Annual report and financial statements | 2017

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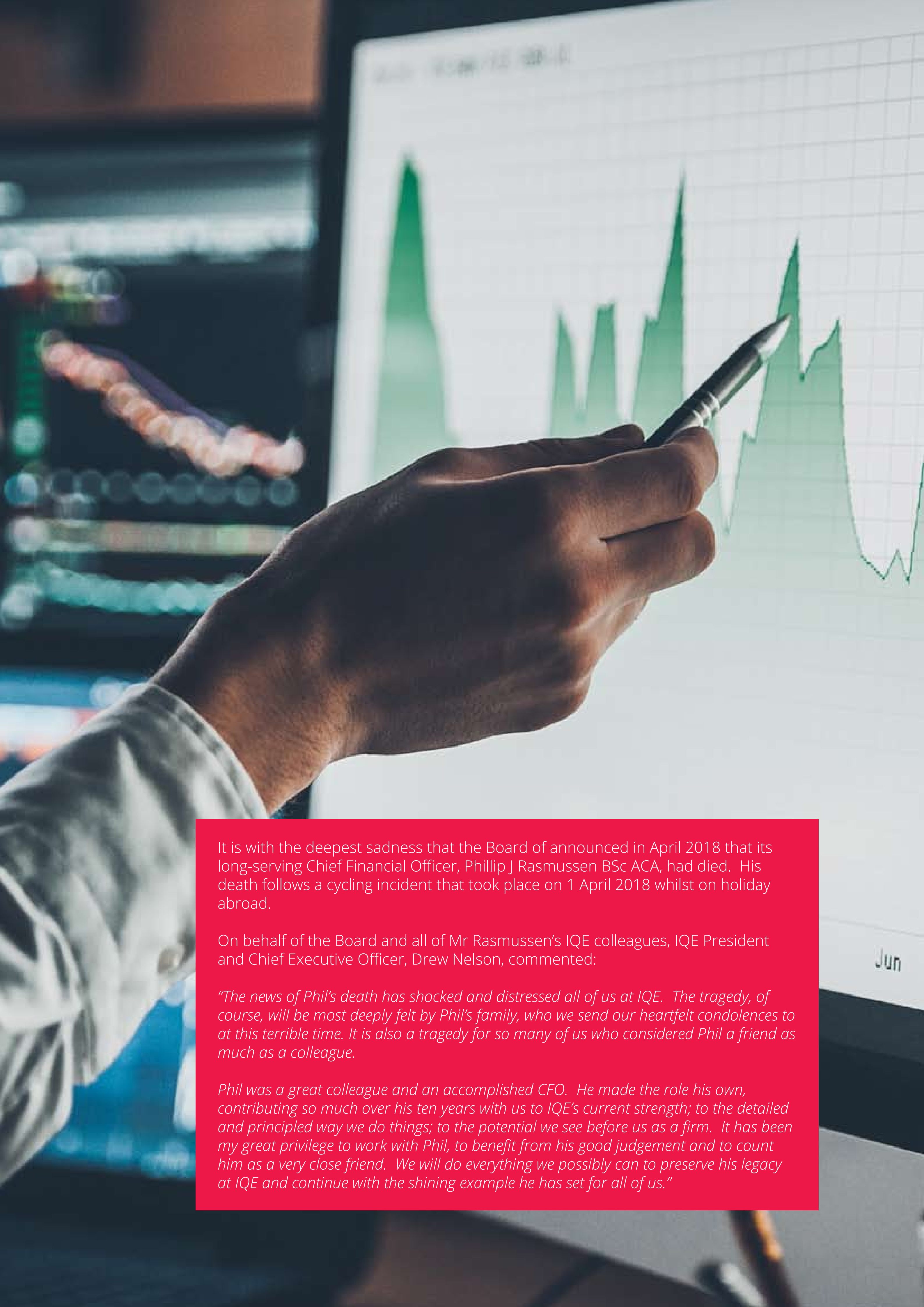
A MEMBER OF THE
IQE
GROUP




It is with the deepest sadness that the Board of announced in April 2018 that its long-serving Chief Financial Officer, Phillip J Rasmussen BSc ACA, had died. His death follows a cycling incident that took place on 1 April 2018 whilst on holiday abroad.

On behalf of the Board and all of Mr Rasmussen's IQE colleagues, IQE President and Chief Executive Officer, Drew Nelson, commented:

*"The news of Phil's death has shocked and distressed all of us at IQE. The tragedy, of course, will be most deeply felt by Phil's family, who we send our heartfelt condolences to at this terrible time. It is also a tragedy for so many of us who considered Phil a friend as much as a colleague.*

*Phil was a great colleague and an accomplished CFO. He made the role his own, contributing so much over his ten years with us to IQE's current strength; to the detailed and principled way we do things; to the potential we see before us as a firm. It has been my great privilege to work with Phil, to benefit from his good judgement and to count him as a very close friend. We will do everything we possibly can to preserve his legacy at IQE and continue with the shining example he has set for all of us."*

# Chairman's report to shareholders

Revenue increased by 16% to
**£154.5m**
(2016: £132.7m)

Adjusted operating profit increased to
**£26.4m**
(2016: £22.1m)

***2017 – A transformational year***

It is with great pleasure that I present our 2017 annual report and financial statements, providing details of the Group's strong operational and financial performance in what has been a transformational year in the Group's history.

During 2017 we continued to deliver 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. In addition to referring to GAAP profit measures, I also refer to adjusted profit measures, which are detailed in note 5.

Revenue increased by 16% to £154.5m (2016: £132.7m). Adjusted operating profit increased to £26.4m (2016: £22.1m), and GAAP operating profit decreased to £17.0m (2016: £19.8m).

This record financial performance marks the adoption of IQE's VCSEL technology in a mass market application during the second half of 2017.

We ended the year with net funds of £45.6m (2016: net debt of £39.5m), reflecting £95m of gross new equity raised in November 2017 which will be used to fund ongoing capacity expansion in 2018 to meet the rapidly rising demand as VCSEL adoption broadens.

***The scene is set***

Our well proven track-record in providing the key enabling technologies that power a wide range of applications including new and emerging wireless and photonics devices, coupled with our innovative product portfolio, should give our investors' confidence in IQE's position and capabilities to provide excellent long-term shareholder returns.

Our commitment to innovation in advanced semiconductor technologies clearly positions IQE centre-stage in helping to shape the future that is transforming the way we live, work, travel and spend our leisure-time.

Over the last few years we have set out our strategic roadmap, setting the scene with our vision and ambition to develop an unparalleled depth and breadth of advanced materials capabilities, and to diversify our technology and product portfolio.

The Group continues to go from strength to strength across each of our primary markets: Wireless, Photonics, Infrared, and CMOS++ and is making good technical progress with our developing markets: Advanced Solar and Power.

The clear focus on the execution of our strategy is demonstrated by our strong financial performance in 2017, with sales of wafer products up 21% to £152.6m (2016: £126.0m), propelling the related operating profit (excluding license income) up 59% to £24.5m on an adjusted basis (2016: £15.4m), and up 15% to £15.1m on a GAAP basis (2016: £13.2m). The increase in adjusted profits reflect a 58% increase in wafer related profits from £15.4m to £24.5m partially offset by the £4.8m reduction in license income.

Our key industry differentiators stem from our superior technology capabilities, the scale of our operations and the breadth of our product and service portfolio. This in turn is enabling the group to distinguish itself in the market, and transition its business model from a "materials solutions company", where wafers are developed to customer specifications, into an "innovative enabler" where IQE's material solutions provide chip designers with a new "toolkit" to develop chips which push the boundaries of performance and reduce the barriers of cost.

The Group continues to drive progress through innovation. We have built our portfolio of pioneering, world-class materials technologies including demonstration of the first single crystal aluminium nitride epi-wafers for high performance wireless filters, cREO™ for integration of complementary materials technologies, and Quasi Photonic Crystals and Nano-Imprint Lithography for a wide range of optical technologies including DFB lasers, and integrated 3D sensing solutions.

During the year, we also saw increased levels of customer engagements in areas such as "see in the dark" technologies that to date have been limited to specialist defence and security applications but are now migrating into mass market consumer applications.

In addition to building our IP portfolio, excellent progress has been made with the new wafer foundry in Newport, South Wales. This 'mega foundry' will house up to 100 tools, creating a facility with unparalleled capacity and economies of scale in our industry. The facility is being leased, and the group is purchasing and installing new equipment into the facility. The related capital expenditure is included within property, plant and equipment in note 14. This facility was not operational in 2017 and hence no depreciation has been charged in 2017. The related lease commitment and capital commitments are incorporated in notes 31 and 32 respectively.

Excellent progress continues at IQE's Joint Ventures in the UK and Singapore, expanding external customer engagements and improving financial performance, reflect key milestones for these early-stage businesses.

### *Driving innovation*

Innovation is central to economic growth and prosperity and a key driver in improving competitiveness, adding value, providing high quality employment opportunities and helping to address major societal challenges.

In recent years, IQE has played a key role in promoting wider understanding of the impact that compound semiconductors will have in transforming the 21st century.

IQE's role in promoting the UK as a global hub for compound semiconductor activities should not be underestimated. South Wales and the West of England has so far attracted more than £300M of committed public/private funding across a range of compound semiconductor related initiatives. Much of the compound semiconductor related activity is centred around IQE's corporate headquarters where the company is regarded as a regional anchor company.

Activities include Cardiff University's Institute for Compound Semiconductors, EPSRC's Compound Semiconductor Manufacturing Hub, The UK Government's 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.

### *Delivering on our strategy*

IQE manufactures and supplies compound semiconductor wafer products. Compound semiconductors offer significantly higher performance in electronic and photonic applications, enabling operating speeds of more than 100 times those of silicon, helping to create a smarter, more advanced and more connected world that, every day, enriches our lives in so many ways.

Our highly skilled and talented people have a keen 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.

2018 marks IQE's thirtieth year pioneering advanced technologies at the forefront of the compound semiconductor industry.

During the last thirty years, we have developed an unparalleled depth and breadth of intellectual property and technical capabilities and are truly established as the clear global leader in advanced semiconductor wafer products.

IQE is the undisputed global leader in the supply of advanced wireless materials and is now replicating this success in other primary markets, particularly the rapidly growing photonics sector where the Group's products enable a wide range of technologies from 3D sensing to high-speed optical communications.

**The Group has firmly established its platform for delivering its 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 2017 we reinforced our strategy by expansion of our technology leadership by the further development of our broad IP portfolio through both internal development and strategic transactions. In so doing, we are transitioning from a "materials solutions company", into an "innovative enabler."

### *Operational highlights*

As shown in note 4, whilst advanced wafers for wireless communications applications continue to represent a key proportion of IQE's business, revenues remained broadly flat at £91.6m (2016: £91.3m), reflecting a £3m managed reduction in supplier managed inventories (SMI), enabling the business to focus capacity on the rapidly expanding photonics division with the ramp of VCSEL product lines during the second half of 2017 to support new consumer applications including 3D sensing. Wireless SMI levels are expected to replenish during 2018.

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 109% growth to £47.6m for the full year (2016: £22.8m), with second half sales up more than 160% over the prior year's second half year. The aggressive ramp of VCSEL sales during H2 represents a unique achievement in the industry, as IQE leveraged its expertise of mass market supply to this complex photonics material.

InfraRed products also demonstrated solid continued growth, increasing by 14% to £12.0m (2016: £10.6m). During the year, we also saw increased levels of customer engagements in areas such as "see in the dark" technologies that to date have been limited to specialist defence and security applications whereas we are now engaged with major OEM and device companies in developing InfraRed products for mass market consumer applications.

As in prior years, we delivered increased underlying profitability, earnings and cash-generation.

Whilst we anticipate that the wireless sector will remain a major part of the Group's future business, we expect significant upside potential in the medium term due to: innovation in smartphone hardware, including the wider adoptions of advanced sensor technologies such as 3D sensing; the adoption of GaN on Silicon technology for base stations; the transition to 5G communications; and the combination of silicon with compound semiconductors using cREO™ for other wireless communication chips.

### *Organisation development*

The Group continued with its Organisational Development Programme. This has involved the transfer of production between our sites to improve operational efficiency. Further operating efficiencies are expected to be achieved through merging and consolidating existing operational facilities over time. Continuous improvement is an ongoing process across IQE's global operations, with numerous programmes under way at any given time.

### *Market diversification*

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.

The business continues to focus on its six key business units with a priority on those market sectors such as photonics and power, which are already exhibiting the highest near term growth potential.

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 and to prioritise and promote the formation of technology clusters focused on compound semiconductors.

### *Realising the opportunity*

I have previously expressed my excitement about our position and the growth prospects for our industry. 2017 saw the early fruits of delivering on just one of the many opportunities for which we have been preparing. Our performance during 2017 demonstrated a successful execution of a strategy that provides solid foundation for repeated future success stories.

As a key enabler at the start of multiple, complex supply chains, IQE's products are not immediately apparent to consumers even though the devices we all depend on such as smartphones, could not work without the part that IQE plays.

It is apparent from attendance at international conferences and trade-shows that IQE is highly regarded across our industry and throughout our supply chains.

The importance of IQE's role in supply chains is evidenced by the levels of non-disclosure agreements between the company and its key suppliers and customers. IQE is seen by our customers as offering unique competitive advantage and our high regard and systems for protecting our own as well as our customers IP and other confidential information is highly respected and considered as one of our key USPs.

We have started 2018 uniquely positioned to continue to build on our successes to date to take advantage of the plethora of high-growth opportunities that lay before us and to deliver further strong results and to take advantage of new, high-growth opportunities.

I would like to thank my fellow Directors and all the management and staff of IQE for the success of the past year and their part in its achievement.

The skills, experience and talent of our people is at the very heart of our business. My sincere thanks go out for the hard work and professional expertise of the whole IQE team 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 Sir Derek Jones, who has joined our Board as a Non-Executive Director. Sir Derek's strong credentials and experience brings a new perspective.

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

***Organisation***
The Group has established six market facing Business Units within the organisation: IQE Wireless, IQE Photonics, IQE InfraRed, IQE Solar, IQE Power, and IQE CMOS++

Each Business Unit has a clear product and customer focus, but continues to benefit from the production and technology synergies of the whole Group. The emerging markets of Solar and Power are in pre-production and hence are not yet significant enough to be separated in our segmental reporting.

***Wireless***
Compound Semiconductors play an essential role in high speed wireless communication, and have been an enabling technology for mass market applications such as smartphones and wifi. IQE is the market leader with an estimated 55%-60% share of this global market. Wireless accounted for approximately 60% of IQE's wafer sales in 2017 (2016: 72%)

Following the launch of the iPhone in 2007 this market enjoyed several years of double digit organic growth, as the launch of new handsets were usually met with a "feeding frenzy" of consumers eager to secure the latest model. However, market growth has cooled since 2013 as the innovation cycle struggled to keep apace. In fact, according to industry analyst IDC, overall smartphone shipments during the year remained flat at 1.47 billion units (2016: 1.47 billion units). This represents a core and stable part of IQE's business.

Despite the lack of growth in smartphone sales, the relentless increase in data traffic continues to drive the need for more sophisticated wireless chip solutions in handsets. This is driving the market towards 5G communication, which IQE sees as a significant upside potential for its wireless business as this transition will require much more complex material technologies.

Infrastructure applications such as base stations, radar and CATV are a small but rapidly growing part of IQE's wireless segment. This is becoming an increasing important part of IQE's business as the superior performance of this CS technology continues to replace the incumbent silicon LDMOS technology. Indeed, in partnership with MACOM Technologies Inc., IQE has developed a high performance low cost solution (GaN on Silicon) to accelerate the displacement of LDMOS. Indeed, MACOM is in the process of qualifying this technology downstream, and concluded a high volume chip fabrication partnership in late 2017 in anticipation of a production ramp on completion of these qualifications.

The fastest growing segment of the wireless chip market over the past few years has been for high performance filters. Although the primary materials technology for filters (aluminium nitride, or AlN) is made from compound semiconductor elements, the wafers have been fabricated using a less sophisticated process called sputtering, reflecting that producing a more sophisticated single crystal epitaxial solution has been a significant IP challenge. IQE overcame these hurdles in late 2017, and prototyped single crystal AlN wafers. We are now engaged with multiple customers who see this advance as a potentially disruptive solution.

**Wireless continues to be a significant and stable business for the group, and is expected to grow at a rate of up to 5% in the near term. Furthermore, this division has several exciting developments which provide routes for a return to double digit growth, including:**

- Innovation in smartphone hardware, including the adoption of advanced photonics sensors;
- The adoption of GaN on Silicon technology for base stations
- The transition to 5G communications, requiring more advanced CS materials
- The adoption of high quality CS materials solutions enabled by cREO™ for wireless filters

### *Photonics*

Photonics refers to devices that emit or detect light, such as advanced laser and sensors. They enable a wide range of end markets in the communications, consumer, and industrial space. This segment accounted for 31% of IQE's wafer sales in 2017, up from 18% in 2016. This is IQE's most rapidly growing segment.

**There are two critical technologies in this segment:**

- Vertical Cavity Surface Emitting Lasers ("VCSEL") - the key enabling technology behind a number of high growth markets including 3D sensing, data communications, data centres, gesture recognition, health, cosmetics, illumination and heating applications. IQE is the market leader for outsourced VCSEL materials, which has been achieved by virtue of its technology leadership. This includes the demonstration of VCSELs with record speeds, efficiencies and temperature performance. In addition, with its 6" wafer capability IQE has been successful at enabling its customers to reduce significantly the unit cost of chips which is accelerating the adoption of this technology.
- Indium Phosphide ("InP") – this technology enables fibre to the premises ("FTTX"). The continued development of this technology to achieve higher performance at lower costs, plus the explosive growth in data traffic is leading to the extension of the fibre optic network "to the premises" – also known as "the last mile". IQE has developed advanced laser technologies with differentiated IP which underpins it high growth expectations for this business.

Photonics sales increased by 109% year-on-year, with H2 sales up more than 160% over prior year H2. This reflects a strong ramp of VCSEL's into a mass market consumer application through the second half of 2017. This was a unique achievement within the industry, as IQE leveraged its expertise of mass market supply to rapidly ramp the supply of this complex photonics material into unprecedented volumes. The supply of materials into this ramp was delivered under multiple multi-year contracts.

There is little doubt that sensing technologies, from facial recognition, to gesture recognition and LIDAR, will represent a major growth area in the near term and extending into the future. Some analysts have referred to this as the start of a "super cycle". Indeed, this is reflected in the breadth of product development programmes in which IQE is engaged, and which now span multiple Tier 1 OEM's (directly and via chip customers) who are targeting mass market ramps in 3D sensing applications over the next 12 to 18 months. However, VCSELs have many more applications beyond sensing, including fibre optics for data centres, industrial heating, and machine vision to name but a few. IQE has built a strong technical lead in this market, which combined with its unparalleled track record for mass market delivery, positions IQE well for continuing strong growth.

Whilst VCSEL has been the star of the show, our InP business continues to perform well. This market is being driven by the need for higher speed, higher capacity fibre optic systems to address continuing growth in data traffic. As a result, more sophisticated materials solutions are becoming critical to achieve higher levels of performance. To address this evolving market, IQE has developed novel technologies which enable higher performance with lower cost of manufacture. This includes an innovative solution for Distributed Feedback Lasers (DFB's) for high speed FTTX chips. We are engaged in qualifications with several customers for this technology, which are expected to ramp into production over the next 6-12 months.

The photonics business is expected to grow at a rate of 35%-60% in the near term based on products currently in production. The introduction of new technologies provide potential for higher growth rates, and therefore we will highlight new technologies as these reach commercial adoption.

### *InfraRed*

IQE is a global leader in the supply of indium antimonide and gallium antimonide wafers for advanced infrared technology, primarily "see in the dark" defence 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 has enabled the business to secure several contract wins and drive sales growth. We expect this business to continue to grow between 5%-15% with its current product range.

Beyond defence, the InfraRed division has been successful in broadening is customer engagements into product development for mass market consumer applications. Indeed, we are now engaged with major OEM and device companies in developing InfraRed products for consumer applications including sensing. This provides potential for higher growth rates, and therefore we will highlight new technologies as these reach commercial adoption.

### *Advanced Solar (CPV)*

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.

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, therefore we will highlight new technologies as these reach commercial adoption.

***Power***

Gallium Nitride on Silicon (GaN on Si) is driving a technology shift in the multi-billion dollar power switching and LED markets. IQE has continued to push the technology boundaries and is making rapid progress both technically and in developing commercial relationships in the supply chain. The power switching market alone is approximately 3-4 times the size of the current wireless PA chip market, and represents a major growth opportunity for IQE. IQE's patented technology, cREO™, provides a significant competitive advantage in this space. We will highlight new technologies as these reach commercial adoption.

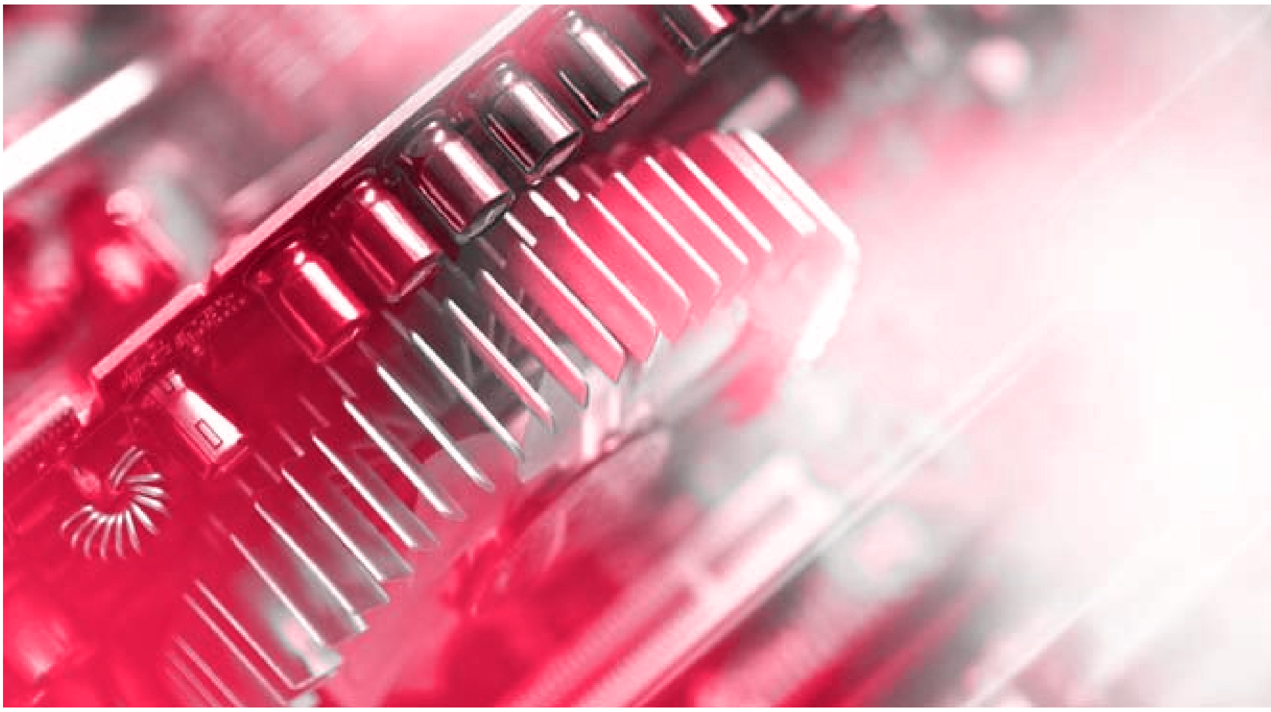
***CMOS++***

Future semiconductor technology architectures are moving strongly toward hybrid integrated chips using a combination of traditional CMOS based chips with Compound Semiconductor chips, all built on a silicon base wafer. This provides the market with the significant technical advantages of Compound Semiconductors at the cost point of silicon, and allows the CS industry to utilise the huge investment already made into large scale Silicon chip manufacturing. As a result, this greatly increases the available market for Compound Semiconductors. IQE has developed multiple routes to delivering this powerful new hybrid, and the addition of cREO™ and other IP provides unique solutions to achieving the end goal. IQE is involved in multiple programmes across the globe, which are developing the core technologies from which we expect highly significant revenue streams to emerge over the next 3-5 years.

***Competitive advantage***

IQE has built a strong leadership position in the market for CS materials. This leadership has been built around an unparalleled breadth of IP, in contrast to IQE's competitors who operate within the constraints of their narrow IP portfolios and inferior research and development capabilities. Uniquely, this makes IQE a "one stop shop" for CS materials, at a time when the market is increasingly seeking multiple material solutions to meet expanding and diverse end markets. This represents a powerful competitive advantage for IQE in a market where qualification barriers are high, and microscopic variations in wafer crystals can have dramatic adverse operational and financial implications downstream.

The operational and financial risks associated with variations between wafers creates the second layer of IQE's defensive moat. To provide context, every epitaxial tool has to be individually qualified in order to be released for production in any supply chain. This is because the complexity of the technology creates an inherent risk of microscopic variations between wafers in the same production run, as well as from run-to-run. These variations can have dramatic and costly implications downstream. Whilst there is a significant IP barrier in being able to produce these materials, there is an equally challenging IP barrier of controlling variations to be able to repeatedly and reliably produce high quality materials in high volume which enable high yields down stream. Accordingly, customers are "sticky",



which reflects why IQE had to use M&A to consolidate the wireless supply chain. Moreover, in simple terms, IQE has shipped more wafers in mass production than any other epi foundry, giving it an unparalleled pedigree in the mass market.

Finally, as the largest outsource epi foundry IQE has created a competitive advantage through specialism and scale. Achieving low cost chip production necessitates high quality wafers, because wafer defects translate into lost capacity and low yields for chip makers. As a materials specialist, IQE has developed the IP to make materials of the highest quality, and it has the accolades and market share to prove it. As the materials specialist with the largest scale it has inherent economies of scale, a feature which IQE is about to intensify with its New foundry which will house up to 100 tools. This is why the outsource model is prevalent in the more mature silicon industry, why the wireless market shifted from a horizontal to vertical model, and why the winner in the initial mass market ramp of VCSELs adopted an outsource strategy.

However, we are not resting on our laurels. IQE is leveraging the strength and depth of its IP portfolio to transition its business model from a "materials solutions company", where we develop bespoke wafer solutions to customer defined specification, to an "innovative enabler" where IQE provides innovative material solutions to chip designers, enabling them to develop new chip designs which push the boundaries of performance and reduce the barriers of cost. A couple of examples illustrate the power of this strategy:

Wireless "Front End Modules" – The Front End Module (FEM) refers to the communications module in a smartphone. It is the FEM that performs all of the wireless communications. The FEM is made up of many individual chips, which can essentially be grouped into Filters (for filtering out undesired wireless frequencies), Switches (for high speed, high efficiency switches), and Power Amplifiers (for high efficiency amplification of wireless signals). Each of these three types of chips is made from different semiconductor materials technology. The sweet spot for IQE has historically been the Power Amplifier, but it has also developed the technologies for Switches (SOI) and for Filters (AlN). Armed with its patented cREO™ technology, IQE has a clear route to combining these three material systems on a single wafer, which paves the way for the complete integration of the FEM on a single chip. This would be highly disruptive. A FEM solution on a single chip would be more efficient, with a smaller footprint at a dramatically lower cost of production.

3D sensing solutions – tear downs of the first 3D sensing solutions show a combination of technologies in a complex module: a VCSEL light source, optical components, and silicon sensing components. Again, IQE has the underlying materials technologies for these components, and the benefit of several patents including Quasi Photonic Crystals and Nanoimprint Lithography for wafer level optics. So again, with its cREO™ technology, IQE has a route to integrating these technologies on a single wafer. This would be highly disruptive as it would result in a 3D sensing solution on a single chip which would again be more efficient, with a smaller footprint at a dramatically lower cost of production.

### *Capacity expansion*

In November 2017, IQE announced the placing of 67.9 million new ordinary shares, raising gross proceeds of approximately £95 million. The fund raise was primarily to finance a capacity expansion programme to deliver the scale needed to capture multiple high growth market opportunities. Of immediate significance is the ramp in demand for VCSELs. In addition, the fund raising is enabling the acceleration of product development.

At the heart of the capacity expansion is the creation of a new foundry in Newport, South Wales. This 'Mega Foundry' will house up to 100 tools, creating a facility with unparalleled capacity and economies of scale in the industry. The first 5 tools are now in-situ and on track for production in H2 2018, a further 5 tools are scheduled for delivery in Q3. Preparation is underway to call off a further 10 tools within the next 12-18 months.

The establishment of the new foundry is being supported by the Cardiff City Region City Deal, which is funding the construction of the infrastructure. IQE is leasing the building under an 11 year lease, which has a 3 year rent free period and an option to purchase. This support has enabled IQE to focus its own investment on adding new tools, which requires upfront investment in both opex and capex. The lead time to get new tools into production is approximately 9-12 months, from which time a fully utilised tool making VCSELs has a payback of c. 1 year.

### *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 on the research pages of the IQE website at www.iqep.com.

IQE's dedicated Technology Group manages the business' impressive IP and patent portfolio.

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

During 2017 IQE hosted a number of events including VCSEL Day and a workshop on sensors, both of which attracted a wide range of industry experts from around the world.

*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.

The Open IQE programme benefits IQE by raising the company's profile throughout multiple supply chains and helps embed IQE's technology within new and emerging markets.
Further details about IQE's open innovation programme can be found on a dedicated website: www.openiqe.com

*CoInnovate*
A product of IQE's open innovation programme "CoInnovate" has become a major event in the Welsh conference calendar. The third CoInnovate conference was held in Cardiff, UK in January 2018 and attracted around 300 delegates from a mix of large businesses, SMEs and academics. The conference is organised by IQE and jointly sponsored by the Welsh Government, academic partners as well as IQE and industrial partners including Airbus, GE Healthcare and General Dynamics.

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 uniquely to capitalize on its high-growth potential over the coming years.

After a significant ramp in production during the second-half of 2017, the current financial year has started in line with expectations. The outlook for the full year is for continuing growth.  The Board anticipates that the group will continue to benefit from strong growth opportunities during this year and in future years.

# 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 model***

*Outsourcing pioneer*

The first industrial revolution ushered in an era of large, vertically integrated enterprises. During the middle of the 20th century, process specialisation became a major competitive advantage and saw the introduction of outsourcing.

New industry sectors may adopt vertically integrated business models out of necessity, but as those industries mature, specialisation becomes a key strategic advantage.

*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 the silicon chip industry matured, the sector 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 thirty 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. As the world's leading outsource supplier of compound semiconductor wafer products and services, IQE offers its customers:

*A 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 and will become even more significant as we transition from a "materials solutions company", in to an "innovative enabler."

*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 markets: Wireless, Photonics, Infrared and CMOS++; and its emerging markets: Solar and Power.

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*
Whilst wireless sales remained broadly flat year-on-year, the sector accounted for 60% of the Group's sales in 2017, down from 69% in 2016 primarily due to the rapid growth in photonics. The wireless market covers electronic radio-frequency (RF) devices that enable wireless communications. Our markets include, but are not limited to, mobile communications (smartphones), base stations, mobile networks, WiFi, smart metering, satellite navigation, and a plethora of other connected devices.

*Photonics*
The proportion of sales generated from photonics products rapidly accelerated during the second-half of 2017, accounting for 31% of the Group's wafer sales in 2017, up from 18% in 2016.

**The photonics market covers applications that either emit or detect light. We segment the photonics market into:**

- Emitters and detectors
- Solar (CPV)
- Lighting

Emitters include laser and LED based devices that emit light. Lasers broadly further sub-divide into edge emitters and surface emitters.

Edge-emitting lasers represent the base technology that has been traditionally used in applications such as optical communications and CD/DVD storage devices.

Surface emitting lasers are highly complex epitaxial structures that allow light to be emitted vertically rather than horizontally. IQE has been highly active in the development and commercialisation of the vertical cavity surface emitting laser (VCSEL) and enjoys a unique world-leading position in this technology that is a key enabler in new and emerging markets such as 3D sensing and LIDAR for autonomous vehicles.

*Infrared*
Infrared sales accounted for 8% of the Group's sales in 2017, approximately the same proportion as 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, IQE is actively engaged with tier 1 OEMs working on major new opportunities to migrate infrared "see in the dark" technologies into consumer markets.

*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.

IQE has developed multiple routes to delivering this powerful new hybrid technology with the addition of cREO™ and other IP and the Group is involved in multiple programmes across the globe, which are developing the core technologies from which we expect highly significant revenue streams to emerge over the next 3-5 years.

*License Income*

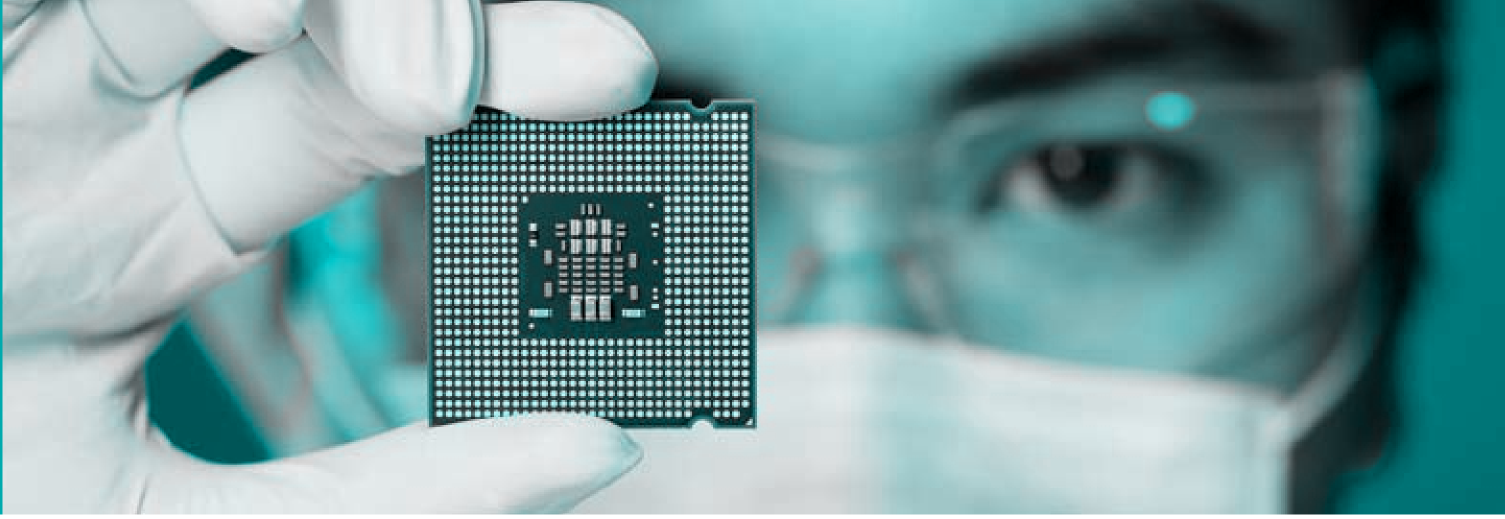
License income, which represented 1% (2016: 5%) of revenues reduced from £6.7m to £1.9m as expected, reflecting that 2016 included a significant portion of up front license fees.

With the roots of our IP in trade secrets, we inevitably initially monetised our IP through wafer sales. However, we made no secret of our strategy to build an increasingly diverse IP portfolio, which, over time would naturally lead to the commercialisation of our IP through new channels, including licensing. Initially realising license income through JV's, we see many opportunities to expand our model to third party license streams over the next few years, and in due course for this to represent a major part of our business.

Our progress in executing this strategy is clear. From only a handful of patents 10 years ago, we have successfully built a portfolio of advanced materials IP which sets us apart in our industry. Today, we have the benefit of over 180 patents, which we will continue to develop and expand both organically and inorganically. Indeed, we have created a virtuous circle with the critical mass for this model to be self-fulfilling and sustaining: we attract the best talent in our industry, which, combined with the best routes to commercialisation attracts the best technology development partners, and so the cycle continues. Add to this the progress being made by our JV's, and the power of the CS Cluster that is gathering momentum, and you begin to see how we are bringing our vision to life.

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 39 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".

*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.

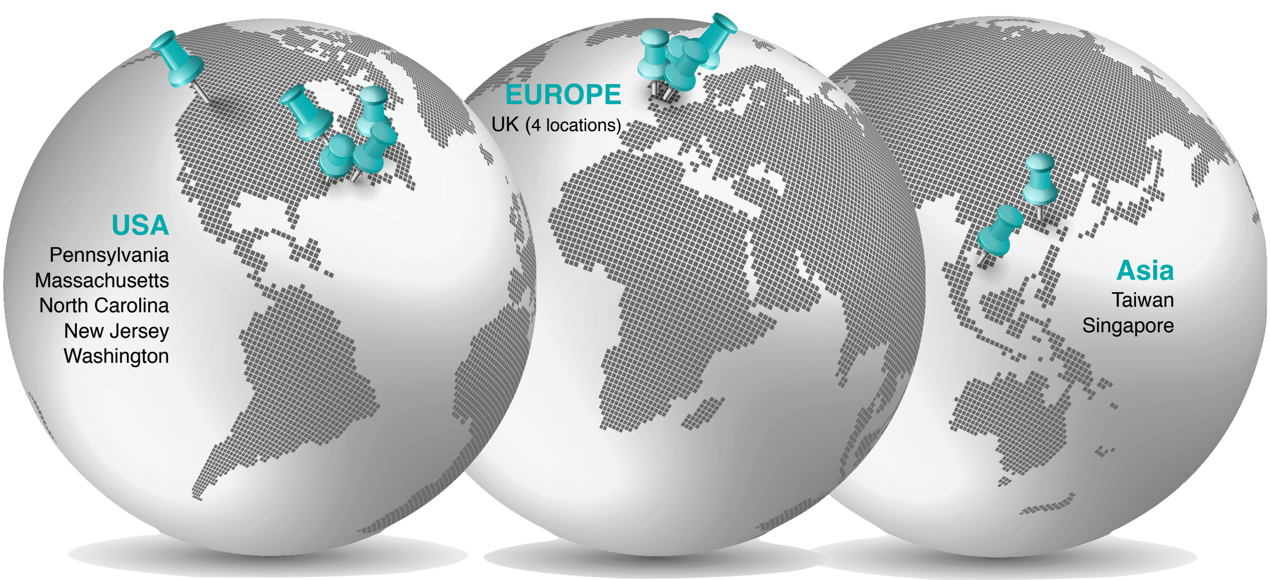
We have established a global manufacturing platform and a breadth of IP and know how relating to the design and manufacture of advanced materials that is second to none. We have been unwavering in our vision and have developed a robust strategy which gives us confidence over the growth prospects of the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

Technology leadership through IP has always been at the heart of IQE's strategy. Indeed, as a pioneer of CS technology over the past 30 years, IQE has built an enviable global reputation in the industry for the breadth and depth of its materials technologies and capabilities. It's clear from IQE's many engagements with leading universities, start-ups, leading chip makers and established global electronics giants, that IQE has succeeded in establishing itself as the 'go to' place for advanced materials, supporting its customers from research and development through to high-volume manufacturing. The growing strength of IQE's IP is reflected in how its relationships within the supply chain have evolved. Historically, IQE was only engaged by the chip makers, whereas it now regularly engages directly with a number of Tier 1 OEMs.

It is well understood 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 ventures in the UK and Singapore, and its highly successful Open Innovation Programme (openiqe.com). Moreover, IQE has been at the heart of creating the CS Cluster in South Wales, which is the first of its kind globally. This new cluster is accelerating research into novel technologies, product development and innovation. The CS cluster, which is branded as CSconnected, follows considerable high-level thinking across government, industry and academia, as well as significant private and public sector investment to establish top-class facilities and infrastructure to support activities along the technology development chain from blue-sky research to high-volume production.

The journey started in 2015, when Cardiff University announced an investment of around £75 million in the Institute of Compound Semiconductors (ICS). The announcement was followed by a £24 million joint venture between IQE Plc and Cardiff University to form the Compound Semiconductor Centre (CSC), allowing businesses and academics to demonstrate production-ready CS materials reducing time-to-market and cost. The facilities at the CSC are being complemented by new materials research, fabrication and testing at the ICS.

2016 saw the announcement by Innovate UK of a £50 million investment to establish the Compound Semiconductor Applications Catapult (CSAC), located in South East Wales; a world-class, open-access R&D facility to support businesses across the UK in exploiting novel CS technologies in key application areas.

In addition to IQE, other organisations in the region include Newport Wafer Fab (an open access chip foundry), and SPTS (Orbotech) who design, manufacture and support a range of wafer processing tools for the semiconductor and microelectronics industries. Downstream capabilities include Microsemi's Advanced Packaging business, delivering novel solutions for miniaturised electronic circuits with wireless connectivity.

High-volume manufacturing is also certainly on the agenda for the cluster; in September 2017, IQE, Welsh and UK Governments and the Cardiff Capital Region City Deal ratified the development of the Compound Semiconductor Foundry in an historic signing ceremony.

The signing followed an agreement in May 2017 by the Cardiff Capital Region (CCR) Regional Cabinet to contribute £37.9 million from the CCR City Deal's Wider Investment Fund towards the establishment of a state-of-the-art foundry for high-end production of compound semiconductors. The CCR City Deal seeks to position the region as the global leader in CS-enabled applications, which was initiated by a £12 million investment from the Welsh Government.

In addition, Cardiff University was awarded £10 million by the Engineering and Physical Sciences Research Council (EPSRC) to lead the EPSRC Manufacturing Hub in Future Compound Semiconductors that will combine and connect the UK research excellence in compound semiconductors, with translational facilities at the new CSAC Catapult to provide a pathway from research through to device and application testing and qualification.

A number of projects are already underway within the CSconnected cluster, such as improving VCSEL manufacturing efficiencies, nanoimprint lithography for laser diodes and enabling miniaturised atomic clocks using VCSEL pump sources, with both the latter projects worth over £1m.

The collaborative environment fosters strong working relationships to encourage sharing of knowledge and ideas. The organisations involved are enthusiastic about the future. CSconnected is open for business.

In addition to generating new IP through collaborative partnership, IQE continues to build on its already broad IP portfolio in areas such as cREO™, whilst also acquiring strategic IP such as the purchase and assignment of a portfolio of patents relating to Quasi Photonic Crystal technologies from the Taiwan based Luxtaltek Corporation announced in December 2017.



# CSR, health, safety and environmental

***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 continuously 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.

### *Data protection*
Closely linked to our policies on confidentiality is the way that we treat personal data. IQE complies with the requirements of data protection legislation and is undertaking a range of activities including group-wide training, data audits and risk assessments, to ensure full compliance with the new General Data Protection Regulations (GDPR) that come into force on 25 May 2018.

### *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 that 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 2017, across the group, 103 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 within 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 that 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.

### *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.  US – "Toys for Tots" toy drive (donating 8 boxes of toys) and a US Food Drive (collecting over 800 lbs of food!).

### *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 "Business in the Community (BITC)" Programme comprising a number of schools and businesses in a partnership cluster to form strong links between schools and local businesses. BITC activities include workshops and competitions with science and technology based themes as well as other business related sessions ranging from interview techniques to marketing and social media awareness.

### *Cluster activities*

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

The UK, and in particular, Wales, is home to a growing number of organisations and businesses that are active in the increasingly important compound semiconductor industry sector.

The World's first cluster on CS technologies and applications, established here in the UK, will accelerate research into novel technologies, product development and innovation. CSconnected is the brand name for the emerging compound semiconductor cluster that follows considerable high-level thinking across government, industry and academia, as well as significant investment to establish top-class facilities and infrastructure to support activities along Technology Readiness Level scale.

In 2015, Cardiff University announced the establishment of the Institute of Compound Semiconductors (ICS) followed by the announcement of a joint venture between IQE Plc and Cardiff University to form the Compound Semiconductor Centre (CSC), allowing businesses and academics to demonstrate production-ready CS materials reducing time-to-market. The facilities at the CSC will be complemented by new materials research, fabrication and testing at the ICS.

2016 saw the £50 million investment by Innovate UK to establish the Compound Semiconductor Applications (CSA) Catapult, located in South East Wales; a world-class, open-access R&D facility to support businesses across the UK in exploiting novel CS technologies in key application areas.

Cardiff University was awarded £10 million by the Engineering and Physical Sciences Research Council (EPSRC) to lead the EPSRC Manufacturing Hub in Future Compound Semiconductors that will combine and connect the UK research excellence in compound semiconductors, with translational facilities at the new CSA Catapult to provide a pathway from research through to device and application testing and qualification.

Other organisations in the region include IQE Plc, a leading provider of CS wafers and SPTS, a company that designs, manufactures and supports a range of wafer processing tools for the semiconductor and microelectronics industries. Downstream capabilities include Newport Wafer Fab Ltd., the UK's largest chip foundry and Microsemi's Advanced Packaging business, delivering novel solutions for miniaturised electronic circuits with wireless connectivity.

A number of projects are already underway within CSconnected, such as improving VCSEL manufacturing efficiencies, nanoimprint lithography for laser diodes and enabling miniaturised atomic clocks using VCSEL pump sources, with both the latter projects worth over £1m.

The collaborative environment fosters strong working relationships to encourage sharing of knowledge and ideas. The organisations involved are enthusiastic about the future and CSconnected is open for business.

All in all, the region is gaining global recognition as being a highly active, global centre in the field of compound semiconductors.

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

### *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 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. 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 that 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 a detailed ongoing continued professional development plan including training and accreditation of competent persons – in the form of Regional EHS Managers. Such appointments provide for high-level advisory roles, identification of global best-practice and adoption of strategic EHS initiatives for all applicable legislative requirements wherever the Group operates.

In addition, by appointing Group-wide safety coordinators, site-specific roles are designed to implement those best-practices identified from strategic initiatives in order to; minimise risks of injury at work; ensure legislative compliance and; assist in creating and monitoring safety practices. Further designation of safety advisors, with the appropriate expertise to support in specific areas of activity such as Local Exhaust Ventilation (LEV) and pressure systems is also implemented at site level.

The EHS group continues to be actively involved in industry-wide initiatives, working with industry associations and proactively registering under regulatory directives such as REACH and GHS-based Hazard Communication. The group also monitors global chemical control activities (e.g. RoHS, TSCA) to ensure continued customer confidence and supply-chain compliance.

### *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, managed by coordinators, are fed into general site management for effective control. Regular analysis and discussion is an agenda item at site periodic management meetings. Coordinators prepare regular site performance metrics for dissemination to Group-level.

EHS Regional Managers oversee site trend analyses 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 Statistical averages.

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

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 EHS Report to the Board.

### *The Environment*

IQE is committed to protecting local and global environments and endeavours to ensure that our activities and manufacturing operations are conducted in an environmentally responsible manner.

We are committed to minimising the environmental impact of our operations by encouraging all employees to promote and adopt 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's policy for conducting business in an environmentally responsible manner states that we "will ensure that:**

- 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".

### *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, and
- Providing evidence of continual improvement of environmental management

By the end of 2017, all IQE's continuously operating facilities had successfully completed independent third party audits of our compliance with ISO 14001:2015, the new revised standard. These audits were very successful with no material deficiencies recorded.

All our plants therefore, clearly demonstrate the commitment to environmental compliance, reducing waste, recycling materials, energy conservation and risk management where appropriate, complementary to our commercial objectives of reducing costs and improving operational efficiency.

***Environmental Legislation Compliance***

Compliance with environmental legislation is critical to our global businesses and is assured through the employment of appropriately qualified and competent managers, reporting through to the Chief Operating Officer. These managers have access to third party professional advisors as required.

IQE maintains membership of a number of professional bodies, which provide a good source of reference and support, enabling it to keep up-to-date with 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, relating to the disclosure of greenhouse gas emissions and other environmental matters, does not apply to IQE.

***Environmental Performance 2017***

IQE closely monitors environmental compliance. In 2017, we experienced no external environmental incidents or compliance concerns at any of our locations.

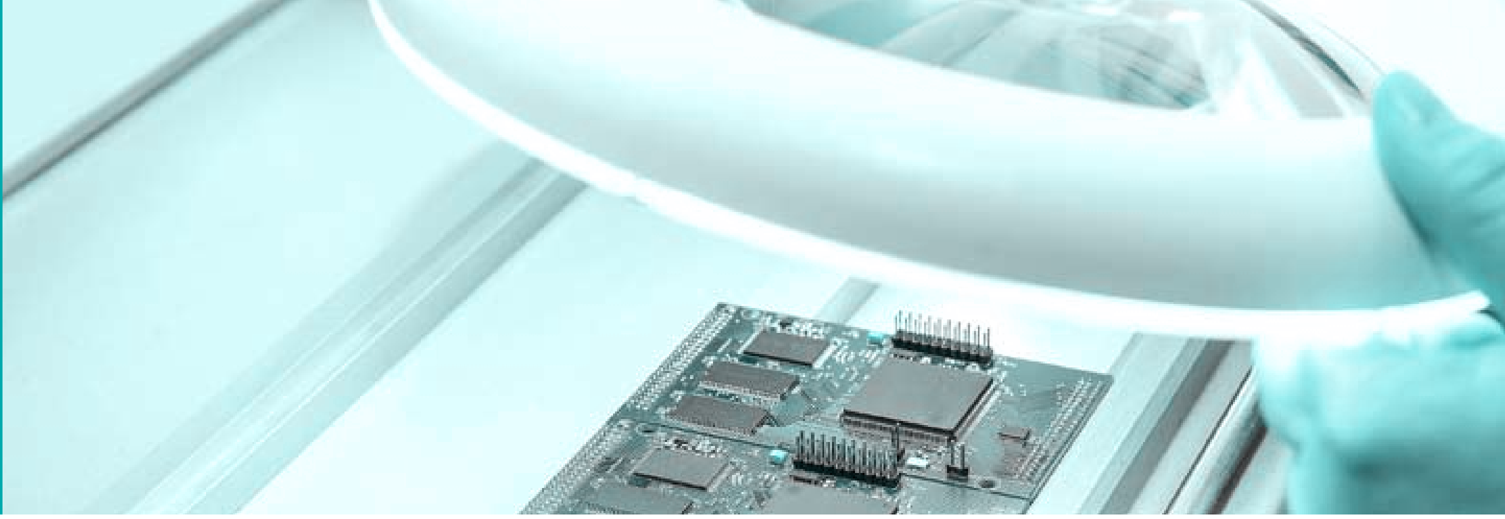
***Recycling and Energy Conservation***

At each of our global sites, we operate continuous improvement programmes to reduce waste and to 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 safely exists. IQE also closely monitors 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.

***Risk Management***

IQE employs risk management techniques to identify, evaluate and prioritize Health, Safety & Environmental risks followed by application of resources to minimize, monitor, and control the probability or impact of unfortunate events. IQE's risks may be inherent to the business or come from a variety of sources including engineering or administrative control failures, accidents, incidents and/or natural causes.

IQE has performed risk management evaluations at its sites and identified the highest potential risks and opportunities. A summary of the mitigation, likelihood and impact of the risks identified is included on pages 28 to 35.



# 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.

**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;
- setting the overall policies for risk management and control;
- ensuring that the above are communicated effectively across the business.

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; and
- 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 below are listed in order of severity. Mitigation, where possible, is described next to each identified risk area.

## Principal Risk: COMPETITION

| Business Risk | Mitigation: | Year on year change in likelihood: |
|---|---|---|
| Loss of share with a significant customer<br><br>Price erosion due to predatory pricing from a competitor | Focus on quality, value and customer service.<br><br>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.<br><br>Continue to invest in product development to ensure competitive advantage.<br><br>Qualification timescales can be long but once a product and relationship is established, it creates significant barriers to entry for competitors.<br><br>In some cases, customers seek second source supply arrangements to meet their own business continuity planning policies, but our multiple site capabilities provide some mitigation against this risk.<br><br>Contractual commitments from customers. | Decreased<br><br>**Potential impact:**<br><br>High<br><br>**Effect:**<br><br>Sales volumes and profitability |

## Principal Risk: TECHNOLOGICAL CHANGE

| Business Risk | Mitigation: | Year on year change in likelihood: |
|---|---|---|
| A disruptive technological change has not been anticipated as a result of a lack of investment in new products and materials<br><br>We do not adequately identify and protect our IP | IQE actively engages with customers, educational institutions and government agencies on a range of research and development ("R&D") programmes.<br><br>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". | Unchanged<br><br>**Potential impact:**<br><br>High<br><br>**Effect:**<br><br>Sales volumes and profitability |

## Principal Risk: HEALTH, SAFETY AND ENVIRONMENT

| Business Risk | Mitigation: | Year on year change in likelihood: |
|---|---|---|
| Gas release to atmosphere<br><br>Loss of ISO14001 registration at a production facility | IQE operates in a COMAH and PPC Regulated environment and employs the highest levels of technical and engineering control measures to prevent and reduce the possibility of a failure event occurring.<br><br>Only trained and competent persons are permitted to work with potentially harmful materials.<br><br>Highly qualified environmental professionals operating within the organisation are trained and certified to Lead Auditor Standard by BSI.<br><br>We continuously audit and monitor environmental performance and management systems, driving continuous improvement across all facilities by sharing best practice. EMS systems at all sites are externally assessed by BSI/BV – up to twice annually. | Unchanged<br><br>**Potential impact:**<br><br>High<br><br>**Effect:**<br><br>Reputational damage, costs, sales and profitability |

## Principal Risk: HUMAN RESOURCING

| Business Risk | Mitigation: | Year on year change in likelihood: |
|---|---|---|
| Loss of key people and critical skills<br><br>Insufficient skilled employees<br><br>Poor engagement and morale | As IQE continues to develop its new manufacturing site in Newport, South Wales, the demand for human resourcing naturally increases, which in turn, increases the overall risk to the Group.  However, the risk is mitigated through effective recruitment planning.<br><br>Retention and development of its workforce is also critical to the long-term success of the Group.<br><br>IQE's people are the heart of the business.  In order to promote the development and retention of its staff, IQE offers career progression, personal development and a range of benefits and incentives. This is reflected in low staff turnover, with many employees who have been with the company since it was formed almost thirty years ago.<br><br>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. | Increased<br><br>**Potential impact:**<br><br>Medium<br><br>**Effect:**<br><br>Quality issues and increased cost |

## 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 including for natural catastrophe despite the availability of natural catastrophe cover in the insurance market reducing during 2017.

Contracts entered into by IQE, including those for the supply of epiwafers to customers provide relief from IQE's obligations to perform during Force Majeure events.

Data is appropriately stored and backed-up with IT system recovery plans in place.

**Year on year change in likelihood:**

Unchanged

**Potential impact:**

Medium/High

**Effect:**

Costs, sales 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 the forecasts, appropriate funding and liquidity solutions are put in place to ensure that appropriate headroom is maintained.

At the year-end 31 December 2017 we had net funds of £45.6M.

**Year on year change in likelihood:**

Decreased

**Potential impact:**

Medium/Low

**Effect:**

Financial loss and reputational damage

## Principal Risk: BUSINESS INTERRUPTION – SUPPLY CHAIN

| Business Risk | Mitigation: | Year on year change in likelihood: |
|---|---|---|
| Dependency on sole supplier<br><br>Availability of qualified raw materials | The raw materials that sustain IQE's products are not scarce resources.<br><br>Active programme to maintain cross qualified second sources.<br><br>Rigorous supplier quality management processes.<br><br>Maintain close relationships with its key suppliers in order to keep well informed about potential supply issues. | Unchanged<br><br>**Potential impact:**<br><br>Medium<br><br>**Effect:**<br><br>Quality issues, costs, sales volumes and profitability |

## Principal Risk: CUSTOMER CONCENTRATION

| Business Risk | Mitigation: | Year on year change in likelihood: |
|---|---|---|
| Dependency on low number of customers could result in significant impact from a loss of share from a customer.<br><br>The group has three customers that individually account for more than 10% of the group sales.<br><br>(2016: two customers more than 10%) | IQE has a diverse portfolio of intellectual property and is in product development and qualifications across many different end markets, which is evident from the continuing diversification of IQE's revenues. The group made great progress in diversifying revenues in 2017 with the adoption of its VCSEL technology in the mass market.<br><br>As an epitaxial wafer supplier with a bespoke offering for each customer we pursue a diversification strategy to become embedded in as many volume supply chains as possible, sometimes into the same end customer but also across competing end products. This provides a hedge against allocation decisions and the competitive landscape in the end market<br><br>The wireless sector, which accounted for 60% of IQE's revenues in 2017 is highly concentrated with the top 5 RF Chip companies accounting for the vast majority of the wireless market.<br><br>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.<br><br>The customer qualification times and high quality standards creates significant barriers to entry for competitors.<br><br>Maintain and advance our technological advantage to deliver value and retain a competitive position.<br><br>Focus on quality, value and customer service. | Reduced<br><br>**Potential impact:**<br><br>Medium/Low<br><br>**Effect:**<br><br>Costs, sales and profitability |

## Principal Risk: LEGAL COMPLIANCE

| Business Risk | Mitigation: | Year on year change in likelihood: |
|---|---|---|
| Failure to comply with applicable laws and regulations such as those concerning export control, anti- bribery & corruption and data protection as well as employment and company law. | Regular reporting of export and ITAR compliance and detailed internal control processes and procedures.<br><br>Continuing education of the team on the legislative developments and requirements.<br><br>Internal reviews and external audits. | Unchanged<br><br>**Potential impact:**<br><br>Medium/Low<br><br>**Effect:**<br><br>Financial loss and reputational damage |

## Principal Risk: LOSS OF INTELLECTUAL PROPERTY

| Business Risk | Mitigation: | Year on year change in likelihood: |
|---|---|---|
| Infringement of IQE patents by third parties<br><br>Loss of trade secrets to third parties<br><br>Claims alleging IQE has breached third party intellectual property rights | As IQE has increased its IP portfolio during the year, this has naturally increased the aggregate risk, however, the risk in respect of each element of IP has not increased and is mitigated as follows.<br><br>IQE protects its technology by strategically patenting in key areas.<br><br>Policies and procedures that ensure contractual non-disclosure and confidentiality obligations are agreed with third parties including employees, vendors, and customers.<br><br>Routine searching of worldwide patent databases in relevant areas of technology in order to identify and assess possible infringement of IQE intellectual property. | Increased<br><br>**Potential impact:**<br><br>Medium/Low<br><br>**Effect:**<br><br>Costs, sales and profitability |

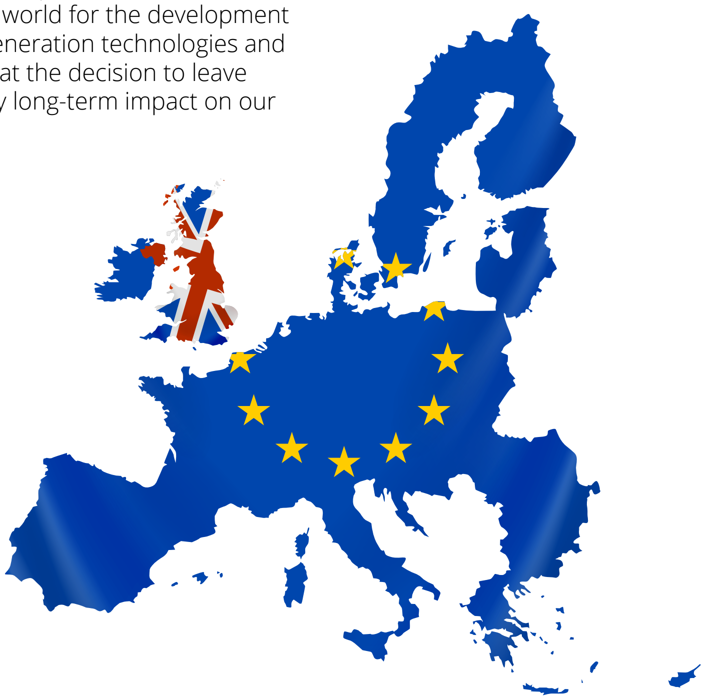
| Principal Risk: INFORMATION TECHNOLOGY FAILURE | | |
|---|---|---|
| **Business Risk**<br><br>Loss of information<br><br>Failure of equipment | **Mitigation:**<br><br>Information and cyber security mitigation plans in place to protect our information assets.<br><br>All IQE personnel are required to complete a rolling programme of training modules concerning information security. IQE monitors and acts upon the completion and assessment metrics for such training.<br><br>A risk framework with plans for the management, mitigation and resolution of device failures are in place.<br><br>Hardware and software systems have in-built resiliency including redundant elements.<br><br>Data is appropriately stored and backed-up with IT system recovery plans in place. | **Year on year change in likelihood:**<br><br>Unchanged<br><br>»<br><br>**Potential impact:**<br><br>Medium<br><br>**Effect:**<br><br>Costs, sales, profitability and reputational damage |

| Principal Risk: TAX LIABILITY | | |
|---|---|---|
| **Business Risk**<br><br>The business is found to be liable to pay sums to tax authorities, which had not been previously anticipated.<br><br>Failure to comply with tax regulations<br><br>Failure to operate in a tax efficient manner. | **Mitigation:**<br><br>The group has historically used independent tax specialists on an ad hoc basis as needed. This has included small, mid-tier and global providers as deemed most cost effective in the circumstances.<br><br>As reported, a material tax exposure was identified in October 2017 relating to a transaction in 2013 where local and a mid-tier firm provided tax structuring advice.<br><br>To assess if there were any other significant tax exposures, the group engaged independent tax advisors to assess the risk of unidentified tax exposures. Where the risk of potential tax exposures were identified, the group engaged independent global tax specialists to assist detailed assessment and quantification of these potential exposures.<br><br>These reviews did not identify any further material tax liabilities. The group is also engaging global independent tax specialists on a proactive and ongoing basis to manage tax compliance and tax strategy. | **Year on year change in likelihood:**<br><br>Unchanged<br><br>»<br><br>**Potential impact:**<br><br>Medium/Low<br><br>**Effect:**<br><br>Financial loss and reputational damage |

***Brexit***

As previously stated ahead of the 23 June 2016 referendum on whether the UK should remain in the European Union, the management team has not changed in its view that the intention for the UK to leave the European Union (commonly referred to as 'Brexit') will have no significant impact on IQE's business. The Group operates and trades globally, with Asia and the USA forming the Group's dominant markets.

There is some uncertainty regarding the availability of EU funding for new research and development proposals involving UK organisations and this uncertainty may continue until the Brexit negotiations between the EU and the UK government are concluded. However, IQE is actively engaged on a number of collaborative activities in areas of research and development including gallium nitride (GaN) and other advanced materials as well as emerging technologies such as graphene. IQE has established trading, development partnerships and grant funding from across all territories in which it operates. Whilst continued membership of the EU would have offered a great deal of upside potential for collaboration across member states, IQE's strength in its market sector means that such collaborations will continue despite likely changes in any government funding mechanisms. Innovation and collaboration are vital components in developing advanced capabilities and technology leadership. IQE has a long history of engagement with other industrial partners, academia and government agencies across the world for the development and commercialisation of next generation technologies and there is no reason to consider that the decision to leave the European Union will have any long-term impact on our business opportunities.



# Financial review

In addition to reporting GAAP profit measures, the Group also provides additional non-GAAP profit measures. Full details of these adjusted measures are provided in note 5. In addition, the prior year financial results have been restated, as detailed in note 2.

Consolidated revenues were up 16% to £154.5m. Wafer sales, which represented 99% (2016: 95%) of revenues, were up 21% (2016: up 19%) reflecting continuing organic growth. License income, which represented 1% (2016: 5%) of revenues reduced from £6.7m to £1.9m as expected, reflecting that 2016 included a significant portion of up front license fees. Growth in underlying demand was accompanied by a currency tailwind of c. 5% (2016: c. 11%). This similarly affects costs, which are also largely denominated in foreign currency.

The growth in wafer sales was largely driven by photonics, where sales were up 109% to £47.6m. This was primarily driven by the adoption of IQE's VCSEL technology in a mass market consumer application which ramped strongly in H2. Indeed, photonics sales in H2 were up more than 160% over H2 2016. InfraRed sales also enjoyed double digit growth, with sales up 14% to £12.0m. Wireless sales were broadly flat at £91.6m (2016: £91.3m), affected by a £3m managed reduction of SMI inventories to focus capacity on the ramp in photonics. The SMI inventories are expected to replenish in 2018. Finally CMOS++ sales were flat at £1.4m (2016: £1.4m).

As a consequence of these growth rates, wafer sales continued to diversify, with wireless accounting for 60% (2016: 72%), photonics 31% (2016 : 18%), InfraRed 8% (2016: 8%), and CMOS++ 1% (2016:1 %).

Gross profit increased from £34.2m to £38.6m. Excluding license income, which has a 100% margin, the gross margin on wafer sales increased from 21.8% to 24.1%. Adjusted gross margin, which excludes the charge for share based payments, increased from £36.4m to £43.6m, reflecting an improvement in the adjusted gross margin on wafer sales from 23.6% to 27.4%. This improvement in margins primarily reflects the benefit of a favourable sales mix with a greater proportion of higher margin photonics sales in 2017 over 2016.

As expected, other income reduced from £2.3m in 2016 to £nil. The gain in 2016 related to the release of the remaining balance of contingent deferred consideration relating to a previous acquisition. This gain did not relate to underlying trade and hence was excluded from adjusted earnings in 2016.

Selling, general and administrative ("SG&A") expenses increased from £16.6m to £21.6m. Adjusted SG&A, which excludes charges for share based payments, the amortisation of acquired intangibles, and non-cash rent increased from £14.2m to £17.3m. In addition to investing for growth, the increase includes the impact of inflation, foreign exchange, and an increase in amortisation.

Operating profit decreased from £19.8m to £17.0m, reflecting the adjustments noted above, whilst adjusted operating profit increased from £22.1m to £26.4m. The increase in adjusted profits reflect a 58% increase in wafer related profits from £15.5m to £24.5m partially offset by the £4.8m reduction in license income.

The segmental analysis in note 4, reflects the adjusted operating margins for the primary segments (before central corporate support costs): Wireless ~15%, Photonics ~38% and InfraRed ~27%. In the current environment we believe that these represent sustainable margins, and hences provide the opportunity for future margin expansion through continuing diversification of revenues. Central corporate support costs are expected to grow approximately 5-10% reflecting a combination of inflation and business growth.

Finance costs increased from £1.5m to £2.1m. Adjusted finance costs, which exclude imputed interest associated with the discounting, increased from £1.5m to £2.0m. This underlying increase in cash interest reflects an increase in borrowings to finance capacity expansion and the impact of foreign exchange. The borrowings were repaid in full prior to year end from the proceeds of the equity fund raising.

The charge for taxation increased from £0.3m to £0.4m. Adjusted tax, which excludes the tax affect associated with the non-GAAP adjustments, was a credit of £0.5m (2016 : credit £0.1m), reflecting the benefit of deferred tax assets recognised less taxes paid relating to 2017. The cash payment of taxes increased from £0.8m to £5.8m due to the settlement of US taxes relating to prior years as detailed in note 2. Cash taxes are expected to remain at approximately £1m to £2m for the near future, whilst the effective rate is expected to be approximately 15% to 20% reflecting the deferred tax charge associated with the utilisation of tax losses.

Cash invested decreased from £30.3m in 2016 to £28.2m in 2017. The reduction reflects that in 2016 the group made the final payment of deferred consideration (£11.3m) in respect of the Kopin acquisition. Excluding this, the group increased its investment from £19.1m to £28.2m, namely: capital expenditure up £0.3m to £11.3m; investment in product development up £8.2m to £14.5m; and investment in intangible assets up £0.6m to £2.4m.
The capital expenditure of £11.3m reflects cash paid

directly to equipment suppliers. In addition, the group financed £6.6m of capital expenditure via finance lease where the bank settled the purchase cost directly with the equipment suppliers. This finance lease was settled prior to the year end (and title to the equipment passed to the group), and hence the cash flow is classified as part of the repayment of borrowings. Aggregating these amounts, the total cash invested in equipment was £17.9m.

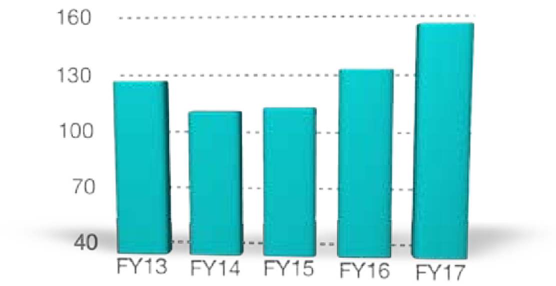
The group increased its investment in product development from £6.3m to £14.5m. IQE is developing products to address a wide range of end market applications within its business segments. Although there are "families" of products such as VCSEL's, EEL's, and HBT's, each product is developed bespoke to the customers' individual specification. IQE does not produce any commodity or "off the shelf" products. The year on year increase in investment, was largely due to the development of the VCSEL technology which ramped into mass market through H2.

The investment in intangible assets includes the purchase of patents from third parties, the cost of patenting internally generated IP, and software. The year on year increase includes the purchase of a portfolio of 54 patents relating to Quasi Photonics Crystals reported in December 2017.

In November 2017, the group issued 67.9 million new ordinary shares, raising gross proceeds of approximately £95 million. This fund raise was primarily to finance a capacity expansion programme to deliver the scale needed to capture multiple high growth market opportunities, and in particular the continuing increase in demand for VCSELs. In addition, the fund raising is enabling the acceleration of product development. Part of the proceeds from the share issue was applied to repay outstanding borrowings in order to save interest charges.

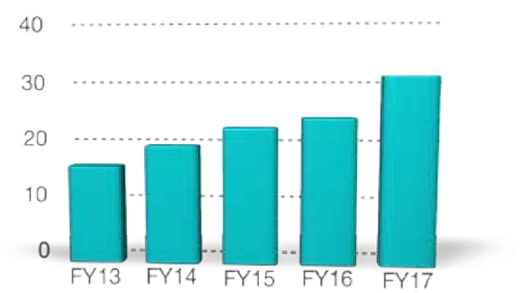
# KPIs (dash-board)

**Sales (£M)**



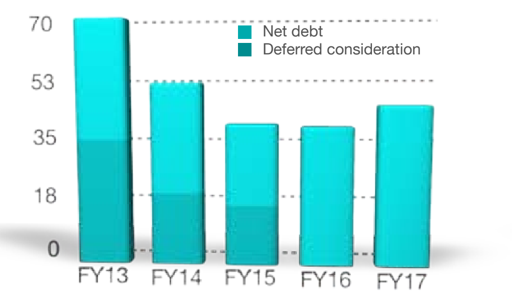

**Operating profit (£M)**
(before exceptional items)


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

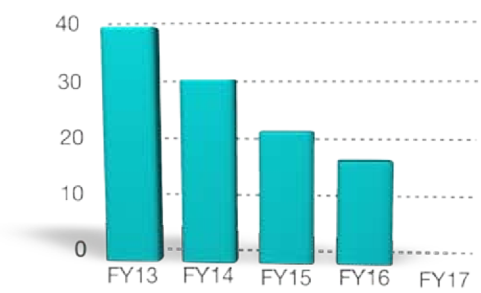



**FD EPS (pence)**
(before exceptional items)


**Leverage (£M)**




**Gearing (%)**




# 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 2017, 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 55 to 70.

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***

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, Mr Phil Smith and Sir Derek Jones who have each 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 Board considers that throughout 2017, 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 2017. However, a formal review is scheduled for 2018.

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 2017 financial year and accords with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

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

Sir David Grant is Chairman of the Remuneration Committee and the Nominations Committee. There have been two changes to the membership of the Board during the year. Prof Simon Gibson retired from the board on 13 June 2017 and Sir Derek Jones joined the board on 29 November 2017.

The Senior Independent Director, Mr Phil Smith, 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 72 and 73. These show the range of business and financial experience upon which the Board is able to call.

The Board's 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 recognises 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 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,
- financial issues, including changes in accounting policy, the approval of dividends, bank facilities and guarantees, and
- 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, Mr Phil Smith, Sir Derek Jones 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 the four non-executive directors. Mr Phil Smith and Sir Derek Jones joined the Committee at the beginning of 2018. Sir David Grant is 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.

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*

The Nominations Committee consists of the four non-executive Directors and is chaired by Sir David Grant. Mr Phil Smith and Sir Derek Jones joined the Committee at the beginning of 2018.

The Board has delegated responsibility for nominations to this Committee. The Nominations Committee has specific terms of reference, which deal with its authority and responsibilities and these are available for inspection from the Company Secretary or at www.iqep.com. The activities of the Nominations Committee have been set out in the Nominations Committee Report on pages 46 and 47.

### *Attendance at meetings*

The number of meetings held during 2017 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 | Nominations Committee |
|---|---|---|---|---|
| **Number of meetings in 2017** | 11* | 5 | 3 | 5 |
| **Attendance** | | | | |
| **Executive** | | | | |
| **Dr A W Nelson** | 9 | N/A | N/A | N/A |
| **Mr P J Rasmussen** | 11 | N/A | N/A | N/A |
| **Dr H R Williams** | 11 | N/A | N/A | N/A |
| **Non-executive** | | | | |
| **Dr G H H Ainsworth** | 10 | 5 | 3 | 5 |
| **Sir D Grant** | 9 | 5 | 3 | 5 |
| **Mr P Smith** | 11 | 5 | N/A | N/A |
| **Prof S J Gibson**** | 3 | 2 | N/A | N/A |
| **Sir D Jones***** | 2 | 1 | N/A | N/A |

* Two of the meetings were called at short notice such that they were quorate, but not all directors were available to attend. As appropriate, Directors that are unavailable to attend a meeting are consulted and their views are made known in advance or at the meeting.  Such directors receive a briefing on matters discussed as soon as possible following the meeting.

** Prof S J Gibson retired from the Board on 13 June 2017

*** Sir D Jones joined the Board on 29 November 2017

### *Shareholder Relations*

The Board regard regular communications with shareholders as one of its key responsibilities. During 2017, the Chief Executive Officer and Chief Financial Officer met with institutional investors on a regular basis to discuss the Group's performance, the shareholders' 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 2017, they met with several major institutional shareholders, 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 annual 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 page 47, 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 29 to 35.

***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 2017. However, a formal review is scheduled for 2018.

***Going concern***
After making enquiries and considering the available resources, the financial forecast together with available cash and committed borrowing facilities, the Directors 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 2020, 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 2020 is an appropriate period over which to provide its viability statement as it reflects period of time over which information and forecasts concerning demand for development, qualification and production of wafers, is considered reasonably reliable. In making their assessment, the Directors have taken account of the Group's 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 2020.

### *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 five times 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 Sir Derek Jones be appointment of as Non-Executive 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 Sir Derek Jones with effect from 29 November 2017. This followed the appointment of Mr Phil Smith on 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 five 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.

During 2017, the Audit Committee completed a review of its external auditors and, further to the recommendation of the Audit Committee, the Board appointed KPMG LLP ("KPMG") as its new auditor in December 2017. KPMG replaces PricewaterhouseCoopers LLP ("PwC") who had acted as IQE's auditors since 2005. As part of the handover process, PwC provided IQE with a written statement, which confirmed there were no matters which needed to be brought to the attention of the Company's members, creditors or directors.

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 2017 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.
- 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.
- The completeness of recorded tax liabilities, and the accounting for current and deferred tax. Following review of reports by independent tax specialists assessing the group tax affairs in the UK, the US, Taiwan and Singapore, and review of reports by management assessing current and deferred tax accounting, the Committee concurred that the provision for tax liabilities, and the current and deferred tax accounting was appropriate.
- The accounting and presentation for Joint Ventures. Following review of reports by management and the external auditors, the Committee concluded the accounting for Joint Ventures, and the related disclosure in the 2017 financial statements 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 46 the Committee concluded that the Going Concern principle was appropriate.
- At the request of the Board, the Committee considered whether the 2017 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 also 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 pre-close full year 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.

During the 2015 to 2017 financial years, PricewaterhouseCoopers LLP ("PwC") had been the Company's external auditors for over 10 years. Therefore, the Committee considered the reappointment of the external auditor and their independence on an annual basis.

During 2017, the Audit Committee completed a review of its auditors and, further to the recommendation of the Audit Committee, the Board appointed KPMG LLP ("KPMG") as its new auditor in December 2017.

The provision of external audit and tax compliance are separated where possible. Tax advice is provided by independent advisors including KPMG, PwC, EY and Bevan & Buckland.

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 that identifies the auditor's 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 2017 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 that 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 KPMG 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:

| PricewaterhouseCoopers LLP (group auditors to December 2017) | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Fees payable to the company's auditor and its associates for the audit of parent company and consolidated financial statements | - | 99 |
| Fees payable to company's auditor and its associates for other services: | | |
| - The audit of company's subsidiaries | - | 10 |
| - Audit related assurance services | 11 | 11 |
| - Tax advisory | 5 | 5 |
| - Tax compliance service | - | - |
| **Total PricewaterhouseCoopers LLP (group auditors to December 2017)** | **16** | **125** |

| KPMG LLP (group auditors from December 2017) | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Fees payable to the company's auditor and its associates for the audit of parent company and consolidated financial statements | 120 | - |
| Fees payable to company's auditor and its associates for other services: | | |
| - The audit of company's subsidiaries | 10 | - |
| - Audit related assurance services | - | - |
| - Tax advisory* | 104 | - |
| - Tax compliance service | - | - |
| **Total KPMG LLP (group auditors)** | **234** | **-** |

*Includes fees payable for services engaged prior to the appointment as group auditors of £84,000

| Ernst and Young (auditors or MBE Technology Pte Limited) | 2017 £'000 | 2016 £'000 |
|---|---|---|
| - Subsidiary company's audit | 8 | 9 |
| - Tax services | 8 | 3 |
| **Total Ernst and Young (auditors or MBE Technology Pte Limited)** | **16** | 12 |

| | | |
|---|---|---|
| **Total** | **266** | **137** |

### *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*

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 the management report any material exceptions to the Audit Committee.  There were no material exceptions identified during 2017.

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 29 to 35.

# Director's report

The directors present their annual report and the audited consolidated financial statements for the year ended 31 December 2017.

***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.

***Corporate details***
IQE public limited company is incorporated and registered in England and Wales number 3745726. The registered office is Pascal Close, St Mellons, Cardiff, CF3 0LW.

***Future developments***
A review of the group's trading during the year, its financial position at the year-end and future developments is provided on pages 8 to 13. 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 page 29 to 35. The future outlook for the Group is set out on page 13.

***Dividends***
The directors do not recommend the payment of a dividend (2016: £nil).

***Directors***
The directors of the Company, who were in office during the year and up to the date of signing the financial statements, unless otherwise stated are set out below:

G H H Ainsworth - Chairman
S Gibson - Non Executive Director (resigned 13 June 2017)
D Jones – Non executive Director (appointed 29 November 2017)
D Grant – Non Executive Director
P Smith – Non Executive Director
D Nelson – Chief Executive Officer
P Rasmussen – Chief Financial Officer
H Williams – Chief Operations Officer

The directors' beneficial interests in the company's issued ordinary share capital, long term incentive share plans and share options are set out in the remuneration report.

***Directors' third party indemnity provisions***
The Company has purchased and maintained 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 Companies Act 2006. These indemnities were in force throughout the year and up to the date of this Report and Annual Accounts.

***Employment policies***
A review of the group's employment policies is set out in the Strategic Report.

***Principal risks and uncertainties***
Details of the principal risks and uncertainties impacting the Group are set out in the Strategic Report on page 29 to 35.

***Financial risk management***
The Group operates a central treasury function which acts in accordance with specific board policies. Speculative transactions are not permitted. Financial risk management objectives and policies of the Group and the significant treasury policies that relate to price risk, credit risk, liquidity risk and cash flow risk are set out in note 21 of the Financial Statements.

### *Substantial interests in shares*

As at 28 February 2018 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 | 9.28% |
| OppenheimerFunds | 6.61% |
| Hargreaves Lansdown Asset Mgt | 6.54% |
| Interactive Investor | 4.44% |
| Barclays Wealth | 4.16% |
| Schroder Investment Mgt | 3.90% |
| Dr Andrew W Nelson | 3.90% |
| T Rowe Price | 3.35% |

*Shareholder analysis by Canaccord Genuity*

### *Research and development*

The group incurred costs in respect of research and development during the year of £17,011,000 (2016: £8,358,000) of which £15,434,000 (2016: £7,599,000) has been capitalised in accordance with IAS 38 ("Intangible assets"). The remaining research and development costs totalling £1,577,000 (2016: £759,000) have been charged to the income statement, net of grant funding of £1,507,000 (2016: £616,000).

### *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.

### *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 21.

### *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 that 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 accounts for the year ended 31 December 2017 and the Group and parent Company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent Company financial statements for each financial year. As required by the AIM Rules of the London Stock Exchange they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the EU (IFRSs as adopted by the EU) and applicable law and have elected to prepare the parent Company financial statements on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent Company and of their profit or loss for that period.

**In preparing each of the Group and parent Company financial statements, the directors are required to:**

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Strategic Report and a Directors' Report that complies with that law and those regulations.

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

***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.

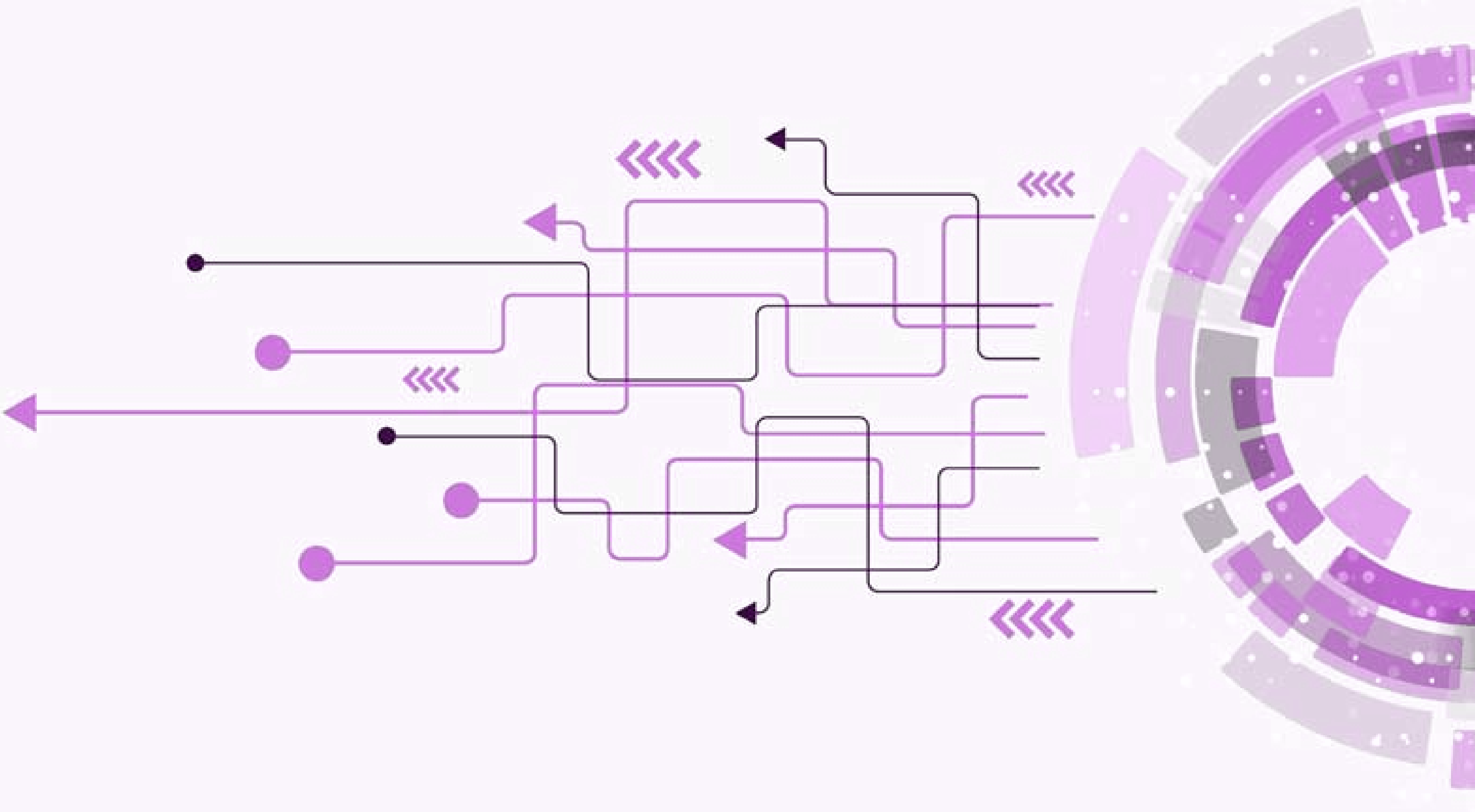
***Independent Auditors***

PricewaterhouseCoopers LLP resigned as auditors on 21 December 2017 and the directors appointed KPMG LLP. A resolution to reappoint KPMG LLP will be proposed at the forthcoming Annual General Meeting.

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

Phillip Rasmussen

Phillip Rasmussen, Chief Financial Officer 20 March 2018





# 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 2017 for which we will be seeking shareholder approval at the Annual General Meeting on 4 June 2018. 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 the 2016 AGM, we voluntarily decided to do so. We appointed Kepler, a brand of Mercer Ltd., to undertake a review of IQE's remuneration arrangements and this culminated in IQE's remuneration policy for the years 2017 to 2019, as set out below. This remuneration policy, along with the annual report for 2016 remuneration was approved at the 2017 AGM, with 99.99% and 99.73% voting in favour respectively. This annual report for 2017 remuneration will be put to a shareholder vote on a voluntary basis at the 2018 AGM.

David Grant

Sir David Grant, Remuneration Committee Chairman

NOTE: This report includes audited and unaudited information, which is identified throughout the report.

## Directors' Remuneration Policy (Unaudited)

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 established 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 was approved by shareholders at the 2017 AGM.

## Policy Table (Unaudited)

| 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.<br>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.<br>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.<br>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 |

| | | | |
|---|---|---|---|
| **Annual Bonus**<br>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.<br>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.<br>Bonus payments are delivered in cash.<br>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.<br>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.<br>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.<br>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.<br>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.<br>Further details of the measures, weightings and targets applicable are provided in the Annual Report on Remuneration. |

| | | | |
|---|---|---|---|
| **LTIP**<br>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.<br>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.<br>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.<br>In exceptional circumstances, including but not limited to recruitment, normal awards may be made up to 200% of salary to secure the right individual.<br>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.<br>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.<br>For 2018, the performance condition for the award will continue to be based on EPS growth from RPI +4% to 10% p.a. over 3 years. The 2017 LTIP award included a provision to double the award if absolute TSR growth over the 3-year performance period is 100% or more. This provision will not apply to the 2018 LTIP award<br>If no entitlement has been earned at the end of the relevant performance period, awards lapse.<br>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.<br>Details of the targets to be used in future LTIP grants are included in the on in the Annual Report on Remuneration. |

## Notes to the policy table (Unaudited)

***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.

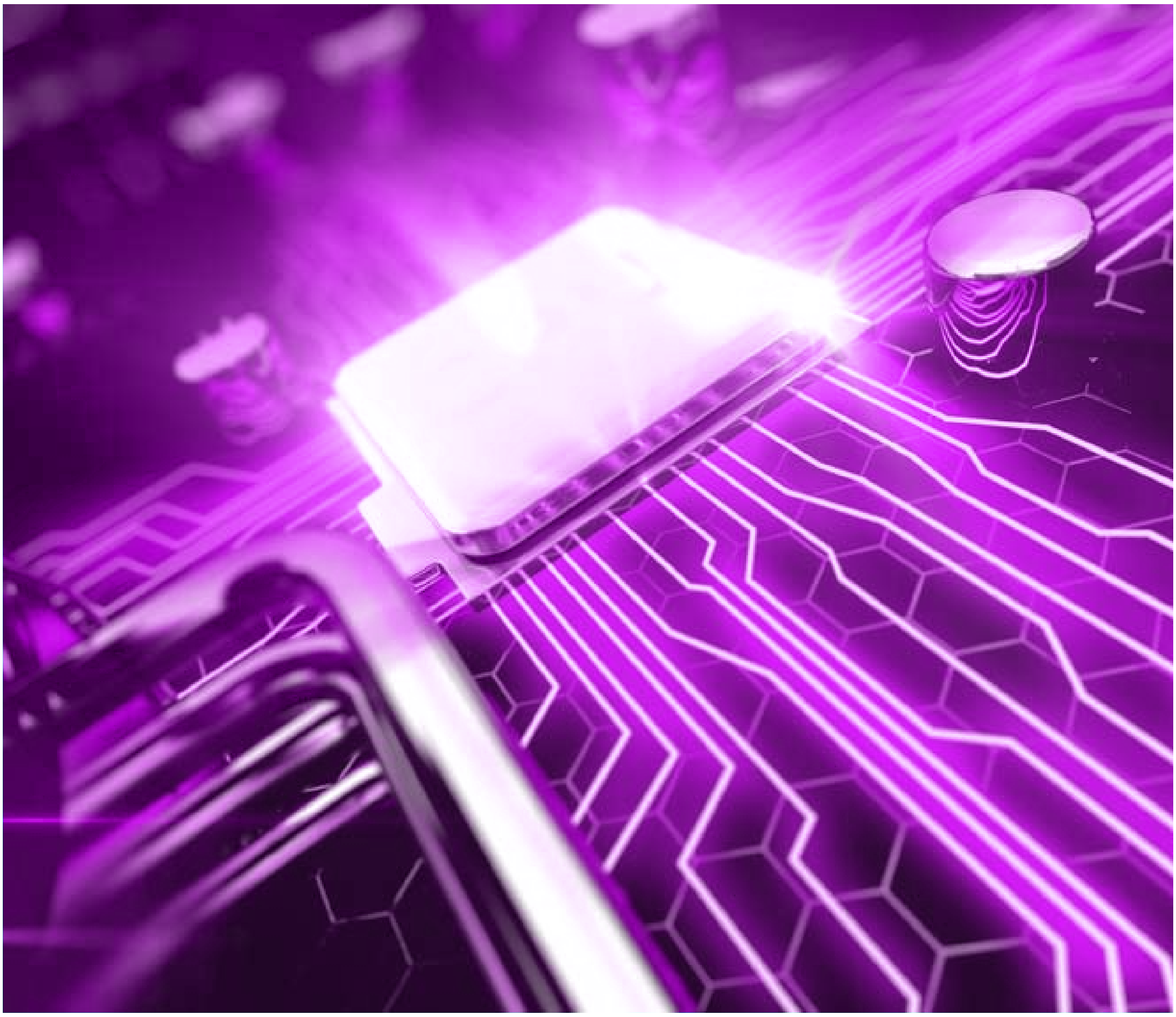
Targets applying to the bonus and LTIP are reviewed annually, based on a number of internal and external reference points. Performance targets are intended to be stretching and achievable, and reflect IQE's strategic priorities and its market opportunities.

***Remuneration policy for other employees***

All employees are eligible to participate in a discretionary annual bonus and our HMRC-approved share option scheme. Only executive directors participated in the Group's LTIP during 2017.

***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 2017.



## Non-Executive Director Remuneration (Unaudited)

Subject to re-election by shareholders, Non-Executive Directors are appointed by the full Board and retire by rotation in accordance with the company's articles of association.
The remuneration of Non-Executive Directors are matters reserved for the full Board subject to a limit of £150,000 per annum (exclusive of value added tax if applicable) or such other figure as shareholders my approve plus reasonable expenses in accordance with the company's articles of association.

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.

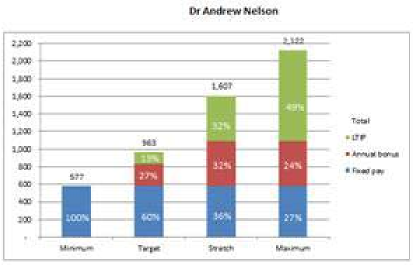
Details of the policy on fees paid to the company's Non-Executive Directors are set out in the table below:

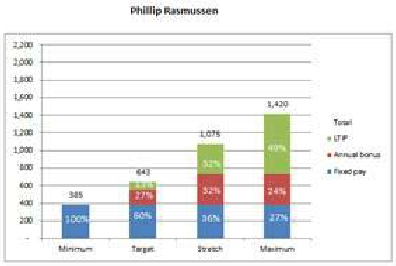
| NED | Date of appointment letter |
|---|---|
| **Dr Godfrey Ainsworth** | 16 June 2016 |
| **Sir David Grant** | 1 September 2012 |
| **Phil Smith** | 30 November 2016 |
| **Sir Derek Jones** | 1 December 2017 |

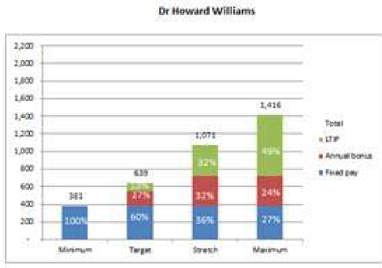
| Function | Operation | Opportunity | Performance metrics |
|---|---|---|---|
| **Fees**<br>To attract and retain Non-Executive Directors of the highest calibre with broad commercial and other experience relevant to the Company. | The fees paid to the Non-Executive Directors are determined by the Board (excluding the NED or group of NEDs whose remuneration is being discussed).<br><br>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.<br><br>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 that 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 (Unaudited)

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 four different performance scenarios: 'Minimum', 'On-target' 'Maximum' and 'Stretch'.




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 2017, 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 (Unaudited)

***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 page 60 .

## Service contracts and treatment for leavers and change of control (Unaudited)

| Executive | Date of service contract |
|---|---|
| Dr Andrew Nelson | 1 June 2016 |
| Phillip Rasmussen | 7 January 2007 |
| Dr Howard Williams | 1 June 2016 |

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.

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<br>Change of control | 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. |
| **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.<br><br>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).<br><br>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 (Unaudited)

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 (Unaudited)

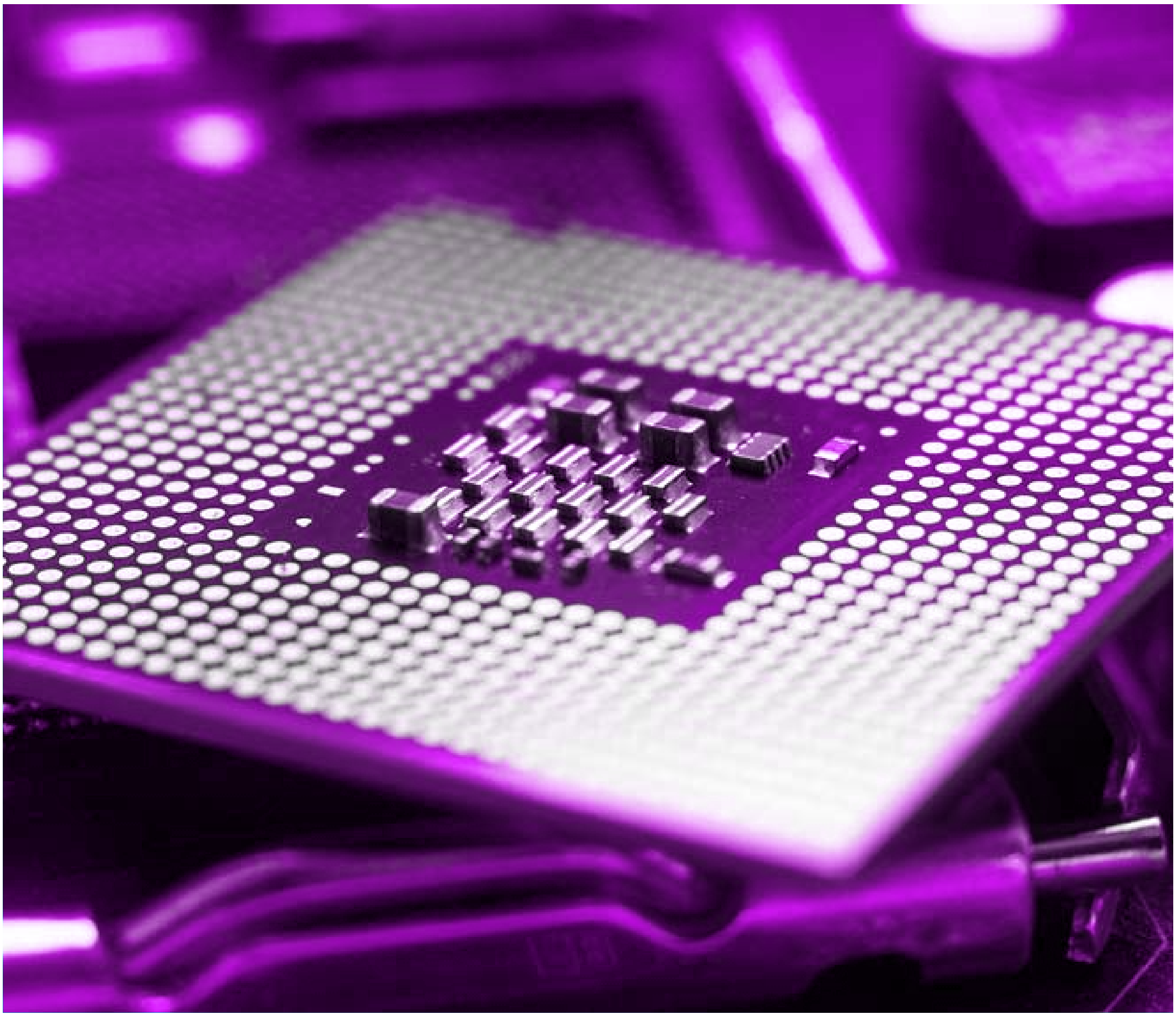
When making decisions on changes to Executive Director remuneration, the Committee considers changes to pay and conditions across the Group.  To this end, the HR Manager provides the Committee with a summary of the proposed level of average increase for employees prior to the annual salary review. For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

## Consideration of shareholder views (Unaudited)

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 the previous 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 director's remuneration report.

## Remuneration Committee role, membership and advice (Unaudited)

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.



# Annual report on remuneration

**The main activities of the Remuneration Committee during the year were as follows:**

- Determined annual bonuses payable to executive directors in 2017.
- Reviewed and approved vesting of LTIP awards.
- Reviewed and approved the executive directors' salaries for 2017.
- Determined performance targets for the executive directors' 2018 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 2 Non-Executive Directors:**

- Sir David Grant, Non-Executive Director and Remuneration Committee Chairman attended 3 out of 3 meetings during the year
- Dr Godfrey Ainsworth, Company Chairman, attended 3 out of 3 meetings during the year

Mr Phil Smith and Sir Derrick Jones joined the Committee at the beginning of 2018. 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
- Representatives from Kepler, a brand of Mercer Ltd, independent advisors to the Committee

Kepler, a brand of Mercer (Kepler), provides 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. Fees of £61,000 were paid to Kepler in respect of services they provided to the Company in 2017 and December 2016 (as they began their appointment in December 2016). 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 Information)

The table below sets out a single figure for the total remuneration received by each Director for the year ended 31 December 2017 and the prior year:

| | Dr Andrew Nelson | | Phillip Rasmussen | | Dr Howard Williams | |
|---|---|---|---|---|---|---|
| | 2017 £'000 | 2016 £'000 | 2017 £'000 | 2016 £'000 | 2017 £'000 | 2016 £'000 |
| Salary | 515 | 503 | 345 | 337 | 345 | 337 |
| Benefits1 | 6 | 10 | 4 | 5 | 1 | 1 |
| Annual bonus2 | 515 | 503 | 345 | 337 | 345 | 337 |
| Long-term incentive3 | - | - | - | - | - | - |
| Pension4 | 51 | 50 | 34 | 36 | 34 | 36 |
| **Total** | **1,087** | **1,066** | **728** | **715** | **725** | **711** |

1. Taxable benefits for 2017 consist of health cover, private medical insurance, life assurance, long-term disability insurance, fuel and car repairs.
2. Annual bonus payments for performance during 2017 were 100% of salary. Details are included below in "Incentive outcomes for year ending 31 December 2017 and 31 December 2016".
3. No LTIP awards were due to vest in 2017 or 2016, as the 2014 and 2015 awards were delayed until 2016 and, as such, will vest based on performance to 1 January 2019. In addition, the Directors did not exercise any share options during the year (2016: nil).
4. Executive directors participate in a defined contribution scheme, in relation to which the Company contributed 10% of salary.

## Incentive outcomes for year ending 31 December 2017 and 31 December 2016 (Unaudited)

***Annual Bonus***
In 2016 financial objectives were met in full and the maximum bonus of 100% of salary was paid.

In 2017 financial objectives were met in full and the maximum bonus of 100% of salary was paid.

***Long-term incentive plan***
No LTIP awards were due to vest in 2016 or 2017, as 2014 and 2015 awards were delayed until 2016 and, as such, will vest based on performance to 1 January 2019.

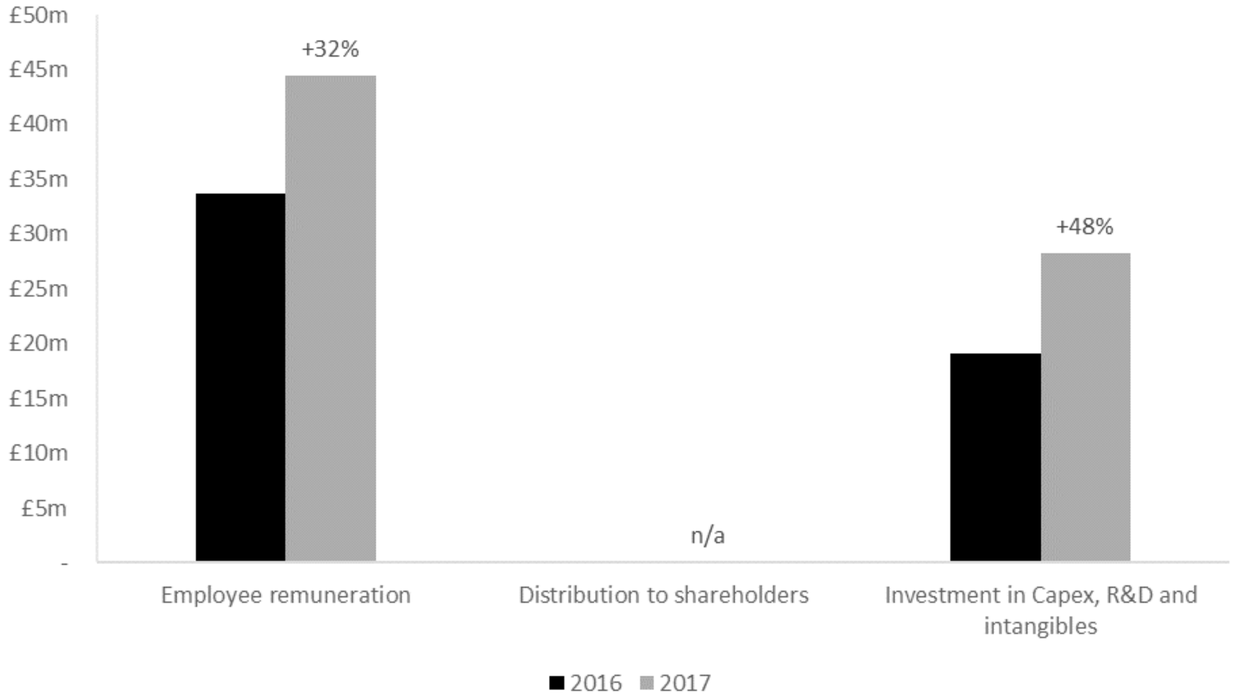
## Percentage change in CEO remuneration (Unaudited)

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 2016 and 2017. 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 2016-17 | |
|---|---|---|
| | CEO | All UK employees |
| Base salary | +2.4% | +3.0% |
| Taxable benefits | - 6.0% | -5.4% |
| Annual bonus | +2.4% | +68% |

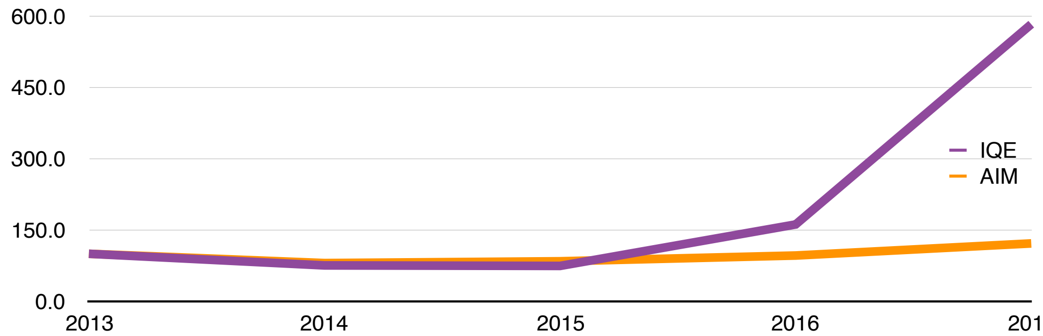
## Relative importance of spend on pay (Unaudited)

The graph below shows shareholder distributions (i.e. dividends and share buybacks) and total employee pay expenditure for the financial years ended 31 December 2016 and 31 December 2017, along with the percentage change.




## Review of past performance (Unaudited)

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 2013 to 31 December 2017.



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

**Historical CEO remuneration**

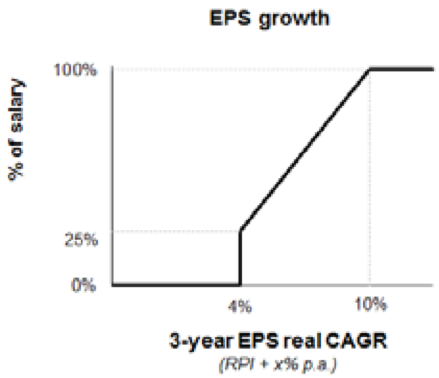
| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| CEO single figure of remuneration (£000) | 1,266 | 889 | 851 | 1,066 | 1,087 |
| STI award as a % of maximum opportunity | 0% | 0% | 0% | 100% | 100% |
| LTI award as a % of maximum opportunity | 100% | 83% | 100% | n/a | n/a |

## Scheme interests awarded in 2017 (Audited Information)

| Executive director | Award type | Date of award | # shares awarded | Face value | End of performance period |
|---|---|---|---|---|---|
| Dr Andrew Nelson | Nil-cost option | 6 January 2017 | 4,069,579 | £1,638,180 | 31 December 2019 |
| Phillip Rasmussen | Nil-cost option | 6 January 2017 | 2,726,537 | £1,104,247 | 31 December 2019 |
| Dr Howard Williams | Nil-cost option | 6 January 2017 | 2,726,537 | £1,104,247 | 31 December 2019 |

The face value of shares was based on the share price at date of award of 40.5p

Vesting of these awards is subject to EPS growth in excess of RPI as illustrated below, where EPS is measured over the period from 1 January 2017 to 1 January 2020. All awards will vest on the third anniversary of the date of grant on 6 January 2020.




## Exit payments made in the year (Unaudited)

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

## Payments to past directors (Unaudited)

No payments were made to past directors during the year.

## Single total figure of remuneration for Non-Executive Directors (Audited Information)

The table below sets out a single figure for the total remuneration received by each Non-Executive Director for the year ended 31 December 2017 and the prior year:

| | NED fees | |
|---|---|---|
| | 2017 £'000 | 2016 £'000 |
| Dr Godfrey Ainsworth | 125 | 125 |
| Sir David Grant | 50 | 50 |
| Prof Simon Gibson1 | 23 | 50 |
| Phil Smith | 50 | n/a |
| Sir Derek Jones2 | 4 | n/a |

1. Prof Simon Gibson retired from the Board on 13 June 2017.

2. Sir Derek Jones was appointed to the Board as an independent director on 29 November 2017.

## Implementation of remuneration policy for 2018 (Unaudited)

***Base salary***

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

| Executive Director | Annual base salary at 1 January 2017 | Annual base salary at 1 January 2018 | Percentage increase |
|---|---|---|---|
| Dr Andrew Nelson | £515,000 | 525,300 | 2% |
| Phillip Rasmussen | £345,000 | 351,900 | 2% |
| Dr Howard Williams | £345,000 | 351,900 | 2% |

***Pension***

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

***Annual bonus (Unaudited)***

For 2018 the Committee approved the following annual bonus opportunities for Executive Directors, as outlined in the Policy Table. The Committee considers annual bonus targets for 2018 to be commercially sensitive at this time but will disclose them retrospectively once they are no longer commercially sensitive.

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

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

***LTIP (Audited Information)***

For 2018, normal LTIP awards of up to 100% of salary may be made to executive directors, 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 below. No award will vest below Threshold performance, and vesting will increase on a straight-line basis between Threshold and Stretch.

## Implementation of remuneration policy for 2018 – continued (Unaudited)

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 January 2018 to 31 Dec 2020 | |
|---|---|---|
| | 3-year EPS growth | % of normal maximum |
| Threshold | +6% | 25% |
| Stretch | 12% | 100% |

## Chairman and Non-Executive Director Fees (Unaudited)

The Board reviewed the Group's Chairman's fee and decided to make no change for 2018. 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 (Unaudited)

A table setting out the beneficial interests of the Directors and their families in the share capital of the Company as at 31 December 2017 is set out below.

Since 31 December 2017 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 2017 | Shares owned outright as at 31 Dec 2017 | Shareholding requirement % salary/fee | Curren shareholding % salary/fee | Requirement met? |
|---|---|---|---|---|---|
| Dr Andrew Nelson | 35,259,218 | 28,459,218 | 200% | 7,571% | Yes |
| Phillip Rasmussen | 3,473,357 | 1,573,357 | 200% | 625% | Yes |
| Dr Howard Williams | 4,292,965 | 2,392,965 | 200% | 950% | Yes |
| Dr Godfrey Ainsworth | 3,154,197 | 2,154,197 | N/A | 2,360% | N/A |
| Sir David Grant | 215,000 | 215,000 | | 589% | |
| Phil Smith | 0 | 0 | | N/A | |
| Sir Derek Jones1 | N/A | 0 | | N/A | |

1. Sir Derek Jones was appointed on 29 November 2017.

| 2017 | 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 | 11,886,782 | - | 3,145,433 | - | - | - |
| Phillip Rasmussen | 7,952,645 | - | 2,211,444 | - | - | - |
| Dr Howard Williams | 7,952,645 | - | 3,089,907 | - | - | - |
| Dr Godfrey Ainsworth | N/A | | | | | |
| Sir David Grant | | | | | | |
| Phil Smith | | | | | | |
| Sir Derek Jones1 | | | | | | |

| 2016 | 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 | | | | | | |
| Phil Smith | | | | | | |
| Sir Derek Jones1 | | | | | | |

## Summary of shareholder voting at the 2016 AGM (Unaudited)

Results of the vote on the remuneration report at the IQE's AGM on 13 June 2017 are as below:

| | Total number of votes | % of votes cast |
|---|---|---|
| For (including discretionary) | 271,462,338 | 99.73% |
| Against | 191,120 | 0.07% |
| **Total votes cast (excluding withheld votes)** | **271,653,458** | **99.81%** |
| Votes withheld | 522,222 | 0.19% |
| **Total votes cast (including withheld votes)** | **272,175,680** | **100%** |

# Director's biographies

## Dr Godfrey H H Ainsworth FCA (62)

*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. In April 2018, Dr Ainsworth became Executive Chairman providing support to the CEO, concentrating on investor and external relations and providing oversight support on an interim basis to the Finance Team..

## Sir David Grant CBE (70) *Non-executive 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, DSTl, STEMNET, NPL.

## Phil Smith (60) *Senior Independent 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: INNOVATE UK.

## Sir Derek Jones KCB (65) *Non-executive Director*

Sir Derek Jones was the Permanent Secretary of the Welsh Government as well as a member of the UK Civil Service Board and its Senior Leadership Committee until he retired from the Welsh Government in February 2017. He spent the earlier part of his government career in Whitehall, working at HM Treasury and the then Department for Trade & Industry, where he headed the Far East Trade Desk. In government in Wales he has also served as Director of Finance and Director of Economic Affairs. Outside government, Sir Derek was Director of Business & Strategic Partnerships at Cardiff University, responsible for securing long-term collaborations with the private sector and is an Honorary Professor and Fellow of the University. Sir Derek is currently the Chair of the Prince's Trust in Wales and is a Vice President of Cardiff Business Club. He was made Companion of the Order of the Bath (CB) in 2009 and subsequently Knight Commander (KCB) in 2014, for services to economic and social conditions. Due to his work in government, Sir Derek does not hold any other current directorships and has not held any past directorships within the last five years.

## Dr Drew Nelson OBE (63)

*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 (47) *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 also served as Company Secretary from January 2009 until March 2017. It is with the deepest sadness that in April 2018, the Board announced that its long-serving Chief Financial Officer, Phillip J Rasmussen BSc ACA, had died. His death follows a cycling incident that took place on 1 April 2018 whilst on holiday abroad.

## Dr Howard Williams (63) *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 (32) *Company Secretary*

Jason Howells studied at University of Oxford where he gained a BA (Hons) in Jurisprudence and subsequently completed his Postgraduate Diploma in Legal Practice at Cardiff University. He qualified as a solicitor at Eversheds LLP, a predecessor of Eversheds Sutherland (International) LLP. After seven years at Eversheds, which included a secondment to GlaxoSmithKline, he moved to Capita Property and Infrastructure in 2015 before joining IQE in October 2016. Jason was appointed Company Secretary in March 2017.

# 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)
Mr P Smith BSc, Hon LLD, DUniv., CEng, FIET (Senior Independent Non-executive Director)
Sir David Grant CBE PhD FREng FLSW CEng FIET (Non-executive Director)
Mr P J Rasmussen BSc, ACA (Chief Financial Officer)
Dr H R Williams BSc, Ph.D, CEng, MIMechE, MCIBSE (Operations Director)

Sir Derek Jones KCB (Non-executive Director) appointed 29 November 2017

## Company Secretary

Mr J M Howells MA (oxon)

## Registered office

Pascal Close, Cardiff, United Kingdom, CF3 0LW

## Principal Bankers

HSBC Bank Plc
8 Canada Square, London, E14 5HQ

## Auditors

KPMG LLP
3 Assembly Square, Britannia Quay, Cardiff CF10 4AX

## 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
Stifel Nicolaus Europe Limited
4th Floor 150 Cheapside, London, United Kingdom, EC2V 6ET

## Registrars

Link Asset Services
The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU

## Investor relations

Chris Meadows
Tel +44(0)29 2083 9400
investors@iqep.com

# Independent auditor's report

## to the members of IQE plc

### 1. Our opinion is unmodified

We have audited the financial statements of IQE plc ("the Company") for the year ended 31 December 2017 which comprise the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity, consolidated cash flow statement, parent company balance sheet, parent company statement of changes in equity, parent company cash flow statement, and the related notes, including the accounting policies in note 2.

In our opinion:

— the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;

— the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);

— the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU 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.

#### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed entities. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

| Overview | |
|---|---|
| **Materiality:** group financial statements as a whole | £940k<br>4.1% of group profit before tax |
| **Coverage** | 97% of group profit before tax |
| **Risks of material misstatement** | |
| **Recurring risks** | Revenue recognition |
| | Valuation of intangible assets and goodwill |
| | Capitalisation of development costs |
| **Parent Company only** | Valuation of investments in subsidiaries |

## 2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, were as follows:

| | The risk | Our response |
|---|---|---|
| **Revenue recognition**<br><br>*Refer to note 2.21 (accounting policy).* | **Inappropriate inclusion of a sale in 2017 rather than 2018:**<br><br>Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.<br><br>Pressures on achieving internal and external expectations of results increase the risk of fraudulent revenue recognition.<br><br>The Group recognises revenue when the risks and rewards of the underlying sale have been transferred to the customer, which is on the delivery and acceptance of the goods by the customer. For certain sales, the Group recognises revenue on Supplier Managed Inventory (SMI) contracts at the point of receipt into the customer's warehouse. Those contracts require the Group to maintain the inventory level at the customer within a specified range.<br><br>Provisions for sales returns and rebates as a result of delivered wafers not being within the required specification may be insufficient at the year-end. | Our procedures included:<br><br>— **Control design:** Matched sales invoices to related orders and dispatch notes at the transaction level.<br><br>— **Enquiry of customers:** Obtained direct confirmation of SMI balances of £7,317k held by customers to determine the level of inventory held by each at the year-end.<br><br>— **Test of details:** Vouched specific billings and accruals around the year-end cut-off period to dispatch note.<br><br>— **Historical comparison:** Assessed the returns and rebates provisions based on historical trends, contract terms and any specific known product issues identified either at or subsequent to the year-end. |
| **Carrying value of intangible assets and goodwill** (£108.5 million; 2016: £104.0m)<br><br>*Refer to note 2.5 (accounting policy) and note 13 (financial disclosures).* | **Forecast based valuation:**<br><br>The carrying amount of intangible assets in the Group is significant, £108.5m at 31 December 2017, consisting of goodwill (£64.4m), development costs (£35.5m) and other intangibles (£8.6m).<br><br>The recoverable amounts of the goodwill (which relates to the III/V Epitaxy and Substrates CGUs) are determined from Value in Use calculations.<br><br>The VIU calculations represent a key judgement area as changes in the underlying assumptions, particularly relating to forecast cash flows and discount rates, could result in a material misstatement through an impairment being required against the goodwill or one or more intangible assets.<br><br>Development costs are tested for impairment only when an indicator of impairment is present. If any such indicators are identified, VIU calculations are prepared. | Our procedures included:<br><br>— **Control design:** Evaluated the Group's budgeting procedures upon which the forecast cash flows are based. Assessed whether the forecasts (including growth rate) were consistent with current business strategies in place.<br><br>— **Historical comparisons:** Compared budgets for the prior year(s) with actual results and understanding the reasons for the variances.<br><br>— **Benchmarking assumptions:** Challenged the Group's selection of discount and growth rates by using external data (including competitor analysis) using our own valuation specialist to determine an appropriate range and comparing the actual rate used to that range.<br><br>— **Sensitivity analysis:** Performed analysis to assess the sensitivity of the Value in Use calculations to changes in the discount rate, growth rate and the forecast cash flows.<br><br>— **Assessing transparency:** Assessed the adequacy of the Group's disclosures in respect of the impairment testing of goodwill and intangibles and whether disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions properly reflected the risks inherent in it. |

## 2. Key audit matters: our assessment of risks of material misstatement (continued)

| | The risk | Our response |
|---|---|---|
| **Capitalisation of development costs** (£15.4 million; 2016: £6.3m)<br><br>*Refer to note 2.5 (accounting policy) and note 13 (financial disclosures).* | **Risk of over-capitalisation:**<br><br>Capitalised development costs are significant and increasing due to investment in areas including VCSEL, GaN, cREO and Photonics.<br><br>The amounts involved are significant, and the application of accounting standards to determine the criteria is inherently subjective as this involves an assessment of the probability of future outcomes.<br><br>The capitalisation also includes the assessment of the time period that constitutes the process development phase and the accurate recording of the related costs to exclude from the capitalised costs any related to saleable wafer product produced at the same time. | Our procedures included:<br><br>— **Our expertise:** Reviewed the Group's accounting paper and critically assessed this against the criteria of the relevant accounting standard for the capitalisation of costs and our understanding of the progress of the Group's projects.<br><br>— **Test of details**: Vouched a sample of labour costs allocated to development projects back to supporting documentation, primarily timesheets and payroll records for relevant employees. Vouched a sample of material costs to supporting documentation including vouching substrate costs to purchase invoices and analysing gas consumption.<br><br>— **Benchmarking assumptions:** Challenged the reasonableness of the assumptions applied in respect of the proportion of labour and overhead costs capitalised with reference to the number of development runs performed during the year compared to the total number of all runs.<br><br>— **Calculation reperformance:** Re-performed management's calculation of standard costs used in allocating costs throughout the year, using actual costs incurred. Critically assessed any differences arising.<br><br>— **Test of details:** Vouched a sample of development items from development run records back to supporting documentation to check whether that the selected wafer is not showing as having been sold and has a nil value in the associated inventory records. Where development projects result in the production of saleable wafers, recalculated the capitalised cost to ensure all costs in respect of those delivered have been appropriately expensed.<br><br>— **Test of details:** Vouched a sample of wafers sold during the year, selected from sales records, back to production/development run records to ensure that the cost of sold wafers has not been capitalised inappropriately. |
| **Parent Company: Valuation of investments in subsidiaries** (£88.1 million; 2016: £48.2m)<br><br>*Refer to note 2.28 (accounting policy) and note 15 (financial disclosures).* | **Forecast-based valuation:**<br><br>The recoverable amounts of investments in subsidiaries are determined from Value in Use calculations.<br><br>The VIU calculations represent a key judgement area as movements in the underlying assumptions, particularly relating to forecast cash flows and discount rates, could result in a material misstatement of the balance. | Our procedures included:<br><br>— **Assessing forecasts:** The work on the group's forecasts as described in the goodwill impairment risk above.<br><br>— **Assessing transparency:** Assessing the adequacy of the disclosures in relation to the Company's investments in its subsidiaries. |

### 3. Our application of materiality and an overview of the scope of our audit

Materiality for the group financial statements as a whole was set at £940k, determined with reference to a benchmark of group profit before tax, normalised to exclude the impact of this year's share-based payment charge as disclosed in note 4, of £22,447k, of which it represents 4.1%.

Materiality for the parent company financial statements as a whole was set at £300k, as communicated by the group audit team. This is lower than the materiality we would otherwise have determined by reference total assets, and represents 0.13% of the Company's total assets.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £50k, in addition to other identified misstatements that warranted reporting on qualitative grounds.

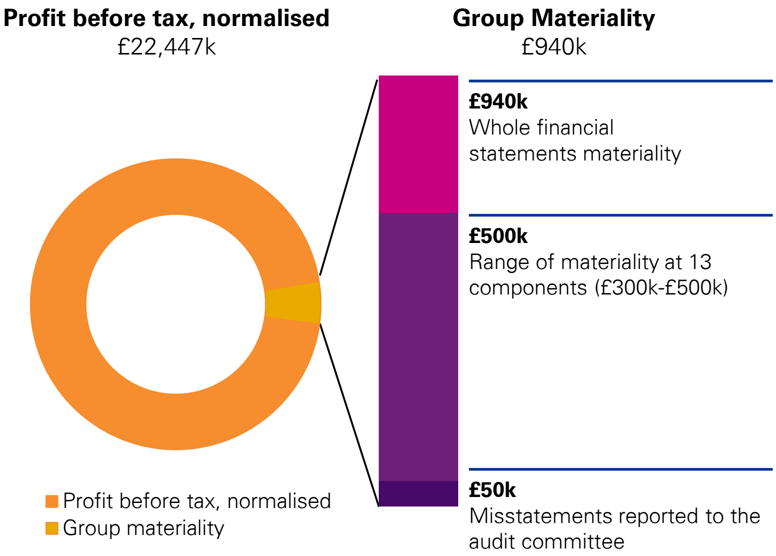
Of the group's 13 reporting components, we subjected 8 to full scope audits for group purposes and 3 to specified risk-focused audit procedures. The latter were not individually financially significant enough to require a full scope audit for group purposes, but did present specific individual risks that needed to be addressed. The group team performed procedures on the items excluded from normalised group profit before tax.

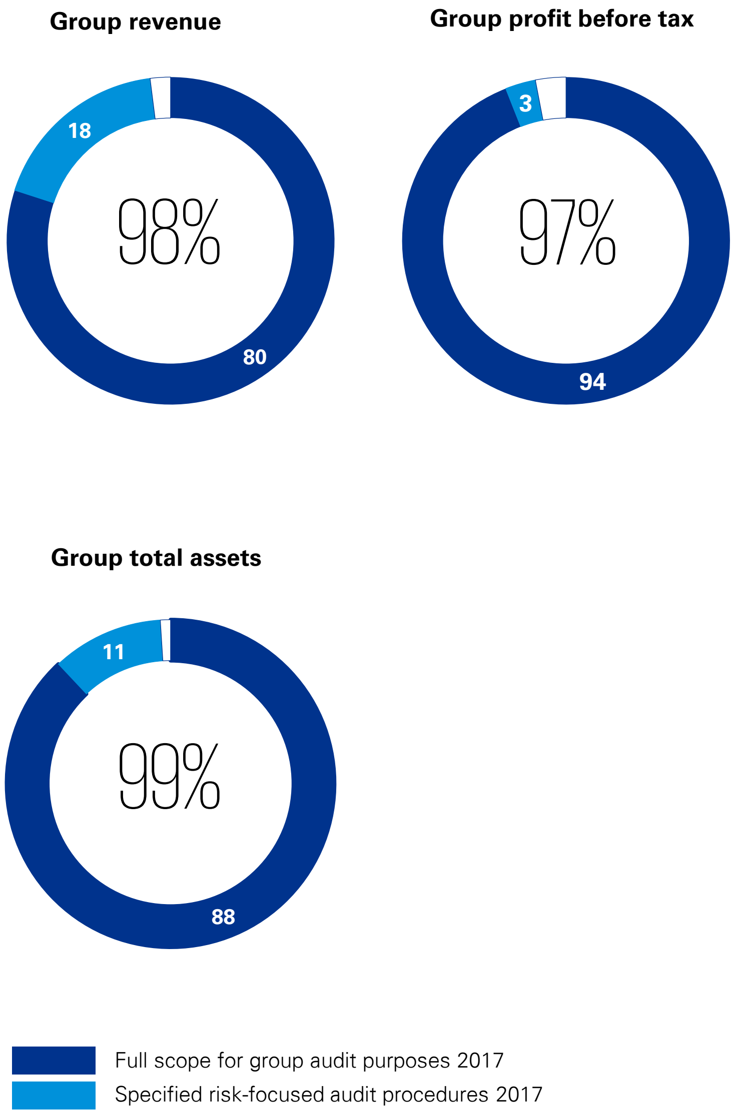
The components within the scope of our work accounted for the percentages illustrated opposite.

The remaining 2% of total group revenue, 3% of group profit before tax and 1% of total group assets is represented by 2 reporting components, none of which individually represented more than 2% of any of total group revenue, group profit before tax or total group assets. For these residual components, we performed analysis at an aggregated group level to re-examine our assessment that there were no significant risks of material misstatement within these.

The work on 1 of the 13 reporting components was performed by a component auditor and the rest, including the audit of the parent company, was performed by the Group team. The Group team instructed the component auditor as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved the component materiality, of £500k, having regard to the mix of size and risk profile of the Group across the components. Video and telephone conference meetings were held with the component auditor. At these meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

The Group's 2 joint ventures were not individually significant enough to require an audit for group reporting purposes, but a review was performed of the management accounts and the Board minutes of these joint ventures and the audit team held discussions with the joint venture management teams. We performed analysis at an aggregated group level to re-examine our assessment that there were no significant risks of material misstatement within these.



## 4. We have nothing to report on going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

## 5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

### Strategic report and directors' report

Based solely on our work on the other information:

— we have not identified material misstatements in the strategic report and the directors' report;

— in our opinion the information given in those reports for the financial year is consistent with the financial statements; and

— in our opinion those reports have been prepared in accordance with the Companies Act 2006.

## 6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

— adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or

— the parent Company financial statements are not in agreement with the accounting records and returns; or

— certain disclosures of directors' remuneration specified by law are not made; or

— we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

## 7. Respective responsibilities

### Directors' responsibilities

As explained more fully in their statement set out on page 53, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

### Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

## 8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

A Campbell

**Andrew Campbell-Orde (Senior Statutory Auditor)**
**for and on behalf of KPMG LLP, Statutory Auditor**

*Chartered Accountants*

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20 March 2018

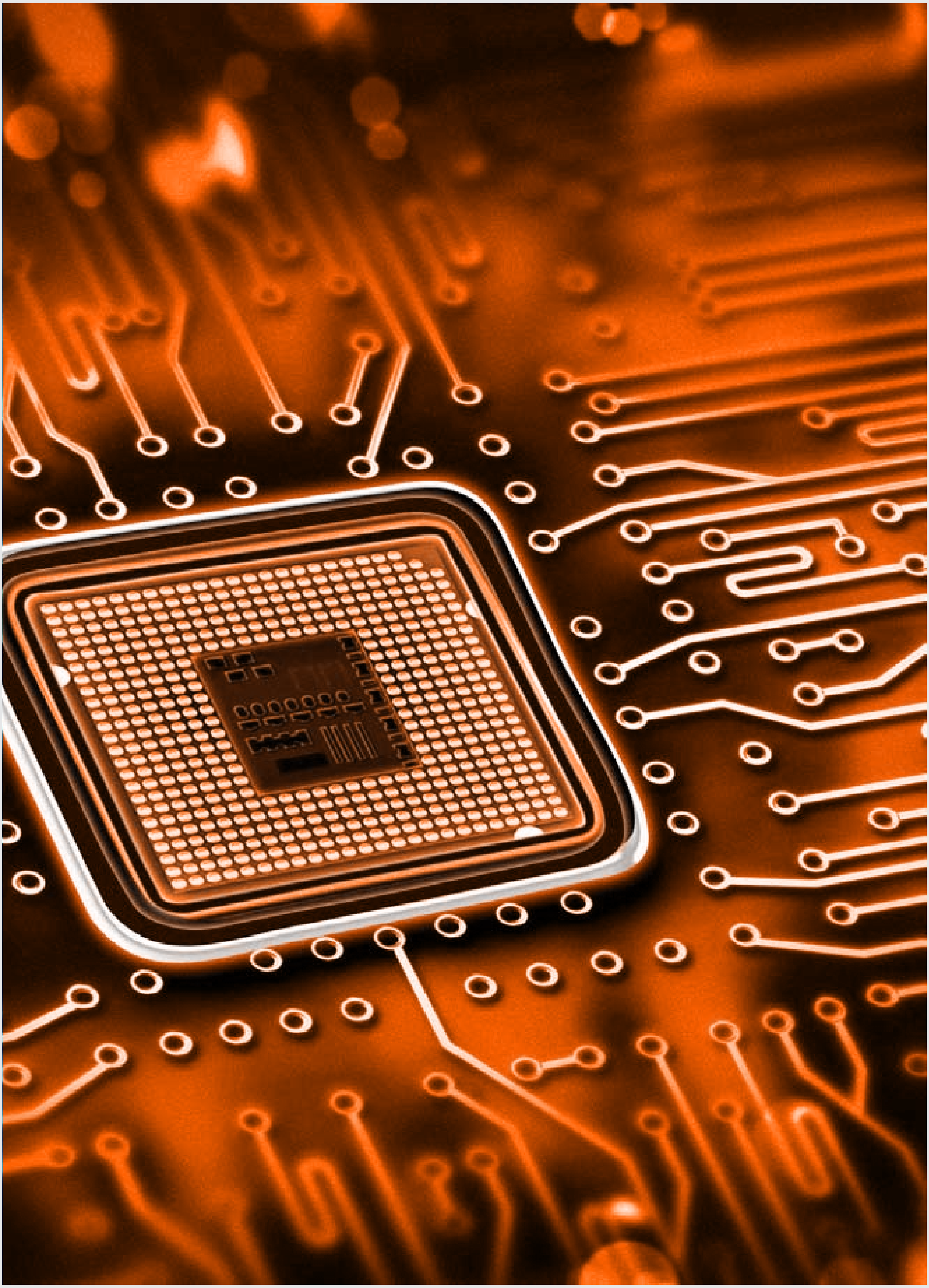
KPMG

# Five year financial summary

| | 2017 £'000 | Restated 2016 £'000 | Restated 2015 £'000 | Restated 2014 £'000 | Restated 2013 £'000 |
|---|---|---|---|---|---|
| **Revenue** | 154,480 | 132,707 | 114,024 | 112,011 | 126,774 |
| **Adjusted EBITDA (see below)** | 36,977 | 31,730 | 29,001 | 27,009 | 24,920 |
| **Operating profit** | | | | | |
| · Adjusted* | 26,359 | 22,119 | 18,977 | 17,618 | 14,556 |
| · Reported | 17,019 | 19,826 | 21,166 | 7,167 | 7,346 |
| **Profit after tax** | | | | | |
| · Adjusted* | 24,823 | 20,692 | 17,045 | 15,496 | 13,232 |
| · Reported | 14,485 | 18,023 | 17,847 | 791 | 5,156 |
| **Net cash flow from operations** | | | | | |
| Before adjustments (note 5) | 31,089 | 24,281 | 22,575 | 19,614 | 16,173 |
| Reported | 29,717 | 22,463 | 20,971 | 14,861 | 12,762 |
| **Free cash flow** | | | | | |
| Before exceptional cash flows | (2,945) | 4,382 | 12,114 | 11,446 | 5,389 |
| Reported | (4,317) | 2,564 | 10,510 | 6,693 | 1,978 |
| **Net cash/(debt)** | 45,612 | (39,549) | (23,223) | (31,251) | (34,351) |
| | | | | | |
| **Equity shareholders' funds** | 287,584 | 184,666 | 142,299 | 117,851 | 109,528 |
| **Basic EPS – adjusted*** | 3.59p | 3.06p | 2.53p | 2.32p | 1.94p |
| **Basic EPS – unadjusted** | 2.09p | 2.66p | 2.65p | 0.06p | 0.78p |
| **Diluted EPS – adjusted*** | 3.36p | 2.89p | 2.45p | 2.24p | 1.86p |
| **Diluted EPS – unadjusted** | 1.95p | 2.52p | 2.56p | 0.06p | 0.75p |

Adjusted EBITDA has been calculated as follows:

| | 2017 £'000 | Restated 2016 £'000 | Restated 2015 £'000 | Restated 2014 £'000 | Restated 2013 £'000 |
|---|---|---|---|---|---|
| | | | | | |
| **Profit after tax** | 14,485 | 18,023 | 17,847 | 791 | 5,156 |
| **Tax** | 435 | 340 | 248 | 4,452 | 36 |
| **Interest** | 2,099 | 1,463 | 1,790 | 1,924 | 2,154 |
| **Share based payments** | 7,526 | 2,881 | 2,001 | 1,458 | 1,415 |
| **Profit & Loss on disposal** | 22 | 47 | (5,187) | 15 | - |
| **Exceptional items** | 385 | (1,962) | 1,070 | 7,877 | 5,065 |
| **Depreciation** | 5,637 | 5,561 | 6,192 | 6,590 | 8,503 |
| **Amortisation of intangible assets** | 6,388 | 5,377 | 5,040 | 3,902 | 2,591 |
| **Adjusted EBITDA** | 36,977 | 31,730 | 29,001 | 27,009 | 24,920 |



The comparative financial information has been restated. Details of the restatement are set out in note 2.30
* The adjusted performance measures are reconciled in note 5.
** Free cash flow is defined as net cash flow before acquisitions, financing and net interest paid.
*** Adjusted EPS measures exclude share based payments, exceptional items, deferred tax, acquisition accounting amortisation and the impact of discounting.

## Consolidated income statement for the year ended 31 December 2017

| | Note | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|---|
| **Revenue** | 4 | **154,480** | **132,707** |
| Cost of sales | | (115,857) | (98,538) |
| **Gross profit** | | **38,623** | **34,169** |
| Other income and expenses | 5 | - | 2,340 |
| Selling, general and administrative expenses | | (21,582) | (16,636) |
| (Loss)/Profit on disposal of property, plant and equipment | 5 | (22) | (47) |
| **Operating profit** | 6 | **17,019** | **19,826** |
| Finance costs | 8 | (2,099) | (1,463) |
| **Adjusted profit before income tax** | | **24,340** | **20,630** |
| Adjustments | 5 | (9,420) | (2,267) |
| **Profit before income tax** | | **14,920** | **18,363** |
| Taxation | 9 | (435) | (340) |
| **Profit for the year** | | **14,485** | **18,023** |
| | | | |
| **Profit attributable to:** | | | |
| Equity shareholders | | 14,385 | 17,859 |
| Non-controlling interest | | 100 | 164 |
| | | **14,485** | **18,023** |
| | | | |
| **Earnings per share attributable to owners of the parent during the year** | | | |
| Basic earnings per share | 12 | 2.09p | 2.66p |
| Diluted earnings per share | 12 | 1.95p | 2.52p |

Adjusted basic and diluted earnings per share is presented in note 12.

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

The company has elected to take the exemption under section 408 of the Companies Act 2006 from presenting the parent company profit and loss account.

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

The notes on pages 91 to 131 form an integral part of these consolidated financial statements.

## Consolidated statement of comprehensive income for the year ended 31 December 2017

| | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| Profit for the year | 14,485 | 18,023 |
| Currency translation differences on foreign currency net investments* | (10,944) | 23,620 |
| **Total comprehensive income for the year** | **3,541** | **41,643** |
| | | |
| **Total comprehensive income attributable to:** | | |
| Equity shareholders | 3,469 | 40,919 |
| Non-controlling interest | 72 | 724 |
| | **3,541** | **41,643** |

* Items that may subsequently be reclassified to profit or loss.

Items in the statement above are disclosed net of tax. The income tax relating to each component of other comprehensive income is disclosed in note 9.

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

The notes on pages 91 to 131 form an integral part of these consolidated financial statements.

## Consolidated balance sheet as at 31 December 2017

| | Note | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 13 | 108,513 | 103,972 |
| Fixed asset investments | 15 | 75 | - |
| Property, plant and equipment | 14 | 90,800 | 85,001 |
| Deferred tax assets | 10 | 17,768 | 18,181 |
| Financial Assets | 17 | 7,680 | 6,889 |
| **Total non-current assets** | | **224,836** | **214,043** |
| **Current assets** | | | |
| Inventories | 16 | 33,707 | 28,498 |
| Trade and other receivables | 17 | 32,240 | 30,868 |
| Cash and cash equivalents | | 45,612 | 4,957 |
| **Total current assets** | | **111,559** | **64,323** |
| **Total assets** | | **336,395** | **278,366** |
| **Current liabilities** | | | |
| Trade and other payables | 18 | (43,172) | (36,916) |
| Current tax liabilities | | (210) | (5,533) |
| Borrowings | 19 | - | (7,652) |
| Provisions for other liabilities and charges | 20 | (1,534) | (1,421) |
| **Total current liabilities** | | **(44,916)** | **(51,522)** |
| **Non-current liabilities** | | | |
| Borrowings | 19 | - | (36,854) |
| Provisions for other liabilities and charges | 20 | (666) | (2,167) |
| **Total non-current liabilities** | | **(666)** | **(39,021)** |
| **Total liabilities** | | **(45,582)** | **(90,543)** |
| **Net assets** | | **290,813** | **187,823** |
| | | | |
| **Equity attributable to the shareholders of the parent** | | | |
| Share capital | 22 | 7,560 | 6,755 |
| Share premium | | 145,927 | 51,081 |
| Retained earnings | | 97,967 | 83,582 |
| Other reserves | | 36,130 | 43,248 |
| | | **287,584** | **184,666** |
| Non-controlling interest | | 3,229 | 3,157 |
| **Total equity** | | **290,813** | **187,823** |

The notes on pages 91 to 131 form an integral part of these consolidated financial statements. The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

The financial statements on pages 91 to 131 were authorised for issue by the board of directors on 20 March 2018 and were signed on its behalf.

Phillip Rasmussen
P J Rasmussen

AW Nelson
Dr A W Nelson

## Consolidated statement of changes in equity for the year ended 31 December 2017

| | Share capital | Share premium | Retained earnings | Exchange rate reserve | Other reserves | Non-controlling interests | Restated Total equity |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Balance at 1 January 2017 - Restated** | **6,755** | **51,081** | **83,582** | **30,985** | **12,263** | **3,157** | **187,823** |
| **Comprehensive income** | | | | | | | |
| Profit for the year | - | - | 14,385 | - | - | 100 | 14,485 |
| Other comprehensive income for the year | - | - | - | (10,916) | - | (28) | (10,944) |
| **Total comprehensive income for the year** | **-** | **-** | **14,385** | **(10,916)** | **-** | **72** | **3,541** |
| **Transactions with owners** | | | | | | | |
| Share based payments | - | - | - | - | 3,854 | - | 3,854 |
| Tax relating to share options | - | - | - | - | 683 | - | 683 |
| Proceeds from shares issued | 805 | 94,846* | - | - | (739) | - | 94,912 |
| **Total transactions with owners** | **805** | **94,846** | **-** | **-** | **3,798** | **-** | **99,449** |
| **Balance at 31 December 2017** | **7,560** | **145,927** | **97,967** | **20,069** | **16,061** | **3,229** | **290,813** |

*See note 22 on page122

| | Share capital | Share premium | Retained earnings | Exchange rate reserve | Other reserves | Non-controlling interests | Restated Total equity |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Balance at 1 January 2016 - Restated** | **6,655** | **49,600** | **65,723** | **7,925** | **10,221** | **2,433** | **142,557** |
| **Comprehensive income** | | | | | | | |
| Profit for the year | - | - | 17,859 | - | - | 164 | 18,023 |
| Other comprehensive income for the year | - | - | - | 23,060 | - | 560 | 23,620 |
| **Total comprehensive income for the year** | **-** | **-** | **17,859** | **23,060** | **-** | **724** | **41,643** |
| **Transactions with owners** | | | | | | | |
| Share based payments | - | - | - | - | 2,042 | - | 2,042 |
| Proceeds from shares issued | 100 | 1,481 | - | - | - | - | 1,581 |
| **Total transactions with owners** | **100** | **1,481** | **-** | **-** | **2,042** | **-** | **3,623** |
| **Balance at 31 December 2016 - Restated** | **6,755** | **51,081** | **83,582** | **30,985** | **12,263** | **3,157** | **187,823** |

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

The notes on pages 91 to 131 form an integral part of these consolidated financial statements.

## Consolidated cash flow statement for the year ended 31 December 2017

| | Note | 2017 £'000 | 2016 £'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| **Adjusted cash inflow from operations** | | **31,089** | **24,281** |
| Cash impact of adjustments | 5 | (1,372) | (1,818) |
| **Cash generated from operations** | 25 | **29,717** | **22,463** |
| Net interest paid | | (2,125) | (1,489) |
| Income tax paid | | (5,844) | (839) |
| **Net cash generated from operating activities** | | **21,748** | **20,135** |
| **Cash flows from investing activities** | | | |
| Acquisition deferred consideration Kopin Wireless | | - | (11,250) |
| Purchase of property, plant and equipment | | (11,260) | (10,956) |
| Purchase of intangible assets | | (2,419) | (1,794) |
| Capitalised development expenditure | | (14,511) | (6,310) |
| **Net cash used in investing activities** | | **(28,190)** | **(30,310)** |
| **Cash flows from financing activities** | | | |
| Proceeds from issuance of ordinary shares | | 94,912 | 578 |
| Proceeds from borrowings | 26 | 27,864 | 12,623 |
| Repayments of borrowings | 26 | (75,430) | (3,341) |
| **Net cash generated from financing activities** | | **47,346** | **9,860** |
| **Net increase/(decrease) in cash and cash equivalents** | | **40,904** | **(315)** |
| Cash and cash equivalents at 1 January | 27 | 4,957 | 4,644 |
| Exchange gains on cash and cash equivalents | | (249) | 628 |
| **Cash and cash equivalents at 31 December** | **27** | **45,612** | **4,957** |

The notes on pages 91 to 131 form an integral part of these consolidated financial statements

## Parent company balance sheet for the year ended 31 December 2017

| | Note | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 13 | 2,076 | 1,748 |
| Property, plant and equipment | 14 | 10 | 5 |
| Investments | 15 | 88,161 | 48,558 |
| Deferred tax assets | 10 | 5,252 | - |
| **Total non-current assets** | | **95,499** | **50,311** |
| **Current assets** | | | |
| Trade and other receivables | 17 | 114,229 | 96,944 |
| Cash and cash equivalents | | 31,281 | - |
| **Total current assets** | | **145,510** | **96,944** |
| **Total assets** | | **241,009** | **147,255** |
| **Current liabilities** | | | |
| Trade and other payables | 18 | (21,236) | (23,784) |
| Borrowings | 19 | - | (8,573) |
| **Total current liabilities** | | **(21,236)** | **(32,357)** |
| **Non-current liabilities** | | | |
| Borrowings | 19 | - | (34,524) |
| **Total non-current liabilities** | | **-** | **(34,524)** |
| **Total liabilities** | | **(21,236)** | **(66,881)** |
| **Net assets** | | **219,773** | **80,374** |
| | | | |
| **Shareholders' equity** | | | |
| Share capital | 22 | 7,560 | 6,755 |
| Share premium | | 145,927 | 51,081 |
| Retained earnings | | 50,476 | 10,089 |
| Other reserves | | 15,810 | 12,449 |
| **Total equity** | | **219,773** | **80,374** |

The notes on pages 91 to 131 form an integral part of these financial statements.

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

The financial statements on pages 91 to 131 were authorised for issue by the board of directors approved on 20 March 2018 and were signed on its behalf.

Phillip Rasmussen

P J Rasmussen

Dr A W Nelson

## Parent company statement of changes in equity for the year ended 31 December 2017

| | Share capital | Share premium | Retained earnings | Other reserves | Restated Total equity |
|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Balance at 1 January 2017 - Restated** | **6,755** | **51,081** | **10,089** | **12,449** | **80,374** |
| **Comprehensive expense** | | | | | |
| Profit for the year | - | - | 40,387 | - | 40,387 |
| **Total comprehensive expense** | **-** | **-** | **40,387** | **-** | **40,387** |
| **Transactions with owners** | | | | | |
| Share based payments | - | - | - | 3,854 | 3,854 |
| Tax relating to share options | - | - | - | 246 | 246 |
| Proceeds from shares issued | 805 | 94,846 | - | (739) | 94,912 |
| **Total transactions with owners** | **805** | **94,846** | **-** | **3,361** | **99,012** |
| **Balance at 31 December 2017** | **7,560** | **145,927** | **50,476** | **15,810** | **219,773** |

| | Share capital £'000 | Share premium £'000 | Retained earnings £'000 | Other reserves £'000 | Restated Total Equity £'000 |
|---|---|---|---|---|---|
| **Balance at 1 January 2016** | **6,655** | **49,600** | **12,505** | **10,407** | **79,167** |
| **Comprehensive expense** | | | | | |
| Loss for the year - restated | - | - | (2,416) | - | (2,416) |
| **Total comprehensive expense** | **-** | **-** | **(2,416)** | **-** | **(2,416)** |
| **Transactions with owners** | | | | | |
| Share based payments | - | - | - | 2,042 | 2,042 |
| Proceeds from shares issued | 100 | 1,481 | - | - | 1,581 |
| **Total transactions with owners** | **100** | **1,481** | **-** | **2,042** | **3,623** |
| **Balance at 31 December 2016 - Restated** | **6,755** | **51,081** | **10,089** | **12,449** | **80,374** |

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

The notes on pages 91 to 131 form an integral part of these financial statements.

## Parent company cash flow statement for the year ended 31 December 2017

| | Note | 2017 £'000 | 2016 £'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash outflow from operations | 25 | (21,785) | (8,812) |
| Interest paid | | (1,846) | (1,278) |
| Income tax paid | | - | (78) |
| **Net cash used in operating activities** | | **(23,631)** | **(10,168)** |
| Purchase of intangible assets | | (375) | (347) |
| Purchase of property plant and equipment | | (11) | (6) |
| **Net cash used in investing activities** | | **(386)** | **(353)** |
| **Cash flows from financing activities** | | | |
| Proceeds from issuance of ordinary shares | | 94,913 | 578 |
| Proceeds from borrowings | | 27,194 | 12,623 |
| Repayments of borrowings | | (65,781) | (2,842) |
| **Net cash generated from financing activities** | | **56,326** | **10,359** |
| **Net decrease in cash and cash equivalents** | | **32,309** | **(162)** |
| Cash and cash equivalents at 1 January | | (1,028) | (866) |
| **Cash and cash equivalents at 31 December** | | **31,281** | **(1,028)** |

The notes on pages 91 to 131 form an integral part of these financial statements.

# Notes to the financial statements for the year ended 31 December 2017

## 1. General information

IQE plc ('the company') and its subsidiaries (together 'the group') develop, manufacture and sell advanced semiconductor materials. The group has manufacturing facilities in Europe, United States of America and Asia and sells to customers located globally.

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.

## 2. Significant accounting policies

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

### 2.1 Basis of preparation

The financial statements of IQE plc have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRS IC) interpretations adopted by the European Union and in accordance with the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements have been prepared under the historical cost convention except where fair value measurement is required by IFRS.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 3.

### 2.2 Going concern

The group meets its day to day working capital requirements through its bank facilities and available cash. The Group's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the group has adequate cash resources to continue operating for the foreseeable future such that the directors consider it appropriate to adopt the going concern basis of accounting in preparing the consolidated financial statements.

### 2.3 Changes in accounting policy and disclosures

***(a) New standards, amendments and interpretations.***

The following new standards, amendments and interpretations have been adopted by the group for the first time for the financial year beginning on 1 January 2017:

- Amendment to IFRS 12 "Disclosure of other interests in entities' clarifying scope.
- IAS Amendments to IAS 7, Statement of cash flows on disclosure initiative.
- Amendments to IAS 12,'Income taxes' on Recognition of deferred tax assets for unrealised losses.

The adoption of these standards and amendments has not had a material impact on the groups consolidated financial statements.

***(b) New standards, amendments and interpretations issued but not effective and not adopted early***

A number of new standards, amendments to standards and interpretations which are set out below are effective for annual periods beginning after 1 January 2017 and have not been applied in preparing these consolidated financial statements.

- Annual improvements 2014-2016 cycle
- Amendment to IFRS 2, 'Share based payments' to clarify the classification and measurement of certain share based payment transactions
- IFRS 9 'Financial instruments'
- IFRS 15 'Revenue from contracts with customers'
- IFRS 16 'Leases'
- IFRS 17 'Insurance contracts'
- Amendment to IAS 28 'Investments in associates and joint ventures' to clarify certain fair value measurements
- Amendment to IAS 40 'Investment property' to clarify transfers or property, to, or from, investment property

The Directors anticipate that none of the new standards, amendments to standards and interpretations is expected to have a significant effect on the financial statements of the group or parent company, except for IFRS 16 'Leases' and IFRS 15, 'Revenue from contracts with customers'.

IFRS16, 'Leases' addresses the definition of a lease, the recognition and measurement of leases and establishes principles for reporting useful information to users of financial statements about the leasing activities of both lessees and lessors. A key change arising from IFRS 16 is that most operating leases will be accounted for on balance sheet for lessees. The standard replaces IAS 17 'Leases', and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2019. The Group currently leases a number of assets, principally property, under operating leases. The adoption of IFRS 16 will have a significant impact on the financial statements as the standard will require the operating leases to be accounted for through the recognition of a 'right of use asset' and a corresponding lease liability. Interest-bearing borrowings and non-current assets will increase on implementation of this standard. Operating lease costs will no longer be classified within the income statement based on amounts paid, but via a 'right of use asset' depreciation charge recognised within operating profit and a lease interest expense within finance costs. The impact will depend on the transition approach and the lease contracts in effect at the date of adoption. At 31 December 2017, operating lease commitments were £38,542,000 (see note 31) and operating lease charges for 2017 were £8,175,000 (see note 6).

IFRS15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction Contracts', and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018. The group has undertaken an assessment of the impact of IFRS 15 and at present, the directors anticipate that any changes in the recognition of revenue will relate to circumstances where the Group produces bespoke customer products with a guaranteed contractual right to payment. In these situations revenue is likely to be accelerated and recognised earlier in the manufacturing process than is currently the case where revenue is typically recognised on the delivery and acceptance of the goods by the customer. Acceleration of revenue recognition in these circumstances will increase revenue and accrued income and reduce work in progress and finished goods in the year the standard is adopted. The detailed impact of this change for each customer arrangement at the balance sheet date is still being quantified.

## 2.4 Consolidation

The consolidated financial statements comprise the results of IQE plc (the Company) and its subsidiary undertakings, together with the Group's share of the results of its associates and joint ventures.

*Subsidiaries*

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 and unrealised gains or losses on transactions between group companies are eliminated and 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 of 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.

Gains by the Group on transactions with joint ventures are eliminated against the carrying value of the Group's interest in its joint ventures to the extent that the gain does not exceed the carrying amount. In circumstances where a gain exceeds the carrying amount the Group has made an accounting policy choice to recognise the gain in the comprehensive income statement, subject to an assessment of recoverability of value from the joint venture rather than recognising the gain as deferred income in the consolidated balance sheet.

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. 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 the acquiree's identifiable net assets.

Acquisition related costs are expensed as incurred.

## 2.5 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 immediately charged to the 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 the assets 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 or 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 directly attributable 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 the development has been released into production.
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 paid 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.

**2.6 Property, plant and equipment**
Property, plant and equipment are 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 property, plant and equipment 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.

Costs incurred after initial recognition are included in the assets' carrying amounts or recognised as a separate asset as appropriate only when it is probable that future economic benefits associated with them will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial year in which they are incurred.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'profit/loss on disposal of property, plant and equipment' 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 2017 which resulted in no material changes to asset residual values and useful economic lives (2016: 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.

### 2.7 Impairment of non-financial assets

Intangible assets that have an indefinite useful life or intangible assets not ready to use are not subject to amortisation and are reviewed for potential impairment at least annually or more frequently if events or circumstances indicate a potential impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. 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).

### 2.8 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 selling expenses.

### 2.9 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.

### 2.10 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.

### 2.11 Preference share debt instruments

Preference share financial assets are debt instruments due from a related party (see note 30). Debt instruments are initially recognised at fair value and subsequently measured at amortised cost.

### 2.12 Financial assets

The group classifies its financial assets as loans and receivables. The classification depends on the purpose for which the financial assets were acquired and the classification is determined at the date of initial recognition. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the reporting period where the item is classified as a non-current asset. The group's loans and receivables comprise trade and other receivables (note 2.9), cash and cash equivalents (note 2.10) and preference share debt instruments (note 2.11).

Financial assets are recognised on the group's balance sheet when the group becomes a party to the contractual provisions of the financial instrument and are derecognised when the rights to receive cash flows have expired or have been transferred and the group has transferred substantially all the risks and rewards of ownership. Loans and receivables are carried at amortised cost using the effective interest method.

A financial asset is impaired and impairment losses are incurred if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event has an impact on the future cash flows of the financial asset that can be reliably estimated. Evidence of impairment may include indications that the debtor is experiencing significant financial difficulty, default or delinquency in payment and can include situations where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults. Trade and other 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. Debt instruments, represented by preference share debt are held at amortised cost less provision for impairment.

### 2.13 Financial liabilities

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. Financial liabilities are non-derivative financial liabilities with fixed or determinable payments and they are included in current liabilities, except for maturities greater than 12 months after the reporting period where the item is classified as a non-current liability. The group's financial liabilities comprise trade and other payables (note 2.14), borrowings (note 2.15) and finance leases (note 2.17) in the balance sheet.

### 2.14 Trade payables
Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables 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.

### 2.15 Borrowings
Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortised cost using the effective interest method.

### 2.16 Borrowing costs
General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

### 2.17 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 (net of any incentives received from the lessor) are charged to the Consolidated Income Statement in equal annual amounts over the lease term.

### 2.18 Government grants
Government grants are recognised at fair value when there is reasonable assurance that the Group has complied with the conditions attaching to them and the grants will be received. Grants related to purchase of assets are treated as deferred income and allocated to the income statement over the useful lives of the related assets while grants related to expenses are treated as other income in the income statement.

### 2.19 Share capital
Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

### 2.20 Provisions
Provisions for onerous leases and restructuring costs are recognised when: the Group has a present 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. Restructuring provisions comprise site closure costs and employee termination payments. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects the time value of money and the risks specific to 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.

### 2.21 Revenue recognition
Revenue represents the fair value of the consideration 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 for the sale of goods and services is recognised when the risks and rewards of the underlying sale have been transferred to the customer, which is on the delivery and acceptance of the goods or services by the customer.

Accrued income is recognised for sales under supplier managed inventory arrangements where, at the balance sheet date, goods have been delivered to the customer but billing has not yet taken place, on the basis that 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.

Intellectual property license income relates to the sale of finite and perpetual period licenses. Revenue is recognised for intellectual property licenses with a finite period on an accruals basis in accordance with the terms of the relevant licensing agreement. Revenue is recognised for perpetual intellectual property licenses when a signed agreement or other persuasive evidence of an arrangement exists, the intellectual property has been delivered, the license fee is fixed or determinable and collection of the resulting receivable is reasonably assured.

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

### 2.22 Segmental reporting
Operating segments are reported in a manner consistent with the internal reporting provided to the Executive 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 a product or service 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.

### 2.23 Pension costs
The group operates defined contribution pension schemes. A defined contribution plan is a pension plan under which the group pays fixed contributions into a separate entity. Contributions are charged in the Consolidated Income Statement as they become payable in accordance with the rules of the scheme. The group has no further obligations once the contributions have been made.

### 2.24 Share based payments
The group operates a number of equity-settled share based compensation plans under which the group receives services from employees as consideration for equity instruments 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 as a credit in other reserves in the consolidated statement of changes in equity except for the social security element of the award which is treated as cash settled with the liability recognised in other taxation and social security within trade and other payables in 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 or hold shares for a specific period of time).

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 consolidated 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 the balance to share premium. 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 charge will be treated as a cash-settled transaction.

### 2.25 Foreign currency
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 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".

### 2.26 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. Exceptional items 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 5.

### 2.27 Current and deferred tax
Income tax for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity, respectively.

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 research and development tax relief under the RDEC scheme are recognised within operating profit in the period in which the research and development costs are treated as an expense. 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.

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

**2.29 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.

**2.30 Prior year restatements**
The comparative information contained in the financial statements has been restated to reflect certain prior year adjustments detailed below.

**Group**
**a) Taxation**
In October 2017, the Group identified historical tax liabilities dating back to 2013 in a US subsidiary. The historical tax liabilities, interest and penalties have been quantified at £4,671,000 and the liability was settled in full in 2017 with the relevant US tax authority. The comparative information in the financial statements has been restated to reflect the tax liability as follows:

- The brought forward retained earnings at 1 January 2016 in the consolidated balance sheet and consolidated statement of changes in equity have been restated by £3,196,000 to reflect the historic tax liability relating to 2013, 2014 and 2015.
- The tax credit in the consolidated income statement for the year ended 31 December 2016 has been restated to reflect the historic tax liability of £748,000 relating to 2016;
- Other comprehensive income in the consolidated statement of changes in equity for the year ended 31 December 2016 has been restated by £727,000 to reflect an exchange loss on the opening 1 January 2016 restated tax liability; and
- Current liabilities in the consolidated balance sheet as at 31 December 2016 has been restated to include a current tax liability of £4,671,000 to reflect the cumulative historic tax liability.

The impact of the prior year restatement has been to reduce total comprehensive income in 2016 by £1,475,000, reduce brought forward reserves at 1 January 2016 by £3,196,000, reduce net assets by £4,671,000 and reduce basic, diluted, adjusted basic and adjusted diluted earnings per share measures by 0.11p. The prior year restatement has no impact on the prior year cash flow as the tax liability was settled in 2017.

**b) Financial assets**
The Group classifies its preference share financial assets as debt instruments. Debt instruments are initially recognised at fair value and subsequently measured at amortised cost.

The debt instruments recognised in the balance sheet were originally recognised at their nominal value. However, this did not discount the carrying value to reflect the forecast repayment profile of the debt.

The initial fair value of the debt instruments has been restated to reflect the impact of discounting on the debt cash flows. The fair value of the instrument at initial recognition has been recalculated by discounting the cash flows using a rate of 5.5%. This rate was determined based on a comparable market transaction.

The impact of this restatement on the comparative information in the financial statements has been as follows:

- Brought forward retained earnings at 1 January 2016 in the comparative financial information in the consolidated balance sheet and consolidated statement of changes in equity has been restated by £1,281,000 to reflect the restated initial fair value of the instruments on initial recognition in 2015.
- The interest charge in the consolidated income statement for the year ended 31 December 2016 has been restated to include a credit of £170,000 to reflect the non-cash unwind of the discounting associated with the initial fair value recognition of the instrument.

The impact of the prior year restatement in the 2016 comparative financial information has been to reduce brought forward reserves by £1,281,000, increase profit for the year by £170,000 for the non-cash unwind of discount, reduce net assets by £1,111,000 and increase basic earnings per share by 0.03p, increase diluted earnings per share by 0.02p. The prior year restatement has no impact on adjusted basic or adjusted diluted earnings per share or on cash flow.

**c) Segmental analysis disclosure**
In the reported results for the 6 months ended 30 June 2017, as part of the group's ongoing improvements to the disclosures in its financial reports the group separately disclosed central corporate costs, which has previously been allocated by segment. The segmental

analysis disclosure for 2016 has similarly been updated in this annual report. Central corporate costs include all head office and other corporate related support functions.

Restatement of the 2016 disclosure has no impact on profit for the year, net assets, cash flow or earnings per share.

**d) Social security costs associated with outstanding long term incentive and share option awards**

In 2016 the social security costs associated with outstanding share options was unrecorded and therefore the comparative information in the financial statement has been restated as follows:

- Profit for the year in the consolidated income statement has been restated by £839,000 (company: £835,000) to reflect the social security costs associated with outstanding share options;
- Other taxation and social security within trade and other payables in the consolidated balance sheet has been restated by £839,000 (company: £835,000) to reflect the social security liability associated with outstanding share options.

The impact of the prior year restatement in the 2016 comparative financial information has been to reduce profit for the year by £839,000, increase trade and other payables by £839,000, reduce net assets by £839,000 and reduce basic and diluted earnings per share measures by 0.12p. The prior year restatement has no impact on adjusted basic or adjusted diluted earnings per share or on cash flow.

**Company**

**e) Fixed asset investments and amounts due to group undertakings**

Fixed asset investments and amounts owed to group undertakings in the Company balance sheet have been restated to reflect a presentational error following the acquisition of a group company by IQE plc from an intermediate subsidiary parent company in 2016.

The comparative financial information has been restated to correctly gross up the carrying value of fixed asset investments and to gross up amounts owed to group undertakings as follows:

- "Fixed asset investments" in the comparative financial information in the company balance sheet has been restated by £19,091,000 to reflect the cost of investment in the acquired subsidiary undertaking.
- Amounts owed to group undertakings in the comparative financial information in the company balance sheet has been restated by £20,488,000 to reflect the exchange adjusted purchase consideration that remains outstanding to the intermediate subsidiary parent company.
- Loss for the year in the comparative financial information for the company has been restated by £1,397,000 to reflect the exchange loss on the retranslation of the foreign currency denominated purchase consideration that remains outstanding on the intercompany account.

## 3. Critical accounting judgements and key sources of estimation uncertainty

The group's principal accounting policies are described in note 2. 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 significant judgement and estimation are set out below:

**(a) Critical accounting judgements in applying the Group's accounting policies**

**Joint Ventures - Evaluation of rights, levels of control and influence**

The determination of the level of influence or control that the Group has over a business is a mix of contractually defined and subjective factors that can be critical to the appropriate accounting treatment of an entity in the Group's consolidated financial statements. Control or influence is achieved through Board representation and by obtaining rights of veto over significant decisions relevant to the activities of the entity.

Investments where the Group holds less than 20% of the equity are treated as fixed asset investments. These investments are carried at cost less provision for impairment.

Investments where the Group does not have control but owns between 20% and 51% of the equity of an entity and is in a position to exercise significant influence over the entity's strategic, operating and financial policies are treated as a joint arrangement or an associate.

The Group applies judgement when assessing whether its joint arrangements represent a joint operation or a joint venture. The Group determines the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement including an assessment of the structure and legal form of the arrangement and the terms agreed by the parties in the contractual arrangement. The Group's 50% interest in The Compound Semiconductor Centre Limited (see note 29) and 51% interest in CSDC Private Limited (see note 29) are treated as joint ventures.

**Joint Ventures – Right of use asset**

The Group established the Compound Semiconductor Centre Limited on 9 July 2015 with its joint venture partner as a centre of excellence for the development and commercialisation of advanced compound semiconductor wafer products in Europe.

On establishment of the joint venture the Group contributed assets valued at £12,000,000 as part of its initial investment and entered into an agreement with the joint venture that conveys to the Group the right to use the assets of the joint venture for a minimum five year period. This agreement that contains rights attaching to the use of the joint venture's assets has been treated as an operating lease in accordance with IFRIC 4

'Determining whether an arrangement contains a lease' in the application of the Group's accounting policies. The requirements of IAS17 have been considered in determining whether this lease should be classified as an operating lease or a finance lease including that the lease term is not for the major part of the expected useful economic life of the assets and the present value of the minimum lease payments is not substantially all of the fair value of the assets, the Group has concluded that it has an operating lease.

**(b) Critical accounting estimates and key sources of estimation uncertainty**

**3.1 Useful economic lives and residual values of property, plant and equipment**
The useful economic life and residual value of property, plant and equipment is reviewed annually. The useful economic life and residual value of an asset is assessed by considering the expected usage, estimated technical obsolescence, physical wear and tear and the operating environment in which the asset is located. Differences between such estimates and actual results may have a material impact on the amount of the carrying values of the property, plant and equipment and may result in adjustments to future rates of depreciation.

**3.2 Useful economic lives of development cost intangible assets**
The periods of amortisation used for product and process development cost assets require judgements to be made on the estimated useful economic lives of the intangible assets to determine an appropriate rate of amortisation. Capitalised development costs are amortised in line with the expected production volume profile of the products to which they relate over the period during which economic benefits are expected to be received which is typically between 3 – 8 years.

The amortisation charge for development cost intangible assets in the current year is £4,349,000. If useful economic lives of development cost intangible assets were reduced by 1 year across the whole portfolio of assets the impact on current year amortisation would be to increase the charge by £670,000 to £5,019,000.

**3.3 Impairment of financial assets – preference share debt**
The Group classifies its preference share financial assets as debt instruments. The initial fair value of the instruments issued by the Group's joint venture, Compound Semiconductor Centre Limited ('CSCL') in 2015 have been restated in the financial statements to reflect discounting associated with the debt cash flows (see note 2.30).

The carrying value of the preference share financial assets are subject to review for impairment on an annual basis or if events or circumstances provide an indication that the carrying value may no longer be recoverable from future estimated cash flows.

The carrying value of the preference share debt due from CSCL has been reviewed for impairment based upon a combination of the progress and milestones that CSCL has achieved against its original business plan, current cash flow forecasts and the capacity for CSCL to redeem the debt. In light of the progress that CSCL has made against its original business plan, current cash flow forecasts and the assessed ability of CSCL to redeem shareholder preference debt the Board has concluded that the amortised cost carrying value of the preference share debt is not impaired.

**3.4 Inventory provisions**
Inventories are carried at the lower of cost and net realisable value. Net realisable value is reviewed in detail on an on-going basis and provision for inventory obsolescence is made based on a number of factors including the age of inventories, the risk of obsolescence and the expected future usage. Differences between such estimates and actual market conditions may have a material impact on the amount of the carrying values of inventory and may result in adjustments to cost of sales. See note 16 for additional details.

**3.5 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, capital expenditure and the utilisation of tax losses for each relevant tax jurisdiction where the Group operates.

The Group has recognised significant deferred income tax assets in relation to historical tax losses in its operations in the United Kingdom (£30,126,000) and United States of America (£79,493,000) which require judgement to determine the extent of the assets recoverability at each balance sheet date. The Group assesses recoverability of its deferred tax assets by reference to Board approved budgets and cash flow forecasts which are also used as the basis for the Group's impairment and going concern reviews.

**3.6 Onerous lease provision**
A provision for onerous leases was made in 2015 following the restructuring of the Group's operations in Singapore. The provision assumes that the lease will be onerous for the next 18 months. 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 extends until 2021.

**3.7 Adjustments to profit**
The board provides an adjusted profit measure to provide additional information to aid an understanding of the group's performance as set out in note 5 where we have detailed all of the items which are included within the adjustments to profit.

## 4. Segmental analysis

The Chief Operating Decision Maker is defined as the executive directors. The executive directors consider that the Wireless, Photonics, Infra-red and CMOS++ markets are the Group's primary reporting segments. The executive directors assess 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.

| | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| **Revenue** | | |
| Wireless | 91,628 | 91,291 |
| Photonics | 47,641 | 22,792 |
| Infra-Red | 11,955 | 10,560 |
| CMOS++ | 1,382 | 1,406 |
| **Total Segment Revenue** | **152,606** | **126,049** |
| License income from joint ventures | 1,874 | 6,658 |
| **Total Revenue** | **154,480** | **132,707** |
| **Adjusted operating profit** | | |
| Wireless | 13,718 | 13,040 |
| Photonics | 18,198 | 9,254 |
| Infra-Red | 3,259 | 2,651 |
| CMOS++ | (1,677) | (1,576) |
| Central corporate costs | (9,013) | (7,908) |
| **Segment adjusted operating profit** | **24,485** | **15,461** |
| Profit from license income from joint ventures | 1,874 | 6,658 |
| **Adjusted operating profit** | **26,359** | **22,119** |
| Adjusted items (see note 5) | (9,340) | (4,255) |
| Net reduction in contingent deferred consideration | - | 2,340 |
| Restructuring and reorganisation | - | (378) |
| **Operating profit** | **17,019** | **19,826** |
| Finance costs | (2,099) | (1,463) |
| **Profit before tax** | **14,920** | **18,363** |

The segmental disclosure for 2016 has been restated to separately disclose central costs following a reorganisation of the Group's functions. Central corporate costs include all head office and other corporate related support functions.

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

Measures of total assets and liabilities for each reportable segment are not reported to the chief operating decision maker and therefore have not been disclosed.

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

| | Segment | 2017 £'000 | 2017 % revenue | 2016 £'000 | 2016 % revenue |
|---|---|---|---|---|---|
| Customer 1 | Wireless | 27,444 | 18% | 32,480 | 24% |
| Customer 2 | Wireless | 23,714 | 15% | 28,456 | 21% |
| Customer 3 | Photonics | 23,000 | 15% | 499 | 0% |

There are no customers in the 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:

| | 2017 £'000 | 2016 £'000 |
|---|---|---|
| **Americas** | **95,084** | **88,794** |
| United States of America | 95,021 | 88,697 |
| Rest of Americas | 63 | 97 |
| **Europe, Middle East & Africa (EMEA)** | **14,332** | **15,915** |
| France | 498 | 435 |
| Germany | 6,697 | 4,652 |
| Israel | 1,843 | 2,077 |
| United Kingdom | 2,570 | 7,340 |
| Rest of EMEA | 2,724 | 1,411 |
| **Asia Pacific** | **45,064** | **27,998** |
| People's Republic of China | 1,246 | 1,413 |
| Japan | 5,057 | 3,830 |
| Taiwan | 31,350 | 17,287 |
| Rest of Asia Pacific | 7,411 | 5,468 |
| **Total revenue** | **154,480** | **132,707** |

Disclosure of non-current assets by location of assets:

| | Property, plant and equipment | | Intangible assets | |
|---|---|---|---|---|
| By location | 2017 £'000 | 2016 £'000 | 2017 £'000 | 2016 £'000 |
| USA | 50,025 | 56,097 | 73,528 | 77,336 |
| Singapore | 7,704 | 7,865 | 9,761 | 10,204 |
| Taiwan | 13,100 | 12,615 | 2,579 | 2,339 |
| UK | 19,971 | 8,424 | 22,645 | 14,093 |
| | **90,800** | **85,001** | **108,513** | **103,972** |

## 5. Adjusted profit measures

The group's results are reported after a number of adjusted items. The directors believe that the selected adjusted measures allow management and other stakeholders to better compare the performance of the Group between the current and prior year, without the effects of one-off or non-operational items and better reflects the normalised underlying earnings in the year. The tables below provide additional information to aid an understanding of the adjusted items and the impact on the Group's performance.

| (All figures £'000s) | Adjusted Results | Adjusted Items | **2017 Reported Results** | Adjusted Results | Adjusted Items | **Restated 2016 Reported Results** |
|---|---|---|---|---|---|---|
| **Revenue** | 154,480 | - | **154,480** | 132,707 | - | **132,707** |
| Cost of sales | (110,840) | (5,017) | (115,857) | (96,292) | (2,246) | (98,538) |
| **Gross profit** | 43,640 | (5,017) | **38,623** | 36,415 | (2,246) | **34,169** |
| Other income | - | - | - | - | 2,340 | 2,340 |
| SG&A | (17,259) | (4,323) | (21,582) | (14,249) | (2,387) | (16,636) |
| Profit on disposal of PPE | (22) | - | (22) | (47) | - | (47) |
| **Operating profit** | 26,359 | (9,340) | **17,019** | 22,119 | (2,293) | **19,826** |
| Finance costs | (2,019) | (80) | (2,099) | (1,489) | 26 | (1,463) |
| **Profit before tax** | 24,340 | (9,420) | **14,920** | 20,630 | (2,267) | **18,363** |
| Taxation | 483 | (918) | (435) | 62 | (402) | (340) |
| **Profit for the period** | 24,823 | (10,338) | **14,485** | 20,692 | (2,669) | **18,023** |

| (All figures £'000s) | Pre tax Adjustment | Tax Impact | **2017 Adjusted Results** | Pre tax Adjustment | Tax Impact | **Restated 2016 Adjusted Results** |
|---|---|---|---|---|---|---|
| Change in US tax rate | - | (7,003) | **(7,003)** | - | - | **-** |
| Share based payments | (7,526) | 5,439 | **(2,087)** | (2,881) | - | **(2,881)** |
| Amortisation of acquired intangibles | (1,429) | 563 | **(866)** | (1,374) | 444 | **(930)** |
| Gain on release of deferred consideration | - | - | **-** | 2,340 | (980) | **1,360** |
| Non cash rent charge | (385) | 69 | **(316)** | - | - | **-** |
| Discounting | (80) | 14 | **(66)** | 26 | 2 | **28** |
| Restructuring | - | - | **-** | (378) | 132 | **(246)** |
| **Total** | (9,420) | (918) | **(10,338)** | (2,267) | (402) | **(2,669)** |

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

The nature of the adjusted items is as follows:

- Change in US tax rate – This refers to a deferred tax charge of £7,003k (2016: £nil) relating to the impact of the change in US Federal tax rates from 35% to 21% and the associated reduction in value of the Group's US deferred tax asset.
- Share based payments – The charge recorded in accordance with IFRS 2 'Share based payment', of which £5,017k (2016: £1,920k) has been classified within cost of sales in gross profit and £2,509k (2016: £961k) has been classified as selling, general and administrative expenses in operating profit.
- Amortisation of acquired intangibles – The amortisation of customer contract intangible assets which arose in respect of the fair value exercise in previous acquisitions. The charge of £1,429k (2016: £1,374k) has been classified as selling, general and administrative expenses within operating profit.
- Gain on release of deferred consideration – The gain in 2016 related to the release of the balance of a provision for deferred consideration. This gain was classified as other income in operating profit. The deferred consideration was settled in full in 2016.
- Non-cash rent charge – The charge associated with rent free periods on leased property of £385k (2016: £nil) (New foundry in Newport) has been classified as selling, general and administrative expenses within operating profit.
- Discounting - This relates to the discounting of long term financial assets of £235k (2016: £nil) and the unwinding of discounting of long term balances of £155k (2016: £26k), and has been classified as finance costs within profit before tax.
- Restructuring – This cost relates to restructuring and reorganisation activities which were concluded in 2016. An amount of £326k was classified as cost of sales in gross profit, and £52k was classified as selling, general and administrative expenses within operating profit

These adjustments were non-cash, other than the restructuring charge in 2016. The cash impact of adjustments in the consolidated cash flow statement represent the rental cost associated with an onerous property lease provision.

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

| | 2017 £'000 | 2016 £'000 |
|---|---|---|
| **Profit attributable to equity shareholders** | 14,385 | 17,859 |
| Non-controlling interest | 100 | 164 |
| Tax | 435 | 340 |
| Share based payments | 7,526 | 2,881 |
| Finance costs | 2,099 | 1,463 |
| Depreciation of tangible fixed assets | 5,637 | 5,561 |
| Amortisation of intangible fixed assets | 6,388 | 5,377 |
| Loss/(Profit) on disposal of fixed assets | 22 | 47 |
| Non cash property lease charge (rent free period)* | 385 | - |
| Gain on release of contingent deferred consideration* | - | (2,340) |
| Restructuring and re-organisation costs* | - | 378 |
| **Adjusted EBITDA** | **36,977** | **31,730** |

* Exceptional items impacting Adjusted EBITDA include non-cash property lease charges associated with rent free periods, wireless business unit re-organisation costs and the release of contingent deferred consideration.

## 6. Operating profit

| | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| **The operating profit is stated after charging/(crediting):** | | |
| Depreciation of property, plant and equipment | 5,637 | 5,561 |
| Amortisation of non-current intangible assets | 6,388 | 5,377 |
| Services provided by auditors* | 247 | 125 |
| Operating lease rentals | 8,715 | 7,827 |
| Research and development | 69 | 143 |
| Exchange gains | 1,434 | (1,269) |
| Share based payments | 7,526 | 2,881 |
| Cost of raw materials consumed | 64,116 | 53,948 |
| Loss/(gain) on disposal of fixed assets | 22 | 47 |
| Exceptional items** | 385 | (1,962) |

The operating lease rental in the comparative financial information has been restated to include the cash costs payable to the Group's joint venture, Compound Semiconductor Centre Limited, associated with the Group's right of use of the joint ventures assets (see note 3 and 30).

*A schedule of services provided by the group's auditors and related fees is disclosed in the Corporate Governance Report.

**Exceptional items include the following items: non cash property lease charges associated with rent free periods, re-organisation costs and the release of contingent deferred consideration. Further details are provided in note 5.

## 7. Employee costs

| | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| **Employee costs (including directors' remuneration)** | | |
| Wages and salaries | 32,783 | 27,834 |
| Social security costs | 3,621 | 2,816 |
| Other pension costs | 1,286 | 1,035 |
| Charge for share based payments | 7,526 | 2,881 |
| | **45,216** | **34,566** |

| | 2017 Number | 2016 Number |
|---|---|---|
| **Average number of employees (including directors)** | | |
| Manufacturing | 400 | 364 |
| Selling, general and administrative | 191 | 111 |
| | **591** | **475** |

The charge for share based payments in the employee cost note for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

Directors' emoluments and compensation, share options and other long term incentive plan details, including details of all outstanding options and long term incentive awards and the value of director pension contributions paid are set out in the Remuneration Report on page 55 to 70 where the relevant disclosures have been highlighted as audited.

Key management within the group comprises the executive and non-executive directors, members of the management board and business unit leaders. Compensation to key management, including pensions of £253,000 (2016: £228,000), was £4,997,000 (2015: £4,545,000) and the charge for share-based payments was £5,792,000 (2016: £1,235,000).

## 8. Finance costs

| | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| Bank and other loans | 2,019 | 1,489 |
| Unwind of discount on long term balances | 80 | (26) |
| | **2,099** | **1,463** |

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

## 9. Taxation

| | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| Current tax on profits for the year | 505 | 1,694 |
| **Total current tax charge** | **505** | **1,694** |
| Origination and reversal of temporary differences | (70) | (1,354) |
| **Total deferred tax credit** | **(70)** | **(1,354)** |
| **Total tax charge** | **435** | **340** |

**Factors affecting total tax charge**

The tax credit assessed for the year is different from that resulting from applying the standard rate of corporation tax in the UK of 19.25% (2016: 20.00%). The differences are explained below:

| | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| Profit on ordinary activities before taxation | 14,920 | 18,363 |
| Tax charge at 19.25% thereon (2016: 20.00%) | (2,872) | (3,673) |
| Effects of : | | |
| Expenses not deductible for tax purposes | (1,063) | (119) |
| Overseas tax rate differences | 309 | (800) |
| Recognition of previously unrecognised tax losses | 3,957 | 3,285 |
| Tax losses utilised for which no deferred tax asset was recognised | 1,250 | - |
| Other deferred tax movements | 5,394 | 967 |
| Re-measurement of deferred tax – change in UK tax rate | (407) | - |
| Impact on deferred tax as a result of changes in tax rates | (7,003) | - |
| **Total tax charge for the year** | **(435)** | **(340)** |

Other deferred tax movements primarily relates to deferred tax recognised on share options.

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

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.

The US tax Reform Bill, H.R.1, which was substantively enacted on 22 December 2017, included legislation to reduce the main rate of US Federal tax from 35% to 21% from 1 January 2018. Accordingly, the closing US deferred tax asset 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.

## 10. Deferred Taxation

| Deferred tax asset | 2017 £'000 | 2016 £'000 |
|---|---|---|
| At 1 January | 18,181 | 14,210 |
| Income statement credit recognised in the year | 70 | 1,354 |
| Tax credit relating to components of other comprehensive income | 683 | - |
| Exchange differences | (1,166) | 2,617 |
| **At 31 December** | **17,768** | **18,181** |

The current portion of the deferred tax asset is £5,000,000 (2016: £1,300,000) in relation to utilisation of tax losses.

The movement in deferred tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

**Group**

| Deferred tax liabilities | Accelerated Capital Allowances £'000 | Intangibles £'000 | Total £'000 |
|---|---|---|---|
| At 1 January 2016 | (8,336) | (7,547) | (15,883) |
| Credited/(charged) to income statement | (708) | 722 | 14 |
| Exchange differences | (1,649) | (1,023) | (2,672) |
| **At 31 December 2016** | **(10,693)** | **(7,848)** | **(18,541)** |
| Credited to income statement | 3,228 | 3,098 | 6,326 |
| Exchange differences | 683 | 249 | 932 |
| **At 31 December 2017** | **(6,782)** | **(4,501)** | **(11,283)** |

| Deferred tax assets | Tax Losses £'000 | Other £'000 | Total £'000 |
|---|---|---|---|
| At 1 January 2016 | 26,661 | 3,432 | 30,093 |
| Credited/(charged) to income statement | 1,918 | (578) | 1,340 |
| Exchange differences | 4,831 | 458 | 5,289 |
| **At 31 December 2016** | **33,410** | **3,312** | **36,722** |
| Credited/(charged) to income statement | (8,933) | 2,677 | (6,256) |
| Credited to equity | - | 683 | 683 |
| Exchange differences | (2,075) | (23) | (2,098) |
| **At 31 December 2017** | **22,402** | **6,649** | **29,051** |

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 group did not recognise deferred income tax assets of £505,000 (2016: £14,339,000) in respect of losses amounting to £2,805,000 (2016: £39,856,000) that can be carried forward against future taxable income. The deferred tax asset would be recognised if sufficient profits from the same trade arise in future periods.

Tax losses arising in the UK totalling £32,931,000 have no date of expiry. Tax losses arising in the US can be carried forward against future taxable income for 20 years before expiring. Of the Group's total US tax losses of £79,493,000 losses amounting to £nil and £1,000 expire in 2018 and 2019.

Deferred tax liabilities have not been recognised for the withholding tax and other taxes that would be payable on the unremitted earnings of certain subsidiaries. Such amounts are permanently reinvested.

**R&D Tax Credits**
The Group recognised a credit of £487,000 (2016: £792,000) within operating profit in relation to claims made under the R&D Expenditure Credit Scheme (RDEC).

**Company**

| Deferred tax assets | Tax Losses £'000 | Share Options £'000 | Other Timing Differences £'000 | Total £'000 |
|---|---|---|---|---|
| At 1 January 2016 | - | - | - | - |
| Charged / (credited) to equity | - | - | - | - |
| **At 31 December 2016** | **-** | **-** | **-** | **-** |
| Credited to income statement | - | 4,974 | 32 | 5,006 |
| Credited to equity | - | 246 | - | 246 |
| **At 31 December 2017** | **-** | **5,220** | **32** | **5,252** |

There is an unrecognised deferred tax asset of £nil (2016: £1,645,000) which relates primarily to short term timing differences arising on share option charges.

## 11. Dividends

No dividend has been paid or proposed in 2017 (2016: £nil).

## 12. 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 adjusted items in order to provide a more meaningful measure of underlying profit. The adjustments are detailed in note 5.

| | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| Profit attributable to ordinary shareholders | 14,385 | 17,859 |
| Adjustments to profit after tax (note 5) | 10,338 | 2,669 |
| **Adjusted profit attributable to ordinary shareholders** | **24,723** | **20,528** |

| | 2017 Number | 2016 Number |
|---|---|---|
| Weighted average number of ordinary shares | 689,537,776 | 671,532,674 |
| Dilutive share options | 47,142,160 | 38,548,084 |
| **Adjusted weighted average number of ordinary shares** | **736,679,936** | **710,080,758** |
| Adjusted basic earnings per share | 3.59p | 3.06p |
| Basic earnings per share | 2.09p | 2.66p |
| Adjusted diluted earnings per share | 3.36p | 2.89p |
| Diluted earnings per share | 1.95p | 2.52p |

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

## 13. Intangible assets

| Group | Goodwill £'000 | Patents £'000 | Development costs £'000 | Software £'000 | Customer contracts £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At 1 January 2017 | 69,574 | 2,195 | 44,899 | 5,265 | 8,129 | 130,062 |
| Additions | - | 874 | 15,434 | 1,548 | - | 17,856 |
| Reclassified to investments | - | - | (75) | - | - | (75) |
| Foreign exchange | (5,166) | (26) | (2,637) | (13) | (702) | (8,544) |
| **At 31 December 2017** | **64,408** | **3,043** | **57,621** | **6,800** | **7,427** | **139,299** |
| | | | | | | |
| **Accumulated amortisation and impairment** | | | | | | |
| At 1 January 2017 | - | 291 | 18,847 | 1,268 | 5,684 | 26,090 |
| Charge for the year | - | 55 | 4,349 | 555 | 1,429 | 6,388 |
| Foreign exchange | - | (6) | (1,113) | (11) | (562) | (1,692) |
| **At 31 December 2017** | **-** | **340** | **22,083** | **1,812** | **6,551** | **30,786** |
| | | | | | | |
| **Net book value** | | | | | | |
| **At 31 December 2017** | **64,408** | **2,703** | **35,538** | **4,988** | **876** | **108,513** |
| At 31 December 2016 | 69,574 | 1,904 | 26,052 | 3,997 | 2,445 | 103,972 |

| Group | Goodwill £'000 | Patents £'000 | Development costs £'000 | Software £'000 | Customer contracts £'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 |

Reclassification in 2017 relates to the Group's investment in Seren Photonics Limited which has been reclassified to fixed asset investments.

Adjustment in 2016 relates to the write down of development costs relating to NanoGan following a reduction in the deferred consideration payable in relation to the NanoGaN acquisition.

Customer contract intangible assets relate to customer contracts acquired as part of a business combination.

The amortisation charge of £6,388,000 (2016: £5,377,000) has been charged to selling, general and administrative expenses in the Consolidated Income Statement.

The carrying value of deferred development costs are 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:

| | 2017 £'000 | 2016 £'000 |
|---|---|---|
| **Allocation of goodwill by CGU** | | |
| III/V Epitaxy | 57,284 | 61,776 |
| Substrates | 7,124 | 7,798 |
| **Total Goodwill** | **64,408** | **69,574** |

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. The Board approved 2018 budget, adjusted to exclude cash flows associated with expansion capital expenditure, has been used for the first year of the forecast.

Key assumptions applied in the forecasts include:

- EBITDA growth in years 2 to 5 of 10%,
- A long term growth rate of 2% (2016: 2%)
- Pre-tax weighted average cost of capital discount rate of 10% (2016: 10%)

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 c21% over the five year period driven by growth in Photonics and emerging markets.

No impairment would arise if the discount rate for the III/V Epitaxy and substrate CGU was increased from 10% to 15%.

No impairment would arise if the EBITDA compound growth rate in the 5 year forecast period for both the III/V Epitaxy and substrates CGU's was restricted to zero.

No impairment would arise if the discount rate for the III/V Epitaxy and substrate CGU was increased from 10% to 15% and the EBITDA growth rate in the 5 year forecast period was restricted to zero.

| Company | Patents £'000 | Software £'000 | Total £'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2017 | 1,372 | 416 | 1,788 |
| Additions | 227 | 148 | 375 |
| **At 31 December 2017** | **1,599** | **564** | **2,163** |
| **Accumulated amortisation** | | | |
| At 1 January 2017 | - | 40 | 40 |
| Charge for the year | - | 47 | 47 |
| **At 31 December 2017** | **-** | **87** | **87** |
| **Net book value** | | | |
| **At 31 December 2017** | **1,599** | **477** | **2,076** |
| At 31 December 2016 | 1,372 | 376 | 1,748 |

| 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 |

## 14. Property, plant and equipment

| Group | Land and buildings £'000 | Short leasehold improvements £'000 | Fixtures and fittings £'000 | Plant and machinery £'000 | Total £'000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 January 2017 | 8,682 | 34,400 | 5,437 | 149,022 | 197,541 |
| Additions | 321 | 70 | 367 | 15,628 | 16,386 |
| Disposals | - | - | - | (1,638) | (1,638) |
| Foreign exchange | (272) | (2,358) | (169) | (9,370) | (12,169) |
| **At 31 December 2017** | **8,731** | **32,112** | **5,635** | **153,642** | **200,120** |
| **Accumulated depreciation** | | | | | |
| At 1 January 2017 | 3,610 | 17,774 | 3,817 | 87,339 | 112,540 |
| Charge for the year | 182 | 547 | 335 | 4,573 | 5,637 |
| Disposals | - | - | - | (1,615) | (1,615) |
| Foreign exchange | (64) | (945) | (153) | (6,080) | (7,242) |
| **At 31 December 2017** | **3,728** | **17,376** | **3,999** | **84,217** | **109,320** |
| **Net book value** | | | | | |
| **At 31 December 2017** | **5,003** | **14,736** | **1,636** | **69,425** | **90,800** |
| At 31 December 2016 | 5,072 | 16,626 | 1,620 | 61,683 | 85,001 |

Property, plant and equipment includes assets in the course of construction with a net carrying value of £9,989,000 (2016: £nil) primarily relating to plant and equipment purchased for the group's manufacturing site at Newport, United Kingdom.

| Group | Land and buildings £'000 | Short leasehold improvements £'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 |

| Company | Fixtures and fittings £'000 |
|---|---|
| **Cost** | |
| At 1 January 2017 | 76 |
| Additions | 11 |
| **At 31 December 2017** | **87** |
| **Accumulated depreciation** | |
| At 1 January 2017 | 71 |
| Charge for the year | 6 |
| **At 31 December 2017** | **77** |
| **Net book value** | |
| **At 31 December 2017** | **10** |
| At 31 December 2016 | 5 |

| 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 |

## 15. Investments

| Group | Other equity investments £'000 | Total £'000 |
|---|---|---|
| **Cost** | | |
| At 1 January 2017 | - | - |
| Reclassified from intangible assets | 75 | 75 |
| **At 31 December 2017** | **75** | **75** |

The reclassification in 2017 relates to the reclassification of the investment in Seren Photonics Limited from intangible assets to fixed asset investments.

| Company | Investments in subsidiaries £'000 | Other equity investments £'000 | Total £'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2017 – restated | 119,997 | 75 | 120,072 |
| Subsidiaries share based payments charge | 121 | - | 121 |
| **At 31 December 2017** | **120,118** | **75** | **120,193** |
| **Provisions for impairment** | | | |
| At 1 January 2017 | 71,514 | - | 71,514 |
| Reversal of impairment | (39,482) | - | (39,482) |
| **At 31 December 2017** | **32,032** | **-** | **32,032** |
| **Net book value** | | | |
| **At 31 December 2017** | 88,086 | 75 | 88,161 |
| At 31 December 2016 | **48,483** | **75** | **48,558** |

| Company | Investments in subsidiaries £'000 | Other equity investments £'000 | Restated Total £'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2016 | 100,509 | 75 | 100,584 |
| Additions | 19,091 | - | 19,091 |
| Subsidiaries share based payments charge | 397 | - | 397 |
| **At 31 December 2016** | **119,997** | **75** | **120,072** |
| **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** | **48,483** | **75** | **48,558** |
| At 31 December 2015 | 28,995 | 75 | 29,070 |

Additions to investments in subsidiaries for the year ended 31 December 2016 have been restated. Details of the restatement are set out in note 2.30.

Details of the company's subsidiaries are set out in note 28.

Investments are reviewed for impairment annually. Where the net realisable value is lower than the investment carrying value an impairment charge is recognised in the income statement. Indicators that impairment losses might have reversed are assessed annually. Where events or circumstances indicate that the impairment loss no longer exists, a reversal of the impairment charge is recognised in the income statement.

Provisions for impairment associated with the company's investment in its subsidiaries, EPI Holding Limited and Wafer Technology Limited have been reversed based upon actual and forecast performance of the underlying trading businesses. The recoverable amount of each investment 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 2018 budget is used for the first year of the forecast. The cash flow projections used are consistent with the cash flow projections used for the goodwill impairment review (see note 13).

## 16. Inventories

| | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Raw materials and consumables | 25,067 | 22,528 |
| Work-in-progress and finished goods | 8,640 | 5,970 |
| | **33,707** | **28,498** |

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 £6,273,000 (2016: £8,076,000). £440,000 (2016: £121,000) of inventories were written down during 2017 and an expense recognised in the income statement.

## 17. Trade and other receivables

| Current | 2017 Group £'000 | 2017 Company £'000 | Restated 2016 Group £'000 | Restated 2016 Company £'000 |
|---|---|---|---|---|
| Trade receivables | 18,440 | - | 14,424 | - |
| Amounts owed by group undertakings | - | 114,138 | - | 96,711 |
| Other receivables | 3,712 | - | 3,554 | 74 |
| Prepayments and accrued income | 10,088 | 91 | 12,890 | 159 |
| | **32,240** | **114,229** | **30,868** | **96,944** |

| Non-current | 2017 Group £'000 | 2017 Company £'000 | Restated 2016 Group £'000 | 2016 Company £'000 |
|---|---|---|---|---|
| Financial assets | 7,680 | - | 6,889 | - |

Non-current financial assets have been restated. Details of the restatement are set out in note 2.30. The comparative financial information has also been restated to separately reclassify other receivables previously reported within prepayments and accrued income.

As at 31 December 2016, 86% (2016: 71%) of trade receivables were within terms. Of the other trade receivables, 69% (2016: 81%) were less than 30 days past due. An allowance has been made for estimated irrecoverable amounts from the sale of goods of £222,000 (2016: £229,000). This allowance has been determined by reference to past default experience. Included in prepayments and accrued income is accrued income of £7,317,000 (2016: £10,421,000) relating to wireless supplier managed inventory sales. There was no accrued income relating to photonics supplier managed inventory arrangements (2016: £nil).

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 (2016: 5% per annum).

Financial assets relate to £8,800,000 of Preferred 'A' shares (2016: £8,000,000) issued by the Compound Semiconductor Centre Limited ('CSC'), a joint venture between the Group and Cardiff University (see Note: 29 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.

## 18. Trade and other payables

| Current | 2017 Group £'000 | 2017 Company £'000 | Restated 2016 Group £'000 | Restated 2016 Company £'000 |
|---|---|---|---|---|
| Trade payables | 23,554 | 1,139 | 23,331 | 773 |
| Amounts owed by group undertakings | - | 14,351 | - | 20,488 |
| Other taxation and social security | 4,778 | 4,151 | 2,046 | 940 |
| Other payables | 5,580 | - | 2,336 | - |
| Accruals and deferred income | 9,260 | 1,595 | 9,203 | 1,583 |
| | **43,172** | **21,236** | **36,916** | **23,784** |

The comparative financial information for the year ended 31 December 2016 has been restated to separately reclassify other payables previously reported within accruals and deferred income, to reclassify overseas tax payable as current tax liabilities as a separate line in the Consolidated Balance Sheet and to restate other taxation and social security as detailed in note 2.30.

Amounts owed by group undertakings in the company has been restated. Details of the restatement are set out in note 2.30.

Amounts owed to group undertakings are unsecured and repayable on demand. Interest is charged at a rate of 5% per annum (2016: 5% per annum).

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

There are no foreign currency exchange contracts held at 31 December 2017 or 31 December 2016.

## 19. Borrowings

| The Group | 2017 £'000 | 2016 £'000 |
|---|---|---|
| **Non-current borrowings:** | | |
| Bank borrowings | - | 36,854 |
| | **-** | **36,854** |
| **Current borrowings:** | | |
| Bank borrowings | - | 7,652 |
| | **-** | **7,652** |
| **Total borrowings** | **-** | **44,506** |

| Bank borrowings | 2017 £'000 | 2016 £'000 |
|---|---|---|
| **Bank borrowings fall due for repayment as follows:** | | |
| Within one year | - | 7,652 |
| Between one and five years | - | 34,906 |
| After five years | - | 1,948 |
| | **-** | **44,506** |

**The company**

The borrowings of the parent company comprise the bank loan of £nil (2016: £42,069,000). The prior period bank loans comprised multi-currency acquisition, capital expenditure and revolving credit facilities and an overdraft of £nil (2016: £1,028,000).

| The Company | 2017 £'000 | 2016 £'000 |
|---|---|---|
| **Non-current borrowings:** | | |
| Bank borrowings | - | 34,524 |
| | **-** | **34,524** |
| **Current borrowings:** | | |
| Bank overdraft | - | 1,028 |
| Bank borrowings | - | 7,545 |
| | **-** | **8,573** |
| **Total borrowings** | **-** | **43,097** |

| | 2017 £'000 | 2016 £'000 |
|---|---|---|
| **Bank borrowings fall due for repayment as follows:** | | |
| Within one year | - | 8,573 |
| Between one and years | - | 34,524 |
| | **-** | **43,097** |

The Group and Company repaid bank loans comprising its multi-currency acquisition loan, capital expenditure loan and revolving credit facilities on 21 November 2017 following an equity placing (see note 22).

## 20. Provisions for other liabilities and charges

| | 2017 £'000 | 2016 £'000 |
|---|---|---|
| **As at 1 January** | **3,588** | **4,038** |
| Charged to the income statement | - | 104 |
| Utilised during the year | (1,372) | (1,283) |
| Foreign exchange | (16) | 729 |
| **As at 31 December** | **2,200** | **3,588** |

| | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Current | 1,534 | 1,421 |
| Non-current | 666 | 2,167 |
| **Total provisions for liabilities and charges** | **2,200** | **3,588** |

During 2015, as part of the re-organisation and rationalisation of the Group's operations the Group restructured its activities in Singapore and established with its joint venture partners the Compound Semiconductor Development Centre. The Group sub-lets space at its Singapore manufacturing facility to its joint venture (see note 30) and established an onerous lease provision for vacant space at the property following the re-organisation. The onerous lease provision is expected to be utilised over the next one and a half years. The provision has been discounted using a risk free rate of 2.5%.

## 21. 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.

Customer credit risk is managed at the Group and site level with credit risk assessments completed for all customers. If no independent credit rating is available the credit quality of the customer is assessed by reference to the customers' financial position, past experience and other relevant factors. Individual credit limits are set based on internal or external ratings in accordance with the Group's credit risk policies. 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. The group has historically experienced low levels of payment default.

Counterparty risk associated with monies on deposit with financial institutions is managed at the Group level in accordance with the Group's treasury policies. The credit quality of banks has been assessed by reference to external credit ratings, based on reputable credit agencies long term issuer ratings.

The maximum exposure to credit risk at the reporting date in relation is the carrying value of each class of financial asset is 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.

| Assets as per balance sheet | 2017 Group £'000 | 2017 Company £'000 | Restated 2016 Group £'000 | Restated 2016 Company £'000 |
|---|---|---|---|---|
| **Carrying amount – Loans and Receivables** | | | | |
| Cash and cash equivalents | 45,612 | 31,281 | 4,957 | - |
| Trade receivables | 18,440 | - | 14,424 | - |
| Amounts owed by group undertakings | - | 114,138 | - | 96,711 |
| Other receivables excluding prepayments | 11,029 | - | 13,975 | 74 |
| Financial Assets (Preference share receivables) | 7,680 | - | 6,889 | - |
| | **82,761** | **145,419** | **40,245** | **96,785** |

Included in other receivables is accrued income of £7,317,000 (2016: £10,421,000).

The Group is exposed to credit concentration risk with its three largest customers which represent 64% (2016: 56%) of outstanding trade receivables and accrued income balances. Customer credit risk is managed according to strict credit control policies. The majority of the group's revenues are derived from large multinational organisations that are established customers of the Group with no prior history of default such that credit risk is considered to be low. The Group monitors customer D&B credit ratings and has had no material defaults in the past. None of the receivables are with customers where we have had any history of default.

| | Gross 2017 £'000 | Provision 2017 £'000 | Net 2017 £'000 | Gross 2016 £'000 | Provision 2016 £'000 | Net 2016 £'000 |
|---|---|---|---|---|---|---|
| Not past due | 15,012 | - | 15,012 | 9,569 | - | 9,569 |
| Past due 0-30 | 2,513 | - | 2,513 | 4,112 | - | 4,112 |
| Past due more than 30 | 1,137 | 222 | 915 | 972 | 229 | 743 |
| | **18,662** | **222** | **18,440** | **14,653** | **229** | **14,424** |

An allowance has been made for estimated irrecoverable amounts from the sale of goods of £222,000 (2016: £229,000). 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 18). 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 2017 a 1 cent movement in the US dollar to Sterling rate would impact the net value of these instruments by £13,000 (2016: £20,000) (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.

The Group ensures that it has sufficient borrowing facilities to meet foreseeable operational expenses. At the year end the group had available facilities of £1.0m (2016: £65.0m).

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 | Carrying amount | Contractual Cash flows | Less than 12 months | 1 –2 Years | 2–5 Years | 5+ Years |
|---|---|---|---|---|---|---|
| **31 December 2017** | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** |
| Trade and other payables | 29,134 | 29,134 | 29,134 | - | - | - |
| | **29,134** | **29,134** | **29,134** | **-** | **-** | **-** |

| Analysis of contractual cash flow maturities - Other financial liabilities at amortised cost | Carrying amount | Contractual Cash flows | Less than 12 months | 1 – 2 Years | 2 – 5 Years | 5+ Years |
|---|---|---|---|---|---|---|
| **31 December 2016 - restated** | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** |
| Trade and other payables | 25,667 | 25,667 | 25,667 | - | - | - |
| Secured bank loans | 44,506 | 47,745 | 9,251 | 32,731 | 2,860 | 2,903 |
| | **70,173** | **73,412** | **34,918** | **32,731** | **2,860** | **2,903** |

**Financial risk management**

**Market risk**

*Foreign Exchange Risk*

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar, Taiwanese dollar, Singapore dollar, Japanese yen and Euro. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations.

The group's presentational currency is sterling. The majority of the Group's sales are denominated in US dollars and 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 2017 and 31 December 2016 there were no contracts in place.

The group has certain investments in foreign operations in North America, Taiwan and Singapore, whose net assets are exposed to foreign currency translation risk. Translation exposures that arise on converting the results of overseas subsidiaries are not hedged.

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 £8,000 (2016: £62,000).

**Cash flow and fair value 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.

The Group's interest rate risk arises from its cash and cash equivalents and its preference share financial assets following repayment of all the Group's bank borrowings during the year. Cash and cash equivalents, including foreign currency cash deposits earn interest at prevailing variable market rates of interest whilst the preference share debt earns interest at HSBC Bank Plc base rate.

Prior to the repayment of all the group's bank borrowings during the year the group's borrowings consisted of a series of variable and fixed rate term loans, a revolving credit facility, overdrafts and an asset lending facility. Bank loans, the revolving credit facility and overdrafts were secured against the assets of the group and the asset lending facility was secured against the specific assets to which it related.

The fixed rate US dollar term loans, which had a principal outstanding of £2.4m at 31 December 2016 bore interest of 5% until 2017. These loans were repayable by monthly instalment prior to its repayment.

The US Dollar acquisition facility, which had a principal outstanding of £6.5m at 31 December 2016 bore interest of between 2.5% to 2.95% over LIBOR. This loan was repayable by quarterly instalments prior to its repayment.

The US Dollar revolving credit facility was a multi-currency facility of up to $63 million, committed until 2018 that bore interest of between 1.75% and 1.90% over LIBOR.

The UK Sterling capital expenditure facility, which had a principal outstanding of £5.0m at 31 December 2016 bore interest at 1.90% over the Bank of England base rate. This loan was repayable by monthly instalment prior to its repayment.

The UK asset lending facility, which was drawn down during the year bore interest at 1.7% per annum over LIBOR. This loan was repayable by monthly instalment prior to its repayment.

The group's policy is to regularly review its exposure to interest rate risk, and in particular the mix between fixed and floating rate financial assets and financial liabilities. The percentage of financial assets bearing variable rate interest was 100% (2016: 100%). The Group had no interest bearing financial liabilities at 31 December 2017.

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 on the interest bearing financial assets held at 31 December 2017 would impact annual interest income by approximately £230,000. At 31 December 2016 the group had interest bearing financial liabilities. A 50 basis point (0.5%) movement in interest rates on the interest bearing financial liabilities held at 31 December 2016 would have impacted the annual interest charge prior to the redemption of the bank borrowings by approximately £170,000.

**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. Total capital at 31 December 2017 was £245,201,000 (2016: £227,372,000).

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 nil (2016: 17%).

All covenants in relation to the group's borrowing facilities were complied with prior to the repayment of the borrowings during the year.

**Fair values**

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

| | 2017 Carrying amount £'000 | 2017 Fair value £'000 | Restated 2016 Carrying amount £'000 | Restated 2016 Fair value £'000 |
|---|---|---|---|---|
| Cash and Cash equivalents | 45,612 | 45,612 | 4,957 | 4,957 |
| Trade receivables | 18,440 | 18,440 | 14,424 | 14,424 |
| Other receivables | 3,712 | 3,712 | 3,554 | 3,554 |
| Accrued income | 7,317 | 7,317 | 10,421 | 10,421 |
| Financial Assets (Preference share receivables) | 7,680 | 7,680 | 6,889 | 6,889 |
| Trade and other payables | (29,133) | (29,133) | (25,667) | (25,667) |
| Secured bank loans | - | - | (44,506) | (44,798) |
| | **53,628** | **53,628** | **(29,928)** | **(30,220)** |

**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.

**Cash and cash equivalents**
Cash and cash equivalents earn interest at prevailing variable market rates of interest such that the carrying value of cash and cash equivalents is deemed to reflect fair value.

**Trade receivables, other receivables and accrued income**
Trade receivables, other receivables and accrued income are short term assets with a remaining life of less than one year such that the amortised cost carrying value of the assets is deemed to reflect fair value.

**Trade and other payables**
Trade and other payables are short term liabilities with a remaining life of less than one year such that the amortised cost carrying value of the liabilities is deemed to reflect fair value.

**Financial Assets (Preference share receivables)**
The fair value of preference share receivables at the initial date of recognition has been restated to reflect the impact of discounting the cash flows using a rate of 5.5% (see note 2.29). The carrying value of the preference shares have been assessed for impairment (see note 3.4) with the cash flow forecasts used as part of this assessment indicating that amortised cost is deemed to reflect fair value.

**Secured loans**
As the loans are floating rate borrowings, amortised cost is deemed to reflect fair value excluding unamortised transaction fees.

## 22. Share capital

| Group and Company | 2017 Number of shares | 2017 £'000 | 2016 Number of shares | 2016 £'000 |
|---|---|---|---|---|
| **Allotted, called up and fully paid** | | | | |
| Ordinary shares of 1p each | 756,050,549 | 7,560 | 675,506,061 | 6,755 |

The movement in the number of ordinary shares during the year was:

| | 2017 Number | 2016 Number |
|---|---|---|
| At 1 January | 675,506,061 | 665,533,170 |
| Employee share schemes | 12,602,907 | 4,831,424 |
| Translucent equity consideration | - | 5,141,467 |
| Equity placing | 67,941,581 | - |
| **At 31 December** | **756,050,549** | **675,506,061** |

80,544,488 ordinary shares (2016: 9,972,891 ordinary shares) were issued during the year as follows:

| | 2017 Number of shares | 2017 Consideration | 2016 Number of shares | 2016 Consideration |
|---|---|---|---|---|
| Equity share placing | 67,941,581 | 1.40p | - | - |
| Employee share schemes | 12,602,907 | Nil to 50.3p | 4,831,424 | Nil to 36.5p |
| Translucent equity consideration | - | - | 5,141,467 | Nil |
| | **80,544,488** | | **9,972,891** | |

The share premium arising from the equity share placing consideration received of £95,118,213 (2016: £nil) was £94,438,797 (2016: £nil). Costs associated with the equity share placing totalling £2,006,366 have been debited to share premium.

The share premium arising from consideration received from employee share scheme exercises of £2,541,029 (2016: £578,000) was £2,415,000 (2016: £1,481,000).

## 23. Share based payments

The total amount charged to the income statement in 2017 in respect of share based payments was £7,526,000 (2016: £2,881,000). Included within the share based payments charge is a £5,668,000 (2016: £2,037,000) charge relating to the Company's Long Term Incentive Plan.

*Long term incentive plan*
IQE plc operates a long term incentive plan for executive directors. Details of the long term incentive plan are set out in the Remuneration Report set out on page 55 to 70.

*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.

Long term incentive awards and share options are valued using either the Black-Scholes option-pricing model or the Monte Carlo simulation model with the total fair value of the award that is to be expensed charged to the income statement over the vesting period of the long term incentive award or share option. The principal assumptions used in the calculation of the fair value of long term incentive awards and share options are as follows:

| Principal assumptions | 2017 | 2016 |
|---|---|---|
| Weighted average share price at grant date | 24.56p | 25.21p |
| Weighted average exercise price | 8.93p | 15.63 |
| Weighted average vesting period (years) | 3 | 3 |
| Option life (years) | 10 | 10 |
| Weighted average expected life (years) | 3 | 3 |
| Weighted average expected volatility factor | 56% | 52% |
| Weighted average risk free rate | 1.20% | 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 long term incentive awards and share options granted during the year ended 31 December 2017 was £3,998,000 (2016: £3,678,693).

The movements on long term incentive awards and share options during the year were as follows:

| | 2017 Number of options | 2017 Average exercise price (pence) | 2016 Number of options | 2016 Average exercise price (pence) |
|---|---|---|---|---|
| At 1 January | 60,557,376 | 9.42 | 45,532,098 | 13.14 |
| Granted | 10,382,654 | 6.42 | 19,258,119 | 2.02 |
| Exercised | (11,468,580) | 15.68 | (3,744,854) | 15.63 |
| Cancelled/lapsed | (2,119,505) | 18.63 | (487,987) | 17.81 |
| **At 31 December** | 57,351,945 | 7.29 | 60,557,376 | 9.42 |

The weighted average share price at the date share options were exercised during 2017 was 94.50p (2016: 21.48p).

No long term incentive awards were exercised during the year (2016: Nil).

As at 31 December 2017, the total number of long term incentive awards and share options held by employees was 57,351,945 (2016: 60,557,376) as follows:

| Option price pence/share | Option period ending | 2017 Number of options | 2016 Number of options |
|---|---|---|---|
| 13.58p - 19.42p | 31 December 2017 | - | 4,690,404 |
| 16.10p - 16.10p | 31 December 2018 | 1,496,029 | 136,875 |
| 3.65p - 17.07p | 31 December 2019 | 3,354,566 | 4,880,325 |
| 0.00p – 45.58p | 31 December 2020 | 913,777 | 1,288,498 |
| 9.15p – 50.25p | 31 December 2021 | 3,121,379 | 4,665,068 |
| 0.00p – 28.17p | 31 December 2022 | 5,210,518 | 5,112,392 |
| 0.00p – 27.75p | 31 December 2023 | 9,509,225 | 14,001,062 |
| 0.00p – 23.83p | 31 December 2024 | 3,799,428 | 5,984,633 |
| 18.42p – 25.17p | 31 December 2025 | 370,000 | 540,000 |
| 0.00p – 37.92p | 31 December 2026 | 19,206,869 | 19,258,119 |
| 0.00p – 169.50p | 31 December 2027 | 10,370,154 | - |
| **At 31 December** | | **57,351,945** | **60,557,376** |

## 24. 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 profit for the financial year amounted to £40,387,000 (2016: Restated loss £2,416,000).

## 25. Cash generated from operations

| Group | 2017 £'000 | Restated 2016 £'000 |
|---|---|---|
| Profit before tax | 14,920 | 18,363 |
| Finance costs | 2,099 | 1,463 |
| Depreciation of property, plant and equipment | 5,637 | 5,561 |
| Amortisation of intangible assets | 6,388 | 5,377 |
| Loss on disposal of fixed assets | 22 | 47 |
| Non cash rent charges on rent free periods on leased property | 385 | - |
| Gain on release of contingent deferred consideration | - | (2,340) |
| Contingent deferred consideration (settled through contractual discounts) | - | (3,959) |
| Share based payments | 7,526 | 2,881 |
| **Cash inflow from operations before changes in working capital** | **36,977** | **27,393** |
| | | |
| Increase in inventories | (6,391) | (4,206) |
| (Increase)/Decrease in trade and other receivables | (6,762) | 1,437 |
| Increase/(Decrease) in trade and other payables | 5,893 | (2,161) |
| **Cash inflow from operations** | **29,717** | **22,463** |

The comparative financial information for the year ended 31 December 2016 has been restated. Details of the restatement are set out in note 2.30.

| Company | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Profit /(loss) before tax | 35,381 | (2,416) |
| Finance income | (5,246) | (4,290) |
| Finance costs | 1,846 | 1,278 |
| Foreign exchange | (2,498) | 8,283 |
| Gain on release of deferred consideration | - | (484) |
| Depreciation | 6 | 5 |
| Amortisation | 47 | 40 |
| Reversal of impairment | (39,482) | - |
| Share based payments | 6,921 | 2,477 |
| **Cash (outflow)/inflow from operations before changes in working capital** | **(3,025)** | **4,893** |
| | | |
| Increase in trade and other receivables | (13,024) | (14,942) |
| (Decrease)/increase in trade and other payables | (5,736) | 1,237 |
| **Cash outflow from operations** | **(21,785)** | **(8,812)** |

## 26. Reconciliation of net cash flow to movement in net funds / (debt)

| | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Increase / (Decrease) in cash in the year | 40,904 | (315) |
| Increase in borrowings | (27,864) | (12,623) |
| Repayment of borrowings | 68,697 | 3,252 |
| Repayment of leases | 6,733 | 89 |
| **Net movement resulting from cash flows** | **88,470** | **(9,597)** |
| | | |
| **Net debt at 1 January** | **(39,549)** | **(23,223)** |
| Net movement resulting from cash flows | 88,470 | (9,597) |
| Non-cash movements (note 25) | (3,309) | (6,729) |
| **Net cash / debt at 31 December** | **45,612** | **(39,549)** |

## 27. Analysis of net funds / (debt)

| | At 1 January 2017 £'000 | Cash flow £'000 | Other non-cash movements £'000 | At 31 December 2017 £'000 |
|---|---|---|---|---|
| Bank borrowings due after one year | (36,854) | 40,277 | (3,423) | - |
| Bank borrowings due within one year | (7,652) | 7,289 | 363 | - |
| Total borrowings | (44,506) | 47,566 | (3,060) | - |
| Cash and cash equivalents | 4,957 | 40,904 | (249) | 45,612 |
| **Net funds / (debt)** | **(39,549)** | **88,470** | **(3,309)** | **45,612** |

Cash and cash equivalents at 31 December 2017 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 £6,564,000 (2106: £nil) relating to finance leases that were used to fund capital expenditure where the bank settled the purchase cost directly with the equipment supplier and foreign exchange movements on US dollar denominated borrowings.

## 28. Subsidiary undertakings

| Name of company | Class of capital | Proportion of shares held | Activity | Country of incorporation | Registered Office |
|---|---|---|---|---|---|
| IQE (Europe) Limited | Ordinary shares of £1 | 100%* | Manufacture of advanced semiconductor materials | UK | Pascal Close, St Mellons, Cardiff CF3 0LW, UK |
| IQE Inc | Common stock of $0.001 | 100%* | Manufacture of advanced semiconductor materials | USA | 119 Technology Drive, Bethlehem, PA 18015, USA |
| IQE KC LLC | Limited liability company | 100%* | Manufacture of advanced semiconductor materials | USA | 200 John Hancock Road, Taunton, MA 02780, USA |
| IQE Taiwan ROC** | Ordinary shares of NT$10 | 90% | Manufacture of advanced semiconductor materials | Taiwan | No. 2-1, Li-Hsin Road Hsinchu Science Park Hsinchu 300, Taiwan |
| IQE RF LLC | Limited liability company | 100%* | Manufacture of advanced semiconductor materials | USA | 265 Davidson Avenue Somerset, NJ 08873, USA |
| IQE Silicon Compounds Limited | Ordinary shares of £1 | 100% | Manufacture of silicon epitaxy | UK | Pascal Close, St Mellons, Cardiff CF3 0LW, UK |
| MBE Technology Pte Ltd | Preferred shares of S$1<br>Ordinary shares of S$1 | 100%<br>100% | Manufacture of advanced semiconductor materials | Singapore | 30 Tampines industrial Avenue 3 Singapore 528775 |
| Wafer Technology Limited | Ordinary shares of £1 | 100%* | Manufacture of semiconductor compounds and ultra high purity materials | UK | Pascal Close, St Mellons, Cardiff CF3 0LW, UK |
| NanoGaN Limited | Ordinary shares of £0.001 | 100% | Development of advanced semiconductor materials | UK | Pascal Close, St Mellons, Cardiff CF3 0LW, UK |
| Galaxy Compound Semiconductors Inc | Common stock of $0.00 par value | 100%* | Manufacture of semiconductor compounds and ultra high purity materials | USA | 9922 E Montgomery Avenue, #7, Spokane, WA 99206, USA |
| EPI Holding Limited | Ordinary shares of £1 | 100% | Dormant holding company | UK | Pascal Close, St Mellons, Cardiff CF3 0LW, UK |
| KTC Wireless LLC | Limited liability company | 100% | Dormant holding company | USA | 119 Technology Drive, Bethlehem, PA 18015, USA |
| IQE USA Inc | Limited liability company | 100% | Dormant holding company | USA | 119 Technology Drive, Bethlehem, PA 18015, USA |
| IQE Solar LLC | Limited liability company | 100%* | Dormant company | USA | 119 Technology Drive, Bethlehem, PA 18015, USA |
| IQE Properties Inc | Limited liability company | 100%* | Property holding company | USA | 119 Technology Drive, Bethlehem, PA 18015, USA |
| Wafer Technology International Limited | Ordinary shares of £1 | 100% | Dormant holding company | UK | Pascal Close, St Mellons, Cardiff CF3 0LW, UK |

* Indirect holdings
** The consolidated results of the Group include revenue (£28,844k), EBITDA (£4,302k) and net assets of (£32,290k) relating to IQE Taiwan ROC
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.

## 29. 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 | Registered Office |
|---|---|---|---|---|---|
| Compound Semiconductor Centre Limited. | Common stock of £1 par value | 50%* | Research, development and Manufacture of semiconductor materials | UK | Pascal Close, St Mellons, Cardiff CF3 0LW, UK |
| CSDC Private Limited. | Common stock of $1 par value | 51%* | Research, development and Manufacture of semiconductor materials | Singapore | 30 Tampines industrial Avenue 3 Singapore 528775 |

* 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.

Both 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 2. Both of the Joint ventures financial year end is 31 December 2017 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.

Summarised financial information for each of the joint ventures for the reporting period is set out below:

**a) Summary information for Compound Semiconductor Centre Limited**

| Summary income statement | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Revenue | 6,369 | 3,955 |
| LBITDA | (463) | (680) |
| Loss from continuing operations | (6,702) | (4,422) |
| Loss for the period | (6,702) | (4,422) |
| **Total comprehensive expense for the period** | **(6,702)** | **(4,422)** |

| Summary balance sheet | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Non-current assets | 34,301 | 38,678 |
| Current assets | 413 | 4,052 |
| Current Liabilities | (1,033) | (4,857) |
| Non-current Liabilities | (21,759) | (19,249) |
| **Equity attributable to Joint Venturers** | **11,922** | **18,624** |

| Carrying value of equity interest in CSC Ltd | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Net assets of CSC Ltd | 11,922 | 18,624 |
| Proportion of the Groups ownership interest | 50% | 50% |
| Groups share of net assets | 5,961 | 9,312 |
| Elimination of unrealised gains on transactions with CSC Ltd | (12,000) | (12,000) |
| Cumulative unrecognised losses | 6,039 | 2,688 |
| **Carrying amount of the Groups interest in the JV** | **-** | **-** |

| Summary of cumulative unrecognised losses | 2017 £'000 | 2016 £'000 |
|---|---|---|
| Unrecognised losses brought forward | (5,402) | (726) |
| Unrecognised unrealised gains on transactions with CSC Ltd | - | (2,465) |
| Unrecognised losses in the year | (3,351) | (2,211) |
| **Cumulative unrecognised losses carried forward** | **(8,753)** | **(5,402)** |

**b) Summary information for CSDC Private Limited**

| Summary income statement | 2017 £'000 | 2017 SG$'000 | 2016 £'000 | 2016 SG$'000 |
|---|---|---|---|---|
| Revenue | 10,373 | 18,199 | 7,163 | 13,264 |
| EBITDA | (1,469) | (2,577) | (1,014) | (1,877) |
| Loss from continuing operations | (1,431) | (2,511) | (1,129) | (2,090) |
| Loss for the period | (1,431) | (2,511) | (1,129) | (2,090) |
| **Total comprehensive expense for the period** | **(1,431)** | **(2,511)** | **(1,129)** | **(2,090)** |

| Summary balance sheet | 2017 £'000 | 2017 SG$'000 | 2016 £'000 | 2016 SG$'000 |
|---|---|---|---|---|
| Non-current assets | - | - | - | - |
| Current assets | 2,854 | 5,189 | 3,897 | 6,959 |
| Current Liabilities | (1,646) | (2,993) | (1,319) | (2,356) |
| Non-current Liabilities | (4,861) | (8,838) | (4,810) | (8,590) |
| **Deficit attributable to Joint venturers** | **(3,653)** | **(6,642)** | **(2,232)** | **(3,987)** |

| Carrying value of equity interest CSDC Private Limited | 2017 £'000 | 2017 SG$'000 | 2016 £'000 | 2016 SG$'000 |
|---|---|---|---|---|
| Net liabilities of CSDC Private Limited | (3,653) | (6,642) | (2,232) | (3,987) |
| Proportion of the Groups ownership interest | 51% | 51% | 51% | 51% |
| Groups share of net assets | (1,863) | (3,387) | (1,138) | (2,033) |
| Cumulative unrecognised losses | 1,863 | 3,387 | 1,138 | 2,033 |
| **Carrying amount of the Groups interest in the JV** | **-** | **-** | **-** | **-** |

| Summary of cumulative unrecognised losses | 2017 £'000 | 2017 SG$'000 | 2016 £'000 | 2016 SG$'000 |
|---|---|---|---|---|
| Cumulative unrecognised losses brought forward | (1,138) | (2,033) | (562) | (967) |
| Unrecognised losses in the year | (725) | (1,354) | (576) | (1,066) |
| **Cumulative unrecognised losses carried forward** | **(1,863)** | **(3,387)** | **(1,138)** | **(2,033)** |

## 30. Related party transactions

The group incurred professional fees and expenses during the year of £150,000 (2016: £126,493) payable to Horton Corporate Finance and £35,420 (2016: £42,000) payable to Fishstone Limited. Dr G H H Ainsworth, who is a director of IQE Plc, is the managing partner of Horton Corporate Finance. S J Gibson, who was a director of IQE Plc during the year is also a director of Fishstone Limited. An amount of £37,500 (2016: £41,750) was outstanding to these parties at the year-end.

At 31 December 2017 IQE plc holds a fixed asset investment in Seren Photonics Limited represented by 69 "B" ordinary shares at a cost of £50,000 and £25,000 Convertible Loan Stock. Dr G H H Ainsworth is a Director of IQE plc and Seren Photonics Limited. During the year the group did not trade with Seren Photonics Limited and as at the 31 December 2017 no balances were receivable from or payable to Seren Photonics Limited.

**Transactions with Joint Ventures**

**Compound Semiconductor Development Centre Private Limited**
CSDC was established by the Group and its joint venture partners as a centre of excellence for the development and commercialisation of advanced compound semiconductor wafer products in Asia and on its formation entered into an agreement to license certain intellectual property and plant and equipment from the Group.

The activities of CSDC include research and development into advanced compound semiconductor wafer products and the provision of contract manufacturing services for compound semiconductor wafers to a subsidiary of the IQE plc group, MBE Technology Pte Limited.

CSDC operates from space within the Group's manufacturing facility in Singapore. During the year the group sub-let space at its manufacturing facility to CSDC for £672,000 (2016: £586,000) at a rental cost per square foot equivalent to the cost paid by the Group on the head lease associated with the property.

The Group licenses intellectual property and equipment to the joint venture and recognised revenue in the year of £1,874,000 (2016: £1,728,000) and purchased advanced compound semiconductor wafer products from CSDC for £10,373,430 (2016: £7,163,000).

An amount of £25,575 was due from (2016: £1,402,000 due to) CSDC Private Limited at 31 December 2017.

**Compound Semiconductor Centre Limited**
CSC was established by the Group and its joint venture partner as a centre of excellence for the development and commercialisation of advanced compound semiconductor wafer products in Europe. On its formation the Group contributed assets to the joint venture valued at £12,000,000 as part of its initial investment.

The activities of CSC include research and development into advanced compound semiconductor wafer products, the provision of contract manufacturing services for compound semiconductor wafers to certain subsidiaries within the IQE plc group and the provision of compound semiconductor manufacturing services to other third parties.

CSC operates from its manufacturing facilities in Cardiff, United Kingdom and leases certain additional administrative building space from the Group. During the year the CSC leased this space from the Group for £115,000 (2016: £115,000) and procured certain administrative support services from the Group for £235,000 (2016: £235,000). As part of the administrative support services provided to CSC the Group procured goods and services, recharged to CSC at cost, totalling £4,497,000 (2016: £2,932,900).

During the year CSC provided the Group with certain contract manufacturing services. Contract manufacturing services are purchased from CSC at a price which reflects CSC's cash cost of production (including direct labour, materials and site costs) but excludes any related depreciation or amortisation of CSC's property, plant and equipment and intangible assets respectively under the terms of the joint venture agreement between the parties. Contract manufacturing services purchased from CSC totalled £6,050,165 (2016: £3,955,000) in the year.

During the year the Group recognised license revenue of £nil (2016: £4,930,000) from CSC and received a short term loan of £600,000 (2016: £nil) that has been fully repaid. At 31 December 2017 an amount of £104,646 (2016: £2,714,268) was owed to the CSC at year end.

During the year CSC issued 800 A preference shares of £1,000 each to the Group. In the groups year-end balance sheet 'A' Preference Shares with a nominal value of £8,800,000 (2016: £8,000,000) are included in financial assets at an amortised cost of £7,680,000 (2016: £6,889,000) and the Group has a shareholder loan of £234,356 (2016: £230,000) due from CSC.

## 31. Operating lease commitments

The group was committed at 31 December 2017 and 31 December 2016 to making the following aggregate payments in respect of non-cancellable operating leases:

| | 2017<br>£'000 | Restated<br>2016<br>£'000 |
|---|---|---|
| Due within one year | 8,770 | 8,019 |
| Due between two and five years | 21,588 | 11,954 |
| Due after five years | 8,184 | 19,361 |
| | **38,542** | **39,334** |

The operating lease commitment has been restated to include the cash costs payable to the Group's joint venture, Compound Semiconductor Centre Limited, associated with the Group's right of use of the joint ventures assets (see note 3 and 30).

Operating leases relate to various building, equipment and vehicle leases.

## 32. Commitments

The group had capital commitments at 31 December 2017 of £5,875,000 (2016: £356,000) primarily relating to plant and equipment purchased for the group's manufacturing site at Newport, United Kingdom.