilent for mass production. He co- founded EPI in 1988 (which became IQE in 1999) and was appointed Chief Executive Officer of IQE Plc in April 1999. Dr Nelson has held several Non- Executive Directorship appointments, and served on several Government and Industry bodies. He received an OBE in 2001 for services to the Electronics Industry. He is currently a member of the High Level Group appointed by the EC to oversee the implementation of Key Enabling Technologies (KETs) throughout Europe.

Phillip Rasmussen (46)
Chief Financial Officer
Phillip Rasmussen qualified as a Chartered Accountant with Coopers and Lybrand, a predecessor firm of PwC. During his career with PwC he spent two years in Toronto, Canada and gained significant experience of working with and advising a broad range of companies in a variety of sectors, including multinational main market and companies trading on AIM. Before joining IQE, Mr Rasmussen was Director of Transaction Services with PwC in Bristol and worked with IQE on two major acquisitions during 2006. He was appointed to the Board of IQE Plc in March 2007 and appointed as Company Secretary in January 2009.

Dr Howard Williams (62)
Chief Operations Officer
Dr Howard Williams has held a number of positions within both manufacturing and service industry sectors, with roles ranging from Engineering Management to General Management. He was a member of the founding team of EPI in 1988 (which became IQE in 1999) and was appointed Operations Director for EPI in 1996. He was appointed General Manager of IQE Inc in 2002 and General Manager of IQE (Europe) Limited in 2003. He was subsequently appointed Chief Operations Officer in 2004 and was appointed to the Board of IQE Plc as Operations Director in December 2004.

Jason Howells (31)
Company Secretary
Jason Howells studied at University of Oxford where he gained a BA (Hons) in Jurisprudence followed by seven years at Eversheds LLP which included a secondment to GlaxoSmithKline. He moved to Capita Property and Infrastructure in 2015 before joining IQE in October 2016.

Officers and advisers

IQE plc is a public limited company incorporated in England and Wales.

Directors
Dr G H H Ainsworth BSc, Ph.D, FCA (Chairman, Non-Executive)
Dr A W Nelson OBE, BSc, Ph.D, FREng (President and Chief Executive Officer)
Professor S J Gibson OBE (Non-Executive)
Sir David Grant CBE PhD FREng FLSW CEng FIET (Senior Independent Non-Executive Director)
Mr P J Rasmussen BSc, ACA (Chief financial Officer)
Dr H R Williams BSc, Ph.D, CEng, MIMechE, MCIBSE (Operations Director)
Mr P Smith BSc, Hon LLD, DUniv., CEng, FIET (Non-executive Director) *appointed 19th December 2016*

Company Secretary
Mr J M Howells MA (oxon)

Registered office
Pascal Close, Cardiff, United Kingdom, CF3 0LW

Principal Bankers
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8 Canada Square, London, E14 5HQ

Auditors
PricewaterhouseCoopers LLP
One Kingsway, Cardiff, CF10 3PW

Nominated advisers and brokers
Canaccord Genuity Limited
88 Wood Street, London, EC2V 7QR

Joint brokers
Peel Hunt LLP
Moor House, 120 London Wall, London EC2Y 5ET

Registrars
Capita Registrars
Northern House, Woodsome Park, Fenay Bridge, Huddersfield, HD8 0GA

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Independent auditors report

Independent auditors' report to the members of IQE plc

Report on the financial statements

Our opinion

In our opinion:

- IQE 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 2016 and of the group's profit and the group's and the parent company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements, included within the Financial Report and Annual Accounts (the "Annual Report"), comprise:

- the consolidated and parent company balance sheets as at 31 December 2016;
- the consolidated income statement and statement of comprehensive income for the year then ended;
- the consolidated and parent company cash flow statements for the year then ended;
- the consolidated and parent company statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006, and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinions on other matters prescribed by the Companies Act 2006

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 financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the group, the parent company and their environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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
- the parent company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of directors' Responsibilities set out on page 51, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

Colin Bates (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cardiff
21 March 2017

Financial statements

Consolidated income statement for the year ended 31 December 2016

	Note	2016 £'000	2015 £'000
Revenue	3	**132,707**	**114,024**
Cost of sales		(97,979)	(83,372)
Gross profit		**34,728**	**30,652**
Other income and expenses	4	2,340	779
Selling, general and administrative expenses		(16,356)	(15,452)
(Loss)/Profit on disposal of property, plant and equipment	4	(47)	5,187
Operating profit	5	**20,665**	**21,166**
Finance costs	7	(1,633)	(1,790)
Adjusted profit before tax		**20,630**	**17,574**
Adjustments	4	(1,598)	1,802
Profit before tax		**19,032**	**19,376**
Taxation	8	408	773
Profit for the year		**19,440**	**20,149**
Profit attributable to:			
Equity shareholders		19,276	19,864
Non-controlling interest		164	285
		19,440	**20,149**
Basic earnings per share	10	2.87p	3.00p
Diluted earnings per share	10	2.71p	2.90p

Adjusted basic and diluted earnings per share is presented in note 10.

The notes on pages 78 to 113 form part of these financial statements.

All items included in the profit for the year relate to continuing operations.

Consolidated statement of comprehensive income for the year ended 31 December 2016

	2016 £'000	2015 £'000
Profit for the year	19,440	20,149
Currency translation differences on foreign currency net investments*	24,347	3,165
Total comprehensive income for the year	**43,787**	**23,314**
*This may be subsequently reclassified to profit or loss		
Total comprehensive income attributable to:		
Equity shareholders	43,063	23,000
Non-controlling interest	724	314
	43,787	**23,314**

*This may be subsequently reclassified to profit or loss

Consolidated balance sheet as at 31 December 2016

	Note	2016 £'000	2015 £'000
Non-current assets:			
Intangible assets	11	103,972	86,843
Property, plant and equipment	12	85,001	65,154
Deferred tax assets	8	18,181	14,210
Financial Assets	15	8,000	8,000
Total non-current assets		**215,154**	**174,207**
Current assets:			
Inventories	14	28,498	21,215
Trade and other receivables	15	30,868	23,050
Cash and cash equivalents		4,957	4,644
Total current assets		**64,323**	**48,909**
Total assets		**279,477**	**223,116**
Current liabilities:			
Borrowings	17	(7,652)	(3,241)
Trade and other payables	16	(36,939)	(43,693)
Provisions for other liabilities and charges	18	(1,421)	(1,116)
Total current liabilities		**(46,012)**	**(48,050)**
Non-current liabilities:			
Borrowings	17	(36,854)	(24,626)
Other payables	16	-	(484)
Provisions for other liabilities and charges	18	(2,167)	(2,922)
Total non-current liabilities		**(39,021)**	**(28,032)**
Total liabilities		**(85,033)**	**(76,082)**
Net assets		**194,444**	**147,034**
Equity attributable to the shareholders of the parent:			
Share capital	20	6,755	6,655
Share premium		51,081	49,600
Retained earnings		89,476	70,200
Other reserves		43,975	18,146
		191,287	**144,601**
Non-controlling interest		3,157	2,433
Total equity		**194,444**	**147,034**

The notes on pages 78 to 113 form part of these financial statements. These financial statements were approved by the Board of Directors on 21 March 2017.

Signed on behalf of the Board of Directors

Phillip Rasmussen

P J Rasmussen

AW Nelson

Dr A W Nelson

Consolidated statement of changes in equity for the year ended 31 December 2016

	Share capital	Share premium	Retained earnings	Exchange rate reserve	Other reserves	Non-controlling interests	Total equity
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Balance at 1 January 2016	**6,655**	**49,600**	**70,200**	**7,925**	**10,221**	**2,433**	**147,034**
Comprehensive income							
Profit for the year	-	-	19,276	-	-	164	19,440
Foreign exchange	-	-	-	23,787	-	560	24,347
Total comprehensive income	**-**	**-**	**19,276**	**23,787**	**-**	**724**	**43,787**
Transactions with owners							
Share based payments	-	-	-	-	2,042	-	2,042
Issues of ordinary shares	100	1,481	-	-	-	-	1,581
Total transactions with owners	**100**	**1,481**	**-**	**-**	**2,042**	**-**	**3,623**
Balance at 31 December 2016	**6,755**	**51,081**	**89,476**	**31,712**	**12,263**	**3,157**	**194,444**

	Share capital	Share premium	Retained earnings	Exchange rate reserve	Other reserves	Non-controlling interests	Total equity
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Balance at 1 January 2015	**6,603**	**49,108**	**50,336**	**4,789**	**8,220**	**2,119**	**121,175**
Comprehensive income							
Profit for the year	-	-	19,864	-	-	285	20,149
Foreign exchange	-	-	-	3,136	-	29	3,165
Total comprehensive income	**-**	**-**	**19,864**	**3,136**	**-**	**314**	**23,314**
Transactions with owners							
Share based payments	-	-	-	-	2,001	-	2,001
Issues of ordinary shares	52	492	-	-	-	-	544
Total transactions with owners	**52**	**492**	**-**	**-**	**2,001**	**-**	**2,545**
Balance at 31 December 2015	**6,655**	**49,600**	**70,200**	**7,925**	**10,221**	**2,433**	**147,034**

The notes on pages 78 to 113 form part of these financial statements.

Consolidated cash flow statement for the year ended 31 December 2016

	Note	2016 £'000	2015 £'000
Cash flows from operating activities:			
Adjusted cash inflow from operations		**24,281**	**22,575**
Cash impact of adjustments		(1,818)	(1,604)
Cash inflow from operations	23	**22,463**	**20,971**
Net interest paid		(1,489)	(1,403)
Income tax paid		(839)	(459)
Net cash generated from operating activities		**20,135**	**19,109**
Cash flows from investing activities:			
Acquisition deferred consideration Kopin Wireless		(11,250)	-
Capitalised development expenditure		(6,310)	(4,979)
Investment in other intangible fixed assets		(1,794)	(1,198)
Purchase of property, plant and equipment		(10,956)	(3,825)
Net cash used in investing activities		**(30,310)**	**(10,002)**
Cash flows from financing activities:			
Issues of ordinary share capital		578	544
Repayment of borrowings	24	(3,341)	(15,109)
Increase in borrowings	24	12,623	4,349
Net cash generated from/(used in) financing activities		**9,860**	**(10,216)**
Net decrease in cash and cash equivalents		**(315)**	**(1,109)**
Cash and cash equivalents at 1 January	25	4,644	5,584
Exchange gains on cash and cash equivalents		628	169
Cash and cash equivalents at 31 December	25	**4,957**	**4,644**

The notes on pages 78 to 113 form part of these financial statements.

Parent company balance sheet for the year ended 31 December 2016

	Note	2016 £'000	2015 £'000
Non-current assets:			
Investments	13	29,467	29,070
Intangible assets	11	1,748	1,441
Property, plant and equipment	12	5	4
Total non-current assets		**31,220**	**30,515**
Current assets:			
Trade and other receivables	15	96,944	77,711
Cash and cash equivalents		-	-
Total current assets		**96,944**	**77,711**
Total assets		**128,164**	**108,226**
Current liabilities:			
Trade and other payables	16	(2,461)	(2,307)
Borrowings	17	(8,573)	(3,546)
Total current liabilities		**(11,034)**	**(5,853)**
Non-current liabilities:			
Trade and other payables	16	-	(484)
Borrowings	17	(34,524)	(22,722)
Total non-current liabilities		**(34,524)**	**(23,206)**
Total liabilities		**(45,558)**	**(29,059)**
Net assets		**82,606**	**79,167**
Shareholders' equity:			
Share capital	20	6,755	6,655
Share premium		51,081	49,600
Retained earnings		12,321	12,505
Other reserves		12,449	10,407
Total equity		**82,606**	**79,167**

The notes on pages 78 to 113 form part of these financial statements. These financial statements were approved by the Board of Directors on 21 March 2017.

Signed on behalf of the Board of Directors

Phillip Rasmussen

P J Rasmussen

Dr A W Nelson

Parent company statement of changes in equity for the year ended 31 December 2016

	Share capital £'000	Share premium £'000	Retained earnings £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2016	**6,655**	**49,600**	**12,505**	**10,407**	**79,167**
Comprehensive expense					
Loss for the year	-	-	(184)	-	(184)
Total comprehensive expense	**-**	**-**	**(184)**	**-**	**(184)**
Transactions with owners					
Share based payments	-	-	-	2,042	2,042
Issues of ordinary shares	100	1,481	-	-	1,581
Total transactions with owners	**100**	**1,481**	**-**	**2,042**	**3,623**
Balance at 31 December 2016	**6,755**	**51,081**	**12,321**	**12,449**	**82,606**

	Share capital £'000	Share premium £'000	Retained earnings £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2015	**6,603**	**49,108**	**12,624**	**8,406**	**76,741**
Comprehensive expense					
Loss for the year	-	-	(119)	-	(119)
Total comprehensive expense	**-**	**-**	**(119)**	**-**	**(119)**
Transactions with owners					
Share based payments	-	-	-	2,001	2,001
Issues of ordinary shares	52	492	-	-	544
Total transactions with owners	**52**	**492**	**-**	**2,001**	**2,545**
Balance at 31 December 2015	**6,655**	**49,600**	**12,505**	**10,407**	**79,167**

The notes on pages 78 to 113 form part of these financial statements.

Parent company cash flow statement for the year ended 31 December 2016

	Note	2016 £'000	2015 £'000
Cash flows from operating activities:			
Cash (outflow)/inflow from operations	23	(8,812)	6,430
Interest paid		(1,278)	(1,088)
Taxation		(78)	-
Net cash (used in)/generated from operating activities		**(10,168)**	**5,342**
Cash flows from investing activities:			
Investment in Seren Photonics Limited		-	(25)
Investment in other intangibles	11	(347)	(104)
Purchase of property plant and equipment	12	(6)	(2)
Net cash used in investing activities		**(353)**	**(131)**
Cash flows from financing activities:			
Issues of ordinary share capital		578	544
Repayment of borrowings		(2,842)	(13,000)
Increase in borrowings		12,623	4,314
Net cash generated from/(used in) financing activities		**10,359**	**(8,142)**
Net decrease in cash and cash equivalents		**(162)**	**(2,931)**
Cash and cash equivalents at 1 January		(866)	2,065
Cash and cash equivalents at 31 December		**(1,028)**	**(866)**

The notes on pages 78 to 113 form part of these financial statements.

Notes to the financial statements

1. Significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented.

General Information

IQE plc Group's principal activity are set out on page 50 of the directors' report. The company is a public limited company admitted to trading on AIM, a market operated by The London Stock Exchange plc and incorporated and domiciled in England and Wales. The address of its registered office is Pascal Close, St Mellons, Cardiff, CF3 0LW.

Basis of preparation

This financial information has been prepared on a going concern basis under the historical cost convention except where fair value measurement is required by IFRS, and in accordance with the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards ("IFRS") as adopted by the European Union and IFRS IC interpretations. The application of these standards and interpretations necessitates the use of estimates and judgements. The main areas involving estimates are set out below in note 2.

Changes in accounting policy and disclosures

(a) *New standards, amendments and interpretations adopted by the group. The following standards have been adopted by the group for the first time for the financial year beginning on or after 1 January 2016. They do not materially impact on the group results:*

- Annual improvements 2010 – 2012
- Annual improvements 2012 – 2014
- Amendment to IFRS 11, 'Joint arrangements' on acquisition of an interest in a joint operation
- Amendment to IAS 16, 'Property, plant and equipment' and IAS 38,'Intangible assets', on depreciation and amortisation
- Amendments to IFRS 10 'Consolidated financial statements' and IAS 28 'Investments in associates and joint ventures'

(b) *New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2016 and not early adopted*

A number of new standards and amendments to standards and interpretations have been endorsed for annual periods beginning after 1 January 2017 (noted below), and have not been early adopted in preparing these consolidated financial statements.

IFRS 15 Revenue from contracts with customers (effective for annual periods beginning on or after 1 January 2018)

IFRS 9 Financial instruments (effective for annual periods beginning on or after 1 January 2018)

None of these are expected to have a significant effect on the consolidated financial statements of the group, however we are undertaking a review of the group's contracts with customers in preparation of the adoption of IFRS 15.

A number of new standards and amendments to standards and interpretations have been issued but are not yet endorsed for annual periods beginning after 1 January 2017 (noted below), and have not been adopted in preparing these consolidated financial statements.

- Annual improvements 2014-2016 cycle
- Amendment to IFRS 2, 'Share based payments' – classification and measurement of share based payment transactions
- Amendment to IFRS 7, 'Statement of cash flows' on disclosure initiative
- Amendment to IAS 12, 'Income Taxes' on recognition of deferred tax assets for unrealised losses
- Amendment to IFRS 10 and IAS 28 on sale of contribution of assets (postponed)
- IFRS 16, Leases

With the exception of IFRS 16, none of these amendments are expected to have a significant effect on the consolidated financial statements of the group. To prepare for the adoption of IFRS 16 we are undertaking a review of the group's leasing arrangements.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the company and its subsidiary undertakings. Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profits and losses resulting from intercompany transactions that are recognised in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the group.

Joint ventures

The group applies IFRS 11 to all joint arrangements. Under IFRS 11 investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations each investor. We have assessed the nature of our joint arrangements and determined them to be joint ventures. Joint ventures are accounted for using the equity method.

Under the equity method of accounting, interests in joint ventures are initially recognised at cost and adjusted thereafter to recognise the group's share of the post-acquisition profits or losses and movements in other comprehensive income. When the group's share of losses in a joint venture equals or exceeds its interests in the joint ventures (which includes any long term interests that, in substance, form part of the group's net investment in the joint ventures), the group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the joint ventures.

Joint ventures (continued)

Unrealised gains on transactions between the group and its joint ventures are eliminated to the extent of the group's interest in the joint ventures. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of the joint ventures have been changed where necessary to ensure consistency with the policies adopted by the group.

Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of an acquisition is measured at the fair value of the consideration. The acquired identifiable assets, liabilities and contingent liabilities are recognised at their fair value at the date of acquisition.

Where the fair values of contingent deferred consideration, assets and liabilities acquired are initially recognised on a provisional basis, these are reassessed during the 12 month period following the date of the business combination. Adjustments to the fair values as at the date of acquisition within this 'measurement period' are recorded, with any net impact being added to or deducted from the goodwill recognised. Such adjustments are recognised in both the current period and restated comparative period balance sheets as if the final fair values had been used in the initial recognition of the acquisition.

Subsequent to the measurement period, any adjustments to the recorded fair value of contingent deferred consideration are taken through the income statement as an exceptional income or expense.

The group recognises any non-controlling interest on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets.

Acquisition related costs are expensed as incurred.

Intangible assets

a) Goodwill

Goodwill arising on an acquisition is recognised as an asset and initially measured at cost, being the excess of the fair value of the consideration over the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Goodwill is not amortised. However, it is reviewed for potential impairment at least annually or more frequently if events or circumstances indicate a potential impairment. For the purpose of impairment testing, goodwill is allocated to each of the Cash Generating Units to which is relates. Any impairment identified is charged directly to Consolidated Income Statement. Subsequent reversals of impairment losses for goodwill are not recognised.

b) Patents trademarks and licences

Separately acquired patents, trademarks and licences are shown at historical cost. Patents, trademarks and licences acquired in a business combination are recognised at fair value at the acquisition date. Patents, Trademarks and licences have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of patents, trademarks and licences over their estimated useful lives of 10 to 15 years.

The carrying value of patents, trademarks and licences is reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement.

c) Development costs

Expenditure incurred that is directly attributable to the development of new or substantially improved products or processes is recognised as an intangible asset when the following criteria are met:

- the product of process is intended for use or sale;
- the development is technically feasible to complete;
- there is an ability to use or sell the product or process;
- it can be demonstrated how the product or process will generate probable future economic benefits;
- there are adequate technical, financial and other resources to complete the development; and
- the development expenditure can be reliably measured.

Directly attributable costs refers to the materials consumed; the directly attributable labour; and the incremental overheads incurred in the development activity. General operating costs, administration costs and selling costs do not form part of directly attributable costs.

All research and other development costs are expensed as incurred.

Capitalised development costs are amortised in-line with the expected production volume profile over the period during which the economic benefits are expected to be received, which typically range between 3 and 8 years. The estimated remaining useful lives of development costs are reviewed at least on an annual basis. Amortisation commences once the project is completed and revenues are being generated.

The carrying value of capitalised development costs is reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement.

d) Software

Directly attributable costs incurred in the development of bespoke software for the group's own use are capitalised and amortised on a straight line basis over the expected useful life of the software, which typically range between 3 and 10 years.

The carrying value of capitalised software costs is reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement.

The costs of maintaining internally developed software, and annual license fees to utilise third party software, are expensed as incurred.

e) Other intangibles recognised on acquisition

Other intangible assets which form part of the identifiable net assets of an acquired business are recognised at their fair value and amortised on a systematic basis over their useful economic life which is up to 7 years.

This includes customer contracts, the fair value of which has been evaluated using the multi period excess earnings method “MEEM”. The MEEM model valuation was cross checked to the cost of product development and qualification to which the contract relates.

The carrying value of other intangible assets is reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. Any impairment identified is immediately charged to the Consolidated Income Statement.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any provision for impairment. Cost comprises all costs that are directly attributable to bringing the asset into working condition for its intended use. Depreciation is calculated to write down the cost of fixed assets to their residual values on a straight-line basis over the following estimated useful economic lives:

Freehold buildings...........................15 to 25 years
Short leasehold improvements ....5 to 27 years
Plant and machinery ....5 to 15 years
Fixtures and fittings..............................3 to 5 years

No depreciation is provided on land or assets yet to be brought into use. Depreciation is charged to cost of sales and selling and general administration expenses in the income statement.

The assets residual values and useful economic lives are reviewed, and adjusted if appropriate, at the end of each reporting period. A review was completed during 2016 which resulted in no material changes to asset residual values and useful economic lives (2015: no material changes). The carrying value of property, plant and equipment is reviewed for potential impairment at least annually. Any impairment identified is immediately charged to the Consolidated Income Statement.

Impairment of non-current assets

Non-current assets are reviewed for potential impairment at least annually, or more frequently if events or circumstances indicate a potential impairment. An impairment loss is recognised for the amount by which the asset’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset’s fair value (less disposal costs) and value in use.

Value in use is based on the present value of the future cash flows relating to the asset, discounted at the Group’s weighted average cost of capital. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (Cash Generating Units).

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. Cost comprises direct materials and, where applicable, direct labour costs and attributable overheads that have been incurred in bringing the inventories to their present location and condition based on normal operating capacity. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. In the consolidated balance sheet bank overdrafts are presented within cash and cash equivalents as group treasury arrangements are pooled by territory. In the parent company balance sheet, bank overdrafts are shown within borrowings in current liabilities.

Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

Provisions

Provisions are recognised when:

- the Group has a legal or constructive obligation as a result of a past event;
- it is probable that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation. Where a leasehold property, or part thereof, is vacant or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease, or the termination payment, if smaller.

Financial instruments

Financial assets and liabilities are recognised on the group's balance sheet when the group becomes a party to the contractual provisions of the financial instrument.

The financial assets held by the group are other equity investments, receivables and cash and cash equivalents. Receivables do not carry interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts. Cash and cash equivalent comprise cash in hand. Other equity investments are held at cost less provision for impairment.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Trade payables are stated at their nominal value and do not bear interest.

Equity instruments issued by the company are recorded at the proceeds received net of any direct issue costs.

Interest bearing loans are recorded at the proceeds received net of any direct issue costs. Finance charges are accounted for on an accrual basis using the effective interest method.

The group does not use derivative financial instruments for speculative purposes. The group uses forward currency contracts as appropriate to manage foreign exchange risk.

Detailed disclosures of the group's financial instruments are provided in note 19.

Leases

Leases which transfer substantially all the risks and rewards of ownership of an asset are treated as a finance lease. Assets held under finance leases are capitalised at their fair value at the inception of the lease and depreciated over the estimated useful economic life of the asset or lease term if shorter. The finance charges are allocated to the Consolidated Income Statement in proportion to the capital amount outstanding.

All other leases are classified as operating leases. Operating lease rentals are charged to the Consolidated Income Statement in equal annual amounts over the lease term.

Revenue recognition

Revenue represents the amounts receivable for goods, services and intellectual property licenses provided in the ordinary course of business net of value added tax and other sales related taxes. Revenue is recognised when the risks and rewards of the underlying sale have been transferred to the customer, which is on the delivery of the goods, services or intellectual property and acceptance by the customer.

Accrued income is recognised for sales where, at the balance sheet date, billing has not yet taken place but contractual terms dictate that the risks and rewards have been transferred to the customer and the customer is committed to payment. Billing is deferred to a contractually defined trigger point.

An acquisition was made during 2012, where the consideration is being settled through agreed contractual price discounts. Subsequent to the measurement period, any adjustments to the recorded fair value of contingent deferred consideration are taken through the income statement within other income as an exceptional income or expense. The revenues of products sold which are subject to this discount are recognised at full market value. On settlement of the transaction, the discount is applied to reduce the deferred consideration balance. The outstanding deferred consideration balance has been fully settled during 2016.

Segmental reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Board of Directors, who oversee the allocation of resources and the assessment of operating segment performance.

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of components operating in other economic environments.

Pension costs

The group operates defined contribution pension schemes. Contributions are charged in the Consolidated Income Statement as they become payable in accordance with the rules of the scheme.

Share based payments

The group operates a Share Option Scheme, under which the group receives services from employees as consideration for share options in IQE plc. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense in the Consolidated Income Statement and in Other Reserves on the Consolidated Balance Sheet. The total amount to be expensed is determined by reference to the fair value of the options granted including any market performance conditions (for example, an entity's share price); excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period) and including the impact of any non-vesting conditions (for example, the requirement for employees to save).

Non-market performance and service conditions are included in assumptions about the number of options that are expected to vest. The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At the end of each reporting period, the group revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

When the options are exercised, the company issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium. The scheme is equity settled.

Share based payments (continued)

In the company's own financial statements, the grant of share options to the employees of subsidiary undertakings is treated as a capital contribution. Specifically, the fair value of employee services received (measured at the date of grant) is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity in the parent entity financial statements.

The social security contributions payable in connection with the grant of the share options is considered an integral part of the grant itself, and the change will be treated as a cash-settled transaction.

Exceptional items

Exceptional items are disclosed separately in the financial statements where it is necessary to do so to provide further understanding of the financial performance of the group. They are material items of income or expense that have been shown separately due to the significance of their nature or amount. Details of the exceptional items are included in note 4.

Foreign currencies

Items included in the financial statements of each subsidiary are measured using the currency of the primary economic environment in which the subsidiary operates ("the functional currency"). The consolidated financial statements are presented in sterling, which is the group's functional and presentational currency.

Foreign currency transactions are translated into the subsidiaries functional currency at the rates of exchange ruling at the date of the transaction, or at the forward currency hedged rate where appropriate. Monetary assets and liabilities in foreign currencies are translated into the subsidiaries functional currency at the rates ruling at the balance sheet date. All exchange differences are taken to the income statement.

The balance sheets of overseas subsidiaries are translated into sterling at the closing rates of exchange at the balance sheet date, whilst the income statements are translated into sterling at the average rate for the period. The resulting translation differences are taken directly to reserves.

Foreign exchange gains and losses on the retranslation of foreign currency borrowings that are used to finance overseas operations are accounted for on the 'net investment' basis and are recorded directly in reserves provided that the hedge is 'effective' as defined in IAS 39 "Financial Instruments : recognition and measurement".

Taxation

Income tax on the profit or loss for the year comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year using rates substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of prior years.

Amounts receivable from tax authorities in relation to R&D tax relief claims for fiscal year 2013 and before are recognised as a credit within the group's tax charge. For subsequent years the R&D tax credits are under the RDEC scheme and are recognised with operating profit.

Where amounts are outstanding at the year end and have not been formally agreed, an appropriate estimate of the amount is included within other receivables.

Deferred tax is provided in full on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts used for taxation purposes. Deferred tax is calculated at the tax rates that have been enacted or substantially enacted at the balance sheet date. 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. Deferred tax liabilities are recognised for taxable temporary differences, unless specifically exempt.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

Tax is recognised in the Consolidated Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Investment in subsidiaries

Investments in subsidiaries are held at cost of investment less provision for impairment in the parent company financial statements.

Other equity investments

Other equity investments are held at cost less provision for impairment in both the parent company and group financial statements on the basis that the Group (and Company) does not have the ability to exert significant influence or control over the strategic and operating activities of the other equity investments.

2. Critical accounting judgements and key sources of estimation uncertainty

The group's principal accounting policies are described in note 1. The application of these policies necessitates the use of estimates and judgements in a number of areas. Accordingly, the actual amounts may differ from these estimates. The main areas involving estimation are set out below:

(a) Impairment of tangible and intangible assets

Goodwill on the group's balance sheet is not subject to amortisation because it is assumed to have an indefinite useful life. In accordance with IAS 36 "Impairment of assets", the carrying value of goodwill is assessed at least annually for impairment. This assessment is based on cash flow forecasts. In light of these forecasts the Board has concluded that goodwill is not impaired.

The group capitalises the cost of developing new and substantially improved products and processes if there is a reasonable expectation of obtaining an appropriate economic return. This necessitates an assessment of the future technical viability, future commercial benefits and expected useful economic life of the product or process. The carrying value for each project is assessed for impairment on an on-going basis.

The key assumptions and judgements adopted in preparing the impairment review are set out in note 11.

(b) Inventory provisions

Inventories are carried at the lower of cost and net realisable value. Provision is made based on a number of factors including the age of inventories, the risk of obsolescence and the expected future usage.

Acquisition fair values

An assessment of the fair value of the purchase consideration and net assets acquired was undertaken for the acquisitions made during 2012 and 2013. We have reassessed the fair value of the deferred contingent consideration in relation to the 2012 RFMD acquisition. This resulted in an exceptional release of £2.3m (2015: £0.8m) to other income as a result of the re-assessment of the forecast volumes. The deferred consideration for the RFMD acquisition is now fully settled. Further details are provided in note 4.

(c) Deferred tax assets

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. This necessitates an assessment of future trading forecasts for each relevant tax authority, capital expenditures and the utilisation of tax losses.

The forecasts used to support deferred tax asset recognition are the same forecasts used in the impairment review and support partial recognition of the available deferred tax assets.

(d) Onerous lease provision

A provision for onerous leases was made in 2014. The provision assumes that the lease will be onerous for the next two and a half years. Subsequent to this period we expect to be able to sublet the premises or negotiate to exit the lease. The full term of the lease obligation is 5 years with the lease running until 2021.

(e) Adjustments to profit

The board provides an adjusted profit measure to provided additional information to aid an understanding of the group's performance as set out in note 4 we have detailed all of the items which are included within the adjustments to profit.

3. Segmental analysis

The board of directors considers that the wireless, photonics, infra red and CMOS++ markets are the group's primary reporting segments. The board of directors assesses the performance of these operating segments based on their adjusted operating profit.

Further detail on the nature of the segments is provided in the Strategic Report.

Revenue	**2016 £'000**	**2015 £'000**
Wireless	91,291	79,482
Photonics	22,792	15,985
Infra Red	10,560	8,878
CMOS++	1,406	1,655
Total Segment Revenue	**126,049**	**106,000**
License income from sales to joint ventures	6,658	8,024
Total Revenue	**132,707**	**114,024**
Adjusted operating profit		
Wireless	7,950	7,147
Photonics	6,888	4,320
Infra Red	2,227	1,181
CMOS++	(1,604)	(1,695)
Segment adjusted operating profit	**15,461**	**10,953**
Profit from license income from sales to joint ventures*	6,658	8,024
Adjusted operating profit	**22,119**	**18,977**
Gain on disposal of fixed assets	-	5,187
Non-cash accounting charges	(3,560)	(3,596)
Net reduction in contingent deferred consideration	2,340	779
Restructuring and reorganisation	(378)	(568)
Finance Costs	(1,489)	(1,403)
Profit before tax	**19,032**	**19,376**

* The profit arising from license income sales to joint ventures in 2015 represents revenue of £15,310,000 offset by an elimination of unrealised profit of £7,286,000 relating to our retained interest in the Compound Semiconductor Centre Limited joint venture. No such elimination has occurred in 2016.

Costs not directly attributable to a segment are allocated based on the proportion of revenue attributable to that segment.

Staff work for multiple segments, therefore it is not possible to allocate staff related expenses and the share based payment charge to specific segments.

Finance costs are not allocated to the segments because treasury is managed centrally.

3. Segmental analysis

In the years set out below, certain customers accounted for greater than 10% of the Group's total revenues:

	Segment	2016 £'000	2016 % revenue	2015 £'000	2015 % revenue
Customer 1	Wireless	32,480	24%	35,022	31%
Customer 2	Wireless	28,456	21%	19,468	17%

There are no customers in the photonics, Infra Red or CMOS++ segments that accounted for greater than 10% of the Group's total revenues.

Geographical information

Disclosure of group revenues by location of customer:

	2016 £'000	2015 £'000
Americas	**88,794**	**69,851**
United States of America	88,697	69,745
Rest of Americas	97	106
Europe, Middle East & Africa (EMEA)	**15,915**	**16,589**
France	435	169
Germany	4,652	3,415
Israel	2,077	1,137
United Kingdom	7,340	9,540
Rest of EMEA	1,411	2,328
Asia Pacific	**27,998**	**27,584**
People's Republic of China	1,413	949
Japan	3,830	4,665
Taiwan	17,287	19,905
Rest of Asia Pacific	5,468	2,065
Total revenue	**132,707**	**114,024**

Disclosure of non-current assets by location of assets:

	Property, plant and equipment		Intangible assets	
By location	2016 £'000	2015 £'000	2016 £'000	2015 £'000
USA	56,097	44,377	77,336	63,694
Singapore	7,865	6,630	10,204	8,502
Taiwan	12,615	8,872	2,339	1,297
UK	8,424	5,275	14,093	13,350
	85,001	**65,154**	**103,972**	**86,843**

4. Adjusted profit measures

The group's results are reported after a number of imputed non-cash charges and non-recurring items.

Therefore, we have provided additional information to aid an understanding of the group's performance.

	2016 £'000	2015 £'000
Gain on disposal of fixed assets	-	5,187
Non-cash accounting charges	(3,560)	(3,596)
Gain on release of contingent deferred consideration	2,340	779
Restructuring and reorganisation	(378)	(568)
Total before tax	**(1,598)**	**1,802**
Deferred tax on adjustments	(402)	281
Total after tax	**(2,000)**	**2,083**

The non-cash accounting charges of £3.6m (2015: £3.6m) reflect a charge for share based payments of £2.0m (2015 £2.0m), the amortisation of acquired intangibles £1.4m (2015 £1.2m) and the unwind of the discounting of long term balances £0.2m (2015 £0.4m).

The Group generated a non-cash profit of £2.3m (2015 £0.8m) arising from a reduction in the estimated remaining deferred consideration (settled via trade discount) in respect of a previous acquisition. The deferred consideration has now been fully settled. This has been classified within other income and expenses in the consolidated income statement.

The restructuring and reorganisation costs of £0.4m (2015: £0.6m) reflects some one-off costs relating to staff, facility and asset write downs associated with the restructuring of the groups manufacturing operations.

The deferred tax charge of £0.4m (2015: £0.3m credit) reflects the net deferred tax impact associated with these adjustments.

The gain on disposal of fixed assets in 2015 related to a non-cash exceptional gain of £4.8m relating to IQE's contribution to the creation of a joint venture Compound Semiconductor Centre Limited. In addition, other unrelated disposals of fixed assets in 2015 realised a net gain of £0.4m.

Certain items noted above are accounting estimates based on judgements, accordingly, the actual amounts may differ from these estimates. The adjustments above are classified £1.7m (2015: £1.8m) within gross margin, and £2.1m (2015: £2.0m) within selling, general and administrative expenses

	2016 £'000	2015 £'000
Adjusted gross margin	36,415	32,439
Reported gross margin	34,728	30,652
Adjusted sales, general and administrative expenses	(14,249)	(13,462)
Reported sales, general and administrative expenses	(16,356)	(15,452)
Adjusted operating profit	22,119	18,977
Reported operating profit	20,665	21,166
Adjusted profit before tax	20,630	17,574
Reported profit before tax	19,032	19,376
Adjusted profit after tax	21,440	18,066
Reported profit after tax	19,440	20,149

4. Adjusted profit measures (continued)

Earnings before interest, tax, depreciation and amortisation (EBITDA) has been calculated as follows:

	2016 £'000	2015 £'000
Profit attributable to equity shareholders	**19,276**	**19,864**
Non-controlling interest	164	285
Tax	(408)	(773)
Share based payments	2,042	2,001
Finance costs	1,633	1,790
Depreciation of tangible fixed assets	5,561	6,192
Amortisation of intangible fixed assets	5,377	5,040
Loss/(Profit) on disposal of fixed assets	47	(5,187)
Impairment of assets*	-	453
Gain on release of contingent deferred consideration*	(2,340)	(779)
Restructuring and re-organisation costs*	378	115
EBITDA	**31,730**	**29,001**

* Exceptional items impacting EBITDA include the following items: impairment of assets, wireless business unit re-organisation costs and the release of contingent deferred consideration.

5. Operating profit

	2016 £'000	2015 £'000
The operating profit is stated after charging/(crediting):		
Depreciation of property, plant and equipment	5,561	6,192
Amortisation of non-current intangible assets	5,377	5,040
Services provided by auditors*	125	141
Operating lease rentals	3,717	3,081
Research and development	143	138
Exchange gains	(1,269)	(675)
Share based payments	2,042	2,001
Cost of raw materials consumed	53,948	45,338
Loss/(gain) on disposal of fixed assets	47	(5,187)
Elimination of unrealised gains with joint ventures	-	7,286
Exceptional items**	(1,962)	(211)

*A schedule of services provided by the group's auditors and related fees is disclosed in the Audit Committee Report on page 48.

**Exceptional items include the following items: re-organisation costs, impairment of assets and the release of contingent deferred consideration. Further details are provided in note 4.

6. Employee costs

	2016 £'000	2015 £'000
Employee costs (including directors' remuneration)		
Wages and salaries	27,834	23,314
Social security costs	2,816	2,664
Other pension costs	1,035	956
Charge for share based payments	2,042	2,001
	33,727	**28,935**

	2016 Number	2015 Number
Average number of employees (including directors)		
Cost of sales	364	364
Selling, general and administrative	111	124
	475	**488**

Directors' emoluments and share option details are disclosed in the Remuneration Report on page 52 to 65. Key management within the group comprises the executive and non-executive directors, the business unit leaders, and other staff who report directly to the executive directors.

Compensation to key management, including pensions of £228,000 (2015: £164,000), was £4,545,000 (2015: £3,581,000) and the charge for share-based payments was £1,235,000 (2015: £1,284,000).

7. Finance costs

	2016 £'000	2015 £'000
Bank and other loans	1,489	1,402
Finance lease interest	-	1
Unwind of discount on long term balances	144	387
	1,633	**1,790**

8. Taxation

Current tax charge	2016 £'000	2015 £'000
Overseas taxes charges	(946)	(635)
Total current tax charge	**(946)**	**(635)**
Deferred tax credit	1,354	1,408
Total tax credit	**408**	**773**

8. Taxation (continued)

Factors affecting total tax credit

The tax credit assessed for the year is different from that resulting from applying the standard rate of corporation tax in the UK: 20.00% (2015: 20.25%). The differences are explained below:

	2016 £'000	2015 £'000
Profit on ordinary activities before taxation	19,032	19,376
Tax charge at 20.00% thereon (2015: 20.25%)	(3,806)	(3,924)
Effects of :		
Expenses not deductible for tax purposes	(119)	(41)
Overseas tax rate differences	(800)	(311)
Recognition of tax losses	3,285	1,774
Tax losses utilised for which no deferred tax asset was recognised	-	3,268
Other deferred tax movements	1,848	242
Impact on deferred tax as a result of changes in tax rates	-	(235)
Total tax credit for the year	**408**	**773**

Finance (No.2) Bill 2016, which was substantively enacted in September 2016, included legislation to reduce the main rate of corporation tax from 20% to 19% from 1 April 2017 with a further reduction to 17% from 1 April 2020. Accordingly, the closing UK deferred tax asset/liability in the financial statements has been recognised on this basis.

Deferred tax is measured at the tax rates that are expected to apply in the relevant territory in the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been substantively enacted at the balance sheet date.

The majority of the deferred tax assets arise in the United States, these are provided at the effective United States Federal and State tax rates where appropriate.

8. Taxation (continued)

Deferred tax asset	2016 £'000	2015 £'000
At 1 January	14,210	12,332
Deferred tax credit recognised in the year	1,354	1,408
Foreign exchange differences	2,617	470
At 31 December	**18,181**	**14,210**

The current portion of the deferred tax asset is £1,300,000 (2015: £2,000,000) in relation to utilisation of tax losses.

Analysis of deferred tax	2016 £'000	2015 £'000
Accelerated capital allowances	(10,693)	(8,336)
Tax losses carried forward	33,410	26,661
Timing differences on Intangible assets	(7,848)	(7,547)
Other	3,312	3,432
At 31 December	**18,181**	**14,210**

Deferred tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through future taxable profits from the same trade is probable.

The net amount not recognised is an asset of £14,339,000 (2015: £10,808,000). The unrecognised amounts relate to tax losses carried forward. The asset would be recognised if sufficient profits from the same trade arise in future periods.

Total tax losses carried forward account for a potential deferred tax asset of £39,856,000 (2015: £37,469,000).

Company

There is an unrecognised deferred tax asset of £1,645,000 (2015: £522,000) which relates primarily to short term timing differences arising on share option charges.

R&D Tax Credits

The Group recognised a credit of £792,000 (2015: £537,000) within operating profit in relation to claims made under the R&D Expenditure Credit Scheme (RDEC).

9. Dividends

No dividend has been paid or proposed in 2016 (2015: £nil).

10. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year.

Diluted earnings per share is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of shares and the dilutive effect of 'in the money' share options in issue. Share options are classified as 'in the money' if their exercise price is lower than the average share price for the year. As required by IAS 33, this calculation assumes that the proceeds receivable from the exercise of 'in the money' options would be used to purchase shares in the open market in order to reduce the number of new shares that would need to be issued.

The directors also present an adjusted earnings per share measure which eliminates certain non-cash items in order to provide a more meaningful underlying profit measure. The adjustments are detailed in note 4.

	2016 £'000	2015 £'000
Profit attributable to ordinary shareholders	19,276	19,864
Adjustments to profit after tax (note 4)	2,000	(2,083)
Adjusted profit attributable to ordinary shareholders	**21,276**	**17,781**

	2016 Number	2015 Number
Weighted average number of ordinary shares	671,532,674	662,633,162
Dilutive share options	38,548,084	21,247,935
Adjusted weighted average number of ordinary shares	**710,080,758**	**683,881,097**
Adjusted basic earnings per share	3.17p	2.68p
Basic earnings per share	2.87p	3.00p
Adjusted diluted earnings per share	3.00p	2.60p
Diluted earnings per share	2.71p	2.90p

11. Intangible assets

The Group	Goodwill £'000	Patents £'000	Development costs £'000	Software £'000	Acquisition intangibles* £'000	Total £'000
Cost						
At 1 January 2016	57,853	1,756	34,751	3,811	6,694	104,865
Additions	-	421	6,310	1,373	34	8,138
Adjustment (see below)	-	-	(484)	-	-	(484)
Disposal	-	(8)	-	-	-	(8)
Foreign exchange	11,721	26	4,322	81	1,401	17,551
At 31 December 2016	**69,574**	**2,195**	**44,899**	**5,265**	**8,129**	**130,062**
Accumulated amortisation and impairment						
At 1 January 2016	-	224	13,381	943	3,474	18,022
Charge for the year	-	52	3,700	251	1,374	5,377
Foreign exchange	-	15	1,766	74	836	2,691
At 31 December 2016	**-**	**291**	**18,847**	**1,268**	**5,684**	**26,090**
Net book value	**69,574**	**1,904**	**26,052**	**3,997**	**2,445**	**103,972**
At 31 December 2016						
At 31 December 2015	57,853	1,532	21,370	2,868	3,220	86,843

The adjustment relates to the reduction in the deferred consideration payable in relation to the NanoGaN acquisition

The Group	Goodwill £'000	Patents £'000	Development costs £'000	Software £'000	Acquisition intangibles* £'000	Total £'000
Cost						
At 1 January 2015	55,885	591	29,014	2,806	6,366	94,662
Additions	-	1,162	4,979	1,003	30	7,174
Foreign exchange	1,968	3	758	2	298	3,029
At 31 December 2015	**57,853**	**1,756**	**34,751**	**3,811**	**6,694**	**104,865**
Accumulated amortisation and impairment						
At 1 January 2015	-	174	9,501	760	2,148	12,583
Charge for the year	-	49	3,601	182	1,208	5,040
Foreign exchange	-	1	279	1	118	399
At 31 December 2015	**-**	**224**	**13,381**	**943**	**3,474**	**18,022**
Net book value						
At 31 December 2015	**57,853**	**1,532**	**21,370**	**2,868**	**3,220**	**86,843**
At 31 December 2014	55,885	417	19,513	2,046	4,218	82,079

* Acquisition intangibles relate to customer contract intangible assets

11. Intangible assets (continued)

The amortisation charge of: £5,377,000 (2015: £5,040,000) has been charged to selling, general and administrative expenses in the Consolidated Income Statement.

The carrying value of deferred development costs continue to be supported by forecast cash flows.

Impairment tests for goodwill

Goodwill is tested for impairment annually and whenever there is an indication of impairment at the level of the cash-generating unit (CGU) or group of CGUs to which it is allocated. Multiple production facilities are included in a single CGU reflecting that production can (and is) transferred between sites for different operating segments to suit capacity planning and operational efficiency. Given the interdependency of facilities, goodwill is therefore tested for impairment by grouping operational sites into a CGU or CGUs based on type of production. This gives rise to the following allocation of Goodwill:

	2016 £'000	2015 £'000
Allocation of goodwill by CGU :		
III/V Epitaxy	61,776	51,403
Substrates	7,798	6,450
Total Goodwill	**69,574**	**57,853**

The recoverable amount of the CGUs has been determined based on value in use calculations, using cash flow projections for a five year period plus a terminal value assuming no subsequent growth. The Board approved budget is used for the first year of the forecast.

Key assumptions applied in the forecasts include:

- Cost inflation 4% (2015: 2%),
- A long term growth rate of 2% (2015: 2%)
- A discount rate of 10% (2015: 9%)

Management believes it is appropriate to use the same discount rate for each CGU given that they have similar risk profiles and common funding.

In respect of the III/V Epitaxy CGU, the forecast EBITDA compound growth rate is c17% over the five year period driven by growth in Photonics and emerging markets. This is consistent with the overall group's compound growth rate over the last 5 years.

An impairment of the III/V Epitaxy CGU goodwill would not arise in the event that the discount rate was increased from 10% to 15%. No impairment would arise if the EBITDA compound growth rate fell to zero over the same period.

11. Intangible assets (continued)

The Company

	Patents £'000	Software £'000	Total £'000
Cost			
At 1 January 2016	1,073	368	1,441
Additions	299	48	347
At 31 December 2016	**1,372**	**416**	**1,788**
Accumulated amortisation			
At 1 January 2016	-	-	-
Charge for the year	-	40	40
At 31 December 2016	**-**	**40**	**40**
Net book value			
At 31 December 2016	**1,372**	**376**	**1,748**
At 31 December 2015	1,073	368	1,441

The Company

	Patents £'000	Software £'000	Total £'000
Cost			
At 1 January 2015	-	332	332
Additions	1,073	36	1,109
At 31 December 2015	**1,073**	**368**	**1,441**
Accumulated amortisation			
At 1 January 2015	-	-	-
Charge for the year	-	-	-
At 31 December 2015	**-**	**-**	**-**
Net book value			
At 31 December 2015	**1,073**	**368**	**1,441**
At 31 December 2014	-	332	332

12. Property, plant and equipment

a) The Group

	Land and buildings £'000	Short leasehold improve-ments £'000	Fixtures and fittings £'000	Plant and machinery £'000	Total £'000
Cost					
At 1 January 2016	7,813	28,542	4,166	112,664	153,185
Additions	4	513	643	11,842	13,002
Disposals	-	-	-	(1,129)	(1,129)
Foreign exchange	865	5,345	628	25,645	32,483
At 31 December 2016	**8,682**	**34,400**	**5,437**	**149,022**	**197,541**
Accumulated depreciation					
At 1 January 2016	3,270	14,841	3,144	66,776	88,031
Charge for the year	200	549	264	4,548	5,561
Disposals	-	-	-	(737)	(737)
Foreign exchange	140	2,384	409	16,752	19,685
At 31 December 2016	**3,610**	**17,774**	**3,817**	**87,339**	**112,540**
Net book value					
At 31 December 2016	**5,072**	**16,626**	**1,620**	**61,683**	**85,001**
At 31 December 2015	4,543	13,701	1,022	45,888	65,154

	Land and buildings £'000	Short leasehold improve-ments £'000	Fixtures and fittings £'000	Plant and machinery £'000	Total £'000
Cost					
At 1 January 2015	7,680	27,953	3,816	147,426	186,875
Additions	-	123	298	5,710	6,131
Disposals	-	(467)	(20)	(43,794)	(44,281)
Foreign exchange	133	933	72	3,322	4,460
At 31 December 2015	**7,813**	**28,542**	**4,166**	**112,664**	**153,185**
Accumulated depreciation					
At 1 January 2015	3,059	13,739	2,834	100,655	120,287
Charge for the year	189	1,196	251	4,556	6,192
Disposals	-	(380)	-	(40,351)	(40,731)
Foreign exchange	22	286	59	1,916	2,283
At 31 December 2015	**3,270**	**14,841**	**3,144**	**66,776**	**88,031**
Net book value					
At 31 December 2015	**4,543**	**13,701**	**1,022**	**45,888**	**65,154**
At 31 December 2014	4,621	14,214	982	46,771	66,588

12. Property, plant and equipment (continued)

b) Capitalised finance leases

Plant and machinery includes the following amounts where the group is a lessee under a finance lease:

	2016 £'000	2015 £'000
Cost	-	2,856
Accumulated Depreciation	-	(408)
Net book value	**-**	**2,448**

The group leases various plant and machinery assets under non-cancellable finance lease agreements. The lease terms are up to three years, and the ownership of the assets lie within the group.

c) The Company

	Fixtures and fittings £'000
Cost	
At 1 January 2016	70
Additions	6
At 31 December 2016	**76**
Accumulated depreciation	
At 1 January 2016	66
Charge for the year	5
At 31 December 2016	**71**
Net book value	
At 31 December 2016	**5**
At 31 December 2015	4

	Fixtures and fittings £'000
Cost	
At 1 January 2015	69
Additions	1
At 31 December 2015	**70**
Accumulated depreciation	
At 1 January 2015	51
Charge for the year	15
At 31 December 2015	**66**
Net book value	
At 31 December 2015	**4**
At 31 December 2014	18

13. Investments

	Investments in subsidiaries £'000	Other equity investments £'000	Total £'000
Cost			
At 1 January 2016	100,509	75	100,584
Subsidiaries share based payments charge	397	-	397
At 31 December 2016	**100,906**	**75**	**100,981**
Provisions for impairment			
At 1 January 2016	71,514	-	71,514
At 31 December 2016	**71,514**	**-**	**71,514**
Net book value			
At 31 December 2016	**29,392**	**75**	**29,467**
At 31 December 2015	28,995	75	29,070

	Investments in subsidiaries £'000	Other equity investments £'000	Total £'000
Cost			
At 1 January 2015	99,894	50	99,944
Additions	-	25	25
Subsidiaries share based payments charge	615	-	615
At 31 December 2015	**100,509**	**75**	**100,584**
Provisions for impairment			
At 1 January 2015	71,514	-	71,514
At 31 December 2015	**71,514**	**-**	**71,514**
Net book value			
At 31 December 2015	**28,995**	**75**	**29,070**
At 31 December 2014	28,380	50	28,430

Details of the company's subsidiaries are set out in note 26.

Investments are reviewed for impairment annually, where the net asset value is lower than the investment carrying value an impairment charge is recognised in the income statement.

14. Inventories

	2016 £'000	2015 £'000
Raw materials and consumables	22,528	16,669
Work-in-progress and finished goods	5,970	4,546
	28,498	**21,215**

The directors are of the opinion that the replacement values of inventories are not materially different to the carrying values stated above. These carrying values are stated net of impairment provisions of £8,076,000 (2015: £6,381,000).

The increase in provision includes a £1,200,000 gross up of provisions following an improvement to management information due to the implementation of a new system. £121,000 (2015: 746,000) of inventories were written down during 2016 and an expense recognised in the income statement.

15. Trade and other receivables

Current	2016 Group £'000	2016 Company £'000	2015 Group £'000	2015 Company £'000
Trade receivables	14,424	-	12,666	-
Amounts owed by group undertakings	-	96,711	-	77,258
Other receivables and prepayments	16,444	233	10,384	453
	30,868	**96,944**	**23,050**	**77,711**

Non-current	2016 Group £'000	2016 Company £'000	2015 Group £'000	2015 Company £'000
Financial assets	8,000	-	8,000	-

As at 31 December 2016, 71% (2015: 82%) of trade receivables were within terms. Of the other trade receivables, 81% (2015: 64%) were less than 30 days past due. An allowance has been made for estimated irrecoverable amounts from the sale of goods of £229,000 (2015: £204,000). This allowance has been determined by reference to past default experience. Included in other receivables is accrued income of £10,421,000 (2015: £7,739,000).

Our trade receivables are with established customers, we monitor customer D&B credit ratings and have had no material defaults in the past. None of our receivables are with customers where we have had any history of default.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable as set out above. In terms of trade receivables, the terms of sale provide that the group has recourse to the products sold in the event of non-payment by a customer.

Amounts owed by group undertakings are unsecured and repayable on demand. Interest is charged at a rate of 5% per annum (2015: 5% per annum).

Financial assets relate to £8,000,000 of Preferred 'A' shares (2015: £8,000,000) issued by the Compound Semiconductor Centre Limited ('CSC'), a joint venture between the Group and Cardiff University (see Note 27 for further details. The preference shares carry the following rights:

- No voting rights
- Dividend equivalent to the HSBC Bank PLC base rate for the applicable period on the amount paid up, subject to CSC having available profits.
- Repayable in proportion to the outstanding principle from surplus cash generated.

The carrying values of trade and other receivables also represent their estimated fair values.

16. Trade and other payables

Current	2016 Group £'000	2016 Company £'000	2015 Group £'000	2015 Company £'000
Trade payables	23,331	773	12,832	691
Deferred consideration	-	-	16,649	1,005
Overseas tax payable	862	-	704	-
Other taxation and social security	1,207	105	1,085	120
Accruals and deferred income	11,539	1,583	12,423	491
	36,939	**2,461**	**43,693**	**2,307**

Non-current	2016 Group £'000	2016 Company £'000	2015 Group £'000	2015 Company £'000
Deferred consideration	-	-	484	484

Within deferred consideration is £nil (2015: £5.6m) being the best estimate of the amount that will be settled through contractually agreed price discounts. Long term contingent deferred consideration balances are discounted at 2.5%.

The fair value of the contingent deferred consideration has been re-assessed during the year resulting in a reduction of £2.3m (2015: £0.8m). This has been credited to the consolidated income statement within other income and expenses. The exceptional income has been excluded from our adjusted profit measure set out in note 4.

Amounts owed to group undertakings are unsecured and repayable on demand. Interest is charged at a rate of 5% per annum (2015: 5% per annum).

The carrying values of trade and other payables also represent their estimated fair values.

There is no foreign currency exchange contracts held at 31 December 2016 or 31 December 2015.

17. Borrowings

The Group	2016 £'000	2015 £'000
Non-current borrowings:		
Bank borrowings	36,854	24,626
Finance leases	-	-
	36,854	**24,626**
Current borrowings:		
Bank borrowings	7,652	3,162
Finance leases	-	79
	7,652	**3,241**
Total borrowings	**44,506**	**27,867**

17. Borrowings (continued)

	2016 £'000	2015 £'000
Bank borrowings fall due for repayment as follows:		
Within one year	7,652	3,162
Between one and five years	34,906	23,084
After five years	1,948	1,542
	44,506	**27,788**

For details of the Group's bank borrowings see note 19.

	2016 £'000	2015 £'000
Gross finance lease liabilities – minimum lease payments:		
Within one year	-	80
Between one and five years	-	-
	-	80
Finance charges	-	(1)
Present value of finance lease liabilities	**-**	**79**

	2016 £'000	2015 £'000
Present value of finance lease liabilities:		
Within one year	-	79
Between one and five years	-	-
	-	**79**

Lease liabilities are effectively secured as the rights to the leased asset reverts to the lessor in the event of default.

The company

The borrowings of the parent company comprise the bank loan of £42,069,000 (2015 £25,402,000) which comprise mutli currency acquisition, capital expenditure and RCF facilities, and an overdraft of £1,028,000 (2015: £866,000).

The Company	2016 £'000	2015 £'000
Non-current borrowings:		
Bank borrowings	34,524	22,722
	34,524	**22,722**
Current borrowings:		
Bank overdraft	1,028	866
Bank borrowings	7,545	2,680
	8,573	**3,546**
Total borrowings	**43,097**	**26,268**

17. Borrowings (continued)

	2016 £'000	2015 £'000
Bank borrowings fall due for repayment as follows:		
Within one year	8,573	3,546
Between one and five years	34,524	22,722
After five years	-	-
	43,097	**26,268**

18. Provisions for other liabilities and charges

	2016 £'000	2015 £'000
As at 1 January	**4,038**	**5,485**
Charged to the income statement	104	116
Utilised during the year	(1,283)	(1,489)
Foreign exchange	729	(74)
As at 31 December	**3,588**	**4,038**

	2016 £'000	2015 £'000
Current	1,421	1,116
Non-Current	2,167	2,922
Total Provisions for other liabilities and charges	**3,588**	**4,038**

During 2015, as part of the re-organisation and rationalisation of the Group's operations the Group ceased activities at its Singapore facility and established the Compound Semiconductor Development Centre.

The provision above represents the onerous lease obligation in respect of the Singapore property. This is expected to be utilised over the next two and a half years. The provision has been discounted using a risk free rate of 2.5%.

19. Financial instruments

Financial instruments by category

Trade and other receivables (excluding prepayments) and cash and cash equivalents are classified as 'loans and receivables'. Borrowings and trade and other payables are classified as 'other financial liabilities at amortised cost'. Both categories are initially measured at fair value and subsequently held at amortised cost. All financial instruments are classified as Level 2 per the fair value hierarchy.

Derivatives (forward exchange contracts) are classified as 'derivatives used for hedging' and accounted for at fair value with gains and losses taken to reserves through the consolidated statement of comprehensive income.

Financial risk and treasury policies

The Group's finance team maintains liquidity, manages relations with the Group's bankers, identifies and manages foreign exchange risk and provides a treasury service to the Group's businesses. Treasury dealings such as investments, borrowings and foreign exchange are conducted only to support underlying business transactions.

The Group has clearly defined policies for the management of foreign exchange rate risk. The Group finance team does not undertake speculative foreign exchange dealings for which there is no underlying exposure. Exposures resulting from sales and purchases in foreign currency are matched where possible and the net exposure may be hedged by the use of forward exchange contracts.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and monies on deposit with financial institutions, of which all are reviewed for appropriate credit worthiness.

Where the group assesses a potential credit risk, this is dealt with either by up-front payment prior to the shipment of goods or by other credit risk mitigation measures. As a result the group has historically had and continues to have a very low level of payment default.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable as set out below. In terms of trade receivables, the terms of sale provide that the group has recourse to the products sold in the event of non-payment by a customer.

Carrying amount – Loans and Receivables	**2016 Group £'000**	**2016 Company £'000**	**2015 Group £'000**	**2015 Company £'000**
Cash and Cash equivalents	4,957	-	4,644	-
Trade receivables	14,424	-	12,666	-
Amounts owed by group undertakings	-	96,711	-	77,258
Other receivables	10,421	-	7,739	-
Financial Assets (Preference share receivables)	8,000	-	8,000	-
	37,802	**96,711**	**33,049**	**77,258**

Included in other receivables is accrued income of £10,421,000 (2015: £7,739,000).

The majority of the group's revenues are derived from large multinational organisations and are with established customers. Therefore the credit risk is considered to be small. We monitor customer D&B credit ratings and have had no material defaults in the past. None of our receivables are with customers where we have had any history of default.

19. Financial instruments (continued)

	Gross 2016 £'000	Provision 2016 £'000	Net 2016 £'000	Gross 2015 £'000	Provision 2015 £'000	Net 2015 £'000
Not past due	9,569	-	9,569	10,033	-	10,033
Past due 0-30	4,112	-	4,112	1,823	-	1,823
Past due more than 30	972	229	743	1,014	204	810
	14,653	**229**	**14,424**	**12,870**	**204**	**12,666**

An allowance has been made for estimated irrecoverable amounts from the sale of goods of £229,000 (2015: £204,000). This allowance has been determined by reference to past default experience. The individually impaired receivables mainly relate to a number of independent customers. A portion of these receivables is expected to be recovered.

The carrying values of trade and other receivables also represent their estimated fair values.

Trade receivables and accrued income are primarily denominated in US dollars, as are trade payables (note 16). The natural hedge between these financial instruments limits the exposure of the group to movements in foreign exchange rates.

Based on the balances held at 31 December 2016 a 1 cent movement in the US dollar to Sterling rate would impact the net value of these instruments by £20,000 (2015: £53,000) (before the mitigating impact of cash flow hedges).

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group manages its funding to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group uses weekly cash flow forecasts to monitor cash requirements and to optimise its borrowing position.

Typically the Group ensures that it has sufficient borrowing facilities to meet foreseeable operational expenses. At the year end the group had available facilities of £65.0m (2015: £41.1m).

The following shows the contractual maturities of financial liabilities, including interest payments, where applicable and excluding the impact of netting agreements and on an undiscounted basis:

Analysis of contractual cash flow maturities - Other financial liabilities at amortised cost 31 December 2016	**Carrying amount £'000**	**Contractual Cash flows £'000**	**Less than 12 months £'000**	**1 – 2 Years £'000**	**2 – 5 Years £'000**	**5+ Years £'000**
Trade and other payables	36,078	36,078	36,078	-	-	-
Deferred consideration	-	-	-	-	-	-
Secured bank loans	44,506	47,745	9,251	32,731	2,860	2,903
Finance leases	-	-	-	-	-	-
	80,584	**83,823**	**45,329**	**32,731**	**2,860**	**2,903**

Analysis of contractual cash flow maturities - Other financial liabilities at amortised cost 31 December 2015	**Carrying amount £'000**	**Contractual Cash flows £'000**	**Less than 12 months £'000**	**1 – 2 Years £'000**	**2 – 5 Years £'000**	**5+ Years £'000**
Trade and other payables	29,798	29,798	29,798	-	-	-
Deferred consideration	11,539	11,539	11,055	-	484	-
Secured bank loans	27,788	30,881	3,956	6,251	18,137	2,537
Finance leases	79	80	80	-	-	-
	69,204	**72,298**	**44,889**	**6,251**	**18,621**	**2,537**

19. Financial instruments (continued)

Market risks

1. Currency risk

(a) Cash flow risk

The group's presentational currency is sterling. However, the majority of sales are denominated in US dollars. Therefore, the group's cash flows are affected by fluctuations in the rate of exchange between Sterling and the US dollar.

This exposure is managed by a natural currency hedge because a significant portion of the group's cost base is also denominated in US dollars. In particular, the majority of the group's raw materials are purchased in US dollars, and a significant portion of labour and overheads are also denominated in US dollars as three of the group's principal subsidiaries are situated in North America.

To a lesser extent, the group also generates sales in other currencies including Yen and Euros which are also partially hedged where possible by purchases of some raw materials in these currencies.

Taking into account the extent of the natural hedge within the business model, management periodically use forward exchange contracts to mitigate the impact of the residual foreign currency exposure. As at 31 December 2016 and 31 December 2015 there were no contracts in place.

(b) Fair value risk

The group has operations in the UK, North America and Asia. Translation exposures that arise on converting the results of overseas subsidiaries are not hedged. Net assets held in foreign currencies are hedged wherever practical by matching borrowings in the same currency.

As a guide to the sensitivity of the group's results to movements in foreign currency exchange rates, a one cent movement in the US dollar to Sterling rate would impact annual earnings by approximately £0.1m (2015: £0.1m).

2. Interest rate risk

The Board is aware of the risks associated with changes in interest rates and does not speculate on future changes in interest rates or currencies. Historically the Group has not undertaken any hedging activity in this area however the board keeps this under regular review. All foreign currency cash deposits are made at prevailing interest rates. The main element of interest rate risk concerns borrowings.

The group's bank borrowings consist of a series of variable and fixed rate term loans, a revolving credit facility and overdrafts. Bank loans are secured against the assets of the group.

The variable rate US dollar term loans, which had a principal outstanding at 31 December 2016 of £nil (2015: £0.3m), and bear interest of between 2.0% to 2.95% over LIBOR. These loans were repayable by monthly instalment with the outstanding balance repaid in full during 2016.

The fixed rate US dollar term loans, which had a principal outstanding at 31 December 2016 of £2.4m (2015: £2.1m), and bear interest of 5% until 2017 and is variable thereafter. These loans are repayable by monthly instalment with remaining terms of up to 20 years.

The US Dollar acquisition facility, which had a principal outstanding at 31 December 2016 of £6.5m (2015: £8.1m), bears interest of between 2.5% to 2.95% over LIBOR. This loan is repayable by quarterly instalments with a remaining term of 1 years.

The US Dollar revolving credit facility is a multi-currency facility of up to $63 million, committed until 2018. It bears interest of between 1.75% to 1.90% over LIBOR. The balance drawn at 31 December 2016 was £30.9m (2015: £17.6m).

The UK Sterling capital expenditure facility, which had a principal outstanding at 31 December 2016 of £5.0m (2015: £nil), bears interest at 1.90% over the bank of England base rate. This loan are repayable by monthly instalment with remaining terms of up to 3 years.

The group's policy is to regularly review its exposure to interest rate risk, and in particular the mix between fixed and floating rate facilities. The percentage of borrowings on fixed rate terms at 31 December 2016 was 7% (2015: 8%).

Floating rate liabilities are primarily indexed to LIBOR. The group did not enter into any interest rate swap instruments during 2016. This remains under regular review.

As a guide to the sensitivity of the group's results to movements in interest rates, a 50 basis point (0.5%) movement in interest rates would have impacted the 2016 annual interest charge by approximately £170,000 (2015: £170,000).

The carrying value of loans approximates to their fair value based on the net present value of future cash flows.

Capital risk management

The group's main objectives when managing capital are to safeguard the group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The group sets the amount of capital in proportion to risk. The group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the characteristic of the underlying assets. The group monitors capital by reviewing net debt against shareholders' funds. The position of these indicators and the movement during the year is shown in the Five Year Financial Summary.

The group defines total capital as equity in the consolidated balance sheet plus net debt or less net funds plus deferred consideration (note 16). Total capital at 31 December 2016 was £233,993,000 (2015: £187,390,000).

Consistent with others in the industry, the group monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt plus deferred consideration divided by total capital. At 31 December 2016 the gearing ratio was 17% (2015: 22%).

All covenants in relation to the group's borrowing facilities have been complied with during the year.

19. Financial instruments (continued)

Fair values

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

	2016 Carrying amount £'000	2016 Fair value £'000	2015 Carrying amount £'000	2015 Fair value £'000
Cash and Cash equivalents	4,957	4,957	4,644	4,644
Trade receivables	14,424	14,424	12,668	12,668
Other receivables – (accrued income)	10,421	10,421	7,739	7,739
Financial Assets (Preference share receivables)	8,000	8,000	8,000	8,000
Trade and other payables	(36,078)	(36,078)	(29,798)	(29,798)
Deferred consideration	-	-	(11,539)	(11,539)
Secured bank loans	(44,506)	(44,798)	(27,788)	(28,136)
Finance leases	-	-	(79)	(79)
	(42,782)	**(43,074)**	**(36,153)**	**(36,501)**

Basis for determining fair value

The following summarises the significant methods and assumptions used in estimating the fair values of financial instruments reflected in the table above.

Secured loans

As the loans are floating rate borrowings, amortised cost is deemed to reflect fair value excluding unamortised transaction fees.

Trade and other receivables/payables

As receivables/payables have a remaining life of less than one year, the notional amount is deemed to reflect the fair value.

Financial Assets (Preference share receivables)

As the preference shares receivables are floating rate receivables, amortised cost is deemed to reflect fair value.

20. Share capital

Group and Company	2016 Number of shares	2016 £'000	2015 Number of shares	2015 £'000
Allotted, called up and fully paid				
Ordinary shares of 1p each	675,506,061	6,755	665,533,170	6,655

The movement in the number of ordinary shares during the year was:

	2016 Number	2015 Number
At 1 January	665,533,170	660,327,767
Employee share schemes	4,831,424	5,205,403
Translucent deferred consideration	5,141,467	-
At 31 December	**675,506,061**	**665,533,170**

20. Share capital (continued)

9,972,891 ordinary shares (2015: 5,205,403 Ordinary shares) were issued during the year as follows:

	2016 Number of shares	2016 Consideration	2015 Number of shares	2015 Consideration
Employee share schemes	4,831,424	Nil to 36.5p	5,205,403	Nil to 15.66p
Translucent deferred consideration	5,141,467	Nil	-	-
	9,972,891		**5,205,403**	

The share premium arising from the consideration received of £578,000 (2015: £544,000) was £1,481,000 (2015: £492,000).

21. Share based payments

The total amount charged to the income statement in 2016 in respect of share based payments was £2,042,000 (2015: £2,001,000). Included within the share based payments charge is a £1,216,000 (2015: £1,186,000) charge relating to the Company's Long Term Incentive Plan.

Share option scheme

The IQE Plc Share Option Scheme was adopted on 26 May 2000 and amended by shareholders at the Annual General Meeting on 17 May 2002. Under the scheme, the Remuneration Committee can grant options over shares in the company to employees of the group.

Options are granted with a contractual life of ten years and with a fixed exercise price equal to the market value of the shares under option at the date of grant or as otherwise disclosed in the remuneration report. Options become exercisable between one and four years from the date of grant subject to continued employment and the achievement of performance conditions, including growth in EBITDA and earnings per share against various targets. The group has no legal or constructive obligation to repurchase or settle the options in cash.

Options are valued using the Black-Scholes option-pricing model and the total amount to be expensed is charged to income statement over the vesting period of the option. The principal assumptions used in the calculation of the fair value of share options are as follows:

Principal assumptions	2016	2015
Weighted average share price at grant date	**25.21**	22.46
Weighted average exercise price	**15.63**	12.49
Weighted average vesting period (years)	**3**	3
Option life (years)	**10**	10
Weighted average expected life (years)	**3**	3
Weighted average expected volatility factor	**52%**	53%
Weighted average risk free rate	**1.25%**	1.25%
Dividend yield	**0%**	0%

The expected volatility factor is based on historical share price volatility over the three years immediately preceding the grant of the option. The expected life is the average expected period to exercise. The risk free rate of return is the yield of zero-coupon UK government bonds of a term consistent with the assumed option life.

Non-market performance conditions are incorporated into the calculation of fair value by estimating the proportion of share options that will vest and be exercised based on a combination of historical trends and future expected trading performance. These are reassessed at the end of each period for each tranche of unvested options.

The fair value of options granted during the year ended 31 December 2016 was £3,678,693 (2015: £33,000).

20. Share based payments (continued)

The movements on share options during the year were as follows:

	2016 Number of options	2016 Average exercise price (pence)	2015 Number of options	2015 Average exercise price (pence)
At 1 January	45,532,098	13.14	50,536,520	13.12
Granted	19,258,119	2.02	540,000	20.50
Exercised	(3,744,854)	15.63	(4,354,287)	12.49
Cancelled/lapsed	(487,987)	17.81	(1,190,135)	18.19
At 31 December	60,557,376	9.42	45,532,098	13.14

The weighted average share price at the time of the options exercised during 2016 was 21.48p (2015: 21.72p).

As at 31 December 2016, the total number of options held by employees was 60,557,376 (2015: 45,532,098) as follows:

Option price pence/share	Option period ending	2016 Number of options	2015 Number of options
10.40p - 19.42p	31 December 2016	-	1,698,091
13.58p - 19.42p	31 December 2017	4,690,404	4,024,597
16.10p - 16.10p	31 December 2018	136,875	179,306
3.65p - 17.07p	31 December 2019	4,880,325	5,366,327
0.00p – 45.58p	31 December 2020	1,288,498	1,398,748
9.15p – 50.25p	31 December 2021	4,665,068	5,059,830
0.00p – 28.17p	31 December 2022	5,112,392	5,322,392
0.00p – 27.75p	31 December 2023	14,001,062	15,611,687
0.00p – 23.83p	31 December 2024	5,984,633	6,357,106
18.42p – 25.17p	31 December 2025	540,000	514,014
0.00p – 37.92p	31 December 2026	19,258,119	-
At 31 December		**60,557,376**	45,532,098

20. Parent company profit and loss

As permitted by Section 408 of the Companies Act 2006, the income statement of the parent company is not presented as part of these financial statements.

The parent company's loss for the financial year amounted to £184,000 (2015: Loss £119,000).

23. Cash generated from operations

The Group	2016 £'000	2015 £'000
Profit before tax	19,032	19,376
Finance costs	1,633	1,790
Depreciation of property, plant and equipment	5,561	6,192
Amortisation of intangible assets	5,377	5,040
Loss/(profit) on disposal of fixed assets	47	(5,187)
Non cash element of joint venture transactions	-	(714)
Impairment of assets	-	453
Gain on release of contingent deferred consideration	(2,340)	(779)
Contingent deferred consideration (settled through contractual discounts)	(3,959)	(4,837)
Share based payments	2,042	2,001
Cash inflow from operations before changes in working capital	**27,393**	**23,335**
Increase in inventories	(4,206)	(2,813)
Decrease in trade and other receivables	1,437	2,739
Decrease in trade and other payables	(2,161)	(2,290)
Cash inflow from operations	**22,463**	**20,971**

The Company	2016 £'000	2015 £'000
Loss before tax	(184)	(119)
Finance income	(4,290)	(4,230)
Finance costs	1,278	1,088
Foreign exchange	6,886	1,614
Gain on release of deferred consideration	(486)	-
Depreciation	5	15
Amortisation	40	-
Share based payments	1,644	1,387
Cash inflow/(outflow) from operations before changes in working capital	**4,893**	**(245)**
(Increase)/Decrease in trade and other receivables	(14,942)	8,126
Increase/(Decrease) in trade and other payables	1,237	(1,451)
Cash (outflow)/inflow from operations	**(8,812)**	**6,430**

24. Reconciliation of net cash flow to movement in net debt

	2016 £'000	2015 £'000
Decrease in cash in the year	(315)	(1,109)
Increase in borrowings	(12,623)	(4,349)
Repayment of borrowings	3,252	14,191
Repayment of leases	89	918
Net movement resulting from cash flows	**(9,597)**	**9,651**
Net debt at 1 January	**(23,223)**	**(31,251)**
Net movement resulting from cash flows	(9,597)	9,651
Non-cash movements (note 25)	(6,729)	(1,623)
Net debt at 31 December	**(39,549)**	**(23,223)**

25. Analysis of net debt

	At 1 January 2016 £'000	Cash flow £'000	Other non-cash movements £'000	At 31 December 2016 £'000
Bank borrowings due after one year	(24,626)	(12,623)	395	(36,854)
Bank borrowings due within one year	(3,162)	3,252	(7,742)	(7,652)
Finance leases due after one year	-	-	-	-
Finance leases due within one year	(79)	89	(10)	-
Total borrowings	(27,867)	(9,282)	(7,357)	(44,506)
Cash and cash equivalents	4,644	(315)	628	4,957
Net debt	**(23,223)**	**(9,597)**	**(6,729)**	**(39,549)**

Cash and cash equivalents at 31 December 2016 comprised balances held in instant access bank accounts and other short term deposits with a maturity of less than 3 months.

Non-cash movements include foreign exchange movements on US dollar denominated borrowings.

26. Subsidiary undertakings

Name of company	Class of capital	Proportion of shares held	Activity	Country of incorporation
IQE (Europe) Limited	Ordinary shares of £1	100%*	Manufacture of advanced semiconductor materials	UK
IQE Inc	Common stock of $0.001	100%*	Manufacture of advanced semiconductor materials	USA
IQE KC LLC	Limited liability company	100%	Manufacture of advanced semiconductor materials	USA
IQE Taiwan ROC	Ordinary shares of NT$10	90%*	Manufacture of advanced semiconductor materials	Taiwan
IQE RF LLC	Limited liability company	100%*	Manufacture of advanced semiconductor materials	USA
IQE Silicon Compounds Limited	Ordinary shares of £1	100%	Manufacture of silicon epitaxy	UK
MBE Technology Pte Ltd	Preferred shares of S$1 Ordinary shares of S$1	100% 100%	Manufacture of advanced semiconductor materials	Singapore
Wafer Technology Limited	Ordinary shares of £1	100%*	Manufacture of semiconductor compounds and ultra high purity materials	UK
NanoGaN Limited	Ordinary shares of £0.001	100%	Development of advanced semiconductor materials	UK
Galaxy Compound Semiconductors Inc	Common stock of $0.00 par value	100%*	Manufacture of semiconductor compounds and ultra high purity materials	USA
EPI Holding Limited	Ordinary shares of £1	100%	Dormant holding company	UK
KTC Wireless LLC	Limited liability company	100%	Dormant holding company	USA
IQE USA Inc	Limited liability company	100%	Dormant holding company	USA
IQE Solar LLC	Limited liability company	100%*	Dormant company	USA
IQE Properties Inc	Limited liability company	100%*	Property holding company	USA
Wafer Technology International Limited	Ordinary shares of £1	100%	Dormant holding company	UK

* Indirect holdings

The proportion of voting rights of subsidiaries held by the group is the same as the proportion of shares held.

All UK subsidiaries are exempt from the requirements to file audited financial statements by virtue of section 479A of the Companies Act 2006. In adopting the exemption IQE plc has provided statutory guarantee to these subsidiaries in accordance with section 479C of the Companies Act 2006.

27. Joint ventures

The group holds investments in two joint ventures as follows:

Name of company	Class of capital	Proportion of shares held	Activity	Country of incorporation
Compound Semiconductor Centre Limited.	Common stock of £1 par value	50%*	Research, development and Manufacture of semiconductor materials	UK
CSDC Private Limited.	Common stock of $1 par value	51%*	Research, development and Manufacture of semiconductor materials	Singapore

* Indirect holdings

On 23 March 2015 the group entered into a joint venture agreement with WIN Semiconductors Corp and Nangyang Technological University to create the Compound Semiconductor Development Centre ("CSDC") in Singapore. The CSDC is a centre of excellence in Asia for the development and commercialisation of advanced semiconductor products. The shareholder agreement establishes that this new entity is jointly controlled by the shareholders who have an equal share of the voting rights.

On 9 July 2015 the group entered into a joint venture agreement with Cardiff University to create the Compound Semiconductor Centre ("CSC") in the United Kingdom. The CSC is a centre of excellence in Europe for the development and commercialisation of advanced semiconductor products. The shareholder agreement establishes that this new entity is jointly controlled by the shareholders who have an equal share of the voting rights.

All of the above Joint ventures are accounted for using the equity method in these consolidated financial statements as set out in the groups accounting policies note 1. All of the Joint ventures financial year end is the 31 December 2016 which is co-terminus with the Group and has been used in preparing these Group accounts. No dividends have been received from the Joint ventures in the period.

We enclose below, summarised financial information for these joint ventures for the reporting period:

a) Summary information for Compound Semiconductor Centre Limited ("CSC Ltd")

Summary income statement	2016 £'000	2015 £'000
Revenue	3,955	1,521
EBITDA	(680)	(315)
Loss from continuing operations	(4,422)	(954)
Loss for the period	(4,422)	(954)
Total comprehensive expense for the period	**(4,422)**	**(954)**

Summary balance sheet	2016 £'000	2015 £'000
Non-current assets	38,678	33,310
Current assets	4,052	5,168
Current Liabilities	(4,857)	(666)
Non-current Liabilities	(19,249)	(14,766)
Equity attributable to Joint Venturers	**18,624**	**23,046**

27. Joint ventures (continued)

Carrying value of equity interest in CSC Ltd	2016 £'000	2015 £'000
Net assets of CSC Ltd	18,624	23,046
Proportion of the Groups ownership interest	50%	50%
Groups share of net assets	9,312	11,523
Elimination of unrealised gains on transactions with CSC Ltd	(12,000)	(12,000)
Cumulative unrecognised losses	2,688	477
Carrying amount of the Groups interest in the JV	**-**	**-**

Summary of cumulative unrecognised losses	2016 £'000	2015 £'000
Unrecognised losses brought forward	(726)	-
Unrecognised unrealised gains on transactions with CSC Ltd	(2,465)	(249)
Unrecognised losses in the year	(2,211)	(477)
Cumulative unrecognised losses carried forward	**(5,402)**	**(726)**

b) Summary information for CSDC Private Limited

Summary income statement	2016 SG$'000	2015 SG$'000
Revenue	13,264	12,208
EBITDA	(1,877)	(1,822)
Loss from continuing operations	(2,090)	(1,820)
Loss for the period	(2,090)	(1,897)
Total comprehensive expense for the period	**(2,090)**	**(1,897)**

Summary balance sheet	2016 SG$'000	2015 SG$'000
Non-current assets	-	-
Current assets	6,959	4,445
Current Liabilities	(2,356)	(3,834)
Non-current Liabilities	(8,590)	(2,508)
Deficit attributable to Joint venturers	**(3,987)**	**(1,897)**

Carrying value of equity interest CSDC Private Limited	2016 SG$'000	2015 SG$'000
Net liabilities of CSDC Private Limited	(3,987)	(1,897)
Proportion of the Groups ownership interest	51%	51%
Groups share of net assets	(2,033)	(967)
Cumulative unrecognised losses	2,033	967
Carrying amount of the Groups interest in the JV	**-**	**-**

27. Joint ventures (continued)

Summary of cumulative unrecognised losses	2016 SG$'000	2015 SG$'000
Cumulative unrecognised losses brought forward	(967)	-
Unrecognised losses in the year	(1,066)	(967)
Cumulative unrecognised losses carried forward	**(2,033)**	**(967)**

28. Related party transactions

The group incurred professional fees and expenses during the year of £126,493 (2015: £125,000) payable to Horton Corporate Finance and £42,000 (2015: £45,000) payable to Fishstone Limited. Dr G H H Ainsworth, who is a director of IQE Plc, is a managing partner of Horton Corporate Finance. S J Gibson, who is a director of IQE Plc, is also a director of Fishstone Limited. An amount of £41,750 (2015: £63,500) was outstanding to these parties at the year-end.

During the year the group recognised Revenue of £nil (2015: £207,000) with Seren Photonics Limited. Dr G H H Ainsworth is a Director of IQE plc and Seren Photonics Limited. As at the 31 December 2016 £nil (2015: £ nil) was receivable from Seren Photonics Limited. During 2015 IQE provided loans to Seren Photonics Limited of £25,000 and during 2014, IQE made a £50,000 investment in Seren Photonics Limited during the year in return for 69 "B" ordinary shares.

During the year the group recognised Revenue of £1,728,000 (2015: £240,000) and also made purchases of £7,163,000 (2015: £5,860,000) with CSDC Private Limited a joint venture of the Group. An amount of £1,402,000 was due from (2015: £457,000 due to) CSDC Private Limited at year end.

During the year the group recognised revenue of £4,930,000 (2015: £7,784,000) which is net of an elimination of unrealised profit of £nil (2015: £7,286,000). The group also made purchases of £3,955,000 (2015: £1,521,000) and recharged other costs of £350,000 (2015: £145,832) with Compound Semiconductor Centre Limited ('CSC') a joint venture of the Group. Transactions relating to the formation of the CSC are disclosed further in note 4. An amount of £2,714,268 (2015: £728,156) was owed to the CSC at year end. In the groups year end balance sheet there are receivables of £8,000,000 (2015: £8,000,000) relating to Preferred 'A' Shares held in CSC and a shareholder loan of £230,000 (2015: £115,000).

29. Operating lease commitments

	2016 £'000	2015 £'000
Due within one year	1,969	2,082
Due between two and five years	6,034	6,519
Due after five years	10,481	11,378
	18,484	**19,979**

Operating leases relate to various building, equipment and vehicle leases.

29. Operating lease commitments

The group had capital commitments at 31 December 2016 of £356,000 (2015: £747,000).


Engineering