QinetiQ

Restoring QinetiQ to Strength

QinetiQ Group plc Annual Report and Accounts 2010

QinetiQ uses its domain knowledge to provide technical advice to customers in the global aerospace, defence and security markets. Its unique positioning enables it to be a trusted partner to government organisations, predominantly in the UK and the US, including defence departments, intelligence services and security agencies.

Key facts

- We employ more than 13,000 people worldwide; 6,900 people in the UK and Australia and 6,100 people in North America.
- Our scientists and engineers solve some of the world's most important problems.
- We are the UK's largest research and technology organisation.
- We are the world's leading supplier of military robotics.
- More than 85% of our workforce carry high-level national security clearances.

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Cautionary statement

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

Our markets are likely to remain uncertain for some time, but we now have a decisive programme of self-help to restore value. We are acting to make our costs more competitive, our productivity better and our debt lower. We are changing our structure to benefit from QinetiQ's overall strengths. Most of all, we are working to transform our culture into one based on leadership, accountability and empowerment of what is an outstanding group of people.

Leo Quinn Chief Executive Officer

Performance

See pages 12-15 for more information

£1,625.4m
Revenue (2009: £1,617.3m)

£457.4m
Net debt (2009: £537.9m)

£120.3m
Underlying operating profit* (2009: £151.6m)

11.1p
Underlying earnings per share* (2009: 15.9p)

£(25.3)m
Operating (loss)/profit (2009: £128.1m)

(9.7)p
Basic earnings per share (2009: 14.3p)

7.4%
Underlying operating margin* (2009: 9.4%)

1.58p
Dividend (2009: 4.75p)

- Difficult year – sales disappointing, margins weakened;
- Markets remain challenging;
- Review of operations complete – priorities agreed;
- Programme underway to restore QinetiQ to strength over next two years;
- Immediate drive on debt reduction to reduce net debt:EBITDA from 2.5x† to a target of below 2x†, by decisive internal programme to restore value; and
- Board recommending a suspension of dividend for 12 months.

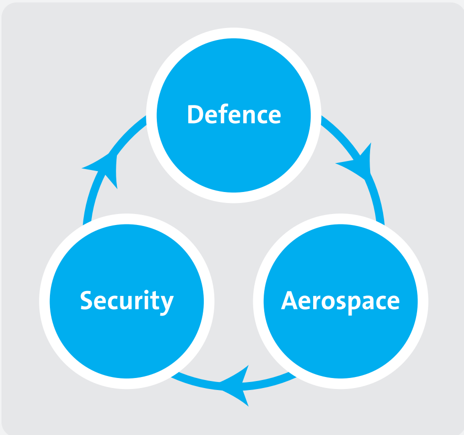
*Definitions of underlying measures of performance are in the glossary on page 98. Underlying financial measures are presented, as the Board believes these provide a better representation of the Group's long-term performance trend.
†Annualised and calculated in accordance with the Group's credit facility ratios.

The business at a glance

How we operate

QinetiQ's business model is based on providing hi-tech advice to customers and building relationships as a trusted partner. Our customers value our technical and domain knowledge in support of professional services. They value our independence and our integrity, and trust us to share in their mission.

Our markets



We provide the following capabilities:

- Technical assistance and programme support
- Technology offerings
- Test and evaluation
- Research and development
- Training delivery

Highlights in our markets during the year

Aerospace

Typhoon programme
The business won a £37m, three-year contract during the year to support the Typhoon programme.

Defence

Iraqi flight-training
We continue to deliver Iraqi flight-training services as part of a multi-year contract worth more than $100m.

Security

Cyveillance
Cyveillance, providing proactive preventative solutions for customers in the cyber security market, was acquired during the year for an initial consideration of £26.1m.

What we offer

QinetiQ provides services and products across international markets. Our services business, which accounts for approximately 80% of total sales, is based on providing expertise and knowledge in national markets. Our products business provides the platform for potential profitable growth on a global basis.

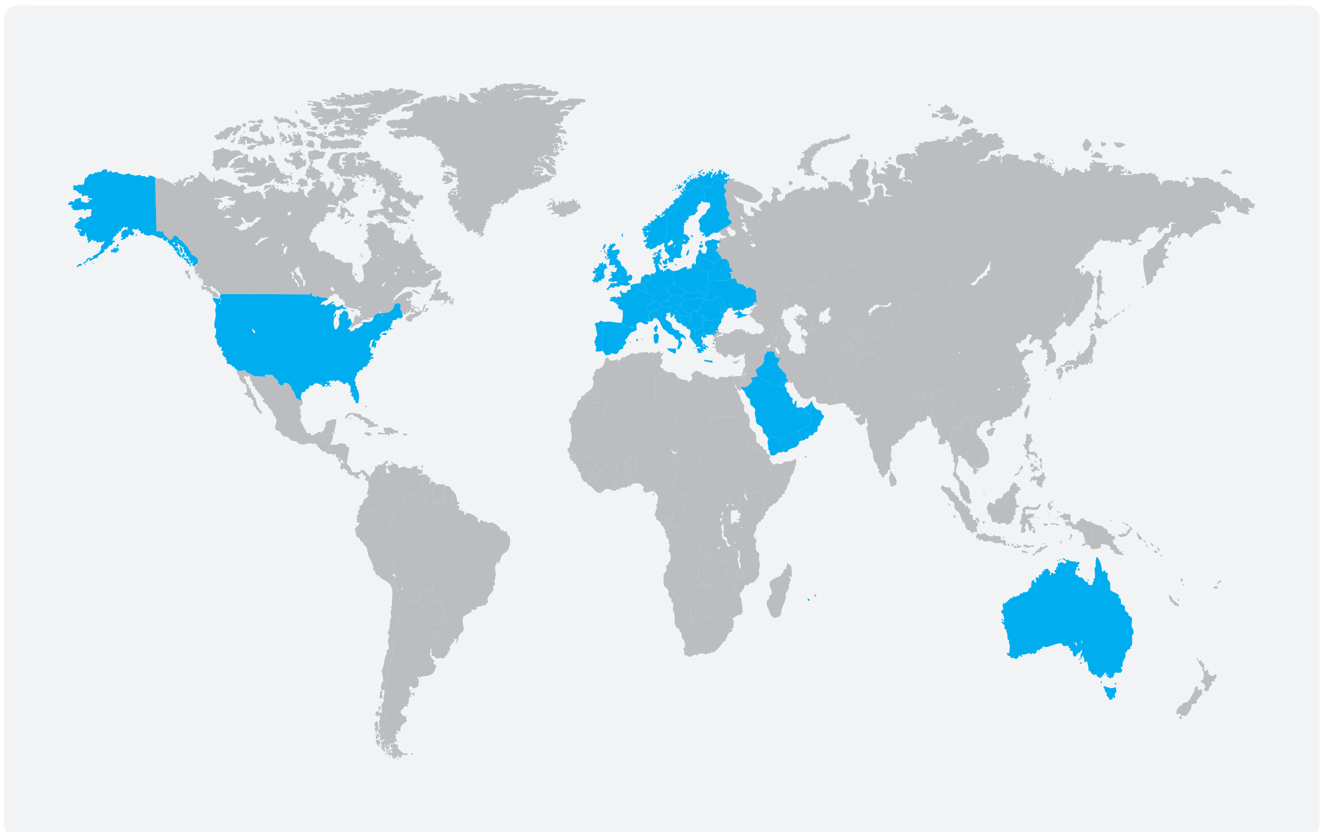
At the start of the new financial year we moved to a new structure:

- US Services
- UK Services
- Global Products

We believe this structure will provide greater focus to leverage QinetiQ's expertise, technology, customer relationships and business development skills, to enable sustainable and profitable growth over the longer-term.

Where we operate

We have operations throughout the UK and North America as well as Australia, as illustrated. Our capabilities are utilised across the world by an international range of customers who recognise QinetiQ as a trusted partner.



Chairman's statement

A tough year, given the economic, market and political uncertainty.

Mark Elliott Chairman

Dear shareholder,

I am pleased to submit my first report as Chairman of QinetiQ, having assumed the role in March this year, following the retirement of Sir John Chisholm.

The last financial year was noteworthy for the Group given the changes in our markets on both sides of the Atlantic. Responding to fast-moving market developments has required a step change by the business and particularly by our people. I would like to pay testimony to our employees who have taken on the challenge to adapt quickly to the changing priorities of our customers.

With changes in the political landscape on both sides of the Atlantic, compounded by economic pressures, our business has experienced considerable uncertainty. On the back of political change, customers have delayed decision making as they review their budgets. As a consequence of these market changes, in November we alerted the market that the Group was unlikely to meet market expectations. The wider UK budget pressures and delays in contract awards resulted in lower utilisation of our teams in the last quarter. This was followed in January by confirmation that the delays in orders for survivability products and Unmanned Ground Vehicles within the QinetiQ North America (QNA) Technology Solutions Group would result in performance for our second half not exceeding that of the first half. This was disappointing and highlighted the need for the business to be more agile and to look to itself to reduce its cost base, to ensure that it remains competitive.

The safety of our operations remains a priority. Following the tragic loss of Nimrod XV230 in 2006 and the subsequent publication of the Haddon-Cave Report in October 2009, we were determined to take on board any key findings which will further improve our ways of working. Subsequently in November 2009, the Board appointed Sir Robert Nelson QC to consider the findings and recommendations of the Haddon-Cave Report. Sir Robert concluded that substantial improvements have occurred in QinetiQ since 2004 but recommended that further changes were implemented and that improvements which have been made to date, are consolidated. I am pleased to report that we are already well underway with implementing Sir Robert's recommendations and are in the process of recruiting a new Group Safety Director to the Executive Team. QinetiQ has a long established heritage and track record in airworthiness and safety. It is important that we ensure through our actions, processes, procedures and people that we are able to reinforce our credentials in this crucially important field.

In November, Leo Quinn joined the Board as Chief Executive Officer to lead the next stage of QinetiQ's development. Leo took over the reins from Graham Love who left the Group after eight years, having taken the organisation through privatisation. Leo joined the Group having led De La Rue plc, overseeing its transformation into a focused, market-leading security printer. Prior to that, Leo was responsible for a number of business turnarounds in both Europe and the US. Leo has drive and energy, and a passion for operational excellence and delivery. I am pleased to report that in the short time that he has been with the Group, he has already started the process of its transformation. The Board is fully supportive of the priorities set out by Leo Quinn in his Chief Executive Officer's report.

The results

Group revenues were flat at £1,625.4m (2009: £1,617.3m), including a £43m benefit from the strengthening US dollar exchange rate. The overall organic decline in US revenues at constant currency was 4%, with the decline in higher margin product sales partially offset by growth in services. The UK businesses suffered from a reduction in the historic concentration of Ministry of Defence (MOD) order flow towards the year end, although this impact was partially masked at the revenue level by higher pass-through revenues, resulting in a 1% organic decline in EMEA revenues.

As a result of the reduction in higher contribution revenues, underlying operating profit* decreased to £120.3m (2009: £151.6m), resulting in an underlying margin* of 7.4% (2009: 9.4%). The EMEA underlying margin* decreased to 7.5% (2009: 10.0%) and the QNA underlying margin* fell to 8.5% (2009: 10.8%). Losses for the Ventures division reduced as a result of the partial disposal of Cody Gate Ventures in the prior year. Underlying profit before tax* was £85.7m (2009: £130.2m).

The Group incurred impairment charges on goodwill of £50.1m, intangible assets and investments of £14.6m and tangible assets of £24.0m. Other non-recurring items include a profit on business divestments of £5.1m (2009: £13.0m) and a charge for reorganising the EMEA business, announced in May 2009, of £42.1m. The resulting statutory loss before tax was £66.1m (2009: profit of £114.0m).

The Group achieved a strong underlying cash conversion* of 145% (2009: 107%) due to a continued focus on cash generation. Cash flow from operations increased to £204.6m (2009: £202.2m), before the costs of the EMEA reorganisation announced in May 2009.

Net debt, as at 31 March 2010, was £457.4m (31 March 2009: £537.9m), resulting from strong cash flow from operations and the beneficial translation impact of the US dollar exchange rate, as the majority of the Group's debt is drawn in US dollars. The Group's gearing ratio† at 31 March 2010 was 2.5x† (31 March 2009: 2.2x†), well inside the covenant level of 3.5x†.

Full year underlying earnings per share* were 11.1p (2009: 15.9p).

The Board is confident that the programme announced on 27 May will restore the Group to strength over the next 24 months, including the rapid pay-down to a target gearing ratio of below 2x†. For this reason, the Board is recommending that no payment be made either of a final dividend for the year just ended or of an interim dividend for the current year. It is the Board's expectation that the Group will pay a final dividend with respect to the financial year ending 31 March 2011.

The Board

There have been a number of changes to the Board during the year.

In May 2009, Sir John Chisholm announced his intention to retire from the Board as Chairman. Some 19 years ago Sir John took on the challenge of creating a successful commercial enterprise out of the research laboratories of the Ministry of Defence. This culminated in the Company's listing on the London Stock Exchange in February 2006. His personal commitment, integrity and phenomenal energy have made QinetiQ the successful organisation it is today and, on behalf of the Board, I thank him for his enormous contribution. I am sure everyone at QinetiQ wishes Sir John all the very best for his retirement.

In August last year, David H Langstaff joined the Board as a Non-executive Director, bringing an in-depth understanding of the North American security market. Non-executive Director Dr Peter Fellner stepped down from the Board at the close of the Group's AGM on 4 August 2009. Graham Love left the Company and Leo Quinn joined the Board in the role of Chief Executive Officer in November. Just after the year end, I was pleased to announce the appointment of Admiral Sir James Burnell-Nugent KCB CBE MA as an Independent Non-executive Director. Sir James brings extensive experience of the operational challenges of the defence sector.

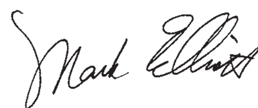
People

QinetiQ is a unique organisation built on the technical knowledge, expertise and integrity of its people. They are involved in solving some of society's most complex problems. I believe our teams undertake their roles with integrity and demonstrate commitment to our customers. During the second half of the year our employees adapted to significant change which will modernise and reposition the business for the future, ensuring we remain competitive in the market. This required flexibility from our people and I thank them for their ongoing commitment and support.

Outlook

In both the US and the UK, the defence markets remain challenging as a result of the economic environment. Additionally in the UK, the impending Strategic Defence and Security Review adds uncertainty to forecasts for defence spending. The Board has concluded its review of operations and reset the priorities of the Group. The new management is taking action over the next 24 months to reduce costs, improve productivity and drive cash generation, both to reduce the Group's net debt rapidly, and to refocus and reposition its businesses over the medium term for a return to profitable growth.

In the current financial year, the performance of QinetiQ's service businesses is likely to remain steady overall. The product businesses, whose performance is by nature more variable, should benefit from the release of some orders in the US delayed from prior period, although this will be partially offset by the weaker UK environment. The Board believes it will meet its expectations for the current year.



Mark Elliott Chairman
2 June 2010

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†The gearing ratio is net debt to adjusted EBITDA and the definition is in the glossary on page 98.

Chief Executive Officer's review

QinetiQ's deep customer relationships in the UK and the US, together with the world-class expertise and innovation of its employees, provide the capacity for longer term profitable growth.

Leo Quinn Chief Executive Officer

During the past year, it became apparent that our markets were undergoing significant changes, as Governments sought to reduce their budgets and their debt, while continuing in the short-term to conduct high levels of military operations abroad. These uncertainties had a marked impact on the Group's performance, but also highlighted the need for substantial internal change if we were to chart a course to profitable and sustainable growth.

That is why, immediately following my appointment in November 2009, I began a review of our operations and processes. That review is now complete and the Board has agreed our priorities and actions to return QinetiQ to strength.

Review of operations and processes

In recent years, QinetiQ has grown rapidly both by acquisition and by seeking to use its technology in industries outside its core expertise. To date, these investments have not delivered their expected returns and the Group's net debt has risen significantly. In addition, the organisational structure and processes within QinetiQ have become overly complex and fragmented which is a barrier to effective performance. These factors, combined with challenging market conditions, make it imperative that QinetiQ ensures it has a strong foundation on which to build.

QinetiQ predominantly comprises a range of service businesses, positioned to advise and support customers to achieve efficiency and effectiveness in the UK and the US. These businesses are based on – and continue to refresh – QinetiQ's deep customer knowledge and technical understanding of the aerospace, defence and security sectors, and are capable of providing a relatively stable and predictable income pattern. This capability is based on the expertise of our people and the relationships they develop in specific national markets and, over time, should create opportunities to provide similar services in other countries.

The Group also possesses a smaller proportion of product businesses with technically advanced offerings developed in-house. Today these products are sold principally to customers in the UK and the US, but the market is potentially global. By their nature – based on technology – these businesses have higher margins but more variable sales and, to date, they have been managed without sufficient sharing of intellectual property or scale between the UK and US operations to maximise opportunities and profitability.

Our US products businesses gives us a strong route into the world's most advanced defence market and we believe that this position, combined with the complementary skills of our research and expertise in the UK, has the potential for profitable growth on a global basis.

Fit for the future

My focus for the Group is to deliver the full potential of the investments which the Group has made. This means removing barriers to success and focusing rigorously on the best opportunities created by our markets and our own strengths. My objective is to build a new trajectory for QinetiQ, one with a very clear direction and more urgent pace. Our customers' needs, the development of offerings which address those needs and their successful execution, must be our touchstone. I am making changes to ensure that QinetiQ competes successfully in challenging markets. We need to remain competitive, have robust processes which make us fit for the future, fit for growth, and that means tackling the way we all work. We are focused on reducing our costs, improving our efficiency, stabilising our business and becoming more flexible and agile. I set out my priorities over the following pages.

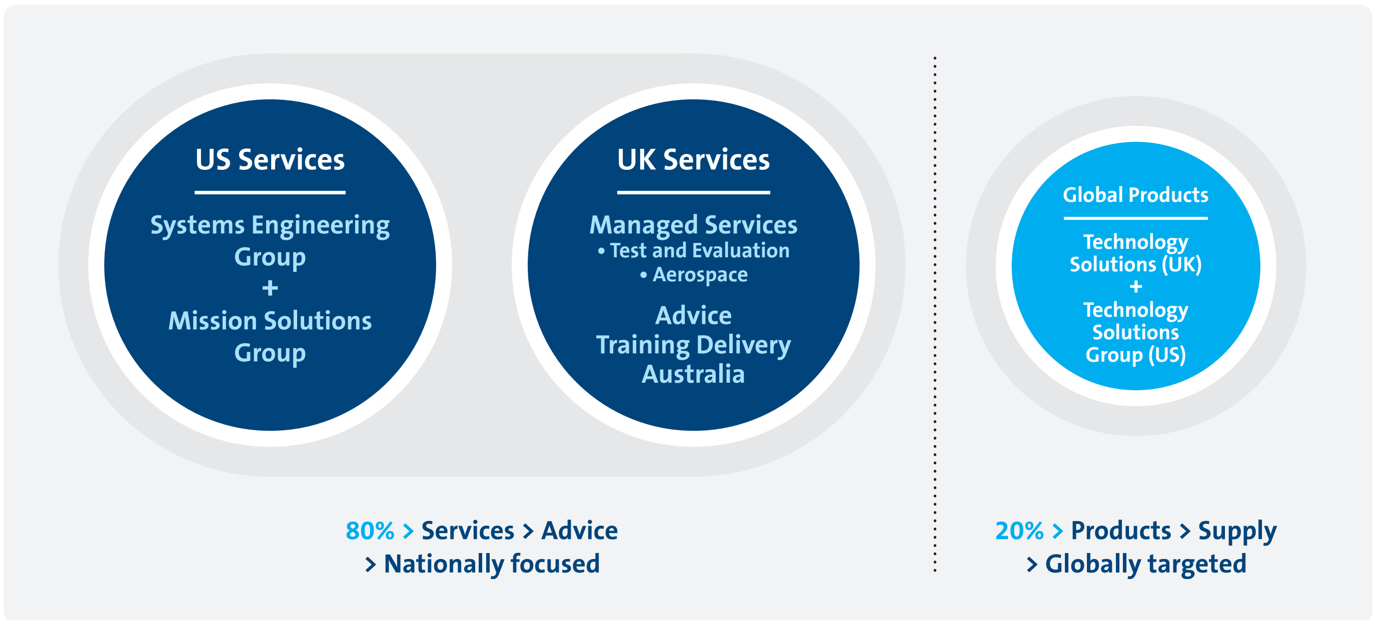
I believe these changes are essential to provide the Group with a solid foundation. QinetiQ's deep customer relationships in the UK and the US, the two leading markets in its core areas, together with the world-class expertise and innovation of its employees, provide the capacity for longer-term profitable growth once the Group's operations and processes have been returned to strength.

Trading environment and outlook

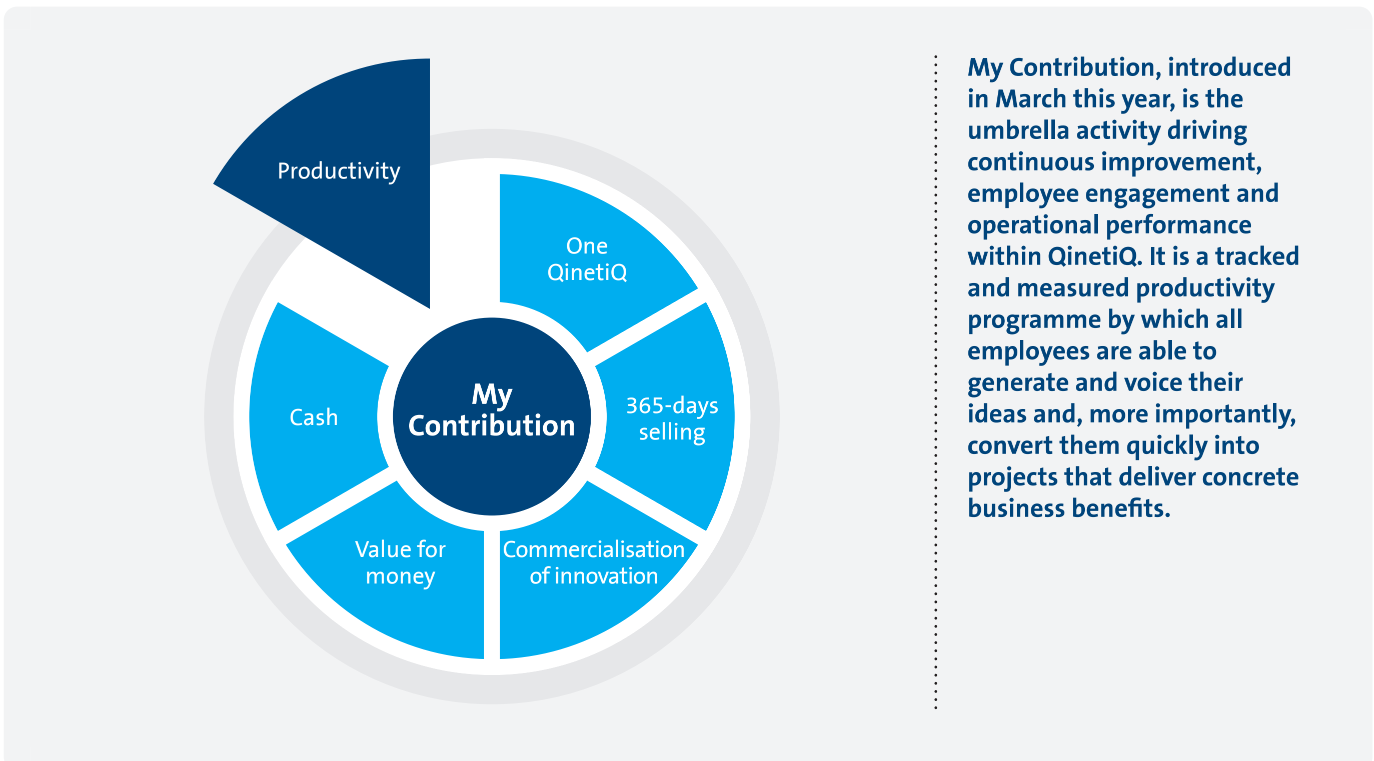
This has been a difficult year for QinetiQ, with challenging conditions in our core markets and considerable internal change. Our markets are likely to remain uncertain for some time, but we now have a decisive programme of self-help to restore value. We are acting to make our costs more competitive, our productivity better and our debt lower. We are changing our structure to benefit from QinetiQ's overall strengths. Most of all, we are working to transform our culture into one based on leadership, accountability and empowerment of what is an outstanding group of people. With these immediate steps, the Board believes that it will meet its expectations for the current year. At the same time our goal is to build the right foundation for a return to profitable and sustainable growth in the future.

Our structure

Our service businesses address national markets and our product businesses address a global market.



The My Contribution programme



My Contribution, introduced in March this year, is the umbrella activity driving continuous improvement, employee engagement and operational performance within QinetiQ. It is a tracked and measured productivity programme by which all employees are able to generate and voice their ideas and, more importantly, convert them quickly into projects that deliver concrete business benefits.

Chief Executive Officer's review (continued)

How we will operate

- Set a clear direction which reduces the span of focus and matches both customer needs and core QinetiQ strength
- Simplify and align our operating structure with the new direction, removing unnecessary layers
- Increase transparency and control through all levels
- Upgrade leadership to ensure a commercial, value-oriented mindset

- Create a strong performance culture of both accountability and empowerment to our people

- Establish a lower level of cost base to ensure future competitiveness
- Ensure a more unified approach Group-wide to exploit key opportunities
- Drive for cash generation to strengthen the Group's balance sheet

Our priorities

To strengthen our foundations and build a future path to sustainable and profitable growth, the following priorities to create value have been put in place.

- **Set a clear direction which reduces the span of focus and matches both customer needs and core QinetiQ strength** – Going forward, our investment decisions will be guided by building on our known strengths. Some parts of the original QinetiQ strategy have proven successful over recent years – focusing on the needs of existing customers, exploiting the potential of our expert technical services and the decision to enter the US marketplace, the largest defence market in the world. However, we have not been successful at commercialising our technology or exploiting it in adjacent markets. As yet, we have not achieved the potential from extending into defence markets beyond the UK and the US, and from fully integrating and developing some of our acquisitions. Unquestionably, QinetiQ's strength lies in its ability to provide customers with trusted advice, working in close partnership, and using its expertise in both technology and specific markets to enable customers to have greater efficiencies and to take effective decisions. This work, including the research we conduct on customers' behalf, in turn continually refreshes the knowledge and value of our people to provide innovative services.

- **Simplify and align our operating structure with the new direction, removing unnecessary layers** – The Group's current fragmented structure has hindered development of its full potential. The operating model and management of the service businesses, which comprise approximately 80% of our total sales, differ markedly from that of our product businesses, which currently account for about 20% of sales. A new structure comprising three divisions – US Services, UK Services and Global Products – will enable greater focus to leverage QinetiQ's expertise, technology, customer relationships and business development skills to enable sustainable and profitable growth.

- **Increase transparency and control through all levels** – Following a period of growth, it is essential to put disciplined standard processes which aid transparency and management visibility into the operations. This includes standard reporting of performance information across the Group and regular reviews of talent, innovation and cost reduction.

- **Upgrade leadership to ensure a commercial, value-oriented mindset** – Given the challenges ahead for the business, it is vital we have the right strength of team in place and remove unnecessary management layers. Continually evaluating and upgrading the top leaders, setting clear expectations which align performance and behaviours with the Group's overall objectives, with appropriate incentives to drive profit and cash, are key to our achievement of success. Increased communications and engagement by leaders, both with their own teams and customers, and the delivery of value for our shareholders, will be laid out in personalised leadership charters and published throughout the organisation.

Action plan	KPIs
> Move to a new reporting structure comprising three divisions; US Services, UK Services and Global Products > Introduce standardised management reporting and regular reviews of key business drivers	> Return on capital employed > Operating profit > Operating profit margin > Operating cash conversion
> Assess the top leaders Group-wide, setting targets for performance and behaviours which reflect Group objectives for profit and cash, and providing appropriate incentives > Install a Group-wide performance management system and directly engage employees in the improvement of productivity	> Employee engagement > Customer satisfaction
> Eliminate waste and reduce costs with better business processes and a unified QinetiQ approach	> Operating profit margin > Employee engagement
> Reduce debt by driving cash generation, including tight measurement of working capital to reduce the ratio of net debt/EBITDA† to below 2.0x > Suspend payment of dividend on QinetiQ's ordinary shares for 12 months	> Net debt/EBITDA ratio† > Operating cash conversion

> **Create a strong performance culture of both accountability and empowerment to our people** – QinetiQ needs to build a culture which embraces individual contribution and responsibility through measurement. A new performance management system, My Personal Success Plan, will focus on identifying our top leaders of the future and helping each person to develop their potential. We will actively enrol the knowledge and ideas of our teams through the roll-out of My Contribution, a tracked and measured productivity programme which embeds the concept of employee engagement to improve business performance. We are refreshing our focus on Health and Safety as this is fundamental not only to employee well-being but also to the nature of the work that we undertake. As part of this, in response to the findings of the Haddon-Cave report, we are recruiting a new Group Safety Director to the Executive Team.

> **Establish a lower level of cost base to ensure future competitiveness** – Our customers are all under increasing pressure to gain better value for their investments and, as a supplier to these markets, we must have a competitive cost base. We are therefore re-examining and streamlining our business processes through a programme called Fit4Growth, focused on improving our systems and procedures to ensure we reduce and retain tight control of our costs, eliminate inefficiencies and address loss-making activities. And, whilst we will continue to invest in developing our businesses and our people, this must be financed by rigorously reducing other costs.

> **Ensure a more unified approach Group-wide to exploit key opportunities** – We need a more unified approach to exploit key opportunities, so that we leverage our customer knowledge and technical expertise better, including our approach to untapped opportunities in smaller international markets outside the UK and the US. Through a more unified approach to working as one team and making key decisions on a global basis, we can develop our best opportunities and most effective routes to market to build QinetiQ's reputation and position.

> **Drive for cash generation to strengthen the Group's balance sheet** – We intend to reduce our indebtedness. We have identified a number of 'self-help' measures to drive cash generation harder, including the reduction of working capital, lowering costs and the elimination of loss-making activities.

†The gearing ratio is net debt to adjusted EBITDA and the definition is in the glossary on page 98.

Chief Executive Officer's review (continued)

Performance Review – QinetiQ North America

	2010 £m	2009 £m
Revenue		
Mission Solutions	**354.7**	289.5
Systems Engineering	**273.3**	244.5
Technology Solutions QNA	**172.1**	231.6
Total	**800.1**	765.6
Underlying operating profit*	**67.7**	83.0
Underlying operating margin*	**8.5%**	10.8%
Funded Orders		
Mission Solutions	**326.6**	283.2
Systems Engineering	**251.0**	267.5
Technology Solutions QNA	**183.0**	187.9
Total	**760.6**	738.6
Book to bill ratio	**1.0:1**	1.0:1
Backlog	**326.3**	415.0

Revenues declined 4% on an organic basis at constant currency to £800.1m (2009: £765.6m). Within this, the services businesses (Mission Solutions and Systems Engineering), which account for c80% of QNA's revenue, grew by 7% on an organic basis. This was offset by the slowdown in Technology Solutions' military product sales as the new US Administration completed many of its key Department of Defense (DoD) leadership appointments and finalised its strategy for the continued involvement in Afghanistan. Underlying operating profit* decreased to £67.7m (2009: £83.0m) delivering an underlying operating margin* of 8.5% (2009: 10.8%). The decline in operating margin is principally reflective of the composition of QNA's revenue, which included a smaller proportion of its higher margin product sales.

Dragon Runner™ Unmanned Ground Vehicles (UGVs) purchased by the UK MOD

The Mission Solutions business grew organically by 8% and continued to broaden its customer base with contract wins from a number of new customers, including the US Department of State, the US Secret Service and a contract with the US Federal Emergency Management Agency. The five-year $100m Janus II contract was awarded in August 2009 to replace and upgrade the Department of State's telecommunications systems at American embassies and other locations worldwide. The Systems Engineering business grew organically by 6% with increased demand on a number of contracts from customers across the US Army, Navy, Marines and Special Forces. In addition, the Systems Engineering business continues successfully to deliver Iraqi flight-training services. The fourth option year of this contract was recently exercised by the customer. Towards the end of the year, the services businesses experienced some delays and curtailments in Government orders.

$100m

Multi-year contract for provision of Iraqi flight-training services

The slowdown in Technology Solutions QNA resulted in a 31% decrease in organic revenues against a very strong comparable prior year. From an international perspective, the Australian Department of Defence placed a AUD$23m contract for TALON® robots and replacement parts to support the Australian Defence Force deployed on operations. A key contract win for Technology Solutions QNA this year was the $31m Q-NETS contract, a vehicle survivability product, for the MRAP Lite fleet.

In July 2009 the Group acquired Cyveillance, Inc. for an initial cash consideration, including costs, of £26.1m ($42.2m). A potential further payment up to a maximum of £26.4m ($40m) will be made depending on performance during the two-year period ending 31 December 2010. Cyveillance develops and operates online monitoring technology to identify and track data on the internet, providing proactive preventative solutions for customers in the cyber security market.

Performance Review – EMEA

	2010 £m	2009 £m
Revenue		
Managed Services	**384.3**	370.7
Consulting	**142.6**	145.1
Technology Solutions EMEA	**291.9**	326.5
Total	**818.8**	842.3
Underlying operating profit*[2]	**61.1**	84.2
Underlying operating margin*[2]	**7.5%**	10%
Funded Orders		
Managed Services	**237.0**	186.6
Consulting	**128.7**	315.7
Technology Solutions EMEA	**269.3**	348.9
Total	**635.0**	851.2
Book to bill ratio[1]	**1.0:1**	1.3:1
Backlog[1]	**839.2**	802.0

[1] Excludes remaining £4.1bn (31 March 2009: £4.5bn), in respect of LTPA contract.
[2] Prior year comparatives have been restated to show the finance element of the IAS 19 pension cost in the finance and expense lines.

Revenue for the period was £818.8m (2009: £842.3m), a 1% decline on an organic basis. The UK budget pressures and delays in contract awards resulted in lower utilisation of employees in Q4 than has been the case in prior years. This impact was masked to a degree on the revenue line by higher levels of pass-through revenue on certain programmes; however, it resulted in underlying operating profit* decreasing to £61.1m (2009: £84.2m). Orders received were down 25% against the prior year, which included the £150m 15-year Maritime Strategic Capability Agreement.

£31m

£31m DTR Early Training Transformation contract signed in August 2009

Both Consulting and Technology Solutions EMEA have previously benefited from a seasonal pick-up in a large number of small-value contracts in Q4 as MOD closed out its financial year. This year the volume of such contracts was much reduced and consequently, Consulting's reported revenues declined by 3% on an organic basis. In Technology Solutions EMEA the equivalent decline was 7%, exacerbated by the decrease in MOD research revenues. During the period, Technology Solutions EMEA worked with QNA in enabling transfer of technologies across the Atlantic, as evidenced by the sale of Dragon Runner™ Unmanned Ground Vehicles (UGVs) to the UK MOD.

*Definitions of underlying measures of performance are in the glossary on page 98. Underlying financial measures are presented, as the Board believes these provide a better representation of the Group's long-term performance trend.
†The gearing ratio is net debt to adjusted EBITDA and the definition is in the glossary on page 98.

Managed Services' revenue for the period increased organically by 6% over the prior period, enhanced predominantly by some pass through revenues on the LTPA contract and the £31m Defence Training Review (DTR) Early Training Transformation contract, signed in August 2009. Package 1 of the UK MOD DTR is progressing. During the period £11.2m of bid costs were capitalised, bringing the total amount of bid costs capitalised as at 31 March 2010 to £30.8m (2009: £19.6m). The programme has been submitted to the MOD Investment Appraisal Board ('Main Gate') which has indicated that MOD may continue to develop the transaction in parallel with the Strategic Defence and Security Review. The MOD's expectation for financial close is currently mid-2011.

Managed Services' revenue increased by 6% in the year

The EMEA restructuring programme announced in May 2009 was largely completed this financial year. The cost of this programme was £42.1m, all of which has been expensed to the income statement in the year as a non-recurring item.

During the period the EMEA business disposed of a number of non-core assets, including the Underwater Systems business, in September 2009 (for a cash consideration before costs of £23.5m), and ASAP Calibration Services Limited, in July 2009 for a nominal consideration.

Ventures

	2010 £m	2009 £m
Revenue	**6.5**	9.4
Underlying operating loss*	**(8.5)**	(15.6)

The Ventures portfolio in the year comprised of three businesses: Tarsier (Foreign Object Detection), GPS Enabled Telematics (a high sensitivity business which delivers tracking solutions in difficult operational environments) and Optasense (an acoustic sensing detection solution). The prior year loss included £7.2m of equity accounted losses from the Cody Gate Ventures Fund prior to the Group's part disposal of the fund in March 2009.

Leo Quinn Chief Executive Officer
2 June 2010

Chief Financial Officer's review

Despite the challenging year, the cash generation across the Group was very strong with net cash flow from operations* up 3% at £174.3m.

David Mellors Chief Financial Officer

Group overview results

Revenue

	2010 £m	2009 £m
Revenue		
QinetiQ North America	**800.1**	765.6
EMEA	**818.8**	842.3
Ventures	**6.5**	9.4
Total	**1,625.4**	1,617.3

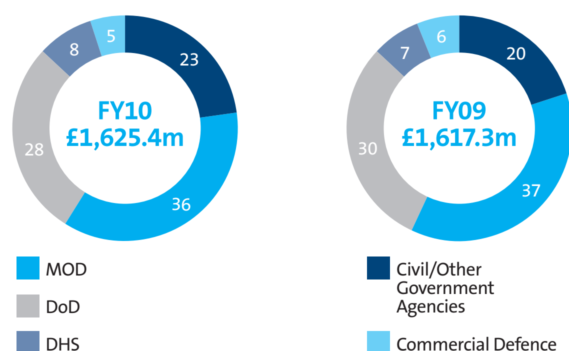
Group revenues were flat at £1,625.4m (2009: £1,617.3m), including a £43m benefit from the strengthening US dollar exchange rate.

QNA revenue declined 4% on an organic basis at constant currency to £800.1m (2009: £765.6m). Within this, the services businesses (Mission Solutions and Systems Engineering), which account for c80% of QNA's revenue, grew by 7% on an organic basis. This was offset by the slowdown in Technology Solutions' military product sales as the new US Administration completed many of its key Department of Defense (DoD) leadership appointments and finalised its strategy for the continued involvement in Afghanistan. Underlying operating profit* decreased to £67.7m (2009: £83.0m) delivering an underlying operating margin* of 8.5% (2009: 10.8%). The decline in operating margin is principally reflective of the composition of QNA's revenue, which included a smaller proportion of its higher margin product sales.

EMEA revenue for the period was £818.8m (2009: £842.3m), a 1% decline on an organic basis. The UK budget pressures and delays in contract awards resulted in lower utilisation of employees in Q4 than has been the case in prior years. This impact was masked to a degree on the revenue line by higher levels of pass through revenue on certain programmes; however it resulted in underlying operating profit* decreasing to £61.1m (2009: £84.2m).

*Definitions of underlying measures of performance are in the glossary on page 98. Underlying financial measures are presented, as the Board believes these provide a better representation of the Group's long-term performance trend.
†The gearing ratio is net debt to adjusted EBITDA and the definition is in the glossary on page 98.

Revenue by customer
(%)



Underlying operating profit*

	2010 £m	2009 £m
Underlying operating profit		
QinetiQ North America	**67.7**	83.0
EMEA	**61.1**	84.2
Ventures	**(8.5)**	(15.6)
Total	**120.3**	151.6
Underlying operating margin*	**7.4%**	9.4%

As a result of the reduction in higher contribution revenues, underlying operating profit* decreased to £120.3m (2009: £151.6m), resulting in an underlying operating margin* of 7.4% (2009: 9.4%). The EMEA underlying operating margin* decreased to 7.5% (2009: 10%) and the QNA underlying operating margin* fell to 8.5% (2009: 10.8%). Losses for the Ventures division reduced as a result of the partial disposal of Cody Gate Ventures in the prior year. Underlying profit before tax* was £85.7m (2009: £130.2m).

Our investment in Ventures continued during the year. The underlying operating loss* of £8.5m (2009: £15.6m) was mitigated during the year following our part disposal of our investment in the Cody Gate Ventures Fund in March 2009. The prior year results included the Group's share of Cody Gate Ventures losses of £7.2m.

Group summary

	2010	2009‡
Revenue (£m)	**1,625.4**	1,617.3
Organic change at constant currency	**(3)%**	7%
Underlying operating profit (£m)[(1)]*	**120.3**	151.6
Underlying operating margin[(1)]*	**7.4%**	9.4%
Underlying profit before tax (£m)[(1)]	**85.7**	130.2
Net finance expense (£m)	**34.6**	21.4
Underlying effective tax rate[(1)]	**15.0%**	20.5%
Basic earnings per share	**(9.7)p**	14.3p
Underlying earnings per share[(1)]	**11.1p**	15.9p
Dividend per share	**1.58p**	4.75p
Underlying net cash from operations (post capex) (£m)[(1)]	**174.3**	169.8
Underlying cash conversion ratio[(1)]	**145%**	107%
Net debt (£m)	**457.4**	537.9
Net debt: EBITDA[(2)]	**2.5x**	2.2x
Average US$/£ exchange rate	**1.59**	1.68
Closing US$/£ exchange rate	**1.52**	1.44

[(1)] Definitions of underlying measures of performance are in the glossary on page 98. Underlying financial measures are presented, as the Board believes these provide a better representation of the Group's long-term performance trend.
[(2)] Annualised and calculated in accordance with the Group's credit facility ratios.
‡ Prior year comparatives have been restated to show the finance element of the IAS 19 pension cost in the finance and expense lines. There is no impact on reported profit before tax from this restatement.

During the period, the Group has elected to align the treatment of the Group's IAS 19 pension charge with that of its peer listed companies by showing the finance element of the pension charge in the finance costs line and the service cost remaining in operating expenses; in prior reported periods these elements had been combined and reported in operating costs. IAS 19 Employee Benefits permits both treatments. The Group's comparative figures have been restated to reflect this change although there is no impact on the Group's profit before tax or retained profit. This pension liability sits within the EMEA business and therefore the operating segment comparatives have also been restated.

Finance costs

Net finance costs have increased to £34.6m (2009: £21.4m) due principally to an adverse movement in the net pension return of £5.9m combined with the effect of refinancing floating rate US dollar debt under the revolving credit facility with more secure long term fixed rate debt obtained from the US private placement market in February 2009.

Taxation

The Group's underlying effective tax rate* was 15% (2009: 20.5%). The reduction on prior year is due to the combination of the cessation of equity accounted losses of Cody Gate Ventures and certain favourable outcomes and settlements to date, coupled with lower reported profits in QinetiQ North America. The Group continues to benefit from the availability of research and development relief and in future years, the Group will benefit from enacted tax law changes having an impact on US State taxes. Overall, the Group effective tax rate is not anticipated to rise significantly in the medium term, subject to any future tax legislation changes.

Acquisition amortisation and specific non-recurring items

The performance of the Group after allowing for non-recurring events and amortisation of acquired intangible assets is shown below.

	2010 £m	2009 £m
Underlying profit for the year attributable to equity shareholders of the parent company	**72.8**	103.5
Impairment of intangible assets	**(53.4)**	–
Amortisation of intangible assets arising from acquisitions	**(26.1)**	(23.5)
Impairment of plant, property and equipment	**(24.0)**	–
EMEA reorganisation	**(42.1)**	–
Gain on business divestments	**5.1**	13.0
Unrealised impairment of investments	**(11.3)**	(5.7)
Tax impact of items above	**15.7**	6.3
(Loss)/profit for the year attributable to equity shareholders of the parent company	**(63.3)**	93.6

The resulting statutory loss after tax was £63.3m (2009: profit of £93.6m).

Non-recurring items that have been excluded from underlying profit relate to gains on business divestments, impairment of investments, impairment of plant, property and equipment, impairment of intangible assets and EMEA reorganisation costs.

Chief Financial Officer's review (continued)

During the year there has been an impairment of £53.4m against intangible assets. A £50.1m impairment of goodwill has arisen in Technology Solutions QNA (£11.4m), Mission Solutions (£30.8m) and Australia (£7.9m). The global economic uncertainty has led to weaker market outlooks which has, in turn, impacted on the future growth potential. The remaining impairment charge of £3.3m is in respect of other intangible assets.

An impairment charge of £20.7m against the Group's land and buildings was taken during the year relating to owned properties within EMEA where there are no external tenants following vacancies arising during the year. An impairment charge of £3.3m was taken against the Group's plant, machinery and vehicles during the year relating to the impairment of assets which are no longer generating a return. Both of these impairments relate to reductions in the carrying value of these assets to their recoverable amounts.

The EMEA restructuring programme announced in May 2009 largely completed this financial year. The cost of this programme was £42.1m, all of which has been expensed to the income statement in the year as a non-recurring item.

The gain on business divestments in the year relates to the disposal of two businesses during the period. On 30 September 2009 the Group disposed of the Underwater Systems business and on 31 July 2009 the Calibration business, including ASAP Calibration Ltd. for a nominal consideration.

Earnings per share

Underlying earnings per share* was 11.1p compared with 15.9p for the year to 31 March 2009. Basic earnings per share reduced to (9.7p) (2009: 14.3p) over the same period.

Dividend

The Group paid an interim dividend of 1.58 pence per share and the Board is recommending that no final dividend be paid (2009: total dividends 4.75 pence per share).

Other Financials

Cash flow

The Group's cash flow from operations before reorganisation costs was £204.6m (2009: £202.2m). The underlying operating cash conversion ratio* post capital expenditure was 145% (2009: 107%), as a result of a keen focus on cash generation. The cash outflow in the year on EMEA reorganisation was £35.4m (2009: £27.0m).

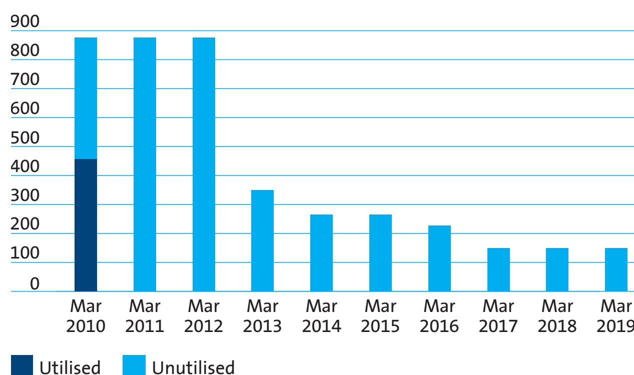
Acquisition expenditure, net of cash acquired, totalled £45.6m (2009: £89.2m), £26.1m of which was due to the acquisition of Cyveillance, Inc. in July 2009 and the remainder was deferred consideration on prior year's acquisitions. Proceeds received from the disposals of Underwater Systems and Calibration businesses totalled £21.1m (2009: £20.9m)

At 31 March 2010, net debt reduced by £80.5m to £457.4m compared with £537.9m at 31 March 2009.

The Group's borrowings remained comfortably within its banking covenants. The Group's two key debt covenant measures are the gearing and interest cover ratios. At 31 March 2010 the actual ratios were well within the maximum covenant levels permitted with the gearing† ratio at 2.5x compared to the covenant maximum level of 3.5 and interest cover of 5.6 compared to a minimum covenant level of 4.0.

The total committed facilities available to the Group, at 31 March 2010, were £877m. The earliest maturity date of the Group's committed facilities is August 2012.

Committed facilities§ maturity profile
(£m)



§Including private placement debt detailed in note 27(e)

Pensions

The net pension liability under IAS 19, after deferred tax, was £106.1m at 31 March 2010 (31 March 2009: £75.8m). The increase in the net pension liability is primarily driven by reductions in the corporate bond discount rate which reduces the extent by which the pension liability is discounted.

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

Assumption	31 March 2010	31 March 2009
Discount rate	**5.6%**	6.5%
Inflation	**3.6%**	3.1%
Salary increase	**4.6%**	4.1%
Life expectancy – male (currently aged 40)	**89**	89
Life expectancy – female (currently aged 40)	**90**	90

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

Assumption	Change in assumption	Indicative effect on scheme liabilities (before deferred tax)
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £23m
Inflation	Increase/decrease by 0.1%	Increase/decrease by £22m
Salary increase	Increase/decrease by 0.1%	Increase/decrease by £6m
Life expectancy	Increase by 1 year	Increase by £22m

The market value of the assets at 31 March 2010 was £915.9m (31 March 2009: £647.4m) and the present value of scheme liabilities was £1,063.2m (31 March 2009: £752.6m).

*Definitions of underlying measures of performance are in the glossary on page 98. Underlying financial measures are presented, as the Board believes these provide a better representation of the Group's long-term performance trend.
†The gearing ratio is net debt to adjusted EBITDA and the definition is in the glossary on page 98.

Capital risk
The Group funds its operations through a mixture of equity funding and debt financing, including bank and capital market borrowings. At 31 March 2010 the Group's capital was £485.8m (2009: £619.4m), which comprises total equity of £473.7m (2009: £602.7m) plus amounts accumulated in equity relating to cash flow hedges of £12.1m (2009: £16.7m). Net debt as defined by the Group was £457.4m (2009: £537.9m).

The capital structure of the Group reflects the judgement of the Directors of an appropriate balance of funding required. The Group's target is to reduce its gearing ratio to 2x EBITDA†. The Directors have recommended a suspension of the dividend until 2011.

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

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

Interest risk management
The Group seeks to reduce the volatility in its interest charge caused by rate fluctuations.

A significant portion of the Group's borrowings are fixed in the short to medium term through a combination of interest rate swaps and fixed-rate debt.

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

	2010	2009
£/US$ – average	**1.59**	1.68
£/US$ – closing rate	**1.52**	1.44
£/US$ – opening rate	**1.44**	1.99

The Group's income and expenditure is largely settled in the functional currency of the relevant Group entity, mainly sterling or US dollar. The Group has a policy in place to hedge all material transaction exposure at the point of commitment to the underlying transaction. Uncommitted future transactions are not routinely hedged. The Group continues its practice of not hedging income statement translation exposure.

To minimise the impact of currency depreciation of the net assets on its overseas subsidiaries, the Group seeks to borrow in the currencies of those subsidiaries, but only to the extent that its gearing covenant within its loan documentation, as well as its facility headroom, are likely to remain comfortably within limits.

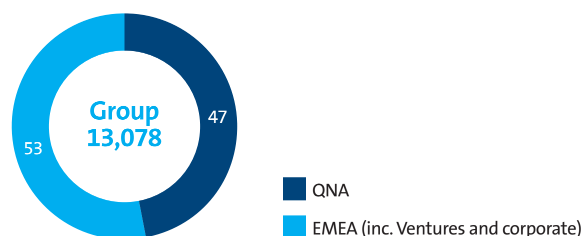
Tax risk management
The central principle of QinetiQ's tax strategy is to manage effective and cash tax rates whilst fully complying with relevant legislation. Tax is managed in alignment with the corporate strategy and with regard to QinetiQ's core value of integrity in all business dealings. These principles are applied in a responsible and transparent manner in pursuing the Group's tax strategy and in all dealings with tax authorities around the world.

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

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

Employees
Year-end employee numbers have decreased by 7% to 13,078 at 31 March 2010. The decline of 812 in EMEA (including Ventures & corporate) reflects normal in-year attrition, departures under the reorganisation programme and the divestment of the Underwater Systems and Calibration business. In QNA total headcount declined from 6,348 to 6,178.

Employees by sector
(%)



Accounting standards
As a UK listed company, the Group is required to adopt EU endorsed IFRSs and comply with the Companies Act 2006. The effect of changes to financial reporting standards in the year and critical accounting estimates and judgements have been disclosed in Note 1 to the Financial Statements.

Critical accounting estimates and judgements in applying accounting policies
A description and consideration of the critical accounting estimates and judgements made in preparing these financial statements is set out in Note 1 to the Group financial statements.

David Mellors Chief Financial Officer
2 June 2010

Key performance indicators

Financial KPIs

KPI	Description	Comment
Underlying EPS* (Pence) 2010: 11.1 2009: 15.9 2008: 13.4	The underlying earnings per share* (EPS) expressed in pence per share	EPS provides shareholders with a measure of the earnings generated by the business after deducting tax and interest. EPS performance also determines the level of payout for the Group's long-term incentive plans.
Underlying Return On Capital Employed (ROCE)* (%) 2010: 9.3 2009: 9.7 2008: 11.7	The underlying profit before interest and tax* over capital employed, defined as total assets less current liabilities.	Underlying ROCE provides shareholders with a measure of the financial returns being generated by the capital used in the business.
Organic revenue growth (%) 2010: -4 2009: 7 2008: 9	The Group's organic revenue growth is calculated by taking the increase in 2010 revenue over 2009 pro forma revenue, at constant exchange rates. The pro forma revenue assumes that any acquisitions were owned and any discontinued operations or disposals excluded, for the comparable period in the prior year.	Organic revenue growth demonstrates the Group's capability to expand its core operations within its chosen markets before the effect of acquisitions and currency translation impacts.
Underlying operating profit* (restated for IAS 19) (£m) 2010: 120.3 2009: 151.6 2008: 118.6	The underlying* earnings before interest and tax. Underlying operating profit* for FY09 and FY08 has been restated to show the finance elements of the IAS 19 pension cost in the finance income and expense lines. There is no impact on reported profit before tax from this restatement.	Underlying operating profit* is used by the Group for internal performance analysis as a measure of operating profitability that is tracked over time.
Underlying operating margin* (restated for IAS 19) (%) 2010: 7.4 2009: 9.4 2008: 8.7	The Group's calculation of underlying operating profit margin is consistent with prior years. Underlying* operating profit margin is calculated by taking the earnings before tax and interest as a percentage of revenue.	Underlying operating profit margin can be used to show the underlying profitability of the revenues delivered by the Group. It can also be used to compare the Group's performance with that of our peers, providing the definition of underlying operating profit is consistent.

Financial KPIs (continued)

KPI	Description	Comment
Operating cash conversion (restated for IAS 19) (%) 2010: 145 2009: 107 2008: 82	The ratio of our net cash flow from operations (excluding reorganisations), less outflows on the purchase of intangible assets, and property plant and equipment to underlying operating profit, excluding the share of post-tax results of equity accounted joint ventures and associates.	Provides a measure of the Group's ability to generate cash from normal operations and gives an indication of its ability to pay dividends, service its debt and to make discretionary investments.
Gearing ratio (restated for IAS 19) 2010: 2.5 2009: 2.2 2008: 2.3	The Group's gearing ratio† is calculated by taking the net debt over EBITDA, as calculated in accordance with the terms of the Group's credit facilities, and is comfortably within our banking covenant limit of 3.5x.	Net debt to EBITDA provides a measure of the strength of the Group's balance sheet.

Non-financial KPIs

KPI	Description	Comment
Health and safety (Lost time injury rate per 1000 employees) 2010: 3.78 2009: 3.00 2008: 5.07	The lost time injury rate is calculated using the total number of work related lost time incidents x1,000 divided by the average number of employees in that year. The 2010 figures are based on Group data. The 2008 and 2009 figures are based on Group data (excluding Australia).	Health and Safety performance is monitored to drive continual improvement in minimising the risk to employees.
Employee engagement score (UK only on a scale of 0-1,000) 2010: 554.1	A measure of employee engagement on a scale of 0-1000, based on the Best Companies Employee Survey. Through this channel, QinetiQ employees share their views of working at QinetiQ under the headings of management, leadership, my company, personal growth, my team, giving back to the community, fair deal and well-being.	The survey forms part of The Sunday Times Best Companies to Work For, an annual survey run in The Sunday Times newspaper that ranks UK employers based on their employees' feedback and allows comparison between QinetiQ and other UK companies.

*Definitions of underlying measures of performance are in the glossary on page 98. Underlying financial measures are presented, as the Board believes these provide a better representation of the Group's long-term performance trend.

†The gearing ratio is net debt to adjusted EBITDA and the definition is in the glossary on page 98.

Principal risks and uncertainties

Risk Management

The understanding, and effective management, of the risks that face QinetiQ is fundamental to its success and is an integral part of managing the business. The identification, assessment, mitigation and reporting of risks are processes carried out at a Group, business and project level and are included as part of the business performance review process. Risks are assessed according to the likelihood of the event's occurrence and its impact, both from a financial and non-financial standpoint. The Group Risk Register includes an analysis of the potential exposures and severity of each risk (as a function of the likelihood and impact of the risk), the assumptions underlying each risk and the mitigating actions required to manage the risk.

It is reviewed by the Executive Team on a monthly basis which considers:

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

The risk register is reviewed quarterly by the Board and, in addition, the risk owners present an update of current status and mitigating actions by rotation throughout the year.

Risk	Potential impact	Mitigation
A change in demand from reduced military operations in Iraq and Afghanistan	A significant shift in policy by either the Administration in the US or the new Government in the UK, which results in a significant reduction in the number of forces personnel present in Iraq and Afghanistan, may have a materially adverse impact on the Group's financial performance.	QinetiQ has capitalised on increased UK and US Government spending on technology in support of operations in Iraq and Afghanistan. Notably, QinetiQ has experienced strong demand for Unmanned Ground Vehicles and survivability products across the duration of both campaigns. However, the focus on operational support in defence, on both sides of the Atlantic, has given rise to a decline in defence expenditure in other areas, such as services to improve procurement efficiency and innovative research. The Group mitigates this by maintaining a market focus and competitive positioning in adjacent markets, including defence services (which are not directly conflict-related); aerospace, security and intelligence, providing a degree of portfolio diversification.
A change in either US or UK Government spending on defence and security	The Strategic Defence and Security Review in the UK, and the financial burden on both UK and US Government budgets from the recent economic downturn, may lead to reduced spending in the markets in which the Group operates. Any reduction in Government defence and security spending in either the UK or the US could have an adverse impact on the Group's financial performance.	The Group is focused on a range of markets in defence, security and intelligence, providing a degree of portfolio diversification. The Group will continue to review trends in defence, aerospace and security expenditure in order to align the business with those trends.

Risk	Potential impact	Mitigation
Defence Training Review (DTR) Package 1 may not reach financial close	In 2007 Metrix, the Group's joint venture with Land Securities Trillium, was confirmed as the preferred bidder for Package 1 of the proposed 30-year DTR contract to outsource training for UK armed forces. The Group is responsible for the design and provision of training to Metrix. In January 2009, Sodexo replaced Land Securities Trillium as the joint venture partner. Metrix and the partners continue to work with the MOD to finalise the scope of the programme as the next stage in moving to a financial close. There is a risk that the DTR programme may suffer material change to the final scope, delay, inability to be financed or even cancellation. This would have a significant impact on the expected future growth of the Group. In addition, if financial close were not reached, the bid costs incurred since preferred bidder status was achieved would have to be written off and expensed through the income statement. These costs capitalised to date amount to £30.8m as at 31 March 2010.	QinetiQ maintains close contact with Metrix, Sodexo and the MOD in relation to the DTR programme, including the potential timing of reaching a financial close. In addition, the MOD has signed some Pre-Contract Award Letters (PCAL) which effectively underwrite a small portion of the external costs incurred by the joint venture partners to date. A funded early training transformation agreement, which will study the proposed technical design and delivery of the training programmes, has been let.
Changing in the timing of contracts	The amounts payable under some Government contracts can be significant and the timing of receiving orders could have a material impact on the Group's performance in a given reporting period.	The contract and orders pipeline is regularly reviewed by senior operational management.
Funding of the defined benefit pension scheme	The Group operates a defined benefit pension scheme in the UK. Presently there is a deficit between the projected liability of the scheme and the value of the assets held by the scheme. The size of the deficit may be materially affected by a number of factors, including inflation, investment returns, changes in interest rates and improvements in life expectancy. An increase in the deficit may require the Group to increase the cash contributions to the scheme which would reduce the Group's available cash for other purposes.	The performance of the pension scheme is reviewed regularly by Group management in conjunction with the scheme's independent trustees. External actuarial and investment advice is also taken on a regular basis to ensure that the scheme is managed in the best interests of both the Group and the scheme's members. The most recent triennial funding valuation of the scheme as at 30 June 2008 resulted in a deficit of £111.3m. The Group and trustees have agreed a ten-year recovery period to make up this deficit.
Policies or attitudes may change towards Organisational Conflicts of Interest (OCI)	The Group provides services to defence customers that meet their needs as part of the defence supply chain and also as technical advisor through its consultancy services. The future growth of the business could be compromised should the current attitudes to policies adopted by our key customers, especially in the UK, change.	The Group takes proactive steps to manage any potential OCI and to maintain its ability to provide independent advice through its consulting and systems engineering activities. In the UK, a formal compliance regime operates with the MOD to monitor and assess potential OCI as part of the sales acceptance process.

Principal risks and uncertainties (continued)

Risk	Potential impact	Mitigation
Tax liabilities may change as a result of changes in tax legislation	QinetiQ is liable to pay tax in the countries in which it operates, principally in the UK and the US. Changes in the tax legislation in these countries could have an adverse impact on the level of tax paid on the profits generated by the Group.	External advice and consultation is sought on potential changes in tax legislation in both the UK and the US. This enables us to plan for and mitigate potential changes in legislation.
A material element of the Group's revenue and operating profit is derived from one contract	The Long-Term Partnering Agreement (LTPA) is a 25-year contract to provide a variety of evaluation and testing services to the MOD. The original contract was signed in 2003. The LTPA operates under five-year periods with specific programmes, targets and performance measures set for each period. On 3 March 2008, the Group signed up to a second five-year period of the LTPA with the MOD. The first break point is in 2013. In the current year, the LTPA directly contributed 11% of the Group's revenue and supported a further 8% through tasking services using LTPA managed facilities. The loss, cancellation or termination of this contract would have a material, adverse impact on the Group's future reported performance.	The Group continues to achieve customer performance and satisfaction levels. QinetiQ achieved a weighted performance rating of 90% against an agreed minimum rating of 80%.
Failure to comply with laws and regulations, particularly trading restrictions and export controls	The Group operates in a highly-regulated environment and the majority of its revenues are generated from sales within the UK and the US. The Group is subject to numerous domestic and international laws, including import and export controls, financial and fiscal laws, health and safety, environmental, money laundering, anti-bribery, etc. Failure to comply with particular regulations could result in a combination of fines, penalties, civil or criminal prosecution, and suspension or debarment from Government contracts, as well as reputational damage to the QinetiQ brand. Any one of these could have a material impact on the Group's financial performance.	The Group has procedures in place to ensure that it meets all current regulations. Local management continuously monitors local laws and regulations, and policies are in place for the appointment of advisors to support business development. Professional advice is sought when engaging in new territories to ensure that the Group complies with local and international regulations and requirements. In the US, the Group undertakes work that is deemed to be of importance to US national security, and arrangements are in place to insulate these activities from undue foreign influence as a result of foreign ownership. The Group has procedures in place to ensure that these arrangements remain effective and to respond to any changes that might occur in US attitudes to foreign ownership of such activities. The terms of reference of the Compliance Committee have been expanded to review the effectiveness of the compliance risk frameworks.
Exchange rate movement	The Group is exposed to volatility in exchange rates due to the international nature of its operations; this includes a translational impact on the key financial statements as a result of the Group reporting its financial results in sterling. The Group has limited transaction exposure as its revenues and related costs are often borne in the same currency, principally US dollars or sterling. QinetiQ North America represents 49% of the Group's consolidated revenues. These operations are funded by US dollar denominated debt. Any significant movement in the foreign exchange markets could have a material impact on the Group's reported financial performance in a given period.	The Group actively hedges all significant transactional foreign exchange exposure as described on page 78 of the notes to the financial statements and has adopted hedge accounting. The Group's objective is to reduce medium-term volatility to cash flow, margins and earnings. The Group protects its balance sheets and reserves from adverse foreign exchange movements by financing acquisitions in North America with US dollar denominated borrowings, partially mitigating the risk as US dollar earnings are used to service and repay US dollar denominated debt.

Risk	Potential impact	Mitigation
Raising external funding and volatility in interest rates	The Group relies on the proper functioning of the credit markets which could have an impact on both the availability and associated costs of financing. The Group is exposed to interest rate risk derived mainly from long-term indebtedness and related to borrowings which have been issued at floating interest rates.	The Group maintains a sufficient level of committed funding facilities, with a phased maturity profile, from commercial banks and private placement investors. The Group also uses fixed-rate debt instruments and interest rate swap derivatives to provide some certainty in the future cost of maintaining these facilities.
Fixed price contracts	Some of the Group's revenue is derived from contracts which have a fixed price. There is a risk that the costs required for delivery of a contract could be higher than those agreed in the contract due to operational overruns or external factors, such as inflation. Any significant increase in costs which cannot be passed on to a customer may reduce the profitability of a contract or even result in a contract becoming loss-making.	The nature of much of the services provided under such fixed-price arrangements is often for a defined amount of effort or resource rather than firm product deliverables and, as such, the risk of cost escalation is substantially mitigated. The Group ensures that its fixed-price bids and projects are reviewed for early detection and management of issues which may result in cost overrun.
Acquisition of businesses	The Group has the ability to acquire other businesses and companies. These acquisitions may not perform in line with expectations, thereby having a detrimental impact on the Group's financial performance.	The risks are mitigated through the due diligence and internal approvals processes. In addition, the usual contractual protections are included in the purchase agreements signed with the vendors.
Inherent risks from trading in a global marketplace	QinetiQ operates internationally. The risks associated with having a large geographic footprint may include: regulation and administration changes; changes in taxation policy; political instability; civil unrest; and cultural and terms of reference differences leading to a lack of common understanding with customers. Any such events could disrupt some of the Group's operations and have a material impact on its future financial performance.	While the core activities of the Group are confined to the UK and the US, the Group continues to explore potential client relationships internationally.
Highly-competitive marketplace	The aerospace, defence and security markets overall are highly competitive. The Group's financial performance may be adversely affected should it not be able to compete in the markets in which it aims to operate.	QinetiQ seeks to focus on areas within these markets in which its deep customer understanding, domain knowledge, technical expertise and platform independence provide a strong proposition and significant advantage in competitive bidding.
Realisation of value from intellectual property may be delayed	The funded research and development work that the Group undertakes for defence and other customers creates intellectual property that the Group retains and can utilise for commercial applications. The uncertainty that exists over new technologies and markets may result in delays, failure to realise value from intellectual property, or the need for a higher level of investment for the opportunity to be realised. The additional investment requirements may have to be funded from the Group's own capital resources which may have an adverse impact on the Group's financial performance.	The Group invests in the development of intellectual property only where it believes there is a substantial and realistic market opportunity for the technology, and it undertakes a portfolio approach, in recognition that not all investments will be successful. The performance of intellectual property realisation programmes is monitored to increase support for successful prospects and reduce expenditure where realisation appears less likely. The Group uses external experts and financial backers as partners in a variety of structures to enhance the performance of certain intellectual property realisation projects.

Corporate responsibility review

This is my first opportunity to report on Corporate Responsibility (CR) at QinetiQ and I am clear that our aim is to be a responsible and sustainable company. Good corporate citizenship is a fundamental tenet of QinetiQ. Our approach to the marketplace, our people, the environment and our community drives our aims. We will continue to ensure this is a key focus as we adapt to our changing environment. The measure of our success in CR is an evolving and key indicator for the business.

Leo Quinn Chief Executive Officer

CR performance overview

What we said	What we did	Where to next
Marketplace Achieve Level 3 of the Government's Flexible Framework for Sustainable Procurement by 2010.	There are five categories in the Flexible Framework, Level 1 to Level 5. We attained Level 3 for two categories and Level 2 for three categories.	Reach Level 3 in all categories of the flexible framework by November 2010 and continue to work proactively with customers and suppliers on sustainable procurement issues.
Our people Continue to drive performance in health and safety (H&S). Maintain UK RIDDOR* rates that are better than the Health and Safety Executive (HSE) benchmark rate. Investigate Learning and Development effectiveness measures for future years. *Reporting of Injuries, Diseases & Dangerous Occurrences Regulations.	A RIDDOR rate of 3.69 per 1,000 employees compared with the HSE benchmark of 5.03. Qualitative and quantitative measures have been identified. We have found that learning and development intervention has a measurable impact on graduate retention and on time taken to achieve chartered status.	Reduce accidents, incidents and the number of employee days away from work. In future we will be reporting Lost Time Injury Rates. Use UK employee survey to understand and improve employee engagement.
Environment Maintain our ISO 14001 certification in the UK. Achieve certification to the Carbon Trust Standard. Extend UK waste data capture to all minor sites and continue to increase recycling (target is 70% by 2014). Contribute to biodiversity through the effective maintenance of our conservation sites.	Successfully retained ISO 14001 for UK sites. Carbon Trust Standard achieved. Data capture extended to almost all minor sites in the UK. Achieved 66% waste recycling on major UK sites. Management plans and conservation leads are in place for designated conservation areas in the UK. We received a Sanctuary Award for conservation work in the Hebrides.	Continue to maintain ISO 14001 for UK sites. 2% CO_2 emissions reduction target in the UK. Achieve 70% recycling rate across the UK by 2012. Delivery of UK conservation management plans.
Community Undertake tour of Lab in a Lorry in 2009/10. Continue to focus and deliver our STEM (Science, Technology, Engineering and Maths) education outreach programmes, where we are working to inspire the next generation of scientists and engineers.	Lab in a Lorry taken to Portsmouth. We have now interacted with 11,000+ students. Development of extended training for STEM Ambassadors. Attained three awards from STEMNET.	Form partnerships with key schools to deliver our STEM education outreach programme effectively.

Corporate responsibility management

The CR Committee met three times during the year to discuss strategy and progress. This new group, which comprises the Executive Team and the Group CR Manager, has enabled greater senior management visibility and support for CR programmes. A report is provided monthly to the Executive Team and the CEO reports to the Board on CR issues as required. Our approach is to embed CR into how we do business and the CR Manager worked with a wide network of domain experts across the UK and the US. In Australia, a new CR Team has been formed and has developed a plan to roll out local initiatives, in line with the Group CR framework.

Delivery of the Business Risk Management process is a key mechanism to improve awareness, understanding and management of risk. CR and ethical risks have previously been held separately but, following a programme of work this year with the UK business, are now integrated to ensure our approach to risk is holistic. We have been refreshing our strategic objectives around Health Safety and Environment (HS&E) and Business Ethics. There is now a clearer focus on leadership, communications, competencies and risk management.

Policy and process

We have a balance between Group and regional policies to encompass regional differences in best practice and law. Relevant policies include HS&E, sustainable procurement, business ethics, equality and diversity. Our Group Business Ethics Policy, which is available in the Investor Relations and CR sections of our website (www.QinetiQ.com), provides a framework of how we operate. Further information on governance can be found on page 28.

Marketplace

Mission statement: to be a responsible and sustainable business

Sustainable procurement

We recognise that how and what we buy needs to be an integral part of our ambition to improve sustainability in QinetiQ. Our UK Sustainable Procurement Forum has been active in raising employee awareness through training, employee campaigns and leadership team briefings. An introduction to Sustainable Procurement is part of the corporate induction for UK employees. A key part of the process is working with our suppliers and this is an area on which we must continue to focus. We are a signatory to the MOD's Sustainable Procurement Charter and are an active member of the MOD-Industry Sustainable Procurement Working Group.

Business ethics

We are committed to the highest standards of ethical conduct. We know this is critical for our success because it builds trust and transparency with our people and with our customers. Maintaining these high standards of ethical behaviour can result in difficult choices. Integrity and ethics may require us to forgo business opportunities, but in the long run we will be better served by doing what is right. Over 95% of UK employees and 100% of QNA employees have undertaken business ethics training. The Australian business now has its Code of Conduct in place.

Policies and procedures are in place to prevent corruption within our operations and activities. We have been working with organisations such as TRACE (Transparent Agents and Contracting Entities), an independent and internationally recognised organisation, in two areas. Firstly, to conduct a due diligence review on the anti-bribery issue associated with engaging third-party representatives overseas: secondly, to provide bespoke training for our sales and commercial employees on international law and regulations covering anti-corruption and bribery.

We have a Whistleblower line available for all employees worldwide and we have developed a new gifts and hospitality register in the UK. There is a need for continual improvement and we are developing our strategic objectives in business ethics, which will focus on leadership, communications, competencies, policy and risk management.

Environmental solutions

Monitoring and collection of environmental data is increasingly crucial in addressing the challenges of climate change and environmental management. The SWIMA project is managed by QinetiQ, working with an international group of companies, the UK Environment Agency and universities. The team is using field trials in the River Tamar catchment in South West England to demonstrate how the exploitation of open standards in 'sensor webs' (networks of disparate sensors connected via the same web interface) can make environmental monitoring more efficient and intelligent while also reducing associated costs. Having this type of data available at the click of a mouse has considerable impact on the accuracy and timely delivery of alerts of pollution and flooding.

Our people

Mission statement: to create an environment which attracts great people and enables them to deliver high levels of performance

Health and safety

Employee safety is a key part of our overall business ethic and duty of care to fellow employees. Senior management is responsible for delivering and embedding the highest standards and we have been refreshing our programme of leadership, including the introduction of Safety Leadership Charters. A comprehensive audit of our UK safety management system was completed by the Explosives Inspectorate of the HSE. Whilst it identified a number of opportunities for improvement, it concluded that we have 'a clear and strong commitment to the safe conduct of the business' and 'a strong culture of safe working'.

Our businesses in the UK, the US and Australia collect and report accident data differently, because of in-country requirements. Going forward, we are looking at greater alignment of reporting metrics.

Health and safety data

	2006	2007	2008	2009	2010
UK RIDDOR rate[1]	3.85	3.47	2.28	2.82	**3.69**
HSE Benchmark[2]	5.90	5.63	5.36	5.19	**5.03**
UK[3]	n/a	n/a	7.61	4.66	**5.32**
QNA[3]	n/a	2.14	1.57	1.09[4]	**2.12**
Australia[3]	n/a	n/a	n/a	n/a	**3.88**

[1] The UK measures the number of RIDDOR accidents as the number of events per 1,000 people during the year.
[2] HSE RIDDOR Benchmark for all 'industries'.
[3] Data are work related lost time accident per 1,000 employees.
[4] Slightly altered from 2009 (0.78) due to legacy entities.

UK employees have access to the Employee Wellbeing Programme service, which provides information and support on financial, legal and family matters, counselling, and an online service. UK employees also have a benefits package through 'QinetiQ Currency', which provides discounts on a range of items such as bicycles, childcare and healthcare. QNA provides an excellent package of healthcare benefits, for employees.

Corporate responsibility review (continued)

Employee engagement

Regular dialogue with employees is part of good leadership, and listening to our people has never been more important whilst we have been undergoing significant change. A range of tools is deployed regularly to keep in touch with our employees, including: CEO notices, team briefings and leaders hosting 'town hall' sessions across all our sites. We also make good use of intranet, newsletters, video and print media. The newly formed Employee Forum and the Communications Network create an open dialogue to give employees across the UK business the opportunity to have their say and to give input into important issues that we face. Employee engagement has been a key part of QNA's programme of bringing many separate companies together into one business.

Employee surveys are also an opportunity for our people to have their say. This year we introduced the widely used 'Best Companies to Work for' questionnaire in the UK, which will enable us to benchmark ourselves against other companies across a wide range of issues. We had a high response of 73% and the survey gave us some clear feedback on areas on which we need to focus.

We have introduced an exciting new programme, 'My Contribution', which enables everyone to play a part in improving our business. It gives employees a way to generate and voice ideas and convert them quickly into projects that will benefit the Company's bottom line. It is a simple, common sense concept enabling continuous improvement. The programme is up and running in the UK and there are plans in place to roll it out across QinetiQ globally.

Learning and development

We support the development and employability of our people. Across QinetiQ we have in place a range of high quality programmes, from apprentice training and graduate entry, to leadership. For example, the UK Graduate Development Programme provides new entrant graduates with business awareness through the Henley Graduate Programme and professional development through the Accredited Initial Professional Development Scheme. Investment in graduate development continues to play a major factor in graduate retention. CR is an integral part of the UK Corporate Induction and is supplemented by a CR e-learning module. In the UK, our Flight Engineering Services Training Centre is currently training just under 100 engineering apprentices from across our Managed Services Group and dstl. The training pathways cover aircraft mechanical and avionics, workshop machining and ground instrumentation/ electrical. The aircraft training pathways conform to the MOD Maintenance Approved Organisation Scheme training requirements for Mechanical (B1) and Avionics (B2) trades.

In Australia, a People Development Programme is establishing career development for our most talented employees and is supporting succession planning. QNA was formed over a short period from a number of companies with different cultures and practices. The focus has been on efficiently implementing consistency in job roles and performance management. QNA has been driving robust succession planning and working with the Darden Business School at the University of Virginia to develop future leaders. For QNA technical employees, the focus is on a rapid and competitive knowledge update.

We are one of only 5% of the 28,000 Investors in People organisations that have chosen to stretch above the standard. Since a key area identified in recent feedback was performance management in the UK, we have carried out a full review and update of our performance management processes, and introduced the Personal Success Plan.

Community

Mission statement: to make a positive contribution to the community

Science for society

Following a request from the Combined Services Disabled Ski Team, our experts designed and manufactured a more competitive ski racing seat for Sergeant Mick Brennan, a double amputee who has discovered a real talent for downhill skiing as part of the Battle Back initiative to rehabilitate injured servicemen and women. Mick's performance improved considerably with the seat and he achieved a Bronze medal in the Giant Slalom at the Canadian Nationals in Vancouver.

In 2009, two UK employees visited Saravan Province in southern Laos and worked with Norwegian People's Aid as part of our unexploded ordnance (UXO) Science for Society Programme, which has been running for five years. The UXO is a legacy of the Vietnam war. The team provided training in UXO pinpointing, CAD, surveying and mapping, as well as simple practical solutions for water purification, bomb disposal and simple protection schemes.

Education outreach

QinetiQ collected three prestigious STEM Education Outreach Awards, from STEMNET including Support & Development, Most Dedicated Ambassador and Most Dedicated Organisation. In 2009 we launched a strategic partnership with Shoeburyness High School to provide some business focus, to complement the STEM curriculum. We are working closely with the school on the delivery of the new, two-year STEM Leadership qualification and supporting 16-year-old Fast Track students on the Applied Science course. Going forward, we aim to focus on our education outreach programmes, by developing partnerships with other key schools near our sites. QNA also recognises the importance of encouraging young people towards maths and science careers, and sponsors science and technology education in schools.

In the UK, we supported many students at various stages in their university careers: 16 pre-university students were hosted on the Year in Industry scheme, while other students worked in the company for up to a year during their undergraduate course. At any time, over 50 doctoral level students are sponsored, in conjunction with the Engineering and Physical Sciences Research Council, on projects that are relevant to our business, with placements on various sites.

Charity and community programmes

Employees across the Group undertook a range of volunteering activities in the community. QNA supported a number of employee-driven initiatives and contributed time, resources and funding to numerous community grassroots efforts, such as Habit for Humanity and the Special Olympics. In addition, QNA encouraged active participation and support for military-aligned programmes, such as the Wounded Warrior Project for injured servicemen and women. In the UK, employees have been involved in a range of community activities, from conservation projects to beach safety talks for children. Total charitable giving from the business across the Group was £114,100 (see page 42). In addition, our UK employees raised £26,112 for our priority charities through a range of events, attracting corporate matched funding for priority charities and made contributions through our payroll giving scheme.

Environment

Mission statement: to be an excellent environmental steward

Carbon management

A highlight this year was meeting our target of attaining the Carbon Trust Standard which demonstrates that we have measured, managed and reduced our carbon emissions. For the third year, we provided information to the Carbon Disclosure Project and we also took part in the Business in the Community May Day Network. We recognise the importance of being prepared for the UK Government's Carbon Reduction Commitment Energy Efficiency Scheme and are well positioned, having put in place the Carbon Management Group (CMG) which brings together expertise from Estates, Environmental Management, CR, Procurement and the business. The CMG oversees our five-year carbon management plan, promotes energy efficiency and awareness, and sets and monitors targets. Following our carbon footprinting programme, this is the first year we are reporting CO_2 emissions from transport as well as from energy used.

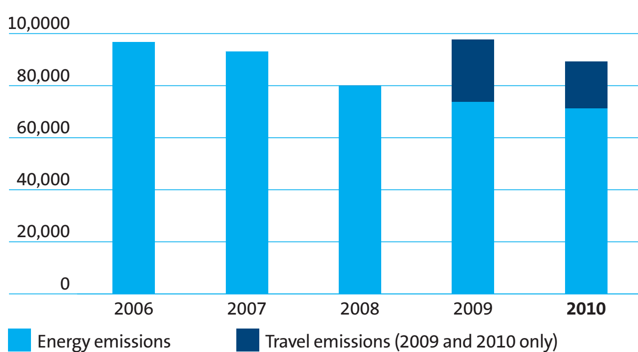
UK carbon management data

	2006	2007	2008	2009	2010
UK gas use (GWH)	84.6	69.6	68.6	66.8	**64.7**
UK oil use (GWH)	25.9	22.5	21.4	21.7	**20.6**
UK electricity use (GWH)	136.9	136.9	113.6	102.7	**99.3**
UK total energy use (GWH)	247.3	229.1	203.6	191.2	**184.7**
UK ktonnes CO_2 from energy use [1]	96.7	93.1	80.0	73.8	**71.3**
UK ktonnes CO_2 from transport [2]	n/a	n/a	n/a	23.8	**17.9**

[1] In the table CO_2 emissions are calculated using the defra October 2009 Greenhouse Gas conversion factors (Gas 0.18358; Oil 0.27927; Electricity 0.54055). These factors change regularly so in order to show actual reductions, we have used the same conversion factor for all years. This will result in slightly different numbers from those reported last year, which were based on a previous conversion factor (2009: 71.8; 2008; 77.8).
[2] The data includes emissions from our own vehicles (aircraft, helicopters and cars) and from employee business mileage (road and air). 2009 data now included.

UK CO_2 emissions data

(tonnes)



Environmental management and conservation

We continue to maintain ISO 14001:2004 certification in the UK. This is evidence of effective controls as part of our Environmental Management Systems, which cover a broad range of activities, from knowledge and technology-based research and services, to weapons and systems testing. Our Australian business has also established a small group responsible for developing environmental initiatives.

We take a responsible and proactive approach to the stewardship of the many Sites of Special Scientific Interest (SSSI) that we manage in the UK, with appropriate conservation management plans in place for all of them. We won a prestigious Sanctuary Award for our work on a SSSI on the MOD Hebrides range.

Waste

As part of our waste management programmes, we have extended data collection to the majority of sites we own or manage for the MOD and incorporated additional waste streams, the largest of which are construction and grounds waste. In QNA, recycling programmes operate across much of the business.

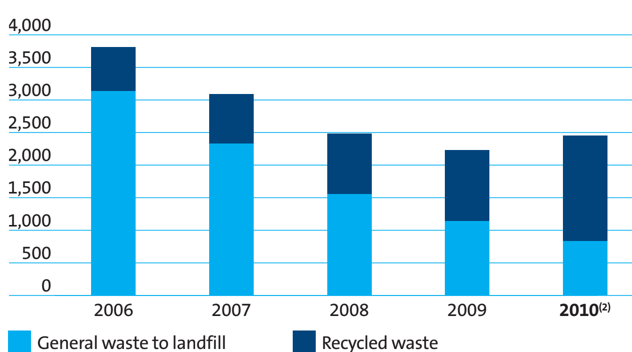
UK waste management data[1]

	2006	2007	2008	2009	2010
General waste to landfill (tonnes)	3,131	2,330	1,551	1,140	**830**
Recycled waste (tonnes)	680	761	932	1,094	**1,623[2]**
Percentage waste recycled	18%	25%	38%	49%	**66%**

[1] Major sites only, for comparative purposes.
[2] Waste data collection now extended to include construction and composting waste.

UK waste data[1]

(tonnes)



[1] Major sites only, for comparative purposes.
[2] Waste data collection now extended to include construction and composting waste.

Board of Directors

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1. Mark Elliott
Non-executive Chairman – 61

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

Member of the Remuneration Committee, Compliance Committee and Nominations Committee.

Mark was previously General Manager of IBM Europe, Middle East and Africa and sat on IBM's Worldwide Management Council. Mark currently serves as a Non-executive Director on the boards of Reed Elsevier Group PLC (in respect of which he is also Chairman of the Remuneration Committee), Reed Elsevier NV and G4S plc. The Board considers that Mark's extensive experience in the technology services sector, both in the US and Europe, coupled with his exposure to a variety of industry sectors on the boards of FTSE listed companies, is a valuable asset to the Group in terms of leadership and addressing the strategic issues affecting the Group.

2. Leo Quinn
Chief Executive Officer – 53

Appointed Chief Executive Officer in November 2009.

Member of the Compliance Committee, Nominations Committee and Security Committee.

Leo was Chief Executive Officer of De La Rue plc between 2005 and 2009. Before that he was Chief Operating Officer of Invensys plc's Production Management Division. Prior to that time, he spent 16 years with Honeywell Inc. in a variety of senior management roles in the USA, Europe, the Middle East and Africa. Leo was formerly a Non-executive Director of Tomkins plc.

3. David Mellors
Chief Financial Officer – 41

Appointed Chief Financial Officer in August 2008.

Member of the Security Committee.

David was previously deputy Chief Financial Officer of Logica plc. David has also held the position of Chief Financial Officer of Logica's international division covering operations in North America, Australia, the Middle East and Asia and, prior to that, he was the Group Financial Controller. Earlier experience included various roles with CMG Plc, Rio Tinto plc and Price Waterhouse. David is a member of the Institute of Chartered Accountants in England and Wales.

4. Sir David Lees
Deputy Chairman and Senior Independent Non-executive Director – 73

Appointed Deputy Chairman and SID in August 2005.

Chairman of the Compliance Committee and Nominations Committee; Member of the Audit Committee and Security Committee.

Sir David is currently Chairman of the Court of the Bank of England; he has also been a member of the UK Panel on Takeovers and Mergers since June 2001. Sir David joined GKN plc in 1970 and had held the position of Group Finance Director, Chief Executive and Executive Chairman before becoming Non-executive Chairman in 1997 until his retirement in May 2004. Other notable roles include being a member of the National Defence Industries Council between 1995 and 2004, Chairman of Courtaulds plc from 1996 to 1998, a Non-executive Director of the Bank of England between 1991 and 1999 and Chairman of Tate & Lyle plc until 2009. From 2001 to 2006, he was Non-executive Joint Deputy Chairman of Brambles Industries plc and Brambles Industries Limited. Sir David is a Fellow of the Institute of Chartered Accountants in England and Wales. The Board considers that Sir David's detailed understanding of the defence sector, coupled with his extensive experience of corporate governance and the City and its institutions, significantly enhances the operation of the Board.

5. Colin Balmer
Non-executive Director – 63

Appointed Non-executive Director in February 2003.

Chairman of the Security Committee; Member of the Compliance Committee, Nominations Committee and Remuneration Committee.

Colin served as Managing Director of the Cabinet Office from 2003 until his retirement in 2006. Previously, he was Finance Director of the MOD, with responsibility for QinetiQ's privatisation and the subsequent investment by Carlyle as part of the PPP Transaction. Colin has extensive experience across the MOD and is currently a member of the Foreign and Commonwealth Office's Audit and Risk Committee and is on the Board of the Royal Mint, chairing its Audit Committee. The Board considers that Colin's extensive knowledge of the development of QinetiQ throughout its public-private partnership, and his in-depth understanding of the working of Government, particularly the UK MOD, provides the Board with a unique insight into the issues facing Government in delivering its procurement objectives and partnering with industry suppliers.

6. Noreen Doyle
Non-executive Director – 61

Appointed Non-executive Director in October 2005.

Chairman of the Remuneration Committee; Member of the Audit Committee.

Noreen sits on the Board of Credit Suisse Group (Zurich) and is a Non-executive Director of Newmont Mining Corporation (Denver) and Rexam plc. Prior to her appointment in 2001 as First Vice President of the European Bank for Reconstruction and Development (EBRD), Noreen was head of Risk Management. Previously, Noreen had a distinguished career at Bankers Trust Company (now Deutsche Bank) in corporate finance and leveraged financing, with a concentration in oil, gas and mining. The Board considers that Noreen's extensive international business experience, particularly in the areas of corporate finance, risk management and banking, is of significant benefit to the Board.

7. David Langstaff
Non-executive Director – 55

Appointed Non-executive Director in August 2009.

Member of the Audit Committee, Nominations Committee and Remuneration Committee.

David was formerly President and Chief Executive Officer of Veridian Corporation. Prior to that, David held positions with First Boston International, Blyth Eastman Dillon International and the Inverness Group, focused on corporate finance, venture capital and mergers and acquisitions. David currently serves on the Boards of TASC, Inc., the US Defense Business Board, SRA International, Inc. and The Aspen Institute Business and Society Program. The Board considers that David's professional services experience and in-depth understanding of the security market is highly beneficial to the future development of QinetiQ's business.

8. Admiral Edmund P. Giambastiani Jr., US Navy (retired)
Non-executive Director – 62

Appointed Non-executive Director in February 2008.

Member of the Compliance Committee.

Between 2005 and 2007, Ed was the second-highest ranking military officer in the United States, having served as the seventh Vice Chairman of the Joint Chiefs of Staff. A career nuclear-trained submarine officer, Ed's distinguished service has also included assignments as Special Assistant to the CIA's Deputy Director for Intelligence, Senior Military Assistant to the US Defense Secretary and Commander, US Joint Forces Command. He also served as NATO's first Supreme Allied Commander Transformation. After retirement and until October 2009, he served as the Non-executive Chairman of the Board of Directors for Alenia North America, Inc. He currently is a Non-executive Director of The Boeing Company, SRA International, Inc. and Monster Worldwide, Inc. and serves in a pro-bono capacity on a number of US Government advisory boards and panels. The Board considers that Ed's extensive knowledge of the US defence and security domain significantly enhances the operation of the Board, as QinetiQ continues to pursue its strategy of developing its US platform in the defence and security technology sector.

9. Nick Luff
Non-executive Director – 43

Appointed Non-executive Director in June 2004.

Chairman of the Audit Committee; Member of the Compliance Committee and Security Committee.

Nick was appointed Finance Director of Centrica plc in March 2007, having previously served as CFO of the P&O Group. He trained as a chartered accountant with KPMG and is a member of the Institute of Chartered Accountants in England and Wales. Nick joined the P&O Board as Finance Director in 1999. In October 2000, he became Chief Financial Officer of P&O Princess Cruises plc on its demerger from the P&O Group and returned as Chief Financial Officer of P&O in May 2003. Nick has also served as a Non-executive Director on the board of Royal P&O Nedlloyd NV, the Dutch-listed international container shipping company. The Board considers that Nick's experience of operating as Chief Financial Officer/Finance Director with P&O and Centrica, coupled with his extensive exposure to a variety of industrial sectors, provides the rigorous financial and commercial scrutiny required of a FTSE-listed company at Board level, particularly in the context of his role as Chairman of the Audit Committee.

10. Admiral Sir James Burnell-Nugent
Non-executive Director – 60

Appointed Non-executive Director in April 2010.

Member of the Compliance Committee, Remuneration Committee and Security Committee.

Sir James commanded the aircraft carrier HMS Invincible and three other ships and submarines during a 37-year career in the Royal Navy which culminated in his appointment as Commander-in-Chief Fleet. In-between operational duties he served in several appointments in the Ministry of Defence and gained cross-Whitehall experience while on secondment to HM Treasury. The Board considers that Sir James' expertise in the Government contracting domain, particularly with the UK MOD and HM Treasury, is highly beneficial in the context of QinetiQ's Government sourced operations.

Corporate governance report

The Board is committed to promoting the highest standards of corporate governance and believes that strong governance is key to delivering value to all stakeholders, maintaining investor confidence and managing change.

This section of the Annual Report, together with the Report of the Remuneration Committee on pages 36 to 41, describes how QinetiQ has promoted strong governance throughout the Group by applying the principles of the UK Financial Reporting Council's Combined Code on Corporate Governance (the Combined Code). The Board considers that QinetiQ has complied with the provisions of the Combined Code throughout the last financial year, except that the Combined Code recommends that a company's chairman should be independent on appointment and that its Chief Executive Officer (CEO) should not become chairman of the same company. Sir John Chisholm, the Chairman of the Group until February 2010, was not regarded as independent under the Combined Code as he was formerly QinetiQ's CEO; the Board gave the reasons for this non-compliance both in the prospectus published as part of the Company's Initial Public Offering (IPO) in 2006 and in subsequent Annual Reports.

The Board – governance, processes and systems

Highlights

- Conducted a global search culminating in the appointment of a new Chairman
- Managed the process of appointing a new Chief Executive Officer
- Created a new Security Committee and conducted a review of the composition of the Board Committees
- Appointed Sir Robert Nelson to conduct an independent investigation into the conclusions and recommendations made in the Haddon-Cave report
- Created a revised risk register and introduced clear processes in relation to oversight and management of risk.

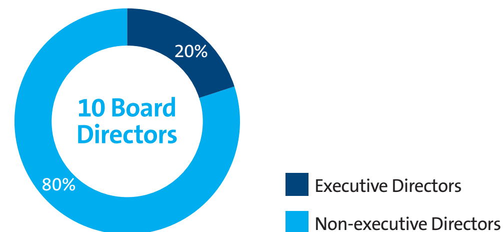
Board objectives

- Provide support to the new Chief Executive Officer to ensure the Group's success
- Assist in the development of a new strategic direction for the Group's business
- Remain focused on succession planning for the Board
- Deliver the highest standards of health and safety management across the Group
- Support the Chief Executive Officer in ensuring that the key recommendations of Sir Robert Nelson's review of the Haddon-Cave report, published in November 2009, are implemented across the Group
- Continue to promote the highest standards of corporate governance and rigorous oversight of Group performance and risk management.

Composition of the Board

The Board currently has ten members: the Non-executive Chairman; seven other Non-executive Directors; and two Executive Directors, namely the CEO and the Chief Financial Officer (CFO); with the objective of achieving a balance of Executive and Non-executive Directors.

Executive and Non-executive Board composition



Mark Elliott has been the Non-executive Chairman of QinetiQ since 1 March 2010 following Sir John Chisholm stepping down from this role. Mr Elliott joined the Board as a Non-executive Director on 1 June 2009. During the year the Board also welcomed David Langstaff, who joined as a Non-executive Director on 5 August 2009, Leo Quinn, who joined as QinetiQ's Chief Executive Officer on 16 November 2009 and Admiral Sir James Burnell-Nugent, who joined the Board as a Non-executive Director on 10 April 2010. Mr Quinn replaced Graham Love, who ceased to be CEO on 31 October 2009. The Board would like to express its thanks to Sir John Chisholm, Graham Love and Dr Peter Fellner, all of whom stepped down during the year, for their dedication and valuable contributions during their years of service.

The Board considers its overall size and composition to be appropriate, having regard in particular to the independence of character and integrity of all the Directors and the experience and skills which they bring to their duties, which prevents any individual or small group from dominating the Board's decision-making.

The Board considers that the skills and experience of its individual members, particularly in the areas of UK/US defence and security, the commercialisation of innovative technologies, corporate finance, mergers and acquisitions and risk management, have been fundamental in the pursuit of QinetiQ's strategic initiatives (as described in the Chief Executive Officer's Review section of this Annual Report) in the past year. In addition, the quoted company experience available to members of the Board in a variety of industry sectors and international markets has also been invaluable to the Group as it seeks to penetrate new markets and geographic territories.

Roles and responsibilities

The Board is responsible for managing the Group's operations and, in this capacity, determines the Group's strategic and investment policies. The Board also monitors the performance of the Group's senior management team and organises its business to have regular interaction with key members of the Group, including those based in North America. The Directors are responsible for the management of the business of the Group and their powers are subject to the Articles of Association and any applicable legislation and regulation.

Chairman and Chief Executive Officer

The roles of Chairman and CEO are separate, with their responsibilities having been clearly articulated by the Board in writing. The Chairman, Mark Elliott, is responsible for the effective operation of the Board and ensures that all Directors are enabled and encouraged to play their full part in Board activities. The CEO, Leo Quinn, is responsible to the Board for directing and promoting the profitable operation and development of the Group consistent with enhancing long-term stakeholder value, which includes the day-to-day management of the Group, formulating, communicating and executing Group strategy, and the implementation of Board policies.

Senior Independent Director

The Senior Independent Non-executive Director is Sir David Lees. Sir David is also Deputy Chairman of the Board and serves as an additional point of contact for shareholders should they feel that their concerns are not being addressed through the normal channels. Sir David is, furthermore, available to fellow Non-executive Directors, either individually or collectively, should they wish to discuss matters of concern in a forum that does not include the Chairman, the Executive Directors or the senior management of QinetiQ.

Independence of Non-executive Directors

Of the current Directors of the Company, the Board considers Admiral Sir James Burnell-Nugent, Noreen Doyle, Mark Elliott, Admiral Edmund P. Giambastiani, David Langstaff, Sir David Lees and Nick Luff to be independent of QinetiQ's executive management and free from any business or other relationships that could materially interfere with the exercise of their independent judgement. Of the remaining Non-executive Directors, the Board considers that Colin Balmer is not independent for Combined Code purposes, on the basis that he was (until MOD sold its entire ordinary shareholding in the Company on 9 September 2008) the MOD's nominated director.

Based on the above, the Board considers that over half of its members were independent Non-executive Directors throughout the last financial year.

Performance of the Board

During the financial year ended 31 March 2010, QinetiQ conducted its fourth evaluation of the performance of the Board and its Committees since IPO. Given that the Group had undertaken an externally facilitated evaluation in the previous financial year, and the number of Board changes occurring in year, the 2009/10 evaluation exercise was an internal exercise led by Sir John Chisholm. The Chairman used the core conclusions arising out of the prior year's exercise as a reference point for a series of questions focused on best practice areas of corporate governance, which was supplemented by a number of meetings held individually with each of the Directors at which the performance of the Board, its Committees and individual Board members was discussed. Sir David Lees, in his capacity as the Senior Independent Non-executive Director, also met with individual members of the Board to evaluate the performance of the Chairman.

The evaluation process revealed that the operation of the Board was conducted in an open and transparent manner, with the Board possessing an appropriate range of skills which were well matched to QinetiQ's business and having devoted increased attention to strategic planning, succession and risk management in the year. As a result of the evaluation exercise, the Board agreed to maintain its focus on these key issues in the coming year.

As a separate exercise, the Chairman held various meetings with the Non-executive Directors in the last financial year, without the Executive Directors present, in order to review both the operation of the Board and the performance of the Executive Directors. In addition, the Executive Directors were appraised as part of the annual salary review process, which was overseen by the Remuneration Committee.

Directors' induction, on-going training and information

All newly-appointed Directors participate in an induction programme, which is tailored to meet their specific needs in relation to information on the Group. This induction programme includes an induction pack, which is refreshed to ensure it contains the most up-to-date information available on the Group.

All Directors are encouraged to visit QinetiQ's principal sites and to meet a wide cross-section of the employee base. During the last financial year, the Board held one of its meetings at QinetiQ's facility in McLean, Virginia and one at QinetiQ's facilities in Waltham, Massachusetts, which allowed members of the Board to better appreciate the operational dynamics and technical offerings of the QNA business. The Board also held one of its meetings at QinetiQ's Farnborough site.

As part of the corporate planning process, the Board has the opportunity to question the sector heads and the Executive Directors in relation to the formulation of the corporate plan at sector level and the impact of these plans on the Group strategy as a whole. The Non-executive Directors also have an opportunity to meet with other employees within the Group (including, but not limited to, other members of the senior management team) at lunchtime/evening events, which are scheduled to coincide with Board meetings.

Training is also available to the Board on key business issues or developments in policy, regulation or legislation on an 'as needed' basis.

Each of the Directors has access to the services of the Company Secretary, and there is also an agreed procedure for the Directors to seek independent advice at the Company's expense.

Re-election of Directors

Rules concerning the appointment and replacement of Directors of the Company are contained in the Articles of Association and changes to these articles must be submitted to shareholders for approval. According to the Articles of Association, all Directors are subject to election by shareholders at the first AGM following their appointment, and to re-election thereafter at intervals of no more than three years. It is the Company's practice for each serving member of the Board to be put forward for election or re-election at each Annual General Meeting.

Corporate governance report (continued)

Board meetings and attendance

The Board has regular scheduled meetings. Nine scheduled Board meetings were held in the last financial year. Members of the Board were also invited to attend a dinner on the occasion of each scheduled Board meeting, to assist in the process of relationship building and to ensure that key strategic initiatives were thoroughly discussed. The Board held two of its scheduled meetings in the US in the last financial year, to give members of the Board an opportunity to meet with senior management in QNA. One Board meeting was held at QinetiQ's Farnborough site to provide members of the Board with greater opportunity to understand the operational dynamics of the UK business at first hand.

The following table shows the number of Board meetings held during the year and the attendance by individual directors.

Attendance at Board meetings April 2009 to March 2010

Members	
Board meetings held in 2009/2010	
Colin Balmer	9/9
Admiral Sir James Burnell-Nugent[(1)]	0/0
Sir John Chisholm[(2)]	8/8
Noreen Doyle	8/9
Mark Elliott[(3)]	7/7
Dr Peter Fellner[(4)]	2/3
Admiral Edmund P. Giambastiani	9/9
David Langstaff[(5)]	7/7
Sir David Lees	9/9
Graham Love[(6)]	5/5
Nick Luff	9/9
David Mellors	9/9
Leo Quinn[(7)]	4/4

(1) Admiral Sir James Burnell-Nugent was appointed to the Board on 10 April 2010.
(2) Sir John Chisholm resigned from the Board on 28 February 2010.
(3) Mark Elliott was appointed to the Board on 1 June 2009.
(4) Dr Peter Fellner resigned from the Board on 4 August 2009.
(5) David Langstaff was appointed to the Board on 5 August 2009.
(6) Graham Love ceased to be a Director on 31 October 2009.
(7) Leo Quinn was appointed to the Board on 16 November 2009.

Matters reserved to the Board

The Board operates through a comprehensive set of processes, which define the schedule of matters to be considered by the Board and its Committees during the annual business cycle, the level of delegated authorities (both financial and non-financial) available to both Executive Directors and other layers of management within the business, and QinetiQ's Business Ethics, Risk Management and Health, Safety and Environmental processes. The Board devotes one entire meeting each year to consider strategy and planning issues which have an impact on the Group, from which the five-year corporate plan is generated. The Board also has a clearly articulated set of matters which are specifically reserved to it for consideration, which include reviewing the annual budgets, raising indebtedness, granting security over Group assets, approving Group strategy and the corporate plan, approval of the annual and interim report and accounts, approval of significant investment, bid, acquisition and divestment transactions, approval of Human Resources policies (including pension arrangements), reviewing material litigation and monitoring the overall system of internal controls, including risk management.

Operation of the Board

The Board receives written reports from the CEO and CFO each month, together with a separate report on investor relations (which is prepared in consultation with QinetiQ's brokers) and a report produced by the Company Secretary on key legal and regulatory issues affecting the Group. The Board also considers reports from the Chairs of the Committees of the Board at the next scheduled Board meeting, following the date on which each Committee meeting was held.

The CEO's monthly report addresses the key strategic initiatives which have had an impact on the Group since the previous meeting of the Board, and focuses, in particular, on the progress of each of the Sectors. Other key areas of focus include health, safety and environmental matters, employee and organisational issues, corporate responsibility, the status of key account management/customer relationship initiatives, the pipeline of potential bids, acquisitions, disposals and investments, and the post-acquisition performance of recently acquired businesses. The Board also receives updates from the CEO's key functional reports on an 'as needed' basis, on issues such as Human Resources, Treasury, Corporate Responsibility, Real Estate and Pensions, throughout the financial year. Key issues considered by the Board in the past year included succession planning, which culminated in the appointment of a new Chairman and CEO in year, strategy (in particular the strategic response to the operational challenges faced by the QNA and EMEA businesses, as described in the Business Review) and the Company's response to the key findings of the Haddon-Cave report into the Nimrod aircraft which crashed in Afghanistan in 2006.

The CFO's monthly report addresses the financial performance and outlook of the Group and each of the sectors, both on a monthly and year-to-date basis, with the key performance indicators analysed by the Board being those identified on pages 16 and 17. The Group Risk Register also forms part of the CFO's report on a quarterly basis and tracks the 'Principal risks and uncertainties' identified on pages 18 to 21 of the Business Review. The CFO also reports on a monthly basis, as part of his investor relations report, on the key issues raised by shareholders, potential investors and other important stakeholders on QinetiQ's performance and key strategic initiatives.

Conflicts of interest

The Company has established a process requiring Directors to disclose proposed outside business interests before they are entered into. This enables prior assessment of any conflict, or potential conflict, of interest and any impact on time commitment. An annual review of all external interests is carried out by the Board.

Directors' responsibilities

Statements explaining the Directors' responsibilities for preparing the Group's financial statements and the auditor's responsibilities for reporting on those statements are set out on pages 44 and 45.

Other Directors' information

Details of Executive Directors' service contracts and the Non-executive Directors' letters of appointment are set out in the Report of the Remuneration Committee. Copies of Directors' service contracts and letters of appointment will be available for inspection at the Company's AGM.

Audit Committee	Remuneration Committee	Nominations Committee	Compliance Committee	Security Committee
Chairman: Nick Luff	**Chairman: Noreen Doyle**	**Chairman: Sir David Lees**	**Chairman: Sir David Lees**	**Chairman: Colin Balmer**
Monitors the Group's integrity in financial reporting and reviews the effectiveness of the risk management framework.	Sets remuneration and incentives for Executive Directors; approves and monitors remuneration and incentives for the Group.	Ensures that the composition of the Board and Committees has the optimum balance of skills, knowledge and experience.	Monitors the Group's adherence to the MOD Compliance Regime and those areas of risk where the principal impact on the Group is not financial.	Considers matters of a UK national security dimension which have an impact on the business (it has not met since its inception in June 2009).

Other management committees

Responsibility for the day-to-day management of the Group's activities, with the exception of QinetiQ's North American operations (which are managed through the Proxy Board, as described in the section below headed 'Management and control of US subsidiaries'), is conducted through the QinetiQ Executive Team (QET). The QET comprises the Group CEO, Group CFO, Functional Directors and the Managing Directors of each of the Sectors. The QET meets on a monthly basis, and receives weekly updates on key operational issues by way of pre-scheduled conference calls. The activities of the QET are supplemented by the Proxy Board and the Executive Management Team in QNA. Separate committees have also been established to review Group strategy in the areas of Technology, Communications and Corporate Responsibility, each of which meets on a periodic basis.

Board committees

The Board has established five principal committees: the Audit Committee, the Remuneration Committee, the Nominations Committee, the Compliance Committee and the Security Committee. Each operates within written terms of reference approved by the Board, details of which are set out in the Investor Relations section of QinetiQ's website (www.QinetiQ.com). Each Chairman of a Board Committee reports on the key issues discussed, and decisions taken, at the next meeting of the Board following the Committee meeting in question. Details of each of these Committees are summarised below, along with details of Committee members' attendance at Committee meetings.

Audit Committee

Members

Committee meetings held in 2009/2010	
Nick Luff (Chairman)	5/5
Noreen Doyle	5/5
Mark Elliott[1]	1/2
Dr Peter Fellner[2]	2/2
David Langstaff[3]	3/3
Sir David Lees[4]	0/0

[1] Appointed on 5 August 2009 and ceased to be a member on 1 March 2010.
[2] Resigned on 4 August 2009.
[3] Appointed on 5 August 2009.
[4] Appointed on 28 April 2010.

Highlights

- Introduction of an updated/more comprehensive self-certification tool
- Increased focus on QNA internal control activity.

Audit Committee – role and focus

Each member of the Audit Committee is an independent Non-executive Director. The Committee is chaired by Nick Luff, who has been a member of the Institute of Chartered Accountants in England and Wales since 1991. The Board considers him to have recent and relevant financial experience, given his former roles as CFO of P&O and P&O Princess Cruises and his current position as Finance Director of Centrica. The Audit Committee meets as necessary and at least four times a year. During the financial year ended 31 March 2010, the Committee met on five occasions. The external auditor has the right to request that a meeting of the Audit Committee be convened. During the past financial year, the Committee met with QinetiQ's external auditor on two separate occasions, without Executive Directors present, to discuss the audit process. The Committee Chairman also met with the Group Head of Internal Audit on the same basis.

The CEO, CFO, Group Financial Controller, Group Head of Internal Audit, the Internal Audit Manager, and a representative of the external auditor, normally attend Audit Committee meetings, except where not permitted.

During the last financial year, consideration of the audit process for the full-year and interim results represented the principal areas of focus for the Audit Committee. These included detailed reviews of asset valuation and impairment testing. The Committee also assessed the effectiveness of the Internal Audit function, through a balanced scorecard review process designed to measure the achievement of Internal Audit objectives, which resulted in the approval of a detailed 12-month work programme for the function.

In the context of the Group's North American business, the Committee undertook two in-depth reviews of the internal controls environment across QNA, which included an assessment of the effectiveness of the financial controls in place across the US business, contract management activity and the resourcing of the QNA Internal Audit team. As part of its review of internal controls, the Committee focused in particular on those matters which had failed to achieve at least a 'satisfactory' audit rating in the year, and the management plans to address the issues raised by the Internal Audit function, which benefited from the introduction of a more comprehensive 'self certification' process across the EMEA and QNA businesses in year. The Committee also reviewed the activities of the pensions, tax, insurance and treasury functions in detail, as well as overseeing the level of KPMG's audit fees. The Committee confirms its view that it has received sufficient reliable and timely information from management in the last financial year to enable it to fulfil its responsibilities.

Corporate governance report (continued)

In order to safeguard auditor independence and objectivity, the Committee ensures that any other advisory/consulting services provided by the auditor does not conflict with their statutory audit responsibilities and are conducted through entirely separate working teams; such advisory and/or consulting services generally only cover regulatory reporting, tax and mergers and acquisitions work. Any non-audit services conducted by the auditor require the consent of the CFO or the Chairman of the Audit Committee before being initiated, with any such services exceeding £50,000 in value requiring the consent of the Audit Committee as a whole. In the last financial year, the only non-audit activity conducted by KPMG on behalf of QinetiQ which exceeded this £50,000 threshold, related to the provision of services to support detailed strategic planning work being conducted across the EMEA business, as well as taxation advisory services to the Group, neither of which the Committee concluded created any conflict of interest issues which might compromise the independence of KPMG audit work.

It is also QinetiQ’s policy that no KPMG employee may be appointed into a senior position within the QinetiQ Group without the prior approval of the CFO. The cost of non-audit work undertaken by the auditor was reviewed by the Committee on several occasions during the last financial year; this process enables the Committee to take corrective action if it believes that there is a risk of the auditor’s independence being undermined through the award of such work.

KPMG has been the Company’s auditor since 2003. The members of the Audit Committee have declared themselves satisfied with the performance of KPMG as the Company’s auditor in the last financial year. A rotation of KPMG’s lead audit partner was undertaken during 2008; it is anticipated that he will continue in this role for a maximum term of five years.

Remuneration Committee
Members

Committee meetings held in 2009/2010	
Noreen Doyle (Chairman)[1]	6/6
Colin Balmer[2]	3/3
Admiral Sir James Burnell-Nugent[3]	0/0
Mark Elliott[2]	3/3
Dr Peter Fellner[4]	3/3
David Langstaff[2]	3/3
Sir David Lees[5]	6/6

[1] Appointed as Chair of the Remuneration Committee on 5 August 2009 upon Dr Peter Fellner’s resignation.
[2] Appointed on 5 August 2009.
[3] Appointed on 28 April 2010.
[4] Resigned on 4 August 2009.
[5] Ceased to be a member on 28 April 2010.

Remuneration Committee – role and focus

The Committee meets as necessary although normally not less than three times a year. During the financial year ended 31 March 2010, the Remuneration Committee met on six occasions. Although not members of the Committee, the former Group Chairman, the Group CEO, the Group HR Director and the Group Head of Reward normally attended Committee meetings, together with representatives of the Committee’s external consultants, Deloitte & Touche LLP, as necessary. Executive Directors are not present when their own remuneration is being discussed. Further information on the activities of the Remuneration Committee during the last financial year are set out in the Report of the Remuneration Committee on pages 36 to 41.

Nominations Committee
Members

Committee meetings held in 2009/2010	
Sir David Lees (Chairman)	3/3
Colin Balmer	3/3
Sir John Chisholm[1]	2/3
Noreen Doyle[2]	2/3
Mark Elliott[3]	1/1
Dr Peter Fellner[4]	2/2
Admiral Edmund P. Giambastiani[2]	2/3
David Langstaff[3]	1/1
Nick Luff[2]	3/3
Leo Quinn[5]	0/0

[1] Resigned on 28 February 2010.
[2] Ceased to be a member on 28 April 2010.
[3] Appointed on 5 August 2009.
[4] Resigned on 4 August 2009.
[5] Appointed on 28 April 2010.

Highlights

- Appointment of Mark Elliott as a Non-executive Director and Chairman elect
- Appointment of David Langstaff and Admiral Sir James Burnell-Nugent as a Non-executive Directors
- Appointment of Leo Quinn as the Group CEO and Executive Director.

Nominations Committee – role and focus

The Committee meets as necessary and when called by its Chair. During the financial year ended 31 March 2010, the Committee met formally on three occasions and consulted informally on several other occasions.

The principal focus of the Committee’s activities during the financial year ended 31 March 2010 was to review QinetiQ’s succession planning processes at both the Executive and Non-executive Director levels. As part of the process, the Committee oversaw the recruitment of a new Chairman elect, which culminated in the appointment of Mark Elliott as Non-executive Director in June 2009. Mark took over the role of Chairman in March 2010. The Committee also oversaw the appointment of two additional Non-executive Directors, which culminated in the appointment of David Langstaff in August 2009 and Admiral Sir James Burnell-Nugent in April 2010, together with a new CEO, which culminated in the appointment of Leo Quinn in November 2009.

Compliance Committee
Members

Committee meetings held in 2009/2010	
Sir David Lees (Chairman)	4/4
Colin Balmer	4/4
Admiral Sir James Burnell-Nugent[(1)]	0/0
Sir John Chisholm[(2)]	4/4
Mark Elliott[(3)]	2/2
Admiral Edmund P. Giambastiani[(3)]	1/2
Graham Love[(4)]	2/2
Nick Luff[(1)]	0/0
Leo Quinn[(5)]	2/2

(1) Appointed on 28 April 2010.
(2) Resigned on 28 February 2010.
(3) Appointed on 5 August 2009.
(4) Ceased to be a member on 31 October 2009.
(5) Appointed on 16 November 2009.

Highlights

- Transition of the Committee's focus to include wider compliance issues, such as ethics and the QNA Proxy Regime
- Further widening of the Committee's remit, to include matters such as Trade Controls and Health, Safety and Environment.

Compliance Committee – role and focus

During the last financial year, the remit of the Committee was widened to provide oversight of other significant compliance issues beyond the operation of the Compliance Regime, particularly: the activities that fall within the scope of the Helsinki Protocol covering trials involving human volunteers; the Group's Business Ethics policy; and the Proxy regime.

The Committee continues to monitor the Compliance Regime, which is designed to give MOD customers confidence that QinetiQ is able to provide impartial advice during any competitive evaluation of a procurement where QinetiQ wishes to operate on both the 'buy' and the 'supply' sides. QinetiQ is required by its Articles of Association to implement a Compliance Regime, which was established on its creation out of DERA. Central to this Regime is the requirement for QinetiQ to seek permission from the MOD prior to providing commercial defence services to others where there is potential for a conflict of interest with the services that QinetiQ provides to the MOD.

In designing the Compliance Regime, the MOD and QinetiQ sought to achieve a balance between meeting the needs of the procurement customers within the MOD (principally Defence Equipment and Support) and the need to allow QinetiQ flexibility to exploit research into the supply chain and pursue its planned commercial activities, without compromising the defence or security interests of the UK. The Compliance Regime is largely self-policing, in that it is applied by QinetiQ in respect of its activities without extensive intervention or oversight by the MOD. Since the inception of the Compliance Regime, over 97% of the requests to the MOD to allow QinetiQ to operate on the supply side of the commercial defence market have been approved. Oversight of the operation of the Regime is provided by the Compliance Committee. The Board nominates two senior executives to act as Compliance Implementation Director and Compliance Audit Director.

QinetiQ's Compliance Committee meets on four occasions each year. It receives a quarterly report on the compliance areas that it monitors from the Head of Business Assurance. In respect of the Compliance Regime, the Committee receives a report from the Company's Compliance Implementation Director which describes the permissions which have been sought and granted since the last meeting of the Committee, and the status of projects where the potential conflicts of interest are being managed. The Committee also receives, from the Compliance Audit Director, a report on the effectiveness of the controls that are in place to ensure that the Regime is operated correctly. The Committee is the forum that would address any issues arising out of QinetiQ's failure to comply with the requirements of the Regime. The Committee reviews the systems that support the Compliance Regime and those that may have an impact on it, directing changes, if appropriate. A computer-based training package continues to be used to ensure that all relevant employees have a satisfactory knowledge of the operation of the Regime. For key roles, competence is demonstrated by passing an annual mandatory test.

The MOD reviews the operation and effectiveness of the Compliance Regime, through its right to have an observer at the Compliance Committee meetings.

During the year, a total of six new permissions were sought from the MOD under the Compliance Regime, where potential conflicts of interest were identified by QinetiQ, with one permission request being outstanding from the previous year. Of these seven requests, five were approved, one was rejected and one remained outstanding at the end of March 2010. At the end of the year, 16 firewalls were in place, with two being established and ten being closed down during the year. Since vesting in 2001, a total of 119 firewalls have operated with 103 now closed. No breaches of the MOD Compliance Regime were noted during the year. A firewall is a series of rules and procedures governing written and oral communication between employees contributing to products in an MOD competition with industry (outside the wall) and employees assessing those products for MOD (inside the wall).

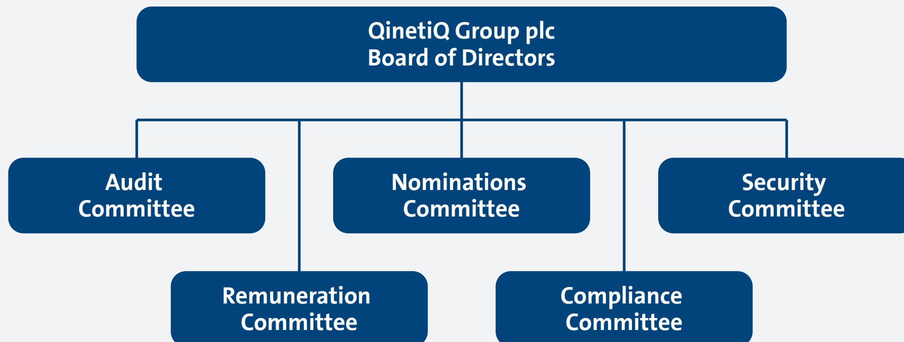
Following the end of the last financial year, the remit of the Committee was further widened to include oversight of Health, Safety and Environment, Trade Controls, Ethics and Security.

Security Committee
Members

Colin Balmer (Chairman)[(1)]
Admiral Sir James Burnell-Nugent[(2)]
Sir John Chisholm[(3)]
Sir David Lees[(1)]
Nick Luff[(1)]
Graham Love[(4)]
David Mellors[(1)]
Leo Quinn[(5)]

(1) Appointed on 5 August 2009.
(2) Appointed on 28 April 2010.
(3) Appointed on 5 August 2009 and resigned on 28 February 2010.
(4) Appointed on 5 August 2009 and ceased to be a member on 31 October 2009.
(5) Appointed on 16 November 2009.

Corporate governance report (continued)



Security Committee – role and focus

The Security Committee was established in June 2009 to allow UK nationals on the Board to consider matters of a UK national security dimension which have an impact on QinetiQ's UK business. The Committee has not met since its inception as no business has arisen which would require it to do so. The Committee is chaired by Colin Balmer.

Going concern

The Group's activities, combined with the factors that are likely to affect its future development and performance, are set out in the CEO's review on pages 6 to 11. The CFO's report on pages 12 to 15 sets out details on the financial position of the Group, the cash flows, committed borrowing facilities, liquidity and the Group's policies and processes for managing both its capital and financial risks. Note 27 to the financial statements also provides details of the Group's hedging activities, financial instruments and its exposure to liquidity and credit risk.

The market conditions in which the Group operates have been, and are expected to continue to be, challenging as spending from the Group's key customers in its primary markets in the UK and US remain under pressure. In light of this, during the year the Group announced revised results expectations which highlighted the challenges experienced from our key markets and customers.

Despite these challenges the Directors believe that the Group is well positioned to manage its overall business risks successfully. After making the appropriate enquiries, including a review of the latest five-year forecast for cash flow and results, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Consequently, the Annual Report and Accounts have been prepared on a going concern basis.

Communication with shareholders

The Company attaches significant importance to the effectiveness of its communications with shareholders. During the last financial year, the Company has maintained regular dialogue with institutional shareholders and the financial community, which has included presentations of the full-year and interim results (including investor 'road shows' held in the UK, Europe and US), regular meetings with major shareholders and industry analysts, participation in stockbrokers' seminars and investor site visits. In addition, each member of the Board attended the Company's Annual General Meeting in August 2009 and a number of Non-executive Directors attended key shareholder events in the last financial year, including the full-year and interim results presentations, at which they were available to take questions from shareholders. All shareholders and potential shareholders can gain access to the Annual Report, presentations to investors and other significant information about QinetiQ on the Company's website (www.QinetiQ.com).

Holders of ordinary shares may attend the Company's AGM at which the Company highlights key business developments during the year and at which shareholders have an opportunity to ask questions. The Chairs of the Audit, Remuneration, Nominations, Compliance and Security Committees will be available to answer any questions on the work of the Committees. The Company confirms that it will send the AGM Notice and relevant documentation to all shareholders at least 20 working days before the date of the AGM. For those shareholders who have elected to receive communications electronically, notice is given of the availability of documents on the Investor Relations Section of the Group's website.

All shareholders will be entitled to vote on the resolutions put to the AGM and, to ensure that all votes are counted, a poll will be taken on all the resolutions in the Notice of Meeting. The results of the votes on the resolutions will be published on the Company's website.

Responsibility for maintaining regular communications with shareholders rests with the Executive Team, led by the CEO, assisted by an investor relations function which reports to the CFO. The Board is informed on a regular basis of key shareholder issues, including share price performance, the composition of the shareholder register and City expectations. The Chairman, the Senior Independent Director and Non-executive Directors make themselves available to meet with shareholders as required.

Management and control of US subsidiaries

QinetiQ's principal US subsidiaries are currently required by the US National Industrial Security Program to maintain facility security clearances and to be insulated from foreign ownership, control or influence. To comply with these requirements, QinetiQ North America, Inc. (formerly known as QinetiQ North America Operations, LLC, a wholly-owned subsidiary of QinetiQ in the US and the holding company for the substantive part of QinetiQ's North American operations) and the US DoD have entered into a proxy agreement that regulates the ownership, management and operation of these companies. Pursuant to this proxy arrangement, QinetiQ has appointed four US citizens (Peter Marino, Riley Mixson, John Currier and Vince Vitto) holding requisite US security clearances as proxy holders to exercise the voting rights of QinetiQ North America, Inc.'s shares in the US subsidiaries. The proxy holders are also appointed as directors of the relevant US subsidiaries and, in addition to their powers as directors, have power under the proxy arrangements to exercise all prerogatives of share ownership of QinetiQ North America, Inc. The proxy holders have a fiduciary duty to, and agree to perform their role in the best interests of, QinetiQ North America, Inc. and consistent with the national security concerns of the US. QinetiQ does not have any representation on the boards of the subsidiaries covered by the proxy agreement and does not have the right to attend board meetings. QinetiQ may not remove the proxy holders except for acts of gross negligence or wilful misconduct or for breach of the proxy agreements (with the consent of the US Defense Security Service).

Internal controls

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness in safeguarding shareholders' interests and the Company's assets. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable and not absolute assurance against material misstatement or loss. QinetiQ managers are responsible for the identification and evaluation of significant risks applicable to their areas of business, together with the design and operation of suitable internal controls to ensure effective mitigation. These risks, which are related to the achievement of business objectives, are assessed on a continual basis and may be associated with a variety of internal and external events, including control breakdowns, competition, disruption, regulatory requirements and natural and other catastrophes.

An annual process of hierarchical self-certification has been established within the organisation which provides a documented and auditable trail of accountability for the operation of the system of internal control.

This process is informed by a rigorous and structured self-assessment that addresses all the guidance cited in the Combined Code and compliance with Company policy. The process provides for successive assurances to be given at increasingly higher levels of management and, finally, to the Board. The process is informed by the Internal Audit function, which also provides a degree of assurance as to the operation and validity of the system of internal control. In the last financial year the assessment was re-designed to provide greater objectivity and incorporate a wider scope. Planned corrective actions are independently monitored for their timely completion.

The centrally provided internal audit programme is prioritised according to risks identified by the Company and is integrated across all business and functional dimensions, thereby reducing issues of overlap or gaps in coverage. These risks are identified dynamically and the Board is involved in this process as well as the QinetiQ Executive Team and the QNA Executive Team.

The Audit Committee reviews, on behalf of the Board, the risk management process and the system of internal control necessary to manage risks and presents its findings to the Board. Internal Audit independently reviews the risk identification and control processes implemented by management and reports to the Audit Committee. Where areas for improvement in the system of internal control are identified, the Board considers the recommendations made by the QinetiQ Executive Team, the QNA Executive Team, the Audit Committee and the Compliance Committee.

The Audit Committee also reviews the assurance process, ensuring that an appropriate mix of techniques is used to obtain the level of assurance required by the Board. It presents its findings to the Board on a regular basis. The Board reviewed the effectiveness of the system of internal control that was in operation during the financial year ended 31 March 2010. The Board also routinely challenges the management to ensure that the systems of internal control are constantly improving to maintain their continuing effectiveness.

QinetiQ has in place internal procedures which are designed not only to comply with, but to exceed, international best practice in relation to the prevention of corruption. This is facilitated by the engagement of independent, internationally recognised organisations, such as TRACE (Transparent Agents and Contracting Entities) which conduct anti-bribery due diligence reviews and compliance training on behalf of the Group, particularly in circumstances in which QinetiQ is planning to engage third-party agents overseas. QinetiQ has, since 2006, been a member of the UK Defence Industry Anti-corruption Forum.

Remuneration report

The key purpose of the Committee is to ensure that the remuneration structure supports the Company's strategy and that we are able to attract, retain and motivate the highest calibre executives while aligning their interests with those of shareholders.

Noreen Doyle Chair, Remuneration Committee

Introduction

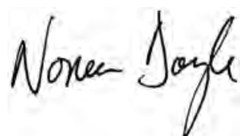
I am pleased to present the Remuneration Committee's report on Directors' remuneration for the year to 31 March 2010.

The primary objectives of our remuneration policy remain unchanged:

- Incentivising key executives and managers
- Driving superior performance in both the short and long term
- Alignment with the interests of shareholders.

During the year, the Committee approved the remuneration arrangements for the new Chief Executive Officer (CEO) which are laid out in this report. Exit payments to the former CEO, Graham Love, were agreed by the Committee in the light of existing contractual arrangements and the performance of the business at the time of exit and these arrangements are also detailed in this report.

Given the current challenging environment and our commitment to pay for performance, we are reviewing all existing incentive arrangements to consider whether they remain appropriate to the Company's strategy.



Noreen Doyle Chair, Remuneration Committee
2 June 2010

Report of the Remuneration Committee

The following Report of the Remuneration Committee has been approved by the Board for submission to shareholders.

The Report covers the remuneration of Directors and includes specific disclosures relating to their compensation, shares and other interests. The report also describes the share-based incentive plans available to Executive Directors and to other employees. This report has been prepared and, where appropriate, audited, in accordance with the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the FSA Listing Rules.

Membership

The Committee is composed of the following Non-executive Directors:

- Noreen Doyle
- Colin Balmer
- Admiral Sir James Burnell-Nugent
- Mark Elliott
- David Langstaff

Dr Peter Fellner served on the Committee until his resignation from the Board on 4 August 2009. Sir David Lees was a member of the Committee until 28 April 2010 when he was replaced by Admiral Sir James Burnell-Nugent.

The full Terms of Reference of the Committee can be found on the QinetiQ website (www.QinetiQ.com). Copies are also available on request.

Governance

The Committee is chaired by Noreen Doyle and all its members are Non-executive Directors. In the financial year 2009/10, the Committee met six times.

During the year, the Committee received advice from its appointed independent advisors, Deloitte LLP ('Deloitte'). Deloitte provided other consulting services during the year to QinetiQ, but did not provide advice on executive remuneration matters other than to the Committee.

Following a review and a formal tender process, the Committee has appointed new independent advisers, to support the review of the existing incentive arrangements.

Market data was provided by Deloitte and by Hewitt New Bridge Street who also advised on whether performance targets had been met.

The former Group Chairman, Group Chief Executive, Group HR Director and Group Head of Reward also provided advice to the Committee. No employee of QinetiQ is permitted to participate in discussions about their own remuneration.

Activities

During 2009/10 the Committee meetings covered a number of topics including:

April	• Executive Directors' FY09 bonuses • FY10 performance targets
May	• Executive Directors' salary reviews • Directors' Remuneration report • Executive team salary reviews and FY09 bonuses
July	• Performance Share Plan, Restricted Stock Unit and Share Option awards
October	• Offer to Leo Quinn • Exit terms for Graham Love
November	• Review of Executive team total compensation • Update on pay trends • Review of Executive team shareholdings
January	• Review of Remuneration Committee remit • Review of comparator group

Directors' remuneration policy

The Committee aims to maintain a remuneration policy, consistent with the Company's business objectives, which:

- attracts, retains and motivates individuals of high calibre;
- is responsive to both Company and personal performance; and
- competitive within industry.

The remuneration policy is built on the following philosophy:

- remuneration packages are structured to support business strategy and conform to current best practice;
- appropriate rewards are given for meeting specific target objectives set at the beginning of each year;
- incremental compensation is achieved for attaining stretch performance targets; and
- objectives are measured on metrics designed to be consistent with the interests of all shareholders.

The total remuneration levels of the Executive Directors are reviewed annually by the Committee, taking into account:

- performance of the executive against specific targets;
- competitive market practice and remuneration levels; and
- the general economic environment.

Base salary

Executive Directors' base salaries are reviewed annually as are all other employees. There were no changes in salary for the Executive Directors in 2009/10, in line with the treatment of the majority of employees within QinetiQ and reflecting market conditions.

External remuneration consultants provide data about market salary levels. For market comparison purposes, account is taken of company type, sector and company size in terms of both market capitalisation and turnover.

No salary increase has been recommended for Executive Directors in respect of 2010/11.

Annual salary	**2009/10**	2008/09
Executive Directors		
Leo Quinn	**£580,000**	–
David Mellors	**£300,000**	£300,000
Former Director		
Graham Love	**£400,000**	£400,000

Benefits

Benefits may include a pension or contribution in lieu, car allowance, health insurance, life insurance and membership of the Group's employee Share Incentive Plan which is open to all UK employees.

Annual cash bonus

Executive Directors participate in an annual cash bonus plan which is non-pensionable. Bonuses are linked to Group performance targets and are modified for performance against personal objectives. The 2009/10 bonus potential and awards are laid out in the following table, expressed as a percentage of salary.

	2009/10		
% of salary	On-target payment	Maximum payment	Actual payment
Executive Directors			
Leo Quinn	50%	100%	0%
David Mellors	50%	100%	0%
Former Director			
Graham Love	50%	100%	0%

The cash bonus was determined on a constant exchange rate basis, against four elements in 2009/10: operating profit; underlying EPS; operating cash flow; and turnover.

During 2009/10, target operating profit was not achieved and therefore annual bonuses have not been awarded.

Leo Quinn joined the Company on 16 November 2009 and was thus eligible for a cash bonus based on his performance during his 4½ months as CEO. The Board agreed that Leo Quinn had achieved his partial year objectives and was eligible for a pro-rated annual cash bonus. However, in reflecting on the current results of the Group, Leo Quinn waived his right to a bonus for the financial year ended 31 March 2010.

In line with the corporate plan for 2010/11 target payment has been reduced as in the table below and the new bonus plan will focus on:

- operating profit;
- operating cash flow; and
- underlying EPS.

	2010/11	
% of salary	On-target payment	Maximum payment
Executive Directors		
Leo Quinn	40%	100%
David Mellors	40%	100%

Deferred Annual Bonus (DAB) Plan

The Deferred Annual Bonus Plan aligns the interests of executives with shareholders and aids retention of key individuals by ensuring that executives are incentivised to take part of their annual bonus awards in shares rather than cash.

Executive Directors have a mandatory deferral of 30% of any bonus payable and may voluntarily defer up to 50% of their bonus into QinetiQ shares. Any deferred bonus will be matched based on EPS performance up to a maximum match of 100% of the deferred element.

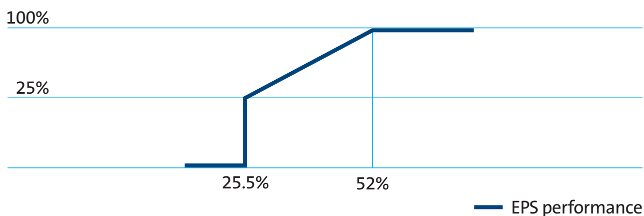
The EPS element is earned only if EPS growth, measured over three years, exceeds defined targets. EPS must grow by at least 22.5% to trigger any vesting, at which point 25% of the award will vest. Vesting increases pro rata to EPS growth up to a maximum of 100% of the award vesting at 52% EPS growth, as illustrated below.

Awards are in the form of matching shares delivered after three years, subject to the achievement of the EPS-based performance conditions.

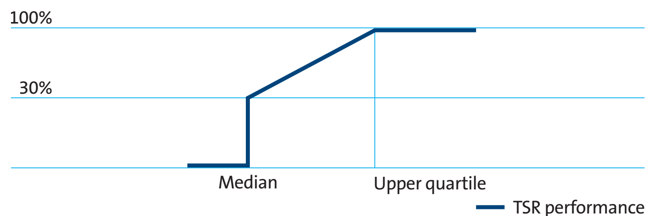
Where an individual participates in the DAB and also receives an award under the Performance Share Plan (PSP), they will not receive share awards which, in aggregate, exceed 150% of base salary in any one year.

Remuneration report (continued)

3 year EPS absolute growth
Award vesting



Performance vs comparators
Award vesting



Long-term incentives for Executive Directors

The objective is to align the rewards of executives with returns to shareholders by a focus on increasing the share price over the medium to long term. Executive Directors are eligible to participate in both the PSP and the DAB Plan.

These arrangements are the principal means for long-term incentivisation of the Executive Directors and the direct reports of the CEO. The Committee considered various performance conditions and determined that the criteria set out below were appropriate to incentivise the long-term creation of shareholder value.

Performance Share Plan (PSP)

Awards of performance shares under the PSP were made to Executive Directors and a limited number of other senior executives in July 2009 and to certain individuals on joining. Share awards are contingent on meeting pre-determined performance criteria. Individual participants' award levels are determined by the Committee annually based on these criteria and, with due consideration of business and personal performance.

Executive Directors are eligible to receive awards with a value of up to 100% of base salary and other executives up to 75% of base salary.

Awards are earned based on an equal weighting of relative total shareholder return (TSR) performance and absolute underlying earnings per share (EPS) growth.

The EPS performance criteria for the PSP is the same as that applied to the DAB (outlined above).

The TSR part of the award is measured against the constituents of the following comparator group of companies:

Babcock International plc	Invensys plc
BAE Systems plc	Logica plc
BBA Aviation plc	Meggitt plc
Bodycote International plc	The Morgan Crucible Company plc
Capita Group plc	Rolls-Royce plc
Chemring Group plc	Serco plc
Cobham plc	Senior plc
Cookson Group plc	Tomkins plc
GKN plc	Ultra Electronics plc
Halma plc	VT Group plc
Hampson Industries PLC	Victrex Group plc
IMI plc	WS Atkins plc

The TSR element is earned only if relative performance is at least at median against this comparator group over a three-year performance period, calculated by an independent third party.

Incentive arrangements for new CEO

The Board appointed Leo Quinn on 16 November 2009. To attract the services of Leo Quinn, the Committee recommended and the Board approved a share scheme based on the existing long-term incentive plan and using the same TSR and EPS metrics as the PSP. The Board granted a Matching Share Award under which Leo Quinn invested £1m in QinetiQ shares. The Company agreed to match that investment based on TSR and EPS criteria as in the PSP.

In addition Leo Quinn was granted a PSP Mirror Award, with the terms of the plan mirroring the normal PSP plan as described opposite.

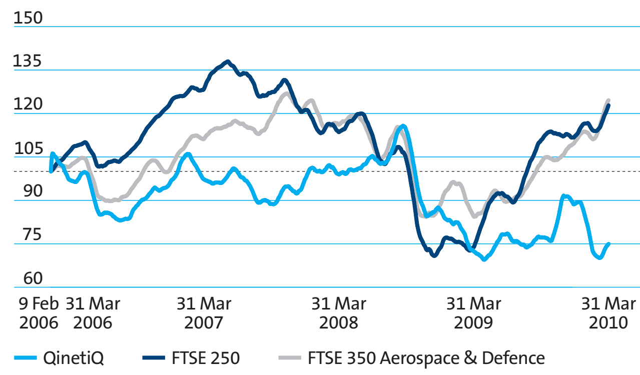
External appointments

QinetiQ allows its Executive Directors to broaden their knowledge and experience by becoming Non-executive Directors of other companies. Appointments are approved by the Board or the Committee on the basis that there is no conflict of interest or deterioration in the Executive Director's performance. Fees are normally retained by the individual. During the year ended 31 March 2010, none of the Executive Directors held such an appointment at a public company.

Performance graph

The graph below shows the Company's TSR over the period from flotation to 31 March 2010 compared to the FTSE 250 and FTSE 350 Aerospace & Defence indices over the same period. These were chosen for comparison as QinetiQ is a constituent of both indices.

Relative total shareholder return



Directors' terms and conditions

Service agreements for the Executive and the Non-executive Directors are reviewed annually and amended as appropriate.

	Notice to be given by the Company	Date of most recent Service Agreement	Date of appointment
Executives			
Leo Quinn[a]	12 months	28 October 2009	November 2009
David Mellors	12 months	20 May 2008	August 2008
Non-executives			
Mark Elliott[b]	–	10 February 2010	June 2009
Sir David Lees	–	16 February 2006	August 2005
Colin Balmer	–	16 February 2006	February 2003
Noreen Doyle	–	16 February 2006	October 2005
Admiral Edmund P. Giambastiani	–	1 February 2008	February 2008
Nick Luff	–	16 February 2006	June 2004
David Langstaff[c]	–	4 August 2009	August 2009
Admiral Sir James Burnell-Nugent[d]	–	10 April 2010	April 2010
Former Directors			
Sir John Chisholm[e]	–	1 October 2006	February 2003
Graham Love[f]	12 months	1 December 2005	February 2003
Peter Fellner[g]	–	16 February 2006	September 2004

[a] Leo Quinn was appointed as a Director on 16 November 2009.
[b] Mark Elliott was appointed as a Director on 1 June 2009 and as Chairman 1 March 2010.
[c] David Langstaff was appointed as a Director on 5 August 2009.
[d] Admiral James Burnell-Nugent was appointed as a Director on 10 April 2010.
[e] Sir John Chisholm resigned as a Director on 28 February 2010.
[f] Graham Love resigned as a Director on 31 October 2009.
[g] Peter Fellner resigned as a Director on 4 August 2009.

QinetiQ's policy is that Executive Directors should have contracts with a rolling term providing for a maximum of one year's notice. Consequently, no Executive Director has a contractual notice period in excess of 12 months. In the event of early termination, this ensures that compensation is restricted to a maximum of 12 months' basic salary and benefits. The Committee will generally require mitigation to reduce the compensation payable to a departing Executive Director.

Non-executive Directors' terms, conditions and fees

The Group Chairman reviews the fees of the Non-executive Directors and makes recommendations to the Board. Non-executive Directors receive additional fees as agreed by the Board for the chairing of Board committees to take account of the additional responsibilities of the role. The Chairman's fees are reviewed by the Senior Independent Non-executive Director who makes recommendations to the Board.

The level of fees paid in UK organisations of a similar size and complexity to QinetiQ is considered in setting the remuneration policy for Non-executive Directors. The fees are neither performance related nor pensionable. Non-executive Directors are not eligible to participate in bonus, profit sharing or employee share schemes.

Current fee structures for Non-executive Directors are shown below.

	2009/10 fees
Non-executive Chairman	£225,000
Basic fee for UK-resident Non-executive Director	£40,000
Basic fee for US-resident Non-executive Director	$100,000 or £50,000
Additional fee for chairing a Committee	£7,000
Additional fee to Deputy Chairman/Senior Independent Non-executive Director	£10,000

As the Group Chairman is a US resident, the Board have agreed an accommodation allowance of £75,000 per annum.

Excluding the Group Chairman, an additional fee of $4,000 is payable to US-resident Non-executive Directors when they attend Board Meetings in the UK.

The review of fees scheduled for October 2009 was deferred until Summer 2010.

Non-executive Directors' contracts are renewed on a rolling twelve-month basis subject to reappointment at the Annual General Meeting. There are no provisions in their contracts for compensation on early termination.

Management of share based rewards

The Committee also oversees arrangements for share-based reward in respect of managers and the wider workforce. In addition to PSP, the Company also operates the following executive share plans:

Executive plans
- QinetiQ Share Option Scheme (QSOS)
- Restricted Stock Units (RSU)

Executive Directors do not participate in either plan.

Remuneration report (continued)

No awards were made during the year under QSOS. Provision exists for annual awards up to a face value of 300% of salary to be granted.

All-employee plans
- Share Incentive Plan (UK and Australia)

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

Restricted Stock Units

RSU awards are used in QinetiQ North America to retain and motivate senior managers. The RSU awards vest evenly over a four-year period. The vesting of half of the award is subject to a condition that organic profit grows by a minimum of 5% per annum. Maximum vesting of 125% of the award occurs at 15% per annum organic profit growth. The other half of the award is subject to time-based vesting criteria.

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

Dilution limits

In accordance with ABI guidelines, the Committee has determined that no more than 10% of the Company's issued share capital will be used under all of the Company's share schemes. The dilution as at 31 March 2010 was significantly below this 10% level, and below 5% in respect of executive schemes. In addition, the Board intends to continue to satisfy a proportion of awards with purchased shares held in the employee benefit trust.

Personal shareholding policy

The Committee believes that a powerful way to align Executives' interests with those of shareholders is for the Executives to build up and retain a personal holding in QinetiQ shares.

The CEO and CFO are required to hold the equivalent of one times their base salary in QinetiQ shares.

David Mellors, having joined on 20 August 2008, has been given four years to build up such a shareholding. The Chief Executive has already met the Committee's guideline on minimum shareholding requirement.

Direct reports of the CEO are required to hold the equivalent of 50% of their base salary in shares. These can be accumulated over a four-year period following appointment.

Interests of Directors in office as at 31 March 2010 (including shares held under SIP and DAB)

	Number 1p ordinary shares held at 1 April 2009	Number 1p ordinary shares held at 31 March 2010	Number 1p ordinary shares held at 27 May 2010
Executives			
Leo Quinn	–	602,757	602,757
David Mellors	249	24,284	24,538
Non-executives			
Mark Elliott	–	100,000	100,000
Sir David Lees	73,000	83,000	83,000
Colin Balmer	–	–	–
Noreen Doyle	17,000	17,000	17,000
Admiral Edmund P. Giambastiani	–	–	–
Nick Luff	50,000	70,000	70,000
David Langstaff	–	12,000	12,000

Audited information

Directors' remuneration

The information about Directors' remuneration and Directors' interests on pages 40 to 41 has been audited.

The table below shows the aggregate remuneration of the Directors for the year ended 31 March 2010.

	Salary/ fees[(a)]	Other compensation[(b)]	Other benefits[(c)]	Payment for loss of office	Total 2010	Total 2009
Executives						
Leo Quinn	£217,872	£600,000	£68,692	–	£886,564	–
David Mellors	£300,000	–	£18,085	–	£318,085	£215,997
Non-Executives						
Mark Elliott	£72,271	–	–	–	£72,271	–
Sir David Lees	£64,000	–	–	–	£64,000	£64,000
Colin Balmer	£40,000	–	–	–	£40,000	£40,000
Noreen Doyle	£44,667	–	–	–	£44,667	£40,000
Admiral Edmund P. Giambastiani	£62,880	–	–	–	£62,880	£61,700
Nick Luff	£47,000	–	–	–	£47,000	£47,000
David Langstaff	£42,643	–	–	–	£42,643	–
Admiral Sir James Burnell-Nugent	–	–	–	–	–	–
Former Directors						
Sir John Chisholm	£197,083	–	£12,633	–	£209,716	£230,100
Graham Love	£366,667[(d)]	–	£64,438	£517,700[(e)]	£948,805	£488,009
Peter Fellner	£16,028	–	–	–	£16,028	£47,000
Doug Webb	–	–	–	–	–	£61,767
Total	**£1,471,111**	**£600,000**	**£163,848**	**£517,700**	**£2,752,659**	**£1,295,573**

[(a)] Before adjustments to basic pay for SMART pensions.
[(b)] Leo Quinn was awarded a payment of £600,000 in lieu of compensation earned but not yet payable from a contractual arrangement with a third party.
[(c)] Includes car allowance, health insurance benefits and payments in lieu of pension.
[(d)] Graham Love has agreed to provide services to the Company during a six-month period on a consultancy basis to ensure a smooth transition on the DTR project, for which he has received £100,000 in February 2010. He received an additional payment of £100,000 in May 2010.
[(e)] In connection with his departure, the following severance payments were made to Graham Love: (i) payment of a cash sum equivalent to 9½ months' basic pay, (ii) payment in lieu of 12 months' pension and for untaken annual leave, (iii) compensation for loss of office, and (iv) reimbursement of fees for legal advice in connection with his severance terms.

Pensions

The Group's policy is to offer all UK employees membership in the QinetiQ Pension Scheme, as described in note 38 to the financial statements. Executives whose benefits are likely to exceed the Lifetime Allowance may opt out of the QinetiQ Pension Plan. In such cases, the individual will be paid a supplement in lieu of pension contributions.

Contributions to the Defined Contribution section of the QinetiQ Pension Scheme were as follows:

	2009/10	2008/09
Executive Directors		
David Mellors	**£60,000**	£36,846

Leo Quinn and Graham Love received contributions in lieu of a pension.

Interests of Directors under long-term incentives

	Grant date	Number at 1 April 2009	Granted in year	Exercised/ vested in year	Lapsed in year	Number at 31 March 2010	Market price on date of grant	Earliest vest date	Latest vest date
Leo Quinn									
Matching award TSR	16/12/09	–	362,844	–	–	362,844	165p[a]	28/10/12[a]	28/10/12[a]
Matching award EPS	16/12/09	–	362,845	–	–	362,845	165p[a]	28/10/12[a]	28/10/12[a]
PSP Mirror TSR	16/12/09	–	210,450	–	–	210,450	165p[a]	28/10/12[a]	28/10/12[a]
PSP Mirror EPS	16/12/09	–	210,450	–	–	210,450	165p[a]	28/10/12[a]	28/10/12[a]
David Mellors									
PSP TSR	21/08/08	75,567	–	–	–	75,567	217.8p[b]	21/08/11	21/08/11
PSP EPS	21/08/08	75,567	–	–	–	75,567	217.8p[b]	21/08/11	21/08/11
DAB match	01/07/09	–	6,859	–	–	6,859	144.7p	01/07/12	01/07/12
PSP TSR	04/08/09	–	100,000	–	–	100,000	135.0p	04/08/12	04/08/12
PSP EPS	04/08/09	–	100,000	–	–	100,000	135.0p	04/08/12	04/08/12
Former Executive Directors									
Graham Love									
PSP TSR	26/07/07	50,288	–	50,288[c]	–	–	174p	26/07/10	26/07/10
PSP EPS	26/07/07	50,287	–	50,287[c]	–	–	174p	26/07/10	26/07/10
DAB match	01/07/08	53,756	–	25,155[c]	28,601	–	195.8p	01/07/11	01/07/11
PSP TSR	07/08/08	100,756	–	43,919[c]	56,837	–	198.5p	07/08/11	07/08/11
PSP EPS	07/08/08	100,755	–	43,919[c]	56,836	–	198.5p	07/08/11	07/08/11
PSP TSR	04/08/09	–	133,333	13,675[c]	119,658	–	135p	04/08/12	04/08/12
PSP EPS	04/08/09	–	133,333	13,675[c]	119,658	–	135p	04/08/12	04/08/12
		506,976	**1,620,114**	**240,918**	**381,590**	**1,504,582**			

[a] Awards to Leo Quinn in 2009 were based on an average market price of 138p representing the average price over the ten days before joining.
[b] Awards to David Mellors in 2008 were based on a market price of 198.5p, as at 7 August 2008.
[c] These shares were subject to EPS and TSR conditions, as outlined earlier in this report. At the time of departure, the Committee considered the time elapsed and the anticipated performance, and resolved that the share awards would vest/lapse as disclosed. These shares vested on 1 December 2009 at which time the market price was 165p.

The interests in the table above are subject to the performance conditions described in note 33. The price of a QinetiQ share at 31 March 2010 was 134p. The highest and lowest prices of a QinetiQ share during the year ended 31 March 2010 were 178.5p and 122.0p respectively.

Directors' interest in the All-Employee Share Incentive Plan

	Interest as at 1 April 2009	Partnership shares acquired during year	Matching shares appropriated during year	Dividend shares allocated during year	Interest as at 31 March 2010
David Mellors	–	1,425	–	–	1,425
Former Directors					
Sir John Chisholm	266*	–	–	–	–
Graham Love	3,562	–	–	–	–

*Acquired as an Executive Director

Other statutory information

Principal activity
QinetiQ Group plc is a public limited company, listed on the London Stock Exchange and incorporated in England and Wales with registered number 4586941.

QinetiQ Group plc is the parent company of a Group whose principal activities during the year were the supply of technical advice to customers in the global aerospace, defence and security markets. Customers include government organisations, such as the UK MOD and the US DoD and commercial customers around the world.

Research and development
One of the Group's principal business streams is the provision of funded research and development (R&D) for customers. The Group also invests in the commercialisation of promising technologies across all areas of business.

The majority of R&D-related expenditure is incurred on behalf of customers as part of specific funded research contracts. R&D costs are included in the income statement and R&D income is reflected within revenue. In the financial year, the Group recorded £425.6m (2009: £468.5m) of total R&D-related expenditure, of which £418.3m was customer-funded work (2009: £457.0m).

In the year to 31 March 2010, £7.3m (2009: £11.5m) of internally funded R&D was charged to the income statement. £70.6m (2009: £0.2m) of late-stage development costs were capitalised and £3.0m (2009: £2.4m) of capitalised development costs were amortised in the year.

Policy and practice on payment of suppliers
The policy of the Group is to agree terms of payment prior to commencing trade with a supplier and to abide by those terms based on the timely submission of satisfactory invoices. At 31 March 2010, the trade creditors of the Group represented 28 days of annual purchases (2009: 42 days).

Political and charitable contributions
QinetiQ does not make political donations to parties as that term would be commonly recognised. The legal definition of that term is, however, quite broad and may have the effect of covering a number of normal business activities that would not commonly be perceived to be political donations, such as sponsorship of events. These may include legitimate interactions in making MPs and others in the political world aware of key industry issues and matters affecting QinetiQ, which make an important contribution to their understanding of QinetiQ, the markets in which it operates and their constituents work. During the last financial year this expenditure amounted to no more than £15,000.

Charitable donations during the year across the Group amounted to £114,100 (2009: £133,500).

Share capital
As at 31 March 2010 the Company had allotted and fully paid share capital of 660,476,373 ordinary shares of 1p each with an aggregate nominal value of £6.6 million (including shares held by employee share trusts) and one Special Share with an aggregate nominal value of £1.

Details of the shares issued during the financial year are shown in note 32 on page 84.

The rights of ordinary shareholders are set out in the Articles of Association. The holders of ordinary shares are entitled to receive the Company's reports and accounts, to attend and speak at General Meetings of the Company, to exercise voting rights in person or by appointing a proxy and to receive a dividend where declared or paid out of profits available for such a purpose.

The Special Share is held by HM Government through the Secretary of State for Defence and it confers certain rights under the Articles of Association which are detailed in note 32 on page 84. These include the right to require certain persons with a material interest in QinetiQ to dispose of some or all of their ordinary shares on the grounds of national security or conflict of interest. The Special Share may only be held by and transferred to HM Government. At any time the Special Shareholder may require QinetiQ to redeem the share at par and if wound up the Special Shareholder would be entitled to be repaid capital before other shareholders. Any variation of the rights attaching to the Special Share requires the written approval of the MOD.

Change of control – significant agreements
The following significant agreements contain provisions entitling the counter parties to require prior approval, exercise termination, alteration or other similar rights in the event of a change of control of the Company or if the Company no longer remains a UK company:

- the Combined Aerial Target Service contract is a 20-year contract awarded to QinetiQ by MOD on 14 December 2006. The terms of this contract require QinetiQ Limited to remain a UK company which is incorporated under the laws of any part of the UK or an overseas company registered in the UK and that at least 50% of the Board of Directors are UK nationals. The terms also contain change of control conditions and restricted share transfer conditions which require prior approval from HM Government if there is a material change in the ownership of QinetiQ Limited's share capital, unless the change relates to shares listed on a regulated market, with material defined as being 10% or more of the share capital. Additionally, there are restrictions on transfers of shares to persons from countries appearing on the restricted list as issued by HM Government; and

- the Long-Term Partnering Agreement is a 25-year contract which QinetiQ Limited signed on 28 February 2003 to provide test, evaluation and training services to the MOD. This contract contains conditions where the prior approval of HM Government is required if the contractor, QinetiQ Limited, ceases to be a subsidiary of the QinetiQ Group, except where such change in control is permitted under the Shareholders Agreement to which MOD is a party.

The Company is party to a £500m Revolving Credit Facility with Lloyds TSB Bank plc (as agent) expiring 19 August 2012. Under the terms of the facility, if either (1) the MOD ceases to retain in its capacity as Special Shareholder its Special Shareholders Rights; or (2) there is a change of control of the Company, any lender may request by not less than 90 days' notice to the Company, that its commitment be cancelled and all outstanding amounts be repaid to that lender at the expiry of such notice period.

On 6 December 2006, QinetiQ US Holdings, Inc., formerly known as QinetiQ North America, Inc (as Borrower) and the Company (as Guarantor) entered into a Note Purchase Agreement to issue $135m 5.44% Senior Notes due 6 December 2013 and $125m 5.50% Senior Notes due 6 December 2016. Under the terms of the agreement, if either (1) the MOD ceases to retain in its capacity as Special Shareholder its Special Shareholders Rights; or (2) there is a change of control of the Company; and (3) in either case where there has been a rating downgrade, or where there are no rated securities (unless a rating of at least investment grade is not obtained within 90 days of the change of control), the Notes must be offered for prepayment by the Company within 21 days of the change of control. The prepayment date would be no later than 45 days after the offer of prepayment by the Company.

On 5 February 2009, QinetiQ US Holdings, Inc., formerly known as QinetiQ North America, Inc. (as Borrower) and the Company (as Guarantor) entered into a Note Purchase Agreement to issue $62m 7.13% Senior Notes due 5 February 2016 and $238m 7.62% Senior Notes due 5 February 2019. Under the terms of the agreement, if either (1) the MOD ceases to retain in its capacity as Special Shareholder its Special Shareholders Rights; or (2) there is a change of control of the Company, the Notes must be offered for prepayment within 21 days of the change of control. The prepayment date would be no later than 45 days after the offer of prepayment by the Company.

Major shareholders

At 24 May 2010, being the latest practicable date prior to the issuance of this report, the Group had been notified of the following shareholdings of at least 3% in the ordinary share capital of the Group:

Ruane, Cunniff & Goldfarb, Inc.	11.26%
Lansdowne Partners Ltd (UK)	9.05%
BlackRock Investment Management Ltd (UK)	8.93%
Artisan	5.04%
Fidelity International Ltd (UK)	4.97%
Standard Life Investments Ltd	4.79%
Legal & General	3.98%
AXA Investment Managers UK Ltd	3.56%

Allotment/purchase of own shares

At the Company's AGM held in August 2009, the shareholders passed resolutions which authorised the Directors to allot relevant securities up to an aggregate nominal value of £4,403,174 (£2,201,587 pursuant only to a rights issue), to disapply pre-emption rights (up to 5% of the issued ordinary share capital) and for the Company to purchase ordinary shares (up to 10% of its ordinary share capital). Equivalent resolutions will be laid before the 2010 AGM.

During the year, the Company provided funding to the trustees of its employee share schemes to make market purchases of the Company's ordinary shares to cover future obligations under outstanding share-option and other share-based awards. Further details are disclosed in note 32 on page 84.

Restrictions on transfer of shares

As outlined in Note 32 on page 84, the Special Share confers certain rights under the Company's Articles of Association to require certain persons with an interest in QinetiQ's shares which exceed certain prescribed thresholds to dispose of some or all of their ordinary shares on grounds of national security or conflict of interest.

Articles of Association

Save in the respect of any variation to the rights attaching to the Special Share, the Company has not adopted any special rules relating to the amendment of the Company's Articles of Association other than as provided under UK corporate law.

Employees

The Group is an equal opportunities employer, upholds the principles of the UK Employment Service's 'Two Ticks' symbol and is accredited by Investors in People. Every possible consideration is given to applications for employment, regardless of gender, religion, disability or ethnic origin, having regard only to skills and competencies. This policy is extended to existing employees and any change which may affect their personal circumstances. The policy is supported by strategies for professional and career development.

QinetiQ seeks to utilise a range of communication channels to employees in order to involve them in the running of the organisation. This is done using various media, including in-house magazines, intranet, regular newsletters, bulletins, management briefings, trade union consultation, the newly created QinetiQ Employee Forum and widespread training programmes.

Employee Share Scheme

Equiniti Share Plan Trustees Limited acts as trustee in respect of all ordinary shares held by employees under the QinetiQ Group plc Share Incentive Plan ('the Plan'). Equiniti Share Plan Trustees Limited will send a Form of Direction to all employees holding shares under the Plan, and will vote on all resolutions proposed at general meetings in accordance with the instructions received. In circumstances where ordinary shares are held by the corporate sponsored nominee service, Equiniti Corporate Nominees Limited will send a Proxy Form to all shareholders utilising such corporate nominee service, and will vote on all resolutions proposed at general meetings in accordance with the instructions received.

Auditor

KPMG Audit Plc has expressed its willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the Annual General Meeting.

Statement of disclosure of information to auditor

The Directors who held office at the date of approval of this Directors' report have confirmed that, so far as the Directors are aware, there is no relevant audit information of which the Company's auditor is unaware; and the Directors have taken all the steps they reasonably ought to have taken as Directors to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Annual General Meeting

The Company's Annual General Meeting will be held on Thursday 29 July 2010 at 2.00pm at The Auditorium, JP Morgan Cazenove, 20 Moorgate, London EC2R 6DA. Details of the business to be proposed and voted upon at the meeting is contained in the Notice of the Annual General Meeting which is sent to all shareholders and also published on the Company's website (www.QinetiQ.com).

By order of the Board

Lynton Boardman Company Secretary

85 Buckingham Gate
London SW1E 6PD
2 June 2010

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRS as adopted by the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRS as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement 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.

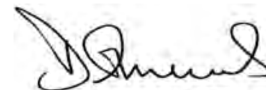
Responsibility statement of the Directors in respect of the Annual Report

We, the Directors of the Company, confirm that to the best of our knowledge:

- the financial statements of the Group have been prepared in accordance with IFRS as adopted by the EU, and for the Company under UK GAAP, in accordance with applicable United Kingdom law and give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group; and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that face the Group.

By order of the Board

Leo Quinn
Chief Executive Officer
2 June 2010



David Mellors
Chief Financial Officer
2 June 2010

Independent Auditor's Report to the Members of QinetiQ Group plc

We have audited the financial statements of QinetiQ Group plc for the year ended 31 March 2010 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity, the Consolidated and Parent Company Balance Sheets, the Consolidated Cash Flow Statement, and the related notes.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 44, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's web-site at www.frc.org.uk/apb/scope/UKP.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2010 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 34, in relation to going concern; and
- the part of the Corporate Governance Statement on pages 28-35 relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Mike Maloney (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants

8 Salisbury Square
London
EC4Y 8BB
2 June 2010

Consolidated income statement

for the year ended 31 March

all figures in £ million	note	2010 Before acquisition amortisation and specific non-recurring items	2010 Acquisition amortisation and specific non-recurring items*	2010 Total	2009 Before acquisition amortisation and specific non-recurring items (restated)†	2009 Acquisition amortisation and specific non-recurring items*	2009 Total (restated)†
Revenue	2, 3	**1,625.4**	**–**	**1,625.4**	**1,617.3**	**–**	**1,617.3**
Other operating costs excluding depreciation and amortisation		**(1,465.8)**	**(42.1)**	**(1,507.9)**	(1,424.0)	–	(1,424.0)
Share of post-tax loss of equity accounted joint ventures and associates	16	**0.2**	**–**	**0.2**	(7.2)	–	(7.2)
Other income	2	**6.9**	**–**	**6.9**	7.9	–	7.9
EBITDA (earnings before interest, tax, depreciation and amortisation)		**166.7**	**(42.1)**	**124.6**	**194.0**	**–**	**194.0**
Depreciation and impairment of property, plant and equipment	14	**(35.1)**	**(24.0)**	**(59.1)**	(33.5)	–	(33.5)
Amortisation and impairment of intangible assets	11,12	**(11.3)**	**(79.5)**	**(90.8)**	(8.9)	(23.5)	(32.4)
Group operating (loss)/profit	3	**120.3**	**(145.6)**	**(25.3)**	**151.6**	**(23.5)**	**128.1**
Gain/(loss) on business divestments and impairment of investments	5	**–**	**(6.2)**	**(6.2)**	–	7.3	7.3
Finance income	6	**48.1**	**–**	**48.1**	59.1	–	59.1
Finance expense	6	**(82.7)**	**–**	**(82.7)**	(80.5)	–	(80.5)
(Loss)/profit before tax	4	**85.7**	**(151.8)**	**(66.1)**	**130.2**	**(16.2)**	**114.0**
Taxation	7	**(12.9)**	**15.7**	**2.8**	(26.7)	6.3	(20.4)
(Loss)/profit for the year attributable to equity shareholders	33	**72.8**	**(136.1)**	**(63.3)**	**103.5**	**(9.9)**	**93.6**
Earnings per share							
Basic	10			**(9.7)p**			14.3p
Diluted	10			**(9.7)p**			14.3p

*Specific non-recurring items include amounts relating to gain/(loss) on business divestments and unrealised impairments of investments and in 2010 the impairment of property, plant and equipment, impairment of intangible assets and EMEA reorganisation costs. See note 4.

†Restatement relates to the transfer of the finance element of the IAS 19 pension cost, totalling a net £3.4m credit to the finance income and expense lines. This was previously reported in other operating costs.

Consolidated statement of comprehensive income

for the year ended 31 March

all figures in £ million	2010	2009
(Loss)/profit for the year	**(63.3)**	**93.6**
Other comprehensive income:		
Effective portion of change in fair value of net investment hedges	**28.7**	(107.6)
Foreign currency translation differences for foreign operations	**(30.8)**	181.6
Decrease in fair value of hedging derivatives	**(0.2)**	(17.6)
Reclassification of hedging derivatives to the income statement	**6.6**	–
Movement in deferred tax on hedging derivatives	**(1.8)**	4.7
Fair value gains on available for sale investments	**1.7**	0.9
Actuarial loss recognised in defined benefit pension schemes	**(60.2)**	(95.8)
Increase in deferred tax asset due to actuarial movement in pension deficit	**16.9**	34.1
Other comprehensive income for the year, net of tax	**(39.1)**	**0.3**
Total comprehensive income for the year attributable to equity holders	**(102.4)**	**93.9**

Consolidated statement of changes in equity

for the year ended 31 March

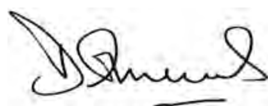
all figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Hedge reserve	Translation reserve	Retained earnings	Total	Minority interest	Total equity
At 1 April 2009	**6.6**	**39.9**	**147.6**	**(16.7)**	**56.5**	**368.7**	**602.6**	**0.1**	**602.7**
Total comprehensive income for the year	**–**	**–**	**–**	**4.6**	**(2.1)**	**(104.9)**	**(102.4)**	**–**	**(102.4)**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**(31.6)**	**(31.6)**	**–**	**(31.6)**
Purchase of own shares	**–**	**–**	**–**	**–**	**–**	**(0.8)**	**(0.8)**	**–**	**(0.8)**
Share-based payments	**–**	**–**	**–**	**–**	**–**	**5.8**	**5.8**	**–**	**5.8**
Deferred tax on share-based payments	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At 31 March 2010	**6.6**	**39.9**	**147.6**	**(12.1)**	**54.4**	**237.2**	**473.6**	**0.1**	**473.7**
At 1 April 2008	6.6	39.9	147.6	(3.8)	(17.5)	360.1	532.9	0.1	533.0
Total comprehensive income for the year	–	–	–	(12.9)	74.0	32.8	93.9	–	93.9
Dividends paid	–	–	–	–	–	(28.9)	(28.9)	–	(28.9)
Purchase of own shares	–	–	–	–	–	(0.8)	(0.8)	–	(0.8)
Share-based payments	–	–	–	–	–	5.6	5.6	–	5.6
Deferred tax on share-based payments	–	–	–	–	–	(0.1)	(0.1)	–	(0.1)
At 31 March 2009	**6.6**	**39.9**	**147.6**	**(16.7)**	**56.5**	**368.7**	**602.6**	**0.1**	**602.7**

Consolidated balance sheet

as at 31 March

all figures in £ million	note	2010	2009
Non-current assets			
Goodwill	11	**579.7**	638.5
Intangible assets	12	**141.7**	164.2
Property, plant and equipment	14	**285.5**	332.4
Other financial assets	15	**10.0**	11.6
Equity accounted investments	16	**0.9**	0.7
Other investments	17	**4.8**	15.7
Deferred tax asset	24	**28.7**	–
		1,051.3	**1,163.1**
Current assets			
Inventories	18	**79.8**	68.3
Other financial assets	15	**7.8**	3.1
Trade and other receivables	19	**423.8**	532.9
Current tax		**–**	8.6
Investments	20	**2.3**	0.6
Assets classified as held for sale		**5.1**	1.8
Cash and cash equivalents	21	**63.9**	262.1
		582.7	**877.4**
Total assets		**1,634.0**	**2,040.5**
Current liabilities			
Trade and other payables	22	**(396.4)**	(447.2)
Current tax		**(7.5)**	–
Provisions	23	**(16.1)**	(4.3)
Other financial liabilities	25	**(8.9)**	(22.1)
		(428.9)	**(473.6)**
Non-current liabilities			
Retirement benefit obligation	38	**(147.3)**	(105.2)
Deferred tax liability	24	**(10.8)**	(8.9)
Provisions	23	**(7.9)**	(8.8)
Other financial liabilities	26	**(530.2)**	(792.6)
Other payables	22	**(35.2)**	(48.7)
		(731.4)	**(964.2)**
Total liabilities		**(1,160.3)**	**(1,437.8)**
Net assets		**473.7**	**602.7**
Capital and reserves			
Ordinary shares	32	**6.6**	6.6
Capital redemption reserve		**39.9**	39.9
Share premium account		**147.6**	147.6
Hedging and translation reserve		**42.3**	39.8
Retained earnings		**237.2**	368.7
Capital and reserves attributable to shareholders of the parent company		**473.6**	**602.6**
Minority interest		**0.1**	0.1
Total shareholders' funds		**473.7**	**602.7**

The financial statements were approved by the Board of Directors and authorised for issue on 2 June 2010 and were signed on its behalf by:



Leo Quinn Chief Executive Officer

David Mellors Chief Financial Officer

Consolidated cash flow statement

for the year ended 31 March

all figures in £ million	note	2010	2009
Net cash inflow from operations before EMEA reorganisation cost	28	**204.6**	**202.2**
Net cash outflow relating to EMEA reorganisation		**(35.4)**	(27.0)
Cash inflow from operations		**169.2**	**175.2**
Tax received/(paid)		**1.5**	(2.5)
Interest received		**0.4**	1.0
Interest paid		**(36.8)**	(21.3)
Net cash inflow from operating activities		**134.3**	**152.4**
Purchases of intangible assets		**(6.2)**	(3.3)
Purchases of property, plant and equipment		**(24.1)**	(29.1)
Costs from sale of property, plant and equipment		**(0.7)**	(1.2)
Equity accounted investments and other investment funding		**(1.1)**	(5.8)
Purchase of subsidiary undertakings		**(46.3)**	(92.9)
Net cash acquired with subsidiary undertakings		**0.7**	3.7
Proceeds from sale of equity accounted investment		**–**	13.7
Proceeds from sale of interests in subsidiary undertakings		**21.1**	7.2
Net cash outflow from investing activities		**(56.6)**	**(107.7)**
Cash outflow from repayment of loan notes		**–**	(0.5)
(Repayment)/proceeds from bank borrowings		**(232.1)**	13.3
Proceeds from US Private Placement		**–**	210.4
Payment of deferred finance costs		**–**	(1.5)
Settlement of forward contracts designated as net investment hedges		**(14.3)**	–
Purchase of own shares		**(0.8)**	(0.8)
Dividends paid to shareholders		**(31.6)**	(28.9)
Capital element of finance lease rental payments		**(2.8)**	(2.8)
Capital element of finance lease rental receipts		**3.0**	3.0
Net cash (outflow)/inflow from financing activities		**(278.6)**	**192.2**
(Decrease)/increase in cash and cash equivalents	29	**(200.9)**	**236.9**
Effect of foreign exchange changes on cash and cash equivalents		**(0.5)**	5.7
Cash and cash equivalents at beginning of the year		**262.1**	19.5
Cash and cash equivalents at end of the year		**60.7**	**262.1**
Cash and cash equivalents	21	**63.9**	262.1
Overdrafts	30	**(3.2)**	–
Cash and cash equivalents at end of the year		**60.7**	**262.1**

Reconciliation of movement in net debt

for the year ended 31 March

all figures in £ million	note	2010	2009
(Decrease)/increase in cash and cash equivalents in the year	29	**(200.9)**	236.9
Cash flows from repayment/(drawdown) of loans, private placement and other financial instruments		**246.2**	(226.1)
Change in net debt resulting from cash flows	30	**45.3**	**10.8**
Other non-cash movements including foreign exchange	30	**35.2**	(168.8)
Movement in net debt in the year		**80.5**	**(158.0)**
Net debt at beginning of the year	30	**(537.9)**	(379.9)
Net debt at end of the year	30	**(457.4)**	**(537.9)**

Notes to the financial statements

1. Significant accounting policies

Accounting policies

The following accounting policies have been applied consistently to all periods presented in dealing with items which are considered material in relation to the Group's financial statements. The Group separately presents acquisition amortisation and specific non-recurring items in the income statement which, in the judgement of the Directors, need to be disclosed separately by virtue of their size and incidence in order for the reader to obtain a proper understanding of the financial information. Specific non-recurring items include amounts relating to gains and losses on business divestments and unrealised impairments and in 2010 the impairment of property, plant and equipment, impairment of intangible assets and EMEA reorganisation costs.

Basis of preparation

The Group's financial statements have been prepared on a going concern basis as discussed in the Corporate Governance report on page 34. The Group's financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU ('Adopted IFRS') and the Companies Act 2006 applicable to companies reporting under IFRS. The Company has elected to prepare its parent company financial statements in accordance with UK GAAP; these are presented on pages 94 to 96. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and other relevant financial assets and liabilities. Non-current assets held for sale are held at the lower of carrying amount and fair value less costs to sell. The Group's reporting currency is sterling and unless otherwise stated the financial statements are rounded to the nearest hundred thousand.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings up to 31 March 2010. The purchase method of accounting has been adopted. Those subsidiary undertakings acquired or disposed of in the period are included in the consolidated income statement from the date control is obtained to the date that control is lost (usually on acquisition and disposal respectively). A subsidiary is an entity over which the Group has the power to govern financial and operating policies in order to obtain benefits. Potential voting rights that are currently exercisable or convertible are considered when determining control.

An associate is an undertaking over which the Group exercises significant influence, usually from 20% to 50% of the equity voting rights, over financial and operating policy. A joint venture is an undertaking over which the Group exercises joint control. Associates and joint ventures are accounted for using the equity method from the date of acquisition up to the date of disposal. The Group's investments in associates and joint ventures are held at cost including goodwill on acquisition and any post-acquisition changes in the Group's share of the net assets of the associate less any impairment to the recoverable amount. Where an associate or joint venture has net liabilities, full provision is made for the Group's share of liabilities where there is a constructive or legal obligation to provide additional funding to the associate or joint venture.

The financial statements of subsidiaries, joint ventures and associates are adjusted where necessary to ensure compliance with Group accounting policies.

On consolidation, all intra-group income, expenses and balances are eliminated.

Revenue

Revenue represents the value of work performed for customers, and is measured net of value added and other sales taxes on the following bases.

Long-term contracts

The Group's long-term contract arrangements are accounted for under IAS 11 Construction Contracts. Revenue is recognised once the Group has obtained the right to consideration in exchange for its performance. No profit is recognised on contracts until the outcome of the contract can be reliably estimated. When the outcome of a contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is normally measured by the proportion of contract costs incurred for work performed to date compared to the estimated total contract costs after making suitable allowances for technical and other risks related to performance milestones yet to be achieved. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

Goods sold and services rendered

Sales of goods and the provision of services not under long-term contract are recognised in the income statement when the significant risks and rewards of ownership have been transferred to the customer and revenue and costs can be reliably measured.

Cost-plus contracts

Revenue on cost-plus and time-and-materials contracts is recognised as work is performed.

Royalties and intellectual property

Royalty revenue is recognised on the earlier of the date on which the income is earned and measurable with reasonable certainty or cash is received. Cash received in advance is deferred over the period to which the royalty relates. Intellectual property revenue can be attributed either to perpetual licences or limited licences. Limited licences are granted for a specified time period and revenue is recognised over the period of the licence. Perpetual licences are granted unlimited time frames and are recognised when the risks and rewards of ownership are transferred to the customer.

Segmental information

Segmental information is presented according to the Group's management structure and markets in which the Group operates. The principal activities of the Group are managed through three sectors organised according to the distinct markets in which the Group operates:

- EMEA (Europe, Middle East and Australasia) mainly delivers technical advice, technology solutions, consultancy and managed services to the Ministry of Defence in the UK, and civil and other Government customers in the UK and Australia;
- QinetiQ North America mainly provides technology and services to the US Government; and
- Ventures mainly comprises commercial product businesses and business venturing activities.

Segmental results represent the contribution of the different segments to the profit of the Group. Corporate expenses are allocated to the corresponding segments. Unallocated items comprise mainly profit on disposal of non-current assets, business divestments and unrealised impairment of investments, financing costs and taxation. Eliminations represent inter-company trading between the different segments.

1. Significant accounting policies (continued)

Segmental assets comprise property, plant and equipment, goodwill and other intangible assets, trade and other receivables, inventories and prepayments and accrued income. Unallocated assets represent financial assets which are included in net debt. Segmental liabilities comprise trade and other payables, accruals and deferred income and retirement benefit obligations. Unallocated liabilities represent financial liabilities which are included in net debt. Segmental assets and liabilities are as at the end of the year.

Research and development expenditure

Research and development costs incurred on behalf of a customer as part of a specific project are directly chargeable to the customer on whose behalf the work is undertaken. Internally funded development expenditure is capitalised in the balance sheet where there is a clearly defined project, the expenditures are separately identifiable, the project is technically and commercially feasible, all costs are recoverable by future revenue and the resources are committed to complete the project. Such capitalised costs are amortised over the forecast period of sales resulting from the development. All other research and development costs are expensed to the income statement in the period in which they are incurred. If the research phase cannot be clearly distinguished from the development phase, the respective project-related costs are treated as if they were incurred in the research phase only and expensed.

Financing

Financing represents the financial expense on borrowings accounted for using the effective rate method and the financial income earned on funds invested. Exchange differences on financial assets and liabilities and the income or expense from interest hedging instruments that are recognised in the income statement are included within interest income and expense in financing.

Taxation

The taxation charge is based on the taxable profit for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes. Current tax and deferred tax are charged or credited to the income statement, except where they relate to items charged or credited to equity in which case the relevant tax is charged or credited to equity. Deferred taxation is the tax attributable to the temporary differences that appear when taxation authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated financial statements. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using rates enacted or substantively enacted at the balance sheet date.

Any change in the tax rates are recognised in the income statement unless related to items directly recognised in equity. Deferred tax liabilities are recognised on all taxable temporary differences excluding non-deductible goodwill. Deferred tax assets are recognised on all deductible temporary differences provided that it is probable that future taxable income will be available against which the asset can be utilised. Deferred tax assets and liabilities are offset only where there is a legally enforceable right to offset and there is an intention to settle balances on a net basis.

Goodwill

Business combinations are accounted for under the purchase accounting method. All identifiable assets acquired and liabilities and contingent liabilities incurred or assumed are recorded at fair value at the date control is transferred to QinetiQ, irrespective of the extent of any minority interest. The cost of a business combination is measured at the fair value of assets received, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Any excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised is capitalised as goodwill. Goodwill is subject to annual impairment reviews (see below). If the cost of an acquisition is less than the fair value of the net assets acquired, the difference is immediately recognised in the Consolidated Income Statement as a gain.

Intangible assets

Intangible assets arising from business combinations are recognised at fair value and are amortised over their expected useful lives, typically between 0 and 9 years. Internally generated intangible assets are recorded at cost, including labour, directly attributable costs and any third-party expenses. Purchased intangible assets are recognised at cost less amortisation. Intangible assets are amortised over their respective useful lives on a straight line basis as follows:

Intellectual property rights	2–8 years
Development costs	Useful economic life or unit of production method subject to a minimum amortisation of no less than straight line method over economic life of 1–4 years
Other	1–9 years

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation. Freehold land is not depreciated. Other tangible non-current assets are depreciated on a straight line basis over their useful economic lives to their estimated residual value as follows:

Freehold buildings	20–25 years
Leasehold land and buildings	Shorter of useful economic life and the period of the lease
Plant and machinery	3–10 years
Fixtures and fittings	5–10 years
Computers	3–5 years
Motor vehicles	3–5 years

Assets under construction are included in property, plant and equipment on the basis of expenditure incurred at the balance sheet date. In the case of assets constructed by the Group, the value includes the cost of own work completed, including directly attributable costs and interest.

The useful lives, depreciation methods and residual values applied to property, plant and equipment are reviewed annually and, if appropriate, adjusted accordingly.

Notes to the financial statements (continued)

1. Significant accounting policies (continued)

Impairment of tangible, goodwill, intangible and held for sale assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If the carrying amount of any asset exceeds its recoverable amount an impairment loss is recognised immediately in the income statement. In addition, goodwill is tested for impairment annually irrespective of any indication of impairment. If the carrying amount exceeds the recoverable amount, the respective asset or the assets in the cash generating unit are written down to their recoverable amounts. The recoverable amount of an asset or a cash generating unit is the higher of its fair value less costs to sell and its value in use. The value in use is the present value of the future cash flows expected to be derived from an asset or cash generating unit calculated using an appropriate pre-tax discount rate. Impairment losses are expensed to the income statement.

Investments in debt and equity securities

Investments held by the Group are classified as either a current asset or as a non-current asset and those classified as available for sale are stated at fair value, with any resultant gain or loss being recognised directly in equity, except for impairment losses. When these investments are de-recognised, the cumulative gain or loss previously recognised directly in equity is recognised in the income statement.

The fair value of quoted financial instruments is their bid price at the balance sheet date. The fair value of unquoted equity investments are held at fair value based upon the price of the most recent investment by the Group or a third party if available or derived from the present value of forecast future cash flows.

Inventories

Inventory and work-in-progress (including DTR pre-contract costs capitalised since QinetiQ was awarded preferred bidder status in 2007) are stated at the lower of cost and net realisable value. Work-in-progress and manufactured finished goods are valued at production cost. Production cost includes direct production costs and an appropriate proportion of production overheads. A provision is established when the net realisable value of any inventory item is lower than its cost.

Bid costs

Costs incurred in bidding for work are normally expensed as incurred. In the case of large multi-year government contracts the bidding process typically involves a competitive bid process to determine a preferred bidder and then a further period to reach financial close with the customer. In these cases, the costs incurred after announcement of the Group achieving preferred bidder status are deferred to the balance sheet within work-in-progress. From the point financial close is reached, the costs are amortised over the life of the contract. If an opportunity for which the Group was awarded preferred bidder status fails to reach financial close, the costs deferred to that point will be expensed in the income statement immediately, when it becomes likely that financial close will not be achieved.

Trade and other receivables

Trade and other receivables are stated net of provisions for doubtful debts. Amounts recoverable on contracts are included in trade and other receivables and represent revenue recognised in excess of amounts invoiced. Payments received on account are included in trade and other payables and represent amounts invoiced in excess of revenue recognised.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and short-term deposits that are readily convertible into cash. In the cash flow statement overdraft balances are included in cash and equivalents.

Current and non-current liabilities

Current liabilities include amounts due within the normal operating cycle of the Group. Interest-bearing current and non-current liabilities are recognised at fair value and then stated at amortised cost with any difference between the cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis. Costs associated with the arrangement of bank facilities or the issue of loans are held net of the associated liability presented in the balance sheet. Capitalised issue costs are released over the estimated life of the facility or instrument to which they relate using the effective interest rate method. If it becomes clear that the facility or instrument will be redeemed early, the amortisation of the issue costs will be accelerated.

Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event which can be reliably estimated, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where appropriate, provisions are determined by discounting the expected cash flows at the Group's weighted average cost of capital.

Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument. The derecognition of a financial instrument takes place when the Group no longer controls the contractual rights that comprise the financial instrument, when the instrument expires or is sold, terminated or exercised.

Derivative financial instruments

Derivative financial instruments are initially recognised and thereafter held at fair value, being the market value for quoted instruments or valuation based on models and discounted cash flow calculations for unlisted instruments.

Fair value hedging

Changes in the fair value of derivatives designated as fair value hedges of currency risk or interest rate risk are recognised in the income statement. The hedged item is held at fair value with respect to the hedged risk with any gain or loss recognised in the income statement.

Cash flow hedging

The effective portion of changes in the fair value of derivatives designated as a cash flow hedge are recognised in equity. The ineffective portion is recognised immediately in the income statement. Where a hedged item results in an asset or a liability, gains and losses previously recognised in equity are included in the cost of the asset or liability. Gains and losses previously recognised in equity are removed and recognised in the income statement at the same time as the hedged transaction.

Hedging of net investment in foreign operations

The effective portion of changes in the fair value of derivatives designated as hedges of the net investment in a foreign entity are recognised in equity until the net investment is sold or disposed. Any ineffective portion is recognised directly in the income statement.

1. Significant accounting policies (continued)

Leased assets

Leases are classified as finance leases when substantially all of the risks and rewards of ownership are held by the lessee. Assets held under finance leases are capitalised and included in property, plant and equipment at the lower of the present value of minimum lease payments and fair value at the inception of the lease. Assets are then depreciated over the shorter of their useful economic lives or the lease term. Obligations relating to finance leases, net of finance charges arising in future periods, are included under financial liabilities.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the lease.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated at period-end rates. Any resulting exchange differences are taken to the income statement. Gains and losses on designated forward foreign exchange hedging contracts are matched against the foreign exchange movements on the underlying transaction.

The individual financial statements of each group company are presented in its functional currency. On consolidation, assets and liabilities of overseas subsidiaries' associated undertakings and joint ventures, including any related goodwill, are translated to sterling at the rate of exchange at the balance sheet date. The results and cash flows of overseas subsidiaries, associated undertakings and joint ventures are translated to sterling using the average rates of exchange during the period. Exchange adjustments arising from the re-translation of the opening net investment and the results for the period to the period-end rate are taken directly to equity and reported in the Statement of Comprehensive Income.

Post-retirement benefits

The Group provides both defined contribution and defined benefit pension arrangements. The liabilities of the Group arising from defined benefit obligations, and the related current service cost, are determined using the projected unit credit method. Valuations for accounting purposes are carried out half yearly for the largest plans and on a regular basis for other plans. Actuarial advice is provided by external consultants. For the funded defined benefit plans, the excess or deficit of the fair value of plan assets less the present value of the defined benefit obligation are recognised as an asset or a liability respectively.

For defined benefit plans, the actuarial cost charged to the income statement consists of service cost, interest cost and expected return on plan assets. The finance element of the pension charge is shown in finance income and expenses, the remaining service cost element is charged as a component of employee costs in the income statement. Actuarial gains and losses are recognised in full immediately through the Statement of Comprehensive Income. Contributions to defined contribution plans are charged to the Income Statement as incurred.

Share-based payments

The Group operates share-based payment arrangements with employees. The fair value of equity-settled awards for share-based payments is determined on grant and expensed straight line over the period from grant to the date of earliest unconditional exercise. The fair value of cash-settled awards for share-based payments is determined each period end until they are exercised or lapse. The value is expensed straight line over the period from grant to the date of earliest unconditional exercise. The charges for both equity and cash-settled share-based payments are updated annually for non-market-based vesting conditions.

Share capital

Ordinary share capital of the Company is recorded as the proceeds received less issue costs. Company shares held by the employee benefit trusts are held at the consideration paid. They are classified as own shares within equity. Any gain or loss on the purchase, sale or issue of Company shares is recorded in equity.

Restatement of prior periods for finalisation of fair values arising on acquisitions

The fair values of the net assets of acquired business are finalised within 12 months of the acquisition date, with the exception of certain deferred tax balances. All fair value adjustments are recorded with effect from the date of acquisition and consequently may result in the restatement of previously reported financial results.

Recent accounting developments

The following EU endorsed new, revised and amended published standards and interpretations are effective for accounting periods beginning on or after 1 April 2009 and have been adopted.

IFRS 8, Operating Segments replaces *IAS 14 Segmental Reporting* and requires an entity to present segment information on the same basis as used for internal management reporting as provided to the chief operating decision maker. Adoption of this standard did not affect the reportable segments, disclosures have been prepared in accordance with the new standard.

IAS 1 (revised), Presentation of Financial Statements requires the Group to present a Statement of Comprehensive Income and Statement of Changes in Equity as primary statements. The Group has elected to present the Statement of Comprehensive Income and the Income Statement as two statements. These consolidated Financial Statements have been prepared under the revised disclosure requirements.

Amendment to IFRS 7, Financial Instruments: Disclosures requires enhanced disclosures around fair value measurement and liquidity risk. The disclosures in these financial statements have been prepared in accordance with the new standard.

The following EU endorsed amendments, improvements and interpretations of published standards are effective for accounting periods beginning on or after 1 April 2009 and have been adopted with no material impact on the Group's financial statements:

- *IAS 23 (revised), Borrowing Costs;*
- *Amendments to IFRS1, First time adoption of IFRS and IAS 27, Consolidation and separate financial statements;*
- *Amendment to IFRS 2, Share-based payment;*
- *Amendments to IFRS 7, Financial Instruments: Disclosures and IAS 39, Financial Instruments: Recognition and Measurement;*
- *Amendments to IAS 32, Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements;*
- *Amendments to IFRIC 9, Reassessment of Embedded Derivatives and IAS 39, Financial Instruments: Recognition and Measurement;*
- *Improvements to IFRS;*
- *IFRIC 13, Customer Loyalty Programmes;*
- *IFRIC 15, Agreements for the Construction of Real Estate;*
- *IFRIC 16, Hedges of a Net Investment in a Foreign Operation (early adopted);*
- *IFRIC 18, Transfers of Assets from Customers;* and
- *Annual Improvements 2008-2009.*

Notes to the financial statements (continued)

1. Significant accounting policies (continued)

At the date of authorisation of these financial statements, the following EU endorsed revised, amended and improved published standards and interpretations, which have not been applied in these financial statements, were in issue but not yet effective:

IFRS 3 (revised), Business Combinations and amendments to IAS 27, Consolidated and Separate Financial Statements. The standard continues to apply the acquisition method to business combinations with some significant changes. For example, all acquisition related costs will be expensed, all payments to purchase a business will be recorded at fair value at the acquisition date, with contingent payments subsequently re-measured at fair value through the income statement. There are also changes to the reporting of non-controlling interest. These revisions will have an impact on the way in which the Group reports all future business combinations.

The impact of adoption of the following new, revised, amended and improved published standards and interpretations in future periods, which were also in issue at the date of authorisation of these Financial Statements, is under assessment:

- *IFRS 9, Financial Instruments, subject to EU endorsement;*
- *IAS 24 (revised), Related Party Disclosures, subject to EU endorsement;*
- *Amendment to IFRIC 14, IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, subject to EU endorsement;*
- *IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments, subject to EU endorsement;* and
- *Improvements to IFRSs 2010, subject to EU endorsement.*

The Directors anticipate that the adoption of the following new, revised, amended and improved published standards and interpretations in future periods, which were also in issue at the date of authorisation of these Financial Statements, will have no material impact on the Financial Statements of the Group:

- *IFRS 1 (revised), First time adoption of IFRS;*
- *Amendments to IFRS 1, First time adoption of IFRS, subject to EU endorsement;*
- *Amendment to IFRS 2, Share-based payment;*
- *Amendment to IAS 32, Financial Instruments: Presentation;*
- *Amendment to IAS 39, Financial Instruments: Recognition and Measurement;* and
- *IFRIC 17, Distributions of Non-cash Assets to Owners;*

Critical accounting estimates and judgements in applying accounting policies

The following commentary is intended to highlight those policies hat are critical to the business based on the level of management judgement required in their application, their complexity and their potential impact on the results and financial position reported for the Group. The level of management judgement required includes assumptions and estimates about future events which are uncertain, the actual outcome of which may result in a materially different outcome from that anticipated.

Revenue and profit recognition

The estimation process required to evaluate the potential outcome of contracts and projects requires skill, knowledge and experience from a variety of sources within the business to assess the status of the contract, costs to complete, internal and external labour resources required and other factors. This process is carried out continuously throughout the business to ensure that project and contract assessments reflect the latest status of such work. No profit is recognised on a contract until the outcome can be reliably estimated.

Business combinations

Intangible assets recognised on business combinations have been valued using established methods and models to determine estimated value and useful economic life, with input, where appropriate, from external valuation consultants. Such methods require the use of estimates which may produce results that are different from actual future outcomes.

The Group tests annually whether goodwill has suffered any impairment. This process is reliant on the use of estimates of the future profitability and cash flows of its cash-generating units which may differ from the actual results delivered. The Group additionally reviews whether identified intangible assets have suffered any impairment.

Post-retirement benefits

The Group's defined benefit pension obligations and net income statement costs are based on key assumptions including return on plan assets, discount rates, mortality, inflation and future salary and pension increases. Management exercises their best judgement, in consultation with actuarial advisors, in selecting the values for these assumptions that are the most appropriate to the Group. Small changes in these assumptions at the balance sheet date, individually or collectively, may result in significant changes in the size of the deficit or the net income statement costs.

Research and development expenditure

Internally-funded development expenditure is capitalised when criteria are met (see page 51), and is written off over the forecast period of sales resulting from the development. Management decides upon the adequacy of future demand and potential market for such new products in order to justify capitalisation of internally-funded development expenditure. These can be difficult to determine when dealing with innovative technologies. Actual product sales may differ from these estimates.

Tax

In determining the Group's provisions for income tax and deferred tax it is necessary to assess the likelihood and timing of recovery of tax losses created, and to consider transactions in a small number of key tax jurisdictions for which the ultimate tax determination is uncertain. To the extent that the final outcome differs from the tax that has been provided, adjustments will be made to income tax and deferred tax provisions held in the period the determination is made.

Unquoted equity investments

The Group usually judges the fair value of unquoted equity investments using the valuation ascribed to the investment by a third-party funding round or similar valuation event for that investment. In determining the value of an investment the Group may use information from funding rounds, business plans and forecasts, market projections and other estimation techniques, including management estimates, as a guide. These valuation techniques require estimates of the business's future performance. The actual business performance of investments may differ from these estimates.

2. Revenue

Revenue and other income is analysed as follows:

Year ended 31 March

all figures in £ million	2010	2009
Sales of goods	**157.9**	216.3
Services	**1,467.5**	1,401.0
Revenue	**1,625.4**	**1,617.3**
Property rental income	**6.9**	**7.9**

3. Segmental analysis

Business segments

Year ended 31 March 2010

all figures in £ million	QinetiQ North America	Europe, Middle East & Australasia	Ventures	Total
Revenue				
External sales[1]	**800.1**	**818.8**	**6.5**	**1,625.4**
Other information				
EBITDA before share of equity accounted joint ventures and associates	**74.3**	**98.5**	**(6.3)**	**166.5**
Share of equity accounted joint ventures and associates	**0.1**	**0.1**	**–**	**0.2**
EBITDA before restructuring	**74.4**	**98.6**	**(6.3)**	**166.7**
Depreciation of property, plant and equipment	**(6.7)**	**(28.9)**	**(0.4)**	**(36.0)**
Amortisation of purchased or internally developed intangible assets	**–**	**(8.6)**	**(1.8)**	**(10.4)**
Group operating profit/(loss) before acquisition amortisation and specific non-recurring items[2]	**67.7**	**61.1**	**(8.5)**	**120.3**
EMEA reorganisation	**–**	**(42.1)**	**–**	**(42.1)**
Impairment of plant, property and equipment	**–**	**(23.0)**	**(1.0)**	**(24.0)**
Amortisation of intangible assets arising from acquisitions	**(20.2)**	**(5.9)**	**–**	**(26.1)**
Impairment of intangible assets	**(42.2)**	**(7.9)**	**(3.3)**	**(53.4)**
Group operating (loss)/profit	**5.3**	**(17.8)**	**(12.8)**	**(25.3)**
(Loss)/gain on business divestments and unrealised impairment of investments				**(6.2)**
Net finance expense				**(34.6)**
Profit/(loss) before tax				**(66.1)**
Taxation				**2.8**
Profit/(loss) for the year				**(63.3)**

[1] There were internal sales of £12.5m from QNA to EMEA during the year.
[2] Group operating profit/(loss) before acquisition amortisation is stated before specific non-recurring items. These comprise the EMEA reorganisation costs and impairment of plant property and equipment and intangible assets. This is the measure of profit presented to the chief operating decision maker.

Notes to the financial statements (continued)

3. Segmental analysis (continued)

Business segments

Year ended 31 March 2009

all figures in £ million	QinetiQ North America	Europe, Middle East & Australasia (restated)[2]	Ventures	Total (restated)[2]
Revenue				
External sales[1]	**765.6**	**842.3**	**9.4**	**1,617.3**
Other information				
EBITDA before share of equity accounted joint ventures and associates	89.5	118.1	(6.4)	201.2
Share of equity accounted joint ventures and associates	–	–	(7.2)	(7.2)
EBITDA	**89.5**	**118.1**	**(13.6)**	**194.0**
Depreciation of property, plant and equipment	(6.5)	(26.7)	(0.3)	(33.5)
Amortisation of purchased or internally developed intangible assets	–	(7.2)	(1.7)	(8.9)
Group operating profit/(loss) before acquisition amortisation	**83.0**	**84.2**	**(15.6)**	**151.6**
Amortisation of intangible assets arising from acquisitions	(18.0)	(5.5)	–	(23.5)
Group operating profit/(loss)	**65.0**	**78.7**	**(15.6)**	**128.1**
Gain on business divestments and unrealised impairment of investments				7.3
Net finance expense				(21.4)
Profit before tax				**114.0**
Taxation				(20.4)
Profit for the year				**93.6**

[1] There were internal sales of £4.0m from QNA to EMEA during the year.
[2] Restatement relates to the transfer of the finance element of the IAS 19 pension cost, totalling a £3.4m net credit to the income statement, to the finance income and expense lines. This was previously reported in other operating costs.

Year ended 31 March 2010

all figures in £ million	QinetiQ North America	Europe, Middle East & Australasia	Ventures	Unallocated	Consolidated
Segment assets+	**898.1**	**638.2**	**16.0**	**–**	**1,552.3**
Segment liabilities+	**(150.6)**	**(464.0)**	**(6.6)**	**–**	**(621.2)**
Unallocated net debt (note 30)	**–**	**–**	**–**	**(457.4)**	**(457.4)**
Net assets	**747.5**	**174.2**	**9.4**	**(457.4)**	**473.7**
Other information					
Capital expenditure – own equipment*	**9.0**	**10.9**	**1.3**	**–**	**21.2**
Capital expenditure – LTPA funded*	**–**	**9.1**	**–**	**–**	**9.1**
Total capital expenditure	**9.0**	**20.0**	**1.3**	**–**	**30.3**

3. Segmental analysis (continued)

Year ended 31 March 2009

all figures in £ million	QinetiQ North America	Europe, Middle East & Australasia	Ventures	Unallocated	Consolidated
Segment assets	983.8	748.8	31.1	–	1,763.7
Segment liabilities	(160.8)	(459.4)	(2.9)	–	(623.1)
Unallocated net debt (note 30)	–	–	–	(537.9)	(537.9)
Net assets	823.0	289.4	28.2	(537.9)	602.7
Other information					
Capital expenditure – own equipment*	9.1	10.8	0.2	–	20.1
Capital expenditure – LTPA funded*	–	12.3	–	–	12.3
Total capital expenditure	9.1	23.1	0.2	–	32.4

+ Segment assets and liabilities exclude unallocated net debt.
* Capital expenditure is defined as cash paid for property, plant and equipment additions, and purchased and internally developed intangible assets.

Revenue by major customer type

Year ended 31 March 2010

all figures in £ million	**QinetiQ North America**	**Europe, Middle East & Australasia**	**Ventures**	**Consolidated**
UK Government	**–**	**614.1**	**0.4**	**614.5**
US Government	**743.2**	**10.3**	**0.6**	**754.1**
Other	**56.9**	**194.4**	**5.5**	**256.8**
Total	**800.1**	**818.8**	**6.5**	**1,625.4**

Year ended 31 March 2009

all figures in £ million	QinetiQ North America	Europe, Middle East & Australasia	Ventures	Consolidated
UK Government	–	638.7	–	638.7
US Government	716.1	4.1	1.2	721.4
Other	49.5	199.5	8.2	257.2
Total	**765.6**	**842.3**	**9.4**	**1,617.3**

Revenue by customer location

Year ended 31 March

all figures in £ million	**2010**	2009
North America	**825.3**	787.5
United Kingdom	**720.0**	772.9
Other	**80.1**	56.9
Total	**1,625.4**	**1,617.3**

Notes to the financial statements (continued)

4. (Loss)/profit before tax

The following items have been charged in arriving at (loss)/profit before tax for the year ended 31 March.

all figures in £ million	2010	2009
Fees payable to the auditor		
– Statutory audit	**1.0**	1.1
– Audit of the Company's subsidiaries pursuant to legislation	**0.1**	0.1
– Other services supplied pursuant to legislation	**–**	0.1
– Other services relating to taxation	**0.1**	0.1
– Other services	**0.4**	–
Total auditor's remuneration	**1.6**	**1.4**
Inventories recognised as an expense	**76.9**	91.8
Depreciation of property, plant and equipment:		
– Owned assets: before impairment	**35.1**	33.5
– Owned assets: impairment	**24.0**	–
– Under finance lease	**–**	–
Foreign exchange gains	**0.2**	0.5
Research and development expenditure – customer funded contracts	**418.3**	457.0
Research and development expenditure – Group funded	**7.3**	11.5

The following items have been charged in arriving at (loss)/profit before tax in the column titled 'acquisition amortisation and specific non-recurring items':

all figures in £ million	note	2010	2009
EMEA reorganisation costs[1]		**(42.1)**	**–**
Impairment of plant property and equipment	14	**(24.0)**	–
Amortisation of intangible asset arising on acquisitions	12	**(26.1)**	(23.5)
Impairment of intangible asset	12	**(3.3)**	–
Impairment of goodwill[2]	11	**(50.1)**	–
Total goodwill and intangible impairment and acquisition amortisation		**(79.5)**	**(23.5)**
Gain/(loss) on business divestment	5	**5.1**	13.0
Unrealised impairment of investment	5	**(11.3)**	(5.7)
Gain/(loss) on business divestment and unrealised impairment of investment	5	**(6.2)**	**7.3**
Total non-recurring items before tax		**(151.8)**	**(16.2)**

[1] The EMEA reorganisation programme announced in May 2009 was largely completed this financial year. The cost of this programme is £42.1m, which has been expensed to the income statement this year as a non-recurring item, the cash spent against this during the year was £35.4m.

[2] The goodwill impairment charge of £50.1m arises in three Cash Generating Units (CGUs): Technology Solutions in QNA (£11.4m); Mission Solutions in QNA (£30.8m); and Australia in EMEA (£7.9m).

5. (Loss)/gain on business divestments and impairment of investments

For the year ended 31 March

all figures in £ million	2010	2009
Gain on business divestments	**5.1**	13.0
Unrealised impairment of investments	**(11.3)**	(5.7)
	(6.2)	**7.3**

The gain on business divestments in the year relates to the disposal of two businesses. On 30 September 2009 the Group disposed of the Underwater Systems business, a division of QinetiQ Limited, to Atlas Elektronik UK Limited for a consideration before costs of £23.5m which resulted in a profit on disposal of £6.9m. On 31 July 2009 the Calibration business of the Group, including ASAP Calibration Ltd, was sold for proceeds before costs of £0.4m and resulted in a loss on disposal of £1.8m

The current year impairment of investments and associated committed costs relates to a £11.3m (2009: £5.7m) charge in respect of the impairment in the carrying value of investments held for sale.

The prior year gain on business divestments of £13.0m comprises £3.5m of profit on the disposal of a sales contract by QNA's Mission Solutions business and a £9.5m profit on the disposal of part of the Cody Gate Ventures LLP (formerly QinetiQ Ventures LLP) which was held as an equity investment.

6. Finance income and expense

For the year ended 31 March

all figures in £ million	2010	2009 (restated)*
Receivable on bank deposits	**0.4**	1.0
Finance lease income	**1.4**	1.6
Expected return on pension scheme assets	**46.3**	56.5
Finance income	**48.1**	**59.1**
Amortisation of recapitalisation fee	**(0.7)**	(0.3)
Payable on bank loans and overdrafts	**(7.9)**	(13.8)
Payable on US dollar private placement debt	**(23.2)**	(10.7)
Finance lease expense	**(1.1)**	(1.4)
Unwinding of discount on financial liabilities	**(1.0)**	(1.2)
Interest on pension scheme liabilities	**(48.8)**	(53.1)
Finance expense	**(82.7)**	**(80.5)**
Net finance expense	**(34.6)**	**(21.4)**

* Restatement relates to the transfer of the finance element of the IAS 19 pension cost, totalling a net £3.4m credit to the income statement, to the finance income and expense lines. This was previously reported in other operating costs.

Notes to the financial statements (continued)

7. Taxation

all figures in £ million	**2010 Before acquisition amortisation and specific non-recurring items**	**2010 Acquisition amortisation and specific non-recurring items**	**2010 Total**	2009 Before acquisition amortisation and specific non-recurring items	2009 Acquisition amortisation and specific non-recurring items	2009 Total
Analysis of charge						
UK corporation tax	**–**	**–**	**–**	–	–	–
Overseas corporation tax	**16.7**	**(8.8)**	**7.9**	2.9	(5.8)	(2.9)
Total corporation tax	**16.7**	**(8.8)**	**7.9**	**2.9**	**(5.8)**	**(2.9)**
Deferred tax	**(3.6)**	**(6.9)**	**(10.5)**	23.1	(0.5)	22.6
Deferred tax in respect of prior years	**(0.2)**	**–**	**(0.2)**	0.7	–	0.7
Taxation (credit)/expense	**12.9**	**(15.7)**	**(2.8)**	**26.7**	**(6.3)**	**20.4**
Factors affecting the tax charge in year						
The principal factors reducing the Group's current year tax charge below the UK statutory rate are explained below:						
(Loss)/profit before tax	**85.7**	**(151.8)**	**(66.1)**	130.2	(16.2)	114.0
Tax on (loss)/profit before tax at 28% (2009: 28%)	**24.0**	**(42.5)**	**(18.5)**	**36.4**	**(4.5)**	**31.9**
Effect of:						
Expenses not deductible for tax purposes, research and development relief and non-taxable items	**(19.6)**	**29.4**	**9.8**	(17.8)	(0.1)	(17.9)
Unprovided tax losses of overseas subsidiaries, joint ventures and associates	**(0.1)**	**–**	**(0.1)**	1.4	–	1.4
Movements in unrecognised deferred tax assets in respect of tax losses	**6.1**	**–**	**6.1**	0.7	–	0.7
Deferred tax in respect of prior years	**(0.2)**	**–**	**(0.2)**	0.9	–	0.9
Effect of different rates in overseas jurisdictions	**2.7**	**(2.6)**	**0.1**	5.1	(1.7)	3.4
Taxation (credit)/expense	**12.9**	**(15.7)**	**(2.8)**	**26.7**	**(6.3)**	**20.4**

The effective tax rate on acquisition amortisation and specific non-recurring items in 2010 is lower than the Group rate as most of the elements do not attract tax relief. The tax rate on acquisition amortisation and specific non-recurring items in 2009 exceeds the overall Group tax rate as it primarily relates to items subject to the higher US tax rate.

Factors affecting future tax charges
The effective tax rate continues to be below the statutory rate in the UK primarily as a result of the benefit of research and development relief in the UK. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to any future tax legislation changes.

8. Dividends

An analysis of the dividends paid and proposed in respect of the years ended 31 March 2010 and 2009 are provided below:

	Pence per share	£m	Date paid/payable
Interim 2010	**1.58**	**10.4**	**Feb 2010**
Final 2010 (proposed)	**–**	**–**	**–**
Total for the year ended 31 March 2010	**1.58**	**10.4**	
Interim 2009	1.50	9.8	Feb 2009
Final 2009	3.25	21.3	Sep 2009
Total for the year ended 31 March 2009	**4.75**	**31.1**	

9. Analysis of employee costs and numbers

The largest component of operating expenses is employee costs. The year-end and average monthly number of persons employed by the Group, including Directors, analysed by business segment, was:

	Year end 31 March		Monthly average	
	2010 Number	2009 Number	**2010 Number**	2009 Number
QinetiQ North America	**6,178**	6,348	**6,316**	6,167
Europe, Middle East & Australasia	**6,760**	7,565	**7,141**	7,570
Ventures	**65**	68	**66**	66
Corporate	**75**	79	**81**	79
Total	**13,078**	**14,060**	**13,604**	**13,882**

The aggregate payroll costs of these persons were as follows:

all figures in £ million	note	**2010**	2009
Wages and salaries		**578.1**	568.2
Social security costs		**52.1**	53.4
Other pension costs		**44.6**	46.6
Cost of share-based payments	33	**5.8**	5.6
Employee costs before EMEA reorganisation costs		**680.6**	**673.8**
EMEA reorganisation costs		**42.1**	–
Total employee costs		**722.7**	**673.8**

The 2010 EMEA reorganisation costs principally comprise the headcount reduction programme announced on 21 May 2009.

Notes to the financial statements (continued)

10. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the year. The weighted average number of shares used excludes those shares bought by the Group and held as own shares (see note 32). For diluted earnings per share the weighted average number of shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares arising from unvested share-based awards including share options. Underlying basic earnings per share figures are presented below in addition to the basic and diluted earnings per share as the Directors consider this gives a more relevant indication of underlying business performance and reflects the adjustments to basic earnings per share for the impact of specific non-recurring items, amortisation of acquired intangible assets and tax thereon

For the year ended 31 March

		2010	2009
Basic EPS			
(Loss)/profit attributable to equity shareholders	£m	**(63.3)**	93.6
Weighted average number of shares	million	**653.5**	652.7
Basic EPS	pence	**(9.7)**	**14.3**
Diluted EPS			
(Loss)/profit attributable to equity shareholders	£m	**(63.3)**	93.6
Weighted average number of shares	million	**653.5**	652.7
Effect of dilutive securities*	million	**–**	2.8
Diluted number of shares	million	**653.5**	655.5
Diluted EPS	pence	**(9.7)**	**14.3**
Underlying basic EPS			
(Loss)/profit attributable to equity shareholders	£m	**(63.3)**	93.6
Reorganisation costs	£m	**42.1**	–
(Gain)/loss on business divestments, disposals and unrealised impairment of investments	£m	**6.2**	(7.3)
Impairment of property plant and equipment	£m	**24.0**	–
Amortisation of intangible assets arising from acquisitions and impairment of intangible assets	£m	**79.5**	23.5
Tax impact of items above	£m	**(15.7)**	(6.3)
Underlying profit after taxation	£m	**72.8**	103.5
Weighted average number of shares	million	**653.5**	652.7
Underlying basic EPS	pence	**11.1**	**15.9**

* The loss attributable to equity shareholders in the year ended 31 March 2010 results in no effect of dilutive securities to the weighted average number of shares. If there had been a profit in the year ended 31 March 2010 the effect of dilutive securities would have been to increase the diluted number of shares by 4.2m.

11. Goodwill

all figures in £ million	note	2010	2009
Cost			
At 1 April		**639.0**	437.9
Acquisitions	13	**19.1**	37.9
Foreign exchange		**(28.2)**	163.2
At 31 March		**629.9**	**639.0**
Impairment			
At 1 April		**(0.5)**	(0.5)
Impairment in year		**(50.1)**	–
Foreign exchange		**0.4**	–
At 31 March		**(50.2)**	**(0.5)**
Net book value at 31 March		**579.7**	**638.5**

Goodwill at 31 March 2010 was allocated across seven cash generating units (CGUs) in QNA and EMEA. In the year two CGUs in the EMEA business were amalgamated into one to reflect the way in which these CGUs are managed and operated.

Goodwill is attributable to the excess of consideration over the fair value of net assets acquired and includes expected synergies, future growth prospects and staff knowledge, expertise, customer contacts and security clearances. The Group tests goodwill impairment for each CGU annually or more frequently if there are indications that goodwill might be impaired.

Key assumptions
The value in use calculations use discounted future cash flows based on the most recent forecasts from the five-year corporate plan. The five-year corporate plan is approved by the Board. Cash flows for periods beyond this period are extrapolated based on the final year of the corporate plan, with a terminal growth rate assumption applied.

Terminal growth rates
The specific plans for each of the CGUs have been extrapolated using a terminal growth rate of 1.5% to 2.5% (2009: 2.5% to 3.0%). Growth rates are formed based on management's estimates which take into consideration the long-term nature of the industry in which the CGUs operate and external forecasts as to the likely growth of the industry in the longer term.

Discount rates
The Group's weighted average cost of capital (WACC) was used as a basis in determining the discount rate to be applied, adjusted for risks, specific to the geographical location of CGUs as appropriate on a pre-tax basis. The pre-tax discount rate applied for QNA CGUs was 11.8%–12.1% and a range from 9.3%–16.9% for EMEA CGUs.

Impairment
The in year impairment charge of £50.1m arises in three CGUs: Technology Solutions in QNA (£11.4m); Mission Solutions in QNA (£30.8m); and Australia in EMEA (£7.9m).

Defence markets remain challenging as a result of the economic environment and both CGUs have seen a moderation in market growth expectations which has led the Group to re-evaluate the growth forecasts for the CGU, including the long-term growth rate. Additionally, Technology Solutions in QNA has been affected by the finalisation of the strategy for the US's continued involvement in Afghanistan and the completion of key Department of Defense (DoD) leadership appointments.

The Australian CGU impairment reflects an overall moderation in anticipated market growth which has, in turn, had an impact on the growth assumptions for this CGU and an associated moderation in the terminal growth rate.

Notes to the financial statements (continued)

11. Goodwill (continued)

Significant CGUs
Sensitivity analysis shows that both the discount rate and growth rate assumptions are key components of the outcome of the recoverable amount.

The Technology Solutions CGU was impaired during the year by £11.4m. If the discount rate assumption was increased by 1% the impairment charge would have increased by £28.1m to £39.5m or, conversely, should the discount rate have been 1% lower this would have given the CGU headroom of £28.3m. Sensitivity analysis shows that a move of up to 1% in the terminal growth rate could result in an impairment of £33.8m or headroom of £20.3m. The resulting carrying value of goodwill for this CGU at 31 March 2010 was £120.7m.

The Systems Engineering CGU had headroom, with current assumptions, of £109.1m. The Group’s sensitivity analysis shows that the pre-tax discount rate would have to increase to 16.6% or the terminal growth rate to decline to (1.4)% to cause the carrying value of the CGU to exceed its recoverable amount. The carrying value of goodwill for this CGU as at 31 March 2010 was £161.4m.

During the period, the Mission Solutions business was impaired by £30.8m. If discount rates were assumed to be 1% higher the impairment charge would have increased by £53.4m to £84.2m. Conversely, if discount rates were 1% lower the CGU would have had a headroom of £47.3m. The sensitivity to terminal growth rates would imply that a decrease of 1% would result in a further impairment of £43.8m, or an increase of 1% would show the CGU with headroom of £32.9m. The resulting carrying value of goodwill for this CGU at 31 March 2010 was £240.4m.

In EMEA, the Managed Services and Consulting CGUs have significant headroom. An increase in either the discount rate or decrease in the terminal growth rate by 1% would not cause the net operating assets to exceed their recoverable amount.

The Technology Solutions CGU in EMEA has headroom, under current assumptions, of £21.7m. If the discount rate was to decrease or increase by 1%, the CGU would have headroom of £43.9m or £5.7m respectively. Similarly, if terminal growth rates were to decrease or increase by 1%, headroom would be £9.3m or £39.1m respectively.

During the period, the Australia CGU was impaired by £7.9m. If discount rates were assumed to be 1% higher the impairment charge would have increased by £0.7m to £8.6m. Conversely, if discount rates were 1% lower the extent of the impairment would have been reduced by £0.8m to £7.1m. The sensitivity to terminal growth rates would imply that a decrease of 1% would result in a further impairment of £0.5m or an increase of 1% would reduce the impairment by £0.6m.

The Directors have not identified any other likely changes in other significant assumptions since 31 March 2010 and the signing of the financial statements that would cause the carrying value of the recognised goodwill to exceed its recoverable amount.

12. Intangible assets

Year ended 31 March 2010

all figures in £ million	note	Acquired intangible assets*	Development costs	Other intangible assets	Total
Cost					
At 1 April 2009		**221.5**	**10.9**	**34.4**	**266.8**
Additions – internally developed		**–**	**0.6**	**–**	**0.6**
Additions – purchased		**–**	**–**	**5.6**	**5.6**
Additions – recognised on acquisitions	13	**16.0**	**–**	**–**	**16.0**
Disposals		**–**	**(0.2)**	**(4.3)**	**(4.5)**
Disposals – recognised on divestments		**(0.5)**	**–**	**(0.8)**	**(1.3)**
Transfers		**–**	**2.1**	**1.4**	**3.5**
Foreign exchange		**(8.2)**	**–**	**(0.2)**	**(8.4)**
At 31 March 2010		**228.8**	**13.4**	**36.1**	**278.3**
Amortisation and impairment					
At 1 April 2009		**86.0**	**4.5**	**12.1**	**102.6**
Amortisation charge for the year		**26.1**	**3.0**	**8.3**	**37.4**
Impairment in year		**–**	**–**	**3.3**	**3.3**
Disposals		**–**	**(0.2)**	**(3.1)**	**(3.3)**
Disposals – recognised on divestments		**(0.5)**	**–**	**(0.4)**	**(0.9)**
Foreign exchange		**(2.4)**	**–**	**(0.1)**	**(2.5)**
At 31 March 2010		**109.2**	**7.3**	**20.1**	**136.6**
Net book value at 31 March 2010		**119.6**	**6.1**	**16.0**	**141.7**

Year ended 31 March 2009

all figures in £ million	note	Acquired intangible assets*	Development costs	Other intangible assets	Total
Cost					
At 1 April 2008		119.4	10.7	31.8	161.9
Additions – internally developed		–	0.2	0.1	0.3
Additions – purchased		–	–	2.2	2.2
Additions – recognised on acquisitions	13	53.4	–	–	53.4
Disposals		(0.3)	–	(0.1)	(0.4)
Foreign exchange		49.0	–	0.4	49.4
At 31 March 2009		**221.5**	**10.9**	**34.4**	**266.8**
Amortisation and impairment					
At 1 April 2008		45.2	2.1	5.5	52.8
Amortisation charge for the year		23.5	2.4	6.5	32.4
Disposals		–	–	(0.1)	(0.1)
Foreign exchange		17.3	–	0.2	17.5
At 31 March 2009		**86.0**	**4.5**	**12.1**	**102.6**
Net book value at 31 March 2009		**135.5**	**6.4**	**22.3**	**164.2**

* Acquired intangible assets principally consist of the value of attributed to customer contracts including orders, backlog and certain customer relationships, a minor element is attributed to technology, patents/licences and brand names. No value is attributed to customer relationships where short-term contracts are held that are subject to regular re-competition.

Notes to the financial statements (continued)

13. Business combinations

In the year to 31 March 2010 the Group acquired 100% of the issued share capital of Cyveillance, Inc. If this acquisition had been completed as at 1 April 2009 Group revenue for the year ended 31 March 2010 would have increased by £2.0m to £1,627.4m and Group loss before tax would have reduced by £0.1m to £66.0m.

Acquisitions in the year to 31 March 2010

all figures in £ million						Contribution post-acquisition	
Company acquired	Date acquired	Cash consideration[1]	Deferred consideration[4]	Goodwill	Fair value of assets acquired[2]	Revenue	Operating profit
QNA acquisitions							
Cyveillance, Inc.	**1 July 2009**	**26.1**	**0.4**	**19.1**	**7.4**	**5.9**	**0.9**
Current year acquisitions		**26.1**	**0.4**	**19.1**	**7.4**	**5.9**	**0.9**
Deferred consideration in respect of prior year acquisitions[3]							
ITS Corporation		**6.2**	**–**	**–**	**–**	**–**	**–**
Novare Services Pty Ltd		**0.4**	**–**	**–**	**–**	**–**	**–**
Spectro, Inc.		**0.8**	**–**	**–**	**–**	**–**	**–**
Dominion Technology Resources, Inc.		**12.8**	**–**	**–**	**–**	**–**	**–**
Total		**46.3**	**0.4**	**19.1**	**7.4**	**5.9**	**0.9**

(1) Initial cash consideration includes acquisition costs and price adjustments for working capital and net debt.
(2) Fair value of assets acquired are provisional.
(3) Cash consideration paid in the year includes deferred consideration amounts in respect of prior year acquisitions as a result of payment criteria being met.
(4) Deferred consideration of £0.4m has been recognised on the acquisition of Cyveillance, Inc. based upon the estimated payment to be made. The maximum amount payable is $40m depending on the financial performance of Cyveillance in the two-year period ending 31 December 2010.

Set out below are the allocations of purchase consideration, assets and liabilities of the acquisitions made in the year and the adjustments required to the book values of the assets and liabilities in order to present the net assets of these businesses at fair value and in accordance with Group accounting policies. These allocations and adjustments are provisional. There were no adjustments to the provisional fair values at 31 March 2009.

Acquisition in the year to 31 March 2010

all figures in £ million	note	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets	12	**–**	**16.0**	**16.0**
Property, plant and equipment	14	**0.4**	**–**	**0.4**
Trade and other receivables		**1.0**	**–**	**1.0**
Other current assets		**0.7**	**–**	**0.7**
Trade and other payables		**(0.2)**	**–**	**(0.2)**
Cash and cash equivalents		**0.7**	**–**	**0.7**
Deferred tax liability	24	**–**	**(6.3)**	**(6.3)**
Other liabilities		**(4.9)**	**–**	**(4.9)**
Net assets acquired		**(2.3)**	**9.7**	**7.4**
Goodwill				**19.1**
				26.5
Consideration satisfied by:				
Cash				**25.6**
Deferred consideration				**0.4**
Total consideration before costs				**26.0**
Related costs of acquisition				**0.5**
				26.5

The fair value adjustments include £16.0m in relation to the recognition of acquired intangible assets less the recognition of a deferred tax liability of £6.3m in relation to these intangible assets.

13. Business combinations (continued)

Acquisitions in the year to 31 March 2009

all figures in £ million						Contribution post-acquisition	
Company acquired	Date acquired	Initial cash consideration[1]	Deferred consideration	Goodwill	Fair value of assets acquired	Revenue	Operating profit
QNA acquisitions							
Spectro, Inc.	23 July 08	6.2	0.5	2.2	4.5	5.9	0.9
Dominion Technology Resources, Inc.	17 Oct 08	74.2	22.6	33.6	63.2	16.0	1.6
EMEA acquisitions							
Commerce Decisions Ltd	13 Oct 08	12.5	–	6.4	6.1	2.4	1.0
Current year acquisitions		**92.9**	**23.1**	**42.2**	**73.8**	**24.3**	**3.5**
Update in respect of acquisitions made in the year to 31 March 2009		–	(4.3)	(4.3)	–	–	–
Total		**92.9**	**18.8**	**37.9**	**73.8**	**24.3**	**3.5**

[1] Initial cash consideration includes acquisition costs and price adjustments for working capital and net debt.

Set out below are the allocations of purchase consideration, assets and liabilities of the acquisitions made in the year and the adjustments required to the book values of the assets and liabilities in order to present the net assets of these businesses at fair value and in accordance with Group accounting policies.

Acquisitions in the year to 31 March 2009

all figures in £ million	note	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets	12	–	53.4	53.4
Property, plant and equipment	14	0.7	0.2	0.9
Deferred tax asset	24	–	34.6	34.6
Trade and other receivables		8.1	–	8.1
Other current assets		1.7	–	1.7
Trade and other payables		(7.3)	(2.0)	(9.3)
Cash and cash equivalents		3.7	–	3.7
Debt and other borrowings		–	–	–
Deferred tax liability	24	–	(19.3)	(19.3)
Net assets acquired		**6.9**	**66.9**	**73.8**
Goodwill				42.2
				116.0
Consideration satisfied by:				
Cash				89.6
Deferred consideration				23.1
Total consideration before costs				**112.7**
Related costs of acquisition				3.3
				116.0

Notes to the financial statements (continued)

14. Property, plant and equipment

Year ended 31 March 2010

all figures in £ million	Land and buildings	Plant, machinery and vehicles	Computers and office equipment	Assets under construction	Total
Cost					
At 1 April 2009	**302.2**	**136.6**	**62.5**	**24.4**	**525.7**
Additions	**1.9**	**3.4**	**3.4**	**14.8**	**23.5**
Acquisition of subsidiaries	**0.1**	**–**	**0.3**	**–**	**0.4**
Disposals	**(3.5)**	**(1.0)**	**(2.2)**	**(4.8)**	**(11.5)**
Disposals – recognised on divestments	**(1.7)**	**(2.8)**	**(1.3)**	**–**	**(5.8)**
Transfers	**5.7**	**15.9**	**(3.0)**	**(22.1)**	**(3.5)**
Foreign exchange	**(0.1)**	**(0.4)**	**(0.9)**	**(0.1)**	**(1.5)**
At 31 March 2010	**304.6**	**151.7**	**58.8**	**12.2**	**527.3**
Depreciation					
At 1 April 2009	**64.5**	**90.1**	**38.7**	**–**	**193.3**
Charge for the year	**11.8**	**16.7**	**6.6**	**–**	**35.1**
Impairment	**20.7**	**3.3**	**–**	**–**	**24.0**
Disposals	**(3.5)**	**(1.0)**	**(2.2)**	**–**	**(6.7)**
Disposals – recognised on divestments	**(1.0)**	**(1.8)**	**(1.0)**	**–**	**(3.8)**
Transfers	**3.1**	**(0.1)**	**(3.0)**	**–**	**–**
Foreign exchange	**–**	**–**	**(0.1)**	**–**	**(0.1)**
At 31 March 2010	**95.6**	**107.2**	**39.0**	**–**	**241.8**
Net book value at 31 March 2010	**209.0**	**44.5**	**19.8**	**12.2**	**285.5**

Impairment of land and buildings of £20.7m relates to vacant owned properties within the EMEA sector where there are no external tenants following vacancies arising in the year. Plant, machinery and vehicles impairments of £3.3m relates to the impairment of assets which are no longer generating a return. Both these impairments relate to reductions in the carrying value of these assets to their recoverable amounts.

Year ended 31 March 2009

all figures in £ million	Land and buildings	Plant, machinery and vehicles	Computers and office equipment	Assets under construction	Total
Cost					
At 1 April 2008	306.8	115.5	42.0	22.0	486.3
Additions	0.9	5.5	4.5	18.2	29.1
Acquisition of subsidiaries	0.3	0.3	0.3	–	0.9
Disposals	(1.8)	(0.8)	(2.0)	–	(4.6)
Transfers	(6.2)	13.1	9.2	(16.1)	–
Foreign exchange	2.2	3.0	8.5	0.3	14.0
At 31 March 2009	**302.2**	**136.6**	**62.5**	**24.4**	**525.7**
Depreciation					
At 1 April 2008	54.6	73.9	25.4	–	153.9
Charge for the year	11.6	14.7	7.2	–	33.5
Disposals	(1.7)	(0.6)	(2.0)	–	(4.3)
Transfers	(1.7)	(0.3)	1.9	–	(0.1)
Foreign exchange	1.7	2.4	6.2	–	10.3
At 31 March 2009	**64.5**	**90.1**	**38.7**	**–**	**193.3**
Net book value at 31 March 2009	**237.7**	**46.5**	**23.8**	**24.4**	**332.4**

Assets held under finance leases, capitalised and included in computers and equipment, have:

- a cost of £nil (31 March 2009: £5.2m);
- aggregate depreciation of £nil (31 March 2009: £5.2m); and
- a net book value of £nil (31 March 2009: £nil).

Under the terms of the Business Transfer Agreement with the MOD, certain restrictions have been placed on freehold land and buildings, and certain plant and machinery related to them. These restrictions are detailed in note 35.

15. Other financial assets

As at 31 March

all figures in £ million	2010	2009
Derivative financial instruments	4.8	0.1
Net investment in finance lease	3.0	3.0
Total current financial assets	**7.8**	3.1
Net investment in finance lease	10.0	11.6
Derivative financial instruments	–	–
Total non-current financial assets	**10.0**	11.6
Total financial assets	**17.8**	14.7

16. Equity accounted investments

Year ended 31 March 2010

all figures in £ million	Joint ventures and associates financial results	Group net share of joint ventures and associates
Revenue	18.9	5.9
Profit after tax	**0.5**	**0.2**
Non-current assets	1.2	0.4
Current assets	6.9	2.1
	8.1	2.5
Current liabilities	(4.7)	(1.5)
Non-current liabilities	(0.2)	(0.1)
	(4.9)	(1.6)
Net assets	**3.2**	**0.9**

Year ended 31 March 2009

all figures in £ million	Joint ventures and associates financial results	Group net share of joint ventures and associates
Revenue	14.2	5.2
Loss after tax	**(14.7)**	**(7.2)**
Non-current assets	0.7	0.2
Current assets	6.4	2.2
	7.1	2.4
Current liabilities	(3.5)	(1.3)
Non-current liabilities	(1.5)	(0.4)
	(5.0)	(1.7)
Net assets	**2.1**	**0.7**

The unrecognised share of losses of equity accounted investments at 31 March 2010 was £nil (31 March 2009: £nil). During the year ended 31 March 2010 there were sales to joint ventures of £nil (2009: £2.6m) and to associates of £2.7m (2009: £nil). At the year end, there were outstanding receivables from joint ventures of £nil (2009: £nil) and £0.3m (2009: £nil) from associates. There were no other related party transactions between the Group and its joint ventures and associates in the year.

Notes to the financial statements (continued)

17. Other non-current investments

all figures in £ million	2010	2009
Available for sale investments at 1 April	**15.7**	14.7
Cash (repaid)/invested in year	**–**	(0.6)
Non-cash additions in year	**–**	5.6
Impairment charged to income statement in year	**(10.8)**	(5.0)
Foreign exchange	**(0.1)**	1.0
Available for sale investments at 31 March	**4.8**	**15.7**

Impairments in the year relate to four unquoted investments due to a decline in the future growth prospects of the markets in which these investments operate.

18. Inventories

As at 31 March

all figures in £ million	2010	2009
Raw materials	**4.4**	3.4
Work in progress	**32.8**	26.4
Finished goods	**42.6**	38.5
	79.8	**68.3**

Included in work in progress is an amount of £30.8m (2009: £19.6m) relating to deferred pre-contract costs relating to the DTR programme which are recoverable in more than one year.

19. Trade and other receivables

As at 31 March

all figures in £ million	2010	2009
Trade debtors	**213.0**	331.2
Amounts recoverable under contracts	**180.7**	169.1
Other debtors	**9.9**	14.8
Prepayments	**20.2**	17.8
	423.8	**532.9**

In determining the recoverability of trade receivables, the Group considers any changes in the credit quality of the trade receivable from the date credit was granted up to the reporting date. Credit risk is limited due to the high percentage of turnover being derived from UK and US defence and other government agencies. Accordingly, the Directors believe there is no further credit provision required in excess of the allowance for doubtful debts. As at 31 March 2010, the Group carried a provision for doubtful debts of £8.8m (2009: £5.9m).

Ageing of past due but not impaired receivables

all figures in £ million	2010	2009
Up to 3 months	**29.4**	83.6
Over 3 months	**2.8**	9.1
	32.2	**92.7**

19. Trade and other receivables (continued)

Movements on the Group doubtful debt provision

all figures in £ million	2010	2009
At 1 April	**5.9**	6.2
Created	**5.6**	3.7
Released	**(2.7)**	(4.0)
Utilised	**–**	–
At 31 March	**8.8**	**5.9**

The maximum exposure to credit risk in relation to trade receivables at the reporting date is the fair value of trade receivables. The Group does not hold any collateral as security.

20. Current asset investments

As at 31 March

all figures in £ million	2010	2009
Available for sale investment	**2.3**	**0.6**

At 31 March 2010 the Group held a 4.9% shareholding in pSivida Limited (31 March 2009: 4.9%) a company listed on NASDAQ and the Australian and Frankfurt Stock Exchanges. The investment is held at fair value of £2.3m (2009: £0.6m) using the closing share price at 31 March 2010 of A$4.20 per share (31 March 2009 A$1.30 per share). During the year, the increase in value of £1.7m (2009: reduction £0.7m) has been recognised as a gain in the statement of comprehensive income.

21. Cash and cash equivalents

As at 31 March

all figures in £ million	2010	2009
Cash	**57.2**	128.2
Cash equivalents	**6.7**	133.9
Total cash and cash equivalents	**63.9**	**262.1**

At 31 March 2010, £4.4m (31 March 2009: £4.5m) of cash was held by the Group's captive insurance subsidiary including £3.6m (2009: £3.5m) which is restricted in its use.

22. Trade and other payables

As at 31 March

all figures in £ million	2010	2009
Payments received on account	**69.9**	82.8
Trade creditors	**48.0**	71.3
Other tax and social security	**36.9**	36.9
Other creditors	**87.3**	66.4
Accruals and deferred income	**154.3**	189.8
Total current trade and other payables	**396.4**	**447.2**
Payments received on account	**23.7**	29.3
Other payables	**11.5**	19.4
Total non-current trade and other payables	**35.2**	**48.7**
Total trade and other payables	**431.6**	**495.9**

Notes to the financial statements (continued)

23. Provisions

Year ended 31 March 2010

all figures in £ million	Reorganisation	Other[1]	Total
At 1 April 2009	**0.9**	**12.2**	**13.1**
Created in year	**44.1**	**7.9**	**52.0**
Released in year	**–**	**(4.1)**	**(4.1)**
Utilised in year	**(35.4)**	**(1.6)**	**(37.0)**
At 31 March 2010	**9.6**	**14.4**	**24.0**
Current liability	**9.6**	**6.5**	**16.1**
Non-current liability	**–**	**7.9**	**7.9**
At 31 March 2010	**9.6**	**14.4**	**24.0**

[1] Other provisions comprise legal, environmental, property and other liabilities

Year ended 31 March 2009

all figures in £ million	Reorganisation	Other	Total
At 1 April 2008	29.3	16.4	45.7
Created in year	–	6.3	6.3
Released in year	(1.1)	(4.0)	(5.1)
Utilised in year	(27.3)	(6.5)	(33.8)
At 31 March 2009	**0.9**	**12.2**	**13.1**
Current liability	0.9	3.4	4.3
Non-current liability	–	8.8	8.8
At 31 March 2009	**0.9**	**12.2**	**13.1**

24. Deferred tax

Deferred tax assets and liabilities are offset only where there is a legally enforceable right to offset and there is an intention to settle the balances net.

Movements in the deferred tax assets and liabilities are shown below:

Year ended 31 March 2010
Deferred tax asset

all figures in £ million	Pension liability	Hedging	Other	Total
At 1 April 2009	**29.4**	**6.6**	**22.0**	**58.0**
Created	**11.8**	**(2.9)**	**6.4**	**15.3**
Prior year adjustment	**–**	**–**	**1.3**	**1.3**
Foreign exchange	**–**	**–**	**(1.1)**	**(1.1)**
Transfer	**–**	**–**	**6.8**	**6.8**
Gross deferred tax asset at 31 March 2010	**41.2**	**3.7**	**35.4**	**80.3**
Less liability available for offset				**(51.6)**
Net deferred tax asset at 31 March 2010				**28.7**

24. Deferred tax (continued)

The net deferred tax asset created in the year relating to the pension liability includes £16.9m released to equity (2009: £34.1m released to equity).

Deferred tax liability

all figures in £ million	Accelerated tax depreciation and amortisation
At 1 April 2009	**(66.9)**
Acquisitions	**(6.3)**
Created	**10.2**
Prior year adjustment	**(1.1)**
Foreign exchange	**1.7**
Gross deferred tax liability at 31 March 2010	**(62.4)**
Less asset available for offset	**51.6**
Net deferred tax liability at 31 March 2010	**(10.8)**

At the balance sheet date, the Group had unused tax losses of £117.1m (2009: £77.5m) potentially available for offset against future profits. No deferred tax asset has been recognised in respect of this amount due to uncertainty over the timing of its utilisation. These losses can be carried forward indefinitely.

Year ended 31 March 2009
Deferred tax asset

all figures in £ million	Pension liability	Hedging	Other	Total
At 1 April 2008	6.5	1.2	11.8	19.5
Created	22.9	4.7	15.4	43.0
Prior year adjustment	–	0.7	(5.2)	(4.5)
Gross deferred tax asset at 31 March 2009	**29.4**	**6.6**	**22.0**	**58.0**
Less liability available for offset				(58.0)
Net deferred tax asset at 31 March 2009				**–**

Deferred tax liability

all figures in £ million	Accelerated tax depreciation and amortisation
At 1 April 2008	(50.3)
Acquisitions	15.3
Created	(26.2)
Foreign exchange	(5.7)
Gross deferred tax liability at 31 March 2009	**(66.9)**
Less asset available for offset	58.0
Net deferred tax liability at 31 March 2009	**(8.9)**

25. Other financial liabilities – current

As at 31 March

all figures in £ million	**2010**	2009
Bank overdraft	**3.2**	–
Deferred financing costs	**(0.7)**	(0.7)
Finance lease creditor	**2.8**	2.8
Derivative financial instruments	**3.6**	20.0
	8.9	**22.1**

Further analysis of the terms and maturity dates for financial liabilities are set out in note 27.

Notes to the financial statements (continued)

26. Other financial liabilities – non-current

As at 31 March

all figures in £ million	2010	2009
Bank loan	**143.7**	386.2
Deferred financing costs	**(0.9)**	(1.6)
	142.8	**384.6**
US $135m 5.44% private placement, repayable December 2013	**90.4**	95.5
US $62m 7.13% private placement, repayable February 2016	**41.9**	43.3
US $125m 5.5% private placement, repayable December 2016	**83.4**	88.0
US $238m 7.62% private placement, repayable February 2019	**161.0**	166.2
Finance lease creditor	**9.7**	11.4
Derivative financial instruments	**1.0**	3.6
	530.2	**792.6**

The bank loan reflects draw-downs under the Revolving Credit Facility comprising loans of US$210m and €6m. After the effect of interest rate swaps the loan has an average fixed rate of 4.35% until September 2010, when it returns to floating rate.

All the US private placements have been issued as fixed rate bonds and have not been converted to floating rate. Further analysis of the terms and maturity dates for financial liabilities are set out in Note 27.

27. Financial risk management

The Group's international operations and debt financing expose it to financial risks which include the effects of changes in foreign exchange rates, interest rates, credit risks and liquidity risks.

Capital, treasury and risk management policies are set by the Board, setting out specific guidelines on financial risks and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives and interest rate derivatives. Group treasury monitors financial risks and compliance with risk management policies. These policies are discussed further in the Chief Financial Officer's review on pages 12-15.

A) Fair values of financial instruments

Effective 1 April 2009, the Group adopted the amendment to IFRS7, Financial Instruments: Disclosures, for the financial instruments that are measured in the balance sheet at fair value. This requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices including within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

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

The following table presents the Group's assets and liabilities that are measured at fair value at 31 March 2010.

	note	Level 1	Level 2	Level 3	2010 Total
Assets					
Current derivative financial instruments	15	**–**	**4.8**	**–**	**4.8**
Current other investments	20	**2.3**	**–**	**–**	**2.3**
Non current other investments	17	**–**	**–**	**4.8**	**4.8**
Liabilities					
Current derivative financial instruments	25	**–**	**(3.6)**	**–**	**(3.6)**
Non-current derivative financial instruments	26	**–**	**(1.0)**	**–**	**(1.0)**
Total		**2.3**	**0.2**	**4.8**	**7.3**

27. Financial risk management (continued)

For cash and cash equivalents, trade and other receivables and bank and current borrowings, the fair value of the financial instruments approximate to their carrying value due to the short maturity periods of these financial instruments. For trade and other receivables, allowances are made within the carrying value for credit risk. For other financial instruments, the fair value is based on market value, where available. Where market values are not available, the fair values have been calculated by discounting cash flows to net present value using prevailing market-based interest rates translated at the year-end rates, except for unlisted fixed asset investments where a fair value equals carrying value.

All financial assets and liabilities have a fair value identical to book value at 31 March 2010 and 31 March 2009 except where noted below:

As at 31 March 2010

all figures in £ million	note	Financial asset fair value through income statement	Available for sale	Loans and receivables	Financial liabilities at amortised cost	Derivatives used as hedges	Total carrying value	Total fair value
Financial assets								
Non-current								
Net investment in finance lease	31	–	–	10.0	–	–	10.0	11.4
Equity accounted investments	16	–	0.9	–	–	–	0.9	0.9
Other investments	17	–	4.8	–	–	–	4.8	4.8
Current								
Derivative financial instruments	15	4.8	–	–	–	–	4.8	4.8
Net investment in finance leases	31	–	–	3.0	–	–	3.0	3.0
Trade and other receivables	19	–	–	423.8	–	–	423.8	423.8
Investments	20	–	2.3	–	–	–	2.3	2.3
Cash and cash equivalents	21	–	–	63.9	–	–	63.9	63.9
		4.8	8.0	500.7	–	–	513.5	514.9
Financial liabilities								
Non-current								
Trade and other payables	22	–	–	–	(35.2)	–	(35.2)	(35.2)
Derivative financial instruments	26	–	–	–	–	(1.0)	(1.0)	(1.0)
Bank and other borrowings	26	–	–	–	(519.5)	–	(519.5)	(552.7)
Finance lease	31	–	–	–	(9.7)	–	(9.7)	(10.7)
Current								
Trade and other payables	22	–	–	–	(396.4)	–	(396.4)	(396.4)
Derivative financial instruments	25	–	–	–	–	(3.6)	(3.6)	(3.6)
Finance lease	31	–	–	–	(2.8)	–	(2.8)	(2.8)
Bank overdraft and finance costs	25	–	–	–	(2.5)	–	(2.5)	(2.5)
		–	–	–	(966.1)	(4.6)	(970.7)	(1,004.9)
Total		4.8	8.0	500.7	(966.1)	(4.6)	(457.2)	(490.0)

Notes to the financial statements (continued)

27. Financial risk management (continued)

As at 31 March 2009

all figures in £ million	note	Financial asset fair value through income statement	Available for sale	Loans and receivables	Financial liabilities at amortised cost	Derivatives used as hedges	Total carrying value	Total fair value
Financial assets								
Non-current								
Net investment in finance lease	31	–	–	11.6	–	–	11.6	12.3
Equity accounted investments	16	–	0.7	–	–	–	0.7	0.7
Other investments	17	–	15.7	–	–	–	15.7	15.7
Current								
Derivative financial instruments	15	0.1	–	–	–	–	0.1	0.1
Net investment in finance leases	31	–	–	3.0	–	–	3.0	3.0
Trade and other receivables	19	–	–	532.9	–	–	532.9	532.9
Investments	20	–	0.6	–	–	–	0.6	0.6
Cash and cash equivalents	21	–	–	262.1	–	–	262.1	262.1
		0.1	**17.0**	**809.6**	**–**	**–**	**826.7**	**827.4**
Financial liabilities								
Non-current								
Trade and other payables	22	–	–	–	(48.7)	–	(48.7)	(48.7)
Derivative financial instruments	26	–	–	–	–	(3.6)	(3.6)	(3.6)
Bank and other borrowings	26	–	–	–	(777.6)	–	(777.6)	(756.8)
Finance lease	31	–	–	–	(11.4)	–	(11.4)	(11.2)
Current								
Trade and other payables	22	–	–	–	(447.2)	–	(447.2)	(447.2)
Derivative financial instruments	25	–	–	–		(20.0)	(20.0)	(20.0)
Finance lease	31	–	–	–	(2.8)	–	(2.8)	(2.8)
Bank overdraft and finance costs	25	–	–	–	0.7	–	0.7	0.7
		–	**–**	**–**	**(1,287.0)**	**(23.6)**	**(1,310.6)**	**(1,289.6)**
Total		**0.1**	**17.0**	**809.6**	**(1,287.0)**	**(23.6)**	**(483.9)**	**(462.2)**

Market values, where available, have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting cash flows to net present values using prevailing market-based interest rates translated at year-end exchange rates, except for unlisted fixed asset investments where a fair value equals book value.

27. Financial risk management (continued)

B) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require rates to be fixed for 30–80% of the level of borrowings, but with a maximum 100% fixed for no more than 12 months. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 March 2010 98% (2009: 73%) of the Group's borrowings were at fixed rates, after adjusting for interest rate swaps.

Financial assets/(liabilities)

As at 31 March 2010

	Financial asset			**Financial liability**		
all figures in £ million	**Fixed or capped**	**Floating**	**Non-interest bearing**	**Fixed or capped**	**Floating**	**Non-interest bearing**
Sterling	**13.0**	**56.3**	**10.5**	**(12.5)**	**(0.3)**	**(0.8)**
US dollar	**–**	**4.4**	**–**	**(515.2)**	**(0.1)**	**(3.8)**
Euro	**–**	**1.4**	**–**	**–**	**(5.2)**	**–**
Australian dollar	**–**	**1.8**	**2.3**	**–**	**(1.2)**	**–**
	13.0	**63.9**	**12.8**	**(527.7)**	**(6.8)**	**(4.6)**

As at 31 March 2009

	Financial asset			Financial liability		
all figures in £ million	Fixed or capped	Floating	Non-interest bearing	Fixed or capped	Floating	Non-interest bearing
Sterling	14.6	216.1	16.5	(14.2)	(97.7)	(18.5)
US dollar	–	42.6	–	(581.1)	(69.6)	(5.1)
Euro	–	1.4	–	–	(11.6)	–
Australian dollar	–	2.0	0.6	–	(16.9)	–
	14.6	**262.1**	**17.1**	**(595.3)**	**(195.8)**	**(23.6)**

Floating rate financial assets attract interest based on the relevant national LIBID equivalent. Floating rate financial liabilities bear interest at the relevant national LIBOR equivalent. Trade and other receivables/(payables) are excluded from this analysis.

For the fixed or capped rate financial assets and liabilities, the average interest rates (including the relevant marginal cost of borrowing) and the average period for which the rates are fixed are:

	2010			2009		
	Fixed or capped £m	**Weighted average interest rate %**	**Weighted average years to maturity**	Fixed or capped £m	Weighted average interest rate %	Weighted average years to maturity
Financial assets:						
Sterling	**13.0**	**13.4%**	**5.5**	14.6	13.4%	6.5
Financial liabilities:						
Sterling	**(12.5)**	**12.1%**	**5.5**	(14.2)	12.1%	6.5
US dollar	**(515.2)**	**5.9%**	**4.8**	(581.1)	5.8%	5.5
	(527.7)	**6.1%**	**4.8**	(595.3)	5.9%	5.5

Sterling assets and liabilities consist primarily of finance leases with the weighted average interest rate reflecting the internal rate of return of those leases.

Interest rate risk management

The majority of the Group's bank and private placement borrowings were fixed through a combination of interest rate swaps and fixed rate debt. The notional principal amount of the outstanding interest rate swap contracts at 31 March 2010 was £138.4m or US$210m (31 March 2009: £188.1m or US$270m). The swaps have the economic effect of converting floating rate US dollar borrowings into fixed rate US dollar borrowings and are accounted for as cash flow hedges.

Notes to the financial statements (continued)

27. Financial risk management (continued)

C) Currency risk

Transactional currency exposure
The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that when such a sale or purchase is certain, the net foreign exchange exposure is hedged using forward foreign exchange contracts. Hedge accounting documentation and effectiveness testing are undertaken for all the Group's transactional hedge contracts.

The table below shows the Group's currency exposures, being exposures on currency transactions that give rise to net currency gains and losses recognised in the income statement. Such exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating company involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas entities.

Functional currency of the operating company

	Net foreign currency monetary assets/(liabilities)				
all figures in £ million	US dollar	Euro	Australian dollar	Other	Total
31 March 2010 – sterling	**5.1**	**1.4**	**4.1**	**0.4**	**11.0**
31 March 2009 – sterling	5.6	1.4	0.6	0.9	8.5

The amounts shown in the table take into account the effect of the forward contracts entered into to manage these currency exposures. The Group enters into forward foreign currency contracts to hedge the currency exposures that arise on sales and purchases denominated in foreign currencies, as the transaction occurs. The principal contract amounts of the outstanding forward currency contracts as at 31 March 2010 against sterling are net US dollars sold of £6.2m ($9.4m) and net Euros sold of £12.5m (€14.1m).

Translational currency exposure
The Group has significant investments in overseas operations, particularly in the United States. As a result, the sterling value of the Group's balance sheet can be significantly affected by movement in exchange rates. The Group seeks to mitigate the effect of these translational exposures by matching the net investment in overseas operations with borrowings denominated in their functional currencies unless the cost of such hedging activity is uneconomic. This is achieved by borrowing in the local currency, or in some cases indirectly through the use of forward foreign exchange contracts.

Net investment hedges
The Group had one €6 million currency loan designated as a net investment hedge at 31 March 2010, but no swap contracts. During the year the Group de-designated currency loans of $210m which had previously been used to hedge translational currency exposures, and entered into offsetting currency swaps to eliminate any future exchange exposure arising from this loan.

D) Financial credit risk

The Group is exposed to credit related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board-approved policy of only selecting counterparties with a strong investment grade long-term credit rating for cash deposits, normally at least AA – or equivalent. In the normal course of business, the Group operates notional cash pooling systems, where a legal right of set-off applies.

The maximum credit-risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables, totals £80.2m. At 31 March 2010 the maximum exposure with a single bank for deposits and cash was £41.9m, whilst the maximum mark to market exposure for derivatives was £4.8m. These exposures were with different financial institutions rated AA or better.

27. Financial risk management (continued)

E) Liquidity risk

Borrowing facilities
As at 31 March 2010, the Group had a Revolving Credit Facility (RCF) of £500m (2009: £500m). The RCF is contracted until 2012 and is utilised as shown in the table below:

	Interest rate %	Total £m	Drawn £m	Undrawn £m
Committed facilities 31 March 2010	**LIBOR plus 0.3%**	**500.0**	**143.7**	**356.3**
Freely available cash and cash equivalents				**63.9**
Available funds 31 March 2010				**420.2**
Committed facilities 31 March 2009		500.0	386.2	113.8
Freely available cash and cash equivalents				258.6
Available funds 31 March 2009				372.4

In addition to the above borrowing facilities there is debt of £376.7m (2009: £393.0m) under the US private placement.

Gross contractual cash flows for borrowings and other financial liabilities
The following are the contractual maturities of financial liabilities, including interest payments. The cash flows associated with derivatives that are cash flow hedges are expected to have an impact on profit or loss in the periods shown.

As at 31 March 2010

all figures in £ million	Book value	Contractual cash flows	1 year or less	1-2 years	3-5 years	More than 5 years
Non-derivative financial liabilities						
Trade and other payables	**(431.6)**	**(431.6)**	**(396.4)**	**(35.2)**	**–**	**–**
Bank overdrafts	**(3.2)**	**(3.2)**	**(3.2)**	**–**	**–**	**–**
US private placement debt	**(376.7)**	**(549.9)**	**(24.2)**	**(24.2)**	**(156.9)**	**(344.6)**
Multi-currency revolving facility	**(143.7)**	**(143.7)**	**–**	**–**	**(143.7)**	**–**
Recapitalisation fee	**1.6**	**–**	**–**	**–**	**–**	**–**
Finance leases	**(12.5)**	**(15.5)**	**(2.8)**	**(2.8)**	**(8.5)**	**(1.4)**
Derivative financial liabilities						
Interest rate swaps – cash flow hedges	**(3.8)**	**(3.8)**	**(2.8)**	**(0.8)**	**(0.2)**	**–**
Forward foreign currency contracts – cash flow hedges	**(0.8)**	**(0.8)**	**(0.8)**	**–**	**–**	**–**
	(970.7)	**(1,148.5)**	**(430.2)**	**(63.0)**	**(309.3)**	**(346.0)**

As at 31 March 2009

all figures in £ million	Book value	Contractual cash flows	1 year or less	1-2 years	3-5 years	More than 5 years
Non-derivative financial liabilities						
Trade and other payables	(495.9)	(495.9)	(447.2)	(15.5)	(33.2)	–
Bank overdrafts	–	–	–	–	–	–
US private placement debt	(393.0)	(601.7)	(20.7)	(25.6)	(76.8)	(478.6)
Multi-currency revolving facility	(386.2)	(389.7)	(6.2)	–	(383.5)	–
Recapitalisation fee	2.3	–	–	–	–	–
Loan notes	–	–	–	–	–	–
Finance leases	(14.2)	(18.3)	(2.8)	(2.8)	(8.4)	(4.3)
Derivative financial liabilities						
Interest rate swaps – cash flow hedges	(8.0)	(8.0)	(5.0)	(2.2)	(0.8)	–
Forward foreign currency contracts – cash flow hedges	(1.3)	(1.3)	(0.6)	(0.7)	–	–
Forward foreign currency contracts – net investment hedges	(14.3)	(14.3)	(14.3)	–	–	–
	(1,310.6)	**(1,529.2)**	**(496.8)**	**(46.8)**	**(502.7)**	**(482.9)**

Notes to the financial statements (continued)

27. Financial risk management (continued)

F) Derivative financial instruments

As at 31 March

	2010			2009		
all figures in £ million	Asset gains	Liability losses	Net	Asset gains	Liability losses	Net
Interest rate swaps	–	(3.8)	(3.8)	–	(8.0)	(8.0)
Forward foreign currency contracts – cash flow hedges	–	(0.8)	(0.8)	0.1	(2.0)	(1.9)
Forward foreign currency contracts – not designated as hedge accounted	4.8	–	4.8	–	–	–
Forward foreign currency contracts – net investment hedges	–	–	–	–	(13.6)	(13.6)
Derivative assets/(liabilities) at the end of the year	**4.8**	**(4.6)**	**0.2**	0.1	(23.6)	(23.5)

As at 31 March

	2010			2009		
all figures in £ million	Asset gains	Liability losses	Net	Asset gains	Liability losses	Net
Expected to be recognised						
In one year or less	4.8	(3.6)	1.2	0.1	(19.9)	(19.8)
Between one and two years	–	(0.8)	(0.8)	–	(2.9)	(2.9)
Between two and five years	–	(0.2)	(0.2)	–	(0.8)	(0.8)
	4.8	**(4.6)**	**0.2**	0.1	(23.6)	(23.5)

The forward currency contracts that are not hedge accounted comprise derivatives entered into during the period to offset the net investment hedges de-designated as explained earlier in Note 27C).

G) Maturity of financial liabilities

As at 31 March 2010

all figures in £ million	Trade and other payables	Bank borrowings and loan notes	Finance leases and derivative financial instruments	Total
Due in one year or less	396.4	2.5	6.4	405.3
Due in more than one year but not more than two years	35.2	(0.7)	2.6	37.1
Due in more than two years but not more than five years	–	143.5	6.7	150.2
Due in more than five years	–	376.7	1.4	378.1
	431.6	**522.0**	**17.1**	**970.7**

As at 31 March 2009

all figures in £ million	Trade and other payables	Bank borrowings and loan notes	Finance leases and derivative financial instruments	Total
Due in one year or less	447.2	(0.7)	22.8	469.3
Due in more than one year but not more than two years	15.5	(0.7)	4.9	19.7
Due in more than two years but not more than five years	33.2	385.3	7.4	425.9
Due in more than five years	–	393.0	2.7	395.7
	495.9	**776.9**	**37.8**	**1,310.6**

27. Financial risk management (continued)

H) Sensitivity analysis

The Group's sensitivity to changes in market rates on financial assets and liabilities as at 31 March 2010 is set out in the table below.

The amounts generated from the sensitivity analysis are forward-looking estimates of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from those projected results due to developments in the global financial markets which may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the table below, which therefore should not be considered a projection of likely future events and losses.

The estimated changes for interest rate movements are based on an instantaneous decrease or increase of 1 percent (100 basis points) in the specific rate of interest applicable to each class of financial instruments from the levels effective at 31 March 2010, with all other variables remaining constant. The estimated changes for foreign exchange rates are based on an instantaneous 10 percent weakening or strengthening in sterling against all other currencies from the levels applicable at 31 March 2010, with all other variables remaining constant. Such analysis is for illustrative purposes only – in practice market rates rarely change in isolation.

As at 31 March 2010

	1% decrease in interest rates		**10% weakening in sterling**	
all figures in £ million	**Equity**	**Profit before tax**	**Equity**	**Profit before tax**
Sterling	**–**	**(0.3)**	**–**	**–**
US dollar	**(3.1)**	**–**	**(41.8)**	**(3.4)**
Other	**–**	**–**	**(0.1)**	**–**

	1% increase in interest rates		**10% strengthening in sterling**	
all figures in £ million	**Equity**	**Profit before tax**	**Equity**	**Profit before tax**
Sterling	**–**	**0.5**	**–**	**–**
US dollar	**3.1**	**–**	**34.2**	**2.8**
Other	**–**	**–**	**0.1**	**–**

As at 31 March 2009

	1% decrease in interest rates		10% weakening in sterling	
all figures in £ million	Equity	Profit before tax	Equity	Profit before tax
Sterling	–	(1.1)	–	–
US dollar	(0.1)	0.6	(68.5)	(3.9)
Other	(0.1)	0.2	(2.7)	(0.1)

Notes to the financial statements (continued)

28. Cash flows from operations

all figures in £ million	Year ended 31 March 2010	Year ended 31 March 2009 (restated)*
(Loss)/profit after tax for the period	**(63.3)**	**93.6**
Adjustments for:		
Taxation	**(2.8)**	20.4
Net finance costs	**34.6**	21.4
Loss/(gain) on business divestments and impairment of investments	**6.2**	(7.3)
Amortisation of purchased or internally developed intangible assets	**11.3**	8.9
Amortisation of intangible assets arising from acquisitions and impairments	**79.5**	23.5
Depreciation and impairment of property, plant and equipment	**59.1**	33.5
Share of post tax (profit)/loss of equity accounted entities	**(0.2)**	7.2
Retirement benefit obligations deficit payments	**(13.0)**	–
Net movement in provisions	**10.9**	(32.6)
	122.3	**168.6**
Increase in inventories	**(13.1)**	(2.9)
Decrease in receivables	**89.9**	4.4
(Decrease)/increase in payables	**(29.9)**	5.1
Changes in working capital	**46.9**	**6.6**
Cash generated from operations	**169.2**	**175.2**
Add back: cash outflow relating to EMEA reorganisation	**35.4**	27.0
Net cash flow from operations before EMEA reorganisation costs	**204.6**	**202.2**

*Restatement relates to the transfer of the finance element of the IAS 19 pension cost, totalling a net £3.4m credit to the income statement, to the finance income and expense lines.

29. Reconciliation of net cash flow to movement in net debt

all figures in £ million	note	Year ended 31 March 2010	Year ended 31 March 2009
(Decrease)/increase in cash in the year		**(200.9)**	236.9
Repayment/(additional) bank loans		**232.1**	(13.3)
US private placements		**–**	(210.4)
Loan note repayments		**–**	0.5
Settlement of forward contracts designated as net investment hedges		**14.3**	–
Payment of deferred financing costs		**–**	1.5
Escrow cash receipt		**–**	(4.2)
Capital element of finance lease payments		**2.8**	2.8
Capital element of finance lease receipts		**(3.0)**	(3.0)
Change in net debt resulting from cash flows		**45.3**	**10.8**
Amortisation of deferred financing costs		**(0.7)**	(0.3)
Finance lease receivables		**1.4**	1.6
Finance lease payables		**(1.1)**	(1.4)
Foreign exchange movements and other non-cash movements		**35.6**	(168.7)
Movement in net debt in the year		**80.5**	**(158.0)**
Net debt at the start of the year		**(537.9)**	(379.9)
Net debt at the end of the year	30	**(457.4)**	**(537.9)**

30. Analysis of net debt

all figures in £ million	Year ended 31 March 2009	Cash flow	Non-cash movement	**Year ended 31 March 2010**
Due within one year				
Bank and cash	262.1	(197.7)	(0.5)	**63.9**
Bank overdraft	–	(3.2)	–	**(3.2)**
Recapitalisation fee	0.7	–	–	**0.7**
Finance lease receivables	3.0	(3.0)	3.0	**3.0**
Finance lease payables	(2.8)	2.8	(2.8)	**(2.8)**
Derivative financial assets	0.1	–	4.7	**4.8**
Derivative financial liabilities	(20.0)	14.3	2.1	**(3.6)**
	243.1	**(186.8)**	**6.5**	**62.8**
Due after one year				
Bank loan	(386.2)	232.1	10.4	**(143.7)**
Recapitalisation fee	1.6	–	(0.7)	**0.9**
US private placement	(393.0)	–	16.3	**(376.7)**
Finance lease receivables	11.6	–	(1.6)	**10.0**
Finance lease payables	(11.4)	–	1.7	**(9.7)**
Derivative financial assets	–	–	–	**–**
Derivative financial liabilities	(3.6)	–	2.6	**(1.0)**
	(781.0)	**232.1**	**28.7**	**(520.2)**
Total net debt as defined by the Group	**(537.9)**	**45.3**	**35.2**	**(457.4)**

31. Finance leases

Group as a lessor
The minimum lease receivables under finance leases fall as follows:

	Minimum lease payments		Present value of minimum lease payments	
all figures in £ million	**2010**	2009	**2010**	2009
Amounts receivable under finance leases				
Within one year	**3.0**	3.0	**3.0**	3.0
In the second to fifth years inclusive	**12.0**	12.0	**8.9**	8.9
Greater than five years	**1.5**	4.5	**1.1**	2.7
	16.5	**19.5**		
Less unearned finance income	**(3.5)**	(4.9)		
Present value of minimum lease payments	**13.0**	**14.6**	**13.0**	**14.6**
Classified as follows:				
Financial asset – current			**3.0**	3.0
Financial asset – non-current			**10.0**	11.6
			13.0	**14.6**

The Group leases out certain buildings under finance leases over a 12-year term expiring in 2015.

Notes to the financial statements (continued)

31. Finance leases (continued)

Group as a lessee
The minimum lease payments under finance leases fall due as follows:

	Minimum lease payments		Present value of minimum lease payments	
all figures in £ million	**2010**	2009	**2010**	2009
Amounts payable under finance leases				
Within one year	**2.8**	2.8	**2.8**	2.8
In the second to fifth years inclusive	**11.3**	11.3	**8.9**	8.9
Greater than five years	**1.4**	4.2	**0.8**	2.5
	15.5	18.3		
Less future finance charges	**(3.0)**	(4.1)		
Present value of minimum lease payments	**12.5**	**14.2**	**12.5**	**14.2**
Classified as follows:				
Financial liability – current			**2.8**	2.8
Financial liability – non-current			**9.7**	11.4
			12.5	**14.2**

The Group utilises certain buildings under finance leases. Average lease terms are typically between two and ten years (31 March 2009: between two and ten years).

32. Share capital and other reserves

Shares allotted, called up and fully paid:

	Ordinary shares of 1p each (equity)		Special share of £1 (non-equity)		Total	
	£	Number	£	Number	£	Number
At 1 April 2008	6,604,764	660,476,373	1	1	6,604,765	660,476,374
Issued in year	–	–	–	–	–	–
At 31 March 2009	6,604,764	660,476,373	1	1	6,604,765	660,476,374
Issued in year	–	–	–	–	–	–
At 31 March 2010	**6,604,764**	**660,476,373**	**1**	**1**	**6,604,765**	**660,476,374**

Except as noted below all shares in issue at 31 March 2010 rank pari passu in all respects.

Rights attaching to the Special Share
QinetiQ carries out activities which are important to UK defence and security interests. To protect these interests in the context of the ongoing commercial relationship between the MOD and QinetiQ, and to promote and reinforce the Compliance Principles, the MOD holds a Special Share in QinetiQ. The Special Share confers certain rights on the holder:

a) to require the Group to implement and maintain the Compliance System (as defined in the Articles of Association) so as to make at all times effective its and each member of QinetiQ Controlled Group's application of the Compliance Principles, in a manner acceptable to the Special Shareholder;

b) to refer matters to the Board or the Compliance Committee for its consideration in relation to the application of the Compliance Principles;

c) to veto any contract, transaction, arrangement or activity which the Special Shareholder considers:

   i) may result in circumstances which constitute unacceptable ownership, influence or control over QinetiQ or any other member of the QinetiQ consolidated Group contrary to the defence or security interests of the United Kingdom; or

   ii) would not, or does not, ensure the effective application of the Compliance Principles to and/or by all members of the QinetiQ Controlled Group or would be or is otherwise contrary to the defence or security interests of the United Kingdom;

d) to require the Board to take any action (including but not limited to amending the Compliance Principles), or rectify any omission in the application of the Compliance Principles, if the Special Shareholder is of the opinion that such steps are necessary to protect the defence or security interest of the United Kingdom;

e) to exercise any of the powers contained in the articles in relation to the Compliance Committee; and

f) to demand a poll at any of QinetiQ's meetings (even though it may have no voting rights except those specifically set out in the Articles).

The Special Shareholder has an option to purchase defined Strategic Assets of the Group in certain circumstances. The Special Shareholder has, inter alia, the right to purchase any Strategic Assets which the Group wishes to sell. Strategic Assets are normally testing and research facilities (see note 35 for further details).

The Special Share may only be issued to, held by and transferred to HM Government (or as it directs). At any time the Special Shareholder may require QinetiQ to redeem the Special Share at par. If QinetiQ is wound up the Special Shareholder will be entitled to be repaid the capital paid up on the Special Share before other shareholders receive any payment. The Special Shareholder has no other right to shares in the capital or profits of QinetiQ.

The Special Shareholder must give consent to a general meeting held on short notice.

The Special Share entitles the Special Shareholder to require certain persons who hold (together with any person acting in concert with them) a material interest in QinetiQ to dispose of some or all of their Ordinary Shares in certain prescribed circumstances on the grounds of national security or conflict of interest.

The Directors must register any transfer of the Special Share within seven days.

Other reserves
The translation reserve includes the cumulative foreign exchange difference arising on translation since the Group transitioned to IFRS. Movements on hedge instruments, where the hedge is effective, are recorded in the hedge reserve until the hedge ceases.

The capital redemption reserve is not distributable and was created following redemption of preference share capital and the bonus issue of shares.

Own shares
Own shares represent shares in the Company that are held by independent trusts and shares held by the employee share ownership plan. Included in retained earnings at 31 March 2010 are 6,440,256 own shares (2009: 7,911,191 shares).

33. Share-based payments

The Group operates a number of share-based payment plans for employees. The total share-based payment expense in the year was £5.8m (year to 31 March 2009: £5.6m).

2003 Employee share option scheme (2003 ESOS)
Under the employee share option scheme all employees as at 25 July 2003 received share options which vested when the Group completed its IPO and had to be exercised within ten years of grant. The options are settled by shares.

	2010		2009	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
Outstanding at start of the year	**924,186**	**2.3p**	1,210,122	2.3p
Exercised during the year	**(103,822)**	**2.3p**	(207,644)	2.3p
Forfeited during the year	**(105,524)**	**2.3p**	(78,292)	2.3p
Outstanding and exercisable at end of the year	**714,840**	**2.3p**	**924,186**	**2.3p**

The 2003 ESOS are equity settled awards and those outstanding at 31 March 2010 had an average remaining life of 3.3 years (31 March 2009: 4.3 years). In respect of the share options exercised during the year, the average share price on the date of exercise was 143p. The exercise price of the outstanding options was 2.3p.

Notes to the financial statements (continued)

33. Share-based payments (continued)

QinetiQ Share Option Scheme (QSOS)

The exercise price of the options is equal to the average market price of the Group's shares on the date of the grant. The options vest after three years. For 8,711,683 (2009: 17,930,229) of the options outstanding at the end of the year the number that will vest is dependent upon the growth of earnings per share ('EPS') over the measurement period. 25% of options will vest if EPS growth is 22.5% for the period and 100% will vest if growth is at least 52%. No options will vest if EPS growth is below 22.5%. Options will vest on a straight line basis if EPS growth is between 22.5% and 52%. There were no options subject to total shareholder return ('TSR') performance targets (2009: 173,071). For awards with a TSR performance condition, the EPS growth target is replaced by a performance target based on QinetiQ's ranking by reference to total shareholder return ('TSR') against a comparator group of FTSE listed companies over a three-year performance period such that a below median ranking will result in nil shares vesting, at the median level 30% of the options would vest and the amount vested will increase on a straight line basis such that 100% would vest if TSR reaches the upper quartile of the ranking over a three-year period.

	2010		2009	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
Outstanding at the start of the year	**18,103,300**	**190.0p**	14,043,584	187.0p
Granted during the year	**–**	**–**	4,723,464	198.5p
Forfeited during the year	**(8,966,544)**	**193.5p**	(663,748)	187.0p
Outstanding at the end of the year	**9,136,756**	**186.2p**	**18,103,300**	**190.0p**

QSOS grants are equity-settled awards and those outstanding at 31 March 2010 had an average remaining life of 0.9 years (2009: 1.0 years). The exercise price of the 2009 QSOS awards was 199p; there were no QSOS awards in 2010.

Performance Share Plan (PSP)

In the year, the Group made awards of conditional shares to certain UK senior executives under the Performance Share Plan. The awards vest after three years with 50% of the awards subject to total shareholder return conditions and 50% subject to EPS conditions as detailed in the QSOS TSR and EPS conditions above.

	2010 Number of shares	2009 Number of shares
Outstanding at the start of the year	**1,318,213**	700,804
Granted during the year	**3,219,463**	956,249
Exercised during the year	**(215,763)**	–
Forfeited during the year	**(635,290)**	(338,840)
Outstanding at the end of the year	**3,686,623**	**1,318,213**

PSP are equity settled awards and those outstanding at 31 March 2010 had an average remaining life of 2.2 years (2009: 1.9 years). There is no exercise price for these PSP awards.

Restricted Stock Units (RSU)

In the year the Group granted RSU awards to certain senior US employees under the RSU Plan. The awards vest over 1 year, 2 years, 3 years and 4 years. Half the awards are dependent on achieving QNA organic profit growth targets and half on a time-based criteria. The time-based criteria require the employee to have been in continued service up to the date of vesting. QNA organic profit growth is measured over the most recent financial year compared with the previous financial year, with 125% of this element awarded at QNA organic profit growth rate above 15%, 100% awarded at 12.5%, 75% awarded at 10% and 25% awarded at 5%.

	2010 Number of shares	2009 Number of shares
Outstanding at the start of the year	**3,694,277**	1,657,330
Granted during the year	**5,304,501**	2,358,130
Exercised during the year	**(1,087,219)**	(94,482)
Forfeited during the year	**(590,331)**	(226,701)
Outstanding at the end of the year	**7,321,228**	**3,694,277**

RSU are equity settled awards and those outstanding at 31 March 2010 had an average remaining life of 1.7 years (2009: 1.7 years). There is no exercise price for these RSU awards.

33. Share-based payments (continued)

Group Share Incentive Plan (SIP)
Under the QinetiQ Share Incentive Plan the Group offers UK employees the opportunity of purchasing up to £125 worth of shares a month at the prevailing market rate. The Group will make a matching share award of a third of the employee's payment. The Group's matching shares may be forfeited if the employee ceases to be employed by QinetiQ within 3 years of the award of the shares. There is no exercise price for these SIP awards.

	2010 Number of matching shares	2009 Number of matching shares
Outstanding at the start of the year	**1,252,730**	871,331
Granted during the year	**555,688**	420,907
Exercised during the year	**(430,743)**	–
Forfeited during the year	**(38,132)**	(39,508)
Outstanding at the end of year	**1,339,543**	**1,252,730**

SIP matching shares are equity settled awards and those outstanding at 31 March 2010 had an average remaining life of 1.5 years (2009: 1.5 years). There is no exercise price for these SIP awards.

Group Deferred Annual Bonus Plan (DAB)
Under the QinetiQ Deferred Annual Bonus Plan the Group requires certain senior executives to defer part of their annual bonus as shares and be entitled to matching awards to a maximum of 1:1 based upon EPS performance. The number that will vest is dependent upon the growth of EPS over the measurement period of 3 years as detailed in the QSOS EPS conditions above. No awards will vest if EPS growth in the vesting period is below 22.5%.

	2010 Number of matching shares	2009 Number of matching shares
Outstanding at the start of the year	**83,539**	–
Granted during the year	**6,859**	94,137
Exercised during the year	**(25,155)**	–
Forfeited during the year	**(53,255)**	(10,598)
Outstanding at the end of the year	**11,988**	**83,539**

DAB matching shares are equity settled awards and those outstanding at 31 March 2010 had an average remaining life of 1.8 years (2009: 2.3 years). There is no exercise price for these DAB awards.

Share-based award pricing – options
Share options (excluding TSR performance related) and awards under the deferred annual bonus plan have been valued using Black-Scholes models to determine the fair value of awards. Assumptions used within the models were as follows for awards in 2009, there were no such awards in 2010:

	2009
Share price at date of grant (pence)	198.5p
Exercise price (pence)	198.5p
Volatility %	31.0%
Average expected term to exercise	3 years
Risk-free rate %	4.3%
Expected dividend yield %	2.2%

No such assumptions have been disclosed in the current year, as no QSOS awards have been made in the year ended 31 March 2010. The average share price in 2009 was 179.7p. The expected volatility assumption is based on the average historic volatility of QinetiQ's share price at the date of grant (commensurate with the vesting period to the extent possible).

Notes to the financial statements (continued)

33. Share-based payments (continued)

Share-based award pricing – other
Share-based awards involving market based performance conditions, including those based on TSR, have used Monte Carlo models to determine the fair value at grant date. Assumptions used in these models included 41% (2009: 32%) for the average share price volatility of the FTSE comparator group and 36% (2009: 33%) for the average correlation to comparator group. The fair value for these awards (before the probability of lapsing) in the year ended March 2010 was 66.5p (2009: 119.1p).

Share-based awards that vest based upon non-market performance conditions, including certain PSP, RSUs and Deferred Annual Bonus awards, have been valued at the share price at grant less attrition. For the 2003 Share Option Scheme, there was a pre-bonus issue weighted average share price of £1 and a weighted average exercise price of £1 based on third-party transactions in the Company's shares in the period immediately prior to the issue of the share options. Prior to IPO in February 2006 there was no active market for the Company's shares therefore expected volatility was determined using the average volatility for a comparable selection of businesses. At this time the Group had no established pattern of dividend payments, therefore no dividends were assumed in this model.

34. Operating leases

Group as a lessor
The Group receives rental income on certain properties. The Group had contracted with tenants for the following future minimum lease payments:

all figures in £ million	2010	2009
Within one year	**4.6**	6.3
In the second to fifth years inclusive	**16.3**	11.5
Greater than five years	**–**	–
	20.9	**17.8**

Group as a lessee

all figures in £ million	2010	2009
Lease and sublease income statement expense – minimum lease payments	**23.3**	**18.9**

The Group had the following future minimum lease payment commitments:

all figures in £ million	2010	2009
Within one year	**16.9**	17.3
In the second to fifth years inclusive	**50.4**	52.5
Greater than five years	**33.2**	22.7
	100.5	**92.5**

Operating lease payments represent rentals payable by the Group on certain office property and plant. Leases are negotiated for an average of three to ten years.

35. Transactions with MOD

The MOD continues to own its special share in QinetiQ which conveys certain rights as set out in note 32. Transactions between the Group and the MOD are disclosed as follows:

Freehold land and buildings and surplus properties
Under the terms of the Group's acquisition of part of the business and certain assets of DERA from the MOD on 1 July 2001, the MOD retained certain rights in respect of the freehold land and buildings transferred.

i) Restrictions on transfer of title
The title deeds of those properties designated as strategic assets (see below) include a clause that prevents their transfer without the approval of the MOD. The MOD also has the right to purchase any strategic assets in certain circumstances.

ii) Property clawback agreement
The MOD retains an interest in future profits on disposal following a 'trigger event'. A 'trigger event' includes the granting of planning permission for development and/or change of use, and the disposition of any of the acquired land and buildings. During the 12 years from 1 July 2001, following a 'trigger event', the MOD is entitled to clawback a proportion of the gain on each individual property transaction in excess of a 30% gain on a July 2001 professional valuation. The proportion of the excess gain due to the MOD is based on a sliding scale which reduces over time from 50% to 9% and at 31 March 2010 stands at 28% (2009: 33%). The July 2001 valuation was approximately 16% greater in aggregate than the consideration paid for the land and buildings on 1 July 2001.

Compliance Regime
The Compliance Committee monitors the effective application of the Compliance Regime required by the MOD to maintain the position of QinetiQ as a supplier of independent and impartial scientific/technical advice to the MOD and ensures that the required standards are met in trials involving human volunteers.

Strategic assets
Under the Principal Agreement with the MOD, the QinetiQ controlled Group is not permitted without the written consent of the MOD, to:

i) dispose of or destroy all or any part of a strategic asset; or

ii) voluntarily undertake any closure of, or cease to provide a strategic capability by means of, all or any part of a strategic asset.

The net book value of assets identified as being strategic assets as at 31 March 2010 was £2.5m (31 March 2009: £2.7m), the principal items being plant and machinery.

Long-Term Partnering Agreement
On 27 February 2003 QinetiQ Limited entered into a Long-Term Partnering Agreement to provide the Test and Evaluation (T&E) facilities and training support services to the MOD. This is a 25-year contract with a total revenue value of up to £5.6bn, dependent on the level of usage by MOD, under which QinetiQ Limited is committed to providing the T&E services with increasing efficiencies through cost saving and innovative service delivery.

36. Directors and other senior management personnel

The remuneration of Directors and other senior management personnel of the Group during the year to 31 March 2010 is set out below.

all figures in £ million	**2010**	2009
Short-term employee remuneration including benefits	**5.4**	3.2
Post-employment benefits	**0.1**	0.2
Share-based payments expense	**1.0**	1.0
Total	**6.5**	**4.4**

Short-term employee remuneration and benefits include salary, bonus, and benefits. Post-employment benefits relate to pension amounts.

Notes to the financial statements (continued)

37. Contingent liabilities and assets

The Group, including subsidiary undertakings, have given unsecured guarantees primarily on leased properties and bank lines of £55.1m at 31 March 2010 (31 March 2009: £34.7m) in the ordinary course of business.

The Group is aware of claims and potential claims by or on behalf of current and former employees, including former employees of the MOD and DERA and contractors, in respect of intellectual property, employment rights and industrial illness and injury which involve or may involve legal proceedings against the Group. The Directors are of the opinion, having regard to legal advice received, and the Group's insurance arrangements and provisions carried in the balance sheet, that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position, results of operations and liquidity.

The Group has not recognised contingent amounts receivable relating to the Chertsey property which was disposed of during 2004 or the Fort Halstead property disposed of in September 2005. Additional consideration, subject to clawback to the MOD pursuant to the arrangements referred to in note 35, is potentially due upon the purchasers obtaining additional planning consents, with the quantum dependent on the scope of the consent achieved.

38. Post-retirement benefits

Triennial funding valuation
The most recent full actuarial valuation of the defined benefit section of the QinetiQ Pension Scheme was undertaken as at 30 June 2008 and resulted in an actuarially assessed deficit of £111.3m. On the basis of this full valuation the Trustees of the scheme and the Company agreed the employer contribution rate of 11.5% from 30 June 2009, and past service deficit recovery payments of £13m per year for a 10-year period from this date.

Introduction and background to IAS 19
International Accounting Standard 19 (Employee Benefits) requires the Group to include in the balance sheet the surplus or deficit on defined benefit schemes calculated as at the balance sheet date. It is a snapshot view which can be significantly influenced by short-term market factors. The calculation of the surplus or deficit is, therefore, dependent on factors which are beyond the control of the Group – principally the value at the balance sheet date of equity shares in which the scheme has invested and long-term interest rates which are used to discount future liabilities. The funding of the scheme is based on long-term trends and assumptions relating to market growth, as advised by qualified actuaries.

The QinetiQ Pension Scheme
In the UK the Group operates the QinetiQ Pension Scheme for the majority of its UK employees, a mixed benefit scheme. The Defined Benefit (DB) section of the scheme provides future service pension benefits to transferring Civil Service employees. All Group employees who were members, or eligible to be members, of the Principal Civil Service Pension Scheme or the UKAEA principal Non-Industrial Superannuation Scheme were invited to join the DB section of the scheme from 1 July 2001, together with all new employees who were previously members of schemes who are part of the Public Sector Transfer Club. On 31 March 2010, the Group withdrew from the Public Sector Transfer Club. The Defined Contribution (DC) section of the scheme was set up for employees who were not eligible or did not wish to join the DB section of the scheme.

Other UK schemes
In the UK the Group operates one further small defined benefit scheme, QinetiQ Prudential Platinum Scheme. The net pension deficits of this scheme at 31 March 2010 amounted to £0.2m (31 March 2009: £0.2m). There were no outstanding or prepaid contributions at the balance sheet date (March 2009: £nil). Set out below is a summary of the overall IAS 19 defined benefit pension schemes' liabilities. The fair value of the schemes' assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the schemes' liabilities, which are derived from cash flow projections over long periods, and thus inherently uncertain, were:

all figures in £ million	**2010**	2009	2008	2007
Equities	**714.6**	473.7	620.8	641.5
Corporate bonds	**69.5**	78.4	83.9	74.5
Government bonds	**69.6**	83.2	76.3	74.7
Property	**53.4**	–	–	–
Cash	**8.8**	12.1	3.2	3.4
Total market value of assets	**915.9**	647.4	784.2	794.1
Present value of scheme liabilities	**(1,063.2)**	(752.6)	(807.6)	(884.9)
Net pension liability before deferred tax	**(147.3)**	**(105.2)**	**(23.4)**	**(90.8)**
Deferred tax asset	**41.2**	29.4	6.5	27.1
Net pension liability	**(106.1)**	**(75.8)**	**(16.9)**	**(63.7)**

38. Post-retirement benefits (continued)

Assumptions
The major assumptions (weighted to reflect individual scheme differences) were:

	2010	2009
Rate of increase in salaries	**4.6%**	4.1%
Rate of increase in pensions in payment	**3.6%**	3.1%
Rate of increase in pensions in deferment	**3.6%**	3.1%
Discount rate applied to scheme liabilities	**5.6%**	6.5%
Inflation assumption	**3.6%**	3.1%
Assumed life expectancies in years		
Future male pensioners (currently aged 60)	**87**	87
Future female pensioners (currently aged 60)	**89**	89
Future male pensioners (currently aged 40)	**89**	89
Future female pensioners (currently aged 40)	**90**	90

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice. It is important to note that these assumptions are long term, and in the case of the discount rate and the inflation rate are measured by external market indicators. The life expectancy assumptions for mortality have remained unchanged in the year to 31 March 2010 with the base tables for mortality in line with the Medium Cohort projections with minimum annual rates of improvement of 1% for males and 0.5% for females (2009: improvement 1% for males and 0.5% for females). The current mortality rates reflect the standard tables PNMA00MC (for males) and PNFA00MC (for females) for members' year of birth. These mortality tables are published by the Continuous Mortality Investigation and adopted by the actuarial profession.

Scheme assets
The overall expected rate of return on plan assets is based upon the expected return rates for each asset class. Equity return rates are the long-term expected return rates based upon the market rates of return for risk free investments, typically government bonds, together with the historical level of risk premium associated with equities; with the resulting rate then being reviewed and benchmarked against a peer group of listed companies. Expected long-term rates of return on scheme assets (weighted to reflect the individual scheme actual asset allocations) were:

	2010	2009
Equities	**8.0%**	8.0%
Corporate bonds	**5.5%**	6.0%
Government bonds	**4.4%**	3.8%
Property	**8.5%**	–
Cash	**4.3%**	4.0%
Weighted average	**7.5%**	**7.1%**

Return on scheme assets

all figures in £ million	2010	2009
Actual return on plan assets:		
Expected return on scheme assets	**46.3**	56.5
Actuarial gain/(loss) on scheme assets	**206.6**	(212.8)
Actual gain/(loss) on scheme assets	**252.9**	**(156.3)**

Value of scheme assets

all figures in £ million	2010	2009
Changes to the fair value of scheme assets:		
Opening fair value of scheme assets	**647.4**	784.2
Expected return on assets	**46.3**	56.5
Actuarial gain/(loss) on scheme assets	**206.6**	(212.8)
Contributions by the employer	**38.4**	37.3
Contributions by plan participants	**0.3**	1.3
Scheme disposal – ASAP Calibration Limited	**(0.6)**	–
Net benefits paid out and transfers	**(22.5)**	(19.1)
Closing fair value of scheme assets	**915.9**	**647.4**

Notes to the financial statements (continued)

38. Post-retirement benefits (continued)

Changes to the present value of the defined benefit obligation

all figures in £ million	2010	2009
Opening defined benefit obligation	**752.6**	807.6
Current service cost	**20.0**	26.8
Interest cost	**48.8**	53.1
Contributions by plan participants	**0.3**	1.3
Actuarial loss/(gains) on scheme liabilities	**266.8**	(117.1)
Scheme disposal – ASAP Calibration Limited	**(0.8)**	–
Curtailment gain	**(2.0)**	–
Net benefits paid out and transfers	**(22.5)**	(19.1)
Closing defined benefit obligation	**1,063.2**	**752.6**

Total expense recognised in the income statement

all figures in £ million	2010	2009
Pension costs charged to the income statement:		
Current service cost	**20.0**	26.8
Interest cost	**48.8**	53.1
Expected return on plan assets	**(46.3)**	(56.5)
Curtailment	**(2.0)**	–
Total expense recognised in the income statement (gross of deferred tax)	**20.5**	**23.4**

Analysis of amounts recognised in Statement of recognised income and expense

all figures in £ million	2010	2009	2008	2007
Total actuarial (loss)/gain (gross of deferred tax)	**(60.2)**	(95.7)	65.5	85.8
Cumulative total actuarial losses recognised in the Statement of recognised income and expense	**(253.4)**	**(193.2)**	**(97.5)**	**(163.0)**
History of scheme experience gains and losses*				
Experience gains/(losses) on scheme assets	**206.6**	(212.8)	(83.9)	7.4
Experience (losses)/gains on scheme liabilities	**(2.9)**	37.1	(1.0)	–

* Experience gains and losses exclude the impact of changes in assumptions.

The expected employer cash contribution to the defined benefit scheme for the year ending 31 March 2011 is £36.5m (2010: £38.4m).

Defined contribution schemes
Payments to the defined contribution schemes totalled £24.6m (March 2009: £23.2m).

39. Capital commitments

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

all figures in £ million	2010	2009
Contracted	**5.9**	**5.0**

Capital commitments at 31 March 2010 include £5.5m (2009: £3.9m) in relation to property, plant and equipment that will be wholly-funded by a third-party customer under long-term contract arrangements.

40. Subsidiaries

The principal subsidiary undertakings at 31 March 2010, all of which are included in the consolidated financial statements are shown below.

Name of company	Principal area of operation	Country of incorporation
Subsidiaries[1] [2] [3]		
QinetiQ Holdings Limited	UK	England & Wales
QinetiQ Limited	UK	England & Wales
QinetiQ Overseas Holdings Limited	UK	England & Wales
QinetiQ North America, Inc.	USA	USA
QinetiQ North America Operations, LLC	USA	USA
Analex Corporation	USA	USA
Apogen Technologies, Inc.	USA	USA
Foster-Miller, Inc.	USA	USA
Westar Aerospace & Defence Group, Inc.	USA	USA

[1] Accounting reference date is 31 March. All principal subsidiary undertakings listed above have financial year ends of 31 March and 100% of the ordinary shares are owned by the Group.
[2] QinetiQ Holdings Limited is a direct subsidiary of QinetiQ Group plc. All other subsidiaries are held indirectly by other subsidiaries of QinetiQ Group plc.
[3] All companies except for holding companies are operating companies engaged in the Group's principal activities as described in the Report of the Directors on page 42.

Company balance sheet

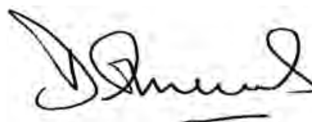
as at 31 March

all figures in £ million	note	2010	2009
Fixed assets			
Investments in subsidiary undertaking	2	**108.7**	102.9
		108.7	**102.9**
Current assets			
Debtors	3	**303.9**	164.8
		303.9	**164.8**
Current liabilities			
Creditors amounts falling due within one year	4	**(91.0)**	–
Net current assets		**212.9**	**164.8**
Net assets		**321.6**	**267.7**
Capital and reserves			
Equity share capital	5, 6	**6.6**	6.6
Capital redemption reserve	6	**39.9**	39.9
Share premium account	6	**147.6**	147.6
Profit and loss account	6	**127.5**	73.6
Capital and reserves attributable to shareholders		**321.6**	**267.7**

There are no other recognised gains and losses.

The financial statements of QinetiQ Group plc (company number 04586941) were approved by the Board of Directors and authorised for issue on 2 June 2010, and were signed on its behalf by:

Leo Quinn Chief Executive Officer



David Mellors Chief Financial Officer

Notes to the Company financial statements

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

Basis of preparation
The financial statements have been prepared under the historical cost convention and in accordance with applicable UK accounting standards. As permitted by section 408(4) of the Companies Act 2006, a separate profit and loss account dealing with the results of the Company has not been presented.

Investments
In the Company's financial statements, investments in subsidiary undertakings are stated at cost less any impairment in value.

Share-based payments
The fair value of equity-settled awards for share-based payments is determined on grant and expensed straight line over the period from grant to the date of earliest unconditional exercise. The fair value of cash-settled awards for share-based payments is determined each period end until they are exercised or lapse. The value is expensed straight line over the period from grant to the date of earliest unconditional exercise. The charges for both equity and cash-settled share-based payments are updated annually for non-market-based vesting conditions. Further details of the Group's share-based payment charge are disclosed in Note 33 of the Group Financial Statements. The cost of share-based payments is charged to subsidiary undertakings.

2. Investment in subsidiary undertaking

As at 31 March

all figures in £ million	**2010**	2009
Subsidiary undertaking – 100% of ordinary share capital of QinetiQ Holdings Limited	**108.7**	102.9

A list of all principal subsidiary undertakings of QinetiQ Group plc is disclosed in note 40 to the Group financial statements. The £5.8m (2009: £5.6m) increase in investment in the year relates to the capital contribution in relation to share-based payments for employees of subsidiary companies.

3. Debtors

As at 31 March

all figures in £ million	**2010**	2009
Amounts owed by Group undertakings	**303.9**	164.7
Other debtors	**–**	0.1
	303.9	164.8

4. Creditors

As at 31 March

all figures in £ million	**2010**	2009
Amounts owed to Group undertakings	**91.0**	–

Notes to the Company financial statements (continued)

5. Share capital

The Company's share capital is disclosed in note 32 to the Group financial statements.

6. Reserves

all figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Profit and loss	Total equity
At 1 April 2009	**6.6**	**39.9**	**147.6**	**73.6**	**267.7**
Profit	**–**	**–**	**–**	**80.5**	**80.5**
Purchase of own shares	**–**	**–**	**–**	**(0.8)**	**(0.8)**
Dividend paid	**–**	**–**	**–**	**(31.6)**	**(31.6)**
Share-based payments	**–**	**–**	**–**	**5.8**	**5.8**
At 31 March 2010	**6.6**	**39.9**	**147.6**	**127.5**	**321.6**
At 1 April 2008	6.6	39.9	147.6	85.6	279.7
Profit	–	–	–	12.1	12.1
Purchase of own shares	–	–	–	(0.8)	(0.8)
Dividend paid	–	–	–	(28.9)	(28.9)
Share-based payments	–	–	–	5.6	5.6
At 31 March 2009	6.6	39.9	147.6	73.6	267.7

The capital redemption reserve is not distributable and was created following redemption of Preference Share capital.

7. Share-based payments

The Company's share-based payment arrangements are set out in note 33 to the Group financial statements.

8. Other information

Directors' emoluments, excluding Company pension contributions, were £2.8m (2009: £1.3m). These emoluments were all in relation to services provided on behalf of the QinetiQ Group with no amount specifically relating to their work for the Company. Details of the Directors' emoluments, share schemes and entitlements under money purchase pension schemes are disclosed in the Report of the Remuneration Committee. Details of one-off payments made to Directors during the year can be found in the footnotes on page 40.

The remuneration of the Company's auditor for the year to 31 March 2010 was £5,000 (2009: £5,000) all of which was for statutory audit services. No other services were provided by the auditor to the Company.

Five-year record for the years ended 31 March (unaudited)

		2010	2009	2008	2007	2006
QinetiQ North America	£m	**800.1**	765.6	540.2	358.2	248.4
EMEA	£m	**818.8**	842.3	820.1	779.3	797.2
Ventures	£m	**6.5**	9.4	5.7	12.0	6.1
Revenue	£m	**1,625.4**	**1,617.3**	**1,366.0**	**1,149.5**	**1,051.7**
QinetiQ North America	£m	**67.7**	83.0	62.1	39.9	24.5
EMEA[2]	£m	**61.1**	84.2	71.6	66.9	74.0
Ventures	£m	**(8.5)**	(15.6)	(15.1)	(6.9)	(7.5)
Operating profit[1] [2]	£m	**120.3**	**151.6**	**118.6**	**99.9**	**91.0**
Operating margin[1]	%	**7.4**	9.4	8.7	8.7	8.7
Underlying* profit before tax[1]	£m	**85.7**	130.2	109.0	94.0	80.1
(Loss)/profit before tax	£m	**(66.1)**	114.0	51.4	89.3	72.5
(Loss)/profit after tax	£m	**(63.3)**	93.6	47.4	69.0	60.4
Underlying* basic EPS	pence	**11.1**	15.9	13.4	11.3	10.2
Diluted EPS	pence	**(9.7)**	14.3	7.2	10.3	9.8
Basic EPS	pence	**(9.7)**	14.3	7.2	10.5	10.0
Dividend per share	pence	**1.58**	4.75	4.25	3.65	2.25
Underlying cash flow from operations post capex*	£m	**174.3**	169.8	100.3	60.1	76.9
Net debt	£m	**457.4**	537.9	379.9	300.8	233.0
Average number of employees		**13,580**	13,882	13,470	11,870	11,024
Orders	£m	**1,400.9**	1,596.0	1,277.1	1,214.0	816.7

(1) Underlying measures are stated before amortisation of intangibles arising from acquisitions, EMEA reorganisation costs in 2010 and 2008 and restructuring costs in 2005, IPO costs in 2006, profit on disposal of interests in subsidiaries, profit on disposal of interest in associates and business divestments and unrealised impairment of investments and tangible fixed assets.

(2) Operating profit and operating margins for 2009, 2008, 2007 and 2006 have been restated to show the net finance element of the IAS19 pension cost in the finance income and expense lines. This was previously reported in other operating costs.

* Definitions of underlying measures of performance are in the glossary on page 98. Underlying financial measures are presented, as the Board believes these provide a better representation of the Group's long-term performance trend.

Glossary

AGM Annual General Meeting

Book to bill ratio Ratio of funded orders received in the year to revenue for the year, adjusted to exclude revenue from the 25-year LTPA contract

CMG Carbon Management Group

Compliance Principles The principles underlying the Compliance Regime, covering impartiality, integrity, conflicts, confidentiality and security

CR Corporate Responsibility

defra Department for Environment Food and Rural Affairs

DHS US Department of Homeland Security

DoD US Department of Defense

Dragon Runner™ A small, unmanned, man-portable ground vehicle intended for use in urban environments

DTR MOD's Defence Training Review programme

EBITDA Earnings before interest, tax, depreciation, amortisation, gains/loss on business divestments, unrealised impairment of investment and disposal of non-current assets

EMEA Europe, Middle East and Australasia

EU European Union

Funded backlog The expected future value of revenue from contractually committed and funded customer orders (excluding £4.1bn value of the remaining 18 years of LTPA contract)

Gearing ratio The gearing is the ratio of net debt at the balance sheet date translated at average exchange rates for the period, to EBITDA generated in the 12-month period to balance sheet date, annualised and calculated in accordance with the Group's credit facility ratios.

HSE Health and Safety Executive

HS&E Health, Safety and Environment

IAS International Accounting Standards

IFRS International Financial Reporting Standards

IPO Initial Public Offering

LIBID London inter-bank bid rate

LIBOR London inter-bank offered rate

LSE London Stock Exchange

LTPA Long-Term Partnering Agreement – 25-year contract established in 2003 to manage the MOD's test and evaluation ranges

MOD UK Ministry of Defence

MRAP Mine Resistant Ambush Protected – armoured vehicle

MSCA Maritime Strategic Capability Agreement

NASA National Aeronautics and Space Administration (USA)

OCI Organisational Conflicts of Interest

Organic Growth The level of year-on-year growth, expressed as a percentage, calculated at constant foreign exchange rates, adjusting comparatives to incorporate the results of acquired entities and excluding the results for any disposals or discontinued operations for the same duration of ownership as the current period

QNA QinetiQ North America

R&D Research & Development

RFID Radio frequency identification

RIDDOR Reporting of Injuries, Diseases & Dangerous Occurrences Regulations

Specific non-recurring items and acquisition amortisation Major restructuring costs, disposal of non-current assets, business divestments, amortisation of intangible assets arising from acquisitions and impairment of investments

SSSI Site of Special Scientific Interest

STEM Science, Technology, Engineering and Mathematics educational programme

TALON® Powerful, durable, lightweight tracked vehicles that are widely used for explosive ordnance disposal (EOD) and reconnaissance, etc.

TRACE Transparent Agents and Contracting Entities

TSR Total Shareholder Return

UAV Unmanned Aerial Vehicle

UGV Unmanned Ground Vehicle

UK GAAP UK Generally Accepted Accounting Practice

Underlying earnings per share Basic earnings per share as adjusted for gain/loss on business divestments, disposal of non-current assets, unrealised impairment of investments, major reorganisation costs and amortisation of intangible assets arising from acquisitions and tax thereon

Underlying effective tax rate The tax charge for the year excluding the tax impact on gain/loss on business divestments, disposal of non-current assets, unrealised impairment of investments, major reorganisation costs, acquisition amortisation and any tax rate change effect expressed as a percentage of underlying profit before tax

Underlying net cash from operations Net cash flow from operations before EMEA reorganisation costs and after capital expenditure.

Underlying cash conversion ratio The ratio of net cash flow from operations (excluding major reorganisations), less outflows on the purchase of intangible assets and property, plant and equipment to underlying operating profit excluding share of post-tax result of equity accounted joint ventures and associates

Underlying operating margin Underlying operating profit expressed as a percentage of revenue

Underlying operating profit/(loss) Earnings before interest, tax, gain/loss on business divestments, disposal of non-current assets, unrealised impairment of investments, major reorganisation costs and amortisation of intangibles arising on acquisitions

Underlying profit before tax Profit before tax excluding gain/loss on business divestments, disposal of non-current assets, unrealised impairment of investments, major reorganisation costs and amortisation of intangible assets arising from acquisitions

UXO Unexploded ordnance

Additional information

Financial calendar

29 July 2010	Interim management statement
29 July 2010	Annual General Meeting
30 September 2010	Interim financial period end
18 November 2010	Interim results announcement
February 2011	Interim management statement (Provisional date)
31 March 2011	Financial year end
May 2011	Preliminary results announcement

Analysis of shareholders*

Institutional investors with a shareholding greater than 0.5m shares	93%
Other (including employees, management and financial institutions with a shareholding less than 0.5m shares)	7%
	100%

* Analysis as at 24 May 2010

Auditor

KPMG Audit Plc
8 Salisbury Square
London
EC4Y 8BB

Advisors

Corporate brokers
JP Morgan Cazenove
20 Moorgate
London
EC2R 6DA

UBS Investment Bank
1 Finsbury Avenue
London
EC2M 2PP

Principal legal advisors
Herbert Smith LLP
Exchange House
Primrose Street
London
EC2A 2HS

Principal Bankers
Lloyds TSB Plc
25 Gresham Street
London
EC2V 7HN

Registrars
Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

Company information

Company Registration Number 4586941

Registered office
85 Buckingham Gate
London
SW1E 6PD

Where can you learn more?

www.QinetiQ.com

www.QinetiQ.com/Investors

www.QinetiQ.com/cr

View our report online at www.QinetiQ.com/Investors
The QinetiQ Annual Report 2010 can be viewed at www.QinetiQ.com/Investors along with further useful shareholder information and information on the Company, its performance, the Annual General Meeting and latest presentations.

For more information visit: www.QinetiQ.com
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- Results and trading updates
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Electronic communication
QinetiQ has taken full advantage of changes brought about by the Companies Act 2006 which recognises the growing importance of electronic communications and allows companies to provide documentation and communications to shareholders via their websites (except to those who have specifically elected to receive a hardcopy (i.e. paper)).

The wider use of electronic communications enables fast receipt of documents, reduces the Company's printing, paper and postal costs and has a positive impact on the environment.

Shareholders may also cast their vote for the 2010 AGM online quickly and easily using the Sharevote-service by using www.sharevote.co.uk

Corporate responsibility
Read more about our Corporate responsibility policy at www.QinetiQ.com/cr

Design
Outfit
www.outfitcreate.com

Production
InHouse Productions
www.inhouse-productions.co.uk

Print management
Urban Life Support
www.urbanlifesupport.co.uk

Photography
Andrew Molyneux
www.molyneuxassociates.com

Print
Park Communications
www.parkcom.co.uk

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Company Registration Number
4586941

Registered office
85 Buckingham Gate
London
SW1E 6PD

Customer Contact Team
QinetiQ
Cody Technology Park
Ively Road, Farnborough
Hampshire
GU14 0LX
United Kingdom

Tel +44 (0) 8700 100 942
www.QinetiQ.com

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