Registration number: 01877695

QinetiQ Target Systems Limited

(formerly Meggitt Defence Systems Limited)

Annual report and financial statements

for the year ended 31 December 2016

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
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QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Company information

Directors as at 31/12/2016	Michael Collier Stephen Webster Kim Garrod
Company secretary	Jon Messent (appointed 21 December 2016)
Registered office	Cody Technology Park Ively Road Farnborough Hampshire GU14 0LX
Independent auditors	PricewaterhouseCoopers LLP Savannah House 3 Ocean Way Southampton SO14 3TJ

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Strategic report for the year ended 31 December 2016

The Directors present their strategic report for the year ended 31 December 2016.

Principal activities

The principal activity of the Company during the year was the manufacture of target drones for the armed forces and the performance of related services and the assembly and distribution of converted electro mechanical weapons for simulation and training systems.

Business review

The profit before taxation of the continuing operations was £6.0m (2015: £2.7m) and the Company has net assets of £10.1m as at 31 December 2016 (2015: £5.9m).

On 2 December 2016, the assembly and distribution of converted electro mechanical weapons for simulation and training systems ('Virtual business') was discontinued and sold to Meggitt Training Systems Limited for £5.1m. A gain of £1.4m credited to the Income statement arose on the divestment of Virtual business.

On 21 December 2016, the Company was acquired by QinetiQ Group plc. On 23 December 2016, the Company changed its name to QinetiQ Target Systems Limited.

The Company's key financial and other performance indicators during the year were as follows:

Continuing operations	Unit	2016	2015
Orders	£ m	33.7	12.9
Revenue	£ m	21.0	17.8
Revenue growth	%	18.0	53.4
Profit before tax	£ m	6.0	2.7
Profit for the financial year	£ m	4.8	2.1

The above figures exclude the performance of the Virtual business.

Principal risks and uncertainties

The key risks and uncertainties impacting on the Company relate to the following:

- Reduced spending in the core markets in which the Company operates. EU exit causes a loss of market confidence and reduction in collaborative EU funding. To monitor this risk, the Company monitors and responds to potential opportunities to deliver improved value for money by making proactive proposals that deliver the desired customer outcomes.
- Failure to create a culture of innovation or to invest adequately in or create value from, our innovation investment. To manage this risk, innovation will be driven through cultural change and investment in our core competences for our customers' advantage.
- Failure to meet customers' cost, quality and delivery standards or quality as preferred suppliers. To monitor this risk, the Company continuously maintain a positive engagement with customers with focus on continuous improvement in product and service base.
- The Company operates in many specialised engineering, technical and scientific domains where a lack of domain-specific graduates leads to a future skills shortage. This risk is managed to include succession planning and ensuring our resourcing pipelines are focussed on our critical skills for the future, including Early Careers.
- A breach of data security, cyber attacks or IT systems failure could have an adverse impact on our customers' operations. Information systems are designed with consideration to single points of failure and comply with relevant accreditation standards. Cyber security is monitored using an internal cyber dashboard.

Principal risks and uncertainties (continued)

- The Company operates in highly regulated environments and recognises that its operations have the potential to have an impact on a variety of stakeholders. The Company has robust policy, procedures and training in place. The QinetiQ Code of Conduct defines clear expectations for the Company and its employees. Key areas of focus for the Company include the following: safety of product and services, health, safety & environment, bribery and ethics, and international trade controls.

Approved by the Board on 26/9/17 and signed by its order by:

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Iain Farley
Director
Cody Technology Park
Ively Road
Farnborough
Hampshire
GU14 0LX

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Directors' report for the year ended 31 December 2016

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

The Company is a private company limited by shares and is incorporated, registered and domiciled in England, registered number 01877695. The address of the registered office is Cody Technology Park, Ively Road, Farnborough, GU14 0LX. The Company is a wholly owned subsidiary of QinetiQ Group plc.

Directors' of the company
The Directors of the Company who were in office during the year and up to the date of signing the financial statements were

Michael Collier (appointed 21 December 2016)

Stephen Webster (appointed 21 December 2016 and resigned 12 January 2017)

Kim Garrod (appointed 21 December 2016 and resigned 12 January 2017)

Douglas Webb (resigned 21 December 2016)

Marina Thomas (resigned 21 December 2016)

Philip Green (resigned 21 December 2016)

Derek O'Neill (resigned 21 December 2016)

Ian Pargeter (resigned 21 December 2016)

Stephen Young (resigned 21 December 2016)

The following directors were appointed after the year end:

Iain Farley (appointed 12 January 2017)

Peter Longstaff (appointed 12 January 2017)

Research and development
The Company incurred £1.1m (2015: £0.8m) research and development cost in the year and this was expensed to the Income statement.

Foreign exchange risk management
The majority of the Company's income and expenditure is settled in sterling. The Company's policy is to use financial instruments to hedge all material transaction exposure at the point of commitment to the underlying transaction. The Company does not typically hedge uncommitted future transactions, although transaction risks are fully considered and appropriately mitigated when bidding for new work.

Dividends
The Company paid a dividend of £3.0m (2015: £1.4m) during the year to its former parent company, Meggitt Properties Plc.

The directors do not propose a final dividend (2015: £nil).

Political donations
No political donations have been made during the year (2015: £nil).

Employees
The Company is committed to the fair treatment of people with disabilities in relation to applications, training, promotion and career development. If an existing employee becomes disabled, we make every effort to enable them to continue their employment and career development, and to arrange appropriate training, wherever practicable.

Environment

The Company is on target to successfully transition to ISO 14001-2015 and are due to achieve certification in the next financial year. Part of this has been our ongoing commitment to review policy and process and communication with our people.

Future developments

The directors are comfortable that the Company has the right strategy in place to drive future growth with further enhancement planned on its product range.

Directors' indemnities

The directors had the benefit of qualifying third-party indemnity provisions for the purposes of section 234 of the Companies Act 2006. This remained in force during the financial year under review and ceased upon the adoption of replacement Articles of Association on 24 February 2017.

Disclosure of information to the auditors

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

Independent auditors

Pursuant to Section 487 of the Companies Act 2006, the auditors will be deemed to be reappointed and PricewaterhouseCoopers LLP will therefore continue in office.

Approved by the Board on 26/9/17 and signed by its order by:

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Iain Farley
Director
Cody Technology Park
Ively Road
Farnborough
Hampshire
GU14 0LX

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual 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 prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework' and applicable law). 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 Company and of the profit or loss of the Company for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable United Kingdom Accounting Standards, comprising FRS 101, have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor's report to the members of QinetiQ Target Systems Limited

Report on the financial statements

Our opinion
In our opinion, QinetiQ Target Systems Limited's financial statements (the 'financial statements'):

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit and cash flows for the year then ended;
- 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.

What we have audited
The financial statements, included within the Annual report and financial statements (the 'Annual Report'), comprise:

- the Balance sheet as at 31 December 2016;
- the Income statement for the year then ended;
- the Statement of cash flows for the year then ended;
- the Statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation of the financial statements is United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework', and applicable law (United Kingdom Generally Accepted Accounting Practice).

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

Opinion on other matter prescribed by the Companies Act 2006
In our opinion, based on the work undertaken in the course of the audit:

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

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

Independent auditor's report to the members of QinetiQ Target Systems Limited (continued)

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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

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

Responsibilities for the financial statements and the audit
Our responsibilities and those of the directors:

As explained more fully in the Statement of Directors' Responsibilities set out on page 6, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

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

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

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

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

Independent auditor's report to the members of QinetiQ Target Systems Limited (continued)

What an audit of financial statements involves (continued)

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

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Trevor Smith (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP,
Chartered Accountants and Statutory Auditors
Southampton

Date: 29 September 2017

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Income statement for the year ended 31 December 2016

	Note	2016 £ 000	2015 £ 000
Continuing operations			
Revenue	3	20,959	17,775
Cost of sales		(10,555)	(10,899)
Gross profit		10,404	6,876
Distribution costs		(1,174)	(1,101)
Administrative expenses		(3,163)	(3,021)
Operating profit	4	6,067	2,754
Interest payable and similar expenses	5	(24)	(31)
Profit before taxation		6,043	2,723
Tax on profit	8	(1,195)	(588)
Profit for the year from continuing operations		4,848	2,135
Discontinued operations			
Profit before tax - discontinued operations	9	2,578	1,192
Tax in respect of discontinued operations	9	(229)	(238)
Profit for the year from discontinued operations		2,349	954
Profit for the financial year attributable to equity shareholders		7,197	3,089

The Company has no other comprehensive income or expenses other than the results for the years as set out above, and therefore no separate statement of comprehensive income has been presented.

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Balance sheet as at 31 December 2016

	Note	2016 £ 000	2015 £ 000
Fixed assets			
Intangible assets	10	59	2,200
Property, plant and equipment	11	803	581
		862	**2,781**
Current assets			
Inventories	12	6,791	4,521
Trade and other receivables	13	4,642	5,122
Deferred tax assets	14	124	129
Cash and cash equivalents		1,292	6
		12,849	**9,778**
Current liabilities			
Creditors: amounts falling due within one year	15	(3,363)	(6,369)
Other financial liabilities	16	-	(98)
Net current assets		**9,486**	**3,311**
Total assets less current liabilities		**10,348**	**6,092**
Non-current liabilities			
Provisions for liabilities	17	(210)	(190)
Net assets		**10,138**	**5,902**
Capital and reserves			
Called up share capital	18	5	5
Share based payment reserve		-	962
Retained earnings		10,133	4,935
Total shareholders' funds		**10,138**	**5,902**

The financial statements of QinetiQ Target Systems Limited (company number 01877695) on pages 10 to 29 were approved by the Board on 26/9/17 and signed on its behalf by:

Peter Longstaff
Director

The notes on pages 14 to 29 form an integral part of these financial statements.

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Statement of changes in equity for the year ended 31 December 2016

	Called up share capital £ 000	Share based payment reserve £ 000	Retained earnings £ 000	Total shareholders funds' £ 000
At 1 January 2015	5	909	3,202	4,116
Profit and total comprehensive income for the year	-	-	3,089	3,089
Dividends	-	-	(1,356)	(1,356)
Recognition of equity-settled share-based payments in the year	-	53	-	53
At 31 December 2015	5	962	4,935	5,902

	Called up share capital £ 000	Share based payment reserve £ 000	Retained earnings £ 000	Total shareholders funds' £ 000
At 1 January 2016	5	962	4,935	5,902
Profit and total comprehensive income for the year	-	-	7,197	7,197
Dividends	-	-	(3,000)	(3,000)
Recognition of equity-settled share-based payments in the year	-	39	-	39
Transfer to retained earnings	-	(1,001)	1,001	-
At 31 December 2016	5	-	10,133	10,138

The only transactions with owners in both years is the payment of the dividends as set out above. Dividends were paid to the former parent company, Meggitt Properties Plc., during the period of ownership.

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Statement of cash flows for the year ended 31 December 2016

	Note	2016 £ 000	2015 £ 000
Cash flows from operating activities			
Profit for the financial year		7,197	3,089
Adjustments to cash flows from non-cash items:			
Depreciation	11	360	344
Amortisation	10	14	2
Finance costs	5	24	31
Share based payment transactions		39	39
Taxation expense	8	1,195	588
Gain on business divestment		(1,433)	-
		7,396	4,093
Working capital adjustments:			
Increase in inventories		(2,321)	(204)
Increase in receivables		(1,478)	(3,302)
(Decrease)/increase in payables		(2,870)	1,350
Net movement in provision		20	80
Cash generated from operations		747	2,017
Tax paid		(892)	(223)
Net cash flow (used in)/generated from operating activities		(145)	1,794
Cash flows from investing activities			
Purchases of property, plant and equipment	11	(596)	(385)
Purchases of intangible assets	10	(49)	(24)
Proceeds from business divestments		5,100	-
Net cash flows generated from/(used in) investing activities		4,455	(409)
Cash flows from financing activities			
Interest paid		(24)	(31)
Dividends paid	7	(3,000)	(1,356)
Net cash flows used in financing activities		(3,024)	(1,387)
Net increase/(decrease) in cash and cash equivalents		1,286	(2)
Cash and cash equivalents at 1 January		6	8
Cash and cash equivalents at 31 December		1,292	6

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Notes to the financial statements

1 Basis of preparation and accounting policies

The following accounting policies have been applied consistently to all periods presented in dealing with items which are considered material in relation to the financial statements.

Basis of preparation

The financial statements have been prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ('FRS 101'). The financial statements have been prepared on the historical cost basis, modified by financial assets and liabilities held at fair value through the Income statement and in accordance with the Companies Act 2006.

The preparation of financial statements in conformity with FRS 101 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas requiring a higher degree of judgement or complexity or areas where assumptions and estimates are significant to the financial statements are discussed in critical accounting estimates and judgements.

The Company has taken advantage of the following disclosure exemptions under FRS 101:

- the requirements of paragraphs 45(b) and 46-52 of IFRS 2 Share based payments;
- the requirements of IFRS 7 Financial Instruments: Disclosures;
- the requirements of paragraphs 91 - 99 of IFRS 13 Fair Value Measurement;
- the requirements in paragraph 38 of IAS 1 'Presentation of Financial Statements' to present comparative information in respect of: (i) paragraph 79(a) (iv) of IAS 1, (ii) paragraph 73(e) of IAS 16 Property, plant and equipment (iii) paragraph 118 (e) of IAS 38 Intangible Assets, and (iv) paragraphs 76 and 79(d) of IAS 40 Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A to 38D, 39 to 40, 111 and 134-136 of IAS 1 Presentation of Financial Statements;
- the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraphs 134(d) - 134(f) and 135(c) - 135(e) of IAS 36 Impairment of Assets.

Going concern

The Directors are comfortable that the Company have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

1 Basis of preparation and accounting policies (continued)

Revenue

Revenue represents amounts receivable for goods and services provided in the normal course of business, net of trade discounts, VAT and other sales related taxes. Revenue is recognised when the earnings process is complete which occurs when the products are shipped to the customer, title and risk of loss have been transferred and collection is probable. On contracts where the Company fulfils its obligations with input from other Group entities, the Company recognises revenue on a gross basis where it is the primary obligator in the arrangement and maintains the credit risk.

Contract accounting revenue: The Company 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 total contract revenue, the proportion costs incurred for work performed in the period bear to total estimated contract costs. Where it is not possible to reliably estimate the outcome of a contract, revenue is recognised equal to 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.

Taxation

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on all temporary differences arising from the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date. Deferred tax assets and liabilities are offset, only if a legally enforceable right exists to set off current tax assets against current tax liabilities, the deferred taxes relate to the same taxation authority and that authority permits the company to make a single net payment.

Income tax is charged or credited to other comprehensive income if it relates to items that are charged or credited to other comprehensive income. Similarly, income tax is charged or credited directly to equity if it relates to items that are credited or charged directly to equity. Otherwise income tax is recognised in the Income statement.

Foreign currencies

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

Operating leases

Rentals payable under operating leases are charged to the Income statement evenly over the term of the lease.

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Notes to the financial statements (continued)

1 Basis of preparation and accounting policies (continued)

Intangible assets

Research and development expenditure is expensed as incurred, with the exception of development expenditure on projects that are undertaken where the related expenditure is separately identifiable and management are satisfied as to the ultimate commercial viability of the project based on all relevant available information. In such cases, the expenditure is capitalised as development costs within intangible fixed assets and written off over the periods expected to benefit commencing with the launch of the project. Development expenditure is reviewed annually for impairment.

Intangible assets are amortised over their respective useful lives on a straight line basis as follows:

Development costs	1 - 4 years
Software	3 years

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation and any provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. There have been no impairments to date.

Property, plant and equipment are depreciated on a straight-line basis over their useful economic lives to their estimated residual value as follows:

Plant, equipment and vehicles	2 - 10 years
Leasehold property	Shorter of useful economic life and the period of the lease

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

The gain or loss arising on the disposal of the asset is determined as the difference between the sale proceeds and the carrying value of the asset, and is recognised in the Income statement.

1 Basis of preparation and accounting policies (continued)

Impairment of fixed assets
The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in the Income statement.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) prior years. A reversal of an impairment loss is recognised immediately in the Income statement.

Inventories
Inventories are valued at the lower of cost and net realisable value. Cost represents materials, direct labour and production overheads. Net realisable value is based on estimated selling price, less further costs expected to be incurred to completion and disposal. Provision is made for obsolete, slow moving or defective items where appropriate.

Work in progress is valued on the basis of direct costs plus attributable overheads based on normal level of activity. Provision is made for any foreseeable losses where appropriate. No element of profit is included in the valuation of work in progress.

Provisions
A provision is made for product warranty claims when the Company has a present legal or constructive obligation as a result of a past event which can be reliably estimated, and it is probable that an outflow of economic benefits will be required to settle the obligation.

Dividends
Dividends paid are shown as a movement in reserves. Dividends are approved and paid within the financial year.

1 Basis of preparation and accounting policies (continued)

Post-retirement benefits

In the prior year and up to the acquiring date of 21 December 2016, the Company was a subsidiary of Meggitt Plc and certain employees of the Company were members of Meggitt group pension schemes, which were both defined benefit and defined contribution schemes funded by both employer's and employees' contributions.

Meggitt operated a defined contribution scheme, the Meggitt Workplace Savings Plan. The assets of the scheme were held separately from those of the company independently administered funds. The minimum level of employee contribution is 3% and the minimum level of employer contributions is 5%. The amounts charged to the Income statement is the contribution payable in the year.

With regards to the defined benefit scheme, as more than one employer participates in the Meggitt Plc group pension schemes and because each company was unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis, the Company was accounting for its contributions to the schemes as if they were defined contributions schemes. Accordingly, the cost of the Company's contributions to the schemes are equal to the contributions payable to the schemes during the year, and this cost has been recognised within operating profit.

From the acquiring date of 21 December 2016 the employees of the Company were no longer active members of defined benefit scheme and became members of the QinetiQ defined contribution plan. For defined contributions plan, the Company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Share based payments

In the prior year, the Company operated a number of equity-settled share-based compensation schemes. The fair value of equity-settled awards for share-based payments was determined on grant and reflects any market-based vesting conditions. Non market-based vesting conditions were excluded from the fair value of the award. At the date of the grant the Company estimated 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 was recognised as an expense in the Income statement on straight-line basis over the period for which services are received. At each balance sheet date the Company revised its estimate of the number of awards expected to vest as a result of non market-based vesting conditions and adjusted the amount recognised cumulatively in the Income statement to reflect the revised estimate.

The share based payments schemes were awarded to the senior executives and employees of the Company and since the Company was acquired by QinetiQ Group plc on 21 December 2016, the share based payments liability remains with Meggitt Plc, the former parent company. No awards have been made since being under QinetiQ ownership.

Financial instruments

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

1 Basis of preparation and accounting policies (continued)

Derivatives financial instruments

The Company uses derivatives financial instruments to hedge its exposure to foreign currency transactional risk. Derivative financial instruments are initially recognised and thereafter held at fair value, being the market value for quoted instruments or valuation based on models and discounted cash flow calculations for unlisted instruments.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and short-term deposits that are readily convertible into cash. Bank overdrafts are shown within borrowings in current liabilities.

2 Critical accounting judgements and key sources of estimation uncertainty

In the application of the Company's accounting policies, the directors are required to make judgements, estimates and assumptions about the carrying amount of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The estimates and assumptions which have a significant risk of causing a material adjustment to the carrying amount of asset and liabilities are outlined below.

Critical judgements

Estimated useful lives of property, plant and equipment

The estimated useful economic lives of property, plant and equipment are based on the Company's judgement and experience. When the Company identifies that actual useful economic lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Variations between actual and estimated useful economic lives could impact operating results both positively and negatively, although historically no changes to estimated useful lives have been required.

Inventory provisioning

The Company is a manufacturer of target drones and associated training systems. As a result, it is necessary to consider the recoverability of the cost of inventory and the associated provisioning required. When calculating the inventory provision, management considers the nature and condition of the inventory as well as applying assumptions around associated saleability of finished goods and future usage of raw materials. Details on the net carrying amount of the inventory and associated provision are shown on note 12.

3 Revenue - continuing operations

The revenue and profit before taxation are attributable to the one principal activity of the Company.

An analysis of the Company's revenue by customer geographic location is as follows:

	UK £ 000	Rest of Europe £ 000	North America £ 000	Rest of World £ 000	Total £ 000
2016					
Revenue	2,479	10,968	113	7,399	20,959

	UK £ 000	Rest of Europe £ 000	North America £ 000	Rest of World £ 000	Total £ 000
2015					
Revenue	3,066	5,749	481	8,479	17,775

4 Operating profit

Arrived at after charging/(crediting)

	2016 £ 000	2015 £ 000
Movement in fair value of foreign currency forward contracts	-	74
Research and development costs	1,062	760
Fees payable to the Company's auditors for the audit of the Company's financial statements	33	29
Depreciation of property, plant and equipment	360	344
Amortisation of intangible assets	14	2
Raw materials and consumables used	8,434	8,219
Changes in inventories of finished goods and work in progress	929	(227)
Staff costs	5,026	4,286
Operating lease costs - land and building	298	269
Exceptional cost	-	299

In the prior year, the exceptional cost relates to costs incurred as part of Meggitt Group-wide initiative to structurally reduce its cost based announced on 28 October 2015.

5 Interest payable and similar expenses - continuing operations

	2016 £ 000	2015 £ 000
Interest payable to Group undertakings	24	31

QinetiQ Target Systems Limited
(formerly Meggitt Defence Systems Limited)
Notes to the financial statements (continued)

6 Particulars of employees

The average monthly number of employees (excluding directors) during the year, were:

	2016 No.	2015 No.
Selling and distribution	9	9
Administration	10	9
Production	93	79
	112	97

The aggregate payroll costs of these persons were as follows:

	2016 £ 000	2015 £ 000
Wages and salaries	4,148	3,562
Social security costs	411	318
Other pension costs	428	367
Share-based payments costs	39	39
Total employee costs	5,026	4,286

All of the directors who served during the year until 21 December 2016, the date of acquisition by QinetiQ Group plc, were employees of the former ultimate parent company, Meggitt PLC, and were remunerated by that company for their services to the group as a whole. The directors who served up to 21 December 2016 did not receive any remuneration in their capacity as directors of QinetiQ Target Systems Limited, as their services to the company were incidental to their services to the group (2015: £nil).

None of the directors who served after 21 December 2016 receive any emoluments from the company for their services during the year as their services to the company were incidental to their services to QinetiQ Group.

7 Dividends

	2016 £ 000	2015 £ 000
Interim dividend of £600.00 (2015 - £271.20) per ordinary share	3,000	1,356

On 19 December 2016 the Directors approved the payment of an interim dividend of £600.00 per £1 ordinary share totalling £3.0m (2015: £271.20 per £1 ordinary share totalling £1.4m). All dividends were approved and paid during the financial year.

8 Tax on profit - continuing operations

(a) Analysis of tax charge in the year

	2016 £ 000	2015 £ 000
Current tax		
UK corporation tax	1,190	570
Adjustments in respect of prior periods	-	(24)
Total current tax	1,190	546
Deferred tax		
Arising from origination and reversal of temporary differences	4	55
Deferred tax in respect of prior years	(6)	(13)
Impact of change in tax laws and rates	7	-
Total deferred tax	5	42
Total tax charge for the year	1,195	588

(b) Tax charge reconciliation

The total tax charge for the year is lower (2015: higher) than the standard rate of corporation tax in the UK of 20% (2015: 20.25%). The differences are reconciled below:

	2016 £ 000	2015 £ 000
Profit before tax	6,043	2,723
Tax calculated at UK standard rate of corporation tax of 20% (2015: 20.25%)	1,209	551
Expenses not deductible for tax purposes and other non-taxable items	40	70
Research and development expenditure credits/relief	(54)	-
Tax overprovided in respect of previous years	(7)	(37)
Change in tax laws and rate	7	-
Total tax charge for the year	1,195	584

(c) Factors that may affect future tax charges

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and to 18% (effective 1 April 2020) had previously been substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the company's future tax charge accordingly. Deferred tax has been calculated using the future statutory tax rates enacted as at 31 December 2016.

9 Discontinued operations

On 2 December 2016, the Company disposed of its Virtual business, which had a principal activity of assembly and distribution of converted electro mechanical weapons for simulation and training systems for a consideration of £5.1m. The business which was not a major line of business or geographical area of location of the Company were no longer considered core to the Company's operations.

a) Results of discontinued operations

The results of the discontinued operations, which have been included in the Income statement, were as follows:

	2016 £ 000	2015 £ 000
Revenue	7,367	5,818
Cost of sales	(6,222)	(4,626)
Operating profit	1,145	1,192
Profit on sale of discontinued operations	1,433	-
Profit before tax of discontinued operations	2,578	1,192
Taxation	(229)	(238)
Profit for the year from discontinued operations	2,349	954

b) Cash flows from discontinued operations

The discontinued operations results contributed the following to the cash flow:

	2016 £ 000	2015 £ 000
Net cash inflows from operating activities	206	1,674
Net cash outflows from investing activities	(2)	(5)
Net cash inflows for the year	204	1,669

9 Discontinued operations (continued)

b) Effect of disposal on the financial position of the Company

	Fair value at 2 December 2016 £ 000
Assets and liabilities disposed of:	
Property, plant and equipment (note 11)	14
Intangible assets - goodwill (note 10)	2,176
Inventory	51
Trade and other receivables	1,958
Trade and other creditors	(532)
Net assets	3,667
Gain on business divestments	1,433
Total considerations received in cash	5,100
Cash flow analysis:	
Total consideration received in cash	5,100
Less: cash and cash equivalent balances disposed of	-
Net cash inflow arising on disposal	5,100

A profit of £1.4m arose on the disposal of Virtual business, calculated as the proceeds of disposal less the carrying amount of the subsidiary's net assets and attributable goodwill.

10 Intangible assets

	Goodwill £ 000	Software £ 000	Development costs £ 000	Total £ 000
Cost				
At 1 January 2016	3,203	63	430	3,696
Additions	-	49	-	49
Divestments	(3,203)	-	-	(3,203)
At 31 December 2016	-	112	430	542
Accumulated amortisation				
At 1 January 2016	1,027	39	430	1,496
Amortisation charge for year	-	14	-	14
Divestments	(1,027)	-	-	(1,027)
At 31 December 2016	-	53	430	483
Net book value				
At 31 December 2016	-	59	-	59
At 31 December 2015	2,176	24	-	2,200

10 Intangible assets (continued)

Intangible assets amortisation is recorded in administrative expenses in the Income statement. Divestments were in respect of the disposal of Virtual business (see note 9).

11 Property, plant and equipment

	Plant, equipment and vehicles £ 000	Leasehold property £ 000	Total £ 000
Cost			
At 1 January 2016	2,890	1,564	4,454
Additions	350	246	596
Divestments	(371)	-	(371)
At 31 December 2016	2,869	1,810	4,679
Accumulated depreciation			
At 1 January 2016	2,325	1,548	3,873
Charge for the year	330	30	360
Divestments	(357)	-	(357)
At 31 December 2016	2,298	1,578	3,876
Net book value			
At 31 December 2016	571	232	803
At 31 December 2015	565	16	581

Divestments were in respect of the disposal of Virtual business (see note 9).

12 Inventories

	2016 £ 000	2015 £ 000
Raw materials	2,854	1,513
Work in progress	1,423	1,497
Finished goods	2,514	1,511
	6,791	4,521

Inventories are stated after provisions for impairment of £2.5m (2015: £2.1m).

13 Trade and other receivables

	2016 £ 000	2015 £ 000
Trade receivables	3,952	3,944
Amounts owed by fellow subsidiary undertakings	635	-
Other receivables	-	61
Prepayments and accrued income	55	1,117
	4,642	5,122

14 Deferred tax assets

	Short-term timing differences £ 000	Fixed assets £ 000	Total £ 000
At 1 January 2016	20	109	129
(Charged)/credited to the Income statement	(20)	15	(5)
Deferred tax asset at 31 December 2016	-	124	124

	Short-term timing differences £ 000	Fixed assets £ 000	Total £ 000
At 1 January 2015	89	85	174
(Charged)/credited to the Income statement	(69)	24	(45)
Deferred tax asset at 31 December 2015	20	109	129

15 Creditors: amounts falling due within one year

	2016 £ 000	2015 £ 000
Trade creditors	873	2,712
Amounts owed to fellow subsidiary undertakings	500	1,561
Accruals and deferred income	1,184	970
Other taxes and social security	653	803
Other creditors	153	323
	3,363	6,369

16 Other financial liabilities

	2016 Assets £ 000	2016 Liabilities £ 000	2016 Net £ 000	2015 Assets £ 000	2015 Liabilities £ 000	2015 Net £ 000
Fair value:						
US dollars forward purchases ($/£)	-	-	-	-	(98)	(98)
Non-current assets/(liabilities)						
US dollars forward purchases ($/£)	-	-	-	-	(1,831)	(1,831)

At 31 December 2015 although the Company 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.

At 31 December 2016 there is £nil foreign currency forward contracts.

17 Provisions for liabilities

	2016 £ 000
At 1 January 2016	190
Created in year	198
Utilised in year	(178)
At 31 December 2016	210

	2015 £ 000
At 1 January 2015	110
Created in year	204
Utilised in year	(124)
At 31 December 2015	190

18 Called up share capital

Allotted, called up and fully paid shares

	2016 No.	2016 £ 000	2015 No.	2015 £ 000
Ordinary shares of £1 each	5,000	5	5,000	5

19 Transactions with other related parties

	2016 £ 000
Sales and purchases of goods and services:	
Sales of various goods and services from other related parties in QinetiQ Group	2,459
Purchases for various goods and services from other related parties in QinetiQ Group	(206)
Purchases for various goods and services from other related parties in Meggitt Group	(6,862)
Purchase of management services from former parent, Meggitt Plc	(424)
Other transactions:	
Dividend paid to former immediate parent entity, Meggitt Properties Plc	3,000

In the prior year, as the Company has taken the exemption under FRS 101 available in respect of transactions with wholly owned subsidiaries on the grounds that the former ultimate parent undertaking included the Company in its own published consolidated financial statements. In the prior year transactions were with wholly owned subsidiaries or third party companies.

20 Share-based payments

In prior year the Company operated a number of equity settled share schemes for the benefit of its employees. The total expense recorded in the Income statement for the year in respect of such schemes was £39,000 (2015: £39,000). On 21 December 2016, the acquisition date by QinetiQ Group plc, the share based payments liability remains with Meggitt Plc, the former parents company and therefore QinetiQ Target Systems Limited have recycled the share based payment reserve of £1,001,000 to retained earnings.

21 Retirement benefit schemes

In the prior year and up to the acquiring date of 21 December 2016, the Company was a subsidiary of Meggitt Plc and certain employees of the Company were members of group pension schemes, which were both defined benefit and defined contribution schemes. With regards to the defined benefit scheme, the full deficit was recorded in the books of Meggitt Plc as the sponsoring employer following its transition to FRS 101. The Company was therefore accounting for its contributions to the schemes as if they are were defined contribution schemes.

For the defined contribution scheme, the pension cost charged to the Income statement, representing employer's contributions was £262,000 (2015: £218,000).

For the defined benefit scheme, the pension cost charged to the Income statement consists of employer's contributions payable which are similar across the group as a whole as a percentage of pensionable earnings. Based on advice from a qualified actuary, the Company contributions for the year was £166,000 (2015: £149,000).

From the acquiring date of 21 December 2016 the employees of the Company were no longer active members of defined benefit scheme and became members of QinetiQ defined contribution plan. For defined contributions plan, the Company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

22 Operating lease commitments

Lessee

Amounts recognised in the Income statement as an expense during the year in respect of operating lease arrangements are as follows:

	2016 £ 000	2015 £ 000
Minimum lease payments under operating lease	(298)	(269)

At the reporting end date the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2016 £ 000	2015 £ 000
Within one year	71	264
Between two to five years	-	71
	71	335

A new lease has been signed on 31 March 2017 and will cost £295,000 per annum until 2027.

23 Parent undertaking and control

In the prior year up to 21 December 2016, the immediate parent undertaking was Meggitt Properties Plc. The ultimate parent undertaking and controlling party was Meggitt Plc, a company incorporated in England and Wales. Meggitt Plc is the parent undertaking of the smallest and largest group of undertakings to consolidate these results for the period to 21 December 2016. The consolidated financial statements of Meggitt Plc are available from its registered office: Atlantic House, Aviation Park West, Bournemouth International Airport, Christchurch, Dorset, BH23 6EW.

From 21 December 2016, the ultimate parent undertaking and controlling party is QinetiQ Group plc, a company registered in England and Wales. The immediate parent undertaking is QinetiQ Holdings Limited, a company registered in England and Wales. QinetiQ Group plc and QinetiQ Holdings Limited have financial year ends of 31 March. QinetiQ Group plc is the parent undertaking of the smallest and largest group of undertakings to consolidate the Company's results from 21 December 2016. The consolidated financial statements of QinetiQ Group plc are available from its registered office: Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX.