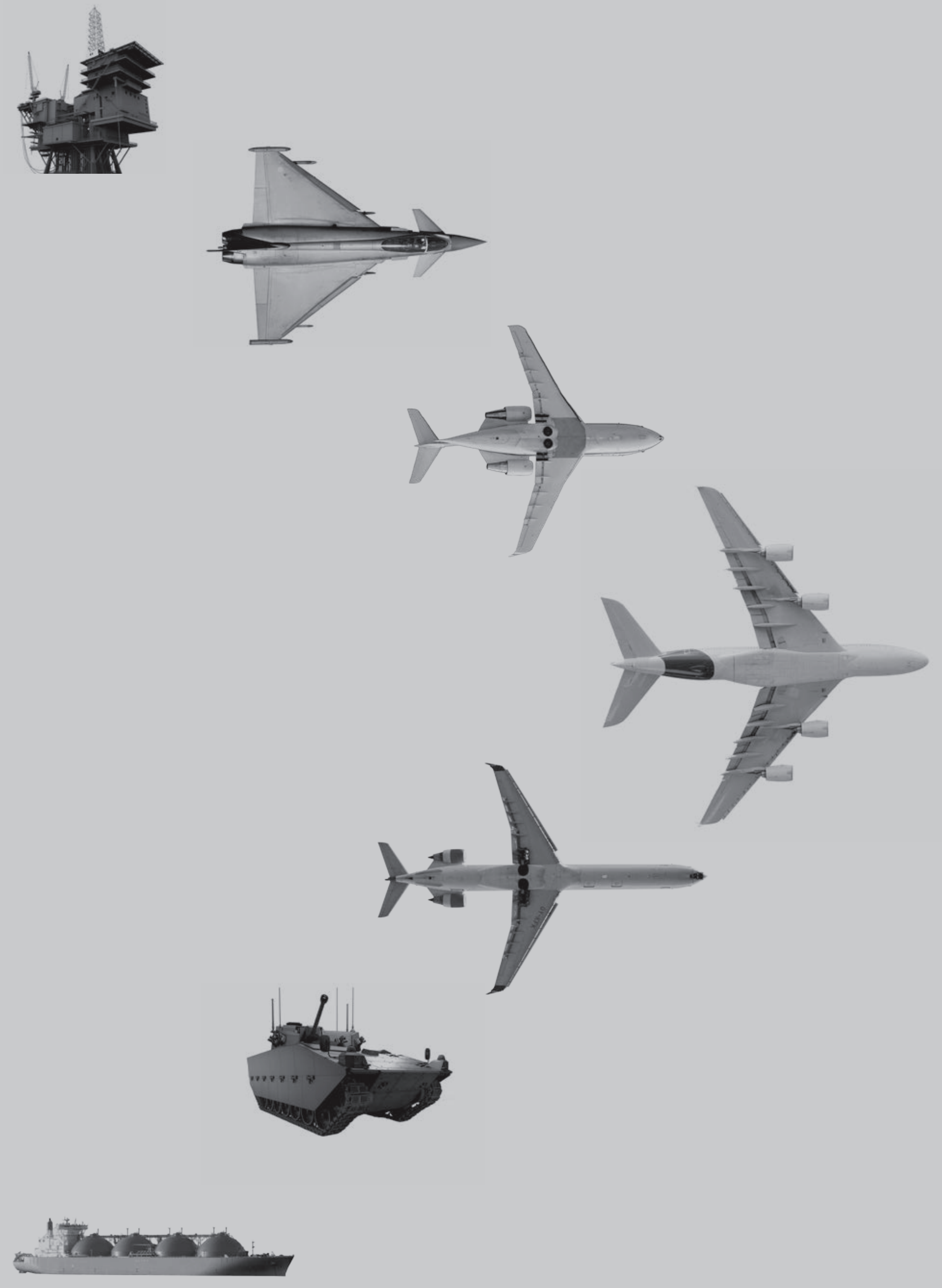
MEGGITT

smart engineering for
extreme environments



# ANNUAL REPORT AND ACCOUNTS **2013**

# Quick reference



# Contents



Download the 2013 Meggitt PLC annual report and accounts from www.meggitt.com

# Group overview

Headquartered in the UK, Meggitt PLC is a global engineering group specialising in *smart engineering for extreme environments*—components and sub-systems providing critical functionality in challenging applications within civil aerospace, military and energy markets.

A workforce of over 10,500 people is employed across facilities in Asia, Europe and North America and in regional bases in Brazil, India and the Middle East.

Meggitt's civil aerospace interests cover large commercial jets, regional aircraft, business jets, helicopters and general aviation.

Its military markets encompass all aircraft types, land systems, naval platforms and aerial, land-based and marine threat simulation for personnel training and weapons systems development. Training extends to law enforcement and security organisations.

The Group's growing presence in energy is driven by control valves for industrial gas turbines; heat transfer engineering for oil and gas platforms and offshore gas processing and storage; and sensing and monitoring capabilities deployed in rotating power generation equipment to promote safety and reduce maintenance costs, fuel consumption and carbon emissions.

The transfer of Meggitt's core technologies to other markets includes sensing materials for breakthrough medical devices.

**Revenue by market**
Total revenue (£ millions)

1,637.3

- **Civil aerospace** 736.2 | 45%
- **Military** 616.4 | 38%
- **Energy and other** 284.7 | 17%

**Employees by region**
Number of employees

10,715

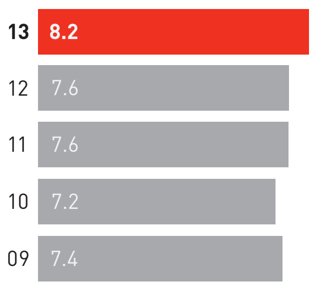
- **North America** 5,514 | 51%
- **UK** 2,797 | 26%
- **Mainland Europe** 1,589 | 15%
- **Rest of World** 815 | 8%

**Revenue by destination**
Total revenue (£ millions)

1,637.3

- **USA** 811.7 | 50%
- **UK** 165.8 | 10%
- **Rest of Europe** 365.1 | 22%
- **Rest of World** 294.7 | 18%

**Total R&D as a % of revenue**



# Financial highlights

Meggitt's 2013 results continued to demonstrate the breadth and resilience of its portfolio. Our equipment is installed on over 60,000 aircraft worldwide—a growing fleet—with a stable aftermarket revenue stream stretching out for many decades. Our excellent win rate on the many new aircraft programmes entering service, which drove our investment in research and development of £134.9m (8.2% of revenue), gives us confidence in making further good progress in the years to come.

## Revenue

(£ millions)

1,637.3

| | |
|---|---|
| **13** | **1,637.3** |
| 12 | 1,605.8 |
| 11 | 1,455.3 |
| 10 | 1,162.0 |
| 09 | 1,150.5 |

» See page 22

## Underlying profit before tax

(£ millions)[1]

377.8

| | |
|---|---|
| **13** | **377.8** |
| 12 | 366.0 |
| 11 | 325.3 |
| 10 | 263.7 |
| 09 | 244.2 |

» See page 24

## Free cash flow

(£ millions)

110.4

| | |
|---|---|
| **13** | **110.4** |
| 12 | 182.4 |
| 11 | 193.0 |
| 10 | 163.3 |
| 09 | 155.0 |

» See page 28

## Underlying earnings per share

(pence)[1]

37.5

| | |
|---|---|
| **13** | **37.5** |
| 12 | 36.5 |
| 11 | 32.1 |
| 10 | 28.6 |
| 09 | 26.4 |

» See page 27

## Dividends per share

(pence)

12.75

| | |
|---|---|
| **13** | **12.75** |
| 12 | 11.80 |
| 11 | 10.50 |
| 10 | 9.20 |
| 09 | 8.45 |

» See page 27

[1] The definition of 'underlying' is provided in notes 10 and 15 to the consolidated financial statements on pages 91 and 94 respectively. The figures for prior years have been restated as explained in note 44 on page 120 to the consolidated financial statements.

# Chairman's statement



We have grown Meggitt with great determination, based on clear-cut principles and practice—the fair and impartial conduct of business that is fully compliant with applicable laws and regulations worldwide and integrity in every business relationship.

It is more than a decade since I joined Meggitt as a non-executive director, becoming Chairman in 2004. Since then, the Group has become progressively integrated, revenue has increased threefold and employee numbers have doubled. We have enjoyed growth organically and by acquisition, which has brought new capabilities and reinforced Meggitt's *smart engineering for extreme environments*.

## Investing for growth

Meggitt continues to expand its market positions and capabilities through investment in research and development, facilities and, most important of all, its people. They are the backbone of our business and I would like to take this opportunity to thank them for their hard work in a challenging year.

We benefit from a talented workforce across all disciplines, which we build on with Group-wide career opportunities and training at all levels. We place special emphasis on leadership development—executive influencing, training in vital front-line supervision, plus strategy development work for future Meggitt leaders within programmes tailored by Oxford University's Said Business School. The Meggitt Production System, the Group's wide-ranging continuous improvement initiative, embodies a faculty of operational excellence for the large number of employees touched by it.

As a leading employer of engineers and manufacturing experts, we are naturally committed to maintaining the industry pipeline of expertise. This will undoubtedly be stimulated by the opportunities arising from the UK government's commitment to co-funding investment in the aerospace and defence industry. As a business we are picking up the baton, developing young talent, sponsoring students with engineering aspirations through the Arkwright Scholarship Trust. In turn, they are benefiting from mentoring by engineering graduates from our own highly successful international graduate development programme in which we take care to engage bright minds early in very challenging engineering projects.

We are also enhancing the professional development of established Meggitt engineers. As an integrated Group, careers can now develop beyond business units and divisions; we have entered into a partnership with the Institution of Mechanical Engineers to provide continuous training, management and leadership development; and we are taking care of our subject matter experts, ensuring that those who wish to remain expert in their fields have career paths as promising as those who move into management roles. This includes plans for a Technical Fellowship programme to reward those at the pinnacle of achievement in their chosen field.

## Doing business the right way

We have grown Meggitt with great determination, based on clear-cut principles and practice. There is zero tolerance for anything other than the fair and impartial conduct of business that is fully compliant with applicable laws and regulations worldwide and integrity in every business relationship.

Meggitt was one of the first companies to commit to comprehensive integrity policies, programmes and practice within its aerospace and defence business operations when we signed a Statement of Adherence to the Global Principles of Business Ethics for the Aerospace and Defense Industry. As Chairman of the Group's Ethics and Trade Compliance Committee, I am proud to say our programmes lead the industry.

## Board of directors

In May, Meggitt Group Finance Director Stephen Young succeeded Terry Twigger as Chief Executive. Terry spent 12 years—nine with Stephen—quadrupling Group revenue and increasing profitability fivefold. Doug Webb, who succeeds Stephen, has held senior financial positions across a broad range of industries. Before joining Meggitt, Doug was Chief Financial Officer of London Stock Exchange Group plc.

David Robins will be retiring from the Board following the AGM on 7 May 2014 after 12 years of service as a non-executive director, during which time he acted as Senior Independent Director and Chairman of the Remuneration Committee.

## Looking ahead

Meggitt delivered a creditable set of results in 2013 despite some operational challenges and weakness in some markets, most notably the highly profitable civil aftermarket.

Sequestration of US defence funding continues to generate uncertainty. However, our flexible manufacturing base enables us to redirect activity where demand remains strong, while retrofit, upgrade and outsourcing opportunities continue for Meggitt, as in the past, from greater utilisation and extension of existing programmes.

We look forward to making further progress in 2014 and beyond, driven by a highly resourceful workforce, underpinned by a resilient installed base of equipment, highly cash-generative business model and robust balance sheet.

**Sir Colin Terry** Chairman

# Chief Executive's review

We have emerged from an intensive bid cycle resulting in technology sales into a significant number of new aircraft programmes, many involve a full suite of Meggitt capabilities, exceeding the shipset content of their predecessors. This is a very strong indicator of future revenue growth.

## Group strategy

In my first Annual Report and Accounts since becoming Meggitt's Chief Executive, I am delighted to reaffirm my commitment to the strategy I was integral in developing since joining the Group as Finance Director in 2004.

Meggitt's strategy comprises four elements.

## Delivering innovation

We focus on highly-engineered components and sub-systems capable of withstanding increasingly harsh environments, such as in the next-generation aero-engines. Our products must operate in extremes of pressure, temperature, impact, vibration and contamination in applications where certification requirements are demanding.

We invest in manufacturing technologies such as automation and additive manufacturing, targeting product technology investment in areas where we see the greatest growth potential. Our power business, for example, continues to provide more electric solutions for our customers and we are embedding this capability increasingly across a broad range of Meggitt products.

At the same time, we seek to leverage shipset content by combining the Group's capabilities. Most recently, we deployed our sensing systems in tyre pressure monitoring for brake control systems and integrated polymers and composites with fluid control technology valves to create complete airborne fuel systems.

We supplement organic* growth with targeted acquisitions, increasing our range of capabilities and improving our market position.

## Securing positions on new platforms

Our leading-edge capabilities, intellectual property and longstanding track record of delivering reliable products, enable us to secure strong positions on new programmes, including the recently announced wheels and brakes contract on the Dassault 5X long-range business jet.

Because our products span multiple platforms across civil aerospace, military and energy markets, we are not dependent on single programmes, customers, regions or segments.

We target specialist applications within these markets, generating revenue from original equipment and maintenance, overhaul, spares and repair services for the life of programmes, which can last for decades.

Our customers' technology roadmaps guide our investments. This is underpinned by rigorous product development, programme management, increased manufacturing capacity and regional support for original equipment manufacturers and their operators.

We have longstanding relationships with major customers. Whether creating a critical component or sub-system for an aircraft engine or a heat exchanger for a floating offshore gas storage and processing vessel, we work together at the start of design phases to ensure demonstrable early-stage solutions.

## Achieving operational excellence

Because superior performance on quality, cost and delivery are the building blocks of future growth, we are intensifying our investment in facilities, production systems, programme management and people.

*Organic excludes the effect of acquisitions, disposals and foreign exchange.

During 2013, we consolidated six factories into three larger, more efficient facilities. We moved a further two businesses to new, expanded sites to meet growth requirements. We also launched the Meggitt Production System (MPS) at 16 of our facilities, with a further 16 scheduled for 2014 and the remainder during 2015.

MPS—our single, global approach to continuous improvement—will create the sustainable delivery and quality culture that confers competitive advantage beyond our technological expertise. It reinforces our commitment to developing our people and doing business the right way, further strengthening our customer partnerships. At the same time, Meggitt will become more cost-competitive. We will reduce working capital. We will reduce the cost of poor quality and, as MPS requires close relationships with suppliers who share our management standards and continuous improvement philosophy, our supply chain will become leaner and more effective. We have already seen significant operational improvements, with on-time delivery up by 10% and defective parts per million (our key performance indicator for quality) down by 54%.

## Providing through-life product support

Once selected on a new platform, Meggitt often becomes the sole source for a given component for the life of the programme. Our equipment typically operates in harsh environments, generating a regular requirement for spares and repairs. This produces an annuity-like income stream over the life of the programme—often several decades.

We continue to invest in our product support capability. In 2013, we opened our new repair and overhaul centre in Singapore, doubling our capacity and introducing more Meggitt product lines, and launched a major review of the best way to deploy Meggitt's growing aftermarket capability to our global customer base.

## After the bid cycle

We have emerged from an intensive bid cycle resulting in technology sales into a significant number of new aircraft programmes, many involve a full suite of Meggitt capabilities, exceeding the shipset content of their predecessors. This is a very strong indicator of future revenue growth.

This accounts for R & D spend in 2013 which, at 8.2% of revenue, was at a record level as we convert these new contracts into sustainable revenue streams.

We are now moving into a major execution phase, which requires us to deliver new programmes on time and to specification and to meet new, tougher requirements in terms of quality, cost and delivery. The necessary improvement in operational performance will be supported by MPS and the recent appointment of a Chief Operating Officer.

## Performance in 2013

Revenue growth in 2013 was weaker than anticipated a year ago. This was due, mainly, to currency movements, a slower than expected recovery in civil aftermarket revenue and uncertainties around defence spending, particularly in the US. Supply chain and operational issues, while now under control, had an impact on revenues and costs in the second half, offset by good progress made in resolving legacy contract issues. Against this challenging background, total revenue rose 2% in the year (organic: +1%) with underlying earnings per share up 3% to 37.5p. Net debt decreased further to 564.6m (2012: 642.5m) and net debt to EBITDA reduced to 1.2x (2012: 1.3x). The recommended final dividend of 8.80p per share (2012: 8.20p) takes the full year dividend to 12.75p (2012: 11.80p), an increase of 8%.

## Outlook

The outlook for our civil markets remains good, with further growth in aircraft deliveries anticipated in 2014 and beyond. During the latter half of 2013, air traffic growth accelerated to above the long term trend rate of 5% and we believe that the destocking seen over the last couple of years is coming to an end. We therefore maintain our view that civil original equipment and aftermarket revenues will grow at an average of 7 to 8% and 8 to 9% respectively, both on an organic basis, over the medium term. Aftermarket revenue will likely grow at less than this rate in 2014 as the gradual recovery continues.

We anticipate a modest decline in military revenue in 2014, reflecting the substantial completion of the Bradley fighting vehicle and KC135 fuel tank retrofit contracts. Looking further ahead, uncertainty around military budgets, notably in the US, persists. As such, while we remain confident in delivering an average compound organic revenue growth rate of 2% in our military markets over the medium term, this will be subject to modest reductions if sequestration impacts future budget cycles as initially envisaged.

Energy, driven by continued strong demand for our printed circuit heat exchangers and new product introductions in the condition-monitoring market, should deliver organic revenue growth averaging greater than 10% over the medium term. Other markets should continue to see modest growth.

On this basis, we expect to make further good progress by delivering mid-single digit organic revenue growth in 2014, weighted towards the second half, and 6 to 7% average organic revenue growth in the medium term.

**Stephen Young** Chief Executive

# Group strategy

## Business model

Objective: deliver strong and sustainable financial returns to shareholders through leading positions in aerospace, defence and energy markets

Our model delivers financial strength and stability throughout the cycle. We deliver innovation, investing in multiple technologies across our primary aerospace, defence and energy markets. Revenues are derived from the successful execution of original equipment programmes and aftermarket products and services that flow from them.


To see how Meggitt's strategy fundamentals are reflected at divisional level, see next page.

The results of strategy implementation are outlined in the Chief Financial Officer's review on pages 22 to 30.

# Market matrix

Meggitt benefits from a balanced portfolio. Capability-based business units deploy technological know-how and intellectual property across all our markets so we are not dependent on single customers, individual programmes or market segments.

| | Meggitt Aircraft Braking Systems | Meggitt Control Systems | Meggitt Polymers & Composites | Meggitt Sensing Systems | Meggitt Equipment Group |
|---|---|---|---|---|---|
| **Civil** | | | | | |
| Original equipment | 1—3% | 3—10% | 1—3% | 3—10% | 3—10% |
| Aftermarket | >10% | 3—10% | 1—3% | 1—3% | 3—10% |
| **Military** | | | | | |
| Original equipment | 1—3% | 1—3% | 3—10% | 1—3% | >10% |
| Aftermarket | 3—10% | 1—3% | 3—10% | 1—3% | 3—10% |
| **Energy** | — | 1—3% | — | 3—10% | 3—10% |
| **Other** | — | 1—3% | — | 1—3% | 1—3% |

>10% of Group revenue 3—10% of Group revenue 1—3% of Group revenue

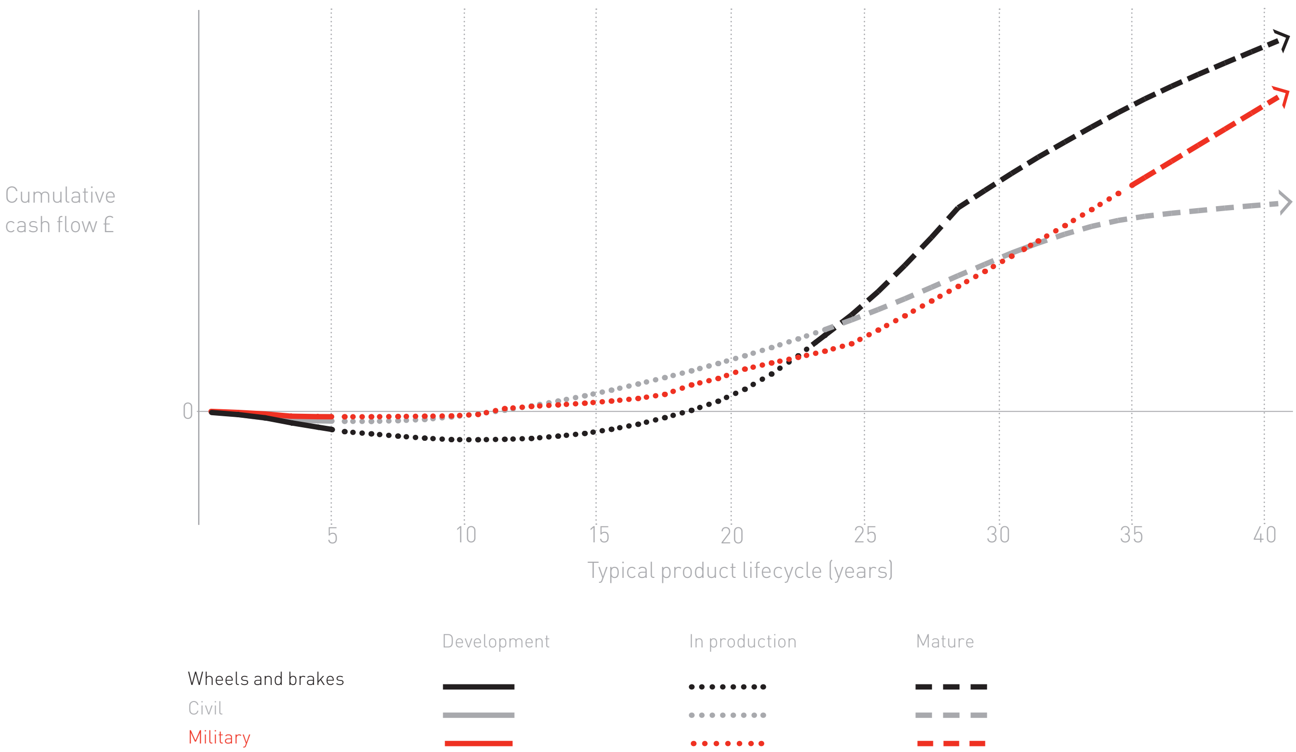
# Investment cycle

We develop technology for applications involving product life-cycles measured in decades. Products must perform without fail in environmental extremes, requiring regular replacement or overhaul, generating strong returns from our initial investment over many years.

Our business model requires significant cash investment in the development phase of programmes and, for our wheels and brakes business, the production phase also. We then make strong positive cashflow in the in-service phase resulting in cash breakeven typically between years 11 and 18.

As our products are developed in line with our customers' technology goals, we have performed strongly in the recent bid cycle, securing positions on key platforms and refreshing the long-term aftermarket pipeline.

Our near-term business is weighted therefore towards investment in new development programmes, the source of sustainable growth over the long term.

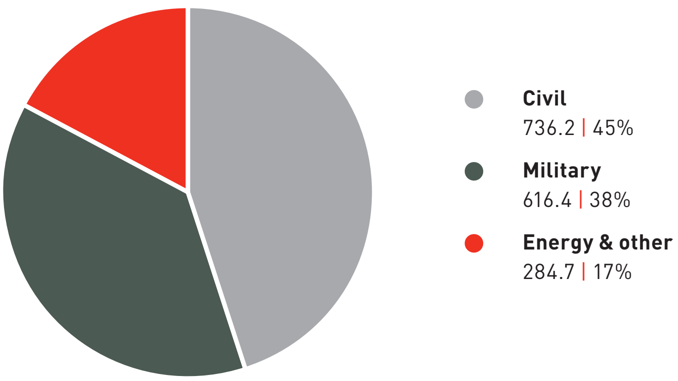


# Market review

Meggitt's principal markets, civil aerospace (45% of revenue), military (38%) and energy (11%), are characterised by long life-cycles and the requirement for smart engineering for extreme environments. This capability ranges from thermal management, condition monitoring and wheel, brake and brake control systems to high-integrity electronics and fire protection systems. Some of these capabilities have applications beyond our core markets, making up the remaining 6% of Group revenues.

**Revenue by market**
(£ millions)

1,637.3




## Civil aerospace

Civil aerospace accounts for 45% of Group revenue, with products and sub-systems installed on almost every jet airliner, regional aircraft and business jet in service. The global fleet of civil aircraft on which Meggitt has content continues to grow, totalling over 41,000 aircraft today.

New aircraft deliveries drive sales of original equipment, and aircraft utilisation generates demand for spare parts and repairs over many decades.

## Original equipment

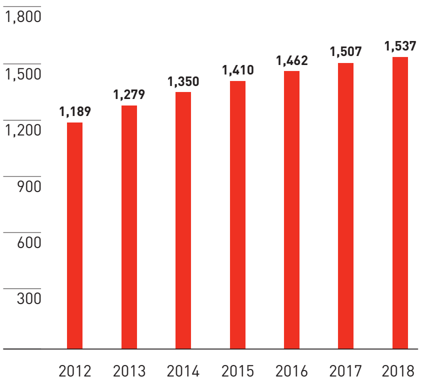
Aircraft deliveries encompass large jets (>100 seats), regional aircraft (<100 seats) and business jets.

Large jet deliveries in 2013 stood at a record 1,279, 8% higher than in 2012. Continued growth is underpinned by an order book at the two major civil aircraft manufacturers, Boeing and Airbus, stretching out for seven years at current production levels, bolstered by new aircraft manufacturers investing in the large jet market including Bombardier, Sukhoi and COMAC. The high level of demand for new aircraft deliveries is driven primarily by high oil prices, the relatively low cost of debt and the wave of newer, more fuel-efficient aircraft coming to market including Boeing's 787 and 737MAX and Airbus' A350XWB and A320neo.

Regional aircraft deliveries of 263 represented an 11% increase on 2012, with growth driven by 70-plus seat aircraft. Growth looks set to continue over the medium term, mirroring the growing internationalisation of the regional aircraft fleet beyond the US.

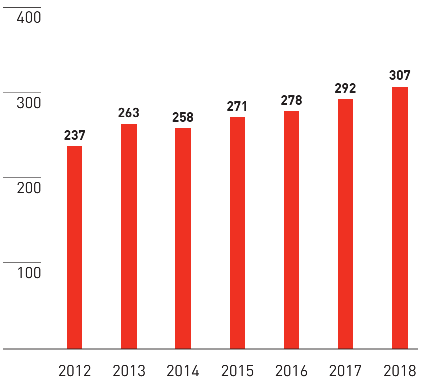
Business jet deliveries totalled 637, an 8% decrease on 2012. Deliveries are still 50% below the peak of 2008. However, inventories are continuing to decline and corporate profitability, historically a good driver of business jet demand, is forecast to rise in the coming years. As with regional aircraft, the fleet is becoming more global—customers in the Americas comprise 76% of the global business jet fleet but order trends suggest this will move to less than 60% over the next decade. Over the medium term, we see deliveries continuing to recover, driven by an improved economic growth outlook in developed economies and the large number of new aircraft models.

### Large jet delivery forecast



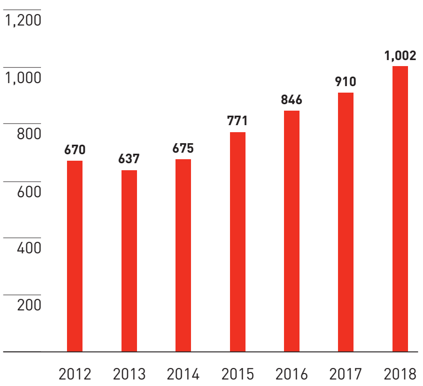

Source: Meggitt management estimates

### Regional aircraft delivery forecast




Source: Meggitt management estimates

### Business jet delivery forecast




Source: Meggitt management estimates

**Meggitt performance**
Meggitt's original equipment (OE) revenue grew organically by 11% in 2013. Large jet deliveries drive the majority of our OE revenues, involving the supply of products and sub-systems on engines and airframes across thermal and fluid control, fire protection, condition-monitoring and high-integrity electronics. Our largest exposure to regional aircraft and business jets is through our wheels and brakes business, which provides most original equipment free of charge to civil aircraft manufacturers. The strong OE performance is also driven in part by our high shipset values on new aircraft programmes, with order books and delivery forecasts for these programmes giving us confidence in future growth prospects with a medium term growth target of 7-8% per annum.

## Aftermarket

The civil aerospace aftermarket is driven primarily by aircraft utilisation which, in the case of large jets and regional aircraft, is measured using available seat kilometres (ASKs). We use take-offs and landings as a proxy for business jet performance.

ASKs in the commercial aircraft fleet grew modestly in the first half of 2013, accelerating to give a full-year growth number of 4.5%, close to the 5% long term average. The Middle East and Africa saw particularly strong growth, with the US market showing a steady recovery. Regional aircraft utilisation picked up noticeably, driven by the recovery in North America. Business jet utilisation in the US and Europe continued to exhibit the gradual improvement seen for the last two years, with take-offs and landings in 2013 up 1% versus 2012. We would normally expect our aftermarket revenues to follow these leading indicators after a lag of a few months.

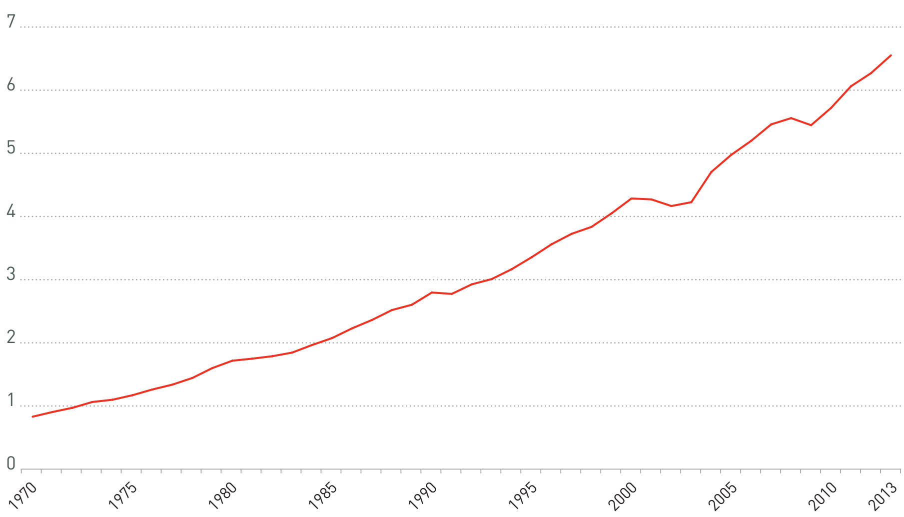
**Meggitt performance**
Meggitt's organic aftermarket revenue was flat for the year, but up 3% in the fourth quarter, which is below the growth rate we would expect given the rise in aircraft utilisation over the course of the year. This is primarily due to a continuation of the destocking seen in 2012. Also, the bulk of ASK growth has been met by new aircraft, typically under warranty for three to five years after initial delivery, holding back growth in aftermarket demand. The rate of new aircraft deliveries has also driven a higher than normal rate of older aircraft cannibalisation and created a surplus of spare parts.

Regional aircraft and business jets are important contributors to the Group's aftermarket revenue and the recovery in regional aircraft utilisation in 2013 helped offset the effects of destocking at a significant large business jet customer.

Aircraft utilisation remains very encouraging, with ASKs now tracking above the long term average. This gives us confidence in our medium term view of annual growth in aftermarket revenue of 8 to 9%, after some of the current cyclical factors reduce in impact.

### Available seat kilometres (ASKs)

(billions)




Source: Meggitt management estimates

# Market review continued

## Military revenue by region

Total revenue (£ millions)

616.4

- **USA** 379.0 | 61%
- **Europe** 144.0 | 23%
- **Rest of World** 93.4 | 16%

## Military

Military accounts for 38% of Group revenue. Meggitt has equipment on over 20,000 aircraft and a variety of ground vehicles, naval vessels and training installations worldwide. During 2013, 61% of our military revenue came from US customers, with 23% from Europe and 16% from the rest of the world.

Defence budgets in some key markets were under pressure in 2013, notably in the US where the effect of Continuing Resolution plus sequestration affected spending levels and the timing and size of orders. However, European markets were stable and parts of the Middle East and Asia saw budget growth. The US defence budget remains constrained, although the Bipartisan Budget Act of December 2013 alleviated some pressure by reducing the proposed cuts in 2014 and 2015 by $22 billion and $9 billion respectively.

Global defence spending is likely to remain restrained. As the operational tempo in Afghanistan slows down, this is likely to reduce equipment utilisation levels, limiting the demand for spare parts and repairs. However, opportunities remain for reset and upgrade of repatriated equipment and supplying new products as a significant tranche of military assets reaches the end of their useful lives.

### Meggitt performance

Meggitt's military revenue declined organically by 3% in 2013—a very creditable performance given the market backdrop. Within this, sales to the US declined by 6%, sales to Europe increased by 12% and sales to the rest of the world increased by 4%.

Our exposure to a broad range of fixed and rotary wing aircraft, ground vehicles, training facilities and naval vessels across original equipment and aftermarket spares and repairs, has enabled us to demonstrate resilience in a challenging environment over the last couple of years. We expect to continue to do so over the medium term. We have enjoyed considerable success, for example, securing retrofit programmes such as blast-proof fuel tanks for the Bradley fighting vehicle fleet and fuel bladders for the KC135 tanker aircraft. While we have now completed the Bradley retrofit contract and the KC135 contract is winding down, there are further opportunities for ground vehicle fuel tank retrofits and good growth in platforms on which we have content such as the A400M, P-8 Poseidon and F-35 Joint Strike Fighter. Accordingly, we are targeting 2% organic revenue growth in the medium term, excluding the impact of sequestration.

## Energy

Our energy business accounted for 11% of Group revenue in 2013. We target power generation and oil and gas markets with condition-monitoring hardware and software, control valves and printed circuit heat exchanger technology.

The market for condition monitoring and control valves has continued to grow, as high input costs drive operators to extract greater efficiency from their assets. As newer, more capable monitoring technologies come to market, operators will maximise their asset utilisation and minimise unplanned downtime by retrofitting new condition-monitoring systems onto existing plant and machinery.

The oil and gas heat transfer market remains robust. Exploration and production companies are increasingly turning to extraction sites which are further offshore and in deeper water, necessitating the commissioning of new equipment designed to operate in these increasingly harsh environments. These factors have resulted in good growth in activity for floating, production, storage and offload (FPSO) and floating liquefied natural gas (FLNG) vessels, markets which are set to grow further in the coming years.

### Meggitt performance

Meggitt's energy revenue grew 5% in 2013. Sales to power generation customers were broadly flat and sales to oil and gas customers, principally through our Heatric printed circuit heat exchanger business, grew 11%.

We saw good growth in our industrial valves business. Growth in our energy condition-monitoring segment was, however, hampered by a key raw material shortage and some production issues following the opening of our new facility in Southern California in October. These issues are now under control and we look forward to resuming growth in this business, augmented by the enhanced functionality of our *VibroSight*® condition-monitoring system which provides more information, better analysis and new decision support features to operators of rotating machinery.

Our Heatric business continued to grow nicely in 2013, with good progress made against the significant contract wins we have enjoyed in the last few years. This business is characterised by large, infrequent orders resulting in uneven growth. We are confident, however, that heightened activity levels in the FPSO and FLNG markets will deliver further strong growth over the next few years from the £600 million pipeline of opportunities in which we are actively engaged.

Our confidence in our positioning in this market is reflected in our medium term growth target of greater than 10% per annum.

Strategy insight
**Deliver innovation**

## I want to build a complete valve out of components made through 3-D printing, strap it on a test engine and run it for 4,000 hours.

**Stewart Chapman**
Engineering Director,
Meggitt Control Systems, Dunstable, UK

**Fêted as the next disruptive technology in an ever-growing mound of press cuttings, Meggitt is already using 3-D printing (additive layer manufacturing—ALM) for aerospace components. To ensure the approach is not dispersed and shallow, the Group's research and technology team is coordinating a project to ensure Meggitt's in-house capability counts, creating its own powders, forging its own design methodology and, over the longer term, making its own manufacturing equipment.**

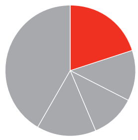
**Over time, Meggitt believes the technology could be present in many of its product lines, enabling more precise use of raw materials, providing additional functionality and lowering inventory as small, complex products are printed on demand. For now, Meggitt is content to create a supply chain ready to design and certify a product for a military jet, on point to respond to its customers as the technology processes mature and customers' own ALM strategies coalesce.**

# Meggitt divisions

## Meggitt Aircraft Braking Systems

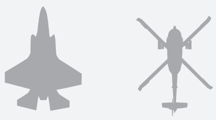
A leading supplier of aircraft wheels, brakes and brake control systems.

| | | | |
|---|---|---|---|
| Revenue (£ millions) | 330.4 | % of Group revenue | 20.2 |
| | | Underlying operating profit (£ millions) | 122.4 |



### Markets

Civil aerospace



Fixed and rotary wing military aircraft

### Capabilities

- Wheels and brakes
- Control—brake, nose wheel steering and landing gear
- Monitoring systems
- Aftermarket services

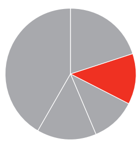
### Growth strategy

- Enhance complete landing gear sub-systems capability
- Secure sole source positions where possible on new aircraft programmes
- Grow share of aftermarket
- Increase competitiveness, implementing Meggitt Production System and increasing use of low-cost manufacturing facilities

## Meggitt Control Systems

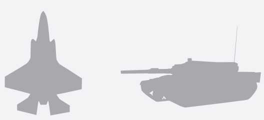
A leading supplier of pneumatic, fluid control, thermal management and electro-mechanical equipment and sub-systems.

| | | | |
|---|---|---|---|
| Revenue (£ millions) | 205.6 | % of Group revenue | 12.5 |
| | | Underlying operating profit (£ millions) | 50.4 |

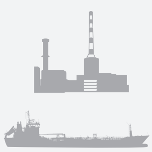


### Markets

Civil aerospace



Military aircraft and ground vehicles



Energy, industrial and marine

Ground fuelling

### Capabilities

- Heat management
- Control valves and sub-systems
- Electro-mechanical controls
- Environmental control
- Fuel handling

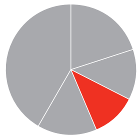
### Growth strategy

- Develop lightweight control systems for extreme temperature and pressure environments to improve aircraft performance
- Develop more products to increase the reliability and efficiency of industrial gas turbines, developing our ability to service them internationally
- Increase competitiveness, implementing Meggitt Production System and increasing use of low-cost manufacturing facilities

## Meggitt Polymers & Composites

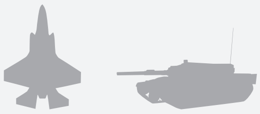
A leading specialist in fuel containment, engineered aircraft sealing solutions and technical polymers, electro-thermal ice protection and complex composite structures and assemblies.

| | |
|---|---|
| Revenue (£ millions) | 181.0 |
| % of Group revenue | 11.1 |
| Underlying operating profit (£ millions) | 30.2 |



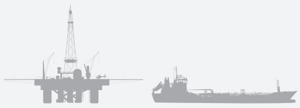
### Markets

Civil aerospace



Military aircraft and ground vehicles

Missile systems and UAVs



Nuclear, marine, heavy transportation and oil and gas sectors

### Capabilities

- Life-saving fuel containment technologies for aerospace and ground vehicles
- Lightweight integral fuel tank sealants
- Smart electro-thermal ice protection with energy-saving proportional control
- Complex composite structures
- Airframe, engine and oil & gas sealing solutions

### Growth strategy

- Extend leading position in fuel tanks, developing complete fuel sub-systems for helicopters and ground combat vehicles
- Develop more sealing solutions and electro-thermal ice protection technology to secure attractive positions on civil and military fixed wing aircraft
- Increase competitiveness, implementing Meggitt Production System and increasing use of low-cost manufacturing facilities

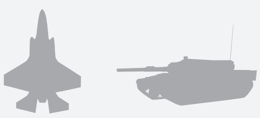
## Meggitt Sensing Systems

A leading provider of high-performance sensing and condition-monitoring solutions for high-value rotating machinery and other assets.

| | |
|---|---|
| Revenue (£ millions) | 240.4 |
| % of Group revenue | 14.7 |
| Underlying operating profit (£ millions) | 34.3 |

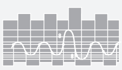
### Markets

Civil aerospace



Military: fixed wing and rotary aircraft, ships, missiles

Energy



Test and measurement

### Capabilities

- High-performance sensing in extreme environments
- Condition-monitoring for air and land-based machinery

### Growth strategy

- Accelerate growth in energy segment, launching innovative new products and expanding sales and aftermarket services in high-growth regional markets
- Develop leading-edge sensing and condition-monitoring technologies for attractive aerospace applications
- Deploy advanced sensing knowledge and intellectual property for high-growth medical ultrasound applications
- Increase competitiveness, implementing Meggitt Production System and increasing use of low-cost manufacturing facilities

# Meggitt divisions continued

## Meggitt Equipment Group

Created to enable a set of strong, technologically-distinct businesses to market their offerings to specialist customers, while benefiting from the wider Meggitt Group's investment in shared services and common processes.

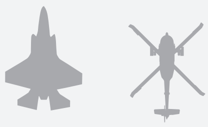
Revenue (£ millions) 679.9

% of Group revenue 41.5

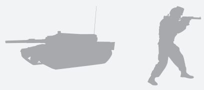
Underlying operating profit (£ millions) 159.9

### Markets

Civil aerospace



Fixed and rotary wing military aircraft



Defence and security

Energy

Automotive and industrial

### Capabilities

- Aircraft fire protection and control systems
- Avionics
- Combat systems (ammunition-handling, military electronics cooling and countermeasure launch and recovery systems)
- Live-fire and simulation training
- Heat transfer equipment for offshore oil and gas
- Power generation
- Linear motion control
- Aircraft safety and security
- Automotive and industrial control electronics

### Growth strategy

- **Fire protection:** deploy integrated fire detection and suppression systems to secure sole source positions on new platforms and continue to develop environmentally-friendly aircraft fire protection systems
- **Heat transfer:** build on market-leading position in compact and high-pressure heat exchangers for high-growth energy markets
- **Power:** exploit capabilities in power generation, conversion and storage for more electric aircraft
- **Avionics:** continue to build our position in state-of-the-art secondary flight displays
- **Training:** grow our market-leading position in live and virtual training systems for international customers in defence and law enforcement markets
- **Combat support:** provide smart thermal management solutions for military electronics systems and extend automatic ammunition handling capability into larger calibre weapons
- Increase competitiveness, implementing Meggitt Production System and increasing use of low-cost manufacturing facilities

# Principal risks and uncertainties



Meggitt's risk management framework includes a formal process for identifying, assessing and responding to risk to support the delivery of the Group's strategy and business objectives.

Risk management operates at all levels throughout Meggitt. The Board has overall responsibility for risk management including maintaining the Group's risk governance structure and an appropriate internal control framework.

Willis Risk Advisory Services have been appointed to assist with a review of the existing risk management processes against international standards and guidelines and to advise on process improvements, reporting and assurance.

During 2013, the Board approved an updated Risk Management Policy, a Group Risk Management Strategy and updated formats for regular Board reports and the Group Risk Register. This was supported by process and guidance documentation detailing the revised Group-wide framework. The implementation of an improved reporting and communication process will ensure the revised risk management framework is embedded properly across the Group.

## Types of risk

We categorise and monitor risk across strategic, operational, business environment and financial categories.

- **Strategic risk** includes, for example, risks arising from making poor business decisions or sub-standard execution of business objectives.
- **Operational risk** covers risk in our business processes and programme risk, relating to technical, quality, project management or organisational risk.
- **Business environment risk** arises when external forces could significantly change the fundamentals driving our overall objectives and strategies.
- **Financial risk** encompasses key financial functions including the provision of adequate liquidity to meet our obligations and management of currency, interest rate, credit and other financial risks.

## Risk disclosure

Following our strategic review of the risk management process in 2013, we have evaluated our risk disclosure and have focused this report on our most significant risks. As a result, some of the risks we disclosed in 2012 are no longer included: risks relating to catastrophic events, the environment, health and safety, acquisitions, contract risk and organisational structure. General financial risks are no longer disclosed here but are described in the Chief Financial Officer's review on pages 29 to 30, including foreign exchange risk to reported results.

The risks outlined overleaf, which are not presented in order of priority, are those the Group believes are the principal ones it currently faces. However, additional risks, of which the Group is unaware, or risks the Group currently considers to be less significant, could have an adverse impact.

**Change in risk in year**

| | |
|---|---|
| No change | ← → |
| Higher risk | ↑ |
| Lower risk | ↓ |

# Principal risks and uncertainties continued

| Risk | Description and impact | How we manage it |
|---|---|---|
| **Strategic** | | |
| **Business model** | Failure to respond to fundamental changes in the civil and military aftermarket.<br>Impact: *decreased revenue and profit* | • Long-term agreements are in place<br>• Customer-facing organisation restructured and boosted<br>• Investing in research and development to maintain and enhance Meggitt's intellectual property<br>• Ongoing strategic review of aftermarket including evaluation of operational model<br>• Implementing Meggitt Production System (MPS) aftermarket module across the Group<br>• Investment in maintenance, repair and overhaul facilities |
| **Operational** | | |
| **Quality escape/ equipment failure** | Defective product leading to in-service failure, accidents, the grounding of aircraft and prolonged production shutdowns for Meggitt and its customers.<br>Impact: *decreased revenue and profit, damage to reputation and operational performance* | • Well-developed verification, validation and system safety analysis policy and processes in place<br>• Quality and customer audits and industry certifications<br>• Upgrading crisis management plans<br>• Implementing MPS across the Group<br>• Implementing an enhanced supplier quality assurance process |
| **Customer satisfaction** | Failure to meet customers' cost, quality and delivery standards or qualify as preferred suppliers.<br>Impact: *failure to win future programmes, decreased revenue and profit* | • Achieve supplier "Gold" status or equivalent with key customers<br>• Step change in performance enabled through quality and delivery initiative (now covered under the implementation of MPS)<br>• Implementation of programme lifecycle management process initiated<br>• Programme management reorganised to increase capability and focus on programme delivery and governance<br>• Developing our commercial function and engineering capability |
| **IT/systems failure** | Prolonged malfunction of critical systems such as SAP, due to badly-executed implementation, poor maintenance, change control, business continuity and back-up procedures; the failure of third-parties to meet service level agreements; or cyber attack.<br>Impact: *decreased revenue and profits, damage to operational performance* | • Rolling programme of system upgrades (including SAP implementation) to replace legacy systems<br>• Programme of IT security enhancements ongoing<br>• Reviewing existing systems, third party service providers and risks, including resilience and disaster recovery processes and taking mitigating action where appropriate |

## Strategic objectives

- Deliver innovation
- Secure positions on new platforms
- Achieve operational excellence
- Provide through-life product support

| Risk | Description and impact | How we manage it |
|---|---|---|
| **Supply chain** | Failure or inability of critical suppliers to supply unique products, capabilities or services which causes the Group to be unable to satisfy customers or meet contractual requirements.<br>Impact: *decreased revenue and profit, damage to reputation* | • Group procurement reviewing supply chain risk management framework<br>• Buffer inventory maintained for critical and sole-source suppliers<br>• Counterfeit and Fraudulent Parts Policy implemented at high-risk facilities<br>• Implementing integrated commercial and procurement approach to contractual terms and conditions |
| **Project/ programme management** | Failure to meet new product development and programme milestones and certification requirements.<br>Impact: *significant financial penalties leading to decreased profit, damage to reputation* | • Implementation of programme lifecycle management process initiated and a range of engineering support applications developed<br>• Structured approach to maturing technologies implemented<br>• Deliver applied research and technology objectives in line with Group strategy<br>• Programme management reorganised to increase capability and focus on programme delivery and governance<br>• Step change in performance enabled by quality and delivery initiative (which is now covered under implementation of MPS) |
| **Legal and regulatory** | Significant breach of increasingly complex trade compliance, bribery and corruption and ethics laws or violating the terms of Meggitt's 2013 Consent Agreement with the US Department of State.<br>Impact: *damage to reputation, loss of supplier accreditations, suspension of activity, fines from civil and criminal proceedings* | • Substantial investment in measures to ensure compliance with 2013 US Department of State Consent Agreement, together with continuing investment in other compliance programmes, means that the Board considers that this risk has decreased during the year<br>• Trade compliance, ethics and anti-corruption policies approved by Board<br>• Implementing a trade compliance global IT solution<br>• Regular monitoring by the Ethics and Trade Compliance Committee<br>• Continue with trade compliance programme including external audits, and comprehensive ethics programme including training, anti-corruption policy, external audits and Ethics line<br>• Implementing import compliance programme in Americas and Europe/Asia |
| **IT and physical security** | Failure to protect intellectual property or other sensitive information arising from cyber attack or physical theft of IT and business assets.<br>Impact: *compromised market position, damage to reputation, financial or contractual liabilities* | • Ongoing development of IT security strategy and enhancing IT security infrastructure, policies and procedures<br>• Group-wide intellectual property protection programme in place<br>• Implementing physical security strategy, including audits, prioritising higher risk environments and regions |
| **Business environment** | | |
| **Product demand** | Significant variation in demand for products should military and civil business downcycles coincide, a serious political, economic or terrorist event take place or an industry consolidation materially change the competitive landscape.<br>Impact: *volatility in underlying profitability* | • Monitoring of external economic and commercial environment and long lead indicators<br>• Focus on balanced portfolio including expansion of energy-related businesses<br>• Regular communication of strategy to shareholders<br>• Maintenance of sufficient headroom in committed bank facilities and against bank covenants<br>• Maintain appropriate cost-base contingency plans |

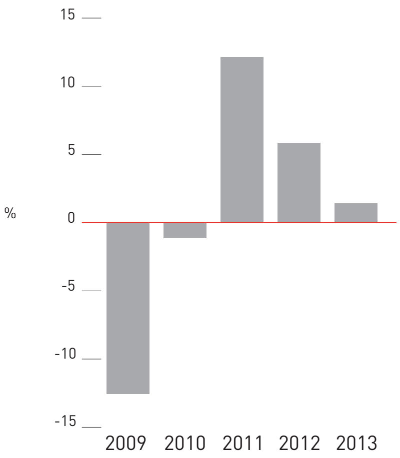
# Key performance indicators

The Group uses a mix of financial and non-financial key performance indicators (KPIs) to measure execution against its strategic objectives. To ensure we deliver value to our shareholders over the cycle, financial KPIs balance short-term measures (underlying PBT and free cash flow in the year) with longer-term measures (organic revenue growth, return on trading assets and underlying EPS growth). Non-financial KPIs focus on investment in R&D to drive future revenues, the health and safety of our employees and raising standards of operational performance to satisfy our customers.

## Strategic objectives

- Deliver innovation
- Secure positions on new platforms
- Achieve operational excellence
- Provide through-life product support

## Organic revenue growth




**Definition and basis of calculation**
Revenue growth calculated by measuring current and prior year revenue at constant currency, excluding revenue from any businesses acquired or disposed of in those periods. To measure revenue at constant currency, current year revenue is restated using translation and transaction exchange rates prevailing in the prior year. See page 27 for a reconciliation of organic revenue to revenue.

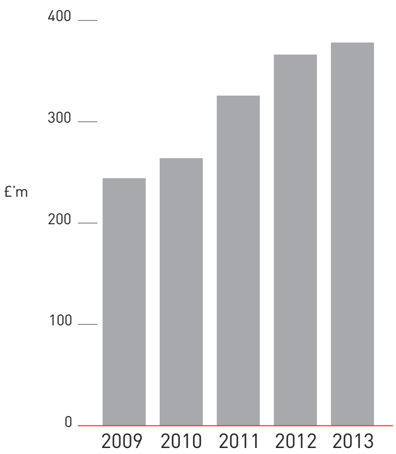
Organic revenue growth better represents underlying business performance and has replaced the previously reported revenue growth KPI which did not exclude the impact of currency or mergers and acquisitions.

**Target**
Mid-single digit in 2014. 6 to 7% over the medium term.

**Result**
Achieved 1.4% (2012: 5.8%). Average achieved over last five years: 1.1%. Average achieved over three years since target was set: 6.4%. See page 22 for details.

**Directors' incentive plans**
Organic revenue growth is proposed as a performance measure for the 2014 Long Term Incentive Plan (LTIP). See pages 50 to 51 for details.

## Underlying PBT



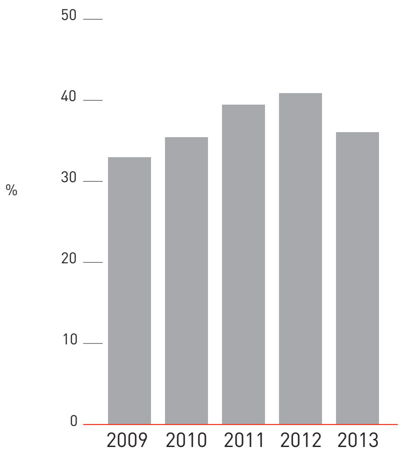

**Definition and basis of calculation**
Underlying PBT is reconciled to statutory measures in note 10 of the Group financial statements. Prior year figures have been restated for the impacts of IAS 19 (Revised) and the treatment of net interest expense on retirement benefit obligations as described in note 44 of the Group financial statements.

**Target**
We do not publish profit targets.

**Result**
Achieved £377.8 million (2012: £366.0 million as restated). See page 24 for details.

**Directors' incentive plans**
Underlying PBT is a performance measure in the 2013 and 2014 Short Term Incentive Plan (STIP). For the purpose of these plans, underlying PBT figures are measured at constant currency. See pages 49 and 51 for details.

## Return on trading assets




**Definition and basis of calculation**
Underlying operating profit after tax expressed as a percentage of average trading assets. Underlying operating profit is defined and reconciled to statutory measures in note 10 of the Group financial statements.

Trading assets are defined as net assets adjusted to exclude goodwill, other intangible assets arising on the acquisition of businesses, net debt, retirement benefit obligations, derivative financial instruments and deferred tax.

Average trading assets are calculated as the average of trading assets at the start and end of the year.

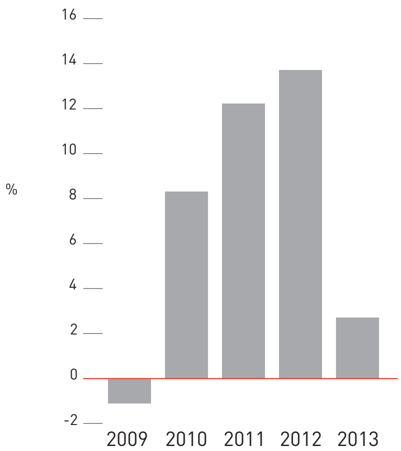
Return on trading assets measures performance by linking operating performance to management of working capital and capital investment. It replaces the previously reported return on sales KPI.

**Target**
Slight reduction in the short-term due to projected high level of investment needed to execute high volume of new platform contracts secured in recent years. Target is to achieve an average return on trading assets of 34.5% over the next three years.

**Result**
Achieved 36.0% (2012: 40.8%). Average achieved over last five years: 36.9%. See page 28 for details.

**Directors' incentive plans**
Return on trading assets is proposed as a measure for the 2014 LTIP. For the purpose of this plan, underlying operating profit after tax and trading assets are measured at constant currency. See pages 50 to 51 for details.

## Underlying EPS growth




**Definition and basis of calculation**
The percentage change in underlying earnings per share (EPS) from the previous year. Underlying EPS is reconciled to statutory measures in note 15 of the Group financial statements.

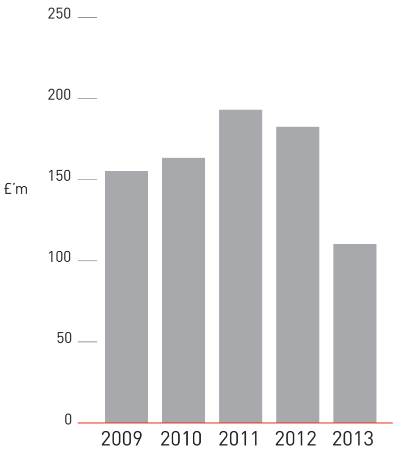
**Target**
We do not publish profit targets. However, the proposed 2014 LTIP includes EPS targets equivalent to growth ranging from 5 to 10% per annum over the next three years.

**Result**
Achieved 2.7% (2012: 13.7%). Average achieved over last five years: 7.2%. See page 27 for details.

**Directors' incentive plans**
Underlying EPS is a performance measure used in the 2013 LTIP and is proposed as a measure for the 2014 LTIP. For the purpose of these plans, underlying EPS is adjusted to exclude the impact of scrip dividends. See pages 50 to 51 for details.

# Key performance indicators continued

## Free cash flow




**Definition and basis of calculation**
Cash generated excluding amounts in respect of acquisition of businesses, disposal of businesses and paid to shareholders. See page 29 for a reconciliation of free cash flow to statutory measures.

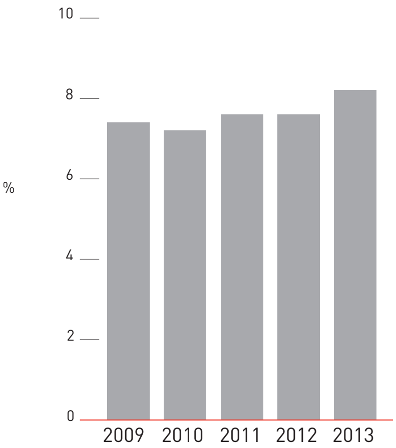
Free cash flow replaces the previously reported cash conversion KPI.

**Target**
We do not publish free cash flow targets.

**Result**
Achieved £110.4 million (2012: £182.4 million). See page 28 for details.

**Directors' incentive plans**
Free cash flow, as defined above, is a performance measure in the 2014 STIP. Free cash flow adjusted to exclude capital expenditure was a measure in the 2013 STIP. For the purpose of these plans, actual and target free cash flow figures are measured at constant currency. See pages 49 and 51 for details.

## R&D investment



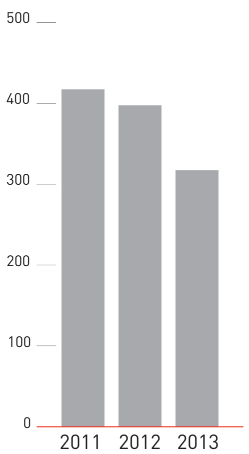

**Definition and basis of calculation**
Investment in research and development (R&D) expressed as a percentage of revenue. Investment is measured as total expenditure in the year and is not adjusted for amounts capitalised or amortised. Investment is measured gross of funding received from customers.

**Target**
Investment of 6 to 8% per annum. This range reflects investment fluctuation within the industry cycle.

**Result**
Achieved 8.2% (2012: 7.6%). Average achieved over last five years: 7.6%. See page 28 for details.

**Directors' incentive plans**
R&D investment is not a specific measure used in any directors' incentive plans. However, the 2014 LTIP proposes to include measures focussed on R&D programme management. See pages 50 to 51 for details.

## Accident/incident rate



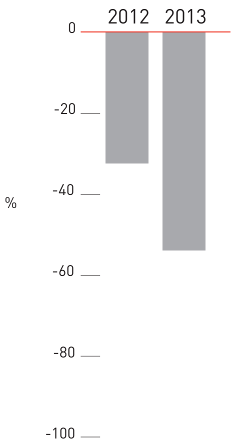

**Definition and basis of calculation**
The number of injuries reportable under local laws and regulations multiplied by 100,000, divided by the average employee headcount during the year. The method of calculation was revised in 2012 and it has not been practical to restate figures prior to 2011 on this basis.

**Target**
Year-on-year improvement with an ultimate goal of nil.

**Result**
2013: 317 (2012: 397). See page 33 for details.

**Directors' incentive plans**
Health and safety performance is included in the personal objectives of two executive directors.

## Reduction in defective parts per million (DPPM)




**Definition and basis of calculation**
Defective parts per million (DPPM) for the year expressed as a percentage improvement from that achieved at 31 December 2011, the date at which the Meggitt Production System introduced this consistent method of measurement. DPPM is defined as the number of defective parts returned by customers in the year multiplied by 1,000,000 and divided by the total number of parts delivered.

Figures include the results of disposed businesses up to the date of sale and include the results of acquired businesses from the later of the start of the financial year following acquisition and the date the information is first available.

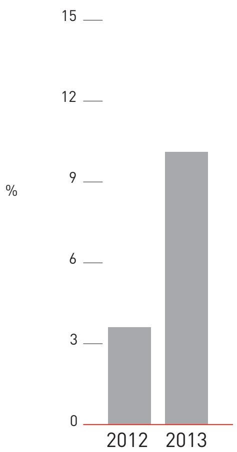
This new KPI monitors the success of the Meggitt Production System.

**Target**
To achieve the levels of performance excellence (e.g. sometimes referred to as 'Supplier Gold') expected by our customers. We use simple on-time delivery and DPPM measures, aggregated at a Group level, to track overall progress towards these objectives. Given the complexity and variety of customer metrics, driven by the large number of customers we serve, we also track performance as reported by our customers through their own supplier scorecards.

**Result**
Cumulative improvement since 31 December 2011: 54% (2012: 32%). See page 5 for details.

**Directors' incentive plans**
DPPM is a measure used in the 2013 STIP and is proposed as a measure for the 2014 LTIP. For the purpose of these plans, it is measured by reference to the number of sites achieving individual targeted reductions in DPPM. See pages 49 to 51 for details.

## On-time delivery improvement




**Definition and basis of calculation**
Average on-time delivery achieved in the year expressed as a percentage improvement from that achieved at 31 December 2011, the date at which the Meggitt Production System introduced this consistent method of measurement. Calculated as the 12-month average of the number of parts delivered on delivery dates agreed with customers, divided by the total number of parts delivered.

Figures include the results of disposed businesses up to the date of sale and include the results of acquired businesses from the later of the start of the financial year following acquisition and the date the information is first available.

This new KPI monitors the success of the Meggitt Production System.

**Target**
To achieve the levels of performance excellence (e.g. sometimes referred to as 'Supplier Gold') expected by our customers. We use simple on-time delivery and DPPM measures, aggregated at a Group level, to track overall progress towards these objectives. Given the complexity and variety of customer metrics, driven by the large number of customers we serve, we also track performance as reported by our customers through their own supplier scorecards.

**Result**
Cumulative improvement since 31 December 2011: 10.1% (2012: 3.6%). See page 5 for details.

**Directors' incentive plans**
On-time delivery is a measure used in the 2013 STIP and is proposed as a measure for the 2014 LTIP. For the purpose of these plans, it is measured by reference to the number of sites achieving individual targeted on-time delivery figures. See pages 49 to 51 for details.

# Chief Financial Officer's review

**Doug Webb** Chief Financial Officer

## Overall performance

Ongoing demand growth in civil original equipment and energy was tempered by softness in civil aftermarket and military, and operational challenges in the year caused a further drag on growth. Revenue grew 2% and underlying profit before tax grew 3%, driving a 3% increase in underlying EPS to 37.5p. With a strong order book and an improving trend in civil aftermarket, there is good momentum going into 2014.

**Financial highlights** (Table 1)

| | **2013 £'m** | 2012[1] £'m | Reported % change | Organic % change |
|---|---|---|---|---|
| Revenue | **1,637.3** | 1,605.8 | +2 | +1 |
| Underlying[2]: | | | | |
| EBITDA[3] | **479.3** | 466.2 | +3 | +2 |
| Operating profit | **397.2** | 392.1 | +1 | 0 |
| Profit before tax | **377.8** | 366.0 | +3 | +2 |
| Earnings per share ('EPS') | **37.5p** | 36.5p | +3 | |
| Statutory: | | | | |
| Operating profit | **300.3** | 321.4 | -7 | |
| Profit before tax | **269.4** | 281.3 | -4 | |
| Earnings per share ('EPS') | **29.4p** | 30.1p | -2 | |
| Free cash flow[4] | **110.4** | 182.4 | -39 | |
| Net debt | **564.6** | 642.5 | -12 | |

1 Restated for the effects of adopting IAS 19 (Revised) and also for underlying profit measures, the treatment of pension interest. See note 44 of the Group financial statements for further details.
2 Underlying profit and EPS are defined and reconciled to statutory measures in notes 10 and 15 respectively of the Group financial statements.
3 Underlying EBITDA represents underlying operating profit adjusted to add back depreciation and amortisation.
4 Free cash flow is defined and reconciled to statutory measures in note 40 of the Group financial statements.

## Revenue

Total revenue increased by 2% to £1,637.3 million. As Table 2 (see page 24) demonstrates, softness in civil aftermarket and military were compensated for by strong growth in civil original equipment (OE). Organic growth was 1% after adjusting for the effects of acquisitions, disposals and foreign exchange.

Total civil aerospace revenue grew 3% (organic: 4%), with strong organic growth in OE of 11%, predominantly on large jets, compensating for lower than expected growth in aftermarket (AM). The AM weakness was largely as a result of the continuation of the destocking seen in 2012, although the growth trend improved as the year progressed, with organic growth of 2% and 3% respectively in Q3 and Q4.

Total military revenue declined by 1% (organic: -3%), reflecting the anticipated effect of the drawdown from Afghanistan, a slowdown in orders in our defence systems business and the substantial completion of two large retrofit programmes, partly offset by good growth in our training business, particularly outside the US.

Total energy revenue increased by 5% in 2013 (organic: +5%). The favourable demand environment for our printed circuit heat exchangers continued, with Heatric growing 11% in the year, although order and milestone timing impacted revenue in the second half. We saw good growth in demand for our innovative valve technology for the power generation market. Our revenue from energy condition monitoring was negatively impacted in the second half by the previously announced operational challenges encountered during the consolidation of our two US-based sensor businesses into a new west coast facility, and shortage of an important raw material. However, the market remains robust and we are confident that these issues are now under control. Our medium term expectation remains that our energy businesses will grow at greater than 10% per annum over the next few years.

Total revenue from other markets grew 9% in 2013 (organic: +1% after adjusting for the Piezotech acquisition), with good growth in medical revenue offsetting weakness in laboratory test and measurement equipment.

Strategy insight
**Secure positions on new platforms**

## If it was a flexible fuel tank you wanted, our name was on it. Now, after collaborating with experts from our Control Systems division, we can put Meggitt's name to complete fuel systems. That's what organic growth is all about, building value from within.

**John Skubina**
Vice President,
Meggitt Polymers & Composites

Meggitt has won a long-term contract starting now and running until 2030 for the Sikorsky S-92® helicopter sponson fuel system. It is based on an innovative combination of Meggitt's extreme environment composites, fuel and fluid control technologies. Of course, innovation gets you the attention but you won't go far in our markets without the trust built up from industry relationships and experience spanning decades.

We launched our long-life, lightweight bladder fuel cell technology 30 years ago, pioneering inner liners that do not dry out and become fatally brittle when empty for extended periods, with the flexibility to withstand the stresses and strains of take-off and landing.

Virtually every US military aircraft carries the ballistically-resistant and crashworthy fuel tanks we introduced 25 years ago. Today, we're making a name for ourselves in IED-resistant fuel tanks for ground vehicles.

That's why, when we make the leap from component to system, the makers of a helicopter certified to the most stringent safety requirements of the Federal Aviation Administration know our landing will be sure.

# Chief Financial Officer's review continued

**Revenue growth** (Table 2)

| | 2013 Revenue £'m | Growth % | Organic growth % |
|---|---|---|---|
| Civil OE | **300.3** | +7 | +11 |
| Civil AM | **435.9** | +1 | 0 |
| Total civil | **736.2** | +3 | +4 |
| Military | **616.4** | -1 | -3 |
| Energy | **173.1** | +5 | +5 |
| Other | **111.6** | +9 | +1 |
| Total | **1,637.3** | +2 | +1 |

## Profit

The Board's preferred measure of the Group's trading performance is underlying profit. Underlying operating profit for the year grew 1% to £397.2 million (2012: £392.1 million). Headwinds included the mix effect of civil OE growing faster than civil AM, increased investment in the Meggitt Production System and some previously announced operational challenges encountered in the third quarter. These were offset by good progress on a legacy product liability issue and renegotiation of a loss-making contract, both of which had previously been provided for, resulting in an operating margin of 24.3% (2012: 24.4%).

Underlying net finance costs decreased to £19.4 million (2012: £26.1 million) as a result of cash generation and lower interest rates, including the benefit from the refinancing of maturing fixed rate private placement notes by lower rate bank debt.

Underlying profit before tax increased by 3% to £377.8 million (2012: £366.0 million).

On a statutory basis, profit before tax decreased by 7% to £300.3 million (2012: £321.4 million), largely as a result of a £20.0 million exceptional charge to cover costs associated with the supply from a vendor of non-conforming raw material in one of our businesses, as communicated in the interim management statement in November 2013.

## Operational highlights (Table 3)

**Meggitt Aircraft Braking Systems (MABS)** provides wheels, brakes and brake control systems for over 30,000 in-service aircraft and continues to develop innovative technology for new programmes including tyre pressure monitoring, auto-braking capability and steering and landing gear control systems across a broad range of programmes. The division targets sole source programmes and is particularly strong in regional aircraft and business jets. MABS represents 20% of Group revenue, generating 86% of its revenue from the aftermarket and 14% from OE sales.

MABS civil AM revenue (65% of divisional total) grew by 3% in 2013 with growth in regional aircraft and large jets offsetting a modest decline in business jets resulting from a significant destocking at one of our major customers. Civil OE saw strong growth, mainly from the sale of electronic brake control systems and A380 components. Military revenue saw a modest increase owing in part to good growth in Blackhawk spares for the US DoD. Operating margins moved from 37.6% to 37.0% reflecting the growth in lower margin military and civil OE sales.

**Meggitt Control Systems (MCS)** designs and manufactures products which manage the flow of liquids and gases around gas turbines (both aerospace and industrial), and control the temperature of oil, fuel and air in aircraft. Its valve business also supplies industrial and airport ground fuelling products. The division represents 13% of Group revenue and generated 53% of its revenue from OE and 47% from the aftermarket.

MCS reported revenue declined 4% in 2013. On an organic basis (including adjusting for the disposal of the Meggitt Addison business during 2013 and the Meggitt Simi business in 2012), MCS revenue grew 2%, with strong civil OE (+8%) and energy (+14%) growth more than offsetting modest declines in civil AM (-2%) and military (-4%). The strong growth in civil OE was driven by large jets, reflecting the increased deliveries by the major manufacturers. Civil AM weakness resulted from a continuation of the destocking seen in 2012. Operating margins improved from 23.2% to 24.5% benefiting from favourable progress on a legacy product liability issue and following the disposal of the relatively lower margin cabin air conditioning business during the year.

**Meggitt Polymers & Composites (MPC)** has a strong military focus, representing 60% of its revenue. It supplies flexible bladder fuel tanks, ice protection products and composite assemblies for a range of fixed wing and rotary aircraft and complex seals packages for civil and military platforms. These market segments are linked by their dependence on similar materials technology and manufacturing processes. MPC represents 11% of Group revenue.

**Operational highlights** (Table 3)

| Revenue 2013 £'m | Revenue 2012 £'m | Revenue Growth % | Revenue Organic growth[1] % | | Underlying operating profit[2] 2013 £'m | Underlying operating profit[2] 2012 £'m | Underlying operating profit[2] Growth % | Underlying operating profit[2] Organic growth[1] % |
|---|---|---|---|---|---|---|---|---|
| **330.4** | 311.2 | 6.2% | 4.7% | Aircraft Braking Systems | **122.4** | 117.1 | 4.5% | 3.5% |
| **205.6** | 214.9 | -4.3% | 1.6% | Control Systems | **50.4** | 49.8 | 1.2% | 7.1% |
| **181.0** | 187.2 | -3.3% | -4.6% | Polymers & Composites | **30.2** | 33.8 | -10.7% | -12.4% |
| **240.4** | 240.2 | 0.1% | -2.2% | Sensing Systems | **34.3** | 36.2 | -5.2% | -13.5% |
| **679.9** | 652.3 | 4.2% | 2.7% | Equipment Group | **159.9** | 155.2 | 3.0% | 2.1% |
| **1,637.3** | 1,605.8 | 2.0% | 1.4% | | **397.2** | 392.1 | 1.3% | 0.4% |

[1] Organic growth excludes the impact of M&A and currency and is reconciled in Table 4.

[2] Restated for the effects of adopting IAS 19 (Revised) and the treatment of pension interest. See note 44 of the Group financial statements for further details.

Strategy insight
**Achieve operational excellence**

## I've seen my world turned upside down by the Meggitt Production System —and it's all the better for it.

**Lee Barnes**
Production Manager, Meggitt Avionics


**Meggitt Production System does turn a workplace on its head. Management, team leaders, production supervisors, all must support the people who make things and get them out of the door. But Lee Barnes is referring to his own personal MPS journey.**

**At first MPS just didn't add up for Lee. Wasn't he already focused on supporting the shopfloor? Where was the time for all the KPI gathering and morning meetings? Hadn't he seen all this before? But then, as each new doubt started to form in his mind, there'd be a twist that defused it; something that neatly turned the nice-but-theoretical into a sustainable, practical, powerful improvement.**

**Four days in and Lee knew he'd been wrong about MPS all along. It is different and Lee couldn't be more pleased to admit it.**

# Chief Financial Officer's review continued

Strategy insight
**Provide through-life product support**

## A third of new airliner deliveries are destined for the Asia Pacific over the next decade, so opening our new aftermarket facility in Singapore couldn't be more timely or its scope more appropriate. Walk down our central aisle and when you reach the end, you will have seen virtually all Meggitt's capability.

**Adrian Plevin**
Vice President and General Manager, Meggitt Aerospace Asia Pacific

We ask the airline operators to send their products home for maintenance. That's because, as the maker of those products, we have the control data at our fingertips to provide optimal repairs and advice. And beyond skilled maintenance, Meggitt's approach to the aftermarket is about going the extra mile, making special logistics arrangements, training technicians to get the best from our products and even adding capability for third-party repairs when our customers ask us to.

We work with the world's premier carriers who have selected us as their strategic partner and we work with owner-operators, distributors and parts brokers. All benefit from the fail-safe service that arises from our consistent management and production processes.

That's because our people are fundamental to the dynamic process that places customers at the heart of our operations.

The Meggitt Production System—which encapsulates the Group's approach to lean manufacturing and continuous improvement—is enhancing this, enabling us to respond with ease to rising demand from the region—and the industry as a whole—in an era of unprecedented new programmes. In short, we're ready.

**Organic growth** (Table 4)

| Revenue 2013 £'m | Revenue 2012 £'m | Revenue Growth % | | Underlying profit before tax 2013 £'m | Underlying profit before tax 2012 £'m | Underlying profit before tax Growth % |
|---|---|---|---|---|---|---|
| **1,637.3** | 1,605.8 | 2.0% | Reported | **377.8** | 366.0 | 3.2% |
| **(44.3)** | (53.1) | | Impact of M&A[1] | **(3.3)** | (8.0) | |
| **(19.0)** | - | | Impact of currency[2] | **(8.4)** | - | |
| **1,574.0** | 1,552.7 | 1.4% | Organic | **366.1** | 358.0 | 2.3% |

[1] Excludes the results of businesses acquired or disposed of during the current and prior year.
[2] Restates the current year using 2012 translation and transaction exchange rates.

Reported revenue in MPC declined 3% (organic: -5%). Civil revenue grew by 11% on an organic basis, with sales of polymer seals for large jets and composites for helicopters growing particularly strongly. As expected, military revenue declined following substantial completion of the KC135 and Bradley fuel tank retrofit contracts during the second half. These programmes contributed £16.5 million to revenue during 2013 (2012: £29.6 million). Operating margins moved from 18.1% to 16.7% reflecting strong growth in the lower margin civil OE products replacing military work, and lower sales of higher margin ice-protection products.

**Meggitt Sensing Systems (MSS)** designs and manufactures highly engineered sensors to measure a variety of parameters such as vibration, temperature, pressure, fluid level and flow. Its products are designed to operate effectively in the extreme conditions of temperature, vibration and contamination that exist in an aircraft or on ground-based turbines. Sensors are combined into broader electronics packages, providing condition data to engine operators and maintenance providers, contributing to improved safety and lower operating costs. MSS has migrated these products into other specialist markets requiring similar capabilities, such as test and measurement, automotive crash test and medical pacemakers. It has also teamed with MABS, winning a number of new commercial tyre pressure monitoring system contracts. This progresses the strategy to apply our condition-monitoring capability beyond engines to structural parts of aircraft, where we see a considerable market opportunity. MSS represents 15% of Group revenue and generated 80% of its revenue from OE and 20% from the aftermarket. MSS revenue is split 39% civil aerospace, 19% military and 42% energy and other, of which the majority is energy.

MSS reported revenue was flat in the year, (organic: -2%, stripping out the effect of the Piezotech acquisition) with growth in military and medical products largely offsetting a decline in energy where the shortage of tourmaline limited the sales of some high margin components. MSS also experienced operational challenges associated with the consolidation of two US factories into one new facility in the second half. A solution to the tourmaline shortage is in process, and will be substantially complete by the end of the first half. Civil OE revenue saw good growth, offset by a decline in civil AM. Operating margins declined to 14.3% (2012: 15.1%) as a result of the operational challenges and OE/AM mix.

**Meggitt Equipment Group (MEG)** comprises a technologically diverse range of businesses (including PacSci), each of which has differentiated capabilities and a specific focus, ranging from fire protection systems through to sophisticated electronics and electro-mechanical components and sub-systems. The division represents 41% of Group revenue and generates approximately 70% of its revenue from OE and 30% from the aftermarket.

Reported revenue in MEG was up 4% on last year (organic: +3% including adjusting for the sale of Sunbank in December 2013 and the acquisition of Precision Micro in 2012). Civil aerospace increased by 4% on an organic basis driven mainly by demand for large jet OE products, and energy grew 11% as a result of continued good performance at our Heatric printed circuit heat exchanger business. Energy revenue growth was skewed towards the first half, reflecting the exceptional growth in the second half of 2012. Military revenue was broadly flat in the year, with good growth in the training businesses offsetting a decline in defence systems. Operating margins remained broadly flat at 23.5% (2012: 23.8%), with incremental synergies from the PacSci acquisition and the renegotiation of a loss-making contract against which a provision had been held largely offsetting unfavourable mix.

## Taxation

Meggitt's underlying tax rate benefited from a one-off research and development credit in the US, reducing slightly to 21% (2012: 22%). We continue to expect an underlying rate of 22% in the medium term based on our current business mix. Cash tax paid as a percentage of underlying profit was 12% (2012: 9%). The rate of cash tax paid is lower than our underlying tax rate due to tax deductible items which do not affect underlying profit, including goodwill amortisation and tax relief on retirement benefit deficit reduction payments.

Our statutory tax rate, which includes items excluded from underlying profit was 14% (2012: 16%).

## Earnings per share (EPS)

Underlying EPS increased by 3% to 37.5 pence (2012; 36.5 pence). An increase in shares in issue, which includes the 21% take up of scrip dividend on 2013 dividend payments, offset the benefits of the lower tax rate and resulted in EPS growth being in line with the growth in underlying profit before tax.

Statutory EPS declined 2% to 29.4 pence (2012: 30.1 pence). The decline is smaller than that in statutory profit before tax with the reduction in statutory tax rate more than offsetting the higher number of shares in issue.

## Dividends

The Board has increased the recommended final dividend to 8.80 pence (2012: 8.20 pence) which would result in an 8% increase in the full-year dividend to 12.75 pence (2012: 11.80 pence).

# Chief Financial Officer's review continued

## Building future growth

The key pillars of our strategy are to deliver innovation, secure positions on new platforms in our chosen markets, develop and sustain a culture of operational excellence and provide our customers with world-class through-life support.

Innovation and technology development are aimed at adding new capabilities to our portfolio in response to customer requirements. During 2013, investment in R&D totalled £134.9 million or 8.2% of revenue (2012: £122.0 million, 7.6%), of which 18% was funded by customers. This is our highest ever level of R&D, and above our normal range of 6-8% of revenue, reflecting the very strong win-rate on new programmes. Areas of focus in 2013 included advancement on a number of wheel and brake technologies including electrically actuated braking and tyre pressure monitoring systems, developing our helicopter fuel system technology in line with Sikorsky's requirements on the S92 programme, and the development of an environmentally responsible fire suppression technology to replace the use of halon as a suppressant in aerospace applications. We also continue to invest in transferring our core aerospace technologies across adjacent markets, and developing manufacturing techniques including additive manufacturing to enhance our prototyping and manufacturing capabilities.

**Analysis of R&D costs** (Table 5)

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Total R&D expenditure | **134.9** | 122.0 |
| % of revenue | **8.2%** | 7.6% |
| Customer-funded R&D | **(24.5)** | (24.9) |
| Capitalised | **(70.2)** | (52.2) |
| Amortisation | **16.9** | 11.6 |
| Charge to income statement | **57.1** | 56.5 |

Meggitt invested a further £35.7 million (2012: £36.1 million) in supplying equipment free of charge to new aircraft and making programme participation contributions, mostly in MABS, and we expect this to grow in the medium term as new regional aircraft and business jets equipped with our wheels and brakes are delivered.

Our leading edge capabilities incorporating high levels of embedded intellectual property, and our lengthy pedigree in our chosen markets, enable us to secure strong positions on new programmes such as the Dassault Falcon 5X announced in the second half of 2013. We target specialist applications where we can generate revenue from original equipment, with annuity-like maintenance, overhaul, spares and repair revenue for the life of programmes, which can last for decades. As our products are spread over multiple platforms and markets, we are not dependent on single programmes, customers or regions.

Capital expenditure on property, plant and equipment and other intangible assets increased to £66.9 million (2012: £63.2 million). There has been substantial investment in our manufacturing facilities during 2013. We have consolidated six factories into three larger, more efficient facilities, and have built additional capacity in some of our businesses to meet future growth requirements. Examples of capacity growth include further investment at our Heatric printed circuit heat exchanger business in the UK and new, larger facilities for our power storage business in North America and our sensor business in Denmark. We have also continued to invest in the roll-out of a common ERP system across the Group.

We believe superior performance on quality and delivery are the building blocks of future growth. As our customers continue to raise the bar, we are intensifying our investment in facilities, production systems, programme management and people. These investments ensure that we will continue to meet our customer expectations, and will further strengthen our customer partnerships.

2013 saw the launch of our global approach to continuous improvement—the Meggitt Production System—which is already delivering tangible improvements in quality and delivery and which will, over the long term, create a sustainable competitive advantage based on our manufacturing and programme management capabilities. We will also become more cost competitive through the reduction in rework costs and working capital.

Finally, we continue to invest in our product support capability. In 2013, we opened our new repair and overhaul centre in Singapore, doubling our capacity and adding more Meggitt product lines, and launched a major review of the optimal way to deploy Meggitt's growing aftermarket capability to our global customer base.

## Cash flow and borrowings

Free cash flow of £110.4m (2012: 182.4m) reflects continued investment in R&D and capital expenditure as well as higher working capital due to the lower than anticipated revenue growth, delayed customer receipts and the timing of milestones in our Heatric business.

Net cash generated of £63.2 million (2012: £116.7 million) reflects the increases in R&D, capital expenditure and working capital referred to above, partially offset by net proceeds from M&A of £25.9 million (2012: £5.2 million). Net debt decreased by 12% to £564.6 million (2012: £642.5 million).

To reflect the Board's focus on efficient deployment of manageable capital, we have introduced a new Return on Trading Assets (ROTA) key performance indicator, which we track at both Group and individual business level. ROTA moved to 36.0% in 2013 (2012: 40.8%) reflecting the investments in R&D, capital expenditure and working capital during the year.

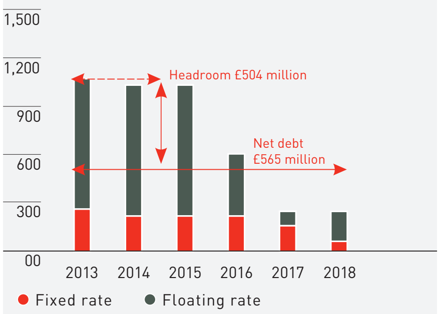
**Movement in net debt (£'m)** (Table 6)

| | 2013 | 2012 |
|---|---|---|
| **Cash flow from operations before exceptional operating costs** | **361.9** | 408.8 |
| Exceptional operating costs excluding M&A costs | **(15.3)** | (12.4) |
| Interest and tax | **(63.4)** | (62.5) |
| Capitalised development costs/programme participation costs | **(105.9)** | (88.3) |
| Capital expenditure | **(66.9)** | (63.2) |
| **Free cash flow** | **110.4** | 182.4 |
| Net proceeds from M&A | **25.9** | 5.2 |
| Net amounts payable to shareholders | **(73.1)** | (70.9) |
| **Net cash generated** | **63.2** | 116.7 |
| Debt acquired with businesses | **(0.3)** | (0.4) |
| Currency movements | **2.7** | 33.9 |
| Other non-cash movements | **12.3** | (4.3) |
| Opening net debt | **(642.5)** | (788.4) |
| **Closing net debt** | **(564.6)** | (642.5) |

## Debt structure and financing

The Group's borrowings comprise a combination of US private placement debt and syndicated bank credit facilities. During the year, the Group repaid, out of existing facilities, expiring US $180 million private placement notes. There were no other changes in facilities available to the Group in the year. As at 31 December 2013, the Group had undrawn committed credit facilities of £504 million after taking account of surplus cash (2012: £557 million). More than 96% of the Group's existing committed facilities expire after 2015.

**Facility headroom (£'m)** (Table 7)




## Debt financing risks

The Group seeks to minimise debt financing risk as follows:

**a. Concentration of risk**
We raise funds through private placement issuances and committed bank facilities to reduce reliance on any one market. Bank financing is sourced from around 15 international institutions spread across North America, Europe and Asia. No single bank accounts for more than 6% of the Group's total credit facilities and the credit rating of lenders is monitored by our treasury department. Our largest six lenders are Bank of America, Barclays, HSBC, JP Morgan, Bank of Tokyo-Mitsubishi and Sumitomo Mitsui Banking Corporation. We also seek to maintain at least £200 million of undrawn committed facilities, net of cash, as a buffer.

**b. Set-off arrangements**
The Group utilises set-off and netting arrangements where possible to reduce the potential effect of counterparty defaults. All treasury transactions are settled on a net basis where possible and surplus cash is generally deposited with our lenders up to the level of their current exposure to us.

**c. Refinancing risk**
We seek to ensure the maturity of our facilities is staggered and refinancings are concluded in good time, typically more than 12 months before expiry.

**d. Currency risk**
To ensure we mitigate headroom erosion due to currency movements our credit facilities are denominated in US dollars, the currency in which most of our borrowings are held.

**Net debt by drawn currency (£'m)** (Table 8)

| | 2013 | 2012 |
|---|---|---|
| Sterling | **(21.2)** | (19.1) |
| US dollar | **462.9** | 592.1 |
| Euro | **53.9** | (10.2) |
| Swiss franc | **78.9** | 88.6 |
| Other | **(9.9)** | (8.9) |
| Net debt | **564.6** | 642.5 |

**e. Covenant risk**
Meggitt's committed credit facilities contain two financial ratio covenants—interest cover and net debt to EBITDA. The covenant calculations are drafted to protect us from potential volatility caused by accounting standard changes, sudden movements in exchange rates and exceptional items. This is achieved by measuring EBITDA on a frozen GAAP basis, retranslating net debt and EBITDA at similar average exchange rates for the year and excluding exceptional items from the definition of EBITDA. We continue to have considerable headroom on both key financial covenant measures.

**Covenant ratios** (Table 9)

| | Covenant | 2013 | 2012 |
|---|---|---|---|
| Net debt/EBITDA | ≤3.5x | **1.2x** | 1.3x |
| Interest cover | ≥3.0x | **22.0x** | 16.2x |

## Interest risk

Meggitt seeks to reduce the volatility caused by interest rate fluctuations on net debt. Our US private placements are subject to fixed interest rates whereas borrowings under our syndicated bank credit facilities are at floating rates. To manage interest rate volatility, we use interest rate derivatives to either convert floating rate interest into fixed rate or vice versa. Our policy is to maintain at least 25% of net debt at fixed rates with a weighted average maturity of two years or more. At 31 December 2013, the percentage of net debt at fixed rates was 46% (2012: 43%) and the weighted average period to maturity of the first 25% was 5.4 years (2012: 5.4 years).

## Foreign exchange risk

The Group is exposed to both translation and transaction impacts due to changes in foreign exchange rates. These risks principally relate to the US dollar/Sterling rate, although exposure also exists in relation to other currency pairs including the US dollar/Swiss franc and US dollar/Euro.

The results of overseas businesses are translated into sterling at weighted average exchange rates. Compared to 2012, the Group's underlying profit before tax for the year benefited by £4.7 million from currency translation of which £3.4 million arose on US dollar denominated profits and

# Chief Financial Officer's review continued

the balance on other currencies. Each five cent weakening of the US dollar versus the 2013 average rate of £1:$1.57 will adversely impact 2014 revenue by approximately £35 million, with the converse also being true. The sensitivity of 2014 underlying profit before tax to a five cent move in the translation rate is approximately £8.0 million.

The net assets of overseas businesses are translated into sterling at year end exchange rates. The resultant exchange rate exposure is mitigated through holding our net debt principally in the currencies of those businesses.

Transaction risk arises where revenues and/or costs of our businesses are denominated in a currency other than their own. We hedge known and some anticipated transaction currency exposures based on historical experience and projections. Our policy is to hedge at least 70% of the next 12 months' anticipated exposure and to permit the placing of cover up to five years ahead. Compared to 2012, the Group's underlying profit before tax for the year benefited by £3.7 million from currency transaction movements, of which £1.6 million relates to US dollar/Sterling exposure and the balance to other currency pairs. Each five cent movement of the US dollar versus the 2013 average hedged rate of £1 = $1.62 impacts underlying profit before tax by approximately £2.5 million. At 31 December 2013, $/£ cover for estimated 2014 exposure was 100% hedged at an average rate of $1.53 and we have covered approximately 50% of our $/£ exposures for the next three subsequent years at an average rate of $1.56.

**Exchange rates (US$/£)** (Table 10)

| | **2013** | 2012 |
|---|---|---|
| Average translation rates | **1.57** | 1.59 |
| Average transaction rates | **1.62** | 1.66 |
| Year-end rates | **1.66** | 1.63 |

## Post-retirement benefit schemes

The Group's principal defined benefit pension schemes are in the UK and US and are closed to new members.

The total pension scheme deficits reduced to £189.8 million (2012: £241.2 million). Net of deferred tax, the deficits reduced to £139.9 million (2012: £169.3 million). The main drivers of the reduction were:

- Net deficit reduction payments of £26.7 million (2012: £22.8 million). Regulations in the UK and US require repayment of deficits over time. In the UK, the 2012 triennial actuarial valuation was finalised during 2013 and a repayment plan agreed with the trustees. Under this agreement, the Group commenced making increased deficit payments from April 2013 with amounts due to gradually increase over the period to 2024. In the US, the level of deficit payments is principally driven by regulations. Amounts required to be paid decreased slightly in the year and are expected to remain relatively flat in 2014. Overall, the Group expects deficit contributions to increase to £30.6 million in 2014.
- An actuarial gain on scheme assets of £25.5 million (2012: £28.8 million) principally driven by the continued global recovery in equity markets.

**Defined benefit pension scheme summary (£'m)** (Table 11)

| | **2013** | 2012 |
|---|---|---|
| Opening net deficit | **241.2** | 265.4 |
| Service cost | **12.7** | 12.3 |
| Group cash contributions | **(39.4)** | (35.1) |
| Net deficit reduction payments | **(26.7)** | (22.8) |
| Other amounts charged to income statement[1] | **11.4** | 13.7 |
| Actuarial gains – schemes' assets | **(25.5)** | (28.8) |
| Actuarial (gains)/losses – schemes' liabilities | **(10.6)** | 18.6 |
| Currency movements | **–** | (4.9) |
| Closing net deficit | **189.8** | 241.2 |
| Assets | **688.4** | 634.7 |
| Liabilities | **878.2** | 875.9 |
| Closing net deficit | **189.8** | 241.2 |
| Funding status | **78%** | 72% |

[1] Comprises past service costs, administration expenses borne directly by schemes and net finance costs.

Meggitt has two other principal post-retirement benefit schemes providing medical and life assurance benefits to certain US employees. The Group's exposure to increases in future medical costs provided under these plans is capped. Both schemes are unfunded and have a combined deficit of £48.3 million (2012: £58.5 million). The main driver of the reduction was the increase in AA corporate bond rates used to measure scheme liabilities. Deficit payments during the year were £0.7 million (2012: £2.2 million).

In 2013, the Group adopted IAS 19 (Revised 2011) which changed the calculation of certain items of pension expense. In addition, the definition of underlying profit measures was amended to exclude net pensions interest. Details of these changes are provided in note 44 of the Group financial statements.

## Going concern

The Group's business activities are described on pages 8 to 14 which include those factors most likely to affect its future development, performance and position. The financial position of the Group is set out in this report and additional information is provided in the financial statements including note 3 (Financial risk management), note 28 (Bank and other borrowings) and note 30 (Derivative financial instruments). Details of the principal risks and uncertainties to which the Group is exposed, and the mitigation plans in place, are set out on pages 15 to 17.

The Group describes in the Strategic report on pages 4 to 7 its cash generative business model designed to deliver organic revenue growth of 6-7% in the medium term and its resilience to one-off global shock events. The Group continues to be cash generative even at the current peak in the investment cycle, has considerable headroom against existing bank facilities and covenants and there is no material facility expiry before 2016.

Accordingly, after making enquiries, the directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the Group and the Company have adequate resources to continue in operational existence for the foreseeable future. For this reason, the directors continue to adopt the going concern basis in preparing the Group and Company financial statements.

# Corporate responsibility



We recognise our responsibility to shareholders, employees, customers, suppliers and the wider community to conduct our operations in a safe, responsible and sustainable manner. We are committed to ensuring compliance with all relevant national laws and regulations and aim to continually improve our financial, social and environmental performance.

**Policy**
We are committed to:

- upholding sound corporate governance principles;
- providing a supportive, rewarding and safe working environment with modern operational practices;
- conducting business relationships in an ethical manner;
- minimising the environmental impact of products and processes and maintaining internationally-accredited environmental management systems;
- independent audits in key compliance areas;
- acting as a responsible supplier and encouraging our contractors and suppliers to do the same;
- supporting our local communities; and
- professional and comprehensive employee training programmes.

**Governance and compliance**
Health, safety and environment (HSE), ethics and business conduct and trade compliance are managed by a highly experienced team of functional specialists, under the leadership of the Corporate Affairs Director. Divisional presidents and site directors are responsible for implementing policies and programmes locally.

The Board has approved policies on corporate responsibility, health and safety, environment, ethics and business conduct and trade compliance, and these are available on our website.

The Board has an Ethics and Trade Compliance Committee, which meets quarterly to discuss these programmes in detail. HSE matters are reviewed and discussed at every Board meeting.

## 2013 Activity

### Environment

Meggitt strives to achieve the highest level of environmental performance throughout our businesses based on standards and procedures set by Group leadership. To achieve the goals of our Environmental Policy, Meggitt's environmental management programme includes setting environmental targets, communicating regulatory developments, training and information-sharing, data analysis and internal and external auditing of environmental management systems and practices.

Our global environmental audit programme, supported by external consultants, includes a comprehensive review of applicable regulatory requirements and best practice standards at all manufacturing facilities every three years. In total, 11 sites were audited in 2013.

78% of our manufacturing facilities had achieved ISO 14001 standard certification by the end of 2013. All facilities should achieve certification by the end of 2014.

**Performance**
Table 1 shows our performance for key environmental metrics. Site consolidations, which reduced floor space, and gas efficiency initiatives completed at our aircraft braking systems facilities in Akron, USA and Coventry, UK contributed to a drop in gas consumption relative to revenue in 2013.

The fall in water consumption relative to revenue is attributable to water conservation measures implemented at many of our facilities. For example, water recirculating systems installed at our North Hollywood, US facility resulted in a 57% decrease in water consumption on 2012. One of our facilities in Oregon, US installed thermostatically-controlled water recirculation systems saving 50% of the water normally used in mould-cooling tanks.

The rise in total waste was due, primarily, to non-recyclable construction debris as a result of site consolidations and from waste produced by the Precision Micro facilities acquired in 2012.

Although site consolidations generate additional waste, our site consolidation projects always include plans to minimise our environmental impact and waste. Our contractors for the site consolidation at Orange County, US diverted more than 70% of waste generated to a recycling facility and were selected partly on the basis of their environmental and waste management credentials.

**Environmental metrics**[1] (Table 1)

| | 2013 | Change | 2012 |
|---|---|---|---|
| **Utilities** | | | |
| Electricity – gWh | **192** | | 188 |
| **MWh per £m revenue** | **120** | 1% | 119 |
| Natural gas – gWh | **183** | | 199 |
| **MWh per £m revenue** | **115** | -9% | 126 |
| Carbon dioxide ($CO_2$)[1] – tonnes at 2012 rates | **133,661** | | 134,444 |
| **Tonnes per £m revenue** | **83.6** | -2% | 84.9 |
| Waste – tonnes | **14,182** | | 12,861 |
| **Tonnes per £m revenue** | **8.87** | 9% | 8.12 |
| Water – cubic metres | **744,196** | | 806,941 |
| **Cubic metres per £m revenue** | **466** | -9% | 510 |

[1] Metrics per £m are calculated using revenue converted at constant exchange rates. $CO_2$ emissions are calculated using conversion factors published in the 2012 Guidelines to DEFRA/DECC's GHG Conversion Factors for Company Reporting. Conversion factors capture only $CO_2$ emissions from Scope 1 and 2 emissions.

# Corporate responsibility continued

### Performance against five-year targets

Table 2 shows our performance against internally set five-year targets. We have met our target for $CO_2$ emissions one year early, and will be setting a new five-year target using 2014 as the baseline year. Our performance is on track to meet targets for most metrics, but acquisitions, facility consolidations and increased production of carbon brakes has impacted our progress on electricity reduction and waste recycled.

### Greenhouse gas emissions (GHG)

Table 3 shows GHG emissions data required to be reported under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulation 2008 as amended in August 2013. The sites reporting GHG data are the same as those consolidated in the Group's financial statements.

### Saving energy

In 2013, we continued to seek improvements in our operations and processes to achieve reductions in energy consumption and improve efficiencies. For example:

- Significant lighting, heating and ventilation system upgrades were made as part of the site consolidation at Orange County, US.
- Several facilities have replaced inefficient air compressors with energy-efficient variable speed drive compressors, resulting in a saving of approximately 1,250 tonnes of carbon per year.
- Several facilities continued to upgrade offices and production floors with high-efficiency compact fluorescent lighting, saving approximately 200 tonnes of carbon per year. One of our facilities in Oregon, US only illuminates office and production floor space when occupied, after installing wireless activity sensors.
- The carbon refurbishment programme at our facility in Akron, US has continued to expand in 2013 with a 54% increase in carbon discs recovered and refurbished from 2012. Reductions to processing time and associated energy consumption of around 75% resulted in savings of approximately 1,600 tonnes of $CO_2$ in 2013.

**Targets** (Table 2)

| | Baseline year | Five year performance period (financial years) | Target improvement over performance period | Achieved as at 31.12.2013 |
|---|---|---|---|---|
| CO2 emissions | 2009 | To 31 December 2014 | -15% | -15.20% |
| Gas | 2011 | To 31 December 2016 | -15% | -13.53% |
| Electricity | 2011 | To 31 December 2016 | -15% | +5.26% |
| Water consumption | 2011 | To 31 December 2016 | -10% | -3.52% |
| Waste to landfill | 2011 | To 31 December 2016 | -10% | -8.22% |
| Waste recycled | 2011 | To 31 December 2016 | +10% | -10.48% |

### REACH

Compliance with the European Community regulation on Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) is managed by the Group's REACH Steering Committee which continues to address the risks associated with the potential obsolescence of chemicals used by aerospace manufacturers. We continuously track substances regulated under REACH and work closely with our chemical suppliers to ensure substances are registered and will be approved for continued use, or a suitable alternative identified.

### Obsolescence

In 2013, our Obsolescence Review Board (ORB) was instrumental in addressing the potential impact of new US legislation on conflict minerals, establishing protocols for understanding how materials are sourced and their paths into our manufacturing facilities and products.

The ORB developed a Counterfeit and Fraudulent Material Avoidance Policy requiring our businesses to develop a process that will protect our supply chain from counterfeit parts. We continued to collaborate with several customers and suppliers to identify and test alternatives to address the increasingly restricted use of particular substances following global regulatory developments (including REACH, described above).

**GHG emissions[1] data** (Table 3)

| | 2013[2] Tonnes of $CO_2$ |
|---|---|
| Combustion of fuel and operation of facilities[3] | 34,323 |
| Electricity, heat, steam and cooling purchased for own use | 100,080 |
| | **134,403** |
| Intensity measurement:<br>Emissions reported above, normalized to tonnes per £m revenue | 84.1 |

[1] Global GHG emissions were calculated using conversion factors published in the 2012 Guidelines to DEFRA/DECC's GHG Conversion Factors for Company Reporting. Conversion factors capture all relevant GHG emissions from the categories specified. The difference between Table 3 and the CO2 emissions in Table 1 is that those in Table 3 include CH4 and N2 O emissions.

[2] 2012 data not available because the regulatory requirement to collect this data only came into force for the financial year ended 31 December 2013. Comparative data will be provided in future years.

[3] Does not include GHG emissions generated from Meggitt-owned and operated vehicles or refrigerant gases as these emissions are not material to the Group's GHG emissions.

**Reportable accidents and incidents** (Table 4)

| | 2013 | Change | 2012 |
|---|---|---|---|
| Reportable accidents and incidents[1] | **35** | -19% | 43 |
| Reportable accident/incident rate[2] | **317** | -20% | 397 |

[1] Reportable accidents and incidents are those directly reportable to a regulatory authority.
[2] Accident/incident rates are the number of reportable accidents/incidents per 100,000 employees.

## Health and safety

Strong, supportive leadership is essential to a sustainable safety culture and in our 2013 employee engagement survey, we received plaudits for our safety culture. However, regrettably, we have to report that in October 2013 one of our employees died in an incident involving a test laboratory autoclave at our facility in Rockmart, US. An investigation is underway by regulatory authorities to determine the cause and we are providing our full support.

In 2013, we continued to implement measures to improve safety in the workplace. These included:

- Group-wide online health and safety awareness training for all employees;
- Integrated daily health and safety inspections and reviews as part of the Meggitt Production System;
- A behavioural health and safety programme implemented at our facility in Loughborough, UK, which contributed to a 75% improvement in its Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) frequency and lost time incident rates and lost days. We plan to roll out this programme to a number of sites across the Group in 2014;
- Continued implementation of the MoveSmart® programme at our facility in Rockmart,US designed to reduce the number of musculoskeletal injuries;
- Improved reporting and investigation of near-miss accidents and unsafe conditions, with special emphasis on root-cause analysis and developing timely corrective action plans; and
- Continued dissemination of information and best practice through intra-Group HSE conferences, health and safety alerts and all-employee safety bulletins.

These measures have resulted in improvements in health and safety performance across the Group and outstanding achievements at some of our sites. We experienced a significant reduction in reportable incidents and associated incident rates across the Group, as shown in Table 4. In 2013, 80% of our manufacturing facilities achieved at least a Bronze Meggitt Safety Star award reflecting a 25% improvement in health and safety performance over the three-year average performance for years 2009 to 2011. Of those, 20 facilities will receive a Platinum Safety Star award for outstanding performance in achieving no work-related lost time accidents and incurring no lost work days in 2013.

## Ethics and business conduct and trade compliance

Our ethics and business conduct programme commits us to conducting business fairly, impartially and in compliance with laws and regulations and acting with integrity and honesty in our business relationships.

In 2013, we provided training on promoting mutual respect, the UK Bribery Act and preventing harassment in the workplace and held two in-house ethics conferences where facility-based ethics coordinators reviewed and provided feedback on the Ethics Programme. As a result of this feedback, we launched a web application for the Ethics Line which allows questions or concerns to be submitted by email and agreed to update our Ethics Guide.

The Board revised our Ethics and Business Conduct Policy and Code of Conduct this year along with the Anti-Corruption Policy, and we launched a Distributors' Policy.

We have a highly-developed trade compliance programme, based on the Nunn-Wolfowitz Task Force Report of 2000 (the influential report on export compliance best practice) and guidelines issued by the regulatory authorities. During 2013, we continued to implement our global trade management software solution to enhance our trade compliance programme and began implementation of our enhanced import compliance programme at several US facilities. We also implemented Phase 1 of the US Government's Export Control Reform programme.

## Local communities and charitable donations

Individual Meggitt facilities work with the local community and support charities at their discretion. Education Business Partnerships and the UK Government's STEM (Science, Technology, Engineering and Mathematics) initiative were supported locally. Meggitt's headquarters, based in Dorset, UK, continued to sponsor the Arkwright Scholarship Trust, the Institute of Mechanical Engineers' Schools Aerospace Challenge, the local Community Foundation and the Poole Hospital Staff Excellence Awards.

## Our employees

Learning, career development, employee engagement, strong leadership and effective teamwork are vital components of Meggitt's performance culture.

In 2013, we undertook our second all-employee survey. 62% of our workforce participated—1,500 more than last time. Overall engagement levels are 7% higher than the global benchmark: people are proud to work for Meggitt and would recommend us as an employer.

# Corporate responsibility continued

**Analysis of employees** (Table 5)

### Employees by division[1]

Number of employees

10,715

| | | |
|---|---|---|
| Aircraft Braking Systems | 1,195 | 11% |
| Control Systems | 1,173 | 11% |
| Polymers & Composites | 1,965 | 18% |
| Sensing Systems | 1,654 | 15% |
| Equipment Group | 4,116 | 39% |
| Cross-group facilities | 612 | 6% |

### Employees by length of service (years)[1]

Number of employees

10,715

| | | |
|---|---|---|
| Less than 5 | 4,641 | 43% |
| Between 5 and 10 | 2,495 | 23% |
| Between 10 and 15 | 1,167 | 11% |
| Between 15 and 20 | 821 | 8% |
| Between 20 and 25 | 443 | 4% |
| Over 25 | 1,148 | 11% |

### Employees by region[1]

Number of employees

10,715

| | | |
|---|---|---|
| North America | 5,514 | 51% |
| UK | 2,797 | 26% |
| Mainland Europe | 1,589 | 15% |
| Rest of World | 815 | 8% |

1 As at 31 December 2013.

## Our employees (continued)

Various initiatives are underway, many of which have overt goals to improve or sustain engagement. Investment in learning and development is one of these. We continue to increase the amount of corporate training, where people from different businesses get to meet, share views and learn together. The most significant investment is in the Meggitt Production System (MPS), our single, global approach to the application of 'lean' tools and other continuous improvement practices. The purpose of MPS is to ensure that everything we do and everyone who does it supports the front line of our business.

In 2013, we launched a state-of-the art human resources information system, in part, to facilitate performance and talent management processes. Advanced analytical tools will enable us to fine-tune our personnel requirements Group-wide, while ensuring that professional development can be managed effectively for all employees. Individual goals are now more easily connected to the strategy of business units and the Group as a whole. The human resources information system is a lever for behavioural change that leads to the kind of performance culture employees want to play a part in.

**Equal opportunities**
The Group supports equal employment opportunities and opposes all forms of unlawful or unfair discrimination. It is Group policy to give full and fair consideration to job applications from disabled people, to provide opportunities for their training, career development and promotion and to continue wherever possible to employ staff who become disabled.

We require all Meggitt employees, through our Ethics training programme and statement of values, to treat all colleagues fairly and with respect.

Table 6 shows the number of female employees at all levels of the workforce. The Board's approach to diversity is discussed in the Nominations Committee report (see page 46).

**Table 6**

| Level | % of females at 31 December 2013 |
|---|---|
| Board of Directors | 10% |
| Executive Board | 9% |
| Senior executives | 9% |
| All employees | 29% |

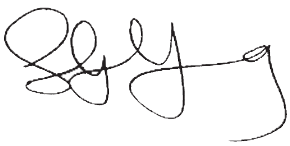
**Human rights**
Respect for human rights is at the heart of Meggitt's Code of Conduct, which we apply across all our businesses.

**Employee consultation**
The Group regards employee communication as a vital business function. Communication and consultation is carried out at facilities by operations directors and other line managers using a variety of forums including daily meetings on shop floors, monthly all-employee 'Town Hall' meetings, team briefings and works councils. We respect all employee relations regulations.

Corporate communications take a variety of forms, including presentations from the Chief Executive via audio-visual media, global web-enabled conferences, publications such as the Meggitt Review and a variety of electronically-distributed newsletters. Results presentations are disseminated across the Group, which enhance our employees' understanding of the financial and economic factors affecting its performance.

The directors encourage employees to become shareholders to improve active participation in, and commitment to, the Group's success. This policy has been pursued for all UK employees through the Share Incentive Plan and the Sharesave Scheme.

**Strategic report**
This 2013 Strategic report on pages 1 to 34 is hereby signed on behalf of the Board of Directors.



**Stephen Young**
Chief Executive
3 March 2014

# Corporate governance report

## Chairman's introduction

Throughout the financial year ended 31 December 2013 and to the date of this report, we have complied with the provisions set out in the UK Corporate Governance Code 2012 published by the Financial Reporting Council (the "Code"). The Company has applied the main and supporting principles set out in the Code. An explanation of how the main principles have been applied is set out in this report and in the Directors' remuneration report, the Nominations Committee report and the Audit Committee report. A number of new disclosure requirements are reflected in this report (in particular, as required under the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and the Code).

The Board is committed to maintaining high standards of corporate governance, which are fundamental to discharging our responsibilities. As Chairman, I encourage open and transparent discussion and constructive challenge. It is my responsibility to ensure that Meggitt is governed and managed in the best interests of shareholders and wider stakeholders. In this report, we set out our governance framework and explain how sound and effective corporate governance practices support our strategy of creating long-term, sustainable growth.

### Leadership

In 2013, Terry Twigger retired from the Board, having served as Chief Executive for over 12 years. He was replaced by Stephen Young (who was, until that time, Group Finance Director) with effect from 1 May 2013. In early June, we appointed Doug Webb as Chief Financial Officer. On behalf of the Board, I would like to thank Terry for his contribution to the success of Meggitt and welcome Stephen and Doug to their new roles. I am pleased to report that we have seen a smooth transition during the succession period. Stephen and Doug have visited our facilities, customers and shareholders, emphasising our continued commitment to returns to shareholders and to improving operational performance and customer service through initiatives such as the Meggitt Production System.

### Effectiveness

After our successful external Board evaluation in 2012, we returned to an internal evaluation in 2013, using lessons learned from the external process. The main findings and recommendations of the evaluations in 2013 were to enhance our strategy reviews and risk management process and continue to improve the annual Board schedule, including site visits and operational and functional presentations. A full description of the process and outcome of this year's formal and rigorous review is on page 41.

### Accountability

The Board, led by executive management, has enhanced our risk management process and reporting in 2013. We have consolidated our key risks detailed in the Annual Report: our shareholders can read about the most significant risks and uncertainties and the revised risk management process on pages 15 to 17.

The Board and Audit Committee have sought to improve this Annual Report and to ensure that it is fair, balanced and understandable.

### Remuneration

During the year, the Remuneration Committee reviewed the directors' remuneration package and prepared the Group's remuneration policy for inclusion in this year's Directors' remuneration report and submission to shareholders for approval at the AGM in 2014. The Directors' remuneration report (pages 47 to 67) provides a detailed review of the Committee's 2013 activity, vesting outcomes and remuneration policy and proposals for 2014 and beyond.

**Sir Colin Terry**
Chairman of the Board of directors
3 March 2014

# Board of directors

Meggitt's Board is characterised by world-class experience of UK, mainland European and North American businesses spanning multiple sectors—many with global reach.

Sir Colin Terry

Philip Green

Paul Heiden

Stephen Young

David Williams

Brenda Reichelderfer

Doug Webb

Guy Berruyer

David Robins

Philip Cox

## Sir Colin Terry KBE CB DL FREng
Non-Executive Chairman + §
Appointed: 2004 | Nationality: British

**Skills and experience**
Chartered engineer with extensive civil aerospace, military and industrial experience.

**Current appointments**
Chairman of the UK Military Aviation Authority Safety Advisory Committee, Non-Executive Director and Chairman of the Audit Committee of Fox Marble Holdings PLC, and Non-Executive Chairman of AviaMedia Tech Limited.

President of Soldiers, Sailors, Airmen and Families Association in Buckinghamshire, of which he is Deputy Lieutenant.

**Previous appointments**
37 years in Royal Air Force, reaching rank of Air Marshal. Since retiring, was Group Managing Director of Inflite Engineering Services, Chairman of the Engineering Council (UK), President of the Royal Aeronautical Society and the Council of European Aerospace Societies.

## Stephen Young
Chief Executive + § ◊
Appointed: 2013 | Nationality: British

**Skills and experience**
Chartered management accountant with wide experience in all financial disciplines gained from national and multi-national businesses across multiple sectors.

**Current appointments**
Non-Executive Director, Audit Committee Chairman and member of Risk and Remuneration committees of Derwent London plc.

**Previous appointments**
Meggitt's Group Finance Director for over nine years before appointment to Chief Executive in May 2013. Senior financial positions held previously include Group Finance Director, Thistle Hotels plc and Group Finance Director of the Automobile Association.

## Doug Webb
Chief Financial Officer § ◊
Appointed: 2013 | Nationality: British

**Skills and experience**
Chartered accountant who has held senior international financial positions in defence, aerospace, engineering, technology and financial services.

**Current appointments**
Non-Executive Director and Chairman of SEGRO Plc's Audit Committee and member of the Hundred Group of Financial Directors.

**Previous appointments**
Chief Financial Officer, London Stock Exchange Group Plc, Chief Financial Officer, QinetiQ Group Plc and various senior financial roles in the UK and US for Logica (now CGI).

**Committee membership**
*** Audit Committee**
**+ Nominations Committee**
**‡ Remuneration Committee**
**§ Ethics and Trade Compliance Committee**
**◊ Finance Committee**

## Philip Green
Group Corporate Affairs Director § ◊
Appointed: 2001 | Nationality: British

**Skills and experience**
Fellow of the Institute of Chartered Secretaries and Administrators, with significant legal and compliance experience.

**Current appointments**
Member of the GC100 and the Dorset Employment and Skills Board.

**Previous appointments**
Meggitt's Company Secretary from 1994 to 2006, after 14 years at British Aerospace in company secretarial roles.

## David Williams
Non-Executive Director * + ‡
Senior Independent Director
Appointed: 2006 | Nationality: British

**Skills and experience**
Chartered accountant with significant experience in senior financial roles.

**Current appointments**
Joint Chairman of Mondi plc and Mondi Limited and Non-Executive Director and Audit Committee Chairman of DP World Limited.

**Previous appointments**
Senior financial roles including 15 years as Finance Director of Bunzl plc. Non-Executive Director and Audit Committee Chairman of Tullow Oil plc until May 2012.

## Guy Berruyer
Non-Executive Director * + ‡
Appointed: 2012 | Nationality: French

**Skills and experience**
Trained as electrical engineer at the École Polytechnique Fédérale de Lausanne and holds Harvard Business School MBA. Brings significant experience to Board as serving FTSE-100 Chief Executive.

**Current appointments**
Group Chief Executive of The Sage Group plc.

**Previous appointments**
Chief Executive of Sage Group plc's French division. Early career spent with software and hardware vendors in French and European management roles.

## Philip Cox CBE
Non-Executive Director * + ‡
Appointed: 2012 | Nationality: British

**Skills and experience**
Senior management experience across a range of sectors from manufacturing to energy.

**Current appointments**
Non-Executive Director, Senior Independent Director and Audit Committee Chairman of Wm Morrison Supermarkets PLC and Non-Executive Director of PPL Corporation, a US-listed energy utility company.

**Previous appointments**
Chief Executive Officer, International Power plc, Senior Vice President, Operational Planning, Invensys plc, Finance Director of Siebe PLC, Non-Executive Director and Chairman of Audit Committee of Wincanton plc.

## Paul Heiden
Non-Executive Director * + ‡
Appointed: 2010 | Nationality: British

**Skills and experience**
Chartered accountant, with considerable experience in senior executive and financial roles in aerospace.

**Current appointments**
Non-Executive Director and Chairman of the Audit Committee of London Stock Exchange Group plc and Chairman of Intelligent Energy Holdings plc.

**Previous appointments**
Chief Executive of FKI Plc from 2003 to 2008, senior positions, including Director, Industrial Business and Finance Director of Rolls-Royce plc and senior financial positions with Peat Marwick, Mitchell and Co, Hanson Plc and Mercury Communications. Non-Executive Director of UU Plc, Bunzl plc, Essentra PLC and Chairman of Talaris Topco Limited.

## Brenda Reichelderfer
Non-Executive Director * + ‡
Appointed: 2011 | Nationality: American

**Skills and experience**
Skilled engineer and business leader with considerable US aerospace and industrial experience.

**Current appointments**
Senior Vice President and Managing Director of private equity sector consulting firm TriVista, member of Technology Transfer Group of Missile Defense Agency and Non-Executive Director of Federal Signal Corporation and Wencor Aerospace.

**Previous appointments**
Senior Vice President, Director of Engineering and Chief Technology Officer, having served as Group President at two operating divisions of ITT Industries Corporation.

## David Robins
Non-Executive Director
Appointed: 2002 | Nationality: British

**Skills and experience**
Extensive knowledge and experience of the interaction between businesses and capital markets developed over a long career spanning investment banking and venture capital.

**Current appointments**
Chairman of The Asian Total Return Investment Company plc and Fidelity Japanese Values plc, Deputy Chairman of Oriel Securities Ltd and a Director of SVG Capital Limited, Pemberton Capital Advisors LLP and a venture capital-backed company.

**Previous appointments**
Until December 2000, Chairman and Chief Executive of ING Barings, before which spent 18 years at Phillips & Drew and UBS, becoming Executive Vice President and Regional Head of UBS Europe.

# Corporate governance report continued

## LEADERSHIP

Our governance framework

### Board of directors

Sir Colin Terry (Chairman)
Three executive directors
Six non-executive directors

Creating and delivering sustainable shareholder value

### Board committees

#### Remuneration

Five independent non-executive directors

Determines the reward strategy for the executive directors and senior management, to align their interests with those of the shareholders

#### Audit

Five independent non-executive directors

Monitors the integrity of the Group's financial statements and the effectiveness of the external and internal auditors

#### Nominations

Chairman, Chief Executive and five independent non-executive directors

Ensures the Board and senior management team have the appropriate skills, knowledge and experience to operate effectively and to deliver the Group's strategy

#### Ethics and trade compliance

Chairman and three executive directors

Ensures the implementation and application of the Ethics and Business Conduct and Trade Compliance policies and programmes

#### Finance

Three executive directors

Approves treasury-related activity, insurance, and other matters delegated to it by the Board

### Management committees

#### Executive Board

Three executive directors, the Chief Operating Officer and four senior executives

Assists the Chief Executive with the development and implementation of the Group's strategy, the management of the business and the discharge of responsibilities delegated by the Board

#### Operations Board

The Chief Operating Officer and five divisional directors

Assists the Chief Operating Officer to manage the Group's operations and discharge the responsibilities delegated by the Executive Board

#### Commercial Committee

Three executive directors, Chief Operating Officer and one Executive Board member

Reviews/approves bids and proposals and any other commercial activity

**The role of the Board**

The Board retains full and effective control of the Group and is collectively responsible for its success. It sets the Group's strategy, ensures appropriate resources are in place to achieve the Group's objectives and reviews performance regularly.

The Board is responsible for setting the Group's values and standards and for ensuring obligations to shareholders, employees and others are met.

There is a Schedule of Matters Reserved for the Board (last updated in 2012) which sets out the matters on which the Board must make the final decision; these include, for example, changes to the Group's capital structure, acquisitions and disposals above a certain threshold, approval of results announcements, annual reports and dividends. If a decision is not reserved for the Board, then authority lies, in accordance with an authorisation policy, with a Board committee, management committee, the Chief Executive or other executive director, divisional president or site director/general manager.

**Board membership and attendance during 2013**

The Board met nine times in 2013 (seven scheduled meetings, shown in the table below, and two unscheduled meetings). In advance of any Board meetings impacted by the absence of directors, the Chairman discussed the matters to be covered at the meeting with, and ascertained the views of, those directors sending their apologies.

| Name | Title | Meetings eligible to attend[1] | Meetings attended |
|---|---|---|---|
| Sir Colin Terry | Chairman | 7 | 7 |
| Mr G S Berruyer | Non-executive director | 7 | 7 |
| Mr P G Cox[2] | Non-executive director | 7 | 7 |
| Mr P E Green[1] | Corporate Affairs Director | 7 | 6 |
| Mr P Heiden[2] | Non-executive director | 7 | 7 |
| Ms B L Reichelderfer | Non-executive director | 7 | 7 |
| Mr D A Robins[1] | Non-executive director | 7 | 6 |
| Mr T Twigger | Chief Executive (to 1 May 2013) | 3 | 3 |
| Mr D R Webb | Chief Financial Officer (from 6 June 2013) | 4 | 4 |
| Mr D M Williams | Non-executive director | 7 | 7 |
| Mr S G Young | Group Finance Director (to 1 May 2013) Chief Executive (from 1 May 2013) | 7 | 7 |

1 All of the directors attended the scheduled meetings during the year, with the exception of Mr Green who sent his apologies for the meeting held in June 2013 as he was undergoing medical treatment and Mr Robins who was unable to attend the meeting held in February 2013 owing to overseas travel.

2 There were also two unscheduled meetings held during the year, which were attended by all of the directors eligible to attend, except Mr Cox and Mr Heiden who sent their apologies for one unscheduled meeting in January 2013.

In advance of any Board meetings impacted by the absence of directors, the Chairman discussed the matters to be covered at the meeting with, and ascertained the views of, those directors.

**Chairman**

- Sir Colin Terry met the independence criteria on appointment as Chairman on 1 July 2004.
- The roles of the Chairman and Chief Executive are separate and a clear division of responsibilities has been approved and agreed in writing by the Board. These were reviewed and updated by the Board in 2013.
- The Chairman is responsible for setting the Board's agenda and ensuring that adequate time is available for discussion of agenda items (including strategic issues); leading the Board; and ensuring its effectiveness.
- The Chairman facilitates the contribution of non-executive directors and oversees the relationship between them and the executive directors. The Chairman holds meetings with other non-executive directors without executive directors present.
- The Chairman is responsible for ensuring directors receive accurate, timely and clear information and is satisfied that effective communication, principally by the Chief Executive and Chief Financial Officer, is undertaken with shareholders.
- The Chairman agrees a personalised approach to the training and development of each director and reviews this regularly.

**Senior Independent Director**

The role of Mr Williams, as Senior Independent Director, is to:

- Make himself available to shareholders if they have concerns that cannot be resolved through normal channels;
- Chair the Nominations Committee when it is considering the Chairman of the Board's succession; and
- Meet with the non-executive directors at least once a year to appraise the Chairman's performance.

**Non-executive directors**

- The non-executive directors play a full part by constructively challenging and contributing to the development of the Group's strategy.
- The non-executive directors scrutinise the performance of executive management and monitor the reporting of the Group's performance, the integrity of financial information and the effectiveness of financial controls and risk management systems.
- The non-executive directors are responsible for determining appropriate levels of remuneration for the executive directors and participating in the selection and recruitment of new directors and succession planning.
- The terms and conditions of appointment of non-executive directors are available for inspection at the Company's registered office during normal business hours.

# Corporate governance report continued

### Company Secretary
The appointment and removal of the Company Secretary is a matter for the Board.

### The work of the Board in 2013
During the year, the Board approved the acquisition of Piezotech LLC and the disposal of Meggitt (Addison), Inc. and the Sunbank Family of Companies LLC. It also approved the appointment of Mr Young as Chief Executive and Mr Webb as Chief Financial Officer. It received regular reports from executive management on strategy and business performance, financial performance (including treasury activity) and corporate affairs (including risk, legal and compliance). The Board visited a number of facilities during the year, across all business divisions. The Board received and discussed:

- An update on Group strategy, including market and competitive environment and strategic priorities;
- The Group budget for 2014;
- Business unit and functional updates and presentations on senior executive succession, operations, IT security, and investor relations;
- Reports on internal control, risk management and going concern; and
- Reports on the activities of its committees.

The Board reviewed and approved:

- The 2012 Annual Report and Accounts, the 2012 full-year results announcement and the 2013 interim results announcement;
- Interim management statements released in May and November;
- Recommendations to shareholders on the final dividend payment in respect of the year ended 31 December 2012 and the interim dividend payment for the year ended 31 December 2013;
- Fees payable to the Group's auditors and a recommendation to shareholders on their reappointment;
- Amended terms of reference for the role of Chairman and Chief Executive; and
- Revisions to the Group's Ethics and Business Conduct Policy, Code of Conduct and Anti-Corruption Policy.

Since the year-end up to the date of the Annual Report, the Board has approved the 2013 Annual Report and Accounts, the 2013 full-year results announcement and the proposed final dividend in respect of the year ended 31 December 2013.

During the year, no unresolved concerns were recorded in the Board's minutes.

## Effectiveness

### Composition
The Board considers it has a good balance of executive and non-executive directors, is of an appropriate size and includes the independence, skills, experience and knowledge to enable the directors to discharge their respective duties and responsibilities effectively. All of the non-executive directors are considered independent under the Code, with the exception of Mr Robins who has served on the Board for over nine years. Mr Robins is retiring from the Board after the 2014 AGM.

All non-executive directors are asked to join the Audit, Remuneration and Nominations Committees on appointment. Chairmanship of Committees is considered during discussions on composition and succession. No one other than Committee chairmen and members are entitled to attend the meetings, although others may be invited. Committee chairmen, members and regular meeting invitees are noted in the respective Committee reports below.

Each of these Committees has specific written terms of reference issued by the Board and adopted by the relevant Committee. These are available on our website. All Committee chairmen report orally on the proceedings of their Committees at the next meeting of the Board. Where appropriate, the Committee chairmen also make recommendations to the Board in respect of appropriate matters, for example, the fairness, balance and understandability of the Annual Report. Further details of the composition and operation of these Committees are set out in the Audit Committee report, the Nominations Committee report and Directors' remuneration report.

### Appointments to the Board
There is a formal, rigorous and transparent procedure for the appointment of new directors to the Board. Full details are available in the Nominations Committee report set out on page 46 which also provides details of the role and activities of the Nominations Committee.

### Commitment
The letters of appointment for the Chairman and non-executive directors set out the expected time commitment required of them and are available for inspection by any person during normal business hours at the Company's registered office and at the AGM. Other significant commitments of the Chairman and non-executive directors are disclosed on appointment and require approval thereafter.

In 2013, the Chairman became chairman of AviaMediaTech Limited. Sir Colin confirms that he continues to have sufficient time to discharge his role as Chairman of the Board.

### Development

The Board is supplied with the information it needs to discharge its duties. All new directors receive an appropriate induction to the business, including meetings with other directors, senior management, auditors, brokers and other professional advisors as appropriate, site visits and a comprehensive induction pack. We will continue to enhance the induction process as feedback is received and incorporated from recently recruited directors.

The Company Secretary facilitates the induction of new directors and assists with professional development where required.

Directors are encouraged to update their skills regularly and their training needs are assessed as part of the Board evaluation process. Their knowledge and familiarity with the Group is facilitated by access to senior management, reports on the business and visits to the Group's operating facilities. Resources are available to all directors for the purposes of developing and updating their knowledge and capabilities.

### Information and support

The Chairman is responsible for ensuring the directors receive accurate, timely and clear information. The Company Secretary is responsible for ensuring good information flows within the Board and committees and between senior management and non-executive directors. The Board members have regular discussions about their information and support requirements, and are involved in setting the annual Board schedule.

The Board and its committees have been provided with sufficient resources to undertake their duties. All directors have had access to the advice and services of the Company Secretary who is responsible to the Board for advising on all governance matters. The Board allows all directors to take external independent professional advice at the Group's expense.

### Board performance evaluation

In 2013, the Board evaluated its own effectiveness, together with the effectiveness of the Chairman, individual directors, its committees, auditors and remuneration advisers and agreed its objectives for 2014. The effectiveness reviews covered strategy, risk management, the annual Board schedule, composition, succession, the appointment process, diversity, remuneration, audit and open channels of communication.

The evaluation in 2013 was undertaken internally (applying lessons learned from the externally facilitated review in 2012). The 2013 evaluation was carried out using questionnaires and group and individual discussions. The Board continues to be thoroughly engaged with the review process, with the main findings and recommendations of the 2013 evaluation identifying the need to enhance strategy reviews and the risk management process and implement continued improvements to the annual Board schedule, adding more facility visits and operational and functional presentations.

## Accountability

### Financial and business reporting

The financial statements contain an explanation of the directors' responsibilities in preparing the Annual Report and the financial statements (page 70) and a statement by the auditors concerning their responsibilities (page 73). The directors also report that the business is a going concern (page 30), detail on how the Group generates and preserves value over the longer term (the business model) and the Group's strategy for delivering its objectives in the Strategic report (pages 1 to 34).

### Internal control and risk management

The Board is responsible for the Group's system of internal control and for maintaining and reviewing its financial and operational effectiveness. The system of internal control is designed to manage, but not to eliminate, the risk of failure to achieve business objectives and to provide reasonable but not absolute assurance against material misstatement or loss. The Group's system of internal controls includes:

- An on-going risk management process for identifying, evaluating and managing the significant risks faced by the Group that was in place for 2013 and up to the date of approval of the Annual Report. This process is regularly reviewed by the Board and accords with the Turnbull Guidance. The risk management process is described in more detail on pages 15 to 17;
- An effective internal audit function which, primarily, performs business unit reviews by rotation (including finance, IT, HR, ethics and the bid process);
- Compliance programmes and external audits (including trade compliance, ethics, anti-corruption, health, safety and environmental);
- A business performance review process (including financial, operational and compliance performance);
- Process controls, including the bid process, programme execution, financial and IT security;
- The forecasting, budget and strategic plan processes;
- A whistleblowing line to enable employees to raise concerns; and
- Group insurance and business continuity programmes.

The Board and Audit Committee applied the following processes in 2013 and up to the date of approval of the Annual Report in order to review the effectiveness of the system of internal controls:

- Reviews of the risk management process and risk register;
- Written and verbal reports to the Audit Committee from internal and external audit on progress with internal control activities, including:
  - reviews of business processes and activities, including action plans to address any identified control weaknesses or recommendations for improvements to controls or processes;
  - the results of internal audits;
  - internal control recommendations made by the external auditors; and
  - follow-up actions from previous internal control recommendations;

# Corporate governance report continued

- Regular compliance reports from the Corporate Affairs Director;
- Regular reports on the state of the business from the Chief Executive and Chief Financial Officer;
- A presentation on IT security activities and plans;
- Review and approval of the strategic plan and budget;
- Written report to the Audit Committee on the effectiveness of whistleblowing procedures; and
- Annual report on insurance coverage.

The Board monitors executive management's action plans to implement improvements in internal controls that have been identified following the above-mentioned reviews and reports. The Board confirms that it has not been advised of any significant failings or weaknesses in the Group's internal controls.

## Remuneration

A separate Remuneration Committee report is set out on pages 47 to 67 and provides details of our remuneration policy and how it has been implemented, together with the activities of the Remuneration Committee.

## Relations with shareholders

The Group values its dialogue with institutional and private investors.

The Board communicates with private investors via direct communication with investor relations and the Company Secretary, material distributed or made available on the investor relations section of our website and at the AGM (see below).

Effective communication with fund managers, institutional investors and analysts about the Group's strategy, performance and policies is promoted by meetings involving the Chief Executive and Chief Financial Officer. The Board receives reports from the Chief Executive and Chief Financial Officer and the Head of Investor Relations on the views of shareholders, which are discussed.

The Chairman and other non-executive directors are available to attend meetings with shareholders and a number of such meetings on corporate governance took place in 2013. Directors' understanding of major shareholders' views is enhanced by reports from the Head of Investor Relations, our brokers and attending analysts' briefings. Analysts' notes on the Group are made available to all directors.

In 2013, a consultation was undertaken with significant shareholders covering a revised proposed remuneration package and policy. The process and outcome of this consultation are described on page 56.

**Constructive use of the Annual General Meeting**

The Board uses the AGM to communicate with its shareholders.

Proxy appointment forms for each resolution provide shareholders with the option to direct their proxy to vote for or against resolutions or to withhold their vote. All proxy votes for, against and withheld are counted by the Company's Registrars and the level of voting for, against and withheld on each resolution is made available after the meeting and on the Group's website. The proxy form and the voting results announcement make it clear that a vote withheld is not a vote in law and will not be counted in the calculation of the proportion of votes for and against the resolution.

Separate resolutions are proposed at the AGM on substantially separate issues and there is a resolution relating to the financial statements. The Notice of AGM and related papers are sent to shareholders at least 20 working days before the meeting.

The respective Chairmen of the Audit, Remuneration and Nominations committees are available at the AGM to respond to questions. It is usual for all other directors to attend.

At the AGM to be held on 7 May 2014, shareholders' consent will be sought on the following special business, in addition to routine business:

(i) approval of the Remuneration Policy;
(ii) approval of a new Long Term Incentive Plan; and
(iii) authority to convene general meetings on 14 clear days' notice in accordance with the Articles (on the terms set out in the Notice of Meeting).

All directors are subject to election by shareholders at the first AGM after their appointment and have been subject to re-election annually since 2012 in compliance with the Code. In 2014, all directors will be subject to election or re-election except for Mr Robins, who will retire from the Board at the end of the AGM on 7 May 2014.

**By order of the Board**

**M L Thomas**
Company Secretary
3 March 2014

# Audit Committee report



### Chairman's introduction

I am pleased to present the report of the Audit Committee for 2013.

I chair the Audit Committee and as a Fellow of the ICAEW, Audit Committee Chairman of DP World Limited and former Finance Director at Bunzl plc, I bring recent and relevant financial experience to the Committee. My fellow committee members throughout 2013 were Guy Berruyer, Philip Cox, Paul Heiden and Brenda Reichelderfer, who attended all three Committee meetings during the year. By invitation, there were a number of other regular attendees including the Chief Financial Officer, the Group Financial Controller and the internal and external auditors. The Chairman of the Board, the Chief Executive, the Corporate Affairs Director and David Robins also attended by invitation.

The key role of the Audit Committee is to provide confidence in the integrity of our processes and procedures relating to internal financial control and corporate reporting. The Board relies on the Committee to review financial reporting and to appoint and oversee the work of the internal and external auditors.

The work of the Committee in 2013 is described below in detail and included providing advice to the Board on whether these accounts are fair, balanced and understandable.

### Committee membership and attendance

| Name | Meetings eligible to attend | Meetings attended |
|---|---|---|
| Mr D M Williams (Committee chairman) | 3 | 3 |
| Mr G S Berruyer | 3 | 3 |
| Mr P G Cox | 3 | 3 |
| Mr P Heiden | 3 | 3 |
| Ms B L Reichelderfer | 3 | 3 |

### Terms of Reference

The Committee operates within agreed terms of reference (last updated in 2012 and scheduled for review in 2014) which are available on our website.

### Responsibilities

The responsibilities of the Audit Committee include:

- Monitoring the integrity of the Group's financial statements and judgements made by executive management, reviewing the Group's financial reporting and accounting policies, including financial information contained in formal announcements and reviewing trading statements relating to the Group's performance;
- Recommending the financial statements to the Board for approval and, since 2013, advising the Board that the Annual Report, taken as a whole, is fair, balanced and understandable, providing the information necessary for shareholders to assess the Group's performance, business model and strategy;
- Reviewing the appointment, performance and independence of the external auditors and the role and effectiveness of the internal audit function. In 2013, the audit partner rotated from Mr Maitland to Mr Paynter;
- Reviewing the process for handling allegations from whistleblowers;
- Reviewing reports from executive management and internal and external audit on the effectiveness of systems for internal financial controls, financial reporting and financial risk management. The Board has overall responsibility for internal controls and risk management (see page 15); and
- Reviewing the Committee's own effectiveness.

### Work of the committee

The Audit Committee reviewed:

- The financial information contained in the 2012 Annual Report and 2012 full-year and 2013 interim results announcements and recommended them to the Board for approval;
- 2013 external audit fees, and recommended them to the Board for approval;
- The external audit strategy memorandum and interim audit clearance report for 2013;
- The independence, effectiveness and reappointment of the external auditors;
- The internal audit plan for 2014 and regular update reports;
- The Group's whistleblowing procedures;
- Technical accounting and governance updates provided by the Group Financial Controller, Company Secretary and the external auditors;
- A tax update from the Group Head of Tax and Treasury;
- The non-audit services policy, and approved and published the policy on the Audit Committee section of our website; and
- The effectiveness of the Committee and internal audit.

Since the year end, the Committee has approved the 2013 Annual Report and Accounts and full-year results announcement and recommended them to the Board for approval and provided advice to the Board that the 2013 Annual Report and Accounts, taken as a whole, is fair, balanced and understandable. The Committee provided this advice having approved and monitored an enhanced review and verification process of the Annual Report undertaken by management and provided confirmation to the Board that this process was both followed and effective.

# Audit Committee report continued

**Significant judgements relating to the financial statements**

The table below summarises the significant judgements considered by the Committee in respect of the Group's financial statements:

| Significant judgements | Action |
|---|---|
| Goodwill and other intangible assets arising on an acquisition | The principal judgements are management's determination of the level at which impairment testing should be performed (including the change in the year whereby certain business units are now aggregated as Cash Generating Units ('CGU's')), the achievability of CGU business plans (and therefore future cash flows) and the appropriateness of the discount rates applied to future cash flows. The Committee addressed this through consideration of a report from management setting out the basis for the assumptions and providing a sensitivity analysis on key assumptions and an analysis of the headroom for each CGU. The Committee agreed the assumptions made by management were appropriate and that no impairment was required. |
| Development costs and programme participation costs | The Committee considered the method of testing for potential impairment used by management, the reasonableness of assumptions used on specific programmes with limited headroom and the aggregation of related intangible assets at an aircraft platform level. The Committee addressed this through consideration of a report from management covering these areas, exposure to different platforms and a sensitivity analysis on specific programmes. The Committee concluded that the assumptions made by management were reasonable and the carrying value of deferred costs appropriate. |
| Provision for environmental and legal matters | The key areas reviewed by the Committee were the ongoing environmental liabilities relating to historic sites, the impact of the administrative settlement with the US Government regarding historic export violations and other litigation matters. The Committee considered a report from management setting out the basis for the judgements made on each of these items and the extent to which this was supported by third party legal and other specialist advice. Additionally, the Board met separately with internal legal counsel and received reports from the Group Corporate Affairs Director regarding the above matters and these discussions were shared with the Audit Committee. The Committee agreed with the judgements made by management. |
| Provision for onerous contracts | The key areas reviewed by the Committee were the issue relating to the supply from a vendor of non-conforming raw material identified in the year and judgements made by management relating to selling prices, product quantities and unit costs on a small number of onerous production contracts. The Committee considered a report from management setting out the bases for the judgements made on each of these items. Additionally, sensitivities were discussed on assumptions which were not contractually agreed at the balance sheet date. The Committee agreed with the accounting treatment adopted. |
| Retirement benefit obligations | Assumptions on mortality, inflation and the rates at which scheme liabilities are discounted can have a significant impact on the value at which retirement benefit obligations are included in the financial statements. The Committee considered a report from management setting out the basis on which the 2013 assumptions had been determined and benchmarking the Group's assumptions used in the 2012 consolidated financial statements against those disclosed by other large corporate entities. The Committee concluded that the assumptions recommended, and which were supported by third party actuarial advice, were appropriate. |
| Income taxes | Judgements have to be made by management on the tax treatment of a number of transactions in advance of the ultimate tax determination being known. In determining the appropriateness of the estimates made, the Committee considered a report from management setting out the basis for the judgements and also met with the Group's independent tax advisors, Deloitte LLP, during the year. The Committee also discussed with management the basis for determining the extent to which deferred tax assets and liabilities were offset against one another in both the current and prior accounting period. The Committee concluded that the position taken was appropriate. |
| Treatment of exceptional operating items | The Audit Committee discussed the treatment and disclosure of items included within exceptional operating items. In particular, the Committee discussed the treatment of the issue relating to the supply from a vendor of non-conforming raw material and agreed that the nature of the item and its significance was such that it should be treated as an exceptional operating item. The Committee also considered the treatment of other exceptional items and noted they were treated appropriately and consistently year on year. The Committee concluded that the treatment and disclosure of exceptional operating items was appropriate. |

The Committee also discussed each of the above judgements with the external auditors in reaching their conclusions.

## Key areas of oversight

### External audit

The external auditors are PricewaterhouseCoopers LLP (PwC) who were appointed as Group auditors on 2 October 2003 after a competitive tender. There are no contractual obligations restricting the Committee's choice of external auditors.

The lead audit partner is Mr A Paynter whose appointment in this role commenced with the audit for the financial year ended 31 December 2013. Mr Paynter has had no previous involvement with the Group in any capacity.

The Committee assessed the effectiveness of PwC and the external audit process using a questionnaire and a Committee discussion on the responses to the questionnaire. The Committee was satisfied with PwC's performance and the external audit process and that they had employed an appropriate level of professional challenge in fulfilling their role. The Committee has determined, on the basis of the satisfactory outcome of the evaluation, that the external audit will not be subject to tender in 2014. It has recommended that the Board submit the re-appointment of PwC to shareholders for approval at the AGM in 2014.

The Committee keeps under review the ongoing legislative proposals on audit tendering and rotation from the EU and the Competition Commission, and will implement them when they become final. These proposals have effectively superseded the comply-or-explain provision in the Code, which would have applied to the Company for the first time this year. The FRC plans to withdraw this tendering provision during 2014. Subject to the changing regulatory regime and the Committee continuing to be satisfied with the effectiveness of the auditors, which they will consider annually, the Group does not expect to put the external audit services out for tender before the end of the current audit partner rotation period in 2018, i.e. after the audit for the financial year ending 31 December 2017.

The Committee met with PwC without executive management present and there were no concerns raised at that meeting. It was confirmed that the external auditors had been able to offer rigorous and constructive challenge to executive management during the year.

### Non-audit services

The Group places great importance on the independence of its external auditors and is careful to ensure their objectivity is not compromised. The Committee agrees the fees paid to external auditors for their services as auditors and is required to approve, in advance, any fees to the external auditors for non-audit services in excess of £0.1 million. Details of the fees paid for audit services, audit-related services and non-audit services can be found in note 8 to the financial statements. The fees paid for non-audit services in 2013 were £0.1 million (6% of the total audit fee). Fees paid related to services permitted to be provided by PwC under the Group's policy on non-audit services.

The Group's policy on non-audit services covers which services can be provided and which generally cannot be provided (for example internal audit services, tax planning). The full policy is disclosed on our website.

On balance, the Committee is satisfied that the overall levels of audit-related and non-audit fees are not material relative to the income of the office of PwC conducting the audit or PwC as a whole and therefore the objectivity and independence of the external auditors was not compromised.

### Internal audit

The Committee agrees the annual internal audit plan which is developed according to a risk assessment process and ensures that adequate resources are available to execute the plan. At each meeting, the Committee receives a status update on the audit programme and reviews, discusses and challenges any significant issues arising and monitors implementation by the business of the recommendations made. All significant Group sites are visited by internal audit at least every three years. In 2013, internal audits were carried out at a number of Group sites, including pre and post-SAP implementation audits and the annual audit of the finance shared service centres. It was also agreed that additional IT areas would be added to the scope of internal audit in 2014.

The Committee met internal audit without executive management present. No concerns were raised at the meeting and it was confirmed that internal audit had been able to carry out their work and offer constructive challenge to executive management during the year.

The Committee considered the effectiveness of internal audit and confirmed that they were satisfied.

### Whistleblowing

The Committee is responsible for reviewing the process for handling allegations from whistleblowers and has confirmed that it is satisfied with the Group's process. Whistleblowing is covered under our Ethics and Business Conduct Policy, which is available on our website.

The Group sponsors an independently operated and monitored Ethics Line, enabling employees to report concerns about possible misconduct, with proportionate and independent investigation and appropriate follow-up action. Whistleblowing reports are reviewed regularly by the Ethics and Trade Compliance Committee of the Board and the Audit Committee is responsible for reviewing whistleblowing procedures annually.

**On behalf of the Audit Committee**

David Williams

**David Williams**
Chairman of the Audit Committee
3 March 2014

# Nominations Committee report

**Chairman's introduction**

The Nominations Committee plays a leading role in assessing the balance of skills and experience on the Board and the Group's principal committees. The Committee identifies the roles and capabilities required to meet the demands of the business and, with due regard to diversity, ensures that a succession plan is in place. Candidates continue to be considered on merit against specific criteria determined by the Committee.

During 2013, a successor was appointed for Mr Young as Group Finance Director, after the announcement on 9 January 2013 of his appointment as Chief Executive effective from 1 May 2013. Following a rigorous search process using executive search firm Russell Reynolds Associates, involving both external and internal candidates, Mr Doug Webb was appointed as Chief Financial Officer on 6 June 2013. Mr Webb is a chartered accountant and was most recently Chief Financial Officer at London Stock Exchange Group Plc and, prior to that, Chief Financial Officer at QinetiQ Group Plc. Mr Webb's extensive experience in senior international financial positions across a range of industries including defence, aerospace, engineering, technology and financial services make him an outstanding appointment for the role of Chief Financial Officer.

As well as considering matters relating to succession and composition, the Committee confirmed it was satisfied with its own effectiveness as a result of its 2013 evaluation.

We announced on 27 February 2014 that David Robins will retire from the Board at the end of the 2014 AGM. Throughout his time on the Board, David has always offered good advice and independent challenge, and we have certainly benefitted from his significant financial markets experience. On behalf of the Board, I would like to thank David for his appreciable contribution to the Board and the Group over the last 12 years.

In 2014, the Committee will continue to review the composition of the Board and succession plans for executive and non-executive directors.

**Committee membership and attendance during 2013**

| Name | Meetings eligible to attend | Meetings attended |
|---|---|---|
| Sir Colin Terry (Chairman) | 7 | 7 |
| Mr T Twigger (to 1 May 2013) | 3 | 3 |
| Mr S G Young (from 1 May 2013) | 4 | 4 |
| Mr G S Berruyer | 7 | 7 |
| Mr P G Cox* | 7 | 6 |
| Mr P Heiden* | 7 | 5 |
| Ms B L Reichelderfer | 7 | 7 |
| Mr D M Williams | 7 | 7 |

* Mr Cox sent his apologies for a Committee meeting held on 9 January 2013 as he had, on that day, a board meeting of another company of which he is a non-executive director which had been arranged before his appointment to the Meggitt board. Mr Heiden sent his apologies for the meetings held on 9 January 2013 and 1 May 2013. In advance of Committee meetings, the Chairman discussed the matters to be covered at the meeting with directors who had sent their apologies.

**Terms of reference**

The Committee operates within agreed Terms of Reference (last updated in 2012 and scheduled for review in 2014) which are on our website.

**Responsibilities**

The Committee reviews the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board and, in consultation with the directors, makes recommendations to the Board on any proposed changes. Decisions on Board changes are taken by the Board as a whole. In performing its duties, the Committee has access to the services of the Company Secretary and may seek external professional advice at the Group's expense.

**Board diversity**

The Board confirms a strong commitment to diversity (including, but not limited to, gender diversity) at all levels of the Group. The Board's policy on diversity commits Meggitt to:

- Ensuring the selection and appointment process for employees and directors includes a diverse range of candidates;
- Aspiring to achieve 25% of Board positions to be filled by women by 2015 and monitoring progress in achieving this;
- Disclosing statistics on gender diversity in every Annual Report (see below and page 34); and
- Reviewing this policy from time to time and continuing to disclose this policy in the Annual Report.

The Board remains committed to ensuring that the directors bring a wide range of skills, knowledge, experience, backgrounds and perspectives. Our non-executive directors are from the UK, US and France, and have a range of different skills and experience, from energy to aerospace, financial, technology and city backgrounds to an electrical engineer and a serving chief executive. At 31 December 2013, 10% of the Board were female. The Board will review our Board diversity target in 2014 in light of succession planning objectives and will publish any proposed changes in our 2014 Annual Report.

**External search consultancies**

During 2013, the Committee used Russell Reynolds Associates to assist in the search for the Chief Financial Officer and another senior financial appointment below Board level. Russell Reynolds Associates do not have any other connection with the Group.

On behalf of the Nominations Committee

**Sir Colin Terry**
Chairman of the Nominations Committee
3 March 2014

# Directors' remuneration report



## Chairman's introduction and annual statement

It is my pleasure to present the Directors' remuneration report for the year ended 31 December 2013. The Remuneration Committee (Committee) hope that you find the new layout of the report (incorporating this annual statement, the Policy report and an annual report on remuneration) to be clear and transparent. The Policy report and annual report on remuneration will be submitted separately to shareholders for approval at our AGM on 7 May 2014. Shareholders will separately be asked to approve a new Long Term Incentive Plan (LTIP) which, if approved, will replace the Equity Participation Plan (EPP) and Executive Share Option Scheme (ESOS) from 2014 onwards.

### Pay philosophy

Executive remuneration packages at Meggitt are designed to attract, motivate and retain directors of a high calibre, to recognise the international nature of the Group's business and to reward the directors for delivering value to shareholders. The package targets fixed pay at market competitive levels to companies of a similar size and with similar operating characteristics, supplemented by performance related annual bonuses and an equity-based long term incentive plan designed to reward and incentivise growth, and provide a strong link to Group and individual performance.

### 2013 activity

The key activity of the Committee in 2013 was to review the remuneration package and policy for senior executives, taking into account shareholders' interests and views on pay structure simplicity and other areas of good practice, whilst keeping the package and policy aligned with our stated pay philosophy. The major changes we consulted on were:

(i) simplifying the long term incentive structure into a single LTIP and introducing performance measures which reflect Meggitt's strategic goals (see page 50);
(ii) introducing annual bonus deferral into shares (see page 49);
(iii) introducing clawback provisions (see pages 49 to 50); and
(iv) increasing directors' share ownership guidelines (see page 51).

The intended remuneration arrangements for 2014 outlined in this report are based on this revised remuneration package and Policy.

### 2013 performance

Ongoing demand growth in civil original equipment and energy was tempered by softness in the civil aftermarket and military, and operational challenges in the year caused a further drag on growth. Revenue grew 2% and underlying profit before tax grew 3%, driving a 3% increase in underlying EPS to 37.5p. With a strong order book and an improving trend in civil aftermarket, there is good momentum going into 2014.

ESOS awards made in 2011 vested at 76.0% based on three-year cumulative underlying EPS performance to 31 December 2013 (see page 59). Performance of the EPP awards made in August 2011, where vesting has not yet been confirmed, is shown on page 58.

The Committee has used its discretion to reduce the vesting outcome under the Short Term Incentive Plan (STIP) (for 2013 performance) and ESOS and EPP (for the EPS element of awards vesting in 2014) in relation to the supply from a vendor of non-conforming raw material in 2012, which was discovered in 2013 and impacted our customers. This issue was caused by a process failure at a properly qualified supplier, and was recovered by the Group with all necessary diligence. However, the Committee feels the financial impact felt by shareholders should be recognised and has therefore used its discretion to reduce the STIP and LTIP (see annual report on remuneration).

This Directors' remuneration report has been prepared in accordance with the provisions of the Companies Act 2006 and Schedule 8 of the Large and Medium sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The report meets the requirements of the UK Listing Authority's Listing Rules and the Disclosure and Transparency Rules. In this report we describe how the principles relating to directors' remuneration, as set out in the Code, are applied in practice. The Committee confirms that throughout the financial year the Company has complied with the Code. We have identified which sections of the report are audited.

**Paul Heiden**
Chairman of the Remuneration Committee

# Directors' remuneration report continued

## The Policy report

This section of the report sets out the Remuneration Policy for the directors, which shareholders will be asked to approve at the 2014 AGM. The Committee intends that the Policy will come into effect from our AGM on 7 May 2014.

### Executive Director Remuneration Policy Table

| **Base salary** | |
|---|---|
| Function | To attract and retain talent by ensuring base salaries are competitive in the relevant talent market. |
| Operation | Salary will be reviewed by the Committee annually, in February, with changes effective from 1 April of that year. Salaries for the year under review are disclosed in the annual report on remuneration.<br>In deciding salary levels, the Committee considers personal performance including how the individual has helped to support the strategic objectives of the Group. The Committee will also consider employment conditions and salary levels across the Group, and prevailing market conditions.<br>Salaries are paid to existing directors in GBP; however the Committee reserves the right to pay future and existing directors in any other currency (converted at the prevailing market rate when a change is agreed). |
| Opportunity | It is not anticipated that percentage salary increases for executive directors will exceed those of the wider workforce over the period this Policy will apply. Where increases are awarded in excess of the wider employee population, for example if there is a material change in the responsibility, size or complexity of the role, the Committee will provide the rationale in the relevant year's annual report on remuneration. |
| Performance metrics | None explicitly, but salaries are independently benchmarked periodically against FTSE companies in similar industries and those with similar market capitalisation. Personal performance is also taken into account when considering salary increases. |

| **Pension** | |
|---|---|
| Function | To provide post-retirement benefits for executive directors in a cost-efficient manner. |
| Operation | The pension plans operated by the Group which executive directors are, or could be, members of are:<br>– Meggitt Pension Plan (defined benefit pension plan, closed to new members).<br>– Meggitt Workplace Savings Plan (defined contribution personal pension scheme, open to new members).<br>Salary is the only element of remuneration that is pensionable. There are no unfunded pension promises or similar arrangements for directors. |
| Opportunity | From 2013, it has been our Policy that new executive director external appointments (including Mr Webb) are eligible for a pension allowance of 25% of salary, payable either as pension contribution up to any limit set in current regulations or, above such limits, in cash. Where agreements have been made prior to the approval of this Policy which entitle an executive to receive a pension allowance higher than 25% of salary, pension allowances up to a maximum of 50% of salary, will be paid; Mr Young and Mr Green had agreements prior to the approval of this Policy which entitles them to receive a pension allowance of 50% of salary and this arrangement will continue for these directors. |
| Performance metrics | None. |

| **Benefits** | |
|---|---|
| Function | To provide non-cash benefits which are competitive in the market in which the executive director is employed. |
| Operation | The Group may provide benefits including, but not limited to, a company car or car allowance, private medical insurance, permanent health insurance, life assurance, a fuel allowance, a mobile phone, relocation costs and any other future benefits made available either to all employees globally or all employees in the region in which the executive director is employed. |
| Opportunity | Benefits vary by role and individual circumstances; eligibility and cost is reviewed periodically. Benefits in respect of the year under review are disclosed in the annual report on remuneration. It is not anticipated that the costs of benefits provided will increase significantly in the financial years over which this Policy will apply, although the Committee retains discretion to approve a higher cost in exceptional circumstances (e.g. to facilitate recruitment, relocation, expatriation etc) or in circumstances where factors outside the Group's control have changed materially (e.g. market increases in insurance costs). |
| Performance metrics | None. |

| **Annual bonus - STIP** | |
|---|---|
| Function | To incentivise executive directors on delivering annual financial and personal targets. |
| Operation | Performance measures, targets and weightings are set at the start of the year.<br><br>The performance period of the STIP is a financial year. After the end of the financial year, to the extent that the performance criteria have been met, 75% of the STIP award is paid in cash to the director. The remaining 25% of the award will be deferred into shares and released (with no further performance conditions attached, and no matching shares provided) after a further period of two years.<br><br>The Committee will have the discretion to apply clawback to reduce the size of deferred STIP awards in the event of a material misstatement of results or personal misconduct, and such awards will lapse in certain leaver circumstances (see page 54 for details). |
| Opportunity | The STIP provides for a maximum award opportunity of up to 150% of salary in normal circumstances with an on-target opportunity of 100% of salary and an opportunity of 50% of salary at threshold for any single measure.<br><br>The Committee has discretion to make a STIP award of up to 200% of salary in exceptional circumstances (e.g. a substantial contract win which has a significant positive financial impact in the long term but which has no, or negative, short term financial impact). Dividends accrue on unvested deferred STIP awards over the vesting period and are released on the vesting date. |
| Performance metrics | STIP awards are based on the achievement of financial and personal performance targets. For the executive directors, two thirds of the STIP will be weighted to financial performance, with the remainder subject to personal performance. The relative weightings of the financial and personal elements for any STIP period, and the measures used to assess financial and non-financial performance, will be set by the Committee in its absolute discretion to align with the Group's operating and strategic priorities for that year.<br><br>The award for performance under each element of the STIP will be calculated independently. The Committee will have discretion to review the consistency of the pay-out of the financial and personal elements and adjust the total up or down (within the levels specified above) if it does not consider this to be a fair reflection of the underlying performance of the Group or the individual.<br><br>The personal performance element will typically be based on three to five objectives relevant to the executive's role.<br><br>Details of the measures, weightings and targets applicable to the STIP for each year, including a description of how they were chosen and whether they were met, will be disclosed retrospectively in the annual report on remuneration for the following year (subject to commercial sensitivity). |

# Directors' remuneration report continued

| **Long Term Incentive Plan (LTIP)—subject to shareholder approval** | |
|---|---|
| Function | To align the interests of executive directors with shareholders in growing the value of the Group over the long term. |
| Operation | The LTIP, the introduction of which is subject to shareholder approval at the 2014 AGM, would replace the EPP and ESOS. Under the LTIP, executive directors will be eligible to receive annual awards over Meggitt shares vesting after three years subject to the achievement of stretching performance targets.<br><br>Whilst it is the current intention that LTIP awards will be in the form of nil cost options, the LTIP provides, at the absolute discretion of the Committee, for awards over conditional shares, market value share options and phantom awards.<br><br>The Committee will have the discretion to apply clawback to reduce the size of unvested LTIP awards in the event of a material misstatement of results or personal misconduct. |
| Opportunity | Executive directors will normally be eligible for annual LTIP awards of 220% of salary. Awards up to a maximum of 300% of salary may be granted in exceptional circumstances (e.g. to support the recruitment of a key executive or to recognise exceptional individual performance). The award opportunity under the LTIP has been calibrated to be equivalent, in fair value terms, to that granted in aggregate under the previous EPP/ESOS structure.<br><br>30% of an award will vest if performance against each performance condition is at threshold and 100% if it is at maximum, with straight line vesting in between.<br><br>Dividends accrue on unvested LTIP awards over the vesting period and are released, to the extent the LTIP award vests, on the vesting/exercise date. |
| Performance metrics | Vesting of LTIP awards is subject to continued employment and performance against three measures, which are intended to be as follows:<br>• Earnings per Share (EPS);<br>• Return on Trading Assets (ROTA), which is underlying operating profit after tax divided by net trading assets, measured at constant currency. Net trading assets are adjusted to exclude goodwill and other intangibles arising on the acquisition of a business, derivative financial instruments, retirement benefit obligations, deferred tax and net debt; and<br>• Strategic goals (typically to be based on three strategic priorities around execution, growth and innovation).<br><br>The way these measures link to our KPIs can be seen on pages 18 to 21. It is the current intention that the weighting of the measures will be equal (i.e. one third each) but that the Committee will consider, and adjust if deemed appropriate, the weighting at the start of each LTIP cycle. Any commercially-sensitive information on measures, targets and performance will be disclosed retrospectively.<br><br>Awards made under the LTIP will have a performance period of three financial years, starting from 1 January of the year in which the award is made and ending on 31 December of the third year. If no entitlement has been earned at the end of the relevant performance period, awards will lapse.<br><br>Vesting of the strategic element will also be subject to a discretionary assessment by the Committee of the extent to which achievement of the strategic objectives is consistent with the underlying financial performance over the three-year period.<br><br>The measures and targets in operation for grants made under the ESOS and EPP in the current year, and which are not deemed commercially sensitive are disclosed in the annual report on remuneration. |

| **Sharesave Scheme and Share Incentive Plan** | |
|---|---|
| Function | To align the interests of employees and shareholders by encouraging all employees to own Meggitt shares. |
| Operation | Sharesave—All employee scheme under which all UK employees (including executive directors) may save up to the maximum monthly savings limit (as determined by legislation) over a period of three or five years. Options under the Sharesave Scheme are granted at a discount of up to 20% to the market value of shares at the date of grant.<br><br>Share Incentive Plan—All employee scheme under which (i) all UK employees (including executive directors) may contribute up to the monthly maximum (as determined by legislation) to purchase shares monthly from pre-tax pay; and (ii) all UK employees (including executive directors) may receive free shares up to the annual maximum value (as determined by legislation). |
| Opportunity | Savings, contributions and free shares are capped at the prevailing legislative limit at the time UK employees are invited to participate. |
| Performance metrics | None. |

## Notes to the Policy table

The Committee is satisfied that the above Policy is in the best interests of shareholders and does not promote excessive risk-taking. The Committee retains discretion to make minor, non-significant changes to the Policy without reverting to shareholders.

**Payments from outstanding awards**

Outstanding awards are currently held by the directors under the EPP and the ESOS, the Group's long term incentives operated prior to the introduction of the proposed LTIP in 2014. These awards will continue to vest (subject to performance conditions being met) and be capable of exercise during the period over which this Policy applies. The tables on pages 66 to 67 highlight outstanding and vested awards.

**Approach to target setting and performance measure selection**

Targets applying to the STIP and LTIP are reviewed annually, based on a number of internal and external reference points, including the Group's strategic plan, analyst forecasts for Meggitt and its sector comparators, historical growth achieved by Meggitt and its sector comparators and external expectations for growth in Meggitt's markets.

**STIP**

The performance measures used under the STIP reflect financial targets for the year and non-financial performance objectives. The Policy provides the Committee with flexibility to select appropriate measures on an annual basis.

STIP performance targets are set to be stretching but achievable, with regard to the particular personal performance objectives and the economic environment in a given year. For financial measures, 'target' is based around the annual budget approved by the Board. Prior to the start of the financial year, the Committee sets an appropriate performance range around target, which it considers provides an appropriate degree of 'stretch' challenge and an incentive to outperform.

**LTIP**

It is proposed that the vesting of future LTIP awards is linked to EPS, ROTA and the achievement of long-term strategic goals.

EPS is considered by the Board to be the most important measure of Meggitt's financial performance. It is highly visible internally, is regularly monitored and reported, and is strongly motivational for participants. EPS targets will continue to be set on a nominal cumulative (pence) basis to incentivise consistent performance and reflect the fact that Meggitt's profits are generated to a large degree outside the UK and not significantly influenced by UK retail price inflation.

ROTA helps to balance the achievement of growth and returns. The Committee believes ROTA is a good internal proxy for total shareholder return (TSR) which focuses executives on managing the balance sheet and Meggitt's operational performance, whilst also being less remote for participants below Board level. The definition of net trading assets for ROTA excludes goodwill and other intangible assets arising when a business is acquired, to reflect that acquisitions are not within the control of the majority of participants. In order to safeguard against poor acquisitions the Committee has overall discretion to reduce the outcome under the ROTA element if in its opinion the outcome does not reflect the underlying financial performance of the Group. The performance of acquisitions against Board approved targets is also monitored separately.

The Committee believes that the strategic goals component will help reinforce the realisation of Group strategy and the achievement of key non-financial and strategic goals over long product cycles which drive long-term value at Meggitt. The element will typically comprise a scorecard of three-year targets across a maximum of three core strategic areas for the Group. The Committee believes that this approach will enable it to reflect the Group's long-term nature and shifting strategic priorities in the LTIP to ensure executives' interests remain closely aligned with those of our shareholders over time. Specific measures and targets for each area will be developed and clearly defined at the start of each three-year cycle to balance leading and lagging indicators of performance. Vesting of this element is subject to a discretionary assessment by the Committee of the extent to which achievement of the strategic objectives is consistent with Meggitt's underlying financial performance over the performance period.

**Remuneration policy for other employees**

The remuneration policy for other employees is based on broadly consistent principles as that for executive directors. Annual salary reviews take into account Group performance, local pay and market conditions, and salary levels for similar roles in comparable companies. Some employees below executive level are eligible to participate in annual bonus schemes; opportunities and performance measures vary by organisational level, geographical region and an individual's role. Senior executives are eligible for LTIP on similar terms as the executive directors, although award opportunities are lower and vary by organisational level. All UK employees are eligible to participate in the Sharesave Scheme and Share Incentive Plan on identical terms.

**Share ownership guidelines**

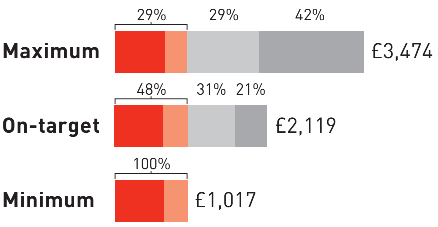
During the year, the Committee increased the minimum shareholding guidelines for executive directors from 100% to 300% of base salary for the Chief Executive and from 100% to 200% of base salary for each of the other executive directors. There is no set time frame within which directors have to meet the guideline, however until they meet the guideline they are not permitted to sell more than 50% of the after-tax value of a vested share award. The shareholding requirement ceases when a director leaves the Group. Further information on the shareholding requirement is in the annual remuneration report (see page 65).

# Directors' remuneration report continued

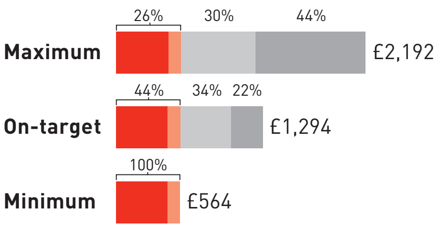
## Pay-for-performance: scenario analysis

The charts below provide an estimate of the potential future reward opportunities for the executive directors, and the potential split between the different elements of remuneration under three different performance scenarios: 'Maximum', 'On-target' and 'Minimum'.

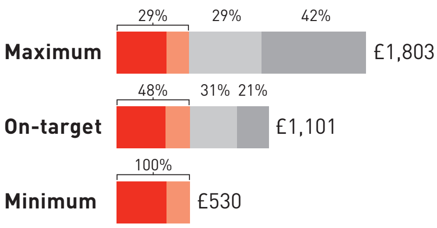
**S G Young** (£'000)




**D R Webb** (£'000)




**P E Green** (£'000)




Salary and benefits
Pension
STIP
LTIP

Potential reward opportunities are based on Policy, applied to 2014 base salaries and 2014 incentive opportunities. Note that the LTIP awards granted in a year will not normally vest until the third anniversary of the date of grant, and the projected value excludes the impact of share price movement or dividend accrual.

The 'Maximum' scenario reflects fixed remuneration (salary and benefits and pension), plus maximum payout under all incentives (150% of salary under the STIP, and full vesting of LTIP awards).

The 'On-target' scenario reflects fixed remuneration as above, plus target STIP (based on two-thirds of maximum opportunity) and LTIP threshold vesting (30% vesting).

The 'Minimum' scenario reflects fixed remuneration only, being the only elements of the executive directors' remuneration package not linked to performance.

## Non-executive directors' remuneration policy table

Non-executive directors are submitted for re-election annually, do not have a contract of service and are not eligible to join the Group's pension or share schemes. Details of the Policy on fees paid to our non-executive directors are set out in the table below:

| | **Fees** |
|---|---|
| Function | To attract and retain non-executive directors of the highest calibre with broad commercial and other experience relevant to the Group. |
| Operation | Fee levels are reviewed annually, with any adjustments effective 1 April each year. The fees paid to the Chairman of the Board are determined by the Committee, while the fees for all other non-executive directors are reviewed by a committee of the Board formed of executive directors. Fees for the year under review and for the current year are disclosed in the annual report on remuneration.<br><br>Additional fees are paid to the chairmen of the Remuneration and Audit Committee and to the Senior Independent Director, to reflect the additional time commitment of these roles.<br><br>In deciding fee increases, the committees consider employment conditions and salary increases across the Group, and prevailing market conditions.<br><br>Currently, all fees are paid in GBP, however the committees reserve the right to pay future and existing non-executive directors in any other currency (converted at the prevailing market rate when a change is agreed) . |
| Opportunity | Fee increases will be applied taking into account the outcome of the annual review. The maximum aggregate annual fee for all non-executive directors (including the Chairman) as provided in the Company's Articles of Association is £1,000,000. |
| Performance metrics | None. |

## Recruitment

**External appointments**
In cases of hiring or appointing a new executive director from outside the Group, the Committee may make use of all existing components of remuneration, as follows:

| Component | Approach | Maximum annual grant value |
|---|---|---|
| Base salary | The base salaries of new appointees will be determined based on the experience and skills of the individual, internal comparisons, employment conditions and salary levels across the Group, and prevailing market conditions. Initial salaries may be set below market and consideration given to phasing any increases over two or three years subject to development in the role. | N/A |
| Pension | In line with the Policy, new appointees will be entitled to become members of the Meggitt Workplace Savings Plan (defined contribution plan) or receive a cash pension allowance of 25% of salary in lieu. | N/A |
| Benefits/ Sharesave/SIP | New appointees will be eligible to receive benefits in line with the Policy, and will be eligible to participate in all-employee share schemes. | N/A<br>N/A |
| STIP | The structure described in the Policy table will apply to new appointees with the relevant maximum being pro-rated to reflect the proportion of employment over the year. Targets for the personal element will be tailored to the appointee. | 150% of salary (200% in exceptional circumstances) |
| LTIP | New executive director appointees will be granted awards under the LTIP on similar terms as other executives, as described in the Policy table. | 220% of salary (300% in exceptional circumstances) |

In determining the appropriate remuneration structure and levels, the Committee will take into consideration all relevant factors to ensure that arrangements are in the best interests of Meggitt and its shareholders. The Committee may make an award in respect of a new appointment to 'buy out' incentive arrangements forfeited on leaving a previous employer, i.e. over and above the approach outlined in the table above. Any such compensatory awards will be made under existing share schemes, where appropriate, and will be subject to the normal performance conditions of those schemes.

The Committee may also consider it appropriate to structure 'buy-out' awards differently to the structure described in the Policy table, exercising the discretion available under UKLA Listing Rule 9.4.2 R where necessary to make a one-off award to an executive director in the context of recruitment. In doing so, the Committee will consider relevant factors including any performance conditions attached to these awards, the likelihood of those conditions being met and the proportion of the vesting period remaining. The value of any such buy-out will be fully disclosed.

**Internal promotion**
In cases of appointing a new executive director by way of internal promotion, the Policy will be consistent with that for external appointees, as detailed above. Any commitments made prior to an individual's promotion will continue to be honoured even if they would not otherwise be consistent with the Policy prevailing when the commitment is fulfilled, although the Group may, where appropriate, seek to revise an individual's existing service contract on promotion to ensure it aligns with other executive directors and prevailing market best practice; in 2013, the Committee reviewed Mr Young's service contract, which was subsequently updated on 1 May, on his promotion to Chief Executive.

Disclosure on the remuneration structure of any new executive director, including details of any exceptional payments will be disclosed in the RIS notification made at the time of appointment and in the annual report on remuneration for the year in which the recruitment occurred.

**Non-executive directors**
In recruiting a new non-executive director, the Committee will use the Policy as set out in the table on page 52.

# Directors' remuneration report continued

**Service contracts and exit payment policy**

Executive director service contracts, including arrangements for early termination, are carefully considered by the Committee and are designed to recruit, retain and motivate directors of the quality required to manage the Group.

The Committee's Policy is that executive director service contracts should be terminable on no more than 12 months' notice. The Committee's approach to payments in the event of termination of employment of a director is to take account of the particular circumstances, including the reasons for termination, individual performance, contractual obligations and the rules of the Group's applicable incentive plans which apply to share awards held by the executive directors:

- Compensation for loss of office in service contracts
  Except as set out in the table below, under the terms of their service contracts, the executive directors may be required to work during their notice period or may, if the Company decides, be paid in lieu of notice if not required to work the full notice period. Payment in lieu of notice will be equal to base salary plus the cost to the Group of providing the contractual benefits (pensions allowance, health insurance and company car or car allowance) that would otherwise have been paid or provided during the notice period. Payments will be in equal monthly instalments and will be subject to mitigation such that payments will either reduce, or stop completely, if the executive director obtains alternative employment.

  An executive director's employment can be terminated by the Group without notice or payment in lieu of notice in specific circumstances including summary dismissal, bankruptcy or resignation.

- Treatment of STIP
  Executive directors have no automatic entitlement to any bonus on termination of employment under the STIP, but the Committee may use its discretion to award a bonus (normally pro-rated).

  Where any bonus is deferred into shares, the award will normally lapse if an executive director's employment terminates unless the executive director leaves for specified 'good leaver' reasons. The 'good leaver' reasons are death, redundancy, retirement, injury, disability, the business or company which employs the executive director ceasing to be part of the Group, any other circumstances in which the Committee exercises discretion to treat the executive director as a 'good leaver' or on a change of control. If the executive director is a 'good leaver' their award will vest on the normal vesting date, or earlier on a change of control, and would not be subject to pro-rating.

- Treatment of long term incentive plan awards
  The treatment of awards under the ESOS and the EPP is governed by the rules of plans which have been approved by shareholders and is described below. Similar treatment will apply under the new LTIP which shareholders are being asked to approve at the 2014 AGM.

  Awards under the plans will normally lapse if an executive director's employment terminates unless the executive director leaves for specified 'good leaver' reasons. The 'good leaver' reasons are the same as described above. If the executive director is a 'good leaver', awards will vest to the extent that the attached performance conditions are met, but on a time pro-rated basis, with Committee discretion to allow early vesting. Under the EPP and ESOS awards vest as soon as practicable after an employee has left. Under the LTIP awards will vest on the normal vesting date.

A summary of the key terms of the executive directors' service contracts on termination of employment or change of control is set out below:

| Name | Position | Notice period from employer | Notice period from employee | Compensation payable on termination of employment or change of control |
|---|---|---|---|---|
| **Mr S G Young** Service contract dated 1 May 2013 (updated on promotion to Chief Executive) | Chief Executive | 12 months | 6 months | As set out in the Policy above, but service contract includes an obligation for the Committee to allow Mr Young to exercise options and awards under the Group's share plans that have already vested at the point of termination.<br>No change of control provisions. |
| **Mr D R Webb** Service contract dated 6 June 2013 | Chief Financial Officer | 12 months | 6 months | As set out in the Policy above.<br>No change of control provisions. |
| **Mr P E Green** Service contract dated 26 February 2001 | Group Corporate Affairs Director | 12 months | 6 months | Mr Green's service contract was entered into before 27 June 2012 and has not been modified or renewed after that date. As such, remuneration or payments for loss of office that are required to be made under Mr Green's service contract are not required to be consistent with the Policy set out above.<br>Payments to Mr Green under his service contract differ from the Policy set out above in the following respects:<br>On termination of employment, Mr Green is entitled to a liquidated damages payment equal to his salary and the value of his contractual benefits (bonus, pension allowance, insurance and company car or car allowance) at the date of termination, pro-rated to the remaining notice period less an amount equal to 5% of the aggregate sum and the Committee shall exercise its discretion under the Group's share plans to treat Mr Green as a 'good leaver'.<br>On change of control, Mr Green may give notice to terminate his employment within 6 months of the event and upon such termination he shall become entitled to the liquidated damages payment summarised above. |

## External appointments held by executive directors

The Board believes that the Group can benefit from experience gained when executive directors hold external non-executive directorships. Executive directors are allowed to hold external appointments and to receive payment provided such appointments are agreed by the Board or Committee in advance, there are no conflicts of interests and the appointment does not lead to deterioration in the individual's performance. Details of external appointments and the associated fees received are included in the annual report on remuneration on page 64.

## Consideration of conditions elsewhere in the Company

The Committee does not consult with employees specifically on executive remuneration policy and framework but does seek to promote and maintain good relations with employee representative bodies—including trade unions and works councils—as part of its broader employee engagement strategy and consults on matters affecting employees and business performance as required in each case by law and regulation in the jurisdictions in which the Group operates. Salary increases made elsewhere in the Group are amongst the data that the Committee considers in determining salaries for executive directors.

## Consideration of shareholder views

The Committee considers shareholder views received during the year and at the AGM each year, as well as guidance from shareholder representative bodies more broadly. The majority of shareholders continue to express support of remuneration arrangements at Meggitt.

# Directors' remuneration report continued

## Annual report on remuneration

The following report provides details of how our Policy was implemented during the year ended 31 December 2013.

### Remuneration Committee—2013 membership and attendance

| Name | Meetings eligible to attend | Meetings attended |
|---|---|---|
| Mr P Heiden (Committee chairman) | 6 | 6 |
| Mr G S Berruyer | 6 | 6 |
| Mr P G Cox | 6 | 6 |
| Ms B L Reichelderfer | 6 | 6 |
| Mr D M Williams | 6 | 6 |

There was one meeting between the end of the financial year and the date of signing of this report, at which all members attended. Activities for the year are described in the Chairman's introduction. The Committee operates within agreed Terms of Reference available on our website. The Committee is responsible for determining the remuneration policy and packages for all executive directors and Executive Board members (covering five of the next most senior executives across the Group) and for agreeing the fees for the Chairman. The Chairman, Chief Executive and Organisational Development Director attend meetings of the Committee by invitation; they are absent when their own remuneration is under consideration.

None of the non-executive directors has, or has had, any personal financial interests or conflicts of interest arising from cross-directorships or day-to-day involvement in running the business.

### Advisers to the Committee

During the year, the Committee's independent remuneration advisor was Kepler Associates ('Kepler'). Kepler, appointed in 2010, was selected by the Committee as a result of a competitive tender process. The Committee evaluates the support provided by Kepler annually and is comfortable that they provide independent remuneration advice to the Committee. Kepler provide guidance on remuneration matters at Board level and below. Kepler do not have any other connection with the Group. Kepler is a member of the Remuneration Consultants Group and adheres to its code of conduct (www.remunerationconsultantsgroup.com). Their total fees in 2013 were £87,000.

### Shareholder consultation and 2013 AGM voting

A consultation letter was issued in October 2013 to our top 20 shareholders covering over 65% of our shareholder base on a revised remuneration package and policy, principally covering the proposed introduction of bonus deferral arrangements and a new LTIP (with clawback provisions attached to both), on which we received positive feedback from most of these investors. We issued a second letter in December 2013 with clarifications, particularly related to LTIP performance measures. The majority of responses were supportive and therefore the Committee agreed to propose the Policy unchanged for shareholder approval at the AGM.

Following feedback received from investor advisory bodies in advance of the 2013 AGM, the Committee also reviewed the level of pension contribution for Mr Young and Mr Green (50% of salary). These arrangements reflect contractual provisions to participate in the Meggitt Pension Plan (MPP), a defined benefit scheme. On reaching the government's Lifetime Allowance (which Mr Young and Mr Green both reached in April 2012), executives may cease accruing further benefit under the MPP and receive the 50% allowance on their full salary. As part of the wider review of executive remuneration, the Committee considered ways to address this concern. The Committee decided that rather than rebalance the package (e.g. through significant salary increases or higher incentive opportunities), it was simpler and more equitable to make no changes to these legacy pension arrangements. As stated in the Policy report, however, pension contributions for new executive directors (as provided to Mr Webb) will be limited to 25% of salary.

The following table shows the results of the advisory vote on the 2012 Directors' remuneration report at the 2013 AGM:

| Resolution text | Votes for[1] | % of votes cast for | Votes against | % of votes cast against | Total votes cast | Votes withheld (abstentions) |
|---|---|---|---|---|---|---|
| Approval of Directors remuneration report | 614,771,357 | 99.3 | 4,225,279 | 0.7 | 618,996,636 | 45,795,274 |

1 A withheld vote is not a vote in law and is not counted in the calculation of the proportion of votes cast for and against a resolution.

## Single total figure of remuneration for executive directors (audited)

The table below sets out a single figure for the total remuneration received by each executive director for the year ended 31 December 2013 and the prior year:

| | Mr S G Young | | Mr D R Webb | | Mr P E Green | | Mr T Twigger[1] | |
|---|---|---|---|---|---|---|---|---|
| | **2013 £'000** | 2012 £'000 | **2013 £'000** | 2012 £'000 | **2013 £'000** | 2012 £'000 | **2013 £'000** | 2012 £'000 |
| Base salary | **554** | 382 | **240** | – | **325** | 309 | **220** | 639 |
| Taxable benefits[2] | **21** | 20 | **8** | – | **14** | 17 | **10** | 30 |
| Pension | **277** | 178 | **57** | – | **163** | 142 | **110** | 320 |
| STIP[3] | **250** | 459 | **93** | – | **126** | 372 | **78** | 767 |
| EPP basic[4] | **153** | 414 | **-** | – | **119** | 316 | **456** | 690 |
| EPP matching[4] | **108** | 307 | **-** | – | **84** | 235 | **312** | 512 |
| ESOS[5] | **280** | 512 | **-** | – | **218** | 391 | **659** | 854 |
| **Total** | **1,643** | 2,272 | **398** | – | **1,049** | 1,782 | **1,845** | 3,812 |

1 Mr Twigger was a director of the Company from 1 January 2013 until 1 May 2013, but continued as an employee until 30 June 2013. Remuneration received as a result of his role as CEO is disclosed in this table. Details of remuneration for the period 1 May to 30 June 2013 is disclosed under payments to past directors on page 62.

2 Taxable benefits consist primarily of company car or car allowance, fuel allowance and private health care insurance.

3 STIP paid for performance over the relevant financial year. Further details of the 2013 STIP, including performance measures, actual performance and bonus payouts, can be found on page 58.

4 EPP is calculated as the number of shares vesting based on performance measures substantially completed during the year, valued at the market value of the shares. For 2013, the figure represents the vesting outcome of the EPS element of the 2011 EPP award (the performance period ended on 31 December 2013) and an estimate of the outcome under the TSR element of the 2011 EPP award (the performance period of which will end in August 2014) based on performance to 31 December 2013. The market value of vested shares is based on the average share price over the last quarter of 2013 of 526.38p. For 2012, the figure represents the actual vesting outcome of 2010 EPP award valued at the share price on the date of vesting (533.00p on 16 August 2013). The valuation of the 2011 EPP award will be updated for the actual vesting outcome of the TSR element in August 2014 and the share price on date of vesting (17 August 2014) in next year's annual report on remuneration. Further details on performance criteria, achievement and resulting vesting levels can be found on pages 58 to 59.

5 ESOS is calculated as the number of shares vesting based on performance measures substantially completed during the year, valued at the difference between the market value of the shares and the exercise price of the award. For 2013, the figure represents the vesting outcome of the 2011 award. The market value of vested shares is based on the average share price over the last quarter of 2013 of 526.38p and an exercise price of 351.70p. For 2012, the 2010 award vested at 100% and the market value and exercise price were 489.70p and 286.10p respectively. The valuation of the 2011 ESOS award will be amended for the share price on date of vesting (2 March 2014) in next year's annual report on remuneration. Further details on performance criteria, achievement and resulting vesting levels can be found on page 59.

## Single total figure of remuneration for non-executive directors (audited)

The table below sets out a single figure for the total remuneration received by each non-executive director for the year ended 31 December 2013 and the prior year:

| | **2013 £'000** | 2012 £'000 |
|---|---|---|
| Sir Colin Terry | **170** | 165 |
| Mr D M Williams | **72** | 70 |
| Mr G S Berruyer[1] | **52** | 12 |
| Mr P G Cox[2] | **52** | 13 |
| Mr P Heiden | **62** | 57 |
| Ms B L Reichelderfer | **52** | 50 |
| Mr D A Robins | **52** | 53 |

1 Appointed 2 October 2012.

2 Appointed 27 September 2012.

# Directors' remuneration report continued

## Incentive outcomes for the year ended 31 December 2013

### STIP in respect of 2013 performance

The Board set stretching financial and strategic targets for the STIP at the start of the 2013 financial year. These targets, and our performance against these, are summarised in the table below.

| | Performance targets | | | |
|---|---|---|---|---|
| Measure | Threshold | Target | Stretch | Actual performance |
| Underlying profit before tax | £365m | £385m | £405m | Between threshold and target |
| Free cash flow[1] | £258m | £283m | £308m | Below threshold |
| Strategic objectives – Q&D improvement | | 28 site targets | | At target |
| Strategic objectives – SAP implementation | | 6 sites | | At target |
| **Personal performance** | | | | |
| Mr S G Young | | | | At target |
| Mr D R Webb | | | | At target |
| Mr P E Green | | | | At target |
| Mr T Twigger | | | | At target |

1 Adjusted to exclude capital expenditure.

The STIP pool generated by the above results is equivalent to approximately 45% of target, however, considering the operational performance of the Group, particularly the supply from a vendor of non-conforming raw material, the Committee has used its discretion to reduce the STIP pool by 20%. The following awards were made to directors in respect of 2013 performance:

| | % salary | £'000 |
|---|---|---|
| Mr S G Young | 39 | 250 |
| Mr D R Webb[1] | 22 | 93 |
| Mr P E Green | 39 | 126 |
| Mr T Twigger[1] | 12 | 78 |

1 Amounts shown in respect of Mr D R Webb and Mr T Twigger have been prorated based on service as a director during the year.

### 2011 EPP

The EPP award made in August 2011 vests 50% on cumulative underlying EPS performance, 25% on cash conversion over three financial years and 25% on the Group's relative TSR performance over a three-year period commencing on the date of grant, as follows:

| Measure | Weighting % | Period ending | Vesting schedule | Outcome | Vesting % |
|---|---|---|---|---|---|
| EPS | 50 | 31-Dec-2013 | 0% vesting below 97p<br>30% vesting for 97p per share<br>100% vesting for 111p or more;<br>Straight line vesting between these points | 106.2p[1] | 76.0[1] |
| Cash conversion | 25 | 31-Dec-2013 | 0% vesting below 87%<br>30% vesting at 87%<br>100% vesting at 95% and above;<br>Straight line vesting between these points | Below threshold | 0 |
| TSR | 25 | 17-Aug-2014 | 0% vesting below median TSR<br>30% vesting for median TSR<br>100% vesting for upper quartile TSR;<br>Straight line vesting between these points | n/a[2] | n/a[2] |

1 Represents growth in EPS of 10.5% over the performance period; the vesting outcome of the EPS portion of the award has been reduced to reflect the cash impact of the issue relating to the supply from a vendor of non-conforming raw material.

2 The vesting outcome of the portion of the award subject to the TSR performance condition will be confirmed at the end of the three-year performance period ending in August 2014. For the purposes of the single figure of remuneration table, the estimated vesting of this element of the 2011 award is 0%, based on Meggitt's relative TSR performance to 31 December 2013 which is below median.

### 2011 ESOS

The ESOS award made in April 2011 vested at 76.0%[1] based on three-year cumulative underlying EPS performance to 31 December 2013.

| Measure | Weighting | Period ending | Vesting schedule | Outcome | Vesting % |
|---|---|---|---|---|---|
| EPS | 100% | 31-Dec-2013 | 0% vesting below 97p<br>30% vesting for 97p per share<br>100% vesting for 111p or more;<br>Straight line vesting between these points | 106.2p[1] | 76.0[1] |

1 Represents growth in EPS of 10.5% over the performance period; the vesting outcome has been reduced to reflect the cash impact of the issue relating to the supply from a vendor of non-conforming raw material.

| Executive | Interests held | Vesting % | Interests vesting | Date vesting | Estimated market price at vesting[1] | Exercise price | Value £'000 |
|---|---|---|---|---|---|---|---|
| Mr S G Young | 210,975 | 76.0 | 160,341 | 2-Mar-14 | 526.38p | 351.70p | £280 |
| Mr P E Green | 164,345 | 76.0 | 124,902 | 2-Mar-14 | 526.38p | 351.70p | £218 |

1 Based on the average share price of the Company over the three months to 31 December 2013.

### 2010 EPP

As disclosed in the 2012 Remuneration report, the Committee determined that 50% of the 2010 EPP award subject to the three-year cumulative underlying EPS performance condition vested in full, based on performance to 31 December 2012. The remaining 50% of the award was dependent on the Group's TSR performance compared to a group of 17 international aerospace and defence companies over the three-year period to 16 August 2013. TSR for all comparator companies is measured on a common currency basis.

| Measure | Weighting | Period ending | Vesting schedule | Outcome | Vesting % |
|---|---|---|---|---|---|
| TSR | 50% | 16-Aug-2013 | 0% vesting below median TSR<br>30% vesting for median TSR<br>100% vesting for upper quartile TSR;<br>Straight line vesting between these points | 66.4th centile | 75.9 |

Following confirmation of the vesting outcome of this TSR element, the overall vesting outcome for the 2010 EPP award (taking into consideration the outcomes of both the EPS and TSR elements) is 87.9% of maximum.

To allow for comparability going forward, the Committee has elected to capture the vesting of the entire 2010 EPP award in the financial year ending 31 December 2012 for the purposes of the single figure, as follows:

| Executive | Interests held | Vesting % | Interests vested | Date vested | Market price at vesting | Value £'000 |
|---|---|---|---|---|---|---|
| Mr S G Young | | | | | | |
| Basic award | 88,379 | 87.9 | 77,729 | 16-Aug-2013 | 533.00p | £414 |
| Matching award | 65,526 | | 57,630 | | | £307 |
| Mr P E Green | | | | | | |
| Basic award | 67,512 | 87.9 | 59,376 | 16-Aug-2013 | 533.00p | £316 |
| Matching award | 50,054 | | 44,022 | | | £235 |

# Directors' remuneration report continued

## Scheme interests awarded in the year ended 31 December 2013 (audited)

### 2013 EPP

| Executive[1] | Form of award | Date of grant | Shares over which awards granted | Award price[2] | Face value £'000 | Face value % of salary[3] | Date of vesting |
|---|---|---|---|---|---|---|---|
| Mr S G Young | | | | | | | |
| Basic award | Nil cost option | 18.03.13 | 114,556 | 419.01p | £480 | 75 | 18.03.16 |
| Matching award | Nil cost option | | 66,946 | 478.00p | £320 | 50 | |
| Mr D R Webb | | | | | | | |
| Basic award | Nil cost option | 05.09.13 | 60,281 | 528.77p | £319 | 75 | 05.09.16 |
| Matching award | Nil cost option | | 39,868 | 533.00p | £212 | 50 | |
| Mr P E Green | | | | | | | |
| Basic award | Nil cost option | 18.03.13 | 58,173 | 419.01p | £244 | 75 | 18.03.16 |
| Matching award | Nil cost option | | 33,996 | 478.00p | £163 | 50 | |

1 Mr Twigger did not receive any awards under the ESOS or EPP in 2013.
2 The award price for the basic award is a 90-day average price up to the award date; the award price for the matching award is based on the market price on the date of the award. The face value has been calculated using the award price for each award.
3 Based on 2013 salary.

Consistent with awards made in 2012, vesting of EPP awards granted in 2013 is dependent on the achievement of three-year targets relating to cumulative underlying EPS, cash conversion and relative TSR outperformance. The three-year period over which performance will be measured will be the three financial years ending 31 December 2015. This includes the performance period for the TSR element, which the Committee considered it appropriate to align with the other performance measures. The performance measures are as follows:

| Measure | Weighting | Vesting schedule | Additional information |
|---|---|---|---|
| EPS | 50% | 0% vesting below 121p<br>30% vesting for 121p per share<br>100% vesting for 133p or more;<br>Straight line vesting between these points | |
| Cash conversion | 25% | 0% vesting below 87%<br>30% vesting for 87%<br>100% vesting for 95%;<br>Straight line vesting between these points | Defined as cash flow as a % of underlying profit after taxation. Cash flow is measured before dividends, merger and acquisition costs and capital expenditure. |
| TSR outperformance of median (p.a.) | 25% | 0% vesting below median TSR<br>30% vesting for 0% p.a. outperformance<br>100% vesting for ≥ 8% p.a. outperformance<br>Straight line vesting between these points | Measured relative to a group of 17 international aerospace and defence companies.[1] TSR for all comparators is measured on a common currency basis. |

1 BAE Systems, BBA Aviation, Boeing, Cobham, Curtiss Wright, EADS, Esterline Technologies, Finmeccanica, Honeywell, Moog, Rockwell Collins, Rolls-Royce Group, Safran, Senior, Ultra Electronic Holdings, Woodward Governor, and Zodiac Aerospace.

### 2013 ESOS

| Executive[1] | Date of grant | Shares over which awards granted | Exercise price[2] | Face value £'000 | Face value % of salary[3] |
|---|---|---|---|---|---|
| Mr S G Young | 05.09.13 | 243,114 | 526.50p | 1,280 | 200 |
| Mr P E Green | 05.09.13 | 123,456 | 526.50p | 650 | 200 |
| Mr D R Webb | 05.09.13 | 161,443 | 526.50p | 850 | 200 |

1 Mr Twigger did not receive any awards under the ESOS or EPP in 2013.
2 The exercise price is based on the close price the date before the award is granted. The face value has been calculated using the award price.
3 Based on 2013 salary.

Consistent with awards made in 2012, vesting of ESOS awards granted in 2013 is dependent on the achievement of three-year cumulative underlying EPS targets. The three-year period over which performance will be measured will be the three financial years ending 31 December 2015. The EPS targets are as follows:

| Measure | Weighting | Vesting schedule |
|---|---|---|
| EPS | 100% | 0% vesting below 121p<br>30% vesting for 121p per share<br>100% vesting for 133p or more;<br>Straight line vesting between these points |

## Total pension entitlements (audited)

The table below sets out details of the pension entitlements under the Meggitt Pension Plan (MPP) for Mr Young, Mr Green and Mr Twigger (until his retirement from the Board on 1 May 2013).

Under the MPP, Mr Young, Mr Green and Mr Twigger accrued defined benefits at 3% of salary per annum up to the Scheme Cap and were entitled to a cash supplement equivalent to 50% of salary above the Scheme Cap. Since reaching the government's Lifetime Allowance Mr Young, Mr Green and Mr Twigger ceased accruing further benefit under the MPP and received a 50% pension allowance on their full salary.

Mr Young and Mr Green both reached the Lifetime Allowance in April 2012 and ceased to accrue further benefit under the MPP and instead received a 50% allowance on their full salary. Mr Twigger also received a 50% of pension allowance on his full salary until he retired from his employment with the Company on 30 June 2013.

Mr Young and Mr Green's dependants remain eligible for dependants' pensions and the payment of a lump sum on death in service.

Mr Webb receives a pension allowance of 25% of base salary.The pension allowance payments made in 2013 are included in the single total figure of remuneration table on page 57.

| | Mr S G Young[1] | | Mr D R Webb[2] | | Mr P E Green[3] | | Mr T Twigger[4] | |
|---|---|---|---|---|---|---|---|---|
| | **2013 £'000** | 2012 £'000 | **2013 £'000** | 2012 £'000 | **2013 £'000** | 2012 £'000 | **2013 £'000** | 2012 £'000 |
| Accrued benefit | **27** | 26 | **N/A** | N/A | **73** | 71 | **46** | 44 |
| Date benefit receivable | **05.04.2012** | 05.04.2012 | **N/A** | N/A | **26.10.2018** | 26.10.2018 | **06.04.2011** | 06.04.2011 |
| Total value of additional benefit if director retires early | **Left MPP and taken benefits** | Left MPP and taken benefits | **N/A** | N/A | **Nil. Early retirement factors cost neutral** | Nil. Early retirement factors cost neutral | **Retired** | Retired |
| Transfer value | **894** | 942 | **–** | – | **1,741** | 1,607 | **1,587** | 1,664 |

1 Mr Young opted to leave the MPP and take his pension benefits with effect from 5 April 2012.

2 Mr Webb is not a member of any defined benefit or defined contribution pension scheme operated by the Group. On appointment (6 June 2013), Mr Webb received a pension allowance of 20% of base salary; this was adjusted to 25% on 1 August 2013, when the Committee agreed the policy on pension allowances for executive directors.

3 Mr Green opted to leave the MPP with effect from 31 March 2012. He has not drawn his pension.

4 Mr Twigger opted to leave the MPP and take his pension benefits with effect from 6 April 2011. He retired from his employment with the Company on 30 June 2013.

## Percentage change in CEO cash remuneration

The table below shows the percentage change in CEO remuneration from the prior year compared to the average percentage change in remuneration for all executive employees, We have selected our executive population (around 250 people) for this comparison because it is considered to be the most relevant, due to the structure of total remuneration; most of our senior executives receive benefits under the same STIP and LTIP structure as our CEO.

| | **2013 £'000** | 2012 £'000 | **CEO % change 2012-2013** | **Executive employees% change 2012-2013** |
|---|---|---|---|---|
| Base salary | **647** | 639 | **+1.3** | **+3.8** |
| Taxable benefits | **24** | 30 | **-20.0** | **+3.4** |
| STIP | **244** | 767 | **-68.2** | **-62.8** |
| **Total** | **915** | 1,436 | **-36.3** | **-13.5** |

The CEO's remuneration includes base salary, taxable benefits and STIP. For 2013, the figures comprise elements paid to Mr T Twigger before his retirement from the Board in May 2013 and payments made to Mr S G Young from his appointment as CEO in May 2013. The pay for executive employees is calculated using the increase in the earnings of full-time executive employees. The analysis is based on a consistent set of employees.

# Directors' remuneration report continued

## Relative importance of spend on pay

The table below shows shareholder distributions (i.e. dividends and share buybacks) and total employee expenditure for 2013 and the prior year, along with the percentage change in both.

| | 2013 £'m | 2012 £'m | % change 2012-2013 |
|---|---|---|---|
| Shareholder distributions – dividends[1] | **101.4** | 92.5 | **9.6%** |
| Total employee expenditure[2] | **475.1** | 453.8 | **4.7%** |

1 Represents dividends paid or proposed in respect of the year. See note 16 of the Group consolidated financial statements.
2 Comprises wages and salaries and retirement benefit costs. See note 9 of the Group consolidated financial statements.

## Exit payments made in the year

No exit payments have been made in 2013.

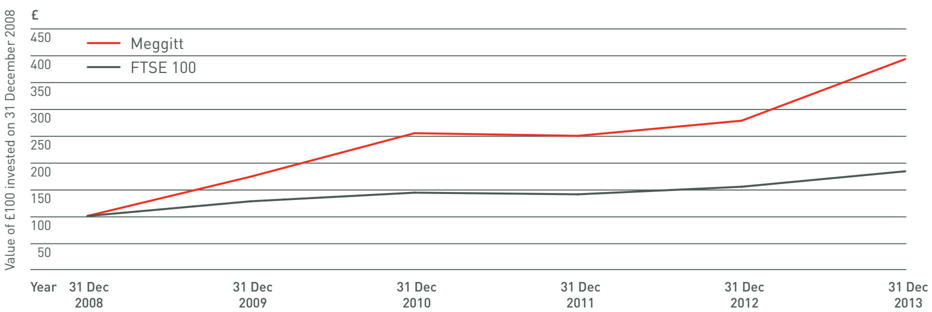
## Payments to past directors (audited)

Mr Twigger ceased to be a director on 1 May 2013, and retired on 30 June 2013. Details of Mr Twigger's remuneration for the period 1 January to 1 May 2013 (including the full value of long-term incentive awards that vested on his retirement from the Group) are disclosed in the single total figure of remuneration table on page 57. For the period 1 May to 30 June 2013, Mr Twigger continued to receive base pay and contractual benefits, and was eligible to receive a pro-rated STIP award for this additional period worked; in total, this amounted to £209,000.

## Review of past performance

The remuneration package is structured to help ensure alignment with shareholders. There is no direct correlation between share price movement and the change in the value of the pay package in any one year (as the remuneration package comprises several components, some fixed, and others based on non-financial measures) the charts below show how the CEO's pay has been sensitive to the share price over the last five years.

This graph illustrates the Company's performance compared to the FTSE100 Index, which is considered the most appropriate broad equity market index against which the Group's performance should be measured. Performance, as required by legislation, is measured by TSR over the five year period from 1 January 2009 to 31 December 2013:




The table below details the CEO's single total figure of remuneration over the same period:

| | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| Mr S G Young | | | | | |
| Single total figure of remuneration (£'000) | – | – | – | – | **1,643** |
| STIP outcome (% of maximum) | – | – | – | – | **39%** |
| EPP vesting (% of maximum) | – | – | – | – | **38%** |
| ESOS vesting (% of maximum) | – | – | – | – | **76%** |
| Mr T Twigger | | | | | |
| Single total figure of remuneration (£'000) | 1,758 | 2,947 | 4,252 | 3,812 | **1,845** |
| STIP outcome (% of maximum) | 86% | 86% | 100% | 80% | **35%** |
| EPP vesting (% of maximum) | – | 50% | 69% | 88% | **56%** |
| ESOS vesting (% of maximum) | 100% | 100% | 100% | 100% | **98%** |

Figures are provided for Mr T Twigger for the period up to 1 May 2013, and Mr S G Young for the period from his appointment as CEO on 1 May 2013.

## Implementation of Remuneration Policy for 2014

### Base salary

Base salaries are reviewed taking into account personal performance, employment conditions and salary levels across the Group, and prevailing market conditions. Base salaries were reviewed in early 2014 and, effective 1 April 2014, will be as follows for the executive directors:

| | % change | 2014 £'000 |
|---|---|---|
| Mr S G Young | 3.75 | 664 |
| Mr D R Webb | 3.53 | 440 |
| Mr P E Green | 5.85 | 344 |

This year, salary adjustments have been harmonised at 1 April across the Group where possible. Where this has delayed an adjustment from January to April, the award has been prorated by 15/12ths: i.e. for a 3% adjustment in January, this is commuted to a 3.75% adjustment in April. This has been applied to the salary awards for Mr Young and Mr Webb. Mr Green's salary continues to be below competitive levels and it was agreed to increase his salary by 5.85%.

For context, salary adjustments across the Group vary from region to region according to local salary inflation; in the UK and the US this is 3%, which will be prorated to 3.75% when applied to the 15 month period described above.

### Pension and benefits

There were no changes in pension contribution rates or benefit provision.

### 2014 STIP measures

STIP measures for 2014 are based two thirds on Group performance—50% PBT and 50% cash—and one third on personal objectives. The STIP targets for 2014, together with details of whether they have been met, will be disclosed (subject to commercial sensitivity) in the 2014 Directors' remuneration report. The opportunity is in line with the Policy disclosed on page 49.

### 2014 LTIP measures

Subject to approval of the LTIP by shareholders at the 2014 AGM, the executive directors will be granted awards under the LTIP in early 2014, vesting of which will be subject to the following measures and targets:

| Weight | Measure | | | | Threshold | Mid-point | Stretch |
|---|---|---|---|---|---|---|---|
| 33.3% | **Underlying EPS** (pence) 3 year aggregate (equivalent to CAGR range of 5 to 10 %) | | | | 124.0 | 130.5 | 137.0 |
| 33.3% | **ROTA** average over three years | | | | 33.0% | 34.5% | 36.0% |
| 33.3% | **Strategic measures**[1] average over 3 years | Execution | Quality | % sites on target (year 1 targets) | 57.0% | 71.0% | 86.0% |
| | | | Delivery | % sites on target (year 1 targets) | 36% | 57% | 79% |
| | | | Meggitt Production System | Average status per schedule | 2.0 | 3.0 | 4.0 |
| | | Growth | Organic revenue growth | % organic revenue growth (CAGR over 3 years) | 5.0% | 6.5% | 8.0% |
| | | | Programme management | Average status per reviews | 2.0 | 3.0 | 4.0 |
| | | Innovation | Schedule | Average status per schedule | 2.0 | 3.0 | 4.0 |

[1]Performance against each strategic measure will be assessed at the end of the 3-year period against a scale of:

- 1.0—threshold objective not met
- 2.0—threshold met
- 3.0—on target
- 4.0—stretch objective met
- 5.0—stretch objective exceeded

# Directors' remuneration report continued

### Chairman and non-executive director fees

The following non-executive director fee structure was in place for the year ended 31 December 2013 and has been agreed for 2014:

| | 2013 £'000 | 2014 £'000 |
|---|---|---|
| Chairman fee | 170 | 176 |
| Non-executive director base fee | 52 | 54 |
| Additional fee for chairing Audit or Remuneration Committee | 10 | 10 |
| Additional fee for Senior Independent Director | 10 | 10 |

This year, salary adjustments have been harmonised on 1 April across the Group where possible. Where this has delayed an adjustment from January to April, the award has been prorated by 15/12ths: i.e. for a 3% adjustment in January, this is commuted to a 3.75% adjustment in April. This has been applied to the fee awards for the non-executive directors and Chairman.

### Directors' beneficial interests (audited)

The beneficial interests of the directors and their connected persons in the ordinary shares of the Company at 31 December 2013, as notified under the Disclosure and Transparency Rules of the Financial Conduct Authority (DTR) (including shares held beneficially in the Share Incentive Plan by executive directors), were as follows:

| | Shareholding Ordinary shares of 5p each 2013 | 2012 |
|---|---|---|
| Sir Colin Terry | **12,041** | 11,846 |
| Mr T Twigger[1] | **1,104,866** | 1,104,756 |
| Mr S G Young | **413,351** | 407,154 |
| Mr G S Berruyer[2] | **3,000** | – |
| Mr P G Cox[3] | **6,824** | – |
| Mr P E Green | **557,978** | 553,260 |
| Mr P Heiden | **5,841** | 5,701 |
| Ms B L Reichelderfer | **6,000** | 6,000 |
| Mr D A Robins | **73,008** | 71,261 |
| Mr D R Webb [4] | **25,648** | – |
| Mr D M Williams | **5,000** | 5,000 |

1 2013 shareholding declared as at 1 May 2013 (the date Mr Twigger ceased to be a director).
2 Appointed on 2 October 2012.
3 Appointed on 27 September 2012.
4 Appointed on 6 June 2013.

Between 1 January 2014 and 17 February 2014, the only changes to the beneficial interests of the directors in the ordinary shares of the Company are that Mr Young and Mr Green each acquired 47 shares through the Meggitt PLC Share Incentive Plan.

### External appointments held by executive directors

| Executive Director | Company | Role | Fees retained £'000 |
|---|---|---|---|
| Mr S G Young | Derwent London plc | Non-executive director | 40 |
| | | Chairman of Audit Committee | 9 |
| | | Member of Remuneration Committee | 4 |
| | | Member of Nomination Committee (stepped down 01.08.2013) | 2 |
| | | Total | 55 |
| Mr D R Webb | SEGRO plc | Non-executive director | 53 |
| | | Chairman of Audit Committee | 10 |
| | | Total | 63 |

## Directors' shareholding requirements (audited)

Shares which are included within the shareholding requirement are:

| Source of shares | Description |
|---|---|
| ESOS, EPP and LTIP | Share awards exercised and retained. |
| Deferred Bonus | Shares released and retained after the two-year deferral period. |
| Ordinary shares | Shares purchased directly in the market. |
| Share dividend plan | Shares acquired through the share dividend plan. |
| Share Incentive Plan | Shares acquired via the monthly SIP partnership share purchase scheme.<br>Free shares retained for more than 5 years under the SIP. |
| Employee schemes (SIP, SAYE) | Share awards exercised and retained. |

The table below shows the shareholding of each executive director against their respective shareholding requirement as at 31 December 2013:

| Name | Shareholding guideline (% 2013 salary) | Shares owned outright[1] | Current shareholding (% 2013 salary)[2] | Guideline met? |
|---|---|---|---|---|
| Mr S G Young | 300% | 413,351 | 341% | Met |
| Mr D R Webb[3] | 200% | 25,648 | 32% | Building |
| Mr P E Green | 200% | 557,978 | 906% | Met |

1 Includes shares invested to be eligible for EPP matching awards.
2 Assessment of shareholding is based on shares owned outright, salaries as at 31 December 2013 and a share price of 527.50 pence (the value of a Meggitt share on 31 December 2013).
3 Appointed on 6 June 2013.

On 1 May 2013, Mr Twigger held 1,104,866 shares, equivalent to 791% of his 2013 salary (valued at 472.50 pence, the value of a Meggitt share on 1 May 2013) against the shareholding requirement which, on that date, was 100% of salary. The shareholding requirement has been increased from 100% to 300% subsequent to Mr Twigger's departure from the Board.

# Directors' remuneration report continued

### Directors' interests in share schemes (audited)

All of the ESOS and EPP awards have performance conditions attached (as detailed in the Directors remuneration report in the year of grant and in this report for those awards made in 2013):

- The awards made up to and including 2010 have already vested to the extent detailed in this and previous reports and the figures shown in the table below for those years are the vested share award amounts.
- The awards made in 2011, 2012 and 2013 were unvested as at 31 December 2013.

Sharesave awards are not subject to performance conditions.

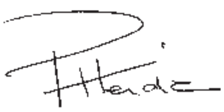
| | | Number of shares under award | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Date of award | at 1 Jan 2013 | Awarded/ (exercised) | at 1 May 2013 | Exercise price | Market price at date of exercise | Date exercisable from | Expiry date |
| **Mr T Twigger** | | | | | | | | |
| ESOS 2005, Part A (options) | 30.04.09 | 17,699 | – | 17,699 | 169.50p | – | 30.04.12 | 29.04.19 |
| 2005, Part B (stock SARs) | 10.10.05 | 322,987 | – | 322,987 | 278.65p | – | 10.10.08 | 09.10.15 |
| | 27.09.06 | 365,613 | – | 365,613 | 263.67p | – | 27.09.09 | 26.09.16 |
| | 29.03.07 | 334,448 | – | 334,448 | 299.00p | – | 29.03.10 | 28.03.17 |
| | 25.03.08 | 475,248 | – | 475,248 | 252.50p | – | 25.03.11 | 24.03.18 |
| | 30.04.09 | 477,876 | (341,957) | 135,919 | 169.50p | – | 30.04.12 | 29.04.19 |
| | 12.03.10 | 419,434 | – | 419,434 | 286.10p | – | 12.03.13 | 11.03.20 |
| | 02.03.11 | 352,573 | – | 352,573 | 351.70p | – | 02.03.14 | 01.03.21 |
| | 10.04.12 | 321,752 | – | 321,752 | 397.20p | – | 10.04.15 | 09.04.22 |
| EPP – Basic | 05.08.09 | 192,363 | – | 192,363 | – | – | 21.08.12 | 04.08.19 |
| (nil cost options) | 21.04.11 | 147,299 | – | 147,299 | – | – | 21.08.13 | 20.04.21 |
| | 17.08.11 | 128,117 | – | 128,117 | – | – | 17.08.14 | 16.08.21 |
| | 22.08.12 | 122,507 | – | 122,507 | – | – | 22.08.15 | 21.08.22 |
| EPP – Match | 12.08.09 | 107,265 | – | 107,265 | – | – | 21.08.12 | 04.08.19 |
| (nil cost options) | 21.04.11 | 109,210 | – | 109,210 | – | – | 21.08.13 | 20.04.21 |
| | 17.08.11 | 89,855 | – | 89,855 | – | – | 17.08.14 | 16.08.21 |
| | 22.08.12 | 79,536 | – | 79,536 | – | – | 22.08.15 | 21.08.22 |
| Sharesave (options) | 14.09.12 | 2,752 | – | 2,752 | 326.94p | – | 01.11.15 | 01.05.16 |
| Total | | 4,066,534 | (341,957) | 3,724,577 | | | | |

| | | Number of shares under award | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Date of award | at 1 Jan 2013 | Awarded/ (exercised) | at 31 Dec 2013 | Award price | Market price at date of exercise | Date exercisable from | Expiry date |
| **Mr S G Young** | | | | | | | | |
| 1996 ESOS No1 (options) | 01.04.04 | 17,200 | – | 17,200 | 174.40p | – | 01.04.07 | 31.03.14 |
| ESOS 2005, Part B (stock SARs) | 10.10.05 | 186,615 | – | 186,615 | 278.65p | – | 10.10.08 | 09.10.15 |
| | 27.09.06 | 210,871 | – | 210,871 | 263.67p | – | 27.09.09 | 26.09.16 |
| | 29.03.07 | 192,642 | – | 192,642 | 299.00p | – | 29.03.10 | 28.03.17 |
| | 25.03.08 | 285,149 | – | 285,149 | 252.50p | – | 25.03.11 | 24.03.18 |
| | 30.04.09 | 297,345 | – | 297,345 | 169.50p | – | 30.04.12 | 29.04.19 |
| | 12.03.10 | 251,660 | – | 251,660 | 286.10p | – | 12.03.13 | 11.03.20 |
| | 02.03.11 | 210,975 | – | 210,975 | 351.70p | – | 02.03.14 | 01.03.21 |
| | 10.04.12 | 288,520 | – | 288,520 | 397.20p | – | 10.04.15 | 09.04.22 |
| | 05.09.13 | – | 243,114 | 243,114 | 526.50p | – | 05.09.16 | 04.09.23 |
| EPP – Basic | 05.08.09 | 115,418 | - | 115,418 | – | – | 21.08.12 | 04.08.19 |
| (nil cost options) | 21.04.11 | 88,379 | (10,650) | 77,729 | – | – | 21.08.13 | 20.04.21 |
| | 17.08.11 | 76,663 | – | 76,663 | – | – | 17.08.14 | 16.08.21 |
| | 22.08.12 | 73,236 | – | 73,236 | – | – | 22.08.15 | 21.08.22 |
| | 18.03.13 | – | 114,556 | 114,556 | – | – | 18.03.16 | 17.03.23 |
| EPP– Match | 12.08.09 | 64,359 | – | 64,359 | - | – | 21.08.12 | 04.08.19 |
| (nil cost options) | 21.04.11 | 65,526 | (7,896) | 57,630 | – | – | 21.08.13 | 20.04.21 |
| | 17.08.11 | 53,768 | – | 53,768 | – | – | 17.08.14 | 16.08.21 |
| | 22.08.12 | 47,547 | – | 47,547 | – | – | 22.08.15 | 21.08.22 |
| | 18.03.13 | – | 66,946 | 66,946 | – | – | 18.03.16 | 17.03.23 |
| Sharesave (options) | 06.09.10 | 4,047 | (4,047) | – | 222.35p | 509.00p | 01.11.13 | 01.05.14 |
| Total | | 2,529,920 | 402,023 | 2,931,943 | | | | |

| | Date of award | Number of shares under award at 1 Jan 2013 | Awarded/ (exercised/ lapsed) | at 31 Dec 2013 | Exercise price | Market price at date of exercise | Date exercisable from | Expiry date |
|---|---|---|---|---|---|---|---|---|
| **Mr P E Green** | | | | | | | | |
| ESOS 2005, Part A (options) | 29.03.07 | 2,759 | – | 2,759 | 299.00p | – | 29.03.10 | 28.03.17 |
| | 30.04.09 | 12,832 | – | 12,832 | 169.50p | – | 30.04.12 | 29.04.19 |
| ESOS 2005, Part B (stock SARs) | 10.10.05 | 143,549 | (122,887) | 20,662 | 278.65p | 526.50p | 10.10.08 | 09.10.15 |
| | 27.09.06 | 162,326 | (138,961) | 23,365 | 263.67p | 526.50p | 27.09.09 | 26.09.16 |
| | 29.03.07 | 145,402 | (145,402) | – | 299.00p | 526.50p | 29.03.10 | 28.03.17 |
| | 25.03.08 | 217,822 | – | 217,822 | 252.50p | – | 25.03.11 | 24.03.18 |
| | 30.04.09 | 214,306 | – | 214,306 | 169.50p | – | 30.04.12 | 29.04.19 |
| | 12.03.10 | 192,240 | – | 192,240 | 286.10p | – | 12.03.13 | 11.03.20 |
| | 02.03.11 | 164,345 | – | 164,345 | 351.70p | – | 02.03.14 | 01.03.21 |
| | 10.04.12 | 233,384 | – | 233,384 | 397.20p | – | 10.04.15 | 09.04.22 |
| | 05.09.13 | – | 123,456 | 123,456 | 526.50p | – | 05.09.16 | 04.09.23 |
| EPP – Basic | 05.08.09 | 88,167 | – | 88,167 | – | – | 21.08.12 | 04.08.19 |
| (nil cost options) | 21.04.11 | 67,512 | (8,135) | 59,377 | – | – | 21.08.13 | 20.04.21 |
| | 17.08.11 | 59,719 | – | 59,719 | – | – | 17.08.14 | 16.08.21 |
| | 22.08.12 | 59,240 | – | 59,240 | – | – | 22.08.15 | 21.08.22 |
| | 18.03.13 | – | 58,173 | 58,172 | – | – | 18.03.16 | 17.03.23 |
| EPP – Match | 12.08.09 | 49,163 | – | 49,163 | | – | 21.08.12 | 04.08.19 |
| (nil cost options) | 21.04.11 | 50,054 | (6,032) | 44,022 | – | – | 21.08.13 | 20.04.21 |
| | 17.08.11 | 41,884 | – | 41,884 | – | – | 17.08.14 | 16.08.21 |
| | 22.08.12 | 38,461 | – | 38,461 | – | – | 22.08.15 | 21.08.22 |
| | 18.03.13 | | 33,996 | 33,996 | – | – | 18.03.16 | 17.03.23 |
| Sharesave (options) | 04.09.08 | 3,798 | (3,798) | – | 171.40p | 509.00p | 01.11.13 | 01.05.14 |
| | 06.09.10 | 1,389 | – | 1,389 | 222.35p | – | 01.11.15 | 01.05.16 |
| | 14.09.12 | 1,835 | – | 1,835 | 326.94p | – | 01.11.17 | 01.05.18 |
| Total | | 1,950,187 | (209,591) | 1,740,596 | | | | |

| | Date of award | Number of shares under award at 1 Jan 2013 | Awarded/ (exercised/ lapsed) | at 31 Dec 2013 | Exercise price | Market price at date of exercise | Date exercisable from | Expiry date |
|---|---|---|---|---|---|---|---|---|
| **Mr D R Webb** | | | | | | | | |
| ESOS 2005, Part A (options) | 05.09.13 | – | 5,698 | 5,698 | 526.50p | – | 05.09.16 | 04.09.23 |
| ESOS 2005, Part B (stock SARs) | 05.09.13 | – | 155,745 | 155,745 | 526.50p | – | 05.09.16 | 04.09.23 |
| EPP – Basic (nil cost options) | 05.09.13 | – | 60,281 | 60,281 | 526.50p | – | 05.09.16 | 04.09.23 |
| EPP – Match (nil cost options) | 05.09.13 | – | 39,868 | 39,868 | 526.50p | – | 05.09.16 | 04.09.23 |
| Sharesave (options) | 13.09.13 | – | 3,517 | 3,517 | 426.40p | – | 01.11.18 | 01.05.19 |
| Total | | – | 265,109 | 265,109 | | | | |

**By order of the Board**



**Paul Heiden**
Chairman, Remuneration Committee
3 March 2014

# Directors' report

The directors present their report together with the audited consolidated financial statements of the Group (prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRSs as adopted by the EU') and the Companies Act 2006) and Company audited financial statements (prepared in accordance with UK Generally Accepted Accounting Practice ('UK GAAP') and the Companies Act 2006) for the year ended 31 December 2013.

## Incorporation by reference

Certain laws and regulations require that specific information should be included in the Directors' report; the following information is incorporated into this Directors' report by reference:

- Likely future developments in the Group's business (page 1 to 34).
- The Corporate Governance Report (page 35 to 46).
- Research and development activities (page 28).
- Policies on financial risk management, including the extent to which financial instruments are utilised to mitigate any significant risks to which the Group is exposed are set out in note 3 of the Group's consolidated financial statements (page 84).
- Greenhouse gas emissions (page 32).
- Employee information (page 34):
  —employee involvement; and
  —employment of disabled persons.
- Independent auditors—disclosure of relevant audit information (page 70).

There are no significant events affecting the Group since the end of the year requiring disclosure.

## Dividends

The directors recommend the payment of a final dividend of 8.80p net per ordinary 5p share (2012: 8.20p), to be paid on 9 May 2014 to those members on the register at close of business on 14 March 2014. An interim dividend of 3.95p (2012: 3.60p) was paid on 4 October 2013. If the final dividend as recommended is approved the total ordinary dividend for the year will amount to 12.75p net per ordinary 5p share (2012: 11.80p).

Dividends are paid to shareholders net of a non-refundable tax credit of 10%. Shareholders liable to higher rates of income tax will have additional tax to pay.

Shareholders will be offered a scrip dividend alternative under the share dividend plan in respect of the proposed final dividend. During 2013, the Company made the Meggitt PLC share dividend plan available for the dividends paid in May 2013 (the final dividend for 2012) and in October 2013 (the interim dividend for 2013). The cash dividend necessary to give an entitlement to one new ordinary share was fixed at 482.02p and 534.80p respectively.

## Directors

The directors of the Company who were in office during the year and up to the date of signing the financial statements were: Sir Colin Terry (Chairman), Mr T Twigger (retired from the Board on 1 May 2013), Mr S G Young (Chief Executive), Mr G S Berruyer, Mr P G Cox, Mr P E Green, Mr P Heiden, Ms B L Reichelderfer, Mr D A Robins, Mr D R Webb (appointed 6 June 2013) and Mr D M Williams (Senior Independent Director). There have been no changes in directors since the end of the year up to the date of this Directors' report.

All directors will be submitted for election or re-election at the Annual General Meeting (AGM), except Mr D A Robins who is due to retire at the AGM. Details of any unexpired terms of the directors' service contracts are in the Directors' remuneration report. Membership of committees and biographical information is disclosed on page 37 and in the notice of AGM.

The directors have the benefit of qualifying third-party indemnity provisions for the purposes of Section 236 of the Companies Act 2006 pursuant to the Articles which were in effect throughout the financial year and up to the date of this Directors' report. The Company also purchased and maintained throughout the year Directors' and Officers' liability insurance. No indemnity is provided for the Company's auditors.

## Conflicts of interest

The Company has a procedure for the disclosure, review, authorisation and management of directors' conflicts of interest and potential conflicts of interest, in accordance with the provisions of the Companies Act 2006. In deciding whether to authorise a conflict or potential conflict the directors must have regard to their general duties under the Companies Act 2006. The authorisation of any conflict matter, and the terms of authorisation, are regularly reviewed by the Board.

## Political donations

No political donations were made during the year (2012: none).

## Share capital and control

The issued share capital of the Company at 31 December 2013 and details of shares issued during the financial year are shown in note 34 of the Group's consolidated financial statements. On 31 December 2013 there were 797,045,208 ordinary shares in issue. A further 379,202 ordinary shares were issued between 1 January 2014 and 25 February 2014, all of which were issued as a result of the exercise of share awards. The ordinary shares are listed on the London Stock Exchange.

The rights and obligations attaching to the Company's ordinary shares are set out in the Articles. A copy of the Articles is available for inspection at the registered office. The holders of ordinary shares are entitled to receive the Company's report and accounts, to attend and speak at general meetings of the Company, to appoint proxies to exercise full voting rights and to participate in any distribution of income or capital.

There are no restrictions on transfer, or limitations on holding ordinary shares and no requirements for prior approval of any transfers. There are no known arrangements under which financial rights are held by persons other than holders of the shares and no known agreements or restrictions on share transfers or on voting rights. Shares acquired through Company share plans rank pari passu (on an equal footing) with the shares in issue and have no special rights.

Rules about the appointment and replacement of Company directors are contained in the Articles which provide that a director may be appointed by ordinary resolution of the shareholders or by the existing directors, either to fill a vacancy or as an additional director. Changes to the Articles must be submitted to the shareholders for approval by way of special resolution. The directors may exercise all the powers of the Company subject to the provisions of relevant legislation, the Articles and any directions given by the Company in general meeting.

The powers of the directors include those in relation to the issue and buyback of shares. At each AGM, the shareholders are requested to renew the directors' powers to allot securities in the Company up to the value specified in the notice of meeting and to renew the directors' powers to allot securities without the application of pre-emption rights up to the value specified in the notice of meeting in accordance with the Articles. The Company can seek authority from the shareholders at the AGM to purchase its own shares.

The Group has significant financing agreements which include change of control provisions which, should there be a change of ownership of the Company, could result in renegotiation, withdrawal or early repayment of these financing agreements. These are a USD 400 million revolving credit agreement dated July 2012, a USD 700 million revolving credit agreement dated April 2011, a USD 600 million note purchase agreement dated June 2010 and a USD 250 million note purchase agreement dated June 2003.

There are a number of other long-term commercial agreements that may alter or terminate upon a change of control of the Company following a successful takeover bid. These arrangements are commercially confidential and their disclosure could be seriously prejudicial to the Company.

Agreements providing compensation in the event of a takeover bid:

| Director | Contractual entitlement |
|---|---|
| Mr S G Young | None except that provisions in the Company's share plans may cause options and/or awards granted to employees under such plans to vest on a takeover. |
| Mr D R Webb | None except that provisions in the Company's share plans may cause options and/or awards granted to employees under such plans to vest on a takeover. |
| Mr P E Green | Mr Green may terminate his employment within six months and would be entitled to compensation from the Company for loss of office. The compensation would be annual remuneration plus the value of benefits for the unexpired notice period less 5%. In addition, provisions in the Company's share plans may cause options and/or awards granted to employees under such plans to vest on a takeover. |
| Non-executive directors | None. |
| All other employees | There are no agreements that would provide compensation for loss of employment resulting from a takeover except that provisions in the Company's share plans may cause options and/or awards granted to employees under such plans to vest on a takeover. |

## Substantial shareholdings

At 25 February 2014, the Company had been notified under the Disclosure and Transparency Rules (DTR) of the following substantial interests in the issued ordinary shares of the Company requiring disclosure:

| | Direct voting rights (m)* | Indirect voting rights (m)* | Percentage of total voting rights attaching to the issued ordinary share capital of the Company |
|---|---|---|---|
| The Capital Group Companies, Inc. | – | 119.5 | 15.02% |
| FMR LLC | – | 40.6 | 5.09% |
| Standard Life Investments Ltd | 22.2 | 3.8 | 3.25% |
| Legal & General Group plc | 23.7 | – | 2.97% |

* One voting right per ordinary share.

These holdings are published on a regulatory information service and on the Company's website.

# Directors' report continued

## Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report, the Directors' remuneration report and the financial statements in accordance with applicable law and regulations. Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and the Company financial statements in accordance with UK GAAP. Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent; and
- state whether IFRSs as adopted by the EU and the UK have been followed, subject to any material departures disclosed and explained in the Group and Company financial statements respectively.

The directors are responsible for keeping adequate accounting records that are sufficient to: (i) show and explain the Group's and the Company's transactions; (ii) disclose with reasonable accuracy at any time the financial position of the Group and the Company; and (iii) enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the International Accounting Standards Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the directors, whose names and functions are listed in the Board of Directors on page 37, confirm that to the best of their knowledge:

- the Group financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
- the strategic report and this Directors' report include 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 it faces.

Each of the persons who is a director as at the date of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the director has taken all the necessary steps in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

**Fair, balanced and understandable**

The directors as at the date of this report consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy. The Board has made this assessment on the basis of a review of the accounts process, a discussion on the content of the annual report assessing its fairness, balance and understandability, together with the confirmation from executive management that the report is fair, balanced and understandable.

By order of the Board

**M L Thomas**
Company Secretary
3 March 2014

# Independent auditors' report to the members of Meggitt PLC

## Report on the Group financial statements

**Our opinion**

In our opinion the Group financial statements, defined below:

- give a true and fair view of the state of the Group's affairs as at 31 December 2013 and of the Group's profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

**What we have audited**

The Group financial statements, which are prepared by Meggitt PLC, comprise:

- the Consolidated balance sheet as at 31 December 2013;
- the Consolidated income statement and Consolidated statement of comprehensive income for the year then ended;
- the Consolidated statement of changes in equity and Consolidated cash flow statement for the year then ended; and
- the notes to the Group financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union.

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

**What an audit of financial statements involves**

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

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

We read all the financial and non-financial information in the 'Annual Report and Accounts' (the 'Annual Report') to identify material inconsistencies with the audited Group financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Overview of our audit approach**

**Materiality**

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of any misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the Group financial statements as a whole to be £14 million, which represents approximately 5% of profit before tax.

We agreed with the Audit Committee that we would report to them any misstatements identified during our audit above £500,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

**Overview of the scope of our audit**

The Group financial statements are a consolidation of a significant number of reporting units, comprising the Group's operating businesses and centralised functions. In establishing our approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the group engagement team, or other audit teams within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by other audit teams, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

Based on our assessment of significance and risk a full scope audit was performed over the complete financial information of 11 reporting units, and targeted audit procedures over specific balances or transactions were performed at a further 21 reporting units. Together these 32 reporting units accounted for 91% of Group profit before tax. This together with additional procedures performed at the Group level, including testing the consolidation process, gave us sufficient appropriate audit evidence for our opinion on the Group financial statements as a whole.

**Areas of particular audit focus**

In preparing the financial statements, the directors made a number of subjective judgements, for example over significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks or areas of focus identified by our audit. We discussed these areas of focus with the Audit Committee. Their report on those matters that they considered to be significant issues in relation to the financial statements is set out on page 44.

# Independent auditors' report to the members of Meggitt PLC continued

| Area of focus | How the scope of our audit addressed the area of focus |
|---|---|
| **Valuation of goodwill and other intangible assets**<br>Goodwill and intangible assets represent the largest assets within the Group's balance sheet.<br><br>The directors' assessment of the carrying value of goodwill and intangible assets and the annual impairment review the directors are required to perform is described in notes 18 to 20 of the financial statements.<br><br>This assessment of the carrying value of these assets is inherently subjective due to the judgement involved in estimating future cash flows and in calculating the discount rate to apply to these cash flows. | Our work included testing management's impairment models including the cash flows and evaluating and corroborating key inputs used in these models.<br><br>We performed sensitivity analysis over the significant assumptions used in the models to ascertain the point at which an impairment would be triggered, and considered the likelihood of such a change in the key assumptions, either individually or in aggregate. The significant assumptions included forecast sales over the next five years, the discount rate and the terminal growth rate.<br><br>We read the disclosures in the financial statements included in note 18 in respect of management's impairment testing and considered whether these were consistent with the conclusions of our audit work and met the disclosure requirements of the relevant accounting standards. |
| **Provisions for environmental, legal and other matters**<br>The Group has a number of material provisions in respect of environmental, legal and other matters. These are set out in note 31 to the financial statements. These provisions require the directors to make estimates of the likely future cash flows that will be required to settle the Group's obligations. These estimates are inherently subjective and therefore give rise to greater audit risk. | The Group has an experienced team who are responsible for managing environmental, legal and other matters and this expertise is supplemented by the use of external third party experts where appropriate. Our audit procedures included an assessment of the experience and expertise of those third parties involved in determining the provisions, and the scope of their work.<br><br>We evaluated the existing obligations of the Group, corroborating key facts surrounding these obligations (including obtaining third party expert reports from the Group's external specialists where appropriate), assessed the extent of any insurance coverage and tested the associated provisions – for example we recalculated provisions and independently assessed future cost estimates. We also used our own experience of similar situations to develop an independent view of the adequacy of the provisions. |
| **Risk of fraud in revenue recognition**<br>ISAs (UK & Ireland) presume there is a risk of fraud in revenue recognition because of the pressure management may feel to achieve results.<br><br>In assessing this risk for the Group we concluded that most significant areas of risk related to revenues where contract accounting principles are followed (as this involves judgement over future cost estimates and percentage of completion), and where adjustments to revenues are made as a result of manual journals. | We tested revenues recognised under contract accounting by checking that an appropriate amount of revenue had been recognised which fairly reflected the stage of completion of the contract. We also evaluated the design of the key controls management has in place over contract accounting and tested some of these controls.<br><br>We tested manual journal entries impacting revenue at in-scope reporting units and at a Group level. Our work specifically focused on understanding the reasons for the adjustments and corroborating the adjustments to appropriate audit evidence. |
| **Risk of management override of internal controls**<br>ISAs (UK & Ireland) require that we consider this. | We considered whether there was evidence of bias by the directors in the significant accounting estimates and judgements relevant to the financial statements. We also assessed the overall control environment of the Group, including arrangements for staff to "whistle-blow" inappropriate actions, and interviewed senior management and the Group's internal audit function.<br><br>We analysed manual journals at in scope reporting units to identify higher risk journals and we performed detailed testing over the higher risk manual journal entries identified. We also tested any significant adjustments made to the financial statements at a Group level. |

**Going concern**

Under the Listing Rules we are required to review the directors' statement, set out on page 30, in relation to going concern. We have nothing to report having performed our review.

As noted in the Chief Financial Officer's review, the directors have concluded that it is appropriate to prepare the Group's financial statements using the going concern basis of accounting. The going concern basis presumes that the Group has adequate resources to remain in operation and that the directors intend it to do so for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's ability to continue as a going concern.

## Opinion on matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic report and the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

## Other matters on which we are required to report by exception

**Adequacy of information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

**Directors' remuneration**

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

**Corporate governance statement**

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code ('the Code'). We have nothing to report having performed our review.

On page 70 of the Annual Report, as required by the Code Provision C.1.1, the directors state that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy. On page 44, as required by C.3.8 of the Code, the Audit Committee has set out the significant matters that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- the statement given by the directors is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit; or
- the section of the Annual Report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have no exceptions to report arising from this responsibility.

**Other information in the Annual Report**

Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited Group financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

## Responsibilities for the financial statements and the audit

**Our responsibilities and those of the directors**

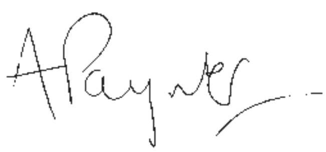
As explained more fully in the statement of directors' responsibilities (set out on page 70), the directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view.

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

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## Other matter

We have reported separately on the Company financial statements of Meggitt PLC for the year ended 31 December 2013 and on the information in the Directors' remuneration report that is described as having been audited.



**Andrew Paynter (Senior Statutory Auditor)**

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
3 March 2014

# Consolidated income statement

For the year ended 31 December 2013

| | Notes | 2013 £'m | 2012 Restated £'m |
|---|---|---|---|
| **Revenue** | 5 | **1,637.3** | 1,605.8 |
| Cost of sales | | **(981.1)** | (929.1) |
| **Gross profit** | | **656.2** | 676.7 |
| Net operating costs | | **(355.9)** | (355.3) |
| **Operating profit**[1] | 6 | **300.3** | 321.4 |
| Finance income | 12 | **0.3** | 2.0 |
| Finance costs | 13 | **(31.2)** | (42.1) |
| Net finance costs | | **(30.9)** | (40.1) |
| **Profit before tax**[2] | 44 | **269.4** | 281.3 |
| Tax | 14 | **(37.1)** | (45.8) |
| **Profit for the year attributable to equity owners of the Company** | 44 | **232.3** | 235.5 |
| Earnings per share: | | | |
| Basic[3] | 15 | **29.4p** | 30.1p |
| Diluted[4] | 15 | **28.9p** | 29.7p |

| | | | |
|---|---|---|---|
| 1 Underlying operating profit | 10 | **397.2** | 392.1 |
| 2 Underlying profit before tax | 10 | **377.8** | 366.0 |
| 3 Underlying basic earnings per share | 15 | **37.5p** | 36.5p |
| 4 Underlying diluted earnings per share | 15 | **36.9p** | 36.0p |

# Consolidated statement of comprehensive income

For the year ended 31 December 2013

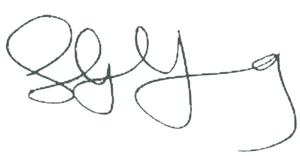
| | Notes | 2013 £'m | 2012 Restated £'m |
|---|---|---|---|
| **Profit for the year** | | **232.3** | 235.5 |
| **Items that may be reclassified to the income statement in subsequent periods:** | | | |
| Currency translation differences | | **(37.2)** | (54.7) |
| Cash flow hedge movements | | **1.9** | (5.8) |
| Tax effect | 14 | **0.1** | 0.6 |
| | | **(35.2)** | (59.9) |
| **Items that will not be reclassified to the income statement in subsequent periods:** | | | |
| Remeasurement of retirement benefit obligations | 33 | **46.8** | 4.0 |
| Tax effect | 14 | **(21.6)** | (2.3) |
| | | **25.2** | 1.7 |
| **Other comprehensive expense for the year** | | **(10.0)** | (58.2) |
| **Total comprehensive income for the year attributable to equity owners of the Company** | | **222.3** | 177.3 |

# Consolidated balance sheet

As at 31 December 2013

| | Notes | **2013 £'m** | 2012 £'m |
|---|---|---|---|
| **Non-current assets** | | | |
| Goodwill | 18 | **1,457.1** | 1,494.2 |
| Development costs | 19 | **270.5** | 221.5 |
| Programme participation costs | 19 | **210.6** | 203.6 |
| Other intangible assets | 20 | **707.3** | 778.9 |
| Property, plant and equipment | 21 | **245.5** | 232.2 |
| Trade and other receivables | 23 | **89.9** | 98.8 |
| Derivative financial instruments | 30 | **35.5** | 49.8 |
| Deferred tax assets | 32 | **9.1** | 100.2 |
| | | **3,025.5** | 3,179.2 |
| **Current assets** | | | |
| Inventories | 22 | **299.2** | 291.2 |
| Trade and other receivables | 23 | **328.9** | 304.2 |
| Derivative financial instruments | 30 | **11.2** | 5.0 |
| Current tax recoverable | | **2.8** | 0.2 |
| Cash and cash equivalents | 24 | **116.1** | 104.9 |
| | | **758.2** | 705.5 |
| **Total assets** | 6 | **3,783.7** | 3,884.7 |
| **Current liabilities** | | | |
| Trade and other payables | 25 | **(329.1)** | (351.9) |
| Derivative financial instruments | 30 | **(0.7)** | (4.0) |
| Current tax liabilities | | **(40.6)** | (57.0) |
| Obligations under finance leases | 27 | **(2.4)** | (3.1) |
| Bank and other borrowings | 28 | **(7.2)** | (127.0) |
| Provisions | 31 | **(44.3)** | (44.8) |
| | | **(424.3)** | (587.8) |
| **Net current assets** | | **333.9** | 117.7 |
| **Non-current liabilities** | | | |
| Trade and other payables | 26 | **(5.2)** | (6.3) |
| Derivative financial instruments | 30 | **(0.1)** | (0.2) |
| Deferred tax liabilities | 32 | **(219.3)** | (289.5) |
| Obligations under finance leases | 27 | **(5.1)** | (5.0) |
| Bank and other borrowings | 28 | **(666.0)** | (612.3) |
| Provisions | 31 | **(149.2)** | (178.5) |
| Retirement benefit obligations | 33 | **(238.1)** | (299.7) |
| | | **(1,283.0)** | (1,391.5) |
| **Total liabilities** | | **(1,707.3)** | (1,979.3) |
| **Net assets** | | **2,076.4** | 1,905.4 |
| **Equity** | | | |
| Share capital | 34 | **39.9** | 39.3 |
| Share premium | | **1,166.3** | 1,143.9 |
| Other reserves | | **14.1** | 14.1 |
| Hedging and translation reserves | | **82.7** | 117.9 |
| Retained earnings | | **773.4** | 590.2 |
| **Total equity attributable to owners of the Company** | | **2,076.4** | 1,905.4 |

The financial statements on pages 74 to 121 were approved by the Board of Directors on 3 March 2014 and signed on its behalf by:



**S G Young**
**Director**

**D R Webb**
**Director**

# Consolidated statement of changes in equity

For the year ended 31 December 2013

| | Notes | Share capital £'m | Share premium £'m | Other reserves* £'m | Hedging and translation reserves** £'m | Retained earnings Restated £'m | Total equity Restated £'m |
|---|---|---|---|---|---|---|---|
| | | Equity attributable to owners of the Company | | | | | |
| **At 1 January 2012** | | 38.9 | 1,130.1 | 14.1 | 177.8 | 432.4 | 1,793.3 |
| Profit for the year | | – | – | – | – | 235.5 | 235.5 |
| Other comprehensive income for the year: | | | | | | | |
| Currency translation differences: | | | | | | | |
| Arising in the year | | – | – | – | (54.4) | – | (54.4) |
| Transferred to income statement | | – | – | – | (0.3) | – | (0.3) |
| Cash flow hedge movements: | | | | | | | |
| Movement in fair value | | – | – | – | (3.9) | – | (3.9) |
| Transferred to income statement | | – | – | – | (1.9) | – | (1.9) |
| Remeasurement of retirement benefit obligations | 33 | – | – | – | – | 4.0 | 4.0 |
| Other comprehensive (expense)/income before tax | | – | – | – | (60.5) | 4.0 | (56.5) |
| Tax effect | 14 | – | – | – | 0.6 | (2.3) | (1.7) |
| Other comprehensive (expense)/income for the year | | – | – | – | (59.9) | 1.7 | (58.2) |
| Total comprehensive (expense)/income for the year | | – | – | – | (59.9) | 237.2 | 177.3 |
| Employee share schemes: | | | | | | | |
| Value of services provided | | – | – | – | – | 5.7 | 5.7 |
| Issue of equity share capital | | 0.2 | 0.8 | – | – | (0.1) | 0.9 |
| Dividends | 16 | 0.2 | 13.0 | – | – | (85.0) | (71.8) |
| **At 31 December 2012** | | 39.3 | 1,143.9 | 14.1 | 117.9 | 590.2 | 1,905.4 |
| **Profit for the year** | | **–** | **–** | **–** | **–** | **232.3** | **232.3** |
| **Other comprehensive income for the year:** | | | | | | | |
| Currency translation differences: | | | | | | | |
| Arising in the year | | – | – | – | (31.9) | – | (31.9) |
| Transferred to income statement | 43 | – | – | – | (5.3) | – | (5.3) |
| Cash flow hedge movements: | | | | | | | |
| Movement in fair value | | – | – | – | 1.6 | – | 1.6 |
| Transferred to income statement | | – | – | – | 0.3 | – | 0.3 |
| Remeasurement of retirement benefit obligations | 33 | – | – | – | – | 46.8 | 46.8 |
| Other comprehensive (expense)/income before tax | | – | – | – | (35.3) | 46.8 | 11.5 |
| Tax effect | 14 | – | – | – | 0.1 | (21.6) | (21.5) |
| **Other comprehensive (expense)/income for the year** | | **–** | **–** | **–** | **(35.2)** | **25.2** | **(10.0)** |
| **Total comprehensive (expense)/income for the year** | | **–** | **–** | **–** | **(35.2)** | **257.5** | **222.3** |
| Employee share schemes: | | | | | | | |
| Value of services provided | | – | – | – | – | 21.8 | 21.8 |
| Issue of equity share capital | 34 | 0.4 | 2.6 | – | – | (0.5) | 2.5 |
| Dividends | 16 | 0.2 | 19.8 | – | – | (95.6) | (75.6) |
| **At 31 December 2013** | | **39.9** | **1,166.3** | **14.1** | **82.7** | **773.4** | **2,076.4** |

* Other reserves relate to capital reserves arising on the acquisition of businesses in 1985 and 1986 where merger accounting was applied.

** Hedging and translation reserves at 31 December 2013 comprise a credit balance on the hedging reserve of £3.2 million (2012: £1.6 million) and a credit balance on the translation reserve of £79.5 million (2012: £116.3 million). Amounts recycled from the hedging reserve to the income statement, in respect of cash flow hedge movements, have been recorded in net finance costs. Amounts recycled from the translation reserve to the income statement, in respect of the disposal of foreign subsidiaries, have been recorded in net operating costs.

# Consolidated cash flow statement

For the year ended 31 December 2013

| | Notes | 2013 £'m | 2012 £'m |
|---|---|---|---|
| Cash inflow from operations before exceptional operating items | | **361.9** | 408.8 |
| Cash outflow from exceptional operating items | 11 | **(16.2)** | (14.7) |
| **Cash inflow from operations** | 39 | **345.7** | 394.1 |
| Interest received | | **0.3** | 0.2 |
| Interest paid | | **(19.7)** | (28.1) |
| Tax paid | | **(44.0)** | (34.6) |
| **Cash inflow from operating activities** | | **282.3** | 331.6 |
| Businesses acquired | 42 | **(26.5)** | (8.4) |
| Businesses disposed | 43 | **53.3** | 15.9 |
| Capitalised development costs | 19 | **(70.2)** | (52.2) |
| Capitalised programme participation costs | 19 | **(35.7)** | (36.1) |
| Purchase of intangible assets | | **(18.4)** | (28.0) |
| Purchase of property, plant and equipment | | **(52.4)** | (35.5) |
| Proceeds from disposal of property, plant and equipment | | **3.9** | 0.3 |
| **Cash outflow from investing activities** | | **(146.0)** | (144.0) |
| Dividends paid to Company's shareholders | 16 | **(75.6)** | (71.8) |
| Issue of equity share capital | 34 | **2.5** | 0.9 |
| Proceeds from borrowings | | **181.5** | 189.3 |
| Debt issue costs | | **–** | (2.0) |
| Repayments of borrowings | | **(231.4)** | (292.7) |
| **Cash outflow from financing activities** | | **(123.0)** | (176.3) |
| **Net increase in cash and cash equivalents** | | **13.3** | 11.3 |
| Cash and cash equivalents at start of the year | | **104.9** | 94.6 |
| Exchange losses on cash and cash equivalents | | **(2.1)** | (1.0) |
| **Cash and cash equivalents at end of the year** | 24 | **116.1** | 104.9 |

# Notes to the consolidated financial statements

## 1. Basis of preparation

Meggitt PLC is a public limited company listed on the London Stock Exchange, domiciled in the United Kingdom and incorporated in England and Wales with the registered number 432989. Its registered office is at Atlantic House, Aviation Park West, Bournemouth International Airport, Christchurch, Dorset, BH23 6EW.

Meggitt PLC is the parent company of a Group whose principal activities during the year were the design and manufacture of high performance components and sub-systems for aerospace, defence and other specialist markets, including energy, medical, industrial, test and automotive.

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union and the Companies Act 2006 applicable to companies reporting under IFRS. The consolidated financial statements have been prepared on a going concern basis under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities (including derivative instruments) at fair value.

## 2. Summary of significant accounting policies

The principal accounting policies adopted by the Group in the preparation of the consolidated financial statements are set out below. These policies have been applied consistently to all periods presented unless stated otherwise.

### Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and all of its subsidiaries. A subsidiary is an entity over which the Group has the power to govern its financial and operating policies. The existence and nature of potential voting rights that are currently available to the Group are considered when determining whether the entity is a subsidiary. The results of subsidiaries acquired are consolidated from the date on which control passes to the Group. The results of subsidiaries disposed are consolidated up to the date on which control passes from the Group.

The cost of an acquisition is the fair value of consideration provided, including the fair value of any contingent consideration, as measured at the acquisition date. Subsequent changes to the fair value of contingent consideration are recorded in the income statement. Identifiable assets and liabilities of an acquired business that meet the conditions for recognition under IFRS 3 are recognised at their fair value at the date of acquisition. To the extent the cost of an acquisition exceeds the fair value of net assets acquired, the difference is recorded as goodwill. To the extent the fair value of net assets acquired exceeds the cost of an acquisition, the difference is recorded immediately in the income statement. Acquisition related expenses are recognised in the income statement as incurred.

When a subsidiary is acquired, the fair values of its identifiable assets and liabilities are finalised within 12 months of the acquisition date. 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.

When a subsidiary is disposed, the difference between the fair value of consideration received or receivable and the value at which net assets of the subsidiary were recorded, immediately prior to disposal, is recognised in the income statement. Any contingent consideration receivable is measured at fair value at the date of disposal in determining the gain or loss to be recognised. Contingent consideration is measured at fair value at each subsequent balance sheet date, with any changes in fair value recorded in the income statement.

Transactions between, and balances with, Group companies are eliminated together with unrealised gains on inter-group transactions. Unrealised losses are eliminated to the extent the asset transferred is not impaired. The accounting policies of acquired businesses are changed where necessary to be consistent with those of the Group.

The following items in respect of the acquisition and disposal of subsidiaries are excluded from the underlying profit measures used by the Board to monitor and measure the underlying performance of the Group (see note 10):

- Any amounts by which the fair value of net assets of an acquired subsidiary exceed the cost of acquisition;
- Acquisition related expenses;
- Any gain or loss arising from the disposal of a subsidiary;and
- Any changes in the fair value of contingent consideration payable in respect of the acquisition of a subsidiary or receivable in respect of the disposal of a subsidiary.

### Foreign currencies

**Functional and presentational currency**
The Group's consolidated financial statements are presented in pounds sterling. Items included in the financial statements of each of the Group's subsidiaries are measured using the functional currency of the primary economic environment in which the subsidiary operates.

**Transactions and balances**
Transactions in foreign currencies are recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are reported at the rates of exchange prevailing at the balance sheet date. Exchange differences on retranslating monetary assets and liabilities are recognised in the income statement except where they relate to qualifying cash flow hedges or net investment hedges in which case exchange differences are recognised in other comprehensive income.

**Foreign subsidiaries**
The results of foreign subsidiaries are translated at the average rates of exchange for the period. Assets and liabilities of foreign subsidiaries are translated at the rates of exchange prevailing at the balance sheet date. Exchange differences arising from the retranslation of the results and opening net assets of foreign subsidiaries are recognised as a separate component of equity in hedging and translation reserves. Exchange differences on borrowings designated as net investment hedges of foreign subsidiaries are also recognised in hedging and translation reserves.

When a foreign subsidiary is sold, the cumulative exchange differences relating to the retranslation of the net investment in the foreign subsidiary are recognised in the income statement as part of the gain or loss on disposal. This applies only to exchange differences recorded in equity after 1 January 2004. Exchange differences arising prior to 1 January 2004 remain in equity on disposal as permitted by IFRS 1 ('First time Adoption of International Financial Reporting Standards').

Goodwill and fair value adjustments arising from the acquisition of a foreign subsidiary are treated as assets and liabilities of the subsidiary and are retranslated at the rates of exchange prevailing at the balance sheet date.

# Notes to the consolidated financial statements continued

## 2. Summary of significant accounting policies continued

### Segment reporting

Operating segments are those segments for which results are reviewed by the Group's Chief Operating Decision Maker ('CODM') to assess performance and make decisions about resources to be allocated. The CODM has been identified as the Board. The Group has determined that its current segments are Meggitt Aircraft Braking Meggitt Systems, Meggitt Control Systems, Meggitt Polymers & Composites, Meggitt Sensing Systems and the Meggitt Equipment Group.

The principal profit measure reviewed by the CODM is 'underlying operating profit' as defined in note 10. A segmental analysis of underlying operating profit is accordingly provided in the notes to the financial statements.

Segmental information on assets is provided in respect of 'trading assets' which are defined to exclude from total assets amounts which the CODM does not review on a segmental level. Excluded assets comprise centrally managed trading assets, goodwill, other intangible assets (excluding software assets), derivative financial instruments, deferred tax assets, current tax recoverable and cash and cash equivalents.

No segmental information is provided in respect of liabilities as no such measure is reviewed by the CODM.

### Revenue recognition

Revenue represents the fair value of consideration received or receivable in respect of goods and services provided in the normal course of business to external customers, net of trade discounts, returns and sales related taxes.

**Sale of goods**
Revenue is recognised when the significant risks and rewards of ownership have transferred to the customer, managerial involvement and control of the goods is not retained by the Group, the revenue and costs associated with the sale can be measured reliably and the collection of related receivables is probable. In the majority of instances these conditions are met when delivery to the customer takes place. In a minority of instances 'bill and hold' arrangements exist whereby revenue is recorded prior to delivery but only when the customer has accepted title to the goods, the goods are separately identifiable and available for delivery on terms agreed with the customer and normal credit terms apply.

**Contract accounting revenue**
The Group is usually able to reliably estimate the outcome of a contract at inception and accordingly recognises revenue and cost of sales by reference to the stage of completion of the contract. Revenue is typically measured by applying to the total contract revenue, the proportion costs incurred in the period for work performed bear to the total estimated contract costs. Where it is not possible to reliably estimate the outcome of a contract, revenue is recognised equal to the costs incurred, provided recovery of such costs is probable. If total contract costs are forecast to exceed total contract revenue then the expected loss is recorded immediately in the income statement.

**Revenue from services**
Revenue is recognised by reference to the stage of completion of the contract. For 'cost-plus fixed fee' contracts, revenue is recognised equal to the costs incurred plus an appropriate proportion of the fee agreed with the customer. For other contracts, stage of completion is typically measured by reference to contractual milestones achieved, number of aircraft flying hours or number of aircraft landings.

**Revenue from funded research and development**
Revenue is recognised according to the stage of completion of the contract. The stage of completion is typically measured by reference to contractual milestones achieved.

### Exceptional operating items

Items which are significant by virtue of their size or nature, which are considered non-recurring and which are excluded from the underlying profit measures used by the Board to monitor and measure the underlying performance of the Group (see note 10) are classified as exceptional operating items. They include, for instance, adjustments to the fair value of contingent consideration payable in respect of an acquired business or receivable in respect of a disposed business, costs directly attributable to the acquisition or disposal of businesses, the costs of integrating significant acquisitions, significant site consolidation and other restructuring costs and gains or losses made on the disposal of businesses. Additionally in 2013, given its significance and non-recurring nature, the raw material supply issue described in note 11 has been treated as an exceptional operating item. Exceptional operating items are included within the appropriate consolidated income statement category but are highlighted separately in the notes to the financial statements.

### Intangible assets

**Goodwill**
Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of identifiable net assets acquired and liabilities and contingent liabilities assumed. Goodwill is tested annually for impairment, and also whenever events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is carried at cost less amortisation charged prior to 1 January 2004 less accumulated impairment losses. In the event the subsidiary to which goodwill relates is disposed of, its attributable goodwill is included in the determination of the gain or loss on disposal.

**Research and development**
Research expenditure is recognised as an expense in the income statement as incurred. Development costs incurred on projects where the related expenditure is separately identifiable, measurable and management are satisfied as to the ultimate technical and commercial viability of the project based on all relevant available information are recognised as an intangible asset. Capitalised development costs are carried at cost less accumulated amortisation and any impairment. Amortisation is charged over the periods expected to benefit, typically up to 10 years, commencing with the launch of the product. Development costs not meeting the criteria for capitalisation are expensed as incurred.

**Programme participation costs**
Programme participation costs consist of incentives given to Original Equipment Manufacturers in connection with their selection of the Group's products for installation onto new aircraft where the Group has obtained principal supplier status. These incentives comprise cash payments and/or the supply of initial manufactured parts on a free of charge or deeply discounted basis. Programme participation costs are recognised as an intangible asset and carried at cost less accumulated amortisation and any impairment. Amortisation is charged over the periods expected to benefit from receiving the status of principal supplier (through the sale of replacement parts), typically up to 15 years.

## 2. Summary of significant accounting policies continued

**Other intangible assets**

**a) Intangible assets acquired as part of a business combination**

For acquisitions, the Group recognises intangible assets separately from goodwill provided they are separable or arise from contractual or other legal rights and their fair value can be measured reliably. Intangible assets are initially recognised at fair value, which is regarded as their cost. Intangible assets are subsequently held at cost less accumulated amortisation and any provision for impairment. Where the intangible assets recognised have finite lives their cost is amortised on a straight-line basis over those lives. The nature of intangible assets recognised and their estimated useful lives are as follows:

| | |
|---|---|
| Customer relationships | Up to 25 years |
| Technology | Up to 25 years |
| Trade names and trademarks | Up to 25 years |
| Order backlogs | Over period of backlog (typically up to 3 years) |

Amortisation of intangible assets acquired as part of a business combination is excluded from the underlying profit measures used by the Board to monitor and measure the underlying performance of the Group (see note 10).

**b) Other purchased intangible assets**

Purchased licences, trademarks, patents and software are carried at cost less accumulated amortisation. Amortisation is charged on a straight-line basis over their estimated useful economic life, typically over periods up to 10 years.

## Property, plant and equipment

Property, plant and equipment is recorded at cost less accumulated depreciation and any impairment, except for land which is shown at cost less any impairment. Cost includes expenditure directly attributable to the acquisition of the asset. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Freehold buildings | Up to 50 years |
| Leasehold property | Over period of lease |
| Plant and machinery | 3 to 10 years |
| Furnaces | Up to 20 years |
| Fixtures and fittings | 3 to 10 years |
| Motor vehicles | 4 to 5 years |

Assets' residual values and useful lives are reviewed annually and adjusted if appropriate.

When property, plant and equipment is disposed, the difference between sale proceeds, net of related costs, and the carrying value of the asset is recognised in the income statement.

## Borrowing costs

Borrowing costs directly attributable to the construction or production of qualifying assets, are capitalised as part of the cost of those assets until such time as the assets are substantially ready for their intended use. Qualifying assets are those that necessarily take a substantial period of time to get ready for their intended use, which would generally be at least twelve months. All other borrowing costs are recognised in the income statement in the period in which they are incurred.

## Taxation

Tax payable is based on taxable profit for the period, calculated using tax rates enacted or substantively enacted at the balance sheet date.

Deferred tax is provided in full using the liability method on temporary differences between the tax bases of assets and liabilities and their corresponding book values as recorded in the Group's financial statements. Deferred tax is provided on unremitted earnings of foreign subsidiaries, except where the Group can control the remittance and it is probable that the earnings will not be remitted in the foreseeable future. Deferred tax assets are recognised only to the extent it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Where deferred tax arises on the initial recognition of an asset or liability, other than in a business combination, and the recognition gives rise to no impact on taxable profit or loss, then deferred tax is not recognised. Deferred tax is calculated using tax rates enacted or substantively enacted at the balance sheet date.

Current tax and deferred tax are recognised in the income statement, other comprehensive income or directly in equity depending on where the item to which they relate has been recognised.

## Impairment of non-current non-financial assets

Assets are reviewed for impairment annually and also whenever events or changes in circumstances indicate the carrying value may not be recoverable. To the extent the carrying value exceeds the recoverable amount, the difference is recorded as an expense in the income statement. The recoverable amount used for impairment testing is the higher of the value in use and fair value less costs of disposal. For the purpose of impairment testing, assets are grouped at the lowest level for which there are separately identifiable cash flows which are largely independent of cash flows from other assets or groups of assets. At each balance sheet date, previously recorded impairment losses, other than any relating to goodwill, are reviewed and if no longer required reversed with a corresponding credit to the income statement.

## Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost represents materials, direct labour, other direct costs and related production overheads, based on normal operating capacity, and is determined using the first-in first-out (FIFO) method. Net realisable value is based on estimated selling price, less further costs expected to be incurred to completion and disposal.

When a subsidiary is acquired, finished goods are valued at fair value, which is typically estimated selling price less costs of disposal and a reasonable profit allowance for the selling effort. Work in progress is also valued at fair value at acquisition, which is typically estimated selling price less costs to complete, costs of disposal and a reasonable profit allowance for work not yet completed. When this inventory is subsequently disposed post acquisition, the fair value is charged to the income statement. The difference between the fair value of the inventory disposed and its actual cost of manufacture is excluded from the underlying profit measures used by the Board to monitor and measure the underlying performance of the Group (see note 10).

Provision is made for obsolete, slow moving or defective items where appropriate and for unrealised profits on items of inter-group manufacture.

# Notes to the consolidated financial statements continued

## 2. Summary of significant accounting policies continued

### Trade receivables

Trade receivables are stated initially at fair value, then measured at amortised cost less any provisions for impairment. Provisions for impairment are recognised in the income statement, when there is objective evidence the Group will not be able to collect all amounts due according to the original terms of the receivables. The impairment recorded is the difference between the carrying value of the receivable and its estimated future cash flows discounted where appropriate.

### Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held at call with banks. Bank overdrafts are disclosed as current liabilities, within bank and other borrowings, except where the Group participates in offset arrangements with certain banks whereby cash and overdraft amounts are offset against each other.

### Trade payables

Trade payables are initially recognised at fair value and subsequently held at amortised cost. Trade payables are not interest bearing.

### Leases

Leases where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at commencement of the lease at the lower of fair value of the leased asset and present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding lease obligations, net of finance charges, are included in liabilities. Assets acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases, net of any incentives received from the lessor, are charged to the income statement on a straight-line basis over the period of the lease.

### Dividends

Interim dividends are recognised as liabilities when they are approved by the Board. Final dividends are recognised as liabilities when they are approved by the shareholders.

### Borrowings

Borrowings are initially recognised at fair value being proceeds received less directly attributable transaction costs incurred. Borrowings are generally subsequently measured at amortised cost with any transaction costs amortised to the income statement over the period of the borrowings using the effective interest method. Certain borrowings however are designated as fair value through profit and loss at inception, if the Group has interest rate derivatives in place which have the economic effect of converting fixed rate borrowings into floating rate borrowings. Such borrowings are measured at fair value at each balance sheet date with any movement in fair value recorded in the income statement within net operating costs. Movements in fair value are excluded from the underlying profit measures used by the Board to monitor and measure the underlying performance of the Group (see note 10).

Any related interest accruals are included within borrowings. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

### Provisions

Provision is made for environmental, legal and regulatory liabilities, onerous contracts and product warranty claims when the Group has a present obligation as a result of past events, it is more likely than not that an outflow of economic benefits will be required to settle the obligation and the amount can be reliably estimated. Provisions are discounted to present value where the impact is significant, using a pre-tax rate. The discount rate used is based on current market assessments of the time value of money, adjusted to reflect any risks specific to the obligation which have not been reflected in the undiscounted provision. The impact of the unwinding of discounting is recognised in the income statement within net finance costs.

### Retirement benefit schemes

For defined benefit schemes, pension costs and the costs of providing other post-retirement benefits, principally healthcare, are charged to the income statement in accordance with the advice of qualified independent actuaries. Past service costs are recognised immediately in the income statement unless the changes are dependent on employees remaining in service for a particular period in which case costs are recognised on a straight-line basis over that period.

Retirement benefit obligations represent, for each scheme, the difference between the fair value of the schemes' assets and the present value of the schemes' defined benefit obligations measured at the balance sheet date. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the defined benefit obligations using interest rates of high quality corporate bonds denominated in the currency in which the benefits will be paid and with terms to maturity comparable with the terms of the related defined benefit obligations.

Remeasurement gains and losses are recognised in the period in which they arise in other comprehensive income.

For defined contribution schemes, payments are recognised in the income statement when they fall due. The Group has no further obligations once the contributions have been paid.

### Share-based compensation

The Group operates a number of equity-settled and cash-settled share-based compensation schemes.

For equity-settled schemes, the fair value of an award is measured at the date of grant and reflects any market-based vesting conditions. Non market-based vesting conditions are excluded from the fair value of the award. At the date of grant, the Group estimates the number of awards expected to vest as a result of non market-based vesting conditions and the fair value of this estimated number of awards is recognised as an expense in the income statement on a straight-line basis over the period for which services are received. At each balance sheet date, the Group revises its estimate of the number of awards expected to vest as a result of non market-based vesting conditions and adjusts the amount recognised cumulatively in the income statement to reflect the revised estimate. When awards are exercised and the Company issues new shares, the proceeds received, net of any directly attributable transaction costs, are credited to share capital (nominal value) and share premium.

For cash-settled schemes, the total amount recognised is based on the fair value of the liability incurred. The fair value of the liability is remeasured at each balance sheet date with changes in fair value recognised in the income statement for the period.

## 2. Summary of significant accounting policies continued

### Derivative financial instruments and hedging

The Group uses derivative financial instruments to hedge its exposure to interest rate risk and foreign currency transactional risk. Derivative financial instruments are recognised at fair value on the date the derivative contract is entered into and are subsequently remeasured at fair value at each balance sheet date using values determined indirectly from quoted prices that are observable for the asset or liability.

The method by which any gain or loss arising from remeasurement is recognised depends on whether the instrument is designated as a hedging instrument and if so the nature of the item hedged. The Group recognises an instrument as a hedging instrument by documenting, at inception of the instrument, the relationship between the instrument and the hedged item and the objectives and strategy for undertaking the hedging transaction. To be designated as a hedging instrument, an instrument must also be assessed, at inception and on an ongoing basis, to be highly effective in offsetting changes in fair values or cash flows of hedged items.

To the extent the maturity of the financial instrument is more than 12 months from the balance sheet date, the fair value is reported as a non-current asset or non-current liability. All other derivative financial instruments are reported as current assets or current liabilities.

**Fair value hedges**
Changes in fair value of derivative financial instruments, that are designated and qualify as fair value hedges, are recognised in the income statement within net operating costs together with changes in fair value of the hedged item. Any difference between the movement in fair value of the derivatives and the hedged item is excluded from the underlying profit measures used by the Board to monitor and measure the underlying performance of the Group (see note 10). The Group currently only applies fair value hedge accounting to the hedging of fixed interest rate risk on borrowings.

**Cash flow hedges**
Changes in fair value of the effective portion of derivative financial instruments, that are designated and qualify as cash flow hedges, are initially recognised in other comprehensive income. Changes in fair value of any ineffective portion are recognised immediately in the income statement within net operating costs.

To the extent changes in fair value are recognised in other comprehensive income, they are recycled to the income statement in the periods in which the hedged item affects the income statement. The Group currently only applies cash flow hedge accounting to the hedging of floating interest rate risk on borrowings.

If the forecast transaction to which the cash flow hedge relates is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is transferred to the income statement immediately. If the hedging instrument is sold, expires or no longer meets the criteria for hedge accounting the cumulative gain or loss previously recognised in other comprehensive income is transferred to the income statement when the forecast transaction is recognised in the income statement.

**Net investment hedges**
Hedges of net investments of foreign subsidiaries are accounted for in a similar way to cash flow hedges. Changes in fair value of the effective portion of any hedge are recognised in other comprehensive income. Changes in fair value of any ineffective portion are recognised immediately in the income statement within net operating costs. Cumulative gains and losses previously recognised in other comprehensive income are transferred to the income statement if the foreign subsidiary to which they relate is disposed.

**Derivatives that do not meet the criteria for hedge accounting**
Where derivatives do not meet the criteria for hedge accounting, changes in fair value are recognised immediately in the income statement. The Group utilises a large number of foreign currency forward contracts to mitigate against currency fluctuations. The Group has determined the additional costs of meeting the extensive documentation requirements in order to apply hedge accounting under IAS 39 'Financial Instruments: Recognition and Measurement' are not merited. Gains and losses arising from measuring these contracts at fair value are excluded from the underlying profit measures used by the Board to monitor and measure the underlying performance of the Group (see note 10).

### Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are deducted from the proceeds recorded in equity.

Own shares represent shares in the Company that are held by an independently managed Employee Share Ownership Plan. Consideration paid for own shares, including any incremental directly attributable costs, is recorded as a deduction from equity. When such shares are sold any consideration received, net of any directly attributable costs, is recorded within equity.

### Adoption of new and revised accounting standards

During the year, the following new accounting standard, and revision and amendment to existing standards, became effective and had a significant impact on the Group's consolidated financial statements:

- IAS 19 (Revised 2011), 'Employee benefits'. The impact of this revision on the Group's consolidated financial statements, including restatement of comparatives, is set out in note 44;
- IAS 1 (Amended), 'Presentation of financial statements'. The main change for the Group arising from this amendment is with regard to the way in which items are presented in the consolidated statement of comprehensive income. Items are now required to be presented according to whether or not they may be reclassified to the income statement in future accounting periods; and
- IFRS 13, 'Fair value measurement'. This standard has not had any significant impact on amounts recognised in the consolidated financial statements. It has however, required additional disclosures which are set out in note 29.

### Recent accounting developments

A number of new standards and amendments and revisions to existing standards have been published and are mandatory for the Group's future accounting periods. They have not been adopted early in these consolidated financial statements. None of these are expected to have a significant impact on the consolidated financial statements when they are adopted except as disclosed below;

- IFRS 9, 'Financial instruments'. The main change is expected to relate to the way in which movements in the fair value of the Group's fixed rate borrowings, attributable to changes in the Group's own credit risk, are accounted for. The Group is yet to assess the full impact of IFRS 9 which becomes effective for accounting periods beginning on or after 1 January 2015. This standard is subject to endorsement by the European Union.

# Notes to the consolidated financial statements continued

## 3. Financial risk management

### Financial risk factors

The Group's operations expose it to a number of financial risks including market risk (principally foreign exchange risk and interest rate risk), credit risk and liquidity risk. These risks are managed by a centralised treasury department, in accordance with Board approved objectives, policies and authorities. Regular reports monitor exposures and assist in managing the associated risks.

### Market risk

**Foreign exchange risk**

The Group operates internationally and is subject to foreign exchange risks on future commercial transactions and the retranslation of the results of, and net investments in, foreign subsidiaries. The principal exposures arise with respect to the US dollar against the Pound sterling. To mitigate risks associated with future commercial transactions, the Group policy is to hedge known and certain forecast transaction exposures based on historical experience and projections. The Group hedges at least 70% of the next 12 months anticipated exposure and can hedge up to five years ahead. Details of hedges in place are provided in note 30. The Group does not currently hedge exposures arising from the retranslation of the results of foreign subsidiaries. The Group uses borrowings denominated in the relevant currencies to hedge its net investments in foreign subsidiaries.

**Interest rate risk**

The Group has borrowings issued at both fixed and floating rates of interest. Borrowings issued at fixed rates expose the Group to fair value interest rate risk whereas borrowings issued at floating rates expose the Group to cash flow interest rate risk. The Group's policy is to maintain at least 25% of its net debt at fixed rates. The Group mitigates interest rate risks through swaps which have the economic effect of converting fixed rate borrowings into floating rate borrowings and floating rate borrowings into fixed rate borrowings. Details of hedges in place are provided in note 30.

### Credit risk

The Group is not subject to significant concentration of credit risk with exposure spread across a large number of customers across the world. In addition, many of the Group's principal customers are either government departments or large multinationals. Policies are maintained to ensure the Group makes sales to customers with an appropriate credit history. Letters of credit, or other appropriate instruments, are put in place to reduce credit risk where considered necessary. The Group is also subject to credit risk on the counterparties to its other financial instruments which it controls through only dealing with highly rated counterparties and netting transactions on settlement wherever possible.

### Liquidity risk

The Group maintains sufficient committed facilities to meet projected borrowing requirements based on cash flow forecasts. Additional headroom is maintained to protect against the variability of cash flows and to accommodate small bolt-on acquisitions. Key ratios are monitored to ensure continued compliance with covenants contained in the Group's principal credit agreements. The following table analyses the Group's non-derivative financial liabilities and derivative assets and liabilities at the balance sheet date. The amounts disclosed in the table are the contractual undiscounted cash flows:

| | **2013** | | | | |
|---|---|---|---|---|---|
| | **Less than 1 year £'m** | **1-2 years £'m** | **2-5 years £'m** | **Greater than 5 years £'m** | **Total £'m** |
| Trade and other payables* | **316.6** | **1.2** | **2.2** | **1.8** | **321.8** |
| Bank and other borrowings | **4.1** | **42.4** | **370.4** | **241.9** | **658.8** |
| Interest payments on borrowings | **20.6** | **19.1** | **48.2** | **28.6** | **116.5** |
| Obligations under finance leases (see note 27) | **3.4** | **1.0** | **2.8** | **12.7** | **19.9** |
| Derivative financial instruments: | | | | | |
| Inflows** | **(8.2)** | **(8.5)** | **(23.5)** | **(15.8)** | **(56.0)** |
| Outflows** | **0.7** | **0.7** | **1.9** | **–** | **3.3** |
| **Total** | **337.2** | **55.9** | **402.0** | **269.2** | **1,064.3** |

| | 2012 | | | | |
|---|---|---|---|---|---|
| | Less than 1 year £'m | 1-2 years £'m | 2-5 years £'m | Greater than 5 years £'m | Total £'m |
| Trade and other payables* | 339.9 | 2.1 | 2.4 | 1.8 | 346.2 |
| Bank and other borrowings | 123.7 | 0.4 | 341.2 | 247.0 | 712.3 |
| Interest payments on borrowings | 23.7 | 20.6 | 55.9 | 41.7 | 141.9 |
| Obligations under finance leases (see note 27) | 3.1 | 0.3 | 0.8 | 3.9 | 8.1 |
| Derivative financial instruments: | | | | | |
| Inflows** | (75.2) | (8.3) | (24.8) | (21.7) | (130.0) |
| Outflows** | 68.5 | 0.7 | 2.1 | 0.4 | 71.7 |
| **Total** | 483.7 | 15.8 | 377.6 | 273.1 | 1,150.2 |

* Excludes social security and other taxes of £12.5 million (2012: £12.0 million) (see note 25).

** Assumes no change in interest rates from those prevailing at year end.

## 3. Financial risk management continued

### Sensitivity analysis

The Group's principal exposures in relation to market risks are to changes in the exchange rate between the US dollar and Pound sterling and to changes in US interest rates. The table below illustrates the sensitivity of the Group's results to changes in these key variables at the balance sheet date. The analysis covers only financial assets and liabilities held at the balance sheet date and is made on the basis of the hedge designations in place on those dates and assuming no hedge ineffectiveness.

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | Income statement £'m | Equity £'m | Income statement £'m | Equity £'m |
| USD/GBP exchange rate +/- 10% | **25.2** | **36.1** | 18.4 | 50.4 |
| US yield curve +/- 1% | **4.6** | **4.1** | 3.2 | 5.0 |

The impact on equity from movements in the exchange rate comprises £46.3 million (2012: £57.6 million) in respect of US dollar net debt, offset by £10.2 million (2012: £7.2 million) in respect of other financial assets and liabilities. However, as all US dollar debt is designated as a net investment hedge, this element of the impact is entirely offset by the retranslation of foreign subsidiaries.

### Capital risk management

The Group's objective when managing its capital structure is to minimise the cost of capital while maintaining adequate capital to protect against volatility in earnings and net asset values. The strategy is designed to maximise shareholder return over the long term. The relative proportion of debt to equity will be adjusted over the medium term depending on the cost of debt compared to equity and the level of uncertainty facing the industry and the Group. The Group's current post-tax average cost of capital is approximately 8% (2012: 8%). The Group's committed credit facilities contain two principal financial covenants. The Group has complied with these covenant requirements for the year ended 31 December 2013. Further details on the covenant requirements and the Group's performance against these can be found on page 29 of the Chief Financial Officer's review. The capital structure of the Group at the balance sheet date is as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Net debt (see note 40) | **564.6** | 642.5 |
| Total equity | **2,076.4** | 1,905.4 |
| **Debt/equity %** | **27.2%** | 33.7% |

## 4. Critical accounting estimates and judgements

In applying the Group's accounting policies set out in note 2, the Group is required to make certain estimates and judgements concerning the future. These estimates and judgements are regularly reviewed and revised as necessary. The estimates and judgements that have the most significant effect on the amounts included in these financial statements are as follows:

### Goodwill

Each year the Group carries out impairment tests of goodwill which require estimates to be made of the value in use of its cash generating units ('CGUs'). These value in use calculations are dependent on estimates of future cash flows, long-term growth rates and appropriate discount rates to be applied to future cash flows of the CGUs. Further details on these estimates and sensitivities of the carrying value of goodwill to these estimates are provided in note 18.

### Fair value of intangible assets acquired in a business combination

On the acquisition of a business, it is necessary to attribute fair values to any intangible assets acquired, provided they meet the criteria to be recognised. The fair values of these intangible assets are dependent on estimates of attributable future revenues, margins, cash flows and appropriate discount rates to be applied to future cash flows. Identified intangibles are subject to impairment testing at least annually or if events or changes in circumstances indicate the carrying value may not be recoverable. Estimates are also required of the useful life of the identified intangible assets and these estimates are reviewed at least annually, and revised if appropriate. The Group takes advice from third parties in determining the fair values and useful lives of intangibles arising on significant acquisitions (see note 20 for further details).

### Development costs and programme participation costs

The Group capitalises development costs and programme participation costs provided they meet certain criteria. Costs are only capitalised where the Group is satisfied as to the ultimate commercial viability of the project based on available information. Projects typically involve long-term relationships on aircraft platforms and, in assessing commercial viability, estimates need to be made of aircraft volumes, aftermarket revenues which are dependent on aircraft utilisation, fleet lives and operator service routines, costs of manufacture and, in the case of development costs, the costs to complete the development activity. Capitalised costs are subject to impairment testing at least annually and, where headroom is limited or if events or changes in circumstances indicate the carrying value may not be recoverable, more frequently (see note 19 for further details).

# Notes to the consolidated financial statements continued

## 4. Critical accounting estimates and judgements continued

### Environmental matters

The Group is involved in the investigation and remediation of certain sites for which it has been identified as a potentially responsible party under US law. Advice is received by the Group from its environmental consultants and legal advisors to assist in the determination of the timing and estimation of the costs the Group may incur in respect of such claims and appropriate provisions are made. The Group has extensive insurance arrangements in place to mitigate the impact of historical environmental events on the Group. To the extent estimates in respect of claims change as more information becomes available, adjustments are made to the carrying value of these provisions and, if the costs are determined to be covered by insurance, to the amounts recoverable from insurers (see note 31 for further details).

### Legal and regulatory

The Group is subject to legal proceedings and other claims arising in the ordinary course of business. The Group is required to assess the likelihood of any adverse judgements or outcomes, as well as potential ranges of probable losses. A determination of the provisions required for these matters is based on a careful analysis of each individual issue with the assistance of outside legal counsel. However, actual losses incurred could differ from the original estimates (see note 31 for further details).

### Onerous contracts

The Group makes provision for any expected losses arising from onerous contracts which require estimates to be made of future contract revenues, margins, potential claims from third parties and cash flows. These estimates are dependent on a number of factors including anticipated sales volumes, future pricing, production costs and the outcome of negotiations with third parties. To the extent these estimates change as more information becomes available, adjustments are made to the carrying value of these provisions. However, actual losses incurred could differ from the original estimates (see note 31 for further details).

### Retirement benefit obligations

The liability recognised in respect of retirement benefit obligations is dependent on a number of estimates including those relating to mortality, inflation, salary increases and the rate at which liabilities are discounted. External actuarial advice is taken with regard to the most appropriate assumptions to use. During 2013, the determination of the discount rate for the UK scheme was impacted by a reduction in the number of high quality UK corporate bonds, following the UK sovereign credit rating downgrade. Advice from the Group's UK actuary was taken as to the extent to which adjustments should be made within the reduced population of high quality bonds for individual bonds with significantly different yields, how to reflect the shortage of bonds at the long end of the yield curve and whether to expand the population based on issue size. Further details on these estimates and sensitivities of the retirement benefit obligations to these estimates are provided in note 33.

### Income taxes

In determining the Group's provisions for income tax and deferred tax, it is necessary to consider transactions in a small number of key tax jurisdictions for which the ultimate tax determination is uncertain. To the extent the final outcome differs from the tax that has been provided, adjustments will be made to income tax and deferred tax balances held in the period the determination is made. If the actual outcome of events differed by 10% from the estimates made at 31 December 2013, the impact on the tax charge would be approximately £4.0 million. Judgements also need to be made as to the extent to which deferred tax assets and liabilities can be offset against one another (see note 32 for further details).

## 5. Revenue

The Group's revenue is analysed as follows:

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| Sale of goods | **1,428.8** | 1,417.2 |
| Contract accounting revenue | **110.1** | 115.1 |
| Revenue from services | **73.9** | 48.6 |
| Revenue from funded research and development | **24.5** | 24.9 |
| **Total** | **1,637.3** | 1,605.8 |

## 6. Segmental analysis

### Analysis by operating segment

The Group manages its businesses under the key segments of Meggitt Aircraft Braking Systems, Meggitt Control Systems, Meggitt Polymers & Composites, Meggitt Sensing Systems and the Meggitt Equipment Group.

- Meggitt Aircraft Braking Systems is a leading supplier of aircraft wheels, brakes and brake control systems.
- Meggitt Control Systems is a leading supplier of pneumatic, fluid control, thermal management and electro-mechanical equipment and sub-systems.
- Meggitt Polymers & Composites is a leading specialist in fuel containment, engineered aircraft sealing solutions and technical polymers, electro-thermal ice protection and complex composite structures and assemblies.
- Meggitt Sensing Systems is a leading provider of high-performance sensing and condition-monitoring solutions for high-value rotating machinery and other assets.
- The Meggitt Equipment Group was created to enable a set of strong, technologically distinct businesses to market their offerings to specialist customers, while benefiting from the Group's investment in shared services and common processes. The division supplies aircraft fire protection and control systems, avionics, combat systems, live-fire and simulation training, heat transfer equipment for off-shore oil and gas, power generation, linear motion control, aircraft safety and security equipment and automotive and industrial control electronics.

**Year ended 31 December 2013**

The key performance measure reviewed by the CODM is underlying operating profit. A detailed reconciliation of operating profit to underlying operating profit is provided in note 10.

| | Meggitt Aircraft Braking Systems £'m | Meggitt Control Systems £'m | Meggitt Polymers & Composites £'m | Meggitt Sensing Systems £'m | Meggitt Equipment Group £'m | Total £'m |
|---|---|---|---|---|---|---|
| Gross segment revenue | 330.4 | 206.5 | 182.9 | 242.0 | 681.4 | 1,643.2 |
| Inter-segment revenue | – | (0.9) | (1.9) | (1.6) | (1.5) | (5.9) |
| **Revenue from external customers** | **330.4** | **205.6** | **181.0** | **240.4** | **679.9** | **1,637.3** |
| **Underlying operating profit (see note 10)*** | **122.4** | **50.4** | **30.2** | **34.3** | **159.9** | **397.2** |
| Items not affecting underlying operating profit (see note 10) | | | | | | (96.9) |
| **Operating profit (see note 10)** | | | | | | **300.3** |
| Finance income (see note 12) | | | | | | 0.3 |
| Finance costs (see note 13) | | | | | | (31.2) |
| Net finance costs | | | | | | (30.9) |
| **Profit before tax** | | | | | | **269.4** |
| Tax (see note 14) | | | | | | (37.1) |
| **Profit for the year** | | | | | | **232.3** |
| Exceptional operating items (see note 11) | 1.5 | 5.3 | – | 6.5 | 15.1 | **28.4** |
| Amortisation of intangible assets (see notes 19 and 20)** | 74.5 | 9.1 | 6.7 | 7.6 | 28.5 | **126.4** |
| Depreciation (see note 21)*** | 8.1 | 2.8 | 3.2 | 7.1 | 11.0 | **32.2** |

* Central costs are allocated using a variety of bases designed to reflect the beneficial relationship between the costs and the segments. Bases include headcount, payroll costs, gross assets and revenue.
** Of the total amortisation in the year, £50.7 million has been charged to underlying operating profit as defined in note 10.
*** Of the total depreciation in the year, £31.4 million has been charged to underlying operating profit as defined in note 10.

The Group's largest customer accounts for 6.6% of revenue (£108.3 million). Revenue from this customer arises across all segments.

| | Meggitt Aircraft Braking Systems £'m | Meggitt Control Systems £'m | Meggitt Polymers & Composites £'m | Meggitt Sensing Systems £'m | Meggitt Equipment Group £'m | Total £'m |
|---|---|---|---|---|---|---|
| **Additions to non-current assets*** | | | | | | |
| Development costs (see note 19) | 24.8 | 11.6 | 2.5 | 15.1 | 16.2 | **70.2** |
| Programme participation costs (see note 19) | 31.5 | 3.2 | – | – | 1.0 | **35.7** |
| Other purchased intangible assets | 0.4 | 4.9 | 0.8 | 1.6 | 1.8 | **9.5** |
| Property, plant and equipment | 4.0 | 3.5 | 2.7 | 15.1 | 24.6 | **49.9** |
| **Total** | **60.7** | **23.2** | **6.0** | **31.8** | **43.6** | **165.3** |

* Relates to those non-current assets included within segmental trading assets reviewed by the CODM.

# Notes to the consolidated financial statements continued

## 6. Segmental analysis continued

**As at 31 December 2013**

| | Total £'m |
|---|---|
| Meggitt Aircraft Braking Systems | 502.2 |
| Meggitt Control Systems | 163.9 |
| Meggitt Polymers & Composites | 87.8 |
| Meggitt Sensing Systems | 231.1 |
| Meggitt Equipment Group | 356.3 |
| **Total segmental trading assets** | **1,341.3** |
| Centrally managed trading assets* | 176.5 |
| Goodwill (see note 18) | 1,457.1 |
| Other intangible assets** | 634.1 |
| Derivative financial instruments – non-current (see note 30) | 35.5 |
| Deferred tax assets (see note 32) | 9.1 |
| Derivative financial instruments – current (see note 30) | 11.2 |
| Current tax recoverable | 2.8 |
| Cash and cash equivalents (see note 24) | 116.1 |
| **Total assets** | **3,783.7** |

* Centrally managed trading assets principally include amounts recoverable from insurers in respect of environmental issues relating to former sites, other receivables and property, plant and equipment of central companies.

** In 2013, trading assets reviewed by the CODM include software assets. Since software assets were not included in trading assets reviewed by the CODM in 2012, the prior year comparatives have not been restated.

**Year ended 31 December 2012 (Restated - see note 44)**

The key performance measure reviewed by the CODM is underlying operating profit. A detailed reconciliation of operating profit to underlying operating profit is provided in note 10.

| | Meggitt Aircraft Braking Systems £'m | Meggitt Control Systems £'m | Meggitt Polymers & Composites £'m | Meggitt Sensing Systems £'m | Meggitt Equipment Group £'m | Total £'m |
|---|---|---|---|---|---|---|
| Gross segment revenue | 311.2 | 215.8 | 189.5 | 241.4 | 652.7 | 1,610.6 |
| Inter-segment revenue | – | (0.9) | (2.3) | (1.2) | (0.4) | (4.8) |
| Revenue from external customers | 311.2 | 214.9 | 187.2 | 240.2 | 652.3 | 1,605.8 |
| Underlying operating profit (see note 10)* | 117.1 | 49.8 | 33.8 | 36.2 | 155.2 | 392.1 |
| Items not affecting underlying operating profit (see note 10) | | | | | | (70.7) |
| Operating profit (see note 10) | | | | | | 321.4 |
| Finance income (see note 12) | | | | | | 2.0 |
| Finance costs (see note 13) | | | | | | (42.1) |
| Net finance costs | | | | | | (40.1) |
| Profit before tax | | | | | | 281.3 |
| Tax (see note 14) | | | | | | (45.8) |
| Profit for the year | | | | | | 235.5 |
| Exceptional operating items (see note 11) | 2.4 | (2.9) | 0.2 | 7.3 | 6.3 | 13.3 |
| Amortisation of intangible assets (see notes 19 and 20)** | 71.1 | 5.1 | 6.5 | 8.3 | 31.8 | 122.8 |
| Depreciation (see note 21) | 8.4 | 2.9 | 3.2 | 7.5 | 9.9 | 31.9 |

* Central costs are allocated using a variety of bases designed to reflect the beneficial relationship between the costs and the segments. Bases include headcount, payroll costs, gross assets and revenue.

** Of the total amortisation in the year, £42.2 million has been charged to underlying operating profit as defined in note 10.

The Group's largest customer accounts for 7.0% of revenue (£112.3 million). Revenue from this customer arises across all segments.

| | Meggitt Aircraft Braking Systems £'m | Meggitt Control Systems £'m | Meggitt Polymers & Composites £'m | Meggitt Sensing Systems £'m | Meggitt Equipment Group £'m | Total £'m |
|---|---|---|---|---|---|---|
| Additions to non-current assets* | | | | | | |
| Development costs (see note 19) | 16.7 | 12.1 | 0.7 | 9.2 | 13.5 | 52.2 |
| Programme participation costs (see note 19) | 33.4 | 2.7 | – | – | – | 36.1 |
| Property, plant and equipment (see note 21) | 4.7 | 3.6 | 3.1 | 7.6 | 17.6 | 36.6 |
| Total | 54.8 | 18.4 | 3.8 | 16.8 | 31.1 | 124.9 |

* Relates to those non-current assets included within segmental trading assets reviewed by the CODM.

## 6. Segmental analysis continued

**As at 31 December 2012**

| | Total £'m |
|---|---|
| Meggitt Aircraft Braking Systems | 479.5 |
| Meggitt Control Systems | 145.0 |
| Meggitt Polymers & Composites | 79.3 |
| Meggitt Sensing Systems | 190.2 |
| Meggitt Equipment Group | 314.2 |
| Total segmental trading assets | 1,208.2 |
| Centrally managed trading assets* | 143.3 |
| Goodwill (see note 18) | 1,494.2 |
| Other intangible assets (see note 20) | 778.9 |
| Derivative financial instruments – non-current (see note 30) | 49.8 |
| Deferred tax assets (see note 32) | 100.2 |
| Derivative financial instruments – current (see note 30) | 5.0 |
| Current tax recoverable | 0.2 |
| Cash and cash equivalents (see note 24) | 104.9 |
| Total assets | 3,884.7 |

* Centrally managed trading assets principally include amounts recoverable from insurers in respect of environmental issues relating to former sites, other receivables and property, plant and equipment of central companies.

## Analysis by geography

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| **Revenue** | | |
| UK | **165.8** | 162.4 |
| Rest of Europe | **365.1** | 343.7 |
| United States of America | **811.7** | 818.4 |
| Rest of World | **294.7** | 281.3 |
| **Total** | **1,637.3** | 1,605.8 |

Revenue is based on the location of the customer.

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| **Non-current assets** | | |
| UK | **714.4** | 708.8 |
| Rest of Europe | **215.6** | 206.9 |
| United States of America | **1,953.0** | 2,006.6 |
| Rest of World | **8.0** | 8.1 |
| **Total** | **2,891.0** | 2,930.4 |

Segmental non-current assets are based on the location of the assets. They exclude trade and other receivables, derivative financial instruments and deferred tax.

# Notes to the consolidated financial statements continued

## 7. Operating profit

Operating profit is stated after charging/(crediting):

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Raw materials and consumables used | **450.6** | 469.7 |
| Changes in inventories of finished goods and work in progress | **(5.9)** | (22.8) |
| Employee costs (see note 9) | **566.1** | 542.7 |
| Research and development costs expensed as incurred | **40.2** | 44.9 |
| Amortisation of capitalised development costs (see note 19) | **16.9** | 11.6 |
| Amortisation of programme participation costs (see note 19) | **25.4** | 23.2 |
| Amortisation of other purchased intangible assets (see note 20) | **9.8** | 7.4 |
| Amortisation of intangible assets acquired in business combinations (see note 10) | **74.3** | 80.6 |
| Depreciation (see note 21) | **32.2** | 31.9 |
| (Gain)/loss on disposal of property, plant and equipment | **(1.1)** | 0.3 |
| Exceptional operating items (see note 11) | **28.4** | 13.3 |
| Financial instruments (see note 10) | **(6.1)** | (23.4) |
| Net foreign exchange loss/(gain) | **2.1** | (2.4) |
| Operating lease rentals | **14.3** | 15.5 |
| Other operating income | **(4.6)** | (4.8) |

## 8. Auditor remuneration

**Payable to PricewaterhouseCoopers LLP and network firms:**

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Fees payable to the Company's auditor and its associates: | | |
| For the audit of the Company and consolidated financial statements in respect of the current year | **0.8** | 0.9 |
| For the audit of the Company and consolidated financial statements in respect of the prior year | **0.1** | – |
| For the audit of the Company's subsidiaries pursuant to legislation | **0.6** | 0.5 |
| For audit related assurance services | **0.1** | 0.1 |
| **Total** | **1.6** | 1.5 |

## 9. Employee information

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Employee costs including executive directors: | | |
| Wages and salaries | **441.0** | 422.2 |
| Social security costs | **79.1** | 76.6 |
| Retirement benefit costs (see note 33) | **34.1** | 31.6 |
| Share-based payment expense (see note 35) | **11.9** | 12.3 |
| **Total** | **566.1** | 542.7 |

Details of directors' remuneration is provided in the Directors' remuneration report on pages 47 to 67, which forms part of these financial statements.

| | 2013 Number | 2012 Number |
|---|---|---|
| Average monthly number of persons employed including executive directors: | | |
| Meggitt Aircraft Braking Systems | **1,191** | 1,216 |
| Meggitt Control Systems | **1,136** | 1,161 |
| Meggitt Polymers & Composites | **1,979** | 2,092 |
| Meggitt Sensing Systems | **1,623** | 1,600 |
| Meggitt Equipment Group | **4,525** | 4,242 |
| Corporate including shared services and centres of excellence | **581** | 520 |
| **Total** | **11,035** | 10,831 |

## 10. Reconciliations between profit and underlying profit

Underlying profit is used by the Board to monitor and measure the underlying trading performance of the Group. It excludes certain items as described below:

| | Note | 2013 £'m | 2012 Restated £'m |
|---|---|---|---|
| Operating profit | | **300.3** | 321.4 |
| Exceptional operating items (see note 11) | | **28.4** | 13.3 |
| Amortisation of intangible assets acquired in business combinations | a | **74.3** | 80.6 |
| Disposal of inventory revalued in business combinations | b | **0.3** | 0.2 |
| Financial instruments | c | **(6.1)** | (23.4) |
| Adjustments to operating profit* | | **96.9** | 70.7 |
| **Underlying operating profit** | | **397.2** | 392.1 |
| Profit before tax | | **269.4** | 281.3 |
| Adjustments to operating profit per above | | **96.9** | 70.7 |
| Net interest expense on retirement benefit obligations (see note 33) | d | **11.5** | 14.0 |
| Adjustments to profit before tax | | **108.4** | 84.7 |
| **Underlying profit before tax** | | **377.8** | 366.0 |
| Profit for the year | | **232.3** | 235.5 |
| Adjustments to profit before tax per above | | **108.4** | 84.7 |
| Tax effect of adjustments to profit before tax | | **(43.8)** | (34.7) |
| Adjustments to profit for the year | | **64.6** | 50.0 |
| **Underlying profit for the year** | | **296.9** | 285.5 |

* Of the adjustments to operating profit, £28.8 million (2012: £5.4 million) relating to exceptional operating items and £0.3 million (2012: £0.2 million) relating to the disposal of inventory revalued in business combinations has been charged to cost of sales, with the balance of £67.8 million (2012: £65.1 million) included within net operating costs.

a. The Group excludes from its underlying profit figures the amortisation of intangible assets acquired in business combinations.

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Amortisation of other intangible assets (see note 20) | **84.1** | 88.0 |
| Less amortisation of other purchased intangible assets (see note 20) | **(9.8)** | (7.4) |
| **Amortisation of intangible assets acquired in business combinations** | **74.3** | 80.6 |

b. IFRS 3 requires finished goods acquired in a business combination to be valued at fair value, which is typically estimated selling price less costs of disposal and a reasonable profit allowance for the selling effort. Work in progress acquired in a business combination is also valued at fair value, which is typically estimated selling price less costs to complete, costs of disposal and a reasonable profit allowance for work still to be carried out. The fair value of acquired inventory is thus significantly higher than the actual cost of manufacture of the same items built post acquisition, the value of which includes no profit element. The difference between the fair value of the inventory disposed of and its actual cost of manufacture is excluded from the Group's underlying profit figures.

c. Although the Group uses foreign currency forward contracts to hedge against foreign currency exposures, it has decided that the costs of meeting the extensive documentation requirements to be able to apply hedge accounting under IAS 39 'Financial Instruments: Recognition and Measurement' are not merited. The Group's underlying profit figures exclude amounts which would not have been recorded if hedge accounting had been applied.

Where interest rate derivatives do not qualify to be hedge accounted, movements in the fair value of the derivatives are excluded from underlying profit. Where interest rate derivatives do qualify to be hedge accounted, any difference between the movement in the fair value of derivatives and in the fair value of fixed rate borrowings is excluded from underlying profit.

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Movement in the fair value of foreign currency forward contracts | **(12.0)** | (20.1) |
| Impact of retranslating net foreign currency assets and liabilities at spot rate | **0.8** | 0.5 |
| Movement in the fair value of interest rate derivatives | **18.6** | (6.4) |
| Movement in the fair value of fixed rate borrowings | **(13.5)** | 2.6 |
| **Financial instruments – gain** | **(6.1)** | (23.4) |

d. As referred to in note 44, in 2013 the Group has adopted IAS 19 (revised 2011), 'Employee benefits'. This revised standard has led to the net pension finance cost recorded in the income statement becoming more significant. As net pension finance cost is a non-cash, non-trading item, the Board has decided to exclude it from the underlying profit measures it uses to monitor and measure the underlying trading performance of the Group. Prior year underlying profit measures have been restated accordingly.

# Notes to the consolidated financial statements continued

## 11. Exceptional operating items

| | Note | Income statement 2013 £'m | Income statement 2012 £'m | Cash expenditure 2013 £'m | Cash expenditure 2012 £'m |
|---|---|---|---|---|---|
| Site consolidations | a | **8.2** | 9.8 | **6.4** | 6.0 |
| Integration of Pacific Scientific Aerospace ('PacSci') | b | **7.2** | 4.8 | **4.6** | 5.6 |
| Gain on disposal of businesses | c | **(9.0)** | (3.2) | **0.5** | 0.9 |
| Raw material supply issue | d | **20.0** | – | **3.1** | – |
| Business acquisition expenses | | **0.7** | 1.3 | **0.4** | 1.4 |
| Other | | **1.3** | 0.6 | **1.2** | 0.8 |
| **Exceptional operating items** | | **28.4** | 13.3 | **16.2** | 14.7 |

a. This principally relates to the consolidation of the Group's two North American sensor businesses onto a single new site in California, USA and the consolidation of the Group's two UK avionics businesses onto a single existing site in Hampshire, UK. These two consolidations were substantially completed in 2013.

b. The integration of PacSci has now been substantially completed, following the consolidation in 2013 of the Group's fire suppression business, acquired as part of the PacSci acquisition, onto the existing site of its fire detection business in California, USA.

c. On 23 May 2013, the Group disposed of the shares of Meggitt (Addison), Inc. and realised a gain of £14.9 million. On 20 December 2013, the Group disposed of the shares of the Sunbank Family of Companies LLC and realised a loss of £5.9 million (see note 43). Cash expenditure relates to business disposal expenses which have been treated as an exceptional operating item. Proceeds from the disposal of businesses are reported separately as part of cash outflow from investing activities (see note 43).

d. On 1 November 2013, the Group announced it had identified an issue relating to the supply from a vendor of non-conforming raw material in one of our businesses. A solution is in place, including where necessary the replacement of the relevant parts over the next few years. The cost of this issue is estimated to be £20.0 million.

The tax credit in respect of exceptional operating items was £10.7 million (2012: £5.4 million).

## 12. Finance income

| | 2013 £'m | 2012 Restated £'m |
|---|---|---|
| Interest on bank deposits | **0.1** | 0.2 |
| Unwinding of interest on other receivables | **–** | 1.7 |
| Other finance income | **0.2** | 0.1 |
| **Finance income** | **0.3** | 2.0 |

## 13. Finance costs

| | 2013 £'m | 2012 Restated £'m |
|---|---|---|
| Interest on bank borrowings | **3.5** | 5.8 |
| Interest on senior notes | **15.4** | 19.4 |
| Interest on obligations under finance leases | **1.1** | 1.1 |
| Unwinding of discount on provisions | **–** | 1.7 |
| Net interest expense on retirement benefit obligations (see note 33) | **11.5** | 14.0 |
| Amortisation of debt issue costs | **1.2** | 1.7 |
| Less: amounts capitalised in the cost of qualifying assets (see notes 19 and 20) | **(1.5)** | (1.6) |
| **Finance costs** | **31.2** | 42.1 |

## 14. Tax

| | 2013 £'m | 2012 Restated £'m |
|---|---|---|
| Current tax – current year | **38.0** | 49.8 |
| Current tax – adjustment in respect of prior years | **(6.5)** | (4.9) |
| Deferred tax – origination and reversal of temporary differences | **11.0** | 5.2 |
| Deferred tax – effect of changes in tax rates | **(5.4)** | (4.3) |
| **Total taxation** | **37.1** | 45.8 |

The Finance Act 2012, included legislation to reduce the main rate of corporation tax in the UK to 23% with effect from 1 April 2013. The Finance Act 2013, included legislation to further reduce the main rate of corporation tax in the UK to 21% with effect from 1 April 2014 and to 20% with effect from 1 April 2015. As these changes were substantively enacted during the year, they have been reflected in the consolidated financial statements. The impact of these changes on net deferred tax liabilities at 31 December 2013, profit for the year (underlying and statutory) and comprehensive income for the year has not been significant.

### Reconciliation of total tax charge

A reconciliation of the notional tax charge based on average standard rates of tax (weighted in proportion to accounting profits) to the actual tax charge is as follows:

| | 2013 £'m | 2012 Restated £'m |
|---|---|---|
| Profit on ordinary activities before tax at UK corporation tax rate of 23.25%* (2012: 24.5% as restated) | **62.6** | 68.9 |
| Effects of: | | |
| Different tax rates of subsidiaries operating in other jurisdictions | **14.1** | 16.6 |
| Permanent differences | **(20.1)** | (19.6) |
| Temporary differences | **(1.5)** | (9.4) |
| Changes in statutory tax rates | **(5.4)** | (4.3) |
| Tax credits and incentives | **(4.4)** | (3.2) |
| Prior year credits | **(8.2)** | (3.2) |
| **Total taxation** | **37.1** | 45.8 |

* The sensitivity of the tax charge to changes in the tax rate is such that a one percentage point increase, or reduction, in the tax rate would cause the total taxation charge for 2013 to increase, or reduce respectively, by approximately £2.7 million.

### Tax relating to components of other comprehensive income

| | 2013 | | | 2012 Restated | | |
|---|---|---|---|---|---|---|
| | **Before tax £'m** | **Tax credit/ (charge) £'m** | **After tax £'m** | Before tax £'m | Tax credit/ (charge) £'m | After tax £'m |
| Current tax – currency translation movements | **(31.9)** | **0.2** | **(31.7)** | (55.1) | (0.7) | (55.8) |
| Deferred tax – currency translation movements | **(5.3)** | **0.2** | **(5.1)** | 0.4 | (0.2) | 0.2 |
| Deferred tax – remeasurement of retirement benefit obligations | **46.8** | **(21.6)** | **25.2** | 4.0 | (2.3) | 1.7 |
| Deferred tax – cash flow hedge movements | **1.9** | **(0.3)** | **1.6** | (5.8) | 1.5 | (4.3) |
| **Other comprehensive income** | **11.5** | **(21.5)** | **(10.0)** | (56.5) | (1.7) | (58.2) |
| Current tax | | **0.2** | | | (0.7) | |
| Deferred tax | | **(21.7)** | | | (1.0) | |
| **Total** | | **(21.5)** | | | (1.7) | |

### Tax relating to items recognised directly in equity

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Current tax credit relating to share-based payment expense | **5.3** | - |
| Deferred tax credit/(charge) relating to share-based payment expense | **3.3** | (3.1) |
| **Total** | **8.6** | (3.1) |

# Notes to the consolidated financial statements continued

## 15. Earnings per ordinary share

Earnings per ordinary share ('EPS') is calculated by dividing the profit attributable to owners of the Company by the weighted average number of shares in issue during the year. The weighted average number of shares used excludes any shares bought by the Group and held during the year by an independently managed Employee Share Ownership Plan Trust (see note 36). The weighted average number of own shares excluded was Nil million shares for both this and the prior year. The calculation of diluted EPS adjusts the weighted average number of shares to reflect the assumption that all potentially dilutive ordinary shares convert. For the Group this means assuming all share awards in issue are exercised.

| | **2013 Profit* £'m** | **2013 Shares Number 'm** | **2013 EPS Pence** | 2012 Profit* Restated £'m | 2012 Shares Number 'm | 2012 EPS Restated Pence |
|---|---|---|---|---|---|---|
| **Basic EPS** | **232.3** | **791.1** | **29.4** | 235.5 | 782.3 | 30.1 |
| Potential effect of dilutive ordinary shares | **–** | **13.1** | **(0.5)** | – | 10.0 | (0.4) |
| **Diluted EPS** | **232.3** | **804.2** | **28.9** | 235.5 | 792.3 | 29.7 |

* Profit for the year attributable to equity owners of the Company.

Underlying EPS is based on underlying profit for the year (see note 10) and the same number of shares as is used in the calculation of basic EPS. It is reconciled to basic EPS below:

| | **2013 Pence** | 2012 Restated Pence |
|---|---|---|
| Basic EPS | **29.4** | 30.1 |
| Adjust for effects of: | | |
| Exceptional operating items | **2.2** | 1.0 |
| Amortisation of intangible assets acquired in business combinations | **5.6** | 6.4 |
| Financial instruments | **(0.7)** | (2.3) |
| Net interest expense on retirement benefit obligations | **1.0** | 1.3 |
| **Underlying basic EPS** | **37.5** | 36.5 |

Diluted underlying EPS is based on underlying profit for the year (see note 10) and the same number of shares used in the calculation of diluted EPS. Diluted underlying EPS for the year was 36.9 pence (2012: 36.0 pence as restated).

## 16. Dividends

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| In respect of earlier years | **–** | 56.9 |
| In respect of 2012: | | |
| Interim of 3.60p per share | **–** | 28.1 |
| Final of 8.20p per share | **64.4** | – |
| In respect of 2013: | | |
| Interim of 3.95p per share | **31.2** | – |
| Dividends paid | **95.6** | 85.0 |
| Less paid as scrip dividend (see note 41) | **(20.0)** | (13.2) |
| **Dividends paid in cash** | **75.6** | 71.8 |

A final dividend in respect of 2013 of 8.80p per share (2012: 8.20p), amounting to an estimated total final dividend of £70.2 million (2012: £64.4 million) is to be proposed at the Annual General Meeting on 7 May 2014. This dividend is not reflected in these financial statements as it is has not been approved by the shareholders at the balance sheet date.

## 17. Related party transactions

Transactions between the Company and its subsidiaries have been eliminated on consolidation. The remuneration of key management personnel of the Group, which is defined as members of the Board and the Management Board, is set out below:

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| Salaries and other short-term employee benefits | **6.8** | 8.5 |
| Retirement benefit expense | **0.4** | 0.3 |
| Share-based payment expense | **3.2** | 4.6 |
| **Total** | **10.4** | 13.4 |

Interests of key management personnel, including executive directors, in share schemes operated by the Group at the balance sheet date are set out below:

| | **2013 Average award price Pence** | **2013 Number outstanding 'm** | 2012 Average award price Pence | 2012 Number outstanding 'm |
|---|---|---|---|---|
| Share options | **348.66** | **0.1** | 182.49 | 0.1 |
| Share appreciation rights – equity-settled | **353.23** | **5.7** | 285.74 | 10.1 |
| Equity participation plan shares | **N/A** | **2.8** | N/A | 3.6 |

Full details of all elements in the remuneration package of each director, together with directors' share interests and share awards, are given in the Directors' remuneration report on pages 47 to 67 which forms part of these financial statements.

## 18. Goodwill

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| **Cost at 1 January** | **1,494.2** | 1,544.0 |
| Exchange rate adjustments | **(19.6)** | (53.7) |
| Businesses acquired (see note 42) | **9.0** | 3.9 |
| Businesses disposed (see note 43) | **(26.5)** | – |
| **Cost at 31 December** | **1,457.1** | 1,494.2 |

Goodwill is tested for impairment annually or more frequently if there is any indication of impairment. No impairment charge was required in the year (2012: £Nil) and the cumulative impairment charge recognised to date is £Nil (2012: £Nil). The total amount of goodwill and other intangible assets acquired as part of a business combination in the year that are expected to be deductible for tax purposes is £24.8 million (2012: £Nil).

For the purpose of impairment testing, goodwill is allocated to the Group's cash generating units ('CGUs') which principally comprise its individual business operations. Goodwill is initially allocated, in the year a business is acquired, to CGUs expected to benefit from the acquisition. Subsequent adjustments are made to this allocation to the extent operations to which goodwill relates are transferred between CGUs.

An analysis of goodwill by principal CGU is shown below:

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| Meggitt Aircraft Braking Systems ('MABS') | **665.3** | 675.8 |
| Meggitt (North Hollywood), Inc. | **177.2** | 165.6 |
| Meggitt Safety Systems, Inc./Pacific Scientific HTL* | **129.6** | 132.0 |
| Meggitt Sensing Systems ('MSS')* | **82.9** | 73.9 |
| Meggitt (Rockmart), Inc. | **68.6** | 69.9 |
| Meggitt Training Systems, Inc. | **62.9** | 64.1 |
| Other | **270.6** | 312.9 |
| **Total** | **1,457.1** | 1,494.2 |

* During the year, the Group determined that the cash flows of certain individual business operations were now so closely related to those of other business unit operations within the Group, they no longer met the definition of a CGU. Accordingly, Meggitt Safety Systems, Inc. and Pacific Scientific HTL are now treated as a single CGU and MSS SBU is treated also as a single CGU.

# Notes to the consolidated financial statements continued

## 18. Goodwill continued

For each CGU, the Group has determined its recoverable amount from value in use calculations. The value in use calculations are based on cash flow forecasts derived from the most recent budgets and plans for the next five years, as approved by management in December 2013. Cash flows for periods beyond five years are extrapolated using estimated growth rates. The resultant cash flows are discounted using a pre-tax discount rate appropriate for the relevant CGU. The key assumptions for the value in use calculations are shown below:

- Sales volumes, selling prices and cost increases over the five years covered by management's detailed plans. Sales volumes are based on industry forecasts and management estimates for the businesses in which each CGU operates including forecasts for OEM deliveries of large jets, regional aircraft and business jets, air traffic growth and military spending by the US DoD and other major governments. Selling prices and cost increases are based on past experience and management expectations of future changes in the market. Overall a cautious approach to volume levels, selling prices and cost increases has been taken given the continued global economic uncertainty. The extent to which these assumptions affect each principal CGU with a significant level of goodwill are described below.

  MABS, Meggitt (North Hollywood), Inc., Meggitt Safety Systems, Inc./Pacific Scientific HTL and MSS are broadly spread across both civil aerospace and military platforms with Meggitt (North Hollywood), Inc. and MSS also operating in the energy sector. MABS is a leading supplier of wheels, brakes and brake control systems, particularly for regional aircraft, business jets and military aircraft. Meggitt (North Hollywood), Inc. designs and manufactures fluid control devices and systems for most aircraft types and has a higher content on large jets. Meggitt Safety Systems, Inc./Pacific Scientific HTL designs and manufactures fire protection and control systems for large, regional, business and military aircraft. MSS is a leading provider of high-performance sensing and condition-monitoring solutions for high-value rotating machinery and other assets and, within the aerospace sector, has a higher content on large jets. All four CGUs have significant OEM and aftermarket revenue derived from sole source positions with the aftermarket, where platform lives can be up to thirty years for civil aircraft and longer for military, representing the greater proportion of revenue except for MSS which has a higher OEM content. Meggitt (Rockmart), Inc. and Meggitt Training Systems, Inc. both operate mainly in military markets. The principal customer of Meggitt (Rockmart), Inc. is the US DoD to whom Meggitt (Rockmart), Inc. are a leading supplier of flexible fuel tanks. Meggitt Training Systems, Inc. supplies integrated live and virtual training packages for armed forces and law enforcement agencies across the world.

  In civil aerospace, growth in capacity terms, measured in available seat kilometres (ASK's), is forecast to grow in line with the long-term trend rate of 5%, which together with the Group's growing fleet and price increases, should drive an increase in aftermarket revenue of 8 to 9% per annum over the medium term. The Group's continuing confidence in air passenger travel growth is supported by the sustained high levels of order intake at Boeing and Airbus. Large jet deliveries increased by 8% in 2013, and the Group expects good delivery growth over the next 5 years underpinned by continued strong recent order intake and a backlog at Boeing and Airbus which equates to over 7 years of deliveries at the current production rate. Deliveries of regional aircraft increased by 11% in 2013, with modest growth anticipated over the next few years, driven principally by demand for 70-90 seat aircraft, on which the Group has a strong shipset content. Total business jet deliveries decreased by 5% in 2013 but deliveries of super-midsize and long-range aircraft, where the Group benefits from particularly strong market positions, grew strongly. Further growth is anticipated in this market over the next 5 years, driven by increasing internationalisation of the customer base and the ongoing improvement in the US economy. In military markets, defence budgets are likely to remain under pressure over the medium term. Sequestration has been implemented in the US, and although the effect in 2014 is unlikely to be as severe as initially anticipated, a cautious stance on near-term revenue growth has been assumed. However, the Group has key positions on future growth platforms and, in the absence of any clarity on where cuts will ultimately fall, continues to anticipate average compound organic military growth of around 2% per annum in the medium term.

- Growth rates used for periods beyond those covered by management's detailed budgets and plans. Growth rates are derived from management's estimates which take into account the long-term nature of the industry in which each CGU operates, external industry forecasts of long-term growth in the aerospace and defence sectors, the extent to which a CGU has sole source position on platforms where it is able to share in a continuing stream of highly profitable aftermarket revenues, the maturity of the platforms supplied by the CGU and the technological content of the CGU's products. For the purpose of impairment testing, a conservative approach has been used and where the derived rate is higher than the long-term GDP growth rates for the countries in which the CGU operates (UK: 2.4% (2012: 2.3%), US: 2.4% (2012: 2.4%)), the latter has been used.

- Discount rates applied to future cash flows. The Group's pre-tax weighted average cost of capital (WACC) was used as the foundation for determining the discount rates to be applied. The WACC was then adjusted to reflect risks specific to the CGU not already reflected in the future cash flows for that CGU. The discount rates used were as follows: MABS 10.3% (2012: 10.8%), Meggitt (North Hollywood), Inc., 11.0% (2012: 11.1%), Meggitt Safety Systems, Inc./Pacific Scientific HTL 10.8% (2012: 9.6%), Meggitt (Rockmart), Inc. 10.7% (2012: 11.2%), and Meggitt Training Systems, Inc. 10.9% (2012: 10.0%). The discount rates used for 'Other' CGU's ranged between 9.3% to 10.9% (2012: 8.4% to 11.3%).

A sensitivity analysis was carried out for each CGU to determine the extent to which its assumptions would need to change for the calculated recoverable amounts from value in use, to fall below the carrying value of goodwill of the CGU. Management has concluded that no reasonably foreseeable change in the key assumptions used in the impairment model would result in a significant impairment charge being recorded in the financial statements. The principal CGU with the least headroom in percentage terms is MABS. 'Other' goodwill of £270.6 million (2012: £312.9 million) relates to approximately 10 individual CGUs for which sensitivities at the aggregated level are also provided below.

To require an impairment in the Group financial statements, one of the following would be required:

| | MABS<br>% | Other<br>% |
|---|---|---|
| Reduction in estimates of cash flows (more than) | **15** | **20** |
| Reduction of long-term growth rates (more than) | **80** | **75** |
| Increase in the discount rate applied to future cash flows (more than) | **15** | **15** |

## 19. Development costs and programme participation costs

| | Development costs £'m | Programme participation costs £'m |
|---|---|---|
| **At 1 January 2012** | | |
| Cost | 230.3 | 301.8 |
| Accumulated amortisation | (44.5) | (104.3) |
| Net book amount | 185.8 | 197.5 |
| **Year ended 31 December 2012** | | |
| Opening net book amount | 185.8 | 197.5 |
| Exchange rate adjustments | (6.2) | (6.8) |
| Additions | 52.2 | 36.1 |
| Interest capitalised | 1.3 | – |
| Amortisation* | (11.6) | (23.2) |
| Net book amount | 221.5 | 203.6 |
| **At 31 December 2012** | | |
| Cost | 276.0 | 326.9 |
| Accumulated amortisation | (54.5) | (123.3) |
| Net book amount | 221.5 | 203.6 |
| **Year ended 31 December 2013** | | |
| Opening net book amount | 221.5 | 203.6 |
| Exchange rate adjustments | (3.8) | (3.3) |
| Additions | 70.2 | 35.7 |
| Disposals | (2.0) | – |
| Interest capitalised | 1.5 | – |
| Amortisation* | (16.9) | (25.4) |
| **Net book amount** | **270.5** | **210.6** |
| **At 31 December 2013** | | |
| Cost | 340.7 | 356.0 |
| Accumulated amortisation | (70.2) | (145.4) |
| **Net book amount** | **270.5** | **210.6** |

* Charged to net operating costs in respect of development costs and to cost of sales in respect of programme participation costs.

Interest has been capitalised using the average rate payable on the Group's floating rate borrowings of 1.6% (2012: 1.6%).

The net book amount of development costs include £91.1 million (2012: £72.5 million) in respect of Meggitt Aircraft Braking Systems which have an estimated weighted average remaining life of 9.1 years (2012: 9.2 years). The net book amount of programme participation costs includes £202.7 million (2012: £199.5 million) in respect of Meggitt Aircraft Braking Systems which have an estimated weighted average remaining life of 8.4 years (2012: 9.1 years).

# Notes to the consolidated financial statements continued

## 20. Other intangible assets

| | Customer relationships (*) £'m | Technology (*) £'m | Order backlogs (*) £'m | Trade names and trademarks (*) £'m | Other purchased (**) £'m | Total £'m |
|---|---|---|---|---|---|---|
| **At 1 January 2012** | | | | | | |
| Cost | 863.2 | 246.7 | 11.4 | 30.9 | 73.4 | 1,225.6 |
| Accumulated amortisation | (229.7) | (80.8) | (8.2) | (16.3) | (24.8) | (359.8) |
| Net book amount | 633.5 | 165.9 | 3.2 | 14.6 | 48.6 | 865.8 |
| **Year ended 31 December 2012** | | | | | | |
| Opening net book amount | 633.5 | 165.9 | 3.2 | 14.6 | 48.6 | 865.8 |
| Exchange rate adjustments | (22.8) | (5.9) | (0.1) | (0.6) | (1.3) | (30.7) |
| Business acquired | 0.7 | 2.9 | 0.1 | – | – | 3.7 |
| Additions | – | – | – | – | 27.9 | 27.9 |
| Disposals | – | – | – | – | (0.1) | (0.1) |
| Interest capitalised | – | – | – | – | 0.3 | 0.3 |
| Amortisation – net operating costs (see note 10) | (59.1) | (16.3) | (2.9) | (2.3) | (7.4) | (88.0) |
| Net book amount | 552.3 | 146.6 | 0.3 | 11.7 | 68.0 | 778.9 |
| **At 31 December 2012** | | | | | | |
| Cost | 832.1 | 240.5 | 11.2 | 29.9 | 98.4 | 1,212.1 |
| Accumulated amortisation | (279.8) | (93.9) | (10.9) | (18.2) | (30.4) | (433.2) |
| Net book amount | 552.3 | 146.6 | 0.3 | 11.7 | 68.0 | 778.9 |
| **Year ended 31 December 2013** | | | | | | |
| Opening net book amount | 552.3 | 146.6 | 0.3 | 11.7 | 68.0 | 778.9 |
| Exchange rate adjustments | (5.8) | (1.4) | – | – | (0.4) | (7.6) |
| Business acquired (see note 42) | 10.0 | 5.6 | 0.1 | – | 0.1 | 15.8 |
| Businesses disposed (see note 43) | (9.5) | (1.1) | – | (0.6) | – | (11.2) |
| Additions | – | – | – | – | 15.5 | 15.5 |
| Amortisation – net operating costs (see note 10) | (54.7) | (17.0) | (0.3) | (2.3) | (9.8) | (84.1) |
| **Net book amount** | **492.3** | **132.7** | **0.1** | **8.8** | **73.4** | **707.3** |
| **At 31 December 2013** | | | | | | |
| Cost | 807.9 | 238.8 | 10.9 | 27.9 | 110.8 | 1,196.3 |
| Accumulated amortisation | (315.6) | (106.1) | (10.8) | (19.1) | (37.4) | (489.0) |
| **Net book amount** | **492.3** | **132.7** | **0.1** | **8.8** | **73.4** | **707.3** |

* Acquired in business combinations. Amortisation of these items is excluded from the Group's underlying profit figures (see note 10).
** Principally relates to software costs. Amortisation of £1.4 million (2012: £Nil) has been charged to exceptional operating items and is excluded from the Group's underlying profit figures (see note 10).

No interest has been capitalised in the year. In 2012, interest was capitalised using the average rate payable on the Group's floating rate borrowings of 1.6%.

The net book amount of customer relationships include £350.2 million (2012: £391.5 million) in respect of Meggitt Aircraft Braking Systems which have an estimated weighted average remaining life of 10.0 years (2012: 11.0 years). The net book amount of technology includes £70.2 million (2012: £78.4 million) in respect of Meggitt Aircraft Braking Systems which have an estimated weighted average remaining life of 10.0 years (2012: 11.0 years).

## 21. Property, plant and equipment

| | Land and buildings £'m | Plant, equipment and vehicles £'m | Total £'m |
|---|---|---|---|
| **At 1 January 2012** | | | |
| Cost | 164.8 | 372.2 | 537.0 |
| Accumulated depreciation | (50.4) | (256.7) | (307.1) |
| Net book amount | 114.4 | 115.5 | 229.9 |
| **Year ended 31 December 2012** | | | |
| Opening net book amount | 114.4 | 115.5 | 229.9 |
| Exchange rate adjustments | (2.5) | (3.5) | (6.0) |
| Business acquired | 2.5 | 1.6 | 4.1 |
| Additions | 6.9 | 29.7 | 36.6 |
| Disposals | (0.1) | (0.4) | (0.5) |
| Depreciation* | (7.0) | (24.9) | (31.9) |
| Net book amount | 114.2 | 118.0 | 232.2 |
| **At 31 December 2012** | | | |
| Cost | 169.2 | 380.7 | 549.9 |
| Accumulated depreciation | (55.0) | (262.7) | (317.7) |
| Net book amount | 114.2 | 118.0 | 232.2 |
| **Year ended 31 December 2013** | | | |
| Opening net book amount | 114.2 | 118.0 | 232.2 |
| Exchange rate adjustments | (0.8) | (1.1) | (1.9) |
| Business acquired (see note 42) | – | 0.7 | 0.7 |
| Businesses disposed (see note 43) | (0.1) | (4.0) | (4.1) |
| Additions | 21.9 | 29.6 | 51.5 |
| Disposals | (0.1) | (0.6) | (0.7) |
| Depreciation* | (6.5) | (25.7) | (32.2) |
| **Net book amount** | **128.6** | **116.9** | **245.5** |
| **At 31 December 2013** | | | |
| Cost | 185.9 | 385.0 | 570.9 |
| Accumulated depreciation | (57.3) | (268.1) | (325.4) |
| **Net book amount** | **128.6** | **116.9** | **245.5** |

* Depreciation of £0.8 million (2012: £Nil) has been charged to exceptional operating items and is excluded from the Group's underlying profit figures (see note 10).

The Group's obligations under finance leases (see note 27) are secured by the lessors' title to the leased assets, which have a carrying amount of £4.4 million included within land and buildings (2012: £4.5 million) and £0.2 million (2012: £1.4 million) included within plant, equipment and vehicles.

## 22. Inventories

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| Contract costs incurred | **10.8** | 8.8 |
| Less progress billings | **(3.0)** | (4.2) |
| Net contract costs | **7.8** | 4.6 |
| Raw materials and bought-in components | **115.1** | 107.8 |
| Manufacturing work in progress | **127.9** | 123.9 |
| Finished goods and goods for resale | **48.4** | 54.9 |
| **Total** | **299.2** | 291.2 |

The cost of inventories recognised as an expense and included in cost of sales was £923.7 million (2012: £896.2 million). The cost of inventories recognised as an expense includes £2.3 million (2012: £7.2 million) in respect of write-downs of inventory to net realisable value, and has been reduced by £7.4 million (2012: £4.9 million) in respect of the reversal of write-downs made in previous years.

# Notes to the consolidated financial statements continued

## 23. Trade and other receivables

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Trade receivables | **244.6** | 240.2 |
| Amounts recoverable on contracts | **35.9** | 14.6 |
| Prepayments and accrued income | **12.2** | 10.4 |
| Other receivables | **126.1** | 137.8 |
| **Total** | **418.8** | 403.0 |
| Less non-current portion: | | |
| Other receivables | **89.9** | 98.8 |
| **Non-current portion** | **89.9** | 98.8 |
| **Current portion** | **328.9** | 304.2 |

Other receivables includes £95.9 million (2012: £102.7 million) in respect of insurance receivables arising on environmental issues pertaining to businesses sold by Whittaker Corporation prior to its acquisition by the Group (see note 31) of which £10.5 million (2012: £10.7 million) is shown as current.

Trade receivables are stated after a provision for impairment of £4.1 million (2012: £6.6 million). Other balances within trade and other receivables do not contain impaired assets. The provision for impairment against trade receivables is based on a specific risk assessment taking into account past default experience and is analysed as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| At 1 January | **6.6** | 7.2 |
| Exchange rate adjustments | **0.1** | (0.2) |
| Businesses disposed | **(0.5)** | - |
| Credit to income statement – net operating costs | **(2.1)** | (0.4) |
| **At 31 December** | **4.1** | 6.6 |

At 31 December 2013, trade receivables of £61.8 million (2012: £50.0 million) were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The ageing analysis of these trade receivables is as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Up to 3 months overdue | **53.2** | 42.7 |
| Over 3 months overdue | **8.6** | 7.3 |
| **Total** | **61.8** | 50.0 |

The maximum exposure to credit risk at the balance sheet date is the fair value of each class of receivable reported above. The Group does not hold any collateral as security.

Trade and other receivables are denominated in the following currencies:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Sterling | **79.2** | 69.3 |
| US dollar | **289.3** | 279.8 |
| Euro | **41.7** | 42.1 |
| Other | **8.6** | 11.8 |
| **Total** | **418.8** | 403.0 |

## 24. Cash and cash equivalents

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Cash at bank and on hand | **101.0** | 94.9 |
| Short-term bank deposits | **15.1** | 10.0 |
| **Total** | **116.1** | 104.9 |

Cash and cash equivalents are subject to interest at floating rates. The credit quality of cash and cash equivalents is as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| S&P/Moody's rating: | | |
| AAA | **0.7** | 1.0 |
| AA | **29.0** | 27.8 |
| A | **81.7** | 72.5 |
| BBB | **4.7** | 3.6 |
| **Total** | **116.1** | 104.9 |

## 25. Trade and other payables – current

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Payments received on account | **42.2** | 42.6 |
| Trade payables | **128.2** | 121.6 |
| Social security and other taxes | **12.5** | 12.0 |
| Accrued expenses | **47.8** | 47.8 |
| Deferred consideration relating to acquired businesses | **–** | 0.2 |
| Other payables | **98.4** | 127.7 |
| **Total** | **329.1** | 351.9 |

## 26. Trade and other payables – non-current

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Deferred consideration relating to acquired businesses | **2.9** | 2.9 |
| Other payables | **2.3** | 3.4 |
| **Total** | **5.2** | 6.3 |

## 27. Obligations under finance leases

| | Minimum lease payments | | Present value of minimum lease payments | |
|---|---|---|---|---|
| | 2013 £'m | 2012 £'m | 2013 £'m | 2012 £'m |
| Amounts payable under finance leases: | | | | |
| In one year or less | **3.4** | 4.3 | **2.4** | 3.1 |
| In more than one year but not more than five years | **3.8** | 3.7 | **1.3** | 1.1 |
| In more than five years | **12.7** | 13.9 | **3.8** | 3.9 |
| **Total** | **19.9** | 21.9 | **7.5** | 8.1 |
| Less: future finance charges | **(12.4)** | (13.8) | | |
| **Present value of lease obligations** | **7.5** | 8.1 | | |
| **Less non-current portion** | **5.1** | 5.0 | | |
| **Current portion** | **2.4** | 3.1 | | |

Obligations under finance leases are principally US dollar denominated. The weighted average period to maturity is 11.0 years (2012: 11.2 years) and the weighted average interest rate is 13.9% (2012: 16.0%).

# Notes to the consolidated financial statements continued

## 28. Bank and other borrowings

| | 2013 £'m | 2012 £'m |
|---|---|---|
| **Current** | | |
| Bank loans | **3.9** | 12.2 |
| Other loans | **3.3** | 114.8 |
| **Total current** | **7.2** | 127.0 |
| **Non-current** | | |
| Bank loans | **245.8** | 170.1 |
| Other loans | **420.2** | 442.2 |
| **Total non-current** | **666.0** | 612.3 |
| **Total** | **673.2** | 739.3 |
| Analysis of bank and other borrowings repayable: | | |
| In one year or less | **7.2** | 127.0 |
| In more than one year but not more than five years | **413.7** | 343.3 |
| In more than five years | **252.3** | 269.0 |
| **Total** | **673.2** | 739.3 |

Bank and other borrowings are stated after deduction of unamortised debt issue costs of £3.9 million (2012: £5.1 million). Debt issue costs are written off over the period of the facility to which they relate. The Group has no secured borrowings (2012: £0.1 million secured by specific land and buildings of the Group).

The Group has the following committed facilities:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Drawn £'m | Undrawn £'m | Total £'m | Drawn £'m | Undrawn £'m | Total £'m |
| Senior notes (2013: USD 70.0 million, 2012: USD 250.0 million) | **42.3** | **–** | **42.3** | 153.8 | – | 153.8 |
| Senior notes (USD 600.0 million) | **362.3** | **–** | **362.3** | 369.1 | – | 369.1 |
| Syndicated credit facility (USD 700.0 million) | **186.4** | **236.1** | **422.5** | 93.8 | 336.8 | 430.6 |
| Syndicated credit facility (USD 400.0 million) | **62.2** | **179.3** | **241.5** | 80.1 | 166.0 | 246.1 |
| **Total** | **653.2** | **415.4** | **1,068.6** | 696.8 | 502.8 | 1,199.6 |

The Group issued USD 250.0 million of loan notes to private placement investors in 2003. The notes were in two tranches as follows: USD 180.0 million carried an interest rate of 5.36% and were repaid in 2013 and USD 70.0 million carry an interest rate of 5.46% and are due for repayment in 2015.

The Group issued USD 600.0 million of loan notes to private placement investors in 2010. The notes are in four tranches as follows: USD 200.0 million carry an interest rate of 4.62% and are due for repayment in 2017, USD 125.0 million carry an interest rate of 5.02% and are due for repayment in 2020, USD 150.0 million carry an interest rate of 5.17% and are due for repayment in 2020 and USD 125.0 million carry an interest rate of 5.12% and are due for repayment in 2022.

The Group has a USD 700.0 million syndicated revolving credit facility which matures in 2016 and a USD 400.0 million syndicated revolving credit facility which matures in 2017. At 31 December 2013, the amounts drawn under revolving credit facilities were £248.6 million (2012: £173.9 million) represented by borrowings denominated in US dollars of £97.0 million (2012: £80.1 million), in Euros of £62.3 million (2012: £Nil), in Swiss francs of £78.3 million (2012: £93.8 million) and in Sterling of £11.0 million (2012: £Nil). Borrowings under the facilities are subject to interest at floating rates.

The committed facilities available at each balance sheet date expire as follows:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Drawn £'m | Undrawn £'m | Total £'m | Drawn £'m | Undrawn £'m | Total £'m |
| In one year or less | **–** | **–** | **–** | 110.7 | – | 110.7 |
| In more than one year but not more than five years | **411.7** | **415.4** | **827.1** | 340.0 | 502.8 | 842.8 |
| In more than five years | **241.5** | **–** | **241.5** | 246.1 | – | 246.1 |
| **Total** | **653.2** | **415.4** | **1,068.6** | 696.8 | 502.8 | 1,199.6 |

The Group also has various uncommitted facilities with its relationship banks.

## 28. Bank and other borrowings continued

The fair value of bank and other borrowings is as follows:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | Book value £'m | Fair value £'m | Book value £'m | Fair value £'m |
| Current | 7.2 | 7.2 | 127.0 | 128.7 |
| Non-current | 666.0 | 676.3 | 612.3 | 628.4 |
| **Total** | **673.2** | **683.5** | 739.3 | 757.1 |

After taking account of the financial derivatives that alter the interest and currency basis of the financial liabilities entered into by the Group, the interest rate exposure on gross bank and other borrowings is:

**As at 31 December 2013:**

| | Floating £'m | Fixed £'m | Non-interest bearing £'m | Total £'m | Fixed rate borrowings: Weighted average interest rate % | Fixed rate borrowings: Weighted average period for which rate is fixed Years |
|---|---|---|---|---|---|---|
| US dollar* | 262.7 | 259.6 | – | 522.3 | 4.2 | 4.3 |
| Swiss franc | 79.6 | – | – | 79.6 | | |
| Euro | 62.3 | 0.3 | 1.6 | 64.2 | 0.7 | 3.1 |
| Sterling | 11.0 | – | – | 11.0 | | |
| Gross bank and other borrowings | 415.6 | 259.9 | 1.6 | 677.1 | | |
| Less unamortised debt issue costs | (3.2) | (0.7) | – | (3.9) | | |
| **Bank and other borrowings** | **412.4** | **259.2** | **1.6** | **673.2** | | |

* On 10 June 2013, USD 180.0 million of loan notes issued in 2003 were repaid using floating rate borrowings. At 31 December 2013, a 5 year floating to fixed interest rate swap has been entered into which has the effect of converting USD 160.0 million of the new floating rate borrowings into fixed rate borrowings.

**As at 31 December 2012:**

| | Floating £'m | Fixed £'m | Non-interest bearing £'m | Total £'m | Fixed rate borrowings: Weighted average interest rate % | Fixed rate borrowings: Weighted average period for which rate is fixed Years |
|---|---|---|---|---|---|---|
| US dollar | 294.8 | 276.8 | – | 571.6 | 5.1 | 5.3 |
| Swiss franc | 93.8 | – | – | 93.8 | | |
| Euro | 68.1 | 0.1 | 3.3 | 71.5 | 5.9 | 0.5 |
| Sterling | 7.5 | – | – | 7.5 | | |
| Gross bank and other borrowings | 464.2 | 276.9 | 3.3 | 744.4 | | |
| Less unamortised debt issue costs | (4.6) | (0.5) | – | (5.1) | | |
| Bank and other borrowings | 459.6 | 276.4 | 3.3 | 739.3 | | |

The weighted average period to maturity for non-interest bearing borrowings is 3.5 years (2012: 3.8 years).

# Notes to the consolidated financial statements continued

## 29. Financial instruments

**As at 31 December 2013:**

| | Held at fair value | | Held at amortised cost | | | |
|---|---|---|---|---|---|---|
| | Through profit & loss £'m | Derivatives used for hedging £'m | Loans & receivables £'m | Liabilities £'m | Total book value £'m | Total fair value £'m |
| Non-current: | | | | | | |
| Trade and other receivables (see note 23) | – | – | 89.9 | – | 89.9 | 89.9 |
| Derivative financial instruments (see note 30) | 33.4 | 2.1 | – | – | 35.5 | 35.5 |
| Current: | | | | | | |
| Trade and other receivables* | – | – | 316.7 | – | 316.7 | 316.7 |
| Derivative financial instruments (see note 30) | 11.2 | – | – | – | 11.2 | 11.2 |
| Cash and cash equivalents (see note 24) | – | – | 116.1 | – | 116.1 | 116.1 |
| **Financial assets** | **44.6** | **2.1** | **522.7** | **–** | **569.4** | **569.4** |
| Current: | | | | | | |
| Trade and other payables** | – | – | – | (316.6) | (316.6) | (316.6) |
| Derivative financial instruments (see note 30) | (0.7) | – | – | – | (0.7) | (0.7) |
| Obligations under finance leases (see note 27) | – | – | – | (2.4) | (2.4) | (2.4) |
| Bank and other borrowings (see note 28) | – | – | – | (7.2) | (7.2) | (7.2) |
| Non-current: | | | | | | |
| Trade and other payables (see note 26) | – | – | – | (5.2) | (5.2) | (5.2) |
| Derivative financial instruments (see note 30) | (0.1) | – | – | – | (0.1) | (0.1) |
| Obligations under finance leases (see note 27) | – | – | – | (5.1) | (5.1) | (5.1) |
| Bank and other borrowings (see note 28) | (256.8) | – | – | (409.2) | (666.0) | (676.3) |
| **Financial liabilities** | **(257.6)** | **–** | **–** | **(745.7)** | **(1,003.3)** | **(1,013.6)** |
| **Total** | **(213.0)** | **2.1** | **522.7** | **(745.7)** | **(433.9)** | **(444.2)** |

**As at 31 December 2012:**

| | Held at fair value | | Held at amortised cost | | | |
|---|---|---|---|---|---|---|
| | Through profit & loss £'m | Derivatives used for hedging £'m | Loans & receivables £'m | Liabilities £'m | Total book value £'m | Total fair value £'m |
| Non-current: | | | | | | |
| Trade and other receivables (see note 23) | – | – | 98.8 | – | 98.8 | 98.8 |
| Derivative financial instruments (see note 30) | 49.8 | – | – | – | 49.8 | 49.8 |
| Current: | | | | | | |
| Trade and other receivables* | – | – | 293.8 | – | 293.8 | 293.8 |
| Derivative financial instruments (see note 30) | 5.0 | – | – | – | 5.0 | 5.0 |
| Cash and cash equivalents (see note 24) | – | – | 104.9 | – | 104.9 | 104.9 |
| Financial assets | 54.8 | – | 497.5 | – | 552.3 | 552.3 |
| Current: | | | | | | |
| Trade and other payables** | – | – | – | (339.9) | (339.9) | (339.9) |
| Derivative financial instruments (see note 30) | (2.7) | (1.3) | – | – | (4.0) | (4.0) |
| Obligations under finance leases (see note 27) | – | – | – | (3.1) | (3.1) | (3.1) |
| Bank and other borrowings (see note 28) | – | – | – | (127.0) | (127.0) | (128.7) |
| Non-current: | | | | | | |
| Trade and other payables (see note 26) | – | – | – | (6.3) | (6.3) | (6.3) |
| Derivative financial instruments (see note 30) | (0.2) | – | – | – | (0.2) | (0.2) |
| Obligations under finance leases (see note 27) | – | – | – | (5.0) | (5.0) | (5.0) |
| Bank and other borrowings (see note 28) | (274.9) | – | – | (337.4) | (612.3) | (628.4) |
| Financial liabilities | (277.8) | (1.3) | – | (818.7) | (1,097.8) | (1,115.6) |
| Total | (223.0) | (1.3) | 497.5 | (818.7) | (545.5) | (563.3) |

* Excludes prepayments and accrued income of £12.2 million (2012: £10.4 million) (see note 23).

** Excludes social security and other taxes of £12.5 million (2012: £12.0 million) (see note 25).

## 29. Financial instruments continued

### Fair value measurement and hierarchy

For trade and other receivables, cash and cash equivalents, trade and other payables, obligations under finance leases and the current element of bank and other borrowings, fair values approximate to their book values due to the short maturity periods of these financial instruments. For trade and other receivables, allowances are made within the book value for credit risk.

Derivative financial instruments measured at fair value, is classified as level 2 in the fair value measurement hierarchy, as they have been determined using significant inputs based on observable market data. The fair values of foreign currency forward contracts have been derived from forward exchange rates observable at the balance sheet date together with the contractual forward rates. The fair values of interest rate derivatives have been derived from forward interest rates based on yield curves observable at the balance sheet date together with the contractual interest rates.

The non-current portion of bank and other borrowings measured at fair value, is classified as level 3 in the fair value measurement hierarchy, as it has been determined using significant inputs which are a mixture of those based on observable market data (interest rate risk) and those not based on observable market data (credit risk). The fair value attributable to interest rate risk has been derived from forward interest rates based on yield curves observable at the balance sheet date together with the contractual interest rates and with the credit risk margin kept constant. The fair value attributable to credit risk has been derived from quotes from lenders for borrowings of similar amounts and maturity periods. Similar methods of valuation have been used to derive the fair value of the non-current portion of bank and other borrowings which is held at amortised cost but for which a fair value is provided in the table above.

There were no transfers of assets or liabilities between levels of the fair value hierarchy during the year.

### Financial liabilities designated as fair value through profit or loss

Cumulative changes in the fair value of the non-current portion of bank and other borrowings arising from changes in credit risk are as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Fair value at 1 January | **10.0** | 11.2 |
| Credit to income statement | **(3.0)** | (1.2) |
| **Fair value at 31 December** | **7.0** | 10.0 |

The difference between the fair value and contractual amount at maturity of the non-current portion of bank and other borrowings is as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Fair value | **256.8** | 274.9 |
| Difference between fair value and contractual amount at maturity | **(15.3)** | (28.8) |
| **Contractual amount payable at maturity** | **241.5** | 246.1 |

### Financial liabilities classified as level 3 in the hierarchy

Changes in fair value are as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Bank and other borrowings at fair value through profit or loss: | | |
| At 1 January | **274.9** | 283.6 |
| Exchange rate adjustments | **(4.4)** | (12.5) |
| (Gain)/loss recognised in net operating costs | **(13.7)** | 3.8 |
| **At 31 December** | **256.8** | 274.9 |

The largest movement in credit spread  seen in a six month period since inception of the borrowings is 75 basis points. A 75 basis point movement in the credit spread used as an input in determining the fair value at 31 December 2013, would impact profit before tax by approximately £10.0 million.

# Notes to the consolidated financial statements continued

## 30. Derivative financial instruments

**As at 31 December 2013:**

| | Contract or underlying principal amount | | Fair value | |
|---|---|---|---|---|
| | Assets £'m | Liabilities £'m | Assets £'m | Liabilities £'m |
| Interest rate swaps – cash flow hedges | 96.6 | – | 2.1 | – |
| Interest rate swaps – fair value hedges | 241.5 | – | 22.8 | – |
| Foreign currency forward contracts – not hedge accounted | 344.5 | (12.4) | 21.8 | (0.8) |
| **Total** | **682.6** | **(12.4)** | **46.7** | **(0.8)** |
| Less non-current portion: | | | | |
| Interest rate swaps – cash flow hedges | 96.6 | – | 2.1 | – |
| Interest rate swaps – fair value hedges | 241.5 | – | 22.8 | – |
| Foreign currency forward contracts – not hedge accounted | 170.6 | (1.6) | 10.6 | (0.1) |
| **Non-current portion** | **508.7** | **(1.6)** | **35.5** | **(0.1)** |
| **Current portion** | **173.9** | **(10.8)** | **11.2** | **(0.7)** |

**As at 31 December 2012:**

| | Contract or underlying principal amount | | Fair value | |
|---|---|---|---|---|
| | Assets £'m | Liabilities £'m | Assets £'m | Liabilities £'m |
| Interest rate swaps – fair value hedges | 246.1 | – | 43.1 | – |
| Interest rate swaps – not hedge accounted | – | (98.4) | – | (0.2) |
| Cross currency swaps – net investment hedges | – | (68.1) | – | (1.3) |
| Foreign currency forward contracts – not hedge accounted | 233.9 | (54.8) | 11.7 | (2.7) |
| Total | 480.0 | (221.3) | 54.8 | (4.2) |
| Less non-current portion: | | | | |
| Interest rate swaps – fair value hedges | 246.1 | – | 43.1 | – |
| Interest rate swaps – not hedge accounted | – | (98.4) | – | (0.2) |
| Foreign currency forward contracts – not hedge accounted | 111.5 | (3.2) | 6.7 | – |
| Non-current portion | 357.6 | (101.6) | 49.8 | (0.2) |
| Current portion | 122.4 | (119.7) | 5.0 | (4.0) |

### Interest rate swaps

The total notional principal amount of outstanding interest rate swap contracts at 31 December 2013 is £338.1 million (2012: £344.5 million), of which £60.4 million will expire in 2017, £96.6 million will expire in 2018, £105.6 million will expire in 2020 and £75.5 million will expire in 2022. The contracts are all denominated in USD. Of the notional principal amount outstanding, £96.6 million (2012: £98.4 million) has the economic effect of converting floating rate US dollar borrowings into fixed rate US dollar borrowings and £241.5 million (2012: £246.1 million) has the economic effect of converting fixed rate US dollar borrowings into floating rate US dollar borrowings. To the extent they meet the criteria for hedge accounting, the floating rate to fixed rate swap contracts are accounted for as cash flow hedges and the fixed rate to floating rate swap contracts as fair value hedges.

### Cross currency swaps

At 31 December 2012, the Group had entered into cross currency swaps which were used to synthetically convert US dollar denominated borrowings into Euro denominated borrowings to hedge against Euro denominated assets of overseas subsidiaries. The swaps were accounted for as net investment hedges. The swaps expired during 2013.

### Foreign currency forward contracts

Although the Group uses foreign currency forward contracts to hedge against foreign currency exposures, it has decided that the costs of meeting the extensive documentation requirements to be able to apply hedge accounting under IAS 39 'Financial Instruments: Recognition and Measurement' are not merited.

| | **2013 Assets £'m** | **2013 Liabilities £'m** | 2012 Assets £'m | 2012 Liabilities £'m |
|---|---|---|---|---|
| Fair value: | | | | |
| US dollar forward sales (USD/£) | **17.4** | **–** | 9.2 | (2.5) |
| Forward sales denominated in other currencies | **4.4** | **(0.8)** | 2.5 | (0.2) |
| **Total** | **21.8** | **(0.8)** | 11.7 | (2.7) |

## 30. Derivative financial instruments continued

### Credit quality of derivative financial assets

The credit quality of derivative financial assets is as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| S&P/Moody's rating: | | |
| AA | **7.2** | 7.7 |
| A | **33.8** | 37.2 |
| BBB | **5.7** | 9.9 |
| **Total** | **46.7** | 54.8 |

## 31. Provisions

| | Environmental legal & regulatory (a) £'m | Onerous contracts (b) £'m | Warranty costs (c) £'m | Total £'m |
|---|---|---|---|---|
| **At 1 January 2013** | 163.7 | 41.1 | 18.5 | 223.3 |
| Exchange rate adjustments | (2.1) | 0.4 | 0.1 | (1.6) |
| Business acquired (see note 42) | 0.3 | – | 0.1 | 0.4 |
| Businesses disposed (see note 43) | – | (0.1) | (0.3) | (0.4) |
| Additional provision in year – cost of sales | – | 21.7 | 5.7 | 27.4 |
| Additional provision in year – net operating costs | 10.5 | – | – | 10.5 |
| Unused amounts reversed – cost of sales | (1.7) | (16.6) | (5.2) | (23.5) |
| Unused amounts reversed – net operating costs | (15.9) | (0.1) | – | (16.0) |
| Utilised | (14.1) | (6.2) | (6.3) | (26.6) |
| **At 31 December 2013** | **140.7** | **40.2** | **12.6** | **193.5** |

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Current | **44.3** | 44.8 |
| Non-current | **149.2** | 178.5 |
| **At 31 December 2013** | **193.5** | 223.3 |

a) Provision has been made for known exposures arising from environmental remediation, health and safety liabilities, product liability matters, legal proceedings and contractual disputes in a number of businesses. The Group's operations and facilities are subject to laws and regulations that govern the discharge of pollutants and hazardous substances into the ground, air and water as well as the handling, storage and disposal of such materials and other environmental matters. Failure to comply with its obligations potentially exposes the Group to serious consequences, including fines, other sanctions and limitations on operations. The Group is involved in the investigation and remediation of current and former sites for which it has been identified as a potentially responsible party under US law. Provision has been made for the expected costs arising from these sites based on information currently available. A receivable has been established to the extent these costs are recoverable under the Group's environmental insurance policies or from other parties (see note 23). A number of asbestos-related claims have been made against subsidiary companies of the Group. To date, the amount connected with such claims in any year has not been material and many claims are covered fully or partly by existing insurance and indemnities. There is a provision for claims which cannot be recovered from insurers. During the year, an administrative settlement was reached with the US Government following its investigation of alleged violations of US export control laws by certain subsidiaries of the Group. Under the terms of the 30-month consent agreement, Meggitt-USA, Inc. was assessed a civil penalty of USD 25 million, of which USD 22 million was suspended on condition the Government approves certain past or future remedial costs incurred or to be incurred by the Group's US subsidiaries. In addition, the Group will be required to implement additional future compliance measures. No provision is held for the suspended penalty as it is not considered probable that such amounts will be payable. The provisions are expected to be substantially utilised over the next ten years and are discounted, where appropriate, using a discount rate appropriate to each provision.

b) Onerous contracts include lease obligations and trading contracts. Provision has been made for the estimated rental shortfall in respect of properties with onerous lease obligations. These will be utilised over the lease terms typically up to five years and are discounted, where appropriate, using a discount rate appropriate to each provision. Provision has also been made for estimated losses under certain trading contracts. As described in note 11, during 2013 the Group has been made aware of an issue relating to the supply from a vendor of non-conforming raw material in one of our businesses. Provision has been made for the estimated future costs associated with this matter, which include the provision of a number of free of charge replacement parts to customers over a period of several years. There are a number of uncertainties regarding the ultimate amounts that will be payable, including the extent to which replacement parts will be required. However, the directors believe, based on the information currently available, that the ultimate outcome will not be significantly different from that recognised. During 2013, the Group made significant progress in resolving a small number of other contractual matters and accordingly was able to reduce, or release, provisions previously created in respect of these matters. Onerous trading contract provisions are expected to be substantially utilised over the next ten years and are discounted, where appropriate, using a discount rate appropriate to each provision.

c) Provision has been made for product warranty claims. These provisions are expected to be utilised over the next three years.

# Notes to the consolidated financial statements continued

## 32. Deferred tax

Movements in deferred tax assets and liabilities during the year, without taking into consideration the offsetting of balances, are as follows:

| Deferred tax assets | Retirement benefit obligations £'m | Other £'m | Total £'m |
|---|---|---|---|
| **At 1 January 2012** | 101.7 | 19.1 | 120.8 |
| Exchange rate adjustments | (2.8) | (0.3) | (3.1) |
| Reclassifications | – | 11.9 | 11.9 |
| Charge to income statement (Restated) (see note 14) | (2.3) | (7.8) | (10.1) |
| Charge/(credit) to other comprehensive income (Restated) (see note 14) | (2.3) | 1.2 | (1.1) |
| Charge to equity (see note 14) | – | (3.1) | (3.1) |
| **At 31 December 2012** | 94.3 | 21.0 | 115.3 |
| Exchange rate adjustments | (0.1) | 0.1 | – |
| Business acquired (see note 42) | – | (0.1) | (0.1) |
| Businesses disposed (see note 43) | – | 4.6 | 4.6 |
| Reclassifications | – | 0.6 | 0.6 |
| Charge to income statement (see note 14) | (4.5) | (13.4) | (17.9) |
| Charge to other comprehensive income (see note 14) | (21.6) | (0.1) | (21.7) |
| Credit to equity (see note 14) | – | 3.3 | 3.3 |
| **At 31 December 2013** | **68.1** | **16.0** | **84.1** |

| Deferred tax liabilities | Accelerated tax depreciation £'m | Intangible assets (*) £'m | Total £'m |
|---|---|---|---|
| **At 1 January 2012** | (18.8) | (306.3) | (325.1) |
| Exchange rate adjustments | 0.6 | 11.4 | 12.0 |
| Business acquired | – | (0.8) | (0.8) |
| Credit to income statement (see note 14) | 1.7 | 7.5 | 9.2 |
| Credit to other comprehensive income (see note 14) | – | 0.1 | 0.1 |
| **At 31 December 2012** | (16.5) | (288.1) | (304.6) |
| Exchange rate adjustments | 0.3 | 4.0 | 4.3 |
| Businesses disposed (see note 43) | – | (6.0) | (6.0) |
| Reclassifications | (0.3) | – | (0.3) |
| (Charge)/credit to income statement (see note 14) | (2.8) | 15.1 | 12.3 |
| **At 31 December 2013** | **(19.3)** | **(275.0)** | **(294.3)** |

* Acquired in business combinations.

Deferred tax assets and liabilities are offset where there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same tax authority. During 2013, the Group reassessed the extent to which deferred tax assets could be offset against deferred tax liabilities and determined that an element of the gross deferred tax asset relating to retirement benefit obligations met the criteria for offset. Accordingly this offset has been reflected in the balance sheet at 31 December 2013. The Group has not restated the balance sheet at 31 December 2012, as the adjustment would not have had a significant impact on total assets and would have had no impact on net assets, income for the year or other comprehensive income for the year. The balances after allowing for such offsets are as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Deferred tax assets | **9.1** | 100.2 |
| Deferred tax liabilities | **(219.3)** | (289.5) |
| **Net balance at 31 December** | **(210.2)** | (189.3) |

Deferred tax assets are analysed as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| To be recovered within one year | **0.2** | 1.5 |
| To be recovered after more than one year | **8.9** | 98.7 |
| **Total** | **9.1** | 100.2 |

Deferred tax liabilities are analysed as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Falling due within one year | **(0.3)** | (0.1) |
| Falling due after more than one year | **(219.0)** | (289.4) |
| **Total** | **(219.3)** | (289.5) |

## 32. Deferred tax continued

The Group has unrecognised deferred tax assets of £8.9 million (2012: £10.0 million), the majority of which relates to capital losses in the UK. Deferred tax assets have not been recognised in respect of these items, as it is not regarded as more likely than not that they will be recovered. Deferred tax assets not recognised would be recoverable in the event that they reverse and suitable taxable profits are available. There are no unremitted earnings in foreign subsidiaries that would give rise to a tax liability in the event of those subsidiaries remitting their earnings.

## 33. Retirement benefit obligations

### Pension schemes

The Group operates a number of pension schemes for the benefit of its employees. The nature of each scheme which has a significant impact on the financial statements is as follows:

- In the UK, the Group operates a funded defined benefit scheme which is closed to new members but open to future accrual for existing members;
- In the US, the Group operates five defined benefit schemes, all of which are closed to new members. With two exceptions, these schemes are open to future accrual for existing members. The schemes are a mixture of funded and unfunded schemes; and
- In Switzerland, the Group operates a funded defined benefit scheme which is open to new members and to future accrual.

The UK and US schemes provide benefits to members in the form of a guaranteed level of pension payable for life. The benefits provided depend on a member's length of service. For the majority of schemes, the benefits are dependent on salary at retirement or average salary over employment in the final years leading up to retirement. In the US, one scheme provides a fixed benefit for each year of service. The Swiss scheme has many of the characteristics of a defined contribution scheme but provides for certain minimum benefits to be guaranteed to members.

For all funded schemes, benefit payments are made from funds administered by third parties unrelated to the Group. The assets of such schemes are held in trust funds, or their equivalent, separate from the Group's finances. Scheme assets held in trusts, or their equivalent, are governed by local regulations and practice in each country, as is the nature of the relationship between the Group and the trustees (or equivalent) and their composition. For all unfunded schemes, benefit payments are made by the Group as the obligations fall due.

The Group also operates a number of defined contribution schemes under which the Group has no further obligations once the contributions have been paid.

### Healthcare schemes

The Group has two principal other post-retirement benefit schemes providing medical and life assurance benefits to certain employees, and former employees, of Meggitt Aircraft Braking Systems Corporation and Meggitt (Rockmart), Inc. These schemes are unfunded.

### Amounts recognised in the income statement

| | 2013 £'m | 2012 Restated £'m |
|---|---|---|
| Total charge in respect of defined contribution pension schemes | **19.2** | 18.3 |
| Defined benefit pension schemes: | | |
| Service cost | **12.7** | 12.3 |
| Past service cost | **0.7** | – |
| Net interest expense on retirement benefit obligations | **9.5** | 11.5 |
| Total charge in respect of defined benefit pension schemes | **22.9** | 23.8 |
| Healthcare schemes: | | |
| Service cost | **1.5** | 1.0 |
| Net interest expense on retirement benefit obligations | **2.0** | 2.5 |
| Total charge in respect of healthcare schemes | **3.5** | 3.5 |
| **Total charge** | **45.6** | 45.6 |

Of the total charge, £34.1 million (2012: £31.6 million) has been charged to operating profit (see note 9), of which £18.9 million (2012: £18.1 million) has been included in cost of sales and £15.2 million (2012: £13.5 million) in net operating costs. The remaining £11.5 million (2012: £14.0 million as restated) is included in finance costs (see note 13).

# Notes to the consolidated financial statements continued

## 33. Retirement benefit obligations continued

### Amounts recognised in the balance sheet

| | 2013 | | | |
|---|---|---|---|---|
| | UK pension scheme £'m | Overseas pension schemes £'m | Overseas healthcare schemes £'m | Total £'m |
| Fair value of scheme assets | **449.9** | **238.5** | **–** | **688.4** |
| Present value of scheme liabilities | **(573.4)** | **(304.8)** | **(48.3)** | **(926.5)** |
| **Retirement benefit obligations** | **(123.5)** | **(66.3)** | **(48.3)** | **(238.1)** |

| | 2012 | | | |
|---|---|---|---|---|
| | UK pension scheme £'m | Overseas pension schemes £'m | Overseas healthcare schemes £'m | Total £'m |
| Fair value of scheme assets | 412.8 | 221.9 | – | 634.7 |
| Present value of scheme liabilities | (546.4) | (329.5) | (58.5) | (934.4) |
| Retirement benefit obligations | (133.6) | (107.6) | (58.5) | (299.7) |

Of the total deficit of £238.1 million (2012: £299.7 million), £61.0 million (2012: £72.5 million) is in respect of unfunded schemes.

### Analysis of pension scheme assets

| | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | Quoted £'m | Unquoted £'m | Total £'m | % | Quoted £'m | Unquoted £'m | Total £'m | % |
| Equities | **199.4** | **0.4** | **199.8** | **44.4** | 124.1 | 0.6 | 124.7 | 30.2 |
| Government bonds | **132.7** | **1.9** | **134.6** | **29.9** | 124.2 | 7.0 | 131.2 | 31.8 |
| Corporate bonds | **42.7** | **26.4** | **69.1** | **15.4** | 55.2 | 38.4 | 93.6 | 22.7 |
| Cash | **22.3** | **–** | **22.3** | **5.0** | 24.9 | – | 24.9 | 6.0 |
| Other assets | **14.6** | **9.5** | **24.1** | **5.3** | 23.7 | 14.7 | 38.4 | 9.3 |
| UK pension scheme | **411.7** | **38.2** | **449.9** | **100.0** | 352.1 | 60.7 | 412.8 | 100.0 |
| Equities | **112.6** | **–** | **112.6** | **47.2** | 110.7 | – | 110.7 | 49.9 |
| Government bonds | **22.8** | **–** | **22.8** | **9.6** | 33.8 | – | 33.8 | 15.2 |
| Corporate bonds | **65.9** | **–** | **65.9** | **27.6** | 50.1 | – | 50.1 | 22.6 |
| Cash | **10.6** | **–** | **10.6** | **4.4** | 4.5 | – | 4.5 | 2.0 |
| Property | **9.9** | **11.5** | **21.4** | **9.0** | 9.4 | 9.9 | 19.3 | 8.7 |
| Other assets | **5.2** | **–** | **5.2** | **2.2** | 3.5 | – | 3.5 | 1.6 |
| Overseas pension schemes | **227.0** | **11.5** | **238.5** | **100.0** | 212.0 | 9.9 | 221.9 | 100.0 |
| Equities | **312.0** | **0.4** | **312.4** | **45.4** | 234.8 | 0.6 | 235.4 | 37.1 |
| Government bonds | **155.5** | **1.9** | **157.4** | **22.8** | 158.0 | 7.0 | 165.0 | 26.0 |
| Corporate bonds | **108.6** | **26.4** | **135.0** | **19.6** | 105.3 | 38.4 | 143.7 | 22.7 |
| Cash | **32.9** | **–** | **32.9** | **4.8** | 29.4 | – | 29.4 | 4.6 |
| Property | **9.9** | **11.5** | **21.4** | **3.1** | 9.4 | 9.9 | 19.3 | 3.0 |
| Other assets | **19.8** | **9.5** | **29.3** | **4.3** | 27.2 | 14.7 | 41.9 | 6.6 |
| **Total pension schemes' assets** | **638.7** | **49.7** | **688.4** | **100.0** | 564.1 | 70.6 | 634.7 | 100.0 |

Other assets include hedge funds, commodities and derivatives. The schemes have no investments in any assets of the Group.

## 33. Retirement benefit obligations continued

### Changes in the fair value of scheme assets

| | 2013 £'m | 2012 Restated £'m |
|---|---|---|
| At 1 January | **634.7** | 584.9 |
| Exchange rate adjustments | **(3.1)** | (8.4) |
| Interest income | **24.9** | 24.7 |
| Contributions – Group | **41.6** | 38.3 |
| Contributions – Members | **3.6** | 3.6 |
| Benefits paid | **(37.5)** | (35.1) |
| Remeasurement gain: Return on schemes' assets excluding amounts included in interest income | **25.5** | 28.9 |
| Administrative expenses borne directly by the schemes * | **(1.3)** | (2.2) |
| **At 31 December** | **688.4** | 634.7 |

* In 2013, certain administrative expenses previously paid by the schemes are now being paid directly by the Group. All administrative expenses, whether paid directly by the Group or borne by the schemes, are charged to net operating costs.

### Financial assumptions used to calculate scheme liabilities

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | UK pension scheme | Overseas pension schemes | Overseas healthcare schemes | UK pension scheme | Overseas pension schemes | Overseas healthcare schemes |
| Discount rate | **4.60%** | **4.55%** | **4.55%** | 4.50% | 3.80% | 3.80% |
| Inflation rate | **3.40%** | **N/A** | **N/A** | 3.00% | N/A | N/A |
| Increases to deferred benefits during deferment* | **2.60%** | **N/A** | **N/A** | 2.50% | N/A | N/A |
| Increases to pensions in payment* | **3.30%** | **N/A** | **N/A** | 3.00% | N/A | N/A |
| Salary increases | **4.40%** | **4.76%** | **N/A** | 4.00% | 4.00% | N/A |

* To the extent not overridden by specific scheme rules.

In determining the fair value of scheme liabilities, the Group uses mortality assumptions which are based on published mortality tables adjusted to reflect the characteristics of the scheme populations. The Group's mortality assumptions in the UK are based on recent mortality investigations of Self Administered Pension Schemes adjusted to reflect the profile of the membership of the Plan, which include the results of a postcode analysis of members used to support the 2012 triennial UK actuarial valuation. Allowance has been made for rates of mortality to continue to fall at the rate of 1.25% per annum. In the US, mortality assumptions are based on the RP2000 IRS RPA tables.

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | UK scheme Years | Overseas schemes Years | UK scheme Years | Overseas schemes Years |
| Member age 45 (life expectancy at age 65) – male | **23.5-25.2** | **19.3** | 23.4-25.1 | 19.2 |
| Member age 45 (life expectancy at age 65) – female | **26.3-27.9** | **21.1** | 26.2-27.9 | 21.0 |
| Member age 65 (current life expectancy) – male | **21.8-23.6** | **19.3** | 21.7-23.5 | 19.2 |
| Member age 65 (current life expectancy) – female | **24.3-26.0** | **21.1** | 24.2-25.9 | 21.0 |

Details on the sensitivity of scheme liabilities to changes in assumptions are provided below:

- The impact of a 10 basis point reduction in discount rate would cause scheme liabilities at 31 December 2013 to increase by approximately £14.4 million;
- The impact of a 10 basis point increase in inflation and salary inflation rates would cause scheme liabilities at 31 December 2013 to increase by approximately £10.7 million;
- The impact of assuming every scheme member were to live for an additional year would cause scheme liabilities at 31 December 2013 to increase by approximately £22.7 million.

The above sensitivity analyses are based on a change in an assumption while keeping all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions, the same method of calculating the defined benefit obligation has been used as when calculating the retirement benefit obligations recognised in the balance sheet. The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous year.

In the US, regulatory bodies are currently consulting on a new set of mortality tables which reflect recently observed longevity experience. New mortality tables are expected to be finalised in the next two years and will, once adopted, likely provide for increased longevity and accordingly higher retirement benefit scheme liabilities for most US schemes. It is not yet possible to quantify the impact any changes may have on our schemes' retirement benefit liabilities.

# Notes to the consolidated financial statements continued

## 33. Retirement benefit obligations continued

### Changes in the present value of retirement benefit obligations

| | 2013 £'m | 2012 Restated £'m |
|---|---|---|
| At 1 January | **299.7** | 319.9 |
| Exchange rate adjustments | **(0.9)** | (7.4) |
| Service cost | **14.2** | 13.3 |
| Past service cost | **0.7** | – |
| Net interest expense on retirement benefit obligations (see note 13) | **11.5** | 14.0 |
| Contributions – Group | **(41.6)** | (38.3) |
| Remeasurement of retirement benefit obligations: | | |
| Gain from change in demographic assumptions | **(6.9)** | (6.2) |
| (Gain)/loss from change in financial assumptions | **(14.4)** | 31.1 |
| Return on schemes' assets excluding amounts included in interest income | **(25.5)** | (28.9) |
| Total remeasurement gain | **(46.8)** | (4.0) |
| Administrative expenses borne directly by the schemes | **1.3** | 2.2 |
| **At 31 December** | **238.1** | 299.7 |

### Risks

The Group is exposed to a number of risks arising from operating its defined benefit pension and healthcare schemes, the most significant of which are detailed below:

**Asset volatility**
In determining the present value of schemes' defined benefit obligations, liabilities are discounted using interest rates of high quality corporate bonds. To the extent the actual return on schemes' assets is below this yield, the retirement benefit obligations recognised in the consolidated financial statements would increase. This risk is partly mitigated by funded schemes investing in matching corporate bonds, such that changes in asset values are offset by similar changes in the value of scheme liabilities. However, the Group also invests in other asset types such as equities, property, commodities, derivatives and hedge funds where movements in asset values may be uncorrelated to movements in the yields on high quality corporate bonds. The Group believes that, due to the long-term nature of its scheme liabilities, it is appropriate to invest in assets which are expected to out-perform corporate bonds over this timeframe. Scheme assets are well diversified, such that the failure of any single investment would not have a material impact on the overall level of assets. The Group actively monitors how the duration and expected yield of scheme assets are matching the expected cash outflows arising from the pension obligations. For each funded scheme, there is a 'glide-path' in place which provides, to the extent the funding position improves, for asset volatility to be reduced by increased investment in long-term fixed interest securities with maturities that match the benefit payments as they fall due.

**Interest rate risk**
In determining the present value of schemes' defined benefit obligations, liabilities are discounted using interest rates of high quality corporate bonds. If these yields fall, the retirement benefit obligations recognised in the consolidated financial statements would increase. This risk is partly mitigated through the funded schemes investing in matching assets as described above.

**Inflation rate risk**
In determining the present value of schemes' defined benefit obligations, estimates are made as to levels of salary inflation, inflation increases that will apply to deferred benefits during deferment and pensions in payment, and healthcare cost inflation. To the extent actual inflation exceeds these estimates, the retirement benefit obligations recognised in the consolidated financial statements would increase. Salary inflation risk is partly mitigated in both the UK and US schemes by linking benefits in respect of future service to average salaries over a period of employment rather than final salary at retirement. Benefits in respect of certain periods of past service are still linked to final salary at retirement. In the UK, inflation risk in respect of deferred benefits and pensions in payment is mitigated by caps on the levels of inflation under the scheme rules. In the US and Switzerland, the schemes provide for no inflation to be applied to benefits in deferment or retirement. Exposure to inflation on US healthcare costs has been mitigated by freezing Group contributions to medical costs at 2011 cost levels.

**Longevity risk**
In determining the present value of schemes' defined benefit obligations, assumptions are made as to the life expectancy of members during employment and in retirement. To the extent life expectancy exceeds this estimate, the retirement benefit obligations recognised in the consolidated financial statements would increase. This risk is more significant in the UK plan, where inflationary increases result in higher sensitivity to changes in life expectancy. The Group currently does not use derivatives, such as longevity swaps, to mitigate this risk.

The Group has not changed the processes used to manage defined benefit scheme risks during the year.

### Other information

In the UK, the last triennial valuation was in 2012 following which the Group agreed with the UK trustees to progressively increase deficit reduction payments, with the aim being to eliminate the deficit by 2024. In the US, deficit reduction levels are driven by regulations and provide for deficits to be eliminated over periods up to 15 years. There is no significant deficit in the Swiss scheme. The estimated Group contributions expected to be paid to the schemes during 2014 are £46.4 million.

## 33. Retirement benefit obligations continued

The weighted average duration of the schemes' defined benefit obligation is 17.1 years. The expected maturity of undiscounted pension and healthcare benefits at 31 December 2013 is as follows:

| | Less than a year £'m | Between 1-2 years £'m | Between 2-5 years £'m | Over 5 years £'m | Total £'m |
|---|---|---|---|---|---|
| Pension schemes | 32.6 | 33.4 | 104.3 | 1,631.0 | 1,801.3 |
| Healthcare schemes | 3.4 | 3.4 | 10.7 | 67.4 | 84.9 |
| **Total** | **36.0** | **36.8** | **115.0** | **1,698.4** | **1,886.2** |

## 34. Share capital and share schemes

### Issued share capital

| | Ordinary shares of 5p each Number 'm | Nominal value £'m | Net consideration £'m |
|---|---|---|---|
| Allotted and fully paid: | | | |
| At 1 January 2012 | 778.8 | 38.9 | |
| Issued on exercise of executive share awards | 2.7 | 0.2 | 0.6 |
| Issued on exercise of sharesave awards | 0.2 | – | 0.4 |
| Scrip dividends | 3.3 | 0.2 | 13.2 |
| At 31 December 2012 | 785.0 | 39.3 | |
| Issued on exercise of executive share awards | 7.2 | 0.3 | 0.5 |
| Issued on exercise of sharesave awards | 1.1 | 0.1 | 2.0 |
| Scrip dividends | 3.8 | 0.2 | 20.0 |
| **At 31 December 2013** | **797.1** | **39.9** | |

### Share Options

| Year of grant | Number of ordinary shares under award | Exercise price per share | Exercise period From | Exercise period To |
|---|---|---|---|---|
| **Meggitt 2008 Sharesave Scheme** | | | | |
| 2008 | 25,066 | 171.40p | 01.11.13 | 30.04.14 |
| 2008 | 74,311 | 171.40p | 01.11.15 | 30.04.16 |
| 2010 | 16,994 | 222.35p | 01.11.13 | 30.04.14 |
| 2010 | 451,831 | 222.35p | 01.11.15 | 30.04.16 |
| 2010 | 50,781 | 222.35p | 01.11.17 | 30.04.18 |
| 2012 | 724,303 | 326.94p | 01.11.15 | 30.04.16 |
| 2012 | 382,279 | 326.94p | 01.11.17 | 30.04.18 |
| 2013 | 511,899 | 426.40p | 01.11.16 | 30.04.17 |
| 2013 | 251,845 | 426.40p | 01.11.18 | 30.04.19 |
| **Meggitt 1996 No 1 Executive Share Option Scheme** | | | | |
| 2004 | 17,200 | 174.40p | 01.04.07 | 31.03.14 |
| **Meggitt Executive Share Option Scheme 2005 Part A** | | | | |
| 2005 | 73,289 | 278.65p | 10.10.08 | 09.10.15 |
| 2006 | 9,471 | 263.67p | 27.09.09 | 26.09.16 |
| 2007 | 8,442 | 299.00p | 29.03.10 | 28.03.17 |
| 2008 | 10,220 | 252.50p | 25.03.11 | 24.03.18 |
| 2009 | 30,531 | 169.50p | 30.04.12 | 29.04.19 |
| 2010 | 19,171 | 286.10p | 12.03.13 | 11.03.20 |
| 2011 | 134,405 | 351.70p | 02.03.14 | 01.03.21 |
| 2011 | 8,683 | 345.50p | 17.08.14 | 16.08.21 |
| 2012 | 221,239 | 397.20p | 10.04.15 | 09.04.22 |
| 2013 | 240,108 | 526.50p | 05.09.16 | 04.09.23 |
| 2013 | 5,504 | 545.00p | 09.09.16 | 08.09.23 |

All the above awards, which were granted for nil consideration, may in certain circumstances, be exercised earlier than the dates given. The weighted average remaining contractual life of outstanding awards is 4.2 years (2012: 3.6 years).

# Notes to the consolidated financial statements continued

## 34. Share capital and share schemes continued

### Share Appreciation Rights – Equity-settled

| Year of grant | Indicative number of shares to be released* | Number of ordinary shares under award | Exercise price per share | Exercise period From | Exercise period To |
|---|---|---|---|---|---|
| **Meggitt Executive Share Option Scheme 2005 Part B** | | | | | |
| 2005 | 193,672 | 410,536 | 278.65p | 10.10.08 | 09.10.15 |
| 2006 | 264,387 | 528,614 | 263.67p | 27.09.09 | 26.09.16 |
| 2007 | 233,089 | 538,093 | 299.00p | 29.03.10 | 28.03.17 |
| 2007 | 43,075 | 95,170 | 288.75p | 17.08.10 | 16.08.17 |
| 2008 | 569,335 | 1,092,088 | 252.50p | 25.03.11 | 24.03.18 |
| 2008 | 307,984 | 502,200 | 204.00p | 07.08.11 | 06.08.18 |
| 2009 | 1,164,992 | 1,716,573 | 169.50p | 30.04.12 | 29.04.19 |
| 2010 | 982,420 | 2,146,754 | 286.10p | 12.03.13 | 11.03.20 |
| 2011 | 1,325,677 | 3,977,785 | 351.70p | 02.03.14 | 01.03.21 |
| 2011 | 184,223 | 533,944 | 345.50p | 17.08.14 | 16.08.21 |
| 2012 | 1,196,324 | 4,843,140 | 397.20p | 10.04.15 | 09.04.22 |
| 2013 | 7,344 | 3,873,782 | 526.50p | 05.09.16 | 04.09.23 |
| 2013 | – | 11,679 | 545.00p | 09.09.16 | 08.09.23 |

* Based on indicative share price of 527.50p, the share price at 31 December 2013.

All the above share appreciation rights, which were granted for nil consideration, may in certain circumstances, be exercised earlier than the dates given. The weighted average remaining contractual life of outstanding awards is 7.1 years (2012: 6.9 years). During the year, a number of cash-settled share appreciation rights were converted into equity-settled share appreciation rights (see note 35).

## 35. Share-based payment

The Group operates a number of share schemes for the benefit of its employees. The total expense recorded in the income statement in respect of such schemes was £11.9 million (2012: £12.3 million) (see note 9). The nature of each scheme which has a significant impact on the expense recorded in the income statement is set out below.

### Meggitt 1996 Executive Share Option Scheme and Meggitt Executive Share Option Scheme 2005

**Equity-settled**

Share awards are granted to certain senior executives at an award price equal to the market price of the shares on the day before the grant is made. The awards are generally exercisable at the earliest three years after the grant is made. Awards can only be exercised if the Group meets an earnings per share performance condition. The Group has no obligation, legal or constructive, to settle the awards in cash. Awards under Part A of the schemes provide for the executive on exercise to be entitled, on payment of the award price, to the number of shares under award. Awards under Part B of the schemes are in the form of equity-settled share appreciation rights (SAR's) and provide for the executive on exercise to be entitled to receive equity equivalent to the gain in value between the award price and the market price on the date of exercise.

During the year, 3.4 million awards (2012: Nil) previously issued as cash-settled, were modified to equity-settled. Of these awards, 0.6 million had not fully vested and were remeasured to fair value at the date they were modified. The fair value derived, is being expensed to the income statement over the remaining vesting period.

An expense of £2.5 million (2012: £3.1 million) was recorded in the year in respect of all equity-settled awards. Movements in the number of outstanding awards and their related weighted average award prices are as follows:

| | 2013 Average award price Pence | 2013 Number of awards outstanding 'm | 2012 Average award price Pence | 2012 Number of awards outstanding 'm |
|---|---|---|---|---|
| At 1 January | **304.35** | **24.5** | 270.11 | 21.5 |
| Granted | **526.58** | **4.1** | 397.20 | 5.5 |
| Lapsed | **365.26** | **(0.5)** | 340.77 | (0.2) |
| Modified from cash-settled | **262.04** | **3.4** | N/A | - |
| Exercised | **262.42** | **(10.4)** | 203.50 | (2.3) |
| **At 31 December** | **360.49** | **21.1** | 304.35 | 24.5 |

## 35. Share-based payment continued

At 31 December 2013, of the total number of awards outstanding, 7.2 million are exercisable at an average exercise price of 245.50 pence (2012: 9.9 million at an average exercise price of 239.54 pence). The fair values of the awards made in the year were determined using the Black-Scholes option pricing model. The significant assumptions used in the model and the fair values determined were:

| | **2013 Award in September** | **2013 Modification in April** | 2012 Award in April |
|---|---|---|---|
| Share price at date of grant/modification (pence) | **526.50** | **468.60** | 397.20 |
| Award price (pence) | **526.50** | **351.70** | 397.20 |
| Vesting period (years) | **3.0** | **1.0** | 3.0 |
| Expected volatility | **35%** | **27%** | 38% |
| Expected life of award (years) | **5.0** | **3.0** | 5.0 |
| Risk free rate | **1.56%** | **0.73%** | 1.07% |
| Expected dividend yield | **3.24%** | **2.65%** | 3.31% |
| Fair value at date of award (pence) | **121.37** | **120.54** | 98.25 |

Expected volatility figures are based on volatility over the last five years measured using a statistical analysis of daily share prices. Awards may be exercised at any point between the vesting date and ten years after the date the award was made.

**Cash-settled**

Under the terms of the Meggitt Executive Share Option Scheme 2005, the Group may grant cash-settled SAR's to certain overseas employees. The Group is required to pay the intrinsic value of the SAR's to the employee at the date of exercise. Awards can only be exercised if the Group meets an earnings per share performance condition.

As referred to above, during the year 3.4 million awards (2012: Nil) were modified from cash-settled to equity-settled. These awards were remeasured to fair value immediately prior to the date of modification and a corresponding expense recorded in the income statement. The liability of £5.9 million was then reclassified to equity on the date the awards were modified.

An expense of £3.1 million (2012: £2.5 million) was recorded in the year in respect of all cash-settled awards. The Group has recorded a liability at the balance sheet date of £0.7 million (2012: £4.9 million). The total intrinsic value at the balance sheet date was £0.9 million (2012: £5.5 million. Movements in the number of outstanding awards and their related weighted average award prices are as follows:

| | **2013 Average award price Pence** | **2013 Number of awards outstanding 'm** | 2012 Average award price Pence | 2012 Number of awards outstanding 'm |
|---|---|---|---|---|
| At 1 January | **267.74** | **4.8** | 252.59 | 6.8 |
| Granted | **526.50** | **0.1** | 397.20 | 0.2 |
| Lapsed | **385.07** | **(0.1)** | 340.43 | (0.1) |
| Modified to equity-settled | **262.04** | **(3.4)** | N/A | - |
| Exercised | **242.59** | **(0.8)** | 232.00 | (2.1) |
| **At 31 December** | **354.05** | **0.6** | 267.74 | 4.8 |

At 31 December 2013, of the total number of awards outstanding, 0.2 million are exercisable at an average exercise price of 205.24 pence (2012: 3.2 million at an average exercise price of 235.26 pence). The fair value of the awards made in the year were determined, at the grant date, using the Black-Scholes option pricing model and reflect the same assumptions used for equity-settled awards as disclosed above. As a cash-settled award, the fair value of outstanding awards is remeasured at each balance sheet date.

### Meggitt Equity Participation Plan 2005

Under the Meggitt Equity Participation Plan 2005, an annual award of shares may be made to certain senior executives. For awards made in 2013 and 2012, the number of shares, if any that an executive ultimately receives, depends on three performance conditions:

- An earnings per share (EPS) measure (50% of the award);
- A cash flow measure (25% of the award); and
- Total Shareholder Return (TSR) achieved by the Group as measured against a comparator group selected by the Remuneration Committee (25% of the award).

Each of the conditions is measured over a three year performance period. For awards made in 2009 and 2010, 50% of the award was based on an EPS measure and 50% on a TSR condition. An expense of £5.4 million (2012: £5.9 million) was recorded in the year. Movements in the number of outstanding shares that may potentially be released to employees are as follows:

| | **2013 Number of shares under award outstanding 'm** | 2012 Number of shares under award outstanding 'm |
|---|---|---|
| At 1 January | **7.8** | 8.3 |
| Awarded | **2.1** | 2.4 |
| Lapsed | **(0.6)** | (1.3) |
| Released to employees | **(1.6)** | (1.6) |
| **At 31 December** | **7.7** | 7.8 |

# Notes to the consolidated financial statements continued

## 35. Share-based payment continued

At 31 December 2013, 1.5 million of the shares under award are eligible for release (2012: 1.1 million).

The fair value of the awards made in 2013, subject to the EPS and cash flow performance conditions, was 478.00 pence (2012: 392.97 pence). The fair value of the awards made in 2013, which were subject to the TSR performance condition, was determined using a Monte Carlo model. The significant assumptions used in the model and the fair values determined, in respect of the principal awards made in the year, were:

| | **2013 Award in March** | 2012 Award in August |
|---|---|---|
| Share price at date of grant (pence) | **478.00** | 392.97 |
| Vesting period (years) | **3.0** | 3.0 |
| Expected volatility | **26%** | 29% |
| Expected life of award (years) | **3.0** | 3.0 |
| Risk free rate | **0.26%** | 0.26% |
| Fair value at date of award (pence) | **248.00** | 240.00 |

## 36. Own shares

Own shares represents shares in the Company that are held by an independently managed Employee Share Ownership Plan Trust ('the trust') formed to purchase shares to be used to meet certain of the Company's future obligations in respect of employee share schemes as described in the Directors' remuneration report on pages 47 to 67. At 31 December 2013, the trust held no ordinary shares (2012: 1,708 shares).

## 37. Contingent liabilities

The Company has given guarantees in respect of credit facilities for certain of its subsidiaries, some property leases, other leasing arrangements and the performance by some current and former subsidiaries of certain contracts. Also, there are similar guarantees given by certain other Group companies. The directors do not believe that the effect of giving these guarantees will have a material adverse effect upon the Group's financial position.

The Company and various of its subsidiaries are, from time to time, parties to legal proceedings and claims which arise in the ordinary course of business. The directors do not anticipate that the outcome of these proceedings, actions and claims, either individually or in aggregate, will have a material adverse effect upon the Group's financial position.

## 38. Contractual commitments

### Capital commitments

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| Contracted for but not incurred: | | |
| Intangible assets | **1.4** | 1.1 |
| Property, plant and equipment | **7.5** | 8.4 |
| **Total** | **8.9** | 9.5 |

### Operating lease commitments

The Group leases various factories, warehouses and offices under non-cancellable operating leases. These leases have various lease periods, escalation clauses and renewal rights. Additionally the Group leases various items of plant and machinery under both cancellable and non-cancellable operating leases. Expenditure on operating leases is charged to the income statement as incurred and is disclosed in note 7.

The future aggregate minimum lease payments under non–cancellable operating leases are as follows:

| | **2013 £'m** | 2012 £'m |
|---|---|---|
| In one year or less | **13.0** | 13.7 |
| In more than one year but not more than five years | **38.2** | 43.6 |
| In more than five years | **25.7** | 25.6 |
| **Total** | **76.9** | 82.9 |

### Other financial commitments

The Group enters into long-term arrangements with Aircraft and Original Equipment Manufacturers to design, develop and supply products to them for the life of the aircraft. This represents a significant long-term financial commitment for the Group and requires the consideration of a number of uncertainties including the feasibility of the product and the ultimate commercial viability over a period which can extend over 40 years.

The directors are satisfied that, at this time, there are no significant contingent liabilities arising from these commitments.

## 39. Cash inflow from operations

| | 2013 £'m | 2012 Restated £'m |
|---|---|---|
| Profit for the year | **232.3** | 235.5 |
| Adjustments for: | | |
| Finance income (see note 12) | **(0.3)** | (2.0) |
| Finance costs (see note 13) | **31.2** | 42.1 |
| Tax (see note 14) | **37.1** | 45.8 |
| Depreciation (see note 21) | **32.2** | 31.9 |
| Amortisation (see notes 19 and 20) | **126.4** | 122.8 |
| (Gain)/loss on disposal of property, plant and equipment | **(1.1)** | 0.3 |
| Gain on disposal of businesses (see note 11) | **(9.0)** | (3.2) |
| Financial instruments (see note 10) | **(6.1)** | (23.4) |
| Retirement benefit obligation deficit payments | **(27.4)** | (25.0) |
| Share-based payment expense (see note 35) | **11.9** | 12.3 |
| Changes in working capital: | | |
| Inventories | **(16.4)** | (30.5) |
| Trade and other receivables | **(24.6)** | 14.7 |
| Trade and other payables | **(13.1)** | 6.7 |
| Provisions | **(27.4)** | (33.9) |
| **Cash inflow from operations** | **345.7** | 394.1 |

## 40. Movements in net debt

| | 2013 £'m | 2012 £'m |
|---|---|---|
| At 1 January | **642.5** | 788.4 |
| Free cash inflow | **(110.4)** | (182.4) |
| Businesses acquired (see note 42) | **26.5** | 8.4 |
| Business acquisition expenses (see note 11) | **0.4** | 1.4 |
| Businesses disposed (see note 43) | **(53.3)** | (15.9) |
| Business disposal expenses (see note 11) | **0.5** | 0.9 |
| Dividends paid to Company's shareholders (see note 16) | **75.6** | 71.8 |
| Issue of equity share capital (see note 34) | **(2.5)** | (0.9) |
| Net cash generated – inflow | **(63.2)** | (116.7) |
| Debt acquired with businesses (see note 42) | **0.3** | 0.4 |
| Exchange rate adjustments | **(2.7)** | (33.9) |
| Other non-cash movements | **(12.3)** | 4.3 |
| **At 31 December** | **564.6** | 642.5 |

**Analysed as:**

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Bank and other borrowings – current (see note 28) | **7.2** | 127.0 |
| Bank and other borrowings – non-current (see note 28) | **666.0** | 612.3 |
| Obligations under finance leases – current (see note 27) | **2.4** | 3.1 |
| Obligations under finance leases – non-current (see note 27) | **5.1** | 5.0 |
| Cash and cash equivalents (see note 24) | **(116.1)** | (104.9) |
| **Total** | **564.6** | 642.5 |

# Notes to the consolidated financial statements continued

## 41. Major non-cash transactions

During the year, Meggitt PLC issued 3.8 million shares worth £20.0 million in respect of scrip dividends (2012: 3.3 million shares worth £13.2 million) (see notes 16 and 34).

## 42. Business combinations

On 27 August 2013, the Group acquired 100% of the voting rights of Piezotech, LLC ('Piezotech'). Piezotech's high-end performance piezo-ceramic technology for extreme temperature gas turbine sensors and its position in emerging energy and medical markets strengthen two strands of the Group's sensing business. The assets and liabilities of Piezotech at the date of acquisition, including the goodwill arising on consolidation, were as follows:

| | Fair value £'m |
|---|---|
| Goodwill (see note 18) | 9.0 |
| Other intangible assets (see note 20) | 15.8 |
| Property, plant and equipment (see note 21) | 0.7 |
| Inventories | 1.0 |
| Trade and other receivables - current | 1.4 |
| Trade and other payables - current | (0.6) |
| Obligations under finance leases - current | (0.1) |
| Provisions - current (see note 31) | (0.4) |
| Obligations under finance leases - non-current | (0.2) |
| Deferred tax liabilities (see note 32) | (0.1) |
| **Net assets** | **26.5** |
| Consideration satisfied in cash | 26.5 |
| **Total consideration payable** | **26.5** |

Goodwill arising on consolidation is based on preliminary estimates of fair values which will be finalised in 2014. Goodwill is attributable to the profitability of the acquired business and expected future synergies arising following the acquisition. Costs related to the acquisition were £0.5 million. These costs have been treated as an exceptional operating item (see note 11). The impact of the acquired business on the results of the Group for the period since acquisition is not significant and would not have been significant had it been acquired on 1 January 2013.

## 43. Business disposals

On 23 May 2013, the Group disposed of 100% of the ordinary shares of Meggitt (Addison), Inc. ('Addison') for a total consideration of £26.0 million. Addison was engaged in vapour cycle air conditioning systems providing cooling, heating and ventilation for fixed wing light aircraft. On 20 December 2013, the Group disposed of 100% of the ordinary shares of the Sunbank Family of Companies LLC ('Sunbank') for a total consideration of £28.3 million. Sunbank supplied connector accessories, backshells, and conduit systems for aerospace and industrial markets. These businesses were no longer considered core to the Group's operations. The impact of the disposals on the Group's results and cash flows for the year was not significant.

The net assets of the businesses at the dates of disposal were as follows:

| | Addison £'m | Sunbank £'m | Total £'m |
|---|---|---|---|
| Goodwill (see note 18) | 8.0 | 18.5 | 26.5 |
| Other intangible assets (see note 20) | 5.6 | 5.6 | 11.2 |
| Property, plant and equipment (see note 21) | 0.3 | 3.8 | 4.1 |
| Deferred tax assets (see note 32) | - | 2.3 | 2.3 |
| Inventories | 2.0 | 4.3 | 6.3 |
| Trade and other receivables - current | 2.2 | 3.1 | 5.3 |
| Cash and cash equivalents | 0.2 | 1.2 | 1.4 |
| Trade and other payables - current | (1.2) | (4.0) | (5.2) |
| Provisions - current (see note 31) | (0.1) | (0.3) | (0.4) |
| Deferred tax liabilities (see note 32) | (0.9) | - | (0.9) |
| **Net assets** | **16.1** | **34.5** | **50.6** |
| Currency translation gain transferred from equity | (5.0) | (0.3) | (5.3) |
| Gain/(loss) on disposal (see note 11) | 14.9 | (5.9) | 9.0 |
| **Total consideration** | **26.0** | **28.3** | **54.3** |
| Satisfied by: | | | |
| Proceeds received from disposal of businesses | 26.4 | 28.3 | 54.7 |
| Business disposal expenses paid (see note 11) | (0.3) | (0.2) | (0.5) |
| Trade and other receivables - contingent consideration | - | 0.8 | 0.8 |
| Trade and other payables - other | (0.1) | (0.6) | (0.7) |
| **Total consideration** | **26.0** | **28.3** | **54.3** |
| Net cash inflow arising on disposal: | | | |
| Proceeds received from disposal of businesses | 26.4 | 28.3 | 54.7 |
| Less: cash and cash equivalents disposed of | (0.2) | (1.2) | (1.4) |
| Businesses disposed | 26.2 | 27.1 | 53.3 |
| Less business disposal expenses paid | (0.3) | (0.2) | (0.5) |
| **Total cash inflow** | **25.9** | **26.9** | **52.8** |

# Notes to the consolidated financial statements continued

## 44. Restatement of prior year comparatives

IAS 19 (Revised 2011), 'Employee benefits' makes changes to the recognition and measurement of certain items of defined benefit pension expense. Scheme administration expenses borne directly by defined benefit schemes are now recorded within net operating costs and not, as previously accounted for, as a reduction in the expected return on scheme assets. The expected return on scheme assets is now calculated using the same rate used to discount scheme liabilities and no longer includes any allowance for equity-like out-performance or deduction for scheme administration expenses. The adverse impact on net operating costs and net finance costs of these changes is offset by an equal reduction in remeasurement losses. As the Group has always recognised remeasurement gains and losses immediately there has been no impact on the value at which retirement benefit obligations are recorded in the balance sheet. As the revised net pension finance cost calculated under IAS 19 (Revised 2011), 'Employee benefits' is a non-cash, non-trading item, the Board has in 2013, as previously announced, excluded it from the underlying profit measures (as defined in note 10) it uses to monitor and measure the underlying performance of the Group. The prior year comparatives have been restated accordingly.

The impact of these changes is set out below:

| | **2013** | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Under prior year policy £'m** | **Change in policy £'m** | **As reported £'m** | Under prior year policy £'m | Change in policy £'m | As restated £'m |
| Revenue | **1,637.3** | **–** | **1,637.3** | 1,605.8 | – | 1,605.8 |
| Cost of sales | **(981.1)** | **–** | **(981.1)** | (929.1) | – | (929.1) |
| **Gross profit** | **656.2** | **–** | **656.2** | 676.7 | – | 676.7 |
| Net operating costs | **(354.2)** | **(1.7)** | **(355.9)** | (353.1) | (2.2) | (355.3) |
| **Operating profit** | **302.0** | **(1.7)** | **300.3** | 323.6 | (2.2) | 321.4 |
| Finance income | **33.2** | **(32.9)** | **0.3** | 35.4 | (33.4) | 2.0 |
| Finance costs | **(56.1)** | **24.9** | **(31.2)** | (66.9) | 24.8 | (42.1) |
| Net finance costs | **(22.9)** | **(8.0)** | **(30.9)** | (31.5) | (8.6) | (40.1) |
| **Profit before tax** | **279.1** | **(9.7)** | **269.4** | 292.1 | (10.8) | 281.3 |
| Tax | **(39.7)** | **2.6** | **(37.1)** | (48.8) | 3.0 | (45.8) |
| **Profit for the year attributable to equity owners of the Company** | **239.4** | **(7.1)** | **232.3** | 243.3 | (7.8) | 235.5 |
| Items that will not be reclassified to the income statement in subsequent periods: | | | | | | |
| Remeasurement of retirement benefit obligations | **37.1** | **9.7** | **46.8** | (6.8) | 10.8 | 4.0 |
| Tax effect | **(19.0)** | **(2.6)** | **(21.6)** | 0.7 | (3.0) | (2.3) |
| Other items affecting other comprehensive income | **(35.2)** | **–** | **(35.2)** | (59.9) | – | (59.9) |
| **Other comprehensive income for the year** | **(17.1)** | **7.1** | **(10.0)** | (66.0) | 7.8 | (58.2) |
| **Total comprehensive income for the year attributable to equity owners of the Company** | **222.3** | **–** | **222.3** | 177.3 | – | 177.3 |
| Earnings per share (pence) | | | | | | |
| Basic | **30.3** | **(0.9)** | **29.4** | 31.1 | (1.0) | 30.1 |
| Diluted | **29.8** | **(0.9)** | **28.9** | 30.7 | (1.0) | 29.7 |
| Underlying operating profit | **398.9** | **(1.7)** | **397.2** | 394.3 | (2.2) | 392.1 |
| Underlying profit before tax | **376.0** | **1.8** | **377.8** | 362.8 | 3.2 | 366.0 |
| Underlying basic earnings per share (pence) | **37.3** | **0.2** | **37.5** | 36.2 | 0.3 | 36.5 |
| Underlying diluted earnings per share (pence) | **36.8** | **0.1** | **36.9** | 35.7 | 0.3 | 36.0 |

## 45. Group companies

The following information is not a complete listing of all subsidiary companies at 31 December 2013 and relates only to those subsidiaries principally affecting the profits or assets of the Group.

### United Kingdom

Meggitt Aerospace Limited
Meggitt Defence Systems Limited
Meggitt Finance Limited ‡
Meggitt (UK) Limited

### Continental Europe

Artus SAS – France
Meggitt SA – Switzerland
Piher Sensors & Controls SA – Spain

### North America

Linear Motion LLC
Meggitt Aircraft Braking Systems Corporation
Meggitt Aircraft Braking Systems Kentucky Corporation
Meggitt Defense Systems, Inc.
Meggitt GP, Inc.‡
Meggitt Oregon, Inc.
Meggitt Safety Systems, Inc.
Meggitt Training Systems, Inc.
Meggitt (North Hollywood), Inc.
Meggitt (Orange County), Inc.
Meggitt (Rockmart), Inc.
NASCO Aircraft Brake, Inc.
OECO, LLC
Pacific Scientific Company
Piezotech, LLC
Securaplane Technologies, Inc.

### Rest of World

Meggitt Aerospace Asia Pacific Pte Limited – Singapore
Meggitt Brasil (Soluçeos de Engenharia) Limited – Brazil

i) United Kingdom companies listed above are incorporated and registered in England and Wales. North American companies listed above are incorporated and registered in the United States of America. Other companies listed above are incorporated in the country named.
ii) The ordinary shares of all subsidiaries were 100% owned by Meggitt PLC, either directly or indirectly, at 31 December 2013.
iii) All companies listed above are included in the consolidation.
iv) Companies marked ‡ are management companies. Otherwise all companies are operating companies engaged in the Group's principal activities as described in note 1.

A full list of subsidiary companies will be annexed to the next annual return to the Registrar of Companies.

# Independent auditors' report to the members of Meggitt PLC

## Report on the Company financial statements

**Our opinion**
In our opinion the Company financial statements, defined below:

- give a true and fair view of the state of the Company's affairs as at 31 December 2013;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

This opinion is to be read in the context of what we say in the remainder of this report.

**What we have audited**
The Company financial statements, which are prepared by Meggitt PLC, comprise:

- the Company balance sheet as at 31 December 2013; and
- the notes to the Company financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework applied in their preparation comprises applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

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

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

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

We read all the financial and non-financial information in the 'Annual Report and Accounts' (the 'Annual Report') to identify material inconsistencies with the audited Company financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Opinions on matters prescribed by the Companies Act 2006

In our opinion:

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

## Other matters on which we are required to report by exception

**Adequacy of accounting records and information and explanations received**
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

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

**Other information in the Annual Report**
Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited Company financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

## Responsibilities for the financial statements and the audit

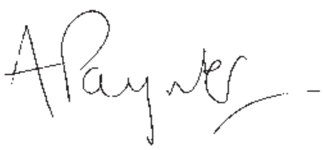
**Our responsibilities and those of the directors**
As explained more fully in the Statement of directors' responsibilities (set out on page 70), the directors are responsible for the preparation of the Company financial statements and for being satisfied that they give a true and fair view.

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

This report, including the opinions, has been prepared only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## Other matter

We have reported separately on the Group financial statements of Meggitt PLC for the year ended 31 December 2013.



**Andrew Paynter (Senior Statutory Auditor)**

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
3 March 2014

# Company balance sheet

As at 31 December 2013

| | Notes | 2013 £'m | 2012 £'m |
|---|---|---|---|
| **Fixed assets** | | | |
| Tangible fixed assets | 3 | **31.1** | 24.6 |
| Derivative financial instruments | 9 | **35.5** | 50.4 |
| Investments | 4 | **2,069.9** | 2,060.7 |
| | | **2,136.5** | 2,135.7 |
| **Current assets** | | | |
| Debtors | 5 | **940.0** | 958.3 |
| Derivative financial instruments | 9 | **11.4** | 4.9 |
| Cash at bank and in hand | | **17.0** | 13.5 |
| | | **968.4** | 976.7 |
| Creditors – amounts falling due within one year | 6 | **(79.5)** | (186.1) |
| Derivative financial instruments | 9 | **(9.3)** | (5.0) |
| **Net current assets** | | **879.6** | 785.6 |
| **Total assets less current liabilities** | | **3,016.1** | 2,921.3 |
| Creditors – amounts falling due after more than one year | 7 | **(664.5)** | (609.8) |
| Provision for liabilities and charges | 8 | **(1.7)** | (2.0) |
| Derivative financial instruments | 9 | **(10.2)** | (0.2) |
| **Net assets** | | **2,339.7** | 2,309.3 |
| **Capital and reserves** | | | |
| Called-up share capital | 12 | **39.9** | 39.3 |
| Share premium account | 13 | **1,166.3** | 1,143.9 |
| Other reserves | 13 | **17.5** | 17.5 |
| Profit and loss reserve | 13 | **1,116.0** | 1,108.6 |
| **Total shareholders' funds** | 13 | **2,339.7** | 2,309.3 |

The financial statements on pages 123 to 129 were approved by the Board of Directors on 3 March 2014 and signed on its behalf by:

**S G Young**
**Director**

**D R Webb**
**Director**

# Notes to the financial statements of the Company

## 1. Basis of preparation

These financial statements have been prepared on a going concern basis under the historical cost accounting convention, as modified by the revaluation of financial assets and financial liabilities (including derivative financial instruments) at fair value, in accordance with the Companies Act 2006. The Company continues to prepare its annual financial statements in accordance with UK Generally Accepted Accounting Practice (UK GAAP).

## 2. Summary of significant accounting policies

The principal accounting policies adopted by the Company in the preparation of the financial statements are set out below. These policies have been applied consistently to all periods presented unless stated otherwise.

### Investments

Investments in subsidiaries are stated at cost less provision for impairment in value except for investments acquired before 1 January 1988 where Section 612 merger relief has been taken and investments are stated at the nominal value of the shares issued in consideration.

### Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Cost includes the original purchase price of the asset and costs attributable to bringing the asset into use. Depreciation is not provided on freehold land. On other assets it is provided in equal annual instalments over the estimated useful lives of the assets as follows:

Land and buildings...................................... over period of lease
Plant and equipment.................................. 3 to 10 years
Motor vehicles............................................. 5 years

### Operating leases

Rental costs under operating leases are charged to the profit and loss account on a straight-line basis over the lease term, even if the payments are not made on this basis.

### Taxation

The charge for taxation is based on the profit for the period and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred taxation is provided in full, without discounting, on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred taxation assets are recognised to the extent it is regarded as more likely than not that they will be recovered.

Deferred taxation is not provided on timing differences arising from the sale or revaluation of fixed assets unless, at the balance sheet date, a binding commitment to sell the asset has been entered into and it is unlikely that any gain will qualify for rollover relief.

### Provision for liabilities and charges

In accordance with FRS 12, provision is made for onerous property leases. Provisions are discounted where appropriate to reflect the time value of money.

### Foreign currencies

Transactions in foreign currencies are recorded at the rates of exchange prevailing at the dates of the transactions. Monetary assets and liabilities, denominated in foreign currencies at the balance sheet date, are reported at the rates of exchange prevailing at that date. Exchange differences on retranslating monetary assets and liabilities are recognised in the profit and loss account except where they relate to qualifying cash flow hedges in which case the exchange differences are recognised in equity.

### Pension scheme arrangements

As the Company is unable to identify its share of the underlying assets and liabilities of the Meggitt Pension Plan on a consistent and reasonable basis, the Company accounts for the scheme as though it were a defined contribution scheme. Accordingly the amount charged to the profit and loss account is the contribution payable in the period. Differences between contributions payable in the period and contributions paid are shown as accruals or prepayments in the balance sheet.

### Share-based compensation

The fair value of services received from employees is recognised as an expense in the profit and loss account over the period for which services are received ('the vesting period').

For equity-settled awards, the fair value of an award is measured at the date of grant and reflects any market-based vesting conditions. Non market-based vesting conditions are excluded from the fair value of the award. At the date of grant, the Company estimates the number of awards expected to vest as a result of non market-based vesting conditions and the fair value of this estimated number of awards is recognised as an expense in the profit and loss account on a straight-line basis over the vesting period. At each balance sheet date, the Company revises its estimate of the number of awards expected to vest as a result of non market-based vesting conditions and adjusts the amount recognised cumulatively in the profit and loss account to reflect the revised estimate. Proceeds received, net of directly attributable transaction costs, are credited to share capital (nominal value) and share premium.

For cash-settled awards, the total amount recognised is based on the fair value of the liability incurred. The fair value of the liability is remeasured at each balance sheet date with changes in fair value recognised in the profit and loss account for the period.

The grant by the Company of options over its equity instruments to employees of subsidiary undertakings, is treated as a capital contribution. The fair value of the awards made is recognised, over the vesting period, as an increase in investment in subsidiary undertakings, with a corresponding credit to the profit and loss reserve.

Shares in the Company are held by an independently managed Employee Share Ownership Trust ('ESOP Trust'), to meet future obligations in respect of the Company's employee share schemes. The cost of own shares held by the ESOP Trust is deducted from shareholders' funds.

## 2. Summary of significant accounting policies continued

### Derivative financial instruments and hedging

Derivative financial instruments are recognised at fair value on the date the derivative contract is entered into and are subsequently remeasured at fair value at each balance sheet date. To the extent the maturity of the financial instrument is more than 12 months from the balance sheet date, the fair value is reported as a non-current asset or liability. Derivative financial instruments with maturities of less than 12 months from the balance sheet are shown as current assets or liabilities. The method by which any gain or loss is recognised depends on the designation of the derivative financial instrument:

**Fair value hedges**
Fair value hedges are hedges of the fair value of recognised assets or liabilities or a firm commitment. Interest rate swaps that change fixed rate interest to variable rate interest are treated as fair value hedges provided they meet the hedge criteria. Changes in the fair value of derivative financial instruments, designated as fair value hedges, are recognised in the profit and loss account together with changes in the fair value of the hedged item.

**Cash flow hedges**
Cash flow hedges are hedges of highly probable forecast transactions. Interest rate swaps that change variable rate interest to fixed rate interest are treated by the Company as cash flow hedges provided they meet the hedge criteria. Changes in fair value of the effective portion of derivative financial instruments, designated as cash flow hedges, are initially recorded within equity. To the extent changes in fair value are recorded in equity, they are recycled to the profit and loss account in the periods in which the hedged item affects the profit and loss account. However, when the transaction to which the hedge relates results in the recognition of a non-monetary asset or a liability then gains and losses previously recognised in equity are included in the initial measurement of the cost of the non-monetary asset or liability.

If the forecast transaction to which the cash flow hedge relates is no longer expected to occur, the cumulative gain or loss previously recognised in equity is transferred to the profit and loss account immediately. If the hedging instrument is sold, expires or no longer meets the criteria for hedge accounting the cumulative gain or loss previously recognised in equity is transferred to the profit and loss account when the forecast transaction is recognised in the profit and loss account.

**Derivatives that do not meet the criteria for hedge accounting**
Where derivatives do not meet the criteria for hedge accounting, changes in fair value are recognised immediately in the profit and loss account. The Company utilises a number of foreign currency forward contracts to mitigate against currency fluctuations. The Company has determined that the additional costs of meeting the extensive documentation requirements for the Company's large number of foreign currency contracts are not merited. Accordingly gains and losses arising from measuring the contracts at fair value are recorded immediately in the profit and loss account.

### Loans

Loans are initially stated at proceeds received less directly attributable transaction costs incurred. Transaction costs are amortised to the profit and loss account over the period of the loans. Loans are held at fair value where a hedge relationship is in place. Any related interest accruals are included within the value at which loans are recorded. Loans are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

### Capital instruments

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are deducted from the proceeds recorded in equity. Other instruments are classified as liabilities if they contain an obligation to transfer economic benefits, otherwise they are included in shareholders' funds.

### Dividends

Interim dividends are recognised when they are approved by the Board. Final dividends are recognised when they are approved by the Company's shareholders.

### Profit and recognised gains and losses of the Company

The Company has taken advantage of the legal dispensation contained in Section 408 of the Companies Act 2006 allowing it not to publish a separate profit and loss account and related notes. The Company has also taken advantage of the legal dispensation contained in Section 408 of the Companies Act 2006 allowing it not to publish a separate statement of recognised gains and losses.

### Related party transactions

The Company has taken advantage of the exemption contained in FRS 8 from the requirement to disclose related party transactions within the Group.

# Notes to the financial statements of the Company continued

## 3. Tangible fixed assets

| | Land and buildings £'m | Plant, equipment and vehicles £'m | Total £'m |
|---|---|---|---|
| Cost at 1 January 2013 | 0.8 | 30.2 | 31.0 |
| Additions | – | 9.0 | 9.0 |
| Disposals | (0.1) | (0.2) | (0.3) |
| **Cost at 31 December 2013** | **0.7** | **39.0** | **39.7** |
| Accumulated depreciation at 1 January 2013 | 0.4 | 6.0 | 6.4 |
| Charge for year | – | 2.4 | 2.4 |
| Disposals | – | (0.2) | (0.2) |
| **Accumulated depreciation at 31 December 2013** | **0.4** | **8.2** | **8.6** |
| **Net book amount at 31 December 2013** | **0.3** | **30.8** | **31.1** |
| Net book amount at 31 December 2012 | 0.4 | 24.2 | 24.6 |

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Net book amount of land and buildings: | | |
| Freehold | **–** | 0.1 |
| Short leasehold | **0.3** | 0.3 |
| **Total** | **0.3** | 0.4 |

## 4. Investments

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Shares in subsidiaries: | | |
| At 1 January | **2,060.7** | 2,052.4 |
| Capital contributions (see note 13) | **9.2** | 8.3 |
| **At 31 December** | **2,069.9** | 2,060.7 |

The directors believe that the carrying value of the investments is supported by their underlying assets. A list of principal subsidiaries is included in note 45 of the Meggitt PLC Group accounts.

## 5. Debtors

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Amounts falling due within one year: | | |
| Amounts owed by subsidiary undertakings | **936.3** | 954.1 |
| Other debtors | **1.2** | 2.5 |
| Prepayments and accrued income | **2.5** | 1.7 |
| **Total** | **940.0** | 958.3 |

## 6. Creditors – amounts falling due within one year

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Bank loans and overdrafts | **0.1** | 7.6 |
| Other loans | **2.9** | 114.0 |
| Trade creditors | **2.8** | 4.0 |
| Amounts owed to subsidiary undertakings | **45.5** | 30.1 |
| UK corporation tax payable | **16.2** | 16.7 |
| Taxation and social security | **5.6** | 3.8 |
| Other creditors | **1.9** | 4.0 |
| Accruals | **4.5** | 5.9 |
| **Total** | **79.5** | 186.1 |

Bank loans and overdrafts, other loans and amounts owed to subsidiary undertakings are unsecured.

## 7. Creditors – amounts falling due after more than one year

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Bank loans | **245.8** | 170.2 |
| Other loans | **418.7** | 439.6 |
| **Total** | **664.5** | 609.8 |

Bank loans and other loans are unsecured.

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Analysis of bank loans and overdrafts repayable: | | |
| In one year or less | **0.1** | 7.6 |
| In more than one year but not more than five years | **245.8** | 170.2 |
| **Total** | **245.9** | 177.8 |

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Analysis of other loans repayable: | | |
| In one year or less | **2.9** | 114.0 |
| In more than one year but not more than five years | **166.8** | 171.5 |
| In more than five years | **251.9** | 268.1 |
| **Total** | **421.6** | 553.6 |

Amounts repayable in more than five years mature in 2020 and 2022.

## 8. Provision for liabilities and charges

| | Onerous lease costs £'m | Deferred tax provision £'m | Total £'m |
|---|---|---|---|
| At 1 January 2013 | 0.2 | 1.8 | 2.0 |
| Credit to profit and loss account | – | (0.2) | (0.2) |
| Charge to profit and loss reserve | – | 0.1 | 0.1 |
| Utilisation of provision | (0.2) | – | (0.2) |
| **At 31 December 2013** | **–** | **1.7** | **1.7** |

The deferred tax provision are analysed as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Accelerated capital allowances | **1.7** | 2.0 |
| Other short-term timing differences | **–** | (0.2) |
| **Total** | **1.7** | 1.8 |

Movements in the deferred tax provision are analysed as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| At 1 January | **1.8** | 0.6 |
| (Credit)/charge to profit and loss account | **(0.2)** | 2.4 |
| Charge/(credit) to profit and loss reserve | **0.1** | (1.2) |
| **At 31 December** | **1.7** | 1.8 |

# Notes to the financial statements of the Company continued

## 9. Derivative financial instruments

| | 2013 Assets £'m | 2013 Liabilities £'m | 2012 Assets £'m | 2012 Liabilities £'m |
|---|---|---|---|---|
| Interest rate swaps | **24.9** | **–** | 43.1 | (0.2) |
| Cross currency swaps | **–** | **–** | – | (1.3) |
| Foreign currency forward contracts | **22.0** | **(19.5)** | 12.2 | (3.7) |
| **Total** | **46.9** | **(19.5)** | 55.3 | (5.2) |
| Less non-current portion: | | | | |
| Interest rate swaps | **24.9** | **–** | 43.1 | (0.2) |
| Foreign currency forward contracts | **10.6** | **(10.2)** | 7.3 | – |
| **Non-current portion** | **35.5** | **(10.2)** | 50.4 | (0.2) |
| **Current portion** | **11.4** | **(9.3)** | 4.9 | (5.0) |

The Company is exempt from the FRS 29 disclosures as the consolidated financial statements of Meggitt PLC give the disclosures required by IFRS 7 (see Meggitt PLC Group accounts notes 29 and 30).

## 10. Commitments

### Capital commitments

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Contracted for but not incurred: | | |
| Plant, equipment and vehicles | **0.1** | 0.1 |
| **Total** | **0.1** | 0.1 |

### Operating lease commitments

The annual commitments under non-cancellable operating leases, all of which relate to land and buildings, expire as follows:

| | 2013 £'m | 2012 £'m |
|---|---|---|
| Within two to five years | **–** | 0.1 |
| Later than five years | **0.1** | 0.1 |
| **Total** | **0.1** | 0.2 |

## 11. Pensions

The Directors believe that the FRS 17 total deficit for the scheme in which the Company participates would be consistent with the IAS 19 deficit reported in note 33 to the Meggitt PLC Group accounts in respect of the UK scheme. At 31 December 2013, an amount of £0.1 million (2012: £0.1 million) relating to contributions payable in respect of the defined contribution scheme were outstanding.

## 12. Called-up share capital

| | Ordinary shares of 5p each Number 'm | Nominal value £'m | Net consideration £'m |
|---|---|---|---|
| Allotted and fully paid: | | | |
| At 1 January 2013 | 785.0 | 39.3 | |
| Issued on exercise of executive share awards | 7.2 | 0.3 | 0.5 |
| Issued on exercise of sharesave awards | 1.1 | 0.1 | 2.0 |
| Scrip dividends | 3.8 | 0.2 | 20.0 |
| **At 31 December 2013** | **797.1** | **39.9** | |

## 13. Reconciliation of movements in shareholders' funds

| | Called-up share capital £'m | Share premium account £'m | Other reserves £'m | Profit and loss reserve £'m | Total 2013 £'m | Total 2012 £'m |
|---|---|---|---|---|---|---|
| At 1 January 2013 | 39.3 | 1,143.9 | 17.5 | 1,108.6 | 2,309.3 | 2,183.5 |
| Profit for the financial year | – | – | – | 90.3 | 90.3 | 188.6 |
| Dividends | – | – | – | (95.6) | (95.6) | (85.0) |
| Cash flow hedge movements | – | – | – | 1.6 | 1.6 | (4.3) |
| Currency translation differences | – | – | – | 0.2 | 0.2 | 1.2 |
| Employee share option schemes: | | | | | | |
| Value of subsidiary employee services (see note 4) | – | – | – | 9.2 | 9.2 | 8.3 |
| Value of services provided | – | – | – | 2.2 | 2.2 | 2.9 |
| Shares issued | 0.4 | 2.6 | – | (0.5) | 2.5 | 0.9 |
| Scrip dividends | 0.2 | 19.8 | – | – | 20.0 | 13.2 |
| **At 31 December 2013** | **39.9** | **1,166.3** | **17.5** | **1,116.0** | **2,339.7** | **2,309.3** |

Details of the Group's employee share schemes are included in note 35 of the Meggitt PLC Group accounts.

# Five-year record

| | 2013 £'m | 2012 £'m | 2011 £'m | 2010 £'m | 2009 £'m |
|---|---|---|---|---|---|
| **Revenue and profit** | | | | | |
| Revenue | **1,637.3** | 1,605.8 | 1,455.3 | 1,162.0 | 1,150.5 |
| Underlying profit before tax* | **377.8** | 366.0 | 325.3 | 263.7 | 244.2 |
| Exceptional operating items | **(28.4)** | (13.3) | (20.3) | (15.7) | (20.8) |
| Amortisation of intangible assets acquired in business combinations | **(74.3)** | (80.6) | (75.1) | (64.7) | (69.2) |
| Disposal of inventory revalued in business combinations | **(0.3)** | (0.2) | (11.3) | – | – |
| Financial instruments | **6.1** | 23.4 | 9.7 | (3.2) | 36.6 |
| Net interest expense on retirement benefit obligations* | **(11.5)** | (14.0) | (12.1) | (15.3) | (13.3) |
| Profit before tax* | **269.4** | 281.3 | 216.2 | 164.8 | 177.5 |
| **Earnings and dividends** | | | | | |
| Earnings per share – basic* | **29.4p** | 30.1p | 23.1p | 19.3p | 20.2p |
| Earnings per share – underlying* | **37.5p** | 36.5p | 32.1p | 28.6p | 26.4p |
| Dividends per ordinary share (paid or proposed in respect of the year) | **12.75p** | 11.80p | 10.50p | 9.20p | 8.45p |
| **Gearing ratio** | | | | | |
| Year end net debt as a percentage of capital employed | **27.2%** | 33.7% | 44.0% | 50.2% | 63.5% |

* The figures for prior years have been restated (see note 44 to the Group financial statements).

# Investor information

## Dividends

The proposed 2013 final dividend of 8.80p per ordinary share, if approved, will be paid on 9 May 2014 to shareholders on the register on 14 March 2014. The expected payment date for the 2014 interim dividend is 3 October 2014.

## Shareholder enquiries

Registrar:
Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ

T: 0870 703 6210
E: www.investorcentre.co.uk/contactus

Enquiries about the following administrative matters should be addressed to Meggitt PLC's registrar:

- Change of address notification.
- Lost share certificates.
- Dividend payment enquiries.
- Dividend mandate instructions. Shareholders may have their dividends paid directly into their bank or building society accounts by completing a dividend mandate form. Tax vouchers are sent directly to shareholders' registered addresses.
- Amalgamation of shareholdings. Shareholders who receive more than one copy of the annual report are invited to amalgamate their accounts on the share register.

Shareholders can view and manage their shareholdings online at www.investorcentre.co.uk, including updating address records, making dividend payment enquiries, updating dividend mandates and viewing the latest share price. Shareholders will need their Shareholder Reference Number (SRN), which can be found on their share certificate or a recent dividend tax voucher, to access this site. Once signed up to Investor Centre, an activation code will be sent to the shareholder's registered address to enable the shareholder to manage their holding.

## Electronic communications and electronic proxy voting

Meggitt encourages shareholders to vote at the Annual General Meeting (AGM) and provides a facility for electronic proxy voting. Shareholders who are not Crest members can vote online on resolutions proposed at the AGM via our website after voting has opened. Proxy cards contain further details on how and when to vote and further information for Crest members.

We provide annual reports and other documents to shareholders in their elected format under the electronic communications provisions, which were approved by the shareholders at the AGM in 2007.

Electronic copies of the Annual Report and Accounts 2013 and the Notice of AGM will be posted on our website where Meggitt PLC's announcements to the Stock Exchange and press releases are also published.

## Share dealing services

8.00am – 4.30pm
Monday – Friday

T: 0870 703 0084

We have established share dealing services with the group's registrar, Computershare Investor Services PLC, which provides shareholders with an easy way to buy or sell Meggitt PLC ordinary shares on the London Stock Exchange.

The internet share dealing service commission is 1% of the value of the transaction, subject to a minimum charge of £30. Stamp duty, currently 0.5%, is payable on purchases. There is no need to open an account to deal. Real-time dealing is available during market hours. There is a facility to place orders outside market hours. Up to 90-day limit orders are available for sales. To access the service, shareholders should have their SRN and log onto www.computershare.com/dealing/uk.

The telephone share dealing service commission is 1% of the value of the transaction plus £35. Stamp duty, currently 0.5%, is payable on purchases. The service is available from 8.00am to 4.30pm Monday to Friday, excluding bank holidays, on telephone number 0870 703 0084. Shareholders should have their SRN when making the call. Detailed terms and conditions are available on request by telephoning 0870 702 0000.

This is not a recommendation to buy, sell or hold shares in Meggitt PLC. Shareholders who are unsure of what action to take should obtain independent financial advice. Share values may go down as well as up which may result in shareholders receiving less than they originally invested.

Insofar as this statement constitutes a financial promotion for the share dealing service provided by Computershare Investor Services PLC, it has been approved by Computershare Investor Services PLC for the purpose of the Financial Services Act 2012 only. Computershare Investor Services PLC is authorised and regulated by the Financial Conduct Authority. Where this statement has been received in a country where providing such a service would be contrary to local laws or regulations, this should be treated as information only.

## ShareGift

17 Carlton House Terrace
London SW1Y 5AH

T: 0207 930 3737

ShareGift (registered charity number 1052686), the independent share donation charity, is especially useful for those who may want to dispose of a small number of shares which are uneconomic to sell on their own. Shares which have been donated to ShareGift are aggregated and sold when practicable, with the proceeds passed on to a wide range of UK registered charities. Further details about ShareGift can be obtained from www.ShareGift.org.

# Investor information continued

## Analysis of ordinary shareholders as at 31 December 2013

| | Number of shareholders | % of total shares |
|---|---|---|
| **Size of holdings** | | |
| 1–999 | 5,529 | 0.16 |
| 1,000–9,999 | 2,557 | 1.00 |
| 10,000–99,999 | 549 | 2.11 |
| 100,000–249,999 | 129 | 2.44 |
| 250,000–499,999 | 74 | 3.36 |
| 500,000–999,999 | 69 | 6.24 |
| 1,000,000 and over | 101 | 84.69 |
| | 9,008 | 100.00 |

| | Number of shareholders | % of total shares |
|---|---|---|
| **Types of shareholder** | | |
| Individuals | 7,438 | 1.78 |
| Banks and nominees | 1,476 | 97.37 |
| Investment and insurance companies | 27 | 0.14 |
| Other | 67 | 0.71 |
| | 9,008 | 100.00 |

## 2014 provisional financial calendar

| | |
|---|---|
| **Full-year results announcement for year ended 31 December 2013** | **4 March** |
| Final dividend ex-dividend date | 12 March |
| Final dividend record date | 14 March |
| Report and accounts for year ended 31 December 2013 despatched | 27 March |
| Deadline for receipt of scrip dividend elections | 17 April |
| **AGM and interim management statement** | **7 May** |
| Final dividend for year ended 31 December 2013 – payment date | 9 May |
| **Interim announcement for period ended 30 June 2014** | **5 August** |
| Interim dividend ex-dividend date | 13 August |
| Interim dividend record date | 15 August |
| Deadline for receipt of scrip dividend elections | 19 September |
| Interim dividend for period ended 30 June 2014 – payment date | 3 October |
| **Interim management statement** | **5 November** |

## Key dates 2014

MARCH
4
Full-year results

MAY
7
AGM & interim management statement

AUGUST
5
Interim results

NOVEMBER
5
Interim management statement

## Advisors

**Registrars**
Computershare Investor Services PLC

**Principal clearing bankers**
HSBC Bank plc
Barclays Bank PLC
Bank of America Merrill Lynch

**Independent auditors**
PricewaterhouseCoopers LLP

**Solicitors**
Clifford Chance LLP

**Brokers**
Bank of America Merrill Lynch

**Financial advisors**
N M Rothschild & Sons Limited

## Contact us

**Investor relations**
T: 01202 597 597

investors@meggitt.com

Information on Meggitt PLC, including the latest share price: www.meggitt.com

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