

28 February 2017

Meggitt PLC 2016 Full-year results

Stronger H2 as expected; further progress on strategic initiatives

Meggitt PLC (“Meggitt” or “the Group”), a leading international engineering company specialising in high performance components and sub-systems for the aerospace, defence and energy markets, today announces audited results for the year ended 31 December 2016.

Group headlines

£m		2016	2015	% change	
				Reported	Organic ¹
Orders		1,990.5	1,630.5	+22	+3
Revenue		1,992.4	1,647.2	+21	+1
Underlying ²					
	EBITDA ³	487.8	414.5	+18	-1
	Operating profit	379.7	325.5	+17	-3
	Profit before tax	352.1	310.3	+13	-3
	Earnings per share (p)	34.8	31.6	+10	
Statutory					
	Operating profit	233.7	236.6	-1	
	Profit before tax	195.5	210.2	-7	
	Earnings per share (p)	22.1	23.2	-5	
Free cash flow ⁴		131.1	199.0	-34	-35
Net debt		1,179.1	1,051.2	+12	
Dividend (p)		15.10	14.40	+5	

- Good organic order intake supports 2017 growth expectations
- Reported revenue growth of 21% benefitted from foreign currency movements and the composites acquisitions completed in late 2015
- Group organic revenue growth of 1%: organic revenue growth of 4% in civil aerospace and 1% in military partially offset by continued weakness in energy
- Underlying operating profit growth of 17% includes benefit from currency and composites acquisitions. Underlying operating margin reduced to 19.1% due to revenue mix, acquisitions and increased depreciation and amortisation
- Further progress on strategic initiatives:
 - Furthest advanced Meggitt Production System (MPS) sites achieving significant inventory and productivity improvement
 - Customer Services & Support (CSS) contributing to strong growth in civil aftermarket: 5.4% versus market growth of 3.5%⁵
 - Footprint rationalisation programme: three sites closed in 2016
 - Portfolio rationalisation: disposal of Meggitt Target Systems
- Integration of composites acquisitions progressing well – synergy target increased 30% to \$12.7m
- Statutory profit before tax decline included £66m non cash loss on the marking to market of financial instruments, principally currency hedges

¹ Organic numbers exclude the impact of acquisitions and foreign exchange. The results of Meggitt Target Systems, which was disposed of by the Group on 21 December 2016, have been included in organic performance for the year given the proximity of the disposal to the balance sheet date.

² Underlying profit and EPS are used by the Board to measure the trading performance of the Group as set out in notes 5 and 11.

³ Underlying EBITDA represents underlying operating profit adjusted to add back depreciation, amortisation and impairment losses.

⁴ Free cash flow as set out in note 24.

⁵ Cannacord Genuity 2016 component maintenance, repair and overhaul (MRO) market inclusive of repairs and spare parts (Herbert, 19 Jan 2017).

- Healthy balance sheet with net debt:EBITDA⁶ reduced to 2.1x, well within target range
- Recommended final dividend up 5% to 10.3p, resulting in full-year dividend up 5% to 15.1p

Stephen Young, Chief Executive, commented:

“2016 trading was very much in line with our expectations and the stronger second half performance gives us good momentum going into 2017.

We are past the peak of engineering investment on the many new aircraft programmes that have recently entered, or are entering, into service. Our increased content on these new programmes will drive higher revenue in the coming years.

We are now focusing our resources to accelerate progress on our key operational initiatives which we expect will deliver significant improvement in operating margin and cash conversion by 2021.

Reflecting our continuing confidence in the prospects for the Group, the proposed final dividend is 10.3p, resulting in a full year dividend up 5% to 15.1p”.

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⁶ Net debt:EBITDA calculated on a covenant basis.
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GROUP OVERVIEW

Meggitt is a global engineering company specialising in high-performance components and sub-systems for aerospace, defence and energy markets. We have a broad-based and well balanced portfolio, with equipment on over 67,000 aircraft and many ground vehicles and energy applications worldwide. This significant and expanding installed base provides us with an aftermarket revenue stream stretching out for decades. Strong customer relationships and high levels of embedded intellectual property span a broad range of products and capabilities. These are enabling us to continue to win good positions on new platforms, normally on a sole-source basis, underpinning our medium-term growth expectations.

We have increased our content on the new civil aerospace programmes which have recently, or are about to, enter service by up to 250%. This has driven our research and development (R&D) costs and new product introduction (NPI) costs to record levels but we are now past the peak in terms of R&D spend and will soon pass the peak of NPI costs. This represents a major refresh of our in-service portfolio and will drive revenue for decades ahead.

Having passed the development peak we are increasingly focused on operational execution. We have made good progress on the deployment of our key strategic initiatives. In late 2016, we launched an operational review to identify opportunities to accelerate the financial benefits.

We continue to make good progress on the Meggitt Production System (MPS), our single, global approach to continuous improvement. MPS was launched in 2013 with a view to creating a sustainable quality and delivery culture that drives competitive advantage beyond our technical expertise and enables the Group to deliver a higher rate of organic growth over the long term. Since its launch, MPS has had a significant impact on our operational performance with an 87% improvement in quality (measured by defective parts per million) and 15% improvement in on-time delivery.

MPS is now in its fourth year and our first three sites have entered the fourth, or bronze, stage where the focus turns to realising the financial benefits from improved productivity and better management of inventory. As a critical mass of sites enter the latter phases of MPS over the next few years these benefits are expected to accelerate.

Meggitt Avionics, our first site to complete the MPS bronze phase demonstrates the strong margin potential that can be realised through productivity improvement, with a 500 basis point improvement since launch, although not all from MPS. Having secured steady operational performance improvements since its initial launch, Meggitt Avionics has significantly reduced the cost of poor quality from inefficiencies in the manufacturing processes, reduced overheads through more effective supply chain management and realised the full run rate savings of consolidating two sites into one. These savings have played their part in delivering meaningful growth in margin since launch. On the back of improved operational performance, the business has also been able to secure future revenue growth, winning contracts to supply the standby flight display for the Boeing 777X and air data system for the Airbus H130 and H125 light helicopters.

Given the importance of preparing our factories for significant ramp-ups in production on key programmes, such as the Leap and PurePower engines, our focus for site rationalisation in 2016 has been on small sites, or those not involved in large civil aerospace programmes. We have closed sites in Kassel, Germany; Rugby, UK; and Louisville, Kentucky and will close a further site in Corona, California in 2017. Over the medium term, we anticipate further rationalisation and have targeted a 20% reduction in total footprint by 2021.

The launch of our CSS organisation in 2015 has enabled us to increase focus on our aftermarket customers, improving operational performance and making us easier to do business with. In its first full year of operation it has made good progress in reducing the loss of market share to surplus parts, consolidating MRO facilities, building a regional operational infrastructure and a pipeline of opportunities for revenue growth. These include development of retrofit, modification and upgrade parts and increasing our market share in the maintenance, repair and overhaul of our components. Organic revenue growth of 5.4% in our civil aftermarket revenues, exceeded the market growth of 3.5%. The foundations being built create a good opportunity to accelerate growth over the medium term.

Taken together we are targeting these initiatives to generate a net 200-250 basis point operating margin⁷ improvement and to improve inventory turns, releasing in excess of £200m of cash by 2021.

HEADLINE FINANCIALS

Order intake grew by 22% reflecting foreign currency movements, the 2015 composites acquisitions and 3% organic growth. Strong organic growth, including multi-year orders, in civil aftermarket (AM) (+11%) and military (+6%), offset declines in civil original equipment (-5%) and a further decline in energy (-20%).

Reported Group revenue of £1,992.4m (2015: £1,647.2m) increased by 21% as analysed in the table below:

	£m	% impact
2015 Revenue	1,647.2	
Currency movements	203.7	+12
Acquisitions	127.2	+8
Organic growth	14.3	+1
2016 Revenue	1,992.4	+21

Currency movements primarily reflect the weakness of sterling against the US dollar and acquisitions relates to the two composites businesses purchased at the end of 2015. Organic growth of 1% is a result of 4% growth in civil aerospace and 1% growth in military revenues offset by a decline in energy.

The composites acquisitions performed broadly in line with expectations contributing £134.4m to 2016 revenue (2015: £7.2m), despite some delays to key civil engine programmes. The integration of these businesses made good progress and we have increased our cost synergy target by 30% to \$12.7m of savings by the end of 2018, with the one-off costs to achieve the higher synergies increasing to \$14m. The breadth and depth of capability that now exists will provide opportunity for rapid growth over the medium term as the ramp up on major new engine programmes accelerates.

The Board's preferred measure of the Group's trading performance is underlying profit. Underlying operating profit was up 17% to £379.7m (2015: £325.5m), representing a margin of 19.1% (2015: 19.8%). The margin decline reflects unfavourable mix in energy and civil aerospace, the expected dilution from acquisitions, and increased depreciation and amortisation (D&A) charges.

Underlying net finance costs increased to £27.6m (2015: £15.2m) reflecting a full year interest charge on the higher debt from the financing of the composites acquisitions, a greater proportion of debt at fixed rates and a stronger US dollar.

Underlying profit before tax was £352.1m (2015: £310.3m). The underlying tax rate increased to 23.5% (2015: 20.0%). This reflects the growth in the proportion of profit generated in the US following the two composites acquisitions completed in 2015, the strengthening of the US dollar and the absence of any significant one-off items this year. Underlying earnings per share was 34.8p (2015: 31.6p).

On a statutory basis, operating profit for the year was £233.7m (2015: £236.6m) and profit before tax was £195.5m (2015: £210.2m). The reduction (vs. underlying) in profit reflects the £66.4m negative (2015: £4.8m negative) non cash marking to market of financial instruments. This was principally due to currency hedges against our future transaction exposures and the full year amortisation of intangible assets arising on the acquisitions of the advanced composites businesses, partially offset by a £40.7m gain on the disposal of Meggitt Target Systems. Earnings per share decreased by 5% to 22.1p (2015: 23.2p), driven by the fall in profit before tax. The adjustments between underlying and statutory profit are consistent with prior years and are described in notes 5 and 11.

⁷ Based on current GAAP (excluding the impact of IFRS15 / IFRS16).
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The recommended final dividend is increased by 5% to 10.3p (2015: 9.8p) and represents a total dividend for the year of 15.1p (2015: 14.4p), an overall increase of 5%. This reflects our on-going confidence in the outlook for the Group and our commitment to a progressive dividend.

Free cash flow reduced to £131.1m (2015: £199.0m), due principally to a working capital outflow of £57.0m, from increased inventory levels to support new programme ramp ups and higher receivables from revenue delivered later in the fourth quarter than normal. As expected, working capital improved during the second half with close to half of the H1 outflow recovered by the year end.

The net cash inflow of £77.9m (2015: outflow of £431.4m) includes the £46.9m proceeds from the sale of Meggitt Target Systems, net of an associated £10.2m payment into the UK pension scheme.

There are two main financial covenants in our financing agreements. The net debt:EBITDA ratio, which must not exceed 3.5x, was at 2.1x at 31 December 2016 (2015: 2.3x) and interest cover, which must be not less than 3.0x, was 14.5x (2015: 21.4x). The Group has, therefore, significant headroom against both key covenant ratios, and net debt:EBITDA is comfortably within our target range of 1.5x to 2.5x.

The Group has £520.3m of undrawn headroom against committed bank facilities, after taking account of surplus cash.

TRADING SUMMARY

	Revenue		Growth	
	2016 £m	2015 £m	Reported %	Organic %
Civil OE	432.0	326.0	+33	+3
Civil AM	577.3	482.7	+20	+5
Total civil aerospace	1,009.3	808.7	+25	+4
Military	697.1	570.2	+22	+1
Energy	137.9	149.8	-8	-17
Other	148.1	118.5	+25	-2
Total	1,992.4	1,647.2	+21	+1

Civil aerospace

Meggitt operates in three main segments of the civil aerospace market: large jets, regional aircraft and business jets. The large jet fleet includes over 21,000 aircraft, the regional aircraft fleet over 6,000 and business jets around 18,000. The Group has products on virtually all these platforms and hence a very large, and growing, installed base. The split of civil revenue, which accounts for 51% of the Group total, is 57% aftermarket and 43% original equipment (OE).

Civil OE revenue grew 3% on an organic basis. Large jet OE, the most significant driver of our OE revenue, grew 10% driven principally by growth in Airbus A320, A350XWB, Boeing 737 and initial deliveries on the Bombardier CSeries. Strong growth in large jet OE revenue was offset by business jet and general aviation which decreased by 11% during the year. Regional aircraft OE revenue was flat.

Civil aftermarket revenue grew organically by 5% with very strong large jet growth of 14%, driven in part by good demand on older aircraft and initial provisioning to support entry into service of the A320neo and CSeries, offset by business jets which were down 8% for the year. Business jet aftermarket, which is weighted towards wheel and brake products, recovered well in the second half of the year (up 6%) after a weak first half (down 21% against a very strong first half in 2015). Our CSS organisation has made good progress in improving operational performance and customer support, and driving incremental growth opportunities, for example in surplus parts trading where revenue more than doubled.

Overall civil aerospace revenues increased by 4% on an organic basis.

Our success in bidding for new large commercial aircraft programmes will further accelerate civil OE growth. We have secured significant increases in shipset values on new generation aircraft. For example, the Airbus A350XWB has 250% more Meggitt content than its predecessor the A340. We have secured strong positions across a broad range of capability areas, including sensors, safety systems, composites and seals. During 2016, the Group saw further progress in securing new civil aerospace contracts, primarily on the Boeing 777X where awards included the standby flight display, emergency passenger assist system ('EPAS') and flight lock actuator. As we approach the end of the industry's major development phase, fewer new OE opportunities are expected.

Deliveries of large jets by Airbus and Boeing are underpinned by a firm order backlog extending over a number of years, which together with increased shipset content, gives us further confidence in the growth outlook for OE revenues. The rate of growth in large jet deliveries is expected to average 4% over the next five years, broadly consistent with the long-term trend rate of traffic growth. Deliveries of regional aircraft are expected to remain at current rates over the next five years. Deliveries of business jets are set to grow gradually to 2019, with the most potential coming at the smaller end of the market which was hardest hit during the last downturn.

Air traffic, measured in available seat kilometres (ASKs) is a key driver of demand for spares and repairs on large and regional aircraft. ASKs grew 6.2% globally in 2016, which is above the long-term trend rate of 5%. Industry forecasts for air traffic continue to grow at or above the trend rate in the medium term. Business jet utilisation in the US and Europe, in contrast, was flat in 2016 but our higher value content and growing market share should continue to drive revenue growth over the medium term, even in this weak market environment.

Military

Military business accounted for 35% of Group revenues in 2016. We have equipment on an installed base of around 22,000 fixed wing and rotary aircraft and a significant number of ground vehicles and training applications. Direct sales to US customers accounted for 63% of military revenue, with 26% to European customers and 11% to the rest of the world.

Military revenue was up 1% on an organic basis, with the expected challenging first half of the year offset by 7% growth in the second half. The second half recovery was particularly strong in both Meggitt Aircraft Braking Systems (MABS), driven by Typhoon and F-35, and Meggitt Control Systems (MCS), driven by strong demand within military transport aircraft. Growth was partially offset by delays within defence systems and training systems at Meggitt Equipment Group (MEG).

Our OE revenues are generated from a broad range of programmes and applications, with good positions on key platforms such as Typhoon, F-35, V22, Apache and BlackHawk. Significant programme wins in 2016 included a number of contracts within our training business, notably multi-year small arms training contracts for the UK MoD and Australian Defence Force worth £40m.

The outlook for defence expenditure in the US, our single most important military market, looks more positive than it has done in recent years. Military budgets have increased in many regions for the first time in several years, and there remains significant opportunity for retrofit and reset activity – a key campaign pledge from President Trump and work which Meggitt is well equipped to win. We expect that it will take time for these increased budgets to impact our revenues, particularly with an ongoing Continuing Resolution and a new administration in the US. However, organic order growth of 6% and a book to bill⁸ ratio of 1.06 in 2016, suggests revenue growth will increase steadily in 2017 and beyond.

Energy and other

Energy and other revenues (14% of Group total) come from a variety of end markets, of which the single most significant is energy (7% of Group total). Our energy capabilities centre on providing valves and condition-monitoring equipment for power generation installations, including ground-based gas and wind turbines, and printed circuit heat exchangers used primarily in the oil and gas market. Other markets (7% of Group total) include the automotive, industrial, test, consumer goods and medical sectors.

⁸ The ratio of orders received to revenue recognised in a specific period.
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Energy revenue declined by 17% in 2016 on an organic basis, including a 36% decline at Heatric (our printed circuit heat exchanger business), reflecting continued challenges in the global oil and gas market. Organic revenues in power generation segments also declined during the year (down 7%), but were flat in the second half, driven by increased demand for gas turbines which contributed to growth of 12% at MCS. We continue to expect headwinds in the energy businesses in the short term, largely driven by the continued absence of capital expenditure on significant new gas projects, on which Heatric's technology is deployed. We have taken further action on costs within Heatric, reducing the headcount from over 400 to 170, while retaining the long-term capability of the business to respond when the market turns.

The long-term growth expectations for our energy businesses, and particularly Heatric, remain good. We have differentiated technology which plays a critical role in the extraction of deep-water offshore gas reserves and good opportunity for use in adjacent markets. The balance of our energy businesses will continue to benefit from synergistic relationships across business divisions and the long term demand for energy, particularly in emerging markets.

OPERATIONAL PERFORMANCE

The financial performance of the individual divisions is summarised in the table below:

£m				Underlying Operating Profit				
Revenue								
2016	2015	% Growth		2016	2015	% Growth		
		Reported	Organic			Reported	Organic	
406.1	353.1	+15	+3	Aircraft Braking Systems	146.6	131.7	+11	-1
475.9	397.9	+20	+6	Control Systems	117.6	97.0	+21	+5
329.7	177.4	+86	+3	Polymers & Composites	39.5	15.4	+156	+16
530.7	474.8	+12	-1	Sensing Systems	73.0	72.3	+1	-14
250.0	244.0	+3	-7	Equipment Group	3.0	9.1	-67	-78
1,992.4	1,647.2	+21	+1	Total Group	379.7	325.5	+17	-3

Meggitt Aircraft Braking Systems (MABS) provides wheels, brakes and brake control systems for around 34,000 in-service aircraft. It continues to develop innovative technology for new programmes enabling the business to retain its leading position in its target markets, underscored by the strong market share gains in recent years, notably on super mid-size and long range business jets. The division targets sole-source programmes and is particularly strong in regional aircraft, large business jets and military aircraft. The division represents 20% of Group revenue, generating 88% of its revenue from the aftermarket and 12% from OE sales.

MABS' civil revenue grew by 5% on an organic basis, with 7% growth in civil aftermarket driven by strong demand for Boeing 757, DC10, MD90, Embraer E-170/175 and Bombardier CRJ aircraft together with initial provisioning for the CSeries. In contrast, the business jet aftermarket declined by 8% with a particularly weak first half of the year against very strong growth in 2015.

MABS' military revenue declined by 2% on an organic basis, with strong aftermarket growth driven by healthy demand for Typhoon brakes, offset by weaker OE revenues with declines across a broad spectrum of fighter and trainer aircraft. We did however see growth in OE revenues for F-35.

Operating margins declined from 37.3% to 36.1% in 2016, driven by the production phasing issues experienced during the first half and an unfavourable mix from lower demand for higher margin business jet spares. Margins in the second half of the year improved in line with recovery in business jet aftermarket, where revenues increased by 2%.

Meggitt Control Systems (MCS) designs and manufactures products which manage the flow of liquids and gases around aero and industrial turbines, and control the temperature of oil, fuel and air in aircraft engines. The division, which also provides fire protection equipment to engines and airframes, represents 24% of Group revenue, generating 46% of its revenue from OE and 54% from the aftermarket.

For MCS, revenue was up by 6% on an organic basis. Civil aerospace grew by 7%, with good growth in both OE, driven by initial deliveries on A320neo, and aftermarket, where demand for A320, A330

and A380 were further supplemented by initial provisioning of spares on the A320neo. Military revenue grew by 7% driven by strong aftermarket growth in the second half. Energy revenues declined by 3% for the full year but recovered strongly in the second half driven by growing demand for industrial gas turbines valves. Operating margins increased from 24.4% to 24.7%.

Meggitt Polymers & Composites (MPC) has a bias towards military, representing 53% of its revenue in 2016. It supplies flexible bladder fuel tanks, ice protection products and composite assemblies for a range of fixed wing and rotorcraft platforms, and complex seals packages for civil and military platforms. These products are linked by their dependence on similar materials technology and manufacturing processes. It supplies over 80% of the US military requirements for fuel bladders and ballistically-resistant and crashworthy fuel tanks. MPC represents 17% of Group revenue and generated 66% of its revenue from OE and 34% from the aftermarket.

MPC revenue increased by 3% on an organic basis. Military revenues grew by 7%, particularly fuel tanks, offsetting weakness in the civil aerospace business with continued slow demand for Sikorsky S92 helicopters. Reported revenue increased by 86% including the full year benefit of the composites acquisitions and foreign exchange movements. Operating margins increased from 8.7% to 12.0% due to accretive margins from the acquired composites businesses and the recovery in our fuel systems business.

The composites acquisitions are being successfully integrated with the existing MPC business and are performing broadly in line with the original investment case. Growth has been delayed by challenges on key civil engine programmes but the combined capability and breadth of customer relationships means MPC is strongly positioned to capitalise on the growth of composite content in airframe and engines. The integration programme is ahead of plan with respect to synergies and we have increased our targets for synergies by 30% to \$12.7m by the end of 2018, with the one-off costs to achieve the higher synergies increasing to \$14m.

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 as well as power storage, conversion and distribution systems and avionics suites for aerospace applications. Its products are designed to operate effectively in the extreme conditions of temperature, vibration and contamination that exist in an aircraft or ground-based turbine engine. Sensors are combined into broader electronics packages, providing condition data to operators and maintainers of engines, 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. Combining its capabilities with MABS, it has a number of civil aerospace tyre pressure monitoring systems already in service and further systems under development, having secured positions for this technology on 10 aircraft platforms. MSS represents 27% of Group revenue and generated 75% of its revenue from OE and 25% from the aftermarket.

MSS revenue declined 1% on an organic basis, with growth of 4% in civil aerospace driven by modest growth in OE relating to A320 and A350XWB and 8% growth in the aftermarket. Military revenue declined by 4% on an organic basis, driven by decreasing demand for Typhoon and a broad range of helicopters. Within energy and other markets (including test, measurement and medical), MSS revenues decreased by 6%.

Operating margins decreased from 15.2% to 13.8% reflecting an unfavourable mix.

Meggitt Equipment Group (MEG) comprises principally our non-engine actuation, dedicated military businesses and Heatric. The division represents 12% of Group revenue and generates 82% of its revenue from OE and 18% from the aftermarket.

MEG revenue declined by 7% on an organic basis. Programme delays in the training businesses and reduced demand for defence systems in helicopter, ground vehicle and scoring sub-systems, offset growth in target systems to deliver flat organic military revenue. The bigger impact was from a 36% revenue decline at Heatric resulting from reduced expenditure by oil and gas customers. Operating margins decreased from 3.7% to 1.2% driven principally by the weakness in Heatric, which made a loss in the year.

Meggitt Target Systems generated £37.2m of revenue during the year, prior to its disposal to QinetiQ Group plc in December 2016 for a total consideration of £58.6m which realised a £40.7m profit on disposal.

INVESTING FOR THE FUTURE

£m	2016	2015	% change	
			Reported	Organic
Total research and development (R&D)	157.8	158.7	-1	-12
<i>Of which:</i> Customer funded	31.7	26.8	+18	-1
Capitalised	72.4	84.8	-15	-24
Charge to net operating costs	71.0	61.4	+16	+4
Programme participation costs	57.5	43.0	+34	+19
Capital expenditure	65.5	55.4	+18	-7

Targeted investment in technology development remains critical to our long-term organic growth. Total R&D expenditure reduced in 2016 to £157.8m and was 7.9% of revenue (2015: £158.7m, 9.6%), of which 20% (2015: 17%) was funded by customers. The charge to net operating costs, including amortisation and impairment, increased by 16% (4% on an organic basis) to £71.0m (2015: £61.4m).

Reduced spend on R&D reflects the progress made on development programmes for major new aircraft platforms including the A320neo and C Series, which entered service in 2016, and the 737MAX, which is due to begin service in 2017. As more programmes pass key milestones over the next few years, we expect R&D to reduce further as a percentage of revenue. The new product introduction (NPI) expenditure associated with these platforms will peak in 2018. This reflects the increased content we have secured on a wide range of new platforms, which is good for future revenues, but the cost of introducing record numbers of new parts impacts profitability in the short term. We continue to expect growth in expensed R&D relating to our successful applied research and technology (AR&T) programmes, which will develop the next generation products and manufacturing technologies required to enable future aircraft programmes.

Our investment in programme participation costs including the supply of equipment free of charge to new aircraft, mostly in MABS, increased by 19% organically. This reflects growth in new platforms where we have strong positions, particularly the C Series that entered service in 2016. Growth is expected to continue into 2017, and well beyond, as deliveries of aircraft equipped with our wheels and brakes increase further, which in turn will drive aftermarket revenue stretching out for decades. Our market share of wheels and brakes on the fleet of super mid-size and large business jets in 2016 was 65%, supportive of our expectation that we will have a market share on the overall fleet in excess of 70% by 2021.

Capital expenditure on property, plant and equipment and intangible assets was £65.5m (2015: £55.4m). This includes the investment required to support factory consolidations and the integration of the composites acquisitions. It also includes initial investment in the expansion of our Vietnam facility and in new plant and equipment to build global capacity to support new engine programmes. Capital expenditure will increase in 2017, as we accelerate plans to consolidate the Group's manufacturing footprint and increase investment in building capacity and capability across our existing sites, some of which had been anticipated but not spent during 2016.

FOREIGN EXCHANGE

The weakening of Sterling against all of the Group's major currencies significantly benefitted our reported results for the year. Translation of results from overseas businesses increased Group revenue by £176.6m and added £33.2m to underlying profit before tax (PBT) in 2016.

The sensitivity of revenue and underlying PBT to future exchange rate translation movements, when compared to the 2016 average rates, is shown in the table below:

	2016 average rate	Revenue £'m	Underlying PBT £'m
<i>Impact of 10 cent movement</i>			
US Dollar	1.33	95.0	17.0
Euro	1.21	11.0	1.0
Swiss Franc	1.32	8.0	2.0

Transaction exposure, where revenues and/or costs of our businesses are denominated in a currency other than their own, increased revenue by £27.1m and underlying PBT by £10.1m in 2016. We typically hedge transaction exposure and the following table details hedging currently in place:

	Hedging in place ¹ %	Average transaction Rates ²
2016		
US Dollar/Sterling		1.49
US Dollar/Euro		1.21
US Dollar/Swiss Franc		1.08
2017		
US Dollar/Sterling	90	1.49
US Dollar/Euro	100	1.18
US Dollar/Swiss Franc	96	1.06
2018 – 2021 inclusive		
US Dollar/Sterling	67	1.39
US Dollar/Euro	48	1.18
US Dollar/Swiss Franc	29	1.08

¹ Based on forecast transaction exposures.

² Hedging in place with unhedged exposures based on exchange rates at 31 December 2016.

Taking both translation and transaction benefit into account, 2016 reported revenue increased by £203.7m and underlying PBT increased by £43.3m.

RETIREMENT BENEFIT SCHEMES

Retirement benefit scheme deficits increased to £414.7m (2015: £284.5m), principally due to the fall in yields on AA corporate bonds used to discount UK scheme liabilities.

The Group made total deficit reduction payments in the year of £35.0m (2015: £24.4m), which includes a one-off payment of £10.2m in 2016 into the UK scheme following the disposal of Meggitt Target Systems. During the year, the Group reached an agreement with the trustees of the UK scheme following the 2015 triennial actuarial valuation. This agreement will see deficit reduction payments increase gradually over the period to 2024. In the US, the level of deficit payments is principally driven by regulation and is expected to increase gradually over the next five years.

BOARD AND SENIOR MANAGEMENT CHANGES

In December, Tony Wood was appointed as an Executive Director and Group Chief Operating Officer. Tony has outstanding experience in civil aerospace and defence. In senior leadership positions at Rolls-Royce and Messier-Dowty, he has run aftermarket businesses, consolidated production across sites and introduced continuous improvement systems. Now that we have passed the peak of

investment in new programmes, Tony's appointment enables Meggitt to accelerate the pace of operational initiatives, whilst ensuring we deliver on our commitments to our customers.

Brenda Reichelderfer will retire from her position as Non-Executive Director on 27 April 2017, to be replaced by Nancy Gioia. Nancy, a US citizen and electrical engineer, joined Ford Motor Company in 1982 and worked in a number of senior roles across engineering and operations before retiring from Ford in 2014. Nancy is currently a non-executive of Exelon Corporation and Brady Corporation.

OPERATIONAL REVIEW

Having passed the peak of activity on new development programmes, we launched an operational review in late 2016, with a view to accelerating the returns from our key strategic initiatives. This operational review has identified four key levers of improvement in margin and cash conversion:

1. Achieving an improvement in inventory turns from 2.3 to 4.0x over the next five years
2. Accelerating margin improvements from site productivity as a critical mass of sites pass through the latter phases of the Meggitt Production System
3. Driving year on year reductions in purchased costs through supply chain consolidation and greater leverage of scale
4. Realising a 20% reduction in our factory footprint by 2021

We are targeting a net operating margin improvement of between 200 and 250 basis points and greater than £200m of incremental cash from improved inventory turns by 2021. Further support to our plans in this area will be provided at our Capital Markets Day on 16 May 2017.

GROUP OUTLOOK

The outlook for our civil markets is encouraging. Production of large jets is expected to continue, and the increased shipset values we enjoy on the latest generation of large jets support organic civil OE revenue growth over the medium term ahead of overall market growth. In 2017, we expect civil OE revenues to grow organically between 6 to 8%.

Available seat kilometres, an important driver of our large and regional jet aftermarket, continue to grow above the long-term trend of 5% per annum. This, combined with the effect of our new CSS organisation and expanded content on new aircraft, means that we should outgrow the market for civil spares in the medium term. In 2017, we expect organic civil aftermarket revenue growth of 4 to 6%.

In military markets, the long-term outlook is positive with organic orders up 6% and a book-to-bill ratio of 1.06 in 2016. Our strong technology offering and broad platform exposure should enable us to outgrow the market overall. However, we remain cautious for 2017, reflecting expected delays to cash flowing to suppliers from the improved budgets, especially given the Continuing Resolution and change of administration in the US. We therefore anticipate organic revenue growth in 2017 of 1 to 3%.

Our energy businesses continue to operate in a difficult market characterised by a lack of investment in infrastructure. This is particularly so for Heatric, which depends on large capital projects in the oil and gas sector where a recovery is unlikely in the near term. In the short term, continued decline in oil and gas will be only partially offset by power generation. As a result, we expect a further organic revenue decline in 2017 of between 5 and 10%, although multiple cost reduction activities in 2016 will help mitigate the financial impact of this decline. Medium term, Heatric's strong technology franchise and growth opportunities in energy condition monitoring give us confidence that our energy revenues will resume their growth trajectory.

On the basis of the above, the Group expects 2 to 4% organic revenue growth in 2017 (i.e. after excluding Meggitt Target Systems from the 2016 base revenue).

In terms of margin, we believe the momentum we have in our strategic initiatives is now sufficient to offset remaining headwinds. As a result, the Group is targeting operating margin to be flat to up 30 basis points in 2017.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2016

	Notes	2016 £m	2015 £m
Revenue	3	1,992.4	1,647.2
Cost of sales		(1,217.2)	(997.2)
Gross profit		775.2	650.0
Net operating costs		(541.5)	(413.4)
Operating profit¹	5	233.7	236.6
Finance income	8	2.0	2.7
Finance costs	9	(40.2)	(29.1)
Net finance costs		(38.2)	(26.4)
Profit before tax²		195.5	210.2
Tax		(24.3)	(28.1)
Profit for the year attributable to equity owners of the Company		171.2	182.1
Earnings per share:			
Basic ³	11	22.1p	23.2p
Diluted ⁴		21.8p	22.9p

¹ Underlying operating profit	5	379.7	325.5
² Underlying profit before tax	5	352.1	310.3
³ Underlying basic earnings per share	11	34.8p	31.6p
⁴ Underlying diluted earnings per share	11	34.3p	31.2p

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

	Note	2016 £m	2015 £m
Profit for the year attributable to equity owners of the Company		171.2	182.1
Items that may be reclassified to the income statement in subsequent periods:			
Currency translation differences		312.1	82.7
Cash flow hedge movements		(0.2)	(0.7)
Tax effect		(3.6)	2.1
	28	<u>308.3</u>	84.1
Items that will not be reclassified to the income statement in subsequent periods:			
Remeasurement of retirement benefit obligations	19	(120.7)	29.4
Tax effect		20.1	(9.5)
		<u>(100.6)</u>	19.9
Other comprehensive income for the year		<u>207.7</u>	104.0
Total comprehensive income for the year attributable to equity owners of the Company		<u><u>378.9</u></u>	<u>286.1</u>

CONSOLIDATED BALANCE SHEET

As at 31 December 2016

	Notes	2016 £m	2015 Restated (note 27) £m
Non-current assets			
Goodwill	14	2,095.7	1,815.5
Development costs	14	533.5	408.4
Programme participation costs	14	333.5	267.6
Other intangible assets	14	817.6	800.0
Property, plant and equipment	15	336.9	288.8
Investments	16	14.8	11.4
Trade and other receivables		58.4	62.2
Derivative financial instruments	17	21.8	25.5
Deferred tax assets		15.9	0.3
		4,228.1	3,679.7
Current assets			
Inventories		468.5	401.6
Trade and other receivables		434.5	351.4
Derivative financial instruments	17	4.2	8.4
Current tax recoverable		4.4	5.5
Cash and cash equivalents	24	173.8	147.3
		1,085.4	914.2
Total assets	4	5,313.5	4,593.9
Current liabilities			
Trade and other payables		(464.0)	(401.8)
Derivative financial instruments	17	(31.2)	(12.7)
Current tax liabilities		(35.6)	(35.1)
Obligations under finance leases	24	(0.1)	(0.1)
Bank and other borrowings	24	(175.7)	(4.0)
Provisions	18	(53.6)	(40.0)
		(760.2)	(493.7)
Net current assets		325.2	420.5
Non-current liabilities			
Trade and other payables		(5.0)	(4.2)
Derivative financial instruments	17	(45.7)	(13.7)
Deferred tax liabilities		(322.6)	(278.8)
Obligations under finance leases	24	(6.5)	(5.4)
Bank and other borrowings	24	(1,170.6)	(1,189.0)
Provisions	18	(131.8)	(146.1)
Retirement benefit obligations	19	(414.7)	(284.5)
		(2,096.9)	(1,921.7)
Total liabilities		(2,857.1)	(2,415.4)
Net assets		2,456.4	2,178.5
Equity			
Share capital		38.8	38.8
Share premium		1,219.8	1,218.9
Other reserves		15.7	15.7
Hedging and translation reserves		551.5	243.2
Retained earnings		630.6	661.9
Total equity attributable to owners of the Company		2,456.4	2,178.5

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

	Equity attributable to owners of the Company					Total equity
	Share capital	Share premium	Other reserves	Hedging and translation reserves	Retained earnings	
	£m	£m	£m	£m	£m	
At 1 January 2015	40.1	1,218.9	14.4	159.1	708.3	2,140.8
Profit for the year	-	-	-	-	182.1	182.1
Other comprehensive income for the year	-	-	-	84.1	19.9	104.0
Total comprehensive income for the year	-	-	-	84.1	202.0	286.1
Employee share schemes:						
Value of services provided	-	-	-	-	3.0	3.0
Purchase of own shares	-	-	-	-	(9.7)	(9.7)
Share buyback – purchased and cancelled	(1.3)	-	1.3	-	(138.8)	(138.8)
Share buyback – purchased and transferred to treasury shares	-	-	-	-	(7.6)	(7.6)
Share buyback – movement in close period commitment	-	-	-	-	15.8	15.8
Dividends	-	-	-	-	(111.1)	(111.1)
At 31 December 2015	38.8	1,218.9	15.7	243.2	661.9	2,178.5
Profit for the year	-	-	-	-	171.2	171.2
Other comprehensive income/(expense) for the year	-	-	-	308.3	(100.6)	207.7
Total comprehensive income for the year	-	-	-	308.3	70.6	378.9
Employee share schemes:						
Value of services provided	-	-	-	-	12.0	12.0
Issue of equity share capital	-	0.9	-	-	(0.9)	-
Dividends	-	-	-	-	(113.0)	(113.0)
At 31 December 2016	38.8	1,219.8	15.7	551.5	630.6	2,456.4

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2016

	Notes	2016 £m	2015 Restated (note 27) £m
Cash inflow from operations before business acquisition and disposal expenses and exceptional operating items		395.8	419.9
Cash outflow from business acquisition and disposal expenses		(1.9)	(2.5)
Cash outflow from exceptional operating items	6	(18.3)	(10.7)
Cash inflow from operations	23	375.6	406.7
Interest received		0.2	0.2
Interest paid		(26.6)	(16.2)
Tax paid		(27.4)	(15.3)
Cash inflow from operating activities		321.8	375.4
Businesses acquired	25	2.1	(362.7)
Businesses disposed	26	59.6	2.0
Capitalised development costs net of funding from customers	14	(69.6)	(80.5)
Capitalised programme participation costs		(57.5)	(43.0)
Purchase of intangible assets		(14.7)	(10.4)
Purchase of property, plant and equipment		(51.7)	(45.8)
Proceeds from disposal of property, plant and equipment		0.9	0.8
Cash outflow from investing activities		(130.9)	(539.6)
Dividends paid to Company's shareholders		(113.0)	(111.1)
Purchase of own shares		-	(9.7)
Share buyback – purchased in year		-	(146.4)
Proceeds from borrowings		466.0	537.0
Debt issue costs		(1.2)	(0.4)
Repayments of borrowings		(537.5)	(65.5)
Cash (outflow)/inflow from financing activities		(185.7)	203.9
Net increase in cash and cash equivalents		5.2	39.7
Cash and cash equivalents at start of the year		147.3	105.5
Exchange gains on cash and cash equivalents		21.3	2.1
Cash and cash equivalents at end of the year	24	173.8	147.3

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2016

1. Basis of preparation

This document contains abridged preliminary financial information for the year ended 31 December 2016 together with comparatives.

The information presented has been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards ('IFRS's) as adopted by the European Union and in accordance with the FSA Listing Rules. It has been prepared on a going concern basis and under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities (including derivative instruments) at fair value.

The financial information contained in this document does not constitute Group statutory accounts as defined in Sections 404 and 435 of the Companies Act 2006. It is based on, and is consistent with, that in the Group's statutory accounts for the year ended 31 December 2016 and those financial statements will be delivered to the Registrar of Companies following the Company's Annual General Meeting. The auditors' report on those accounts is unqualified, does not draw attention to any matters by way of emphasis and does not contain a statement under Section 498(2) or (3) of the Companies Act 2006.

Group statutory accounts for the year ended 31 December 2015 were approved by the Board of Directors on 22 February 2016 and have been filed with the Registrar of Companies. The auditors' report on those accounts was unqualified, did not draw attention to any matters by way of emphasis and did not contain a statement under Section 498(2) or (3) of the Companies Act 2006.

2. Accounting policies

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 early adopted 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 Group is continuing to assess the full impact of IFRS 9 which becomes effective for accounting periods beginning on or after 1 January 2018. 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.
- IFRS 15, 'Revenue from contracts with customers'. This standard establishes principles for reporting the nature, amount and timing of revenue arising from an entity's contracts with customers. The Group is continuing to assess the full impact of IFRS 15. The principal areas of the Group's existing accounting that are currently expected to be affected include:
 - Programme participation costs. It is likely that the cost of free of charge/deeply discounted manufactured parts (but generally not cash programme payments) will be expensed as incurred under IFRS 15, rather than being recognised as an intangible asset and amortised over their useful lives. Had the Group adopted this policy for 2016, its profit before tax and net assets (after taking account of related deferred tax balances) would be lower by £23.4m and £195.1m respectively.
 - Revenue from sale of goods (2016 revenue: £1,798.8m). The timing of revenue recognised on the substantial majority of such contracts is not expected to be significantly affected by IFRS 15 with revenue continuing to be recognised as goods are delivered to the customer. A minority of contracts will require changes to the timing of recognition of revenue to reflect IFRS 15 guidance on areas such as the accounting for customer price changes and whether multiple deliveries and services provided to a customer should be accounted for individually or aggregated.

2. Accounting policies continued

- Contract accounting revenue (2016 revenue: £59.8m). It is likely that revenue on most contracts for which revenue is currently recognised using contract accounting will continue to be accounted for as performance occurs, although the method by which the stage of completion is measured may change on certain contracts. A small number of contracts may no longer qualify to be contract accounted and revenue will instead be deferred until completion of the contract.
- Revenue from power by the hour and cost per brake landing type contracts (2016 revenue: £39.0m). An element of revenue on these contracts is likely to no longer be recognised by reference to the number of aircraft flying hours or aircraft landings but when maintenance events are carried out. This will lead to revenue being recognised in different accounting periods to those in which it is currently recognised. Across all cost per brake landing contracts (2016 revenue: £29.1m), the impact in any one period is likely however, to be mitigated by virtue of the large number of aircraft covered by such contracts and the relatively short period between maintenance events.
- Revenue from other services (2016 revenue: £56.0m). No significant changes are currently expected.
- Revenue from funded research and development contracts (2016 revenue: £38.8m). Revenue from certain contracts is likely to no longer be recognised as contractually agreed milestones are achieved, but either as costs are incurred (thus accelerating the recognition of revenue) or when the contract is completed (thus delaying the recognition of revenue).

The adoption of the standard may also require certain reclassifications between revenue, cost of sales and net operating costs, but which have no overall impact on operating profit.

The standard becomes effective for accounting periods beginning on or after 1 January 2018.

- IFRS 16, 'Leases'. The Group is continuing to assess the full impact of IFRS 16 which becomes effective for accounting periods beginning on or after 1 January 2019. The main change is expected to relate to the recognition on the Group's balance sheet of assets and liabilities relating to leases which are currently being accounted for as operating leases. As at 31 December 2016, the Group has a future commitment in respect of operating leases which expire more than 12 months from the balance sheet date of £110.2m, mainly in respect of property leases, and for which the present value is likely to be recognised on the balance sheet at transition. This standard is subject to endorsement by the European Union. Subject to such endorsement, it is the Group's current intention to early adopt this standard in its accounting periods beginning on or after 1 January 2018.

3. Revenue

The Group's revenue is analysed as follows:

	2016 £m	2015 £m
Sale of goods	1,798.8	1,470.4
Contract accounting revenue	59.8	66.7
Revenue from services – Power by the hour/Cost per brake landing	39.0	38.8
Revenue from services – Other	56.0	40.1
Revenue from funded research and development	38.8	31.2
Total	1,992.4	1,647.2

4. Segmental analysis

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.

Year ended 31 December 2016

	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	406.2	476.7	331.2	543.6	262.8	2,020.5
Inter-segment revenue	(0.1)	(0.8)	(1.5)	(12.9)	(12.8)	(28.1)
Revenue	406.1	475.9	329.7	530.7	250.0	1,992.4
Underlying operating profit*	146.6	117.6	39.5	73.0	3.0	379.7

* A reconciliation of operating profit to underlying operating profit is shown in note 5.

Year ended 31 December 2015

	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	353.3	398.8	178.0	480.8	244.9	1,655.8
Inter-segment revenue	(0.2)	(0.9)	(0.6)	(6.0)	(0.9)	(8.6)
Revenue	353.1	397.9	177.4	474.8	244.0	1,647.2
Underlying operating profit*	131.7	97.0	15.4	72.3	9.1	325.5

* A reconciliation of operating profit to underlying operating profit is shown in note 5.

4. Segmental analysis continued

Segmental assets

	31 December 2016	31 December 2015 Restated (note 27)
	£m	£m
Meggitt Aircraft Braking Systems	832.6	666.6
Meggitt Control Systems	364.2	303.7
Meggitt Polymers & Composites	230.0	173.6
Meggitt Sensing Systems	463.2	387.7
Meggitt Equipment Group	178.6	145.9
Total segmental trading assets	2,068.6	1,677.5
Centrally managed trading assets*	176.0	179.8
Goodwill	2,095.7	1,815.5
Other intangible assets	738.3	722.7
Investments	14.8	11.4
Derivative financial instruments – non-current	21.8	25.5
Deferred tax assets	15.9	0.3
Derivative financial instruments – current	4.2	8.4
Current tax recoverable	4.4	5.5
Cash and cash equivalents	173.8	147.3
Total assets	5,313.5	4,593.9

- * Centrally managed trading assets principally include amounts recoverable from insurers and other third parties in respect of environmental issues relating to former sites, other receivables and property, plant and equipment of central companies.

5. 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	2016 £m	2015 £m
Operating profit		233.7	236.6
Exceptional operating items (note 6)		15.5	10.4
Amounts arising on the acquisition, disposal and closure of businesses	a	(39.1)	0.2
Amortisation of intangible assets acquired in business combinations (note 14)		98.6	71.9
Disposal of inventory revalued in business combinations		4.6	1.6
Financial instruments (note 7)		66.4	4.8
Adjustments to operating profit*		146.0	88.9
Underlying operating profit		379.7	325.5
Profit before tax		195.5	210.2
Adjustments to operating profit per above		146.0	88.9
Net interest expense on retirement benefit obligations (note 19)		10.6	11.2
Adjustments to profit before tax		156.6	100.1
Underlying profit before tax		352.1	310.3
Profit for the year		171.2	182.1
Adjustments to profit before tax per above		156.6	100.1
Tax effect of adjustments to profit before tax		(58.4)	(33.9)
Adjustments to profit for the year		98.2	66.2
Underlying profit for the year		269.4	248.3

* Of the adjustments to operating profit, £3.6m (2015: £4.0m) relating to exceptional operating items and £4.6m (2015: £1.6m) relating to the disposal of inventory revalued in business combinations has been charged to cost of sales, with the balance of £137.8m (2015: £83.3m) included within net operating costs.

a The Group separately presents amounts arising on the acquisition, disposal and closure of businesses. These include gains or losses made on the disposal or closure of a business, adjustments to the fair value of contingent consideration payable in respect of an acquired business or receivable in respect of a disposed business and costs directly attributable to the acquisition of a business.

	2016 £m	2015 £m
Gain on disposal businesses (note 26)	(40.7)	(1.2)
Remeasurement of fair value of contingent consideration receivable relating to previously disposed businesses	0.3	(2.5)
Costs related to the acquisition of businesses	1.3	3.9
Amounts arising on the acquisition, disposal and closure of businesses	(39.1)	0.2

6. Exceptional operating items

Items which are significant by virtue of their size or nature and which are considered non-recurring are classified as exceptional operating items.

	Note	Income statement		Cash expenditure	
		2016 £m	2015 £m	2016 £m	2015 £m
Business restructuring costs	a	5.7	9.2	6.2	4.8
Integration of acquired businesses	b	6.6	0.3	6.6	0.1
Site consolidations	c	7.0	0.9	4.7	0.9
Raw material supply issue	d	(3.8)	-	0.8	4.9
Exceptional operating items		15.5	10.4	18.3	10.7

- This relates to costs incurred as part of a Group-wide initiative to structurally reduce its cost base announced on 28 October 2015, which completed in 2016. Total costs incurred since the announcement in 2015 are £11.0m.
- This relates to costs incurred in respect of the on-going integration of the advanced composites businesses of Cobham and EDAC, acquired in November and December 2015 respectively.
- This principally relates to the closure of the Group's sensor operations in Rugby, UK and control systems operations in Corona, USA and transfer of their activities to the Group's existing operations in Hampshire, UK and California, USA together with the consolidation of the Group's US braking systems maintenance, repair and overhaul services onto a single site in Kentucky.
- This relates to unused amounts reversed in the year in respect of the provision originally created in 2013 relating to the supply from a vendor of non-conforming raw materials in one of our businesses.

7. Financial instruments

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 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. Where cross currency derivatives and treasury lock derivatives do not qualify to be hedge accounted, movements in the fair value of the derivatives are excluded from underlying profit.

Gains or losses arising from the remeasurement of the fair value of close period share buyback commitments are excluded from underlying profit.

	2016 £m	2015 £m
Movement in the fair value of foreign currency forward contracts	48.0	16.1
Impact of retranslating net foreign currency assets and liabilities at spot rate	2.3	(0.1)
Movement in the fair value of interest rate derivatives	3.8	2.2
Movement in the fair value of fixed rate borrowings	0.8	(1.1)
Movement in the fair value of cross currency derivatives	2.9	(4.4)
Movement in the fair value of treasury lock derivative	8.6	(3.7)
Remeasurement of share buyback close period commitment	-	(4.2)
Financial instruments – loss	66.4	4.8

8. Finance income

	2016 £m	2015 £m
Interest on bank deposits	0.1	0.1
Unwinding of interest on other receivables (note 18)	1.8	2.5
Other finance income	0.1	0.1
Finance income	2.0	2.7

9. Finance costs

	2016 £m	2015 £m
Interest on bank borrowings	7.0	4.1
Interest on senior notes	21.8	11.7
Interest on obligations under finance leases	1.1	1.0
Unwinding of discount on provisions (note 18)	2.5	3.2
Net interest expense on retirement benefit obligations (note 19)	10.6	11.2
Amortisation of debt issue costs	1.2	0.8
Less: amounts capitalised in the cost of qualifying assets (note 14)	(4.0)	(2.9)
Finance costs	40.2	29.1

10. Tax

The Finance (No 2) Act 2015, included legislation to reduce the main rate of corporation tax in the UK from 20% to 19% with effect from 1 April 2017 and to 18% with effect from 1 April 2020. As these changes were substantively enacted during 2015, they are reflected in the tax charge for the prior year. The Finance Act 2016, included legislation to further reduce the main rate of corporation tax in the UK to 17% from 1 April 2020. As this change was substantively enacted during 2016, it has been reflected in the tax charge for the current year. The impact of this change on net deferred tax liabilities at 31 December 2016, profit for the year (underlying and statutory) and comprehensive income for the year was not significant.

11. Earnings per ordinary share

Earnings per ordinary share ('EPS') is calculated by dividing the profit attributable to owners of the Company of £171.2m (2015: £182.1m) by the weighted average number of shares in issue during the year of 774.7m (2015: 785.4m shares).

Underlying EPS is based on underlying profit (note 5) and is calculated below:

	2016	2015
	Pence	Pence
Basic EPS	22.1	23.2
Adjust for effects of:		
Exceptional operating items	1.4	0.9
Amounts arising on the acquisition, disposal and closure of businesses	(5.1)	0.2
Amortisation of intangible assets acquired in business combinations	8.2	5.8
Disposal of inventory revalued in business combinations	0.4	0.1
Financial instruments	6.8	0.4
Net interest expense on retirement benefit obligations	1.0	1.0
Underlying basic EPS	34.8	31.6

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. The weighted average number of shares used in the calculation of diluted EPS was 786.0m (2015: 796.3m).

Diluted underlying EPS for the year was 34.3p (2015: 31.2p).

12. Dividends

The Board is recommending a final dividend of 10.30p per share (2015: 9.80p per share). Taken with the interim dividend of 4.80p (2015: 4.60p) paid in the year, this gives a total dividend of 15.10p (2015: 14.40p), an increase of 5%. Subject to approval at the Annual General Meeting to be held on 27 April 2017, the proposed dividend will be paid on 5 May 2017 to shareholders on the register at close of business on 24 March 2017. A dividend reinvestment plan will be made available, in respect of the final dividend, for shareholders who wish to elect for shares in lieu of cash.

13. Related party transactions

During the year, the Group made sales to the joint venture of £3.4m and purchases from the joint venture of £0.7m. Amounts due from the joint venture at the balance sheet date were £0.4m (2015: £Nil).

Transactions between the Company and its subsidiaries have been eliminated on consolidation.

The remuneration of key management personnel of the Group, which is defined for 2016 as members of the Board and the Group Leadership team, is set out below.

	2016	2015
	£m	£m
Salaries and other short-term employee benefits	11.3	9.0
Retirement benefit expense	0.3	0.3
Share-based payment expense	2.7	1.3
Total	14.3	10.6

14. Intangible assets

	Goodwill	Development costs	Programme participation costs *	Other intangible assets
	£m	£m	£m	£m
At 1 January 2015	1,534.7	342.9	242.4	684.9
Exchange rate adjustments	69.8	17.7	11.1	29.7
Businesses acquired as restated (note 25)	211.0	-	-	157.7
Additions**	-	84.8	43.0	11.9
Funding from customers	-	(4.3)	-	-
Interest capitalised (note 9)	-	2.9	-	-
Transfers to inventory	-	(21.3)	-	-
Impairment loss	-	(6.4)	-	-
Amortisation***	-	(7.9)	(28.9)	(84.2)
At 31 December 2015 as restated	1,815.5	408.4	267.6	800.0
Exchange rate adjustments	282.8	68.8	41.4	120.5
Businesses disposed (note 26)	(2.6)	-	-	(0.1)
Additions**	-	72.4	57.9	11.9
Funding from customers	-	(2.8)	-	-
Interest capitalised (note 9)	-	4.0	-	-
Impairment loss	-	(3.3)	-	-
Amortisation***	-	(14.0)	(33.4)	(114.7)
At 31 December 2016	2,095.7	533.5	333.5	817.6

* Included within programme participation costs is £283.4m (2015: £226.4m) in respect of free of charge/deeply discounted manufactured parts and £50.1m (2015: £41.2m) in respect of cash programme payments.

** Included within additions to programme participation costs, are free of charge/deeply discounted manufactured parts supplied in the year of £53.5m (2015: £41.4m) and cash programme payments of £4.4m (2015: £1.6m).

*** Included within amortisation of other intangible assets is £98.6m (2015: £71.9m) relating to intangible assets acquired in business combinations and which is excluded from the Group's underlying profit figures (note 5).

Goodwill is tested for impairment annually, or more frequently if there is any indication of impairment. No impairment charge was required in the year (2015: £Nil) and the cumulative impairment charge recognised to date is £Nil (2015: £Nil).

15. Property, plant and equipment

	2016	2015
	£m	Restated (note 27) £m
At 1 January	288.8	251.1
Exchange rate adjustments	37.4	7.2
Businesses acquired as restated (note 25)	-	20.4
Businesses disposed (note 26)	(1.9)	-
Additions	56.2	44.3
Disposals	(2.3)	(0.7)
Depreciation	(41.3)	(33.5)
At 31 December	336.9	288.8

16. Investments

The Group's investment in its joint venture, Parkway-HS, LLC has been accounted for using the equity method and is stated as follows:

	2016	2015 Restated (note 27)
	£m	£m
At 1 January	11.4	-
Exchange rate adjustments	2.2	0.1
Arising on the acquisition of EDAC (see note 25)	-	11.3
Share of profit after tax	1.2	-
At 31 December	14.8	11.4

17. Financial Instruments – fair value measurement

For trade and other receivables, cash and cash equivalents, trade and other payables, obligations under finance leases and the current element of floating rate bank and other borrowings, fair values approximate to book values due to the short maturity periods of these financial instruments. For trade and other receivables, allowances are made within book value for credit risk.

For other financial instruments, a comparison of book values and fair values is provided below:

	Book value		Fair value	
	2016 £m	2015 £m	2016 £m	2015 £m
Derivative financial instruments – non-current	21.8	25.5	21.8	25.5
Derivative financial instruments – current	4.2	8.4	4.2	8.4
Financial assets	26.0	33.9	26.0	33.9
Derivative financial instruments – current	(31.2)	(12.7)	(31.2)	(12.7)
Bank and other borrowings – current	(175.7)	(4.0)	(177.2)	(4.0)
Derivative financial instruments – non-current	(45.7)	(13.7)	(45.7)	(13.7)
Bank and other borrowings – non-current	(1,170.6)	(1,189.0)	(1,160.2)	(1,196.9)
Financial liabilities	(1,423.2)	(1,219.4)	(1,414.3)	(1,227.3)
Total	(1,397.2)	(1,185.5)	(1,388.3)	(1,193.4)

Derivative financial instruments measured at fair value are 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 and the treasury lock derivative, have been derived from forward interest rates based on yield curves observable at the balance sheet date together with the contractual interest rates. The fair value of cross currency derivatives have been derived from forward interest rates based on yield curves observable at the balance sheet date, forward exchange rates observable at the balance sheet date and the contractual interest and forward exchange rates.

The current and non-current portion of bank and other borrowings measured at fair value, are classified as level 3 in the fair value measurement hierarchy, as they have 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. The same methods of valuation have been used to derive the fair value of the current and non-current element of bank and other borrowings which are held at amortised cost, but for which fair values are provided in the table above.

17. Financial Instruments – fair value measurement continued

The book value of the current and non-current element of bank and other borrowings is analysed as follows:

	2016 £m	2015 £m
Held at fair value through profit and loss	344.3	290.8
Held at amortised cost	1,002.0	902.2
Total	1,346.3	1,193.0

There were no transfers of assets or liabilities between levels of the fair value hierarchy during the year.

18. Provisions

	2016 Environmental receivables* £m	2016 Provisions £m
At 1 January – as restated (note 27)	(83.4)	186.1
Exchange rate adjustments	(14.3)	28.3
Business disposed (note 26)	-	(0.2)
Additional provision in year	(4.7)	16.2
Unused amounts reversed	2.0	(10.5)
(Credit)/charge to net finance costs (notes 8 and 9)	(1.8)	2.5
Transfer to trade and other payables	-	(0.2)
Utilised	24.8	(36.8)
At 31 December	(77.4)	185.4

Disclosed as:

Current	53.6
Non-current	131.8
At 31 December	185.4

Analysed as:

Environmental	121.7
Onerous contracts	38.1
Warranty costs	17.8
Other	7.8
At 31 December	185.4

- * Included within trade and other receivables in respect of amounts recoverable from insurers and other third parties in respect of environmental issues relating to historic sites.

19. Retirement benefit obligations

	2016 £m	2015 £m
At 1 January	284.5	317.8
Exchange rate adjustments	31.5	7.3
Service cost	16.2	15.3
Past service cost	-	0.3
Curtailment gain (note 26)	(1.2)	-
Net interest expense (note 9)	10.6	11.2
Contributions - Group	(51.2)	(39.7)
Remeasurement of retirement benefit obligations	120.7	(29.4)
Administrative expenses borne directly by schemes	3.6	1.7
At 31 December	414.7	284.5
Analysis of retirement benefit obligations:		
Pension schemes	360.2	239.1
Healthcare schemes	54.5	45.4
At 31 December	414.7	284.5

Key financial assumptions used to calculate scheme liabilities

	2016	2015
UK scheme:		
Discount rate	2.65%	3.85%
Inflation rate	3.30%	3.10%
Salary inflation rate	4.30%	4.10%
Current life expectancy: Male aged 65 years	21.7 to 23.2	21.9 to 23.4
US schemes:		
Discount rate	3.95%	4.20%
Salary increases	4.51%	4.66%
Current life expectancy: Male aged 65 years	20.2 to 20.8	20.3 to 21.0

Group cash contributions paid during the year included deficit reduction payments of £35.0m (2015: £24.4m). Included within deficit payments in 2016, is a one-off payment of £10.2m made into the UK scheme upon the sale of Meggitt Target Systems.

20. Issued share capital

	2016 No. m	2015 No. m
Allotted and fully paid	775.7	775.5

21. 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.

22. Capital commitments

	2016 £m	2015 £m
Contracted for but not incurred:		
Intangible assets	1.3	0.6
Property, plant and equipment	13.5	8.2
Total	14.8	8.8

23. Cash inflow from operations

	2016 £m	2015 £m
Profit for the year	171.2	182.1
Adjustments for:		
Finance income (note 8)	(2.0)	(2.7)
Finance costs (note 9)	40.2	29.1
Tax	24.3	28.1
Depreciation (note 15)	41.3	33.5
Amortisation (note 14)	162.1	121.0
Impairment loss (note 14)	3.3	6.4
Loss on disposal of property, plant and equipment	1.4	-
Gain on disposal and closure of businesses (note 26)	(40.7)	(1.2)
Remeasurement of fair value of contingent consideration receivable*	0.3	(2.5)
Financial instruments (note 7)	66.4	4.8
Share of profit after tax of joint venture (note 16)	(1.2)	-
Retirement benefit obligation deficit payments (note 19)	(35.0)	(24.4)
Share-based payment expense	8.0	4.1
Changes in working capital	(64.0)	28.4
Cash inflow from operations	375.6	406.7

* In respect of previously disposed businesses (note 5).

24. Movements in net debt

	2016	2015
	£m	Restated (note 27) £m
At 1 January	1,051.2	575.5
Free cash inflow	(131.1)	(199.0)
Businesses acquired (note 25)	(2.1)	362.7
Business acquisition expenses	1.6	2.5
Businesses disposed (note 26)	(59.6)	(2.0)
Business disposal expenses	0.3	-
Dividends paid to Company's shareholders	113.0	111.1
Purchase of own shares	-	9.7
Share buyback – purchased	-	146.4
Net cash generated – (inflow)/outflow	<u>(77.9)</u>	431.4
Debt acquired with businesses (note 25)	-	4.4
Exchange rate adjustments	195.4	39.6
Other non-cash movements	10.4	0.3
At 31 December	<u>1,179.1</u>	<u>1,051.2</u>
Analysed as:		
Bank and other borrowings – current	175.7	4.0
Bank and other borrowings – non-current	1,170.6	1,189.0
Obligations under finance leases – current	0.1	0.1
Obligations under finance leases – non-current	6.5	5.4
Cash and cash equivalents	(173.8)	(147.3)
Total	<u>1,179.1</u>	<u>1,051.2</u>

25. Business combinations

IFRS 3 requires fair values of assets and liabilities acquired to be finalised within 12 months of the acquisition date. During 2016, the Group finalised the fair values of the assets and liabilities of the advanced composites businesses of Cobham plc ('Advanced Composites') which completed on 25 November 2015 and of EDAC Composites LLC ('EDAC') which completed on 21 December 2015. Changes were made as necessary to align the accounting policies of the acquired businesses with those of the Group. The adjustments made in finalising fair values primarily relate to the recognition of intangible assets separately from goodwill, obligations in respect of onerous production contracts and associated deferred tax liabilities. Additionally, with regards to EDAC, it was determined that one of the businesses acquired met the criteria to be treated as a joint venture and accounted for using the equity method. Goodwill is attributable to the profitability of the acquired businesses and expected future synergies arising following their acquisition. The total amount of goodwill and other intangible assets acquired as part of the acquisitions that is deductible for tax purposes is £Nil. Fair values as at the date of each acquisition are shown below:

25. Business combinations continued

	Advanced Composites £m	EDAC £m	Total £m
Goodwill (note 14)	94.1	116.9	211.0
Other intangible assets (note 14)	50.8	106.9	157.7
Property, plant and equipment (note 15)	12.0	8.4	20.4
Investments (note 16)	-	11.3	11.3
Trade and other receivables – non-current	2.3	1.0	3.3
Inventories	10.4	13.9	24.3
Trade and other receivables – current	9.2	9.9	19.1
Current tax recoverable	1.7	-	1.7
Trade and other payables – current	(12.4)	(8.3)	(20.7)
Bank and other borrowings – current	(4.1)	(0.3)	(4.4)
Provisions – current	(4.0)	-	(4.0)
Deferred tax liabilities	(2.9)	(20.4)	(23.3)
Provisions – non-current	(26.3)	(8.9)	(35.2)
Fair values at acquisition	<u>130.8</u>	<u>230.4</u>	<u>261.2</u>

Total consideration received/(paid) in respect of acquisitions was as follows:

	2016 £m	2015 £m
In respect of Advanced Composites*	1.4	(132.1)
In respect of EDAC*	0.7	(231.0)
In respect of an acquisition in prior years	-	0.4
Total	<u>2.1</u>	<u>(362.7)</u>

* Amounts received in 2016, relate to the finalisation of working capital adjustments.

26. Business disposals

On 21 December 2016, the Group disposed of 100% of the ordinary shares of Meggitt Defence Systems Ltd and Meggitt Training Systems Canada Inc, (collectively 'Meggitt Target Systems') for an initial consideration of £58.6m which is subject to an adjustment for the working capital in the businesses at the date of disposal. Meggitt Target Systems was engaged in the provision of unmanned target packages for weapon simulation and training programmes. The businesses, which were not a major line of business or geographical area of operation of the Group, were no longer considered core to the Group's operations. The net assets of Meggitt Target Systems at the date of disposal were as follows:

	Total £m
Goodwill (note 14)	2.6
Other intangible assets (note 14)	0.1
Property, plant and equipment (note 15)	1.9
Inventories	8.6
Trade and other receivables – current	6.9
Current tax recoverable	1.1
Cash and cash equivalents	1.5
Trade and other payables – current	(3.7)
Current tax liabilities	(0.8)
Provisions - current (note 18)	(0.2)
Deferred tax liabilities	(0.2)
Net assets	17.8
Currency translation gain transferred from equity (note 28)	(0.5)
Curtailed gain (note 19)	(1.2)
Business disposal expenses	1.8
Gain on disposal (note 5)	40.7
Total consideration received in cash	58.6
Net cash inflow arising on disposal:	
Total consideration received in cash	58.6
Less: cash and cash equivalents disposed of	(1.5)
Businesses disposed	57.1
Less: business disposal expenses paid	(0.3)
Total cash inflow	56.8

Total consideration received in respect of disposed businesses was as follows:

	2016 £m	2015 £m
In respect of Meggitt Target Systems	57.1	-
In respect of a business disposed of in prior years	2.5	2.0
Total	59.6	2.0

27. Restatement of prior year comparatives

As described in note 25, the fair values of the assets and liabilities of Advanced Composites and EDAC were finalised during 2016. IFRS 3 requires fair value adjustments to be recorded with effect from the date of acquisition and consequently result in the restatement of previously reported financial results. The impact on the balance sheet as at 31 December 2015 is shown below:

	As reported £m	Adjustments* £m	Other** £m	As restated £m
Goodwill	1,866.0	(49.8)	(0.7)	1,815.5
Other intangible assets	689.1	109.3	1.6	800.0
Property, plant and equipment	290.3	(1.5)	-	288.8
Investments	-	11.3	0.1	11.4
Trade and other receivables - non-current	58.9	3.3	-	62.2
Inventories	415.2	(13.4)	(0.2)	401.6
Trade and other receivables – current	353.7	(4.2)	1.9	351.4
Current tax recoverable	5.5	1.6	(1.6)	5.5
Cash and cash equivalents	145.4	-	1.9	147.3
Trade and other payables - current	(402.1)	0.3	-	(401.8)
Current tax liabilities	(37.3)	0.6	1.6	(35.1)
Bank and other borrowings - current	(4.0)	1.9	(1.9)	(4.0)
Provisions - current	(36.0)	(4.0)	-	(40.0)
Deferred tax liabilities	(255.8)	(22.7)	(0.3)	(278.8)
Provisions – non-current	(111.0)	(34.6)	(0.5)	(146.1)
Other net liabilities – not affected by restatement	(799.4)	-	-	(799.4)
Net assets	<u>2,178.5</u>	<u>(1.9)</u>	<u>1.9</u>	<u>2,178.5</u>

* Represents the impact of the finalisation of fair values and alignment with the Group's accounting policies of Advanced Composites and EDAC as at the date of their acquisitions.

** Represents the impact of exchange rate movements on the adjustments from the dates of acquisition to the balance sheet date and other reclassifications.

The Group has not restated the income statement for the year ended 31 December 2015, as the impact on underlying profit and statutory profit was not significant.

28. Components of other comprehensive income

	2016 £m	2015 £m
Arising in the year	312.6	82.7
Transferred to the income statement (note 26)	(0.5)	-
Currency translation differences – gain	312.1	82.7
Movement in fair value	(0.6)	(1.5)
Transferred to the income statement	0.4	0.8
Cash flow hedge movements – loss	(0.2)	(0.7)
Tax effect	(3.6)	2.1
Items that may be reclassified to the income statement in subsequent periods	308.3	84.1

PRINCIPAL RISKS AND UNCERTAINTIES

Strategic – Business model

Description and impact

Failure to respond to fundamental changes in our aerospace business model, primarily the evolving aftermarket. This includes more durable parts requiring less frequent replacement, a growing supply of surplus parts, OE customers seeking greater control of their aftermarket supply chain and accelerated pace of new aircraft deliveries leading to the earlier retirement of older aircraft.

Impact: decreased revenue and profit

How we manage it

- Alignment of Group, divisional and functional strategy processes
- Establishment of dedicated full-service aftermarket organisation
- Implementation of long-term customer agreements as part of maintaining and monitoring pricing strategy
- Implementation of Meggitt Production System (MPS) in aftermarket operations
- Investment in research and development to maintain and enhance Meggitt's intellectual property
- Strengthened commercial function

Strategic – Product Demand

Description and impact

Significant variation in demand for products should civil aerospace, military and energy business downcycles coincide, a serious political, economic or terrorist event take place or industry consolidation materially change the competitive landscape.

Impact: volatility in underlying profitability

How we manage it

- Monitoring external economic and commercial environment and long-lead indicators whilst maintaining focus on balanced portfolio
- Regularly communicating strategy to shareholders
- Maintaining sufficient headroom in committed bank facilities and against bank covenants whilst implementing appropriate cost-base contingency plans

Strategic – Technology strategy

Description and impact

Failure to develop and implement meaningful technology strategies to meet customers' needs.

Impact: restriction of ability to compete on new programmes with consequent decrease in revenue and profit

How we manage it

- Creation of technology roadmaps with customers and investment in applied research and technology
- Focus on technology during Group strategy process
- Recruiting first-class engineers with appropriate technology skills
- Ring-fenced budgets focused on longer-term technology developments
- Partnerships with government, academia and other companies to leverage our R&D budgets

Operational – Quality escape/equipment failure

Description and impact

Defective product leading to in-service failure, accidents, the grounding of aircraft or prolonged production shut-downs for the Group and its customers.

Impact: decreased revenue and profit, damage to operational performance and reputation

How we manage it

- Implementation of well-developed system safety analysis, verification and validation policy and processes, combined with quality and customer audits and industry certifications
- Implementing MPS across the Group
- Implementation of enhanced supplier quality assurance process

Operational – Project/programme management

Description and impact

Failure to meet new product development programme milestones and certification requirements and successfully transition new products into manufacturing as production rates increase.

Impact: significant financial penalties leading to decreased profit and damage to reputation

How we manage it

- Implementation of a programme lifecycle management process and engineering support applications, combined with enhanced internal review process to stress-test readiness to proceed at each stage of key programmes
- Implementation of improved technology readiness and bid approval diligence methodology
- Delivery of applied research and technology objectives in line with Group strategy
- Incremental improvement in performance following MPS implementation and reorganisation of programme management to increase capability and focus on delivery and governance
- Active participation in customer rate-readiness processes

Operational – Business interruption

Description and impact

A catastrophic event such as earthquake (The Group has a significant operational presence in Southern California) or fire could lead to infrastructure and property damage which prevents the Group from fulfilling its contractual obligations.

Impact: decreased revenue and profit, damage to operational performance and reputation

How we manage it

- Group-wide business continuity and crisis management plans, subject to regular testing
- Comprehensive insurance programme, renewed annually and subject to property risk assessment visits

Operational – Customer Satisfaction

Description and impact

Failure to meet customers' cost, quality and delivery standards or qualify as preferred suppliers.

Impact: failure to win future programmes, decreased revenue and profit

How we manage it

- Creation of dedicated aftermarket organisation
- Implementation of supplier excellence framework following risk analysis and on-site assessments
- Implementation of MPS combined with a programme lifecycle management process leading to step change in performance
- Reorganisation of programme management to increase capability and focus on delivery and governance
- Development of commercial function and engineering capability
- Increased utilisation of low-cost manufacturing base
- Regular monitoring of customer scorecards and ensuring responsiveness to issues via Voice of the Customer process

Operational – Acquisition integration

Description and impact

Failure to integrate effectively the composites acquisitions and realise expected financial returns in line with business case.

Impact: decreased revenue and profit

How we manage it

- Internal pre-acquisition due diligence supplemented by external experts
- Implementation of MPS as part of proven post-merger integration process led by incumbent divisional management, supported by experienced dedicated integration teams with a senior oversight committee
- PMO established to manage integration and delivery of financial model, including cost synergies

Operational – IT/systems failure

Description and impact

Prolonged lack of availability of critical systems such as SAP due to badly-executed implementation or change of control; poor maintenance, business continuity or back-up procedures; failure of third-parties to meet service level agreements; or cyber-attack including failure to protect IP or other sensitive information.

Impact: decreased revenue and profit, damage to operational performance and reputation

How we manage it

- Implementation of rolling programme of system upgrades (including SAP implementation) to replace legacy systems
- Ongoing implementation of IT security strategy and enhancement of IT security infrastructure, policies and procedures
- Establishment of Group-wide intellectual property protection programme
- Review of existing systems, third-party service providers and risks, including resilience and disaster recovery processes, undertaking mitigating action where appropriate
- Roll-out of deployment and architectural review processes

Operational – Supply chain

Description and impact

Failure or inability of critical suppliers to supply unique products, capabilities or services preventing the Group from satisfying customers or meeting contractual requirements.

Impact: decreased revenue and profit, damage to operational performance and reputation

How we manage it

- Implementation of supplier excellence framework combined with integrated commercial and procurement approach to contractual terms and conditions including development of long-term agreements
- Maintenance of buffer inventory for critical and sole-source suppliers
- Implementation of measures to mitigate counterfeit and fraudulent parts at high-risk facilities

Corporate – Legal & Regulatory

Description and impact

Significant breach of increasingly complex trade compliance, bribery & corruption, ethics, environmental and health & safety laws.

Impact: damage to reputation, loss of supplier accreditations, suspension of activity, fines from civil and criminal proceedings

How we manage it

- Continuing investment in compliance programmes
- Implementation of Board-approved trade compliance, ethics and anti-corruption policies
- Roll-out of global trade compliance IT solution and import compliance programme
- Regular monitoring by Ethics and Trade Compliance Committee, supported by on-going trade compliance programme including third party audits; and comprehensive ethics programme including training, anti-corruption policy, external audits and Ethics line
- MPS implementation to enhance safety measures validated by third party audits

Financial - Taxation

Description and impact

Tax legislation is complex and compliance can be subject to interpretation. Legislation, including response to the OECD BEPS programme and the new US Presidential administration, is subject to change which could negate the effectiveness of the Group's current, well-established, tax-efficient international structures, including those used to finance acquisitions.

Impact: higher effective tax rates resulting in decreased profit

How we manage it

- Monitoring international tax developments to assess implications of future legislation
- Maintenance of a low-risk rating with UK HMRC and other tax authorities through open dialogue and, where possible, pre-agreement of arrangements to confirm compliance with legislation
- Assessment of options to mitigate impact of legislative changes on the Group's effective tax rate
- Use of multiple expert third party tax advisors

DIRECTORS' RESPONSIBILITIES STATEMENT

Each of the persons who is a director at the date of the approval of this report 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 the 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; and
- 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.

By order of the Board:

S G Young
Director
27 February 2017

D R Webb
Director
27 February 2017

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