

# Restoring QinetiQ to Strength

**QinetiQ Annual Results 2010**

Thursday 27 May 2010

# Leo Quinn

Chief Executive Officer

# Agenda

1. Headlines
2. Financial overview
3. Review of operations
4. Q&A

# Headlines

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

+The definitions of gearing ratio can be found on slide 39

# David Mellors

Chief Financial Officer

# Financial overview

# Summary financial headlines

## Revenue £m

	FY10 £m	FY09 £m	Change	Organic change at constant currency
Revenue	1,625.4	1,617.3	+1%	(3)%
Operating profit*^	120.3	151.6	(21)%	
Operating margin*^	7.4%	9.4%		
Earnings per share* (pence)	11.1	15.9	(30)%	
Net cash from operations* (post capex)	174.3	169.8	+3%	
Cash conversion* (post capex)	145%	107%		
Net Debt	(457.4)	(537.9)	15%	
Dividend (pence)	1.58 <sup>##</sup>	4.75 <sup>#</sup>		

\* Underlying performance as defined on slide 39

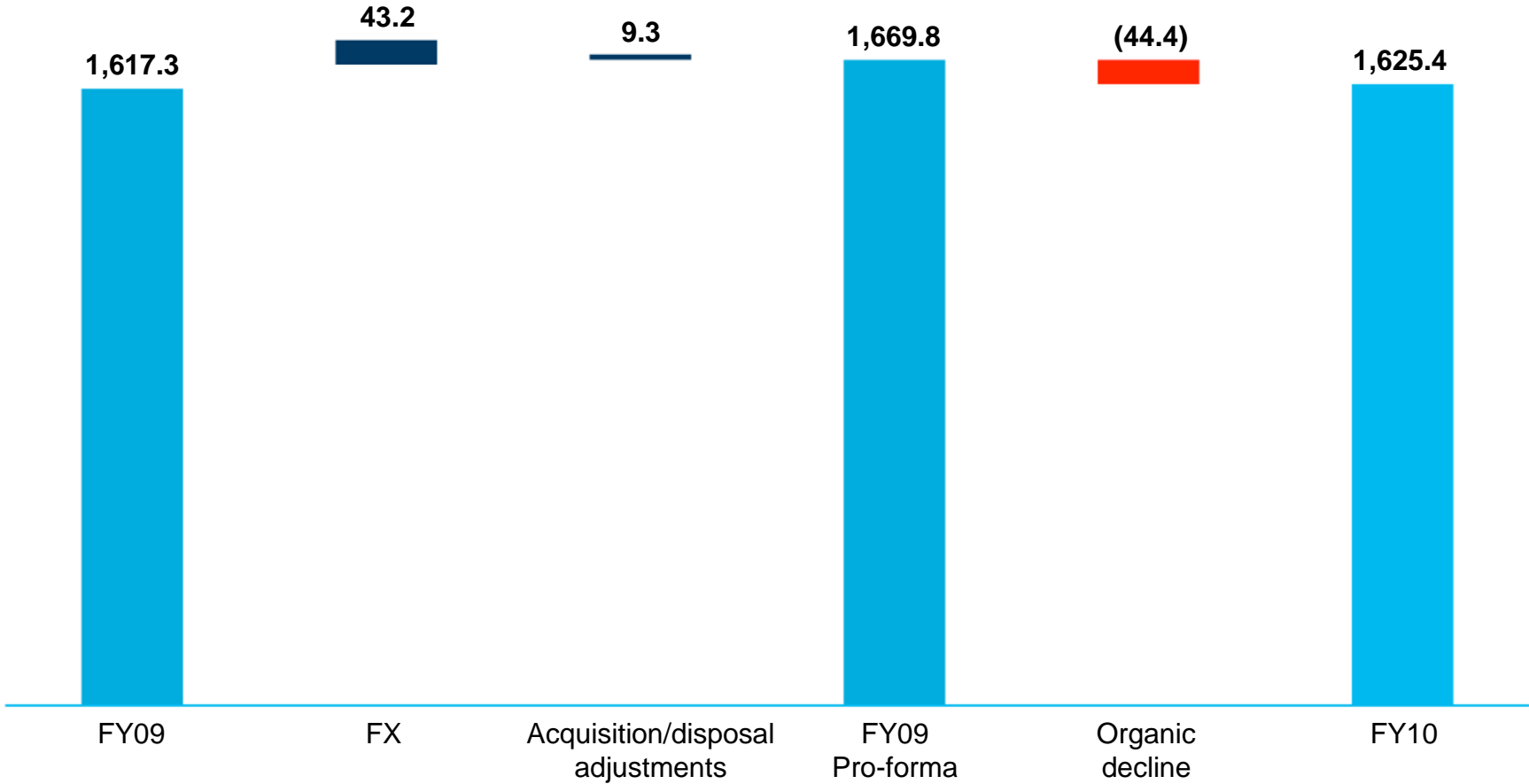
^ Operating profit for FY09 has been restated to show the finance elements of the IAS19 pension cost in the finance income and expense lines. There is no impact on reported profit before tax from this restatement.

# FY09 total dividend (1.50p interim, 3.25p final).

## No final dividend with respect to H2 FY10

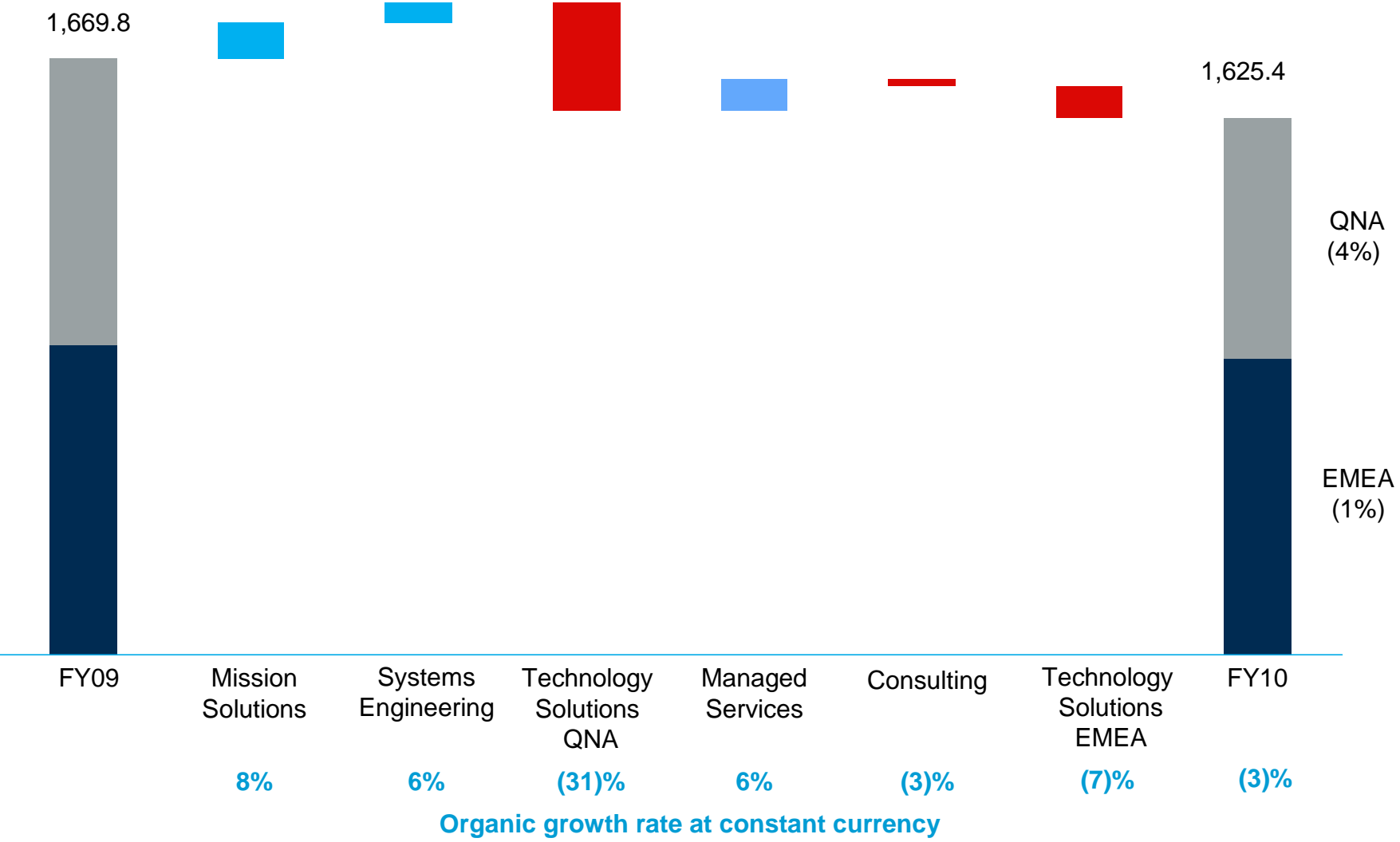
# Group revenue bridge

£m



# Organic revenue bridge

£m



# Segmental analysis of profit

	Operating profit*		Operating profit margin*	
	FY10 £m	FY09^ £m	FY10	FY09^
QNA	<b>67.7</b>	83.0	8.5%	10.8%
EMEA	<b>61.1</b>	84.2	7.5%	10.0%
Ventures	<b>(8.5)</b>	(15.6)		
<b>Group</b>	<b>120.3</b>	151.6	7.4%	9.4%

^ Operating profit for FY09 has been restated to show the finance elements of the IAS19 pension cost in the finance income and expense lines. There is no impact on reported profit before tax from this restatement.

\* Underlying performance as defined on slide 39

# Non recurring items\*

	FY10 £m	FY09 £m
<b>Non cash items:</b>		
Impairments: Goodwill and intangibles	(53.4)	–
Fixed asset investments	(11.3)	(5.7)
Property, plant and equipment	(24.0)	–
	<b>(88.7)</b>	<b>(5.7)</b>
Amortisation of acquisition intangibles	(26.1)	(23.5)
	<b>(114.8)</b>	<b>(29.2)</b>
<b>Items with cash impact:</b>		
EMEA reorganisation (announced May 2009)	<b>(42.1)</b>	–
Profit on business divestments	<b>5.1</b>	13.0
<b>Total (pre tax)</b>	<b>(151.8)</b>	<b>(16.2)</b>

\* Acquisition amortisation and specific non recurring items.

# Cash conversion

## Strong cash generation

	FY10 £m	FY09 <sup>^</sup> £m
Underlying operating profit	120.3	151.6
Share of JVs/associates	(0.2)	7.2
<b>Operating profit before JVs/assoc</b>	<b>120.1</b>	<b>158.8</b>
Cash flow from operations*	204.6	202.2
Purchase of PPE and intangible assets	(30.3)	(32.4)
<b>Net cash flow from operations post capex</b>	<b>174.3</b>	<b>169.8</b>
<b>Cash conversion %*</b>	<b>145%</b>	<b>107%</b>
Net interest paid	(36.4)	(20.3)
Tax	1.5	(2.5)
<b>Free cash flow*</b>	<b>139.4</b>	<b>147.0</b>

\* Before impact of EMEA reorganisation

<sup>^</sup> Operating profit for FY09 has been restated to show the finance elements of the IAS19 pension cost in the finance income and expense lines. There is no impact on reported profit before tax from this restatement.

# Movements in net debt

	FY10 £m	FY09 £m
<b>Free cash flow</b>	<b>139.4</b>	<b>147.0</b>
EMEA reorganisation costs	(35.4)	(27.0)
Acquisitions and investments*	(46.7)	(95.0)
Divestments	21.1	16.7
Dividends	(31.6)	(28.9)
Other	7.5	(6.9)
<b>Change in net debt before FX</b>	<b>54.3</b>	<b>5.9</b>
FX translation impact	26.2	(163.9)
<b>Change in net debt</b>	<b>80.5</b>	<b>(158.0)</b>
Opening net debt	(537.9)	(379.9)
<b>Closing net debt<sup>+</sup></b>	<b>(457.4)</b>	<b>(537.9)</b>

+ US\$:GBP£ rate 1.52 at 31 March 2010 (1.44 at 31 March 2009)

\* Including \$10m deferred cash consideration with respect to ITS acquisition paid in May 2009 and \$21m deferred consideration on DTRI paid in October 2009

# Borrowings and debt facilities

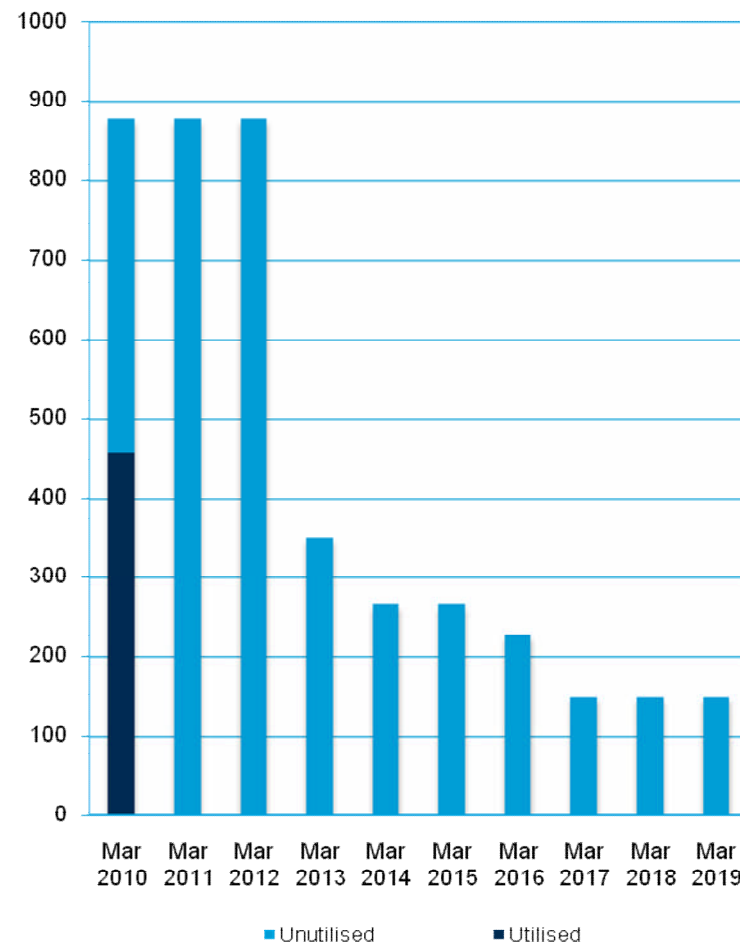
	FY10 £m	FY09 £m
Net debt (£m)	<b>457.4</b>	537.9
Committed facilities* (£m)	<b>876.7</b>	893.0
Net debt: EBITDA**	<b>2.5</b>	2.2
Covenant limit**	<b>3.5</b>	3.5

\* US\$ denominated facilities translated at 31 March 2010 rate of \$1.52:£1 and 31 March 2009 rate of \$1.44:£1

\*\* Annualised and calculated in accordance with credit facility ratios

Committed facilities include:

- £500m revolving credit facility maturing Aug 2012
- \$135m private placement maturing 2013
- \$187m private placement maturing 2016
- \$238m private placement maturing 2019



# Defined benefit pension scheme

## IAS19 balance sheet position

	31 March 2010 £m	30 Sept 2009 £m	31 March 2009 £m
Market value of assets	915.9	795.8	647.4
Present value of scheme liabilities	(1,063.2)	(952.9)	(752.6)
Net pension liability before deferred tax	(147.3)	(157.1)	(105.2)
Deferred tax	41.2	44.0	29.4
Net pension liability	(106.1)	(113.1)	(75.8)

Assumptions:	FY10 %	H1 10 %	FY09 %
Discount rate	5.6	5.5	6.5
Inflation	3.6	3.1	3.1

Sensitivity of deficit to main assumptions:

- Discount rate: 0.1% change +/-£23m
- Inflation rate: 0.1% change +/-£22m
- Real salary increase: 0.1% change +/-£6m
- Life expectancy 1yr +/-£22m

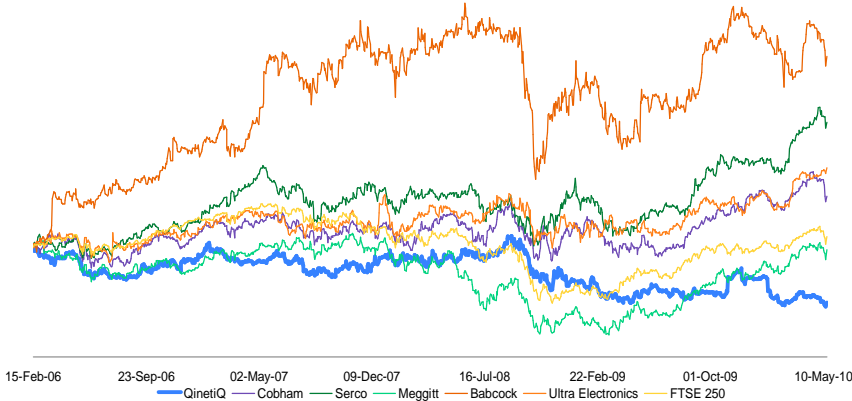
# Leo Quinn

Chief Executive Officer

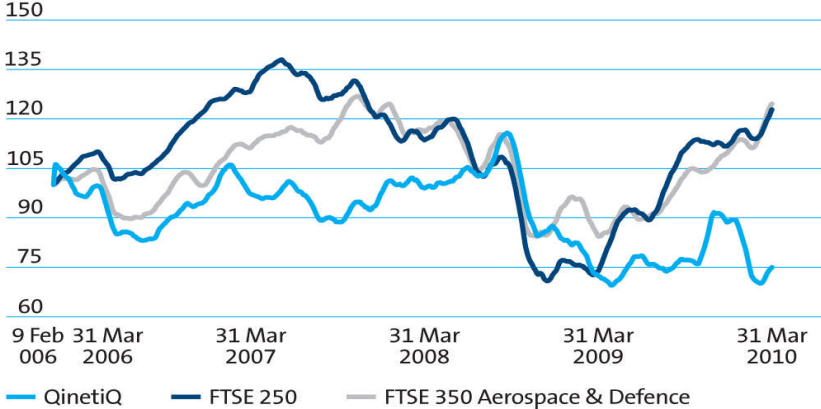
# Review of operations

# Value has been lost

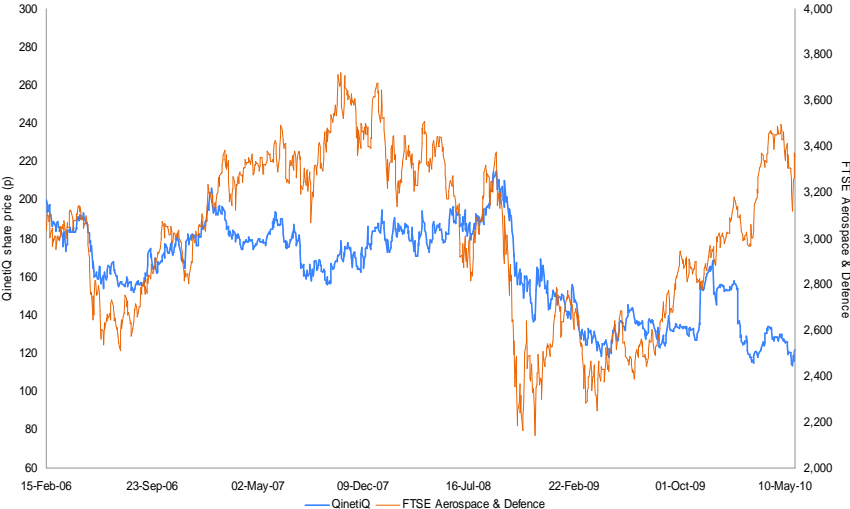
Indexed Share Price Performance since IPO



Relative Total Shareholder Return



Actual Share Price Performance since IPO



**QinetiQ has failed to deliver its potential**

# Symptoms of forced growth

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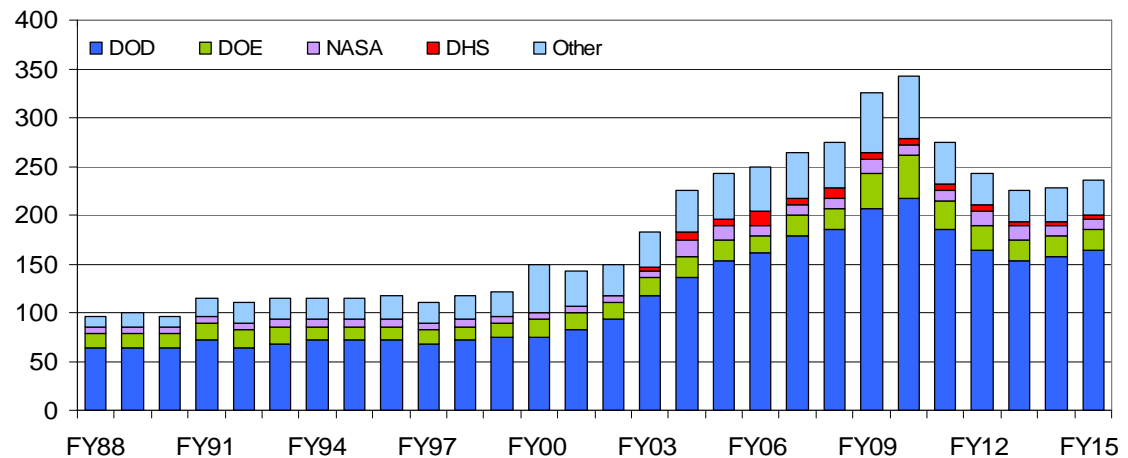
- Loss of clear direction
- High organisational complexity
- Lack of transparency
- Innovation not managed– too many loss makers
- Costs too high
- Fragmented culture – leaders, processes, execution
- Siloed organisation
- Over-stretched balance sheet

**“Rising tide” has masked weaknesses**

# A difficult environment

- New UK Government; Strategic Defence and Security Review
- US Government policy
  - Insourcing
  - Delays and curtailments
- Large market
  - Players consolidating
- Customer drive to partition Advice and Supply

**US Federal Spending for Professional Services / Aftermarket By Top Agencies (1988 - 2015) - \$bn**



**Markets will remain challenging**

# Summary of issues

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- QinetiQ has failed to deliver its potential
- Symptoms of forced growth
- Rising tide has masked weaknesses
- Markets will remain challenging

# QinetiQ has a number of strengths

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## Strong customer relationships in two world leading defence markets

- Multiple contracting vehicles – barrier to entry
- Excellent reference base – under exploited global potential

## Potentially well-balanced portfolio

- Service models in more resilient sectors
- Differentiated products, but lumpy revenues

## QinetiQ's people: most valuable asset

- World class expertise
- Highly self-motivated

**Considerable scope for self-help**

# Priorities to restore value

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## Focus

1. Clarify direction
2. Simplify and align structure

## Cultural transformation

3. Increase transparency and control
4. Upgrade leaders
5. Drive performance
6. Reset cost base
7. Create single QinetiQ mindset

## Strengthen balance sheet

8. Pay down debt

**Strong foundation comes first**

# 1. Clarify direction

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## Of the original QinetiQ strategy

- What has delivered
  - ✓ Focus on existing customers
  - ✓ Expert technical services
  - ✓ Enter US defence market
- What has not delivered – unproven or under-exploited
  - ? Applications in adjacent markets
  - ? Penetration of defence beyond UK/US
  - ? IP exploitation
  - ? Bolt-on acquisitions

Strategy requires reset

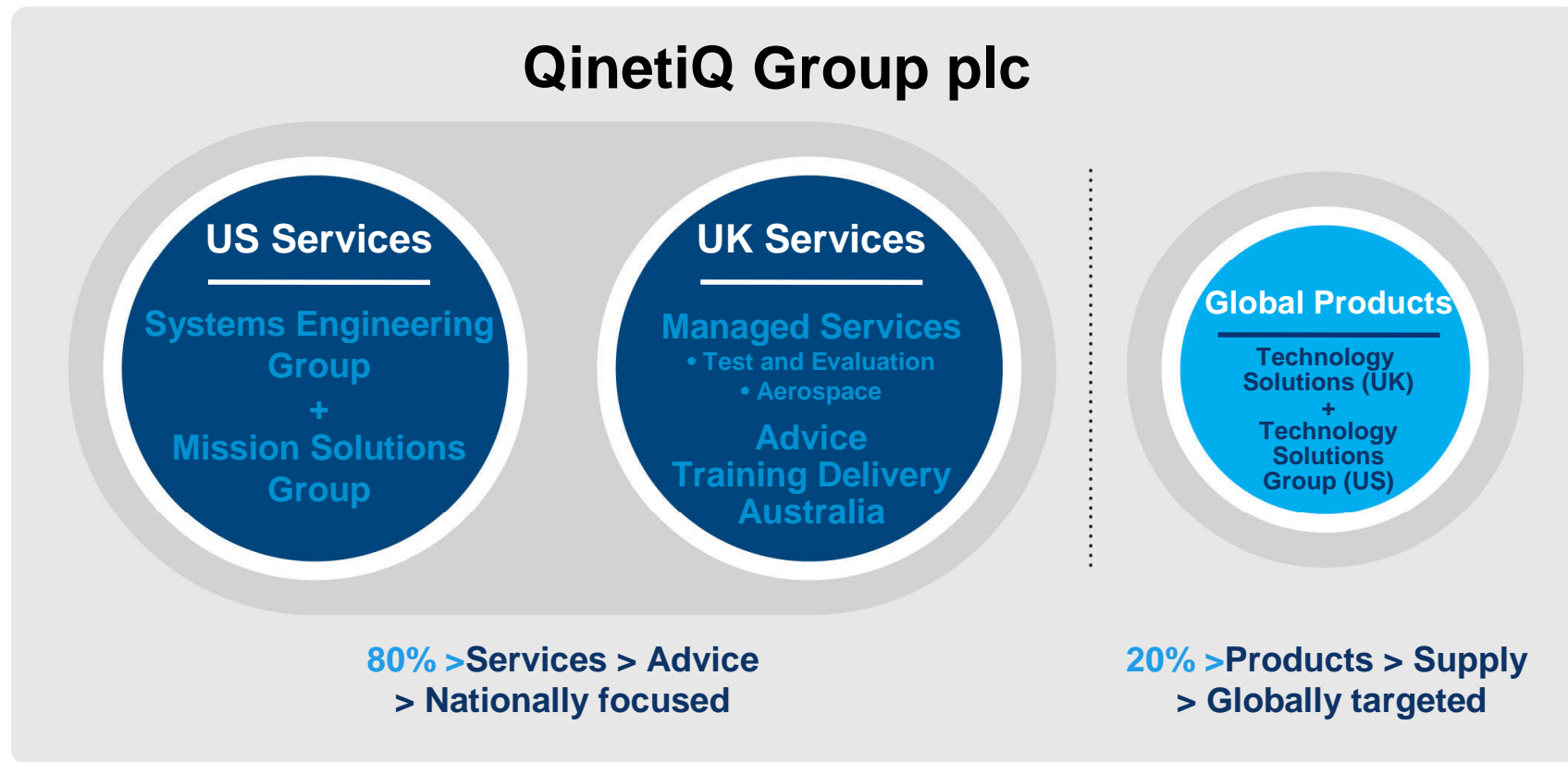
# Where we win is where we play to our strengths

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- ✓ Unique domain knowledge - aerospace, defence, security
- ✓ Trusted partner to governments
  - UK (MOD - Defence Equipment & Support; Dstl; Home Office; Highways Agency)
  - US (DoD and DHS)
- ✓ Proven expertise delivering outsourced technology services at lower cost to taxpayer
  - LTPA, CATS, MSCA
- ✓ Early stage technology development and knowledge regeneration through funded research and hands-on problem solving (UK)
- ✓ Commercialisation of IP into product e.g. Talon®, Q-NETS (US)

**Leveraging our strengths globally**

## 2. Simplify and align structure



**Maximises focus and opportunities**

# Service businesses model

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- Clear customer benefit
  - Outsourcing expert technical services
  - Domain knowledge
- Delivered nationally
- People-based
  - Security clearance
  - Relationship-driven
- Contract 'vehicles'
- Utilisation level – key metric
- More predictable income and cash flow



**Stable earnings**

# Product businesses model

- Technology based – IP exploitation
- Global marketplace, driven by US
  - Existing channel
  - Scalable
- Complementary skills – improve output
  - Research/IP in UK
  - Productisation and business development in US
- Reduce structural cost base
- Higher margins, but uneven revenues



Lumpy profile

# 3. Increase transparency and control

## Standard operational processes

## Single financial reporting pack

- Line of sight, baseline
- Common KPIs

## Rolling quarterly reviews of

- Businesses
- Talent
- Innovation
- Cost takeout (Fit 4 Growth)
- Productivity (My Contribution)
- Portfolio – stop loss-makers

\* F4G = Fit 4 Growth



Relentless process

## 4. Upgrade leaders

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- Rigorously upgrade top 100
- Senior team changes – business leaders; energised
- Results and behaviours – candour, edge, example
- Remove layers
- Leadership charters
- Customer focus – executive account sponsorship
- Align incentives

**Leadership makes the difference**

## 5. Drive performance

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- **Empower** = Accountability with measurement
- **Manage** = Individual performance
- **Enrol** = 'Brains on the case'
- **Engage** = Communicate, communicate, communicate



Proven methodology – tangible benefits

## 6. Reset cost base

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- Fit 4 Growth = commercial process overhaul
  - Win business
  - Value-based selling
  - Negotiating
  - Project delivery
  - Eliminate inefficiencies
  
- Address onerous legacy UK Terms and Conditions



**Future growth depends on competitive cost base**

## 7. Create single QinetiQ mindset

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- Decide investments on global basis
- Leverage domain and technical expertise
  - Ex US/UK, international markets largely untapped
- Share IP – best route to market
- Build on QinetiQ's reputation
- One leadership team



**Extract full potential**

## 8. Strengthen balance sheet – pay down debt

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- Net debt : EBITDA too high – target is below 2x
- Address by self-help
  - Focus on working capital
  - Improve cash generation
  - Eliminate loss-makers
  - Resolve structural cost in UK businesses
- Enables investment in future
- Suspend dividend for 12 months
  - Recommence payment with final dividend for year ending March 2011

**Reduce net debt through self-help**

# Summary: restore QinetiQ to strength

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- Right leaders
- Right investments and priorities
- Right cost base
- Right focus – extract full value from assets
- Right balance sheet

**Build path to sustainable growth**

# Outlook

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- Defence markets remain challenging
  - Strategic Defence and Security Review
- The Board has concluded its review of the operations and reset the priorities of the Group
- Priorities over the next 24 months;
  - reduce costs
  - improve productivity
  - drive cash generation
- Reduce net debt rapidly and refocus and reposition the Group's businesses over the medium term for a return to profitable growth
- Current financial year, service businesses likely to remain steady overall
- Product businesses:
  - benefit from the release of some orders in the US delayed from prior period
  - this will be partially offset by the weaker UK environment
- The Board believes it will meet its expectations for the current year.

# Q&A

# Appendix

# Definitions

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## Underlying performance is stated before:

- Major reorganisation costs
- Business divestments and unrealised impairment of investments
- Amortisation of acquisition related intangible assets
- Impairment of intangible assets and property plant and equipment
- Tax effect of the above

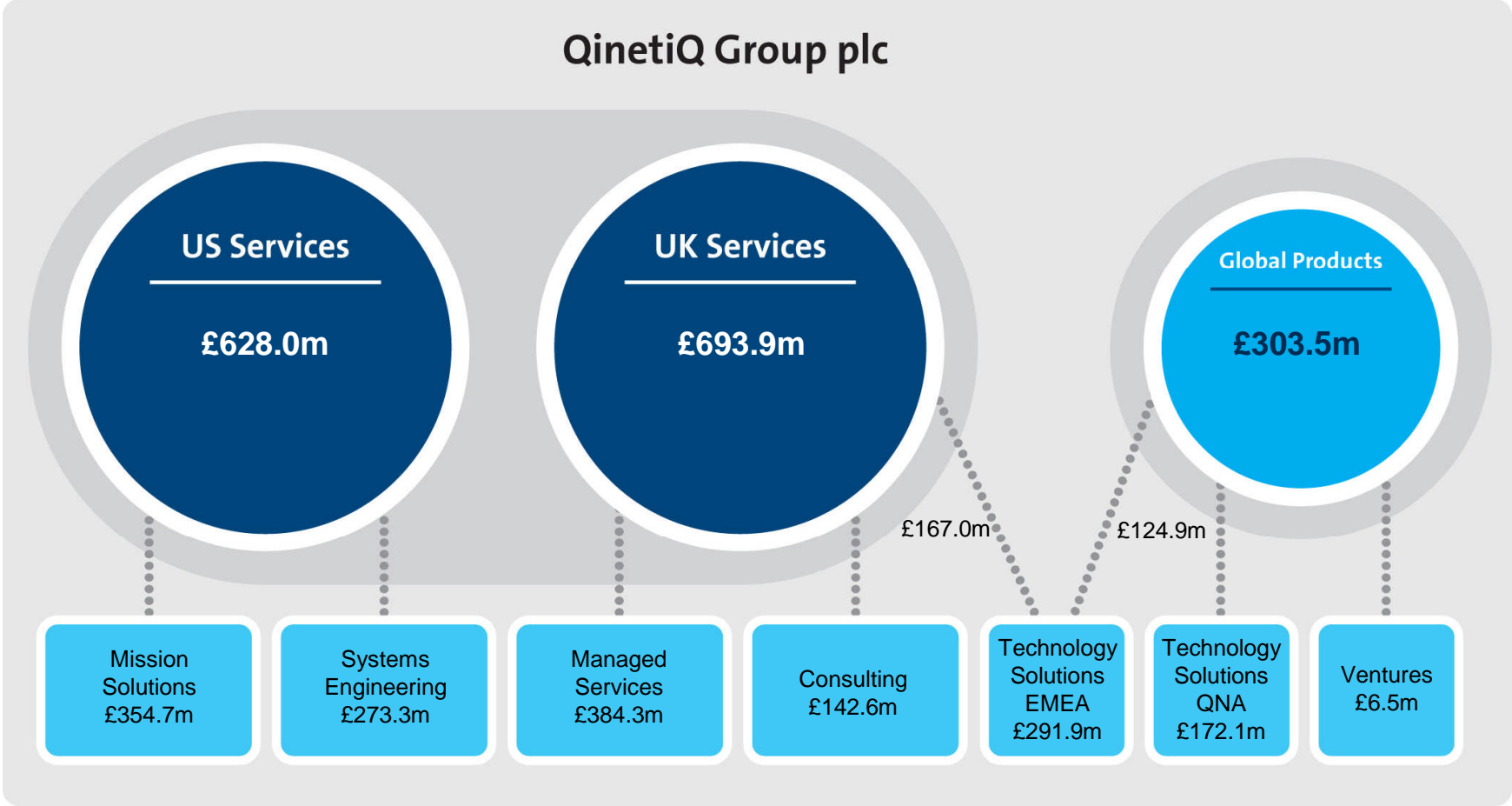
## Organic growth:

- Is calculated at constant foreign exchange rates, adjusting the comparatives to incorporate the results of acquired entities and excluding the results for any disposals for the same duration of ownership as the current period

Prior year comparatives have been restated to show the finance elements of the IAS 19 pension cost in the finance income and expense lines. There is no impact on reported profit before tax from this restatement.

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

# Financial reconciliation to new structure



# Pro-forma segmental analysis for new structure

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Year ended 31 March 2010	Revenue	Operating Profit*	Operating Margin*
	£m	£m	%
US Services Business	628.0	52.6	8.4
UK Services Business	693.9	59.1	8.5
Global Products	303.5	8.6	2.8
Total	1,625.4	120.3	7.4

\* Underlying performance as defined on slide 39

# Detailed income statement

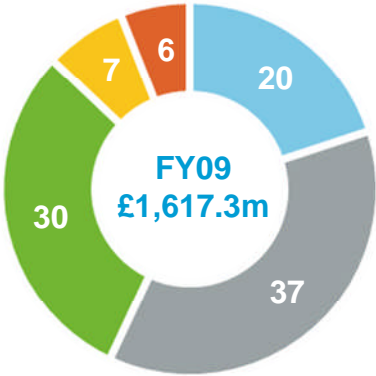
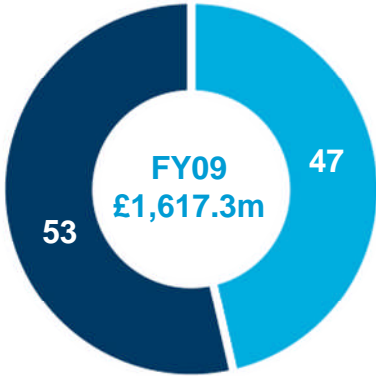
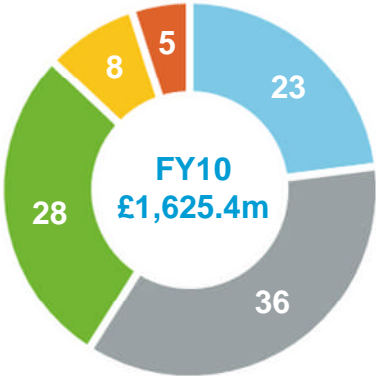
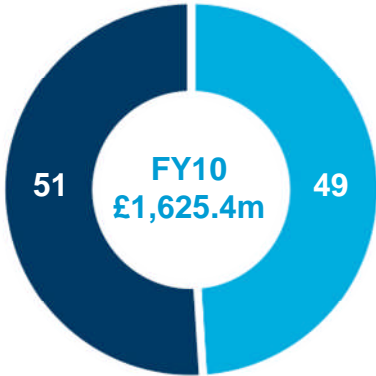
	FY10 £m	FY09 <sup>^</sup> £m
Revenue	<b>1,625.4</b>	1,617.3
Underlying operating profit <sup>^</sup>	<b>120.3</b>	151.6
Net finance expense <sup>^</sup>	<b>(34.6)</b>	(21.4)
Underlying profit before tax	<b>85.7</b>	130.2
Business disposals and asset impairments	<b>(83.6)</b>	7.3
Amortisation of acquisition related intangibles	<b>(26.1)</b>	(23.5)
EMEA restructuring	<b>(42.1)</b>	–
Statutory profit before tax	<b>(66.1)</b>	114.0
Taxation	<b>2.8</b>	(20.4)
Statutory profit after tax attributable to equity shareholders	<b>(63.3)</b>	93.6

<sup>^</sup> Operating profit for FY09 has been restated to show the finance elements of the IAS19 pension cost in the finance income and expense lines. There is no impact on reported profit before tax from this restatement.

# Revenue analysis

	FY10 £m	FY09 £m
Mission Solutions	354.7	289.5
Systems Engineering	273.3	244.5
Technology Solutions QNA	172.1	231.6
<b>QinetiQ North America</b>	<b>800.1</b>	<b>765.6</b>
Managed Services	384.3	370.7
Consulting	142.6	145.1
Technology Solutions EMEA	291.9	326.5
<b>EMEA</b>	<b>818.8</b>	<b>842.3</b>
<b>Ventures</b>	<b>6.5</b>	<b>9.4</b>
<b>Group revenue</b>	<b>1,625.4</b>	<b>1,617.3</b>

# Revenue by sector and customer



Revenue by sector (%)

■ QNA ■ EMEA Ventures (<0.5%)

Revenue by customer (%)

■ Civil/Other Government Agencies ■ MOD  
 ■ DoD ■ DHS ■ Commercial Defence

# Taxation

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	FY10	FY09
Headline tax credit (charge)	2.8	(20.4)
Tax on non-recurring items	(15.7)	(6.3)
Underlying tax charge*	(12.9)	(26.7)

**Underlying tax rate\* %**

**15.0%**

**20.5%**

Underlying tax rate not expected to rise significantly in the medium term\*

\* Underlying performance as defined on slide 39

# Balance sheet

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	FY10 £m	FY09 £m
Goodwill	<b>579.7</b>	638.5
Intangible assets	<b>141.7</b>	164.2
Property, plant and equipment	<b>285.5</b>	332.4
Working capital	<b>107.2</b>	154.0
Retirement benefit obligation (net of tax)	<b>(106.1)</b>	(75.8)
Other assets and liabilities	<b>(76.9)</b>	(72.7)
Net debt	<b>(457.4)</b>	(537.9)
Net assets	<b>473.7</b>	602.7

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# Capital investment

	FY10 £m	FY09 £m
LTPA Expenditure on tangible assets	9.1	12.3
Non LTPA Expenditure on tangible assets	15.0	16.8
<b>Expenditure on tangible assets</b>	<b>24.1</b>	<b>29.1</b>
<b>Investment in intangible assets*</b>		
• Development costs	<b>0.6</b>	0.2
• Purchased software and other intangibles	<b>5.6</b>	3.1
	<b>6.2</b>	<b>3.3</b>
<b>Depreciation and amortisation*</b>		
• Tangible	<b>35.1</b>	33.5
• Intangible assets		
– Development costs	<b>3.0</b>	2.4
– Other*	<b>8.3</b>	6.5
	<b>46.4</b>	<b>42.4</b>

\* Excluding amounts arising on acquisition of the business

# Disclaimer

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## Cautionary statement regarding forward-looking statements

This document contains certain forward-looking statements relating to the business, financial performance and results of the Company and/or the industry in which it operates. Actual results, levels of activity, performance, achievements and events are most likely to vary materially from those implied by the forward-looking statements. The forward-looking statements concern future circumstances and results and other statements that are not historical facts, sometimes identified by the words 'believes', 'expects', 'predicts', 'intends', 'projects', 'plans', 'estimates', 'aims', 'foresees', 'anticipates', 'targets', 'goals', 'due', 'could', 'may', 'should', and similar expressions. These forward-looking statements include, without limitation, statements regarding the Company's future financial position, income growth, impairment charges, business strategy, projected levels of growth in the relevant markets, projected costs, estimates of capital expenditures, and plans and objectives for future operations. Nothing in this document should be regarded as a profit forecast.

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- Defence budgets which are subject to review and change from time to time and the level of available funding open to private contractors in the United Kingdom and United States;
- The winning of new business or retention of previous business through a competitive bidding process;
- The continued growth of the Company's US business and the availability of attractive candidates for further acquisitions;
- The level of pension liability the Company accrues, given market conditions and actuarial factors;
- Material adverse changes in economic conditions in the markets served by the Company; and
- Future regulatory actions and conditions in the Company's operating areas, including competition from others.

Most of these factors are difficult to predict accurately and are generally beyond the control of the Company. Any forward-looking statements made by or on behalf of the Company speak only as of the date they are made. Save as required by law, the Company will not publicly release the results of any revisions to any forward-looking statements in this document that may occur due to any change in the Directors' expectations or to reflect events or circumstances after the date of this document.