

# DELIVERING GLOBAL PROTECTION



**The Group delivers high-reliability solutions to protect people, platforms, missions and information against constantly-changing threats. With international production facilities, Chemring meets specific customer requirements in defence and security markets in more than fifty countries worldwide.**

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## OUR BUSINESSES

We have three business segments.

### Countermeasures

➔ for more information see page 16



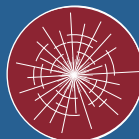
### Sensors & Electronics

➔ for more information see page 18

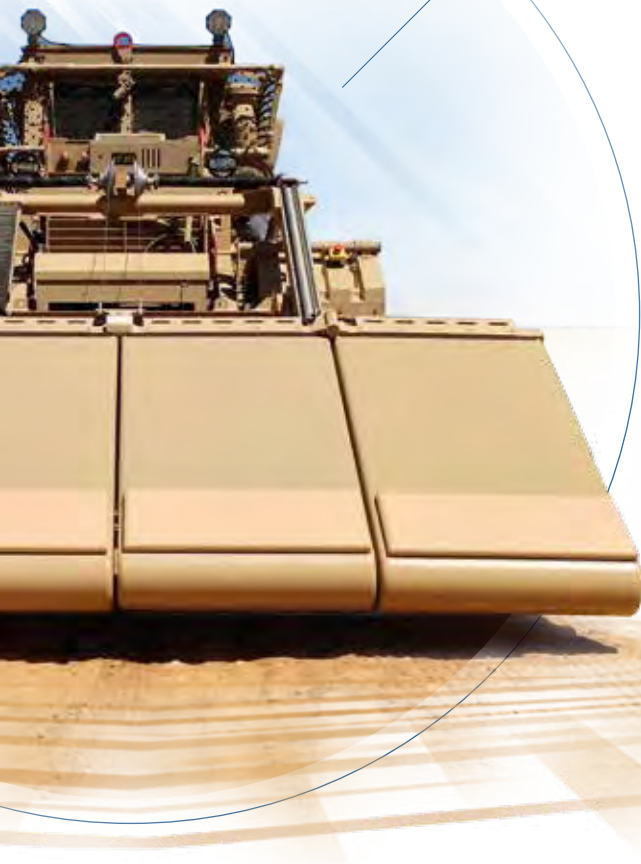


### Energetic Systems

➔ for more information see page 20



## 2016 PERFORMANCE



## FINANCIAL DEVELOPMENTS

## Order book

# £592.9m

(2015: £569.6m)

| Underlying operating profit* | Revenue         | Underlying operating margin |
|------------------------------|-----------------|-----------------------------|
| <b>£48.5m</b>                | <b>£477.1m</b>  | <b>10.2%</b>                |
| (2015: £34.4m)               | (2015: £377.3m) | (2015: 9.1%)                |

## KEY DEVELOPMENTS

- Operational and financial performance improved in H2 with strong 40mm volumes and favourable currency impact
- Cash generation improved with cash flows from operating activities of £76.4 million (2015: £35.4 million), giving cash conversion\*\* of underlying operating profit of 123% (2015: 53%)
- Net debt reduced to £87.6 million; net debt to EBITDA at 1.15x
- Continued improvement in safety performance, with LTI rate the lowest on record
- Continued progress on R&D phases of key US Programs of Record and on F-35
- Operational Excellence Programme launched to drive further improvements in safety, knowledge sharing, gross margins and cash generation
- New Group Finance Director appointed post period end
- Order book at year end of £592.9 million (2015: £569.6 million), of which £368.0 million is currently expected to be recognised as revenue in 2017
- Board recommending a final dividend of 1.3p per share (2015: nil)

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\* Underlying measures referred to in this report are stated before costs relating to acquisitions and disposals, business restructuring and incident costs, profit/loss on disposal of businesses, items deemed to be of an exceptional nature, impairment of goodwill and acquired intangibles, impairment of assets held for sale, amortisation of acquired intangibles and gains/losses on the movement in the fair value of derivative financial instruments. A reconciliation of underlying and total operating profit is set out in note 2 of the Group financial statements.

\*\* See accounting policies section for further detail.

2016 has been a year of progress with the Group continuing its recent focus on operational and safety improvements, in addition to restructuring its balance sheet.

**Carl-Peter Forster**

Chairman



After a disappointing first half that was impacted by delayed contract starts and operational issues, full year performance was heavily weighted to the second half. Production and delivery performance across all sites in the second half was at or above target levels and the Group therefore met the Board's expectations for the year.

This improved performance reflects the progress that has been made, and continues to be made, across the Group. Improved operational focus and greater collaboration amongst the businesses is delivering tangible benefit in a market that is starting to recover from multi-year softness, while the Programs of Record in the Sensors & Electronics segment offer opportunities for future growth.

In February 2016, the Company raised £80.8 million via a rights issue, the primary purpose of which was to alleviate the constraints that the Group's indebtedness was putting on growth opportunities. £48.8 million of the proceeds was used to repay a proportion of the Group's outstanding US loan notes, significantly reducing the Group's future finance costs.

Having strengthened the balance sheet, the Group is now fully focusing on the operational priorities that will underpin its future growth. These priorities include capacity investment projects, implementing significant cost saving initiatives, ensuring excellence in contract delivery and delivering improved working capital management.

The effects of this renewed focus are visible in these results and, in particular, the improving operational performance across the Group in the second half of the year.

Site consolidation initiatives are now underway, such as the enhancement of our Chemring Energetic Devices' facility in Illinois, that will allow the transition of operations to Illinois and subsequent closure of the California facility, delivering \$5 million of annual cost savings. We are also looking to close one of our two Countermeasure facilities in Philadelphia, delivering further ongoing savings.

Since joining the board on 1 May 2016, and my subsequent appointment as Chairman on 1 July 2016, I have taken the opportunity to visit most of our manufacturing operations both in Europe and North America. I have been encouraged by the Group's diverse portfolio of products and the strength of its market positions, and by the quality of many of our facilities.

But I have been most encouraged by the calibre of our many employees who, through difficult times, have remained committed to Chemring and focused on the goals of collaboration and continued operational improvement. I would like to take this opportunity to thank them for their loyal service and hard work.

A significant amount has been achieved over the past couple of years in terms of re-shaping the Group's organisational structure, reducing the cost base and improving operational performance. However, if Chemring is to remain at the forefront of its markets, then we need to build on this progress, and commit further investment in both people and practices.

At the start of 2017 we therefore launched the Operational Excellence Programme. This initiative is designed to enable the Group to realise its full potential. It will focus on safety, reliability, on-time delivery, improved productivity and profitability,



and reduced working capital. It will develop strategic and operational process sets that are, where appropriate, common across the Group.

Aligned to this programme, a best practice sharing forum will be established for each production and functional area. This will be aimed at determining where within the Group we currently achieve best practice and how we can share this better, what we can do to enhance recognised best practice against our industry background, and how we can roll this out to other business units.

The ability to focus on these operational priorities and growth initiatives comes as a direct result of the rights issue, which has enabled management to focus on managing the business, rather than managing the debt. This could not have happened without the support of our shareholders and I would therefore like to acknowledge and thank them for their continued support.

There is a growing sense of momentum across the Group. We entered the new financial year with a strong order book, excellent strategic positions on long-term programmes, and with a focus on continued operational improvement. Overall, I look to the future with optimism.

### Trading summary

Revenue from continuing operations was £477.1 million (2015: £377.3 million). This revenue generated an underlying operating profit of £48.5 million (2015: £34.4 million). Including non-underlying items, total operating profit was £26.2 million (2015: £5.5 million).

Underlying profit before tax increased by 71.7% from £19.8 million to £34.0 million, resulting in underlying earnings per share of 10.3p (2015 as restated: 7.1p).

The closing order book for continuing operations increased by £23.3 million during the year and at 31 October 2016 was £592.9 million (2015: £569.6 million).

The Group's net debt at 31 October 2016 was £87.6 million (2015: £154.3 million).

### Underlying earnings per share

**10.3p**

(2015 as restated: 7.1p)

### Dividend per share

**1.3p**

(2015 as restated: 2.1p)

### Net debt

**£87.6m**

(2015: £154.3m)



## Dividends

In view of the rights issue that was announced in January 2016, the Board did not recommend a final dividend in respect of 2015, nor did it recommend an interim dividend in respect of the six month period ended 30 April 2016.

Recognising that dividends are an important component of total shareholder returns, and in view of the Group's improved trading performance for 2016, the Board intends to resume paying dividends and is recommending a final dividend for the year ended 30 October 2016 of 1.3p per ordinary share. If approved, the final dividend will be paid on 18 May 2017 to shareholders on the register on 28 April 2017.

## Board of directors

This year has seen the Group reshape the membership of the Board.

Peter Hickson retired as a director at the end of June 2016, having been appointed as Chairman of the Board in October 2010. During Peter's tenure the Group transitioned through a period of unprecedented change within the defence industry, following the end to the wars in Iraq and Afghanistan. This was not an easy period and Peter deserves the Group's gratitude for his leadership and commitment. He left the business well-placed for future growth.

I joined the Board on 1 May 2016 as an independent non-executive director and Chairman-designate. I succeeded Peter Hickson as Chairman of the Board following Peter's retirement on 30 June 2016.

Daniel Dayan joined the Board as an independent non-executive director on 7 March 2016, becoming Chairman of the Remuneration Committee from that date.

Ian Much and Andy Hamment stood down from the Board on 21 March 2016 and 30 April 2016 respectively. Nigel Young succeeded Ian Much as Senior Independent Director with effect from 21 March 2016.

Andrew Davies joined the Board as an independent non-executive director on 17 May 2016.

On 29 June 2016, the Group announced that Steve Bowers, Group Finance Director, had informed the Board of his intention to leave the Group. Steve left the Group on 30 September 2016 and his role has since been covered on an interim basis by Andrew P. Davies, Deputy Group Finance Director.

On 13 December 2016, the Group announced the appointment of Andrew Lewis as Group Finance Director. He was previously Group Finance Director of Avon Rubber p.l.c. Andrew joined Chemring on 9 January 2017 and will join the Board of Chemring on 19 January 2017 after the approval and announcement of the 2016 results.

## Current trading and outlook

Trading since the start of 2017 has been in line with expectations across all businesses.

The Board's expectations for the Group's performance for 2017 remain unchanged, based on current foreign exchange rates.

The expected profile of orders, revenue and margins, combined with routine seasonality within the business, means that the Group continues to expect 2017 to reflect a significant second-half weighting in profitability.

The order book as at 31 October 2016 increased 4.1% to £592.9 million, of which £368.0 million is currently expected to be recognised as revenue in 2017. On a constant currency basis using 2015 rates, the order book was £489.8 million.

The order book at 31 December 2016 was £572.1 million.

### Carl-Peter Forster

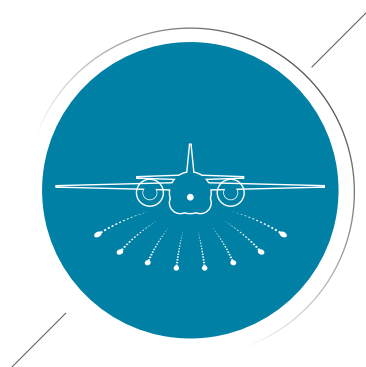
Chairman  
19 January 2017





# WHAT WE DO

## COUNTERMEASURES



Chemring is well-established as the world leader in the design, development and manufacture of advanced expendable countermeasures and countermeasure suites for protecting air, sea and land platforms against the growing threat of guided missiles. The Group has a broad product range including conventional flares, advanced flares, special material decoys, chaff and naval countermeasures.

➔ for more information see page 16

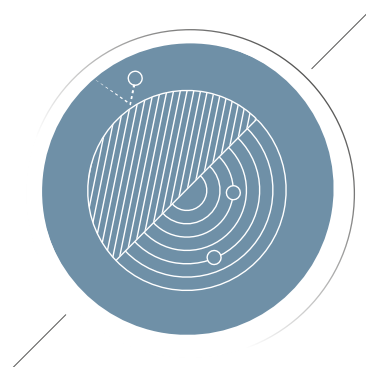
### Revenue

**£138.3m**

### Underlying operating profit

**£12.8m**

## SENSORS & ELECTRONICS



Chemring's Sensors & Electronics products include world-leading systems for detecting improvised explosive devices ("IEDs"), and chemical and biological agents, and core technologies for detecting, intercepting and jamming electronic communications. The Group is also a leading contract research and development supplier, trusted by government and industrial partners worldwide to solve technically challenging problems.

➔ for more information see page 18

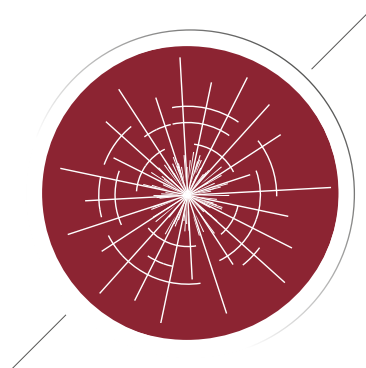
### Revenue

**£96.9m**

### Underlying operating profit

**£11.4m**

## ENERGETIC SYSTEMS



Chemring's energetic sub-systems are safety-critical components of missiles, aircraft and space launch systems. Operators and prime contractors depend on Chemring's very high reliability, single-use devices to perform key functions, including satellite deployment, aircrew egress and missile self-destruct. Chemring manufactures a range of pyrotechnic products which are used by military and security forces around the world for screening, signalling and illumination. In addition, the Group produces a specialist range of high explosive products, including minefield clearance systems, demolition stores and 40mm ammunition.

➔ for more information see page 20

### Revenue

**£241.9m**

### Underlying operating profit

**£31.7m**



## WHERE WE OPERATE

### NORTH AMERICA



Chemring has four business units in North America, supplying mainly to the US Department of Defense and its prime contractors:

- **Chemring Countermeasures USA**  
(Alloy Surfaces in Pennsylvania and Kilgore Flares in Tennessee) - manufactures conventional, advanced and special material decoys
- **Chemring Sensors & Electronic Systems**  
(Virginia and North Carolina) - manufactures IED, chemical and biological detection systems
- **Chemring Energetic Devices**  
(Illinois and California) - makes pyrotechnic components for aircraft, missile and space applications
- **Chemring Ordnance**  
(Florida) - manufactures the Anti-Personnel Obstacle Breaching System and 40mm ammunition

### EUROPE



Chemring has seven businesses in Europe, supplying NATO and non-NATO customers:

- **Chemring Countermeasures**  
(UK) - manufactures conventional and advanced air countermeasures, naval decoys and launchers
- **Chemring Defence**  
(UK) - manufactures smoke and illumination pyrotechnics and payloads for military, original equipment manufacturers ("OEM") and security customers
- **Roke**  
(UK) - a leading contract research and development organisation
- **Chemring Technology Solutions**  
(UK) - manufactures electronic warfare, EOD, counter-IED, cyber protection and security systems
- **Chemring Energetics**  
(UK) - makes pyrotechnic components for aircraft, missile and space applications, and high-quality military demolition stores
- **Chemring Nobel**  
(Norway) - manufactures explosive raw materials
- **3d-Radar**  
(Norway) - developer of ground penetrating radar

### ASIA PACIFIC



- **Chemring Australia**  
(Victoria) - operates a modern countermeasures and pyrotechnics manufacturing facility, and supplies other Group products into the Australian market

# IMPROVING OPERATIONAL PERFORMANCE

2016 was a busy year for Chemring, both from a corporate and operational perspective, and it is pleasing to see that the efforts of so many have delivered a positive result.

**Michael Flowers**

Group Chief Executive



Order intake and revenue has been solid across the Group, and strong in the Energetics segment. Subsequent to the completion of the rights issue and with good cash conversion, the balance sheet is now strengthened, positioning us well for the future.

## Safety

As always, safety remains the Group's first priority and the Group continues to drive improvement in this area.

Lost time injury performance continues to improve, and the lost time injury rate of 0.35 is the best result to date. Of the nine lost time injuries, only one resulted from an energetic incident. This improvement in performance has been driven by a four pronged approach to safety process improvement, capital improvement, enhanced leadership engagement and cultural improvement. Capital investment in safety has continued, with key projects undertaken during the year including the automated countermeasure slurry process at Kilgore, detonator loading at Chemring Energetics and improvements to energetic waste disposal facilities.

Despite best efforts, some energetic incidents did occur during the year, most notably at the Australian and US countermeasures facilities. Whilst these caused some disruption to operations and impacted first half financial performance, these incidents resulted in no injuries, with all safety systems operating as planned, protective equipment exceeding design performance, and personnel response appropriate.

In the forthcoming year we shall prioritise our effort to reduce further the exposure of our people to potentially lethal hazards. The focus will be on removing the hazard where possible, followed by the reduction in exposure through plant and engineering controls and automation.

## Strategy and organisation

The Countermeasures strategy remains unchanged as the Group seeks to strengthen its position in the global market. A new special material decoy has been launched with initial and follow-on orders received. In Australia, qualification as the second source supplier for F-35 Joint Strike Fighter ("F-35") flares continues, with three of the four qualification phases now completed. In the US, Low Rate Initial Production ("LRIP") 5 F-35 deliveries were completed, the Group is under contract for LRIP 6, and has won the competition for initial supply of F-35 training flares. The acquisition of key assets and technology from Wallop Defence Systems in the UK, which was completed in May 2016, has further strengthened the air countermeasures portfolio and positioning, particularly in the European market.

Within Sensors & Electronics, the focus continues to be on expansion of capability and product portfolio in the major operating niches of tactical electronic warfare ("EW"), counter-IED and explosives detection, chemical warfare detection and biological warfare detection. Progression against the US Programs of Record continues, with the progression into stage 3 (prototype development) of the Next Generation Chemical Detector ("NGCD") most noteworthy. Success on the major US Programs of Record remains the Group's absolute focus, both due to the financial return from these programmes, and the leading global technological position that will result.

Multiple orders have been received for the Resolve tactical EW system, including repeat orders in Europe and the Middle East, with the winning of the Land 500 programme in Australia being the largest order achieved to date. Post year end, a further order was received from a new NATO customer. Post year end negotiations have commenced with the US Government for the first hardware test stage for Husky Mounted Detection System ("HMDS") enhanced systems, with supply of an initial eight systems for trial in-theatre. In addition, the Group received an upgrade contract for the same enhanced capability from another NATO HMDS user.

Roke's focus will remain on delivering consultancy and contract R&D services to critical government and commercial customers. Investment focus shall be on people, to ensure their training and development matches emergent market needs. Having opened a new satellite office in Gloucester to better service the needs of the customer base, further geographic expansion may be undertaken as market needs dictate.

The Energetic Systems businesses continue to be managed in order to maximise market position in their operating niches, maintain product qualification, and ensure safe and effective operations. Recognising that this segment is far more commodity based than the other segments, with price being the key discriminator, cost base management, footprint and delivery performance remain critical to ensure maximum returns.

Given its strong position in the space, missile and aerospace market, the Group shall continue to invest in the niche market positions held by Chemring Energetic Devices. Future investment will focus on new devices for forthcoming satellite applications, development of an in-house precision manufacturing capability, and relocation of the primary explosives capability from California to Illinois. This will result in a single, vertically integrated facility that will better meet emergent customer needs.

During 2016 the US management structure has been revised to improve efficiency.

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## Operational overview

Following a disappointing first half, driven by delayed contract starts and operational execution that was below expectations, the Group delivered a strong second half with production and delivery performance across all sites at or above targeted levels, leading to £297 million of revenue and £45 million of operating profit in the half.

This improved performance has been driven by improvements in consistency of production at the Countermeasures businesses, with prior investment in design and process control starting to bear fruit. Production gains have been made at Chemring Ordnance, where 40mm ammunition manufacture quickly ramped-up. Similarly, second half performance at other Energetic Systems sites has met expectations.

The major restructuring completed at Roke during 2015 has delivered positive results, with operating profit and cash flow returns improving year-on-year. Other structural, cost base optimisation and site consolidation efforts are delivering to plan, with further initiatives in development.

In late 2016 a Group-wide Operational Excellence Programme was initiated with the clear aims of further improving safety, increasing operating margins, and delivering greater levels of cash conversion. This programme includes initiatives driven at the Group's centre, such as process alignment and further investment prioritisation; however, the key elements of the programme are business and segment focused. These centre around knowledge and best practice sharing to enable all businesses to meet internal best practice, combined with external benchmarking to further enhance operations. The programme has also identified a number of business unit and segment specific activities that will be progressed, such as further vertical integration in the Group's space and missile energetic components businesses, lean and engineering

process control implementation within all businesses, and alternate energetic material mixing technologies for countermeasures.

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## Rights issue

The rights issue was successfully completed on 23 February 2016 raising £80.8 million. The net proceeds of the rights issue after equity issue costs were £75.2 million, and £48.8 million was immediately used to pay down loan notes. The balance of the raise was used for make-whole premiums pursuant to the terms of the loan notes (£3.7 million), repayment costs (£1.4 million) and general corporate purposes. In respect of the latter, the scheduled repayment of loan notes due in November 2016 of \$36.0 million was repaid from cash at hand, enabled in part by rights issue funds.

The high level of indebtedness has ceased to be a day-to-day management issue for the business subsequent to the rights issue, allowing focus to be placed on operational and strategic initiatives that will support growth and deliver shareholder value. As advised when launching the rights issue, the Group's target capital structure is 1.0x - 1.5x net debt to EBITDA, a range the Group was well within at the end of 2016.



## Conclusion

Against the backdrop of a stronger balance sheet and improving delivery performance, I see continued opportunities for the Group. The ongoing execution against the US Programs of Record within the Sensors businesses, combined with a slow but steady ramp up of F-35 countermeasure requirements, are key to future growth, as is the continued level of performance at Roke. Our base business in Energetic Systems and Countermeasures continues to be solid, and the order book provides good visibility.

Progress on site and business consolidations in 2017, combined with efforts to ensure our cost base matches market need, is expected to underpin profitability, and the Board's expectations for 2017 are unchanged, based on current FX rates. The initiation of an Operational Excellence Programme, designed to further enhance safety, improve gross margins and cash conversion, is expected to deliver improved returns in the coming years.

### Michael Flowers

Group Chief Executive  
19 January 2017



## BUSINESS MODEL

Chemring delivers sustainable returns to its investors by delivering specialist products and services to its customers. In our Countermeasures and Energetics businesses these products incorporate materials which are relatively inexpensive, but can be hazardous if mis-handled, so our dedicated sites, processes and know-how ensure that we can safely and cost effectively produce these products at attractive margins. In our Sensors & Electronics businesses, the proprietary intellectual property embedded in our product hardware and software underpins the creation of high value solutions which detect threats, ranging from buried IEDs to sophisticated cyber-attacks on an organisation's data.

Our business model is based on a continuous cycle of applying technology to meet customer needs. This builds on four key elements:





## Customer understanding

The Group delivers protection solutions in a world facing rapidly-evolving threats from both organised militaries and the growing base of insurgents. The Group's home markets in the United States, United Kingdom and Australia are amongst the largest in the world, and comprise a base of sophisticated and influential users who have demanding requirements for new solutions to meet these threats.

Our understanding of these customers, their threats, concepts of operations and specific technical requirements underpins everything we do.



## New technology

The Group continually invests in research into new solutions to meet our customers' evolving threats. We use internally-funded research to secure critical intellectual property, and develop proprietary solutions. A key part of our business model is to secure customer funding for our development efforts - this not only supplements our own funding, but this commitment provides valuable confirmation that we are addressing problems they need to solve as well as validation of the proposed technical solution. This partnership with customers also extends to the final qualification and acceptance of our products - in some areas, such as countermeasures and chemical/biological agent detection, customers provide test and qualification services, such as aircraft flight trials or live agent testing, which would be impossible to complete internally.

The Group's commitment to research and development has established its leading position in expendable countermeasures, chemical, biological and explosives detection, and cyber electro-magnetic activity ("CEMA").



## Excellent delivery

The Group delivers a diverse range of offerings, from consultancy and development services, to very high volumes of highly energetic aircraft flares. It has manufacturing and delivery operations across twenty sites, matched to the nature of customer demand and the characteristics of the specific offerings:

- In consultancy and R&D services, we form and re-form bespoke teams for each project
- Sensors & Electronics are assembled and tested in batch operations
- Energetic components use bought-in mechanical hardware with special batch operations to install the small energetic elements
- High volume products such as flares and some energetic products are manufactured on semi-continuous, automated production lines

We maintain excellent delivery across the Group by integrating operations, continuous improvement and automation.

We evaluate our factory footprint, both in terms of the cost base, and also in terms of the effectiveness and efficiency of the operations - where appropriate, we integrate operations on to a single location and in several cases have not only reduced costs, but also improved delivery performance.

Our continuous improvement initiatives are based on "Lean" and "Six-Sigma" techniques, tailored to the special characteristics of our operations, particularly when processing energetic materials.

Finally, we aim to automate high volume operations, particularly where we are processing energetic materials. This improves operator safety by separating them from hazardous materials, but has also improved quality and consistency of product performance and delivery.



## Extended reach

Chemring sells to over fifty countries around the world through a combination of direct sales and a network of sales partners who have strong in-country relationships with national procurement offices. A key element of our business model is our "Land and Expand" approach. We build on a single successful sale into a new customer and seek to expand on this by cross-selling all of the Group's capabilities into that particular customer.

Secondly, we try to get close to our important customers by establishing a presence nearby:

- Our Australian operations are a focal point for all Chemring's offerings into the Commonwealth, including, most recently our land EW capability from the UK
- We have established a regional sales office in the UAE as a central access point to most of the GCC countries
- We have set up an office in Gloucester in the UK, close to a key consultancy and contract R&D customer

In addition, we recognise that defence is a sensitive capability for all countries, and many aim to develop a local industrial base to support their national security. This is particularly true for consumables such as countermeasures, where the ability of a supply chain to support military operations is key - the Group's US and UK-based flare manufacturing capabilities were critical to support operations in Iraq and Afghanistan, and other nations are also seeking to be self-sufficient in their own supply chain. The Group works with nations who wish to develop indigenous capability, and supports product development and local manufacturing facilities to establish an expanded circle of "home" customers.

The Group is structured to facilitate each of these four elements across all our businesses, and to maximise the common themes and synergies amongst similar businesses, particularly within specific segments. Conversely, where there is limited commonality, we have separated operations to enable businesses to focus on the specific customers, technologies and operations which suit their business model - for example, splitting Roke's contract development business from its product business has enabled both to focus and thrive. In Countermeasures, we have established a common international sales and marketing structure; in Sensors & Electronics, we share and transfer technology from the UK to the US to enable new detection capabilities; and in Energetics, we are building internal supply from our materials and components businesses into our products businesses.

### Our strategy builds on our business model and reflects the current dynamics of our defence and security markets.

#### Markets

Our markets have been driven by the long decline in defence spending over the last five years. In particular, the US, which accounts for about half of Chemring's revenues, has reduced its total spend by nearly 20% since 2010, with much of the reduction in Overseas Contingency Operations funding. This US trend has been mirrored across NATO allies as operations have ceased in Iraq and Afghanistan. Now, across the US and Europe the decline appears to have levelled at a macro level, and the impact of this is slowly filtering down to the relatively low value systems, products and components which Chemring manufactures: IED detection systems are now recognised as Programs of Record in the US defence budget; excessive stockpiles of consumables bought to support operations have now been run down; and procurement of new combat aircraft is driving emerging demand for

bespoke, next-generation countermeasures. We anticipate that the overall defence markets in the US and Europe will remain subdued but stable.

In the UK, Roke, which provides technology solutions to security agencies, is seeing a growth in demand for its services – following the Chancellor's commitment to increase spending on cyber-security for the UK, this growth is likely to continue.

Australia is Chemring's other "home" market. The Commonwealth has declared a ten-year plan to grow defence spending by over 80%, and in particular has recognised that this needs to be de-coupled from GDP growth to maintain an appropriate response to China's increasingly capable forces in the region.

#### OUR STRATEGY

**DELIVER PROFIT  
AND CASH**

**EMBED  
OPERATIONAL  
EXCELLENCE**

**INVEST FOR  
GROWTH**

#### SEGMENTS

|                    |   |   |                             |
|--------------------|---|---|-----------------------------|
| Countermeasures    | Complete restructuring and site rationalisations                              | Operational Excellence Programme<br>Targeted facilities investment                            | Secure F-35 flare           |
| Sensors – products | Rationalise sites and manufacturing operations                                | Targeted R&D investment to secure growth programmes   |                             |
| Roke               | Recruit to meet current demand  | Establish satellite offices   |                             |
| Energetic Systems  | Deliver current order book<br>Complete restructuring and site rationalisation | Operational Excellence Programme<br>Exploit synergies in internal supply and routes to market | Deliver cash to fund growth |

#### KEY PERFORMANCE INDICATORS

- Profit
- Cash

- Safety
- Cost of re-work
- On-time delivery
- Gross margin improvement
- Working capital

- R&D investment
- Order intake
- Revenue growth



The Middle East remains an important export market for Chemring, but it has become much more volatile, with the opposing forces of escalating conflicts in the region, countered by the collapse in oil prices since 2014. The region had consistently increased year-on-year defence spending from 2006 to 2014, but in 2015 defence spending reduced by 10% as oil-producing countries were forced to tighten their belts in response to declining income. The Group has already seen a number of order delays and cancellations, and the outlook is likely to remain volatile, with only urgent operational requirements likely to receive support and funding.

Against this backdrop, our strategy builds on three themes.

### Deliver profit and cash

As the defence sector emerges from a period of sustained decline, our short-term priority is to deliver profit and cash. We have re-scaled the Group to reflect current market conditions and have completed several restructuring programmes, with several more under way as specific production programmes complete.

Many of our facilities handle and process energetic materials, which require special facilities and often large sites with high fixed costs. We continue to monitor the cost base at a Group, segment and site level, and benchmark fixed costs both internally and externally to ensure that all our businesses are scaled and scoped to operate safely, effectively and efficiently.

Tight control of the overhead base means that the Group is positioned to deliver profit and cash from its strong order book, which currently benefits from a handful of major international orders in the Energetic Systems segments.

### Embed operational excellence

The second theme of our strategy is to systematically upgrade our businesses through a Group-wide Operational Excellence Programme.

As a Group, we have recognised that there are common operational themes and challenges across the Countermeasures, Sensors & Electronics, and Energetic Systems segments, despite the apparent diversity of products across the businesses. For example, few of our manufacturing operations are continuously producing any single product, and several businesses deliver completely different products from one year to the next. Other common challenges include development to production transition, right-first-time production and a systematic approach to trouble-shooting when there are problems.

In order to address these common challenges, we have established a programme to develop and roll-out a common operating model and tool-set, which builds on and shares the collective experiences and best practices across the Group. We expect this to deliver tangible benefits in:

- Safety
- Eliminating rework
- On-time delivery
- Profitability
- Working capital

A key part of the programme will be to establish common key performance indicators, and to measure progress and improvements against these KPIs.

### Invest for growth

Finally, the Group will prioritise investment in equipment, facilities and development to deliver growth. As a result of its position in the US countermeasures market, and strategic investments in sensors technology, the Group is well positioned on several major programmes, mainly in the US. These multi-year, multi-million dollar “Growth Programmes” underpin the growth of the Group and extend to the mid-2020s, and include:

- F-35 countermeasures
- Joint Biological Tactical Detection System
- Next Generation Chemical Detector
- Husky Mounted Detection System

In addition to these specific Programs of Record in the US, our UK Sensors & Electronics businesses face exciting opportunities in next-generation electronic warfare, cyber electro-magnetic activity (“CEMA”) and consulting and R&D for UK agencies.

These programmes are the main priorities for investment to ensure that Chemring secures and maintains its position as sole-source supplier of these key military capabilities. We will fund this investment by managing the portfolio, particularly in the Energetic Systems segments, to deliver profit and cash.

# COUNTERMEASURES

Countermeasures revenue reflected the continued recovery in the segment, increasing by 9.9% on the prior year to £138.3 million (2015: £125.8 million). The impact of the production issues and energetic incidents that were experienced in the first half were partly offset by £2.8 million of insurance proceeds related to an earlier energetic incident. This resulted in a decline in margins from 13.9% to 9.3% and an underlying profit of £12.8 million, compared with £17.5 million in 2015. On a constant currency basis using 2015 rates, revenue was £127.8 million and underlying operating profit was £11.7 million.

The closing order book for Countermeasures was £177.0 million, down 3.9% on 2015. The decline, principally in the US, reflects the improved production consistency and the progressive working through of orders placed in earlier years, but also reflects the budget constraints that continue to be experienced with many customers. The transition from legacy aircraft to next generation platforms together with the continued depletion of customer inventory, built up during the Iraq and Afghanistan conflicts, is currently resulting in low order placement. Initial production contracts on the next-generation platforms including the F-35 are beginning to be placed more frequently.

Order book

**£177.0m**

(2015: £184.1m)

Revenue

**£138.3m**

(2015: £125.8m)

Underlying operating profit

**£12.8m**

(2015: £17.5m)

Underlying operating margin

**9.3%**

(2015: 13.9%)

## STRATEGY

The Group intends to maintain its leading position in the market for conventional and advanced countermeasures through continuous operational improvement and targeted investment in technology.

New automated manufacturing facilities in the UK and Australia are operational, and Chemring has a strong focus on improving the operational performance of all facilities. The Group also intends to maintain its technological lead in air countermeasures through targeted R&D investment to meet evolving needs and to sustain its sole source positions on the key US and NATO next-generation platforms - the Typhoon, F-22 and F-35. In May 2016, as part of its targeted investment in technology, the Group completed the purchase of Wallop Defence Systems Limited's countermeasures products, patents and intellectual property.

In the naval countermeasures segment, the Group intends to complete the development of the CENTURION fully-trainable naval decoy launcher in close collaboration with a launch customer, and will continue to evolve naval decoy technology by working closely with lead users, particularly the UK MoD. Additionally, the Group plans to grow its market share through in-country relationships and technology transfer in emerging markets.

Over the past year new systems have been implemented to improve the management of safety and production, and further initiatives are underway to focus on the delivery of production efficiencies, waste reduction and more efficient working capital management.

## ACTIVITIES DURING THE YEAR

The facility consolidation at Philadelphia continues to plan. All necessary approvals are in place and, depending on customer delivery requirements, will complete in the second quarter of 2017. The remaining site will temporarily close in the second quarter of 2017 to enable the relocation of assets and the modification of the plant's layout and services. The cash costs of the project are expected to be approximately \$3.0 million, with the project expected to deliver approximately \$1.4 million in annualised savings from 2018.

The implementation of a long-term manufacturing plan in the US, incorporating productivity improvements, waste and waste removal cost reduction, personnel reduction and overhead reduction is underway. This initiative is expected to position the business well for the future.

The UK Countermeasures business had an improved second half, overcoming technical issues on one product line that occurred in the first half, although the resolution of these issues meant operating margins were lower than expected. The stronger second half performance was further aided through a shift in product mix utilising existing spare capacity. In particular, demand for chaff products was higher than in previous years and this increased demand was met through manufacturing efficiency improvements implemented during the previous twelve months.

### Outlook

2017 trading performance for Countermeasures, while underpinned by a good order book, is expected to be slightly down year-on-year, as production will be impacted by US site consolidation activities in the first half.

## OUR BUSINESS UNITS

### Chemring Countermeasures USA

Consists of Alloy Surfaces, based in Pennsylvania, and Kilgore Flares, based in Tennessee.

Alloy Surfaces is a leading developer of special material decoys for the US Navy, Marine Corps, Army and Air Force, with exports to the UK and Australia.

Kilgore Flares operates a high volume manufacturing facility making conventional and advanced flares, including flares for the F-22 and F-35.

### Chemring Countermeasures UK

Manufactures advanced expendable countermeasures for air and sea platforms. Its aircraft products include conventional and advanced flares, chaff, and decoys specifically for civilian platforms. Its naval products include infra-red and radio frequency decoys and the CENTURION trainable naval decoy launcher.

### Chemring Australia

Develops and manufactures aircraft countermeasures, pyrotechnics, and counter-IED and electronic warfare solutions.

### SENSORS & ELECTRONICS

Revenue in the Sensors & Electronics segment decreased by 2.2% from the prior year to £96.9 million (2015: £99.1 million), reflecting the completion of production contracts with the US Department of Defense in the comparative period, although revenue grew at the UK businesses. Margins improved from 9.4% to 11.8% and Sensors & Electronics increased its operating profit by 22.6% to £11.4 million (2015: £9.3 million). On a constant currency basis using 2015 rates, revenue was £92.4 million and underlying operating profit was £11.3 million.

Many of the Group's Sensors and Electronics products relate to long-term counter-IED, chemical and biological detection Programs of Record for the US DoD. These programmes are currently transitioning through research and development phases, where contract sizes and margins are significantly smaller than full rate production contracts. The closing order book for Sensors & Electronics was £49.3 million, a decrease of 34.9% on 2015. This decrease principally reflects the reversing of an order from Turkey that was booked in 2014. The progression of this contract in its originally envisaged form is now considered unlikely given the overall political uncertainty within Turkey. The Board therefore considered it prudent to de-book this contract until greater clarity exists. Activity in the US has primarily focused on the progression of long-term Programs of Record for the US DoD, and good progress has been made this year.

Order book

**£49.3m**

(2015: £75.8m)

Revenue

**£96.9m**

(2015: £99.1m)

Underlying operating profit

**£11.4m**

(2015: £9.3m)

Underlying operating margin

**11.8%**

(2015: 9.4%)



#### STRATEGY

The Group intends to grow its Sensors & Electronics business by developing and exploiting technologies for its niche markets in IED defeat, chemical and biological threat detection, and land-based electronic warfare. To do so, the Group aims to exploit its international footprint to continue to develop advanced technologies and win key, identified programmes such as the Husky Mounted Detection System ("HMDS") Program of

Record, the Next Generation Chemical Detector ("NGCD"), the Joint Biological Tactical Detection System ("JBTDs"), and several next-generation electronic warfare programmes.

The Group also intends to maintain and grow its specialist contract research and development business to sustain its technology base and benefit from the customer insights this provides.



## ACTIVITIES DURING THE YEAR

In response to identified capability needs, the US Government realigned the HMDS upgrade programme to incorporate spiral development. The next major milestone for the Program of Record will be contract award for deliveries of enhanced capability detectors for in-theatre trial, to be followed, if successful, by contracting for fleet upgrade. Concurrently, further customer funded R&D will be undertaken to develop ongoing system enhancements. Overall funding allocation is unchanged. Customer engagement in the Middle East remains encouraging, with vehicle mounted ground penetrating radar ("GPR") variants being evaluated by a number of potential customers.

In chemical and biological detection, the Group has also continued to focus activity on the long-term DoD Programs of Record. In addition to the progress being made on the NGCD programme, funded development of Chemring's sole source position on the Joint Biological Tactical Detection System programme is ongoing. In 2017 it is expected that the JBTD programme, for which Chemring is the sole source supplier, will move from the engineering and manufacturing development ("EMD") phase into low rate initial production. The NGCD programme, for which the Group is contracted for the R&D phase of all three streams, is expected to move into the EMD phase in 2017. Winning of these phases will be subject to competitive tender.

While good progress has been made, the transition through research and development phases and the resulting pause in manufacturing for some of the Group's key sensors and electronics products has resulted in a decline in earnings derived from these products. Chemring Sensors & Electronic Systems ("CSES") has therefore taken the necessary action to address its structure and cost base. NIITEK and Chemring Detection Systems have been merged into a single legal entity under one senior management team. The merger of these two businesses will facilitate the closure of one facility. Overhead reduction measures continue to be balanced with the need for continued investment in research and development capability.

In the UK, the separation of the contract R&D activities of Roke from the products-based business undertaken by Chemring Technology Solutions has delivered positive results. Roke exceeded its order and revenue targets and utilisation rates have continued to rise. A growing number of opportunities in the communications intelligence and cyber areas, combined with the impact of the new operating model, have driven an increase in profitability.

### Outlook

2017 trading performance for Sensors & Electronics is expected to benefit from the continued improvement in profitability in the UK businesses, primarily in electronic warfare and cyber security. Research and development activities in the US are expected, subject to contract award, to transition to engineering and manufacturing development ("EMD") and low rate initial production ("LRIP") phases as the year progresses.

## OUR BUSINESS UNITS

### Chemring Sensors & Electronic Systems

Comprises the former NIITEK business in Dulles, Virginia, and the former Chemring Detection Systems business in Charlotte, North Carolina. NIITEK develops and manufactures ground penetrating radar IED detection systems and chemical and biological threat detection systems.

### Chemring Technology Solutions

The Group's centre of excellence in land EW, and also develops and manufactures IED detection and neutralisation systems, including vehicle-mounted and hand-held sensors, disruptors and initiation systems.

### Roke

A technology company that provides electronics research, development and engineering services, and cyber-security solutions for UK government agencies and prime contractors.

## SEGMENTAL REVIEWS

### ENERGETIC SYSTEMS

Revenue for the Energetic Systems segment increased by £89.5 million to £241.9 million (2015: £152.4 million). This improved performance was primarily as a result of the 40mm ammunition contract with a customer in the Middle East which, despite its delayed start, has performed well and contributed £44.5 million of revenue. Margins improved from 9.9% to 13.1% and Energetic Systems increased its operating profit by 109.9% to £31.7 million (2015: £15.1 million). On a constant currency basis using 2015 rates, revenue was £220.1 million and underlying operating profit was £27.4 million.

With the exception of Chemring Defence, which continues to experience very challenging markets, every business within the segment saw order book growth. The closing order book for Energetic Systems was £366.6 million, an increase of 18.4% on 2015.

Order book

**£366.6m**

(2015: £309.7m)

Revenue

**£241.9m**

(2015: £152.4m)

Underlying operating profit

**£31.7m**

(2015: £15.1m)

Underlying operating margin

**13.1%**

(2015: 9.9%)

## STRATEGY

The Group intends to secure the position of its Energetic Systems components on next-generation platforms for missile and space programmes in the United States and Europe, through improved delivery performance on current programmes and strong customer and partner interaction. In military pyrotechnics, it intends to upgrade key products to ensure that it can offer the full range of rockets, smoke grenades and flares required by its military and security customers. In addition to maintaining and upgrading its current business base and product offering, the Group intends to seek new markets with a focus on growing its business in the Middle East and Asia Pacific markets.

## ACTIVITIES DURING THE YEAR

Delays in necessary permits and export approvals associated with the 40mm ammunition contract meant that production under this contract did not fully commence until late in the first half of the year. This resulted in a heavier second half weighting and slightly lower than expected contribution to the full year. Production and deliveries ramped-up during the second half, in line with expectations. The contract continues to perform well and, assuming the extension of the existing letter of credit, is expected to be a strong contributor to 2017 performance.

At Chemring Energetic Devices, the consolidation of the Downers Grove, Illinois and Torrance, California facilities is progressing in line with expectations, with all planning approvals in place. Over 40% of the Torrance product line has now been successfully transferred, and the NASA Standard Initiator qualification at Downers Grove, the most critical element of the transition, is progressing to plan. Manufacture of Torrance product at Downers Grove is achieving improved on-time in-full performance, with initial evidence showing gross margin improvement in addition to the overhead savings to be achieved once the Torrance site is closed. Customers continue to support the efforts to transition production to the Illinois facility, and this improved adherence to customers' delivery schedules has resulted in increased order intake. This project is still anticipated to have a cash cost of approximately \$7.0 million, with the site rationalisation expected to deliver approximately \$5.0 million in annual savings from 2019.

Chemring Defence has for some time been operating in very challenging markets and has recently experienced a substantial downturn in customer requirements. Depressed oil prices and significantly reduced budgets have led to changing customer needs, and many of the expected orders from the business's largest customers have been delayed or have failed to materialise. In light of these reduced customer requirements, a major restructuring programme has been implemented in order to reduce the current overcapacity within the business and place it on a more sustainable footing for the future.

### Outlook

2017 trading performance for Energetic Systems is again expected to be strong, with the segment benefiting from a strong order book, and continued improvement in delivery performance across the segment.

## OUR BUSINESS UNITS

### Chemring Energetic Devices

Formed by the integration of Chemring Energetic Devices and Hi-Shear Technology Corporation, and located in California and Illinois. A leading US supplier of pyrotechnic and electro-mechanical systems for missiles, space and safety applications. Products include satellite and space launch vehicle separation systems, initiators and low-shock satellite separation systems, and a range of pyromechanisms for aircrew egress. Chemring Energetic Devices also supplies sub-systems for missiles.

### Chemring Energetics

Incorporating Chemring Energetics UK in Scotland and Chemring Nobel in Norway. A leading supplier of detonators, actuators, rocket motors, high explosive charges, canopy cutting cords and pyromechanisms for aircrew egress, and demolition stores. It is also a leading supplier of high explosive charges, high explosives and energetic binders to the defence, security, oil and gas industries.

### Chemring Defence UK

Designs, develops and produces smoke and illumination pyrotechnics and payloads for military, OEM and security customers.

### Chemring Ordnance

A leading US manufacturer of Anti-Personnel Obstacle Breaching Systems ("APOBS"), 40mm ammunition and military pyrotechnics, located in Perry, Florida. It also operates a procurement service, supplying non-NATO standard ammunition to the US Army and other customers.

Chemring's focus on restructuring, operational improvement and cost control continues to deliver greater resilience, providing mitigation to the impact of current defence market cycles.

### Group results

An analysis of underlying and total results is set out below:

|                                 | 2016             |              | 2015             |             |
|---------------------------------|------------------|--------------|------------------|-------------|
|                                 | Underlying<br>£m | Total<br>£m  | Underlying<br>£m | Total<br>£m |
| <b>Revenue</b>                  | <b>477.1</b>     | <b>477.1</b> | 377.3            | 377.3       |
| <b>Operating profit</b>         |                  |              |                  |             |
| - continuing operations         | 48.5             | 26.2         | 34.4             | 5.5         |
| - discontinued operations       | –                | 4.7          | –                | 4.9         |
|                                 | 48.5             | 30.9         | 34.4             | 10.4        |
| Net finance expense             | (14.5)           | (18.2)       | (14.6)           | (14.6)      |
| <b>Profit/(loss) before tax</b> | <b>34.0</b>      | <b>12.7</b>  | 19.8             | (4.2)       |
| Tax                             | (7.1)            | (1.6)        | (4.1)            | 3.8         |
| <b>Profit/(loss) after tax</b>  | <b>26.9</b>      | <b>11.1</b>  | 15.7             | (0.4)       |

The use of underlying measures, in addition to total measures, is considered by the Board to improve comparability of business performance between periods.

Underlying measures referred to are stated before costs relating to acquisitions and disposals, business restructuring and incident costs, profit/loss on disposal of businesses, items deemed to be of an exceptional nature, impairment of goodwill and acquired intangibles, impairment of assets held for sale, amortisation of acquired intangibles and gains/losses on the movement in the fair value of derivative financial instruments. A reconciliation of underlying and total operating profit is set out in note 2 of the Group financial statements.

During the year, changes in foreign exchange rates, principally the depreciation of sterling against the US dollar, increased reported revenue from continuing operations by £36.8 million. At constant exchange rates, revenue from continuing operations was £440.3 million, an increase of 16.7%.

Chemring's operating segments are Countermeasures, Sensors & Electronics and Energetic Systems. An analysis of segmental revenue and underlying operating profit is set out below:

|                             | 2016          |   |  | 2015          |   |  |
|-----------------------------|---------------|---|--|---------------|---|--|
|                             | Revenue<br>£m | Underlying<br>operating<br>profit<br>£m | Underlying<br>operating<br>margin<br>% | Revenue<br>£m | Underlying<br>operating<br>profit<br>£m | Underlying<br>operating<br>margin<br>% |
| Countermeasures             | 138.3         | 12.8                                    | 9.3                                    | 125.8         | 17.5                                    | 13.9                                   |
| Sensors & Electronics       | 96.9          | 11.4                                    | 11.8                                   | 99.1          | 9.3                                     | 9.4                                    |
| Energetic Systems           | 241.9         | 31.7                                    | 13.1                                   | 152.4         | 15.1                                    | 9.9                                    |
|                             | 477.1         | 55.9                                    | 11.7                                   | 377.3         | 41.9                                    | 11.1                                   |
| Unallocated corporate costs | –             | (7.4)                                   | –                                      | –             | (7.5)                                   | –                                      |
| <b>Group</b>                | <b>477.1</b>  | <b>48.5</b>                             | <b>10.2</b>                            | 377.3         | 34.4                                    | 9.1                                    |

Countermeasures revenue reflected the continued recovery in the segment, increasing by 9.9% on the prior year to £138.3 million (2015: £125.8 million). The impact of the production issues and energetic incidents that were experienced in the first half were partly offset by £2.8 million of insurance proceeds related to an earlier energetic incident. This resulted in a decline in margins from 13.9% to 9.3% and an underlying profit of £12.8 million, compared with £17.5 million in 2015. On a constant currency basis using 2015 rates, revenue was £127.8 million and underlying operating profit was £11.7 million.



Revenue in the Sensors & Electronics segment decreased by 2.2% from the prior year to £96.9 million (2015: £99.1 million), reflecting the completion of production contracts with the US Department of Defense in the comparative period, although revenue grew at the UK businesses. Margins improved from 9.4% to 11.8% and Sensors & Electronics increased its operating profit by 22.6% to £11.4 million (2015: £9.3 million). On a constant currency basis using 2015 rates, revenue was £92.4 million and underlying operating profit was £11.3 million.

Revenue for the Energetic Systems segment increased by £89.5 million to £241.9 million (2015: £152.4 million). This improved performance was primarily as a result of the 40mm ammunition contract with a customer in the Middle East which, despite its delayed start, has performed well and contributed £44.5 million of revenue. Margins improved from 9.9% to 13.1% and Energetic Systems increased its operating profit by 109.9% to £31.7 million (2015: £15.1 million). On a constant currency basis using 2015 rates, revenue was £220.1 million and underlying operating profit was £27.4 million.

Underlying operating profit from continuing operations was £48.5 million (2015: £34.4 million), an increase of 41.0%. The underlying operating margin was 10.2% (2015: 9.1%).

Discontinued operations mainly comprises the release of disposal provisions relating to the European munitions businesses - Mecar, based in Belgium, and Simmel, located in Italy - which were sold in May 2014.

The total operating profit was £30.9 million (2015: £10.4 million). This includes non-underlying costs of £17.6 million (2015: £24.0 million), split between continuing costs of £22.3 million and discontinued credits of £4.7 million.

Net underlying finance expense was £14.5 million (2015: £14.6 million). The reduction reflects the repayment of loan note debt during the year and lower usage of the revolving credit facility, offset by adverse foreign exchange movements and an increase in the amortisation of prepaid facility fees.

Underlying profit before tax from continuing operations was £34.0 million (2015: £19.8 million), an increase of 71.7%. Tax on underlying profit before tax from continuing operations was £7.1 million (2015: £4.1 million), representing an effective tax rate of 20.9% (2015: 20.7%). The tax rate on underlying profit before tax remains comparable to the UK corporation tax rate, and continues to benefit from the utilisation of R&D and other tax credits. Including non-underlying items, the total profit before tax from continuing operations was £8.0 million (2015: £9.1 million loss).

The effective tax rate on the total profit before tax from continuing operations was 18.8% (2015: 41.8%) due to the geographic mix of profits, changes to the amounts of deferred tax assets considered recoverable in respect of both tax losses and US interest limitations, prior year adjustments and the recent changes in UK corporation tax rates.

### Analysis of non-underlying items

The use of underlying measures, in addition to total measures noted above, is considered by the Board to improve comparability of business performance between periods and, consistent with past practice, certain items are classed as non-underlying, as set out below:

|  | 2016<br>£m  | 2015<br>£m  |
|--|-------------|-------------|
| Acquisition and disposal related costs                                 | 0.3         | 0.5         |
| Business restructuring and incident costs                              | 5.4         | 6.4         |
| Claim related (credit)/costs   | (0.6)       | 8.5         |
| Loan note repayment costs  | 1.4         | -           |
| Intangible amortisation arising from business combinations             | 14.8        | 14.0        |
| Loss/(gain) on fair value movement of derivative financial instruments | 1.0         | (0.5)       |
| Non-underlying items excluded from underlying operating profit         | 22.3        | 28.9        |
| Accelerated interest costs   | 3.7         | -           |
| <b>Non-underlying items excluded from underlying profit before tax</b> | <b>26.0</b> | <b>28.9</b> |
| Discontinued operations:   |             |             |
| Disposal related credit  | (4.7)       | (4.9)       |
| <b>Non-underlying items excluded from underlying profit before tax</b> | <b>21.3</b> | <b>24.0</b> |

An impairment analysis, based on value-in-use calculations reflecting current conditions in the defence industry, has been conducted and no impairments are considered to exist at 31 October 2016.

## FINANCIAL REVIEW

### continued

The amortisation of intangible assets arising from business combinations was £14.8 million (2015: £14.0 million). This cost is treated as non-underlying to improve comparability and understanding of the results given its large size and non-cash nature.

Disposal related credits of £4.7 million relate to the expiry of certain tax and environmental liabilities arising from the disposal of several businesses in prior years. Business restructuring and incident costs of £5.4 million principally comprise of restructuring costs in relation to Chemring Defence UK and across the US businesses.

The cash outflow from non-underlying items was £8.1 million (2015: £8.4 million).

### Shareholder returns

Underlying earnings per share from continuing operations were 10.3p (2015 as restated: 7.1p), an increase of 45.1%. The total earnings per share from continuing operations were 2.5p (2015 as restated: 2.4p loss).

Shareholders' funds were £413.4 million (2015: £290.6 million), with the increase principally comprising the effects of the rights issue, favourable exchange rate movements and the profit after tax for the year.

### Exchange rates

The following exchange rates applied during the year:

|           | Average rate<br>2016 | Closing rate<br>2016 | Average rate<br>2015 | Closing rate<br>2015 |
|-----------|----------------------|----------------------|----------------------|----------------------|
| US Dollar | 1.28                 | 1.22                 | 1.53                 | 1.54                 |

The translation of foreign currency items in the financial statements are dependent on the prevailing foreign exchange rates. For the year ended 31 October 2016, a 1 cent decrease in the US dollar exchange rate would have increased reported underlying operating profit by approximately £0.2 million and increased reported net debt by approximately £0.9 million.

### Pensions

The deficit on the Group's defined benefit pension schemes was £17.3 million (2015: £17.7 million), measured in accordance with IAS 19 (Revised) *Employee Benefits*.

The deficit relates to the Chemring Group Staff Pension Scheme (the "Scheme"), a UK defined benefit scheme whose assets are held in a separately administered fund. The Scheme was closed to future accrual in April 2012. A full actuarial valuation for the Scheme as at 6 April 2015 has been prepared and updated to 31 October 2016, using the projected unit credit method. This valuation showed a deficit of £17.3 million (2015: £17.8 million). The reduction reflects the funding structure agreed with the trustees, under which contributions of £5.0 million were paid in 2016, offset by the effect of changes in actuarial assumptions. The Group has given a bank guarantee and letters of credit totalling £8.5 million (2015: £13.5 million) to the Scheme in respect of future contributions, which are progressively reducing as contributions are paid under the agreed funding structure.

### Research and development

R&D expenditure was £57.8 million (2015: £56.3 million). Continued investment in R&D is a key aspect of the Group's strategy, and levels of internally-funded R&D are expected to be maintained as investment in product development continues, particularly within Sensors & Electronics. An analysis of R&D expenditure is set out below:

|                                    | 2016<br>£m  | 2015<br>£m  |
|------------------------------------|-------------|-------------|
| Customer-funded R&D                | 43.4        | 38.2        |
| Internally-funded R&D              |             |             |
| - expensed to the income statement | 7.7         | 9.2         |
| - capitalised                      | 6.7         | 8.9         |
| <b>Total R&amp;D expenditure</b>   | <b>57.8</b> | <b>56.3</b> |

Amortisation of development and patent costs was £6.9 million (2015: £6.4 million), with the increase reflecting a number of previously capitalised projects coming on-stream. A further increase in amortisation of development and patent costs is anticipated for 2017 as additional Sensors & Electronics projects complete their development phase.

## Cash flow

The cash inflow generated from underlying operations was £76.4 million (2015: £35.4 million). A summary of underlying free cash flow is set out below:

|   | 2016<br>£m    | 2015<br>£m |
|---|---------------|------------|
| <b>Underlying operating profit</b>                      | <b>48.5</b>   | 34.4       |
| Depreciation and loss on disposal of non-current assets | <b>18.6</b>   | 16.6       |
| Amortisation of development costs, patents and licences | <b>6.9</b>    | 6.4        |
|   | <b>74.0</b>   | 57.4       |
| Decrease/(increase) in working capital                  | <b>6.4</b>    | (18.2)     |
| Other movements   | <b>(4.0)</b>  | (3.8)      |
| <b>Cash generated from underlying operations</b>        | <b>76.4</b>   | 35.4       |
| Expenditure on capitalised development costs            | <b>(6.7)</b>  | (8.9)      |
| Expenditure on property, plant and equipment            | <b>(10.3)</b> | (8.2)      |
| Tax   | <b>(3.1)</b>  | (1.3)      |
| Interest  | <b>(11.9)</b> | (11.8)     |
| <b>Underlying free cash flow</b>                        | <b>44.4</b>   | 5.2        |

Expenditure on property, plant and equipment was £10.3 million (2015: £8.2 million). This comprised various projects related to health and safety improvements, production automation and systems upgrades.

Expenditure on capitalised development projects was £6.7 million (2015: £8.9 million), of which £5.1 million (2015: £7.2 million) related to the Sensors & Electronics segment, where significant investment has been made in technology developed in association with DoD Programs of Record. The carrying value of capitalised development costs at 31 October 2016 was £40.9 million (2015: £36.1 million).

Tax payments were £3.1 million (2015: £1.3 million), with the increase reflecting the higher profitability of the Group.

## Working capital

A summary of working capital in respect of continuing operations is set out below:

|                        | 2016<br>£m    | 2016<br>constant<br>currency<br>£m | 2015<br>£m |
|------------------------|---------------|------------------------------------|------------|
| Inventories            | <b>104.8</b>  | 87.1                               | 96.2       |
| Trade receivables      | <b>82.7</b>   | 70.5                               | 66.1       |
| Contract receivables   | <b>7.0</b>    | 7.0                                | 15.2       |
| Prepayments            | <b>22.0</b>   | 15.5                               | 6.8        |
| Trade payables         | <b>(53.5)</b> | (44.9)                             | (46.7)     |
| Advance payments       | <b>(12.4)</b> | (10.1)                             | (11.5)     |
| Other items            | <b>(51.5)</b> | (47.0)                             | (44.3)     |
| <b>Working capital</b> | <b>99.1</b>   | 78.1                               | 81.8       |

Working capital was £99.1 million (2015: £81.8 million), an increase of £17.3 million, with £21.0 million of this increase attributable to foreign exchange translation. At constant currency (2015 exchange rates) working capital was £78.1 million, a reduction of £3.7 million.

Inventory increased in Countermeasures and Sensors & Electronics but fell in Energetic Systems.

Trade receivables increased by £16.6 million and trade payables increased by £6.8 million as a result of the high levels of activity in the final quarter of the year.

Prepayments increased significantly in the year, principally in Energetic Systems. This was mainly due to advance supplier payments made in order to secure continuing production on supplies needed for the 40mm and other Middle East contracts.

## Net debt and covenants

Net debt at 31 October 2016 was £87.6 million (2015: £154.3 million). The Group's principal debt facilities comprise £153.4 million of private placement loan notes and a £100.0 million revolving credit facility. The revolving credit facility was established in July 2014, is with a syndicate of three banks and has a four-year term, and was increased from £70.0 million during the year. The Group had £108.0 million (2015: £78.5 million) of undrawn borrowing facilities at the year end.

In addition to borrowing facilities, the Group has £60.4 million (2015: £62.4 million) of facilities in respect of bonding and trade finance requirements. At 31 October 2016, £23.9 million (2015: £28.0 million) of these facilities were utilised.

The Group is subject to two key financial covenants, which are tested quarterly. These covenants relate to the leverage ratio between underlying EBITDA and debt; and the interest cover ratio between underlying EBITDA and finance costs. The calculation of these ratios involves the translation of non-sterling denominated debt using average, rather than closing, rates of exchange. The revolving credit facility and the loan notes have differing covenant compliance calculations.

In respect of the revolving credit facility, leverage is measured by reference to net debt. The maximum permitted ratio of net debt to underlying EBITDA under the revolving credit facilities is 3.00x. The permitted ratio at October 2015 and January 2016 was amended to 3.90x with the agreement of the revolving credit facility syndicate in January 2016.

The provisions of the private placement loan notes contain two leverage tests, each of which are tested quarterly. The first test measures leverage by reference to total gross debt. The maximum permitted ratio of gross debt to underlying EBITDA is 3.75x. This was amended to 4.00x for the October 2015 and January 2016 tests. The second test measures leverage by reference to adjusted debt, which is calculated as total gross debt less certain disposal proceeds that had previously been offered to the noteholders but had not been accepted. The value of such proceeds at 31 October 2016 was £nil (2015: £4.6 million). The maximum permitted ratio of adjusted debt to underlying EBITDA is 3.00x. For the tests at October 2015 and January 2016 this was also amended to 4.00x.

The Group complied with these covenants throughout the year and the results of covenant tests at the year end are detailed below:

|  | 2016         | 2015  |
|--|--------------|-------|
| <b>Covenant ratios - revolving credit facility</b> |              |       |
| Actual ratio of net debt to underlying EBITDA      | <b>1.15x</b> | 2.83x |
| Actual ratio of underlying EBITDA to finance costs | <b>6.82x</b> | 4.75x |
| <b>Covenant ratios - loan note agreements</b>      |              |       |
| Actual ratio of adjusted debt to underlying EBITDA | <b>1.89x</b> | 2.84x |
| Actual ratio of total debt to underlying EBITDA    | <b>1.89x</b> | 2.92x |
| Actual ratio of underlying EBITDA to finance costs | <b>6.54x</b> | 4.67x |

The composition of gross and net debt is set out below:

|                                  | 2016<br>£m     | 2015<br>£m |
|----------------------------------|----------------|------------|
| Loan notes, net of facility fees | <b>(150.5)</b> | (161.3)    |
| Other loans and finance leases   | <b>(0.2)</b>   | (0.6)      |
| <b>Gross debt</b>                | <b>(150.7)</b> | (161.9)    |
| Cash                             | <b>63.1</b>    | 7.6        |
| <b>Net debt</b>                  | <b>(87.6)</b>  | (154.3)    |

## Going concern and long-term viability statement

The Group's business activities, key performance indicators, and principal risks and uncertainties are described within the 2016 Annual Report and Accounts. In light of the continued trading volatility, and as part of a regular assessment of the Group's working capital and financing position, the directors have prepared a detailed bottom-up two year trading budget and cash flow forecast for the period through to October 2018, being at least twelve months after the date of approval of the financial statements. This is in addition to the Group's longer-term strategic planning process. In assessing the forecast, the directors have considered:

- trading risks presented by economic conditions in the defence market, particularly in relation to government budgets and spends;
- the timing of delivering key contracts, in particular the HMDS and 40mm orders for end users in the Middle East;
- the impact of macroeconomic factors, particularly interest rates and foreign exchange rates;
- the status of the Group's existing financial arrangements and associated covenant requirements; and
- the availability of mitigating actions should business activities fall behind current expectations, including the deferral of discretionary overheads and restricting cash flows.

Additional detailed sensitivity analysis has been performed on the forecasts to consider the impact of severe, but plausible, reasonable worse case scenarios on the covenant requirements. These scenarios, which sensitised the forecasts for specific identified risks, modelled the reduction in anticipated levels of underlying EBITDA and the associated increase in net debt. These scenarios included significant delays to major contracts and new product launches, and the temporary closure of a major facility. This sensitised scenario shows headroom on all covenant test dates for the foreseeable future.

The directors have acknowledged the latest guidance on going concern. They have made appropriate enquiries and taken into account factors which are detailed in the strategic report within the 2016 Annual Report and Accounts. As a consequence, the directors believe that the Company is well placed to manage its risks.

The directors having considered the forecasts, the risks, and associated mitigating actions, have a reasonable expectation that adequate financial resources will continue to be available for the foreseeable future. Thus, they continue to support the going concern basis in preparing the financial statements.

The directors have assessed the Group's viability over a three-year period to October 2019 based on the above assessment, combined with the Group's strategic planning process, which gives greater certainty over the forecasting assumptions used. Based on this assessment the directors have a reasonable expectation that the Group will be able to continue in operation and meet all its liabilities as they fall due up to October 2019.



## KEY PERFORMANCE INDICATORS

The Group's strategy is underpinned by focusing on a number of key performance indicators ("KPIs"). The KPIs that the Board and senior management utilise to assess Group performance are set out below.

These KPIs enable progress to be monitored on the implementation of the Group's strategy, levels of investment, operational performance and business development. They also give an early insight into how well the principal risks and uncertainties are

being managed. Similar indicators are used to review performance by each of the Group's businesses, albeit that the exact nature of these varies between business units to reflect the differing nature of their operations.

## ORDERS

The Group uses a number of KPIs relating to orders. These comprise order intake, order book and the level of forecast revenue for the current financial year covered by orders on-hand.

The closing order book at 31 October 2016 of £592.9 million represents an increase of 4.1% on the prior year, principally reflecting the weakening of sterling. As at 31 October 2016, of the orders on hand of £592.9 million, £368.0 million were expected to be fulfilled in the year ending 31 October 2017.

|                       | Order intake |            | Order book   |            |
|-----------------------|--------------|------------|--------------|------------|
|                       | 2016<br>£m   | 2015<br>£m | 2016<br>£m   | 2015<br>£m |
| Countermeasures       | 95.4         | 119.1      | 177.0        | 184.1      |
| Sensors & Electronics | 55.2         | 95.3       | 49.3         | 75.8       |
| Energetic Systems     | 220.5        | 242.4      | 366.6        | 309.7      |
| <b>Group</b>          | <b>371.1</b> | 456.8      | <b>592.9</b> | 569.6      |

## REVENUE

Revenue provides a measure of business activity and growth, enabling customer behaviour trends to be identified and acted upon. In the case of business units that have experienced operational and production issues, revenue levels indicate their ability to deliver throughput and fulfil customer orders.

|                       | 2016<br>£m   | 2015<br>£m |
|-----------------------|--------------|------------|
| Countermeasures       | 138.3        | 125.8      |
| Sensors & Electronics | 96.9         | 99.1       |
| Energetic Systems     | 241.9        | 152.4      |
| <b>Group</b>          | <b>477.1</b> | 377.3      |

## SEGMENTAL UNDERLYING OPERATING PROFIT

Segmental underlying operating profit is stated before charges for unallocated corporate costs and non-underlying items, as shown in note 2 of the Group financial statements. Segmental underlying operating profit provides a consistent year-on-year measure of the trading performance of the Group's operations. It does not include significant non-recurring or exceptional costs that would distort a comparative assessment, nor does it include unallocated corporate costs associated with operating a public company. The continuing segmental underlying operating profit increased by 33.4% during the year, reflecting the change in revenue and the operating leverage effects associated with the high fixed-cost nature of certain of the Group's activities.

|                       | 2016<br>£m  | 2015<br>£m |
|-----------------------|-------------|------------|
| Countermeasures       | <b>12.8</b> | 17.5       |
| Sensors & Electronics | <b>11.4</b> | 9.3        |
| Energetic Systems     | <b>31.7</b> | 15.1       |
| <b>Group</b>          | <b>55.9</b> | 41.9       |

## UNDERLYING OPERATING MARGIN

Underlying operating margin is based on underlying segmental operating profit and provides an assessment of the profitability of the business. A focus on operating margin allows the impact of changes in revenue and cost base to be monitored, enabling comparisons to be made of management performance and trading effectiveness. The changes in margin of each segment reflect the weak market conditions, volume changes and performance improvement actions, as set out in this strategic report. The changes in margin also reflect the impact of movements in revenue, offset by the benefit of cost saving measures.

|                       | 2016<br>%   | 2015<br>% |
|-----------------------|-------------|-----------|
| Countermeasures       | <b>9.3</b>  | 13.9      |
| Sensors & Electronics | <b>11.8</b> | 9.4       |
| Energetic Systems     | <b>13.1</b> | 9.9       |
| <b>Group</b>          | <b>11.7</b> | 9.1       |

## WORKING CAPITAL AND INVENTORY

Working capital is defined as inventories, trade and other receivables, contract receivables, trade and other payables, and provisions. The primary focus for improvement within working capital is inventory.

Optimum inventory levels drive both effective staff utilisation and cost efficiency. Excess inventory results in second order costs such as increased storage and inventory management costs, the write-off of ageing or obsolete inventory, and disposal costs, which can be significant for energetic materials.

|                       | Working capital |            | Inventory    |            |
|-----------------------|-----------------|------------|--------------|------------|
|                       | 2016<br>£m      | 2015<br>£m | 2016<br>£m   | 2015<br>£m |
| Countermeasures       | <b>30.4</b>     | 31.5       | <b>36.4</b>  | 35.4       |
| Sensors & Electronics | <b>23.6</b>     | 19.8       | <b>27.7</b>  | 18.2       |
| Energetic Systems     | <b>54.5</b>     | 40.9       | <b>40.7</b>  | 42.6       |
| Central               | <b>(9.4)</b>    | (10.4)     | –            | –          |
| <b>Group</b>          | <b>99.1</b>     | 81.8       | <b>104.8</b> | 96.2       |

## KEY PERFORMANCE INDICATORS

continued

### CONTINUING UNDERLYING EARNINGS PER SHARE

Underlying earnings per share is a key measure for the Group, reflecting the combined trading performance together with the impact of its funding structure and taxation. The increase in the year reflects the Group's improved trading performance.

\*As restated to reflect the rights issue

|  | 2016         | 2015*   |
|--|--------------|---------|
| Continuing underlying earnings per share | <b>10.3p</b> | 7.1p    |
| Change from previous year                | <b>45.1%</b> | (30.4%) |

### DEBT TO UNDERLYING EBITDA

The ratio of underlying EBITDA to the Group's debt levels is a clear indicator of the leverage borne by the Group. The ratio is a specified financial covenant within the Group's principal debt finance facilities, comprising the revolving credit facility and the loan note agreements, and the ratios under each of the measurement bases required in these facilities form KPIs for the Group. The basis of calculation under the two debt finance facilities differs in some regards, notably in the use of gross debt and adjusted debt measures in the loan note agreements, compared to net debt in the revolving credit facility. The Group's aim over the medium-term is to reduce the ratio of net debt to underlying EBITDA to an average level of 1.50x.

|   | 2016         | 2015  |
|---|--------------|-------|
| <b>Revolving credit facility</b>  |              |       |
| Actual ratio of net debt to underlying EBITDA (maximum allowed ratio of 3.00x)      | <b>1.15x</b> | 2.83x |
| <b>Loan note agreements</b>   |              |       |
| Actual ratio of adjusted debt to underlying EBITDA (maximum allowed ratio of 3.00x) | <b>1.89x</b> | 2.84x |
| Actual ratio of total debt to underlying EBITDA (maximum allowed ratio of 3.75x)    | <b>1.89x</b> | 2.92x |

### INTEREST COVER

Interest cover provides a simple measure of the ratio between underlying EBITDA and the finance costs incurred in servicing the Group's debt. It is an important indicator for the Group, and is a specified financial covenant under the revolving credit facility and loan note agreements. As with the ratio of debt to underlying EBITDA, there are certain differences in the bases of calculation of interest cover under the two facilities.

|   | 2016         | 2015  |
|---|--------------|-------|
| <b>Revolving credit facility</b>  |              |       |
| Actual ratio of underlying EBITDA to finance costs (minimum allowed ratio of 4.00x) | <b>6.82x</b> | 4.75x |
| <b>Loan note agreements</b>   |              |       |
| Actual ratio of underlying EBITDA to finance costs (minimum allowed ratio of 3.50x) | <b>6.54x</b> | 4.67x |

## UNDERLYING CONTINUING OPERATING CASH FLOW

Operating cash flow provides a measure of the cash generated by the Group's trading. It represents the cash that is generated to fund capital expenditure, interest payments, tax and dividends. Given the Group's relatively short-cycle manufacturing operations and with working capital being improved through greater efficiency, operating cash conversion closely follows operating profit. The Group's underlying continuing operating cash flow increased by 115.8% to £76.4 million during the year, reflecting the change in underlying operating profit and increase in working capital.

|   | 2016<br>£m  | 2015<br>£m |
|---|-------------|------------|
| Underlying continuing operating cash flow | <b>76.4</b> | 35.4       |

## SAFETY

Many of Chemring's manufacturing activities involve the use of hazardous substances and energetic materials, and safety metrics are a fundamental part of the key performance indicators used to manage the business. All incidents and near misses are reported and investigated, in order to share findings and corrective actions throughout the Group. The Group's key lagging indicators are fatalities, the number of incidents that result in working time being lost through injury, and the number of energetic incidents that do not cause injury. In addition, the Group has a number of leading indicators, principally the level of near misses. The active reporting of near misses by employees is encouraged in order to highlight potential risk issues and enable these to be considered and addressed on a timely basis. Each of these is reviewed and resolved, gradually reducing risk.

|  | 2016         | 2015  |
|--|--------------|-------|
| <b>Lagging indicators</b>                          |              |       |
| Fatalities   | –            | –     |
| Lost time incidents                                | <b>9</b>     | 15    |
| Lost time incident rate                            | <b>0.35</b>  | 0.57  |
| Significant energetic incidents not causing injury | <b>2</b>     | –     |
| <b>Leading indicators</b>                          |              |       |
| Near misses reported and actioned                  | <b>2,265</b> | 2,801 |

## OPERATIONAL PERFORMANCE

Operational performance is measured using a series of indicators that include efficiency, labour utilisation and customer order performance. These performance indicators are considered at business unit level, as the varying nature of the Group's operations mean that it is not appropriate to consolidate this data. Improving operational performance is key to securing strong customer relationships and maximising returns from production activities. Closely monitored measures include gross margin percentages by business, on-time delivery of customer orders, overall manufacturing utilisation and product development spend.

## HOW WE MANAGE RISK

### Risk organisational structure



#### The Board

The Board is responsible for determining the nature and extent of risks it is willing to accept in delivering the Group's strategy and running the Group's operations, and ensuring that risks are effectively managed across the Group.

The Board reviews the Group risk register on a regular basis, and considers whether the Risk Management Committee has appropriately identified the principal risks to which the Group is exposed.

#### The Audit Committee

The Audit Committee is responsible for reviewing in detail the effectiveness of the Group's systems of internal control, including financial, operational and compliance controls, and its risk management systems.

#### The Risk Management Committee

The Risk Management Committee meets on a quarterly basis to review the business unit risk registers. The Risk Management Committee is responsible for identifying the principal risks to which the Group is exposed, monitoring key mitigation plans, and maintaining the Group risk register. All members of the Executive Committee are also members of the Risk Management Committee.

#### Risk management framework

The Group's risk management framework draws fundamentally from the "Three Lines of Defence Methodology", with the "First Line" being day-to-day management of risk and maintenance of effective control procedures at individual business units. The "Second Line" comprises various risk management and control functions established at the corporate management level designed to enhance and monitor the First Line. These functions include a Risk Management Committee, health, safety and environmental management function, financial controls, and a compliance function responsible for anti-corruption and ethical compliance. The "Third Line" comprises the Group's internal audit function utilising KPMG, who report directly to the Audit Committee and the Board.

The management of each of the business units is responsible for the identification, management and reporting of local risks, in accordance with the Group's risk management framework. The business unit's management are also responsible for the maintenance of business unit risk registers and the implementation of mitigation plans.

Each business unit is required to maintain a risk register identifying the key risks to achievement of their current year's budget and their five year plan, and their most significant health and safety risks. The risk registers also include an analysis of the likelihood and impact of each risk – before and after mitigation actions are taken to manage the risk, together with details of the mitigation plans and progress against them. Each risk is allocated an owner, who has responsibility for managing the risk.

The business unit risk registers are updated locally on a monthly basis, and are reviewed in detail by the Group Chief Executive, the Group Finance Director and other members of the Executive Committee at quarterly review meetings with each of the businesses.

The Risk Management Committee also reviews the business unit risk registers on a quarterly basis, and utilising the input from the businesses, the Risk Management Committee identifies those principal risks which are material to the Group as a whole. The Risk Management Committee also considers corporate-level risks. These risks are collated on the Group risk register, together with details of the applicable mitigation plans and risk owners.

The current Group risk register comprises various risks including health, safety and environmental risks, market-related risks, political risks, operational risks, legal and compliance risks, reputational risks and financial risks. Details of the principal risks are set out on pages 34 to 40.

#### Internal control and risk management systems

In addition to reviewing the Group risk register on a regular basis, the Board is also required to carry out an annual review of the effectiveness of the Group's systems of internal control and risk management systems in compliance with provision C2.3 of the UK Corporate Governance Code (the "Code"). In the year under review, the Board considered the following key features of the Group's risk management systems and control procedures which operated during the year:

- the Board assesses the key risks associated with achievement of the Group's business objectives as part of the annual strategic planning process and on a continuing basis thereafter;
- the performance of each business against budget and the prior year is reviewed on a monthly basis at both the operational management level and by the Board;
- the Group Chief Executive, the Group Finance Director and other members of the Executive Committee attend quarterly review meetings with each of the businesses. In the case of the US businesses, formal Board meetings are also held quarterly, and these are attended by main Board directors and external independent non-executive directors appointed in the US. The US non-executive directors are required to provide guidance and monitor governance in the US businesses throughout the year. An external independent non-executive director is also appointed to the Board of the Group's Norwegian subsidiary;
- each business is required to comply with the Group's accounting policy manual, which sets out formal procedures for incurring certain types of expenditure and making contractual commitments. Compliance with the accounting policy manual is audited by the internal auditors, who report regularly to the Audit Committee on their findings;



- the Board retains primary responsibility for acquisitions and disposals, and financing arrangements for the Group. Treasury management, IT strategy, insurance and significant legal matters are dealt with centrally from the Group head office, and the Board receives regular reports on each of these items. Reviews of the Group's pensions, insurance and physical risk management arrangements are carried out by external advisers on a regular basis;
- the Group Director of Safety, supported by business-specific health and safety management committees, co-ordinates and controls the activities of each business in relation to health, safety and environmental matters, which are a key focus for the Board in view of the nature of the Group's operations. The Group Chief Executive is the Board member nominated with specific responsibility for health and safety;
- the Group maintains a Bribery Act compliance manual incorporating its anti-corruption policies and procedures; and
- the Board has established a broad internal audit function utilising the services of KPMG. In addition to reviewing financial controls, the internal auditors review a wide range of non-financial processes and procedures, which provides additional assurance to the Board on the adequacy of the Group's internal controls. The internal auditors report to the Audit Committee on a quarterly basis, and progress on identified improvement actions is monitored and tracked.

The Board confirms that it has reviewed the effectiveness of the Group's systems of internal control and risk management which were in place during the financial year ended 31 October 2016, and it confirms that:

- there is an ongoing process for identifying, evaluating and managing the principal risks faced by the Company and the Group;
- systems of internal control and risk management compliant with the Code and the Turnbull Guidance were in place throughout the year and have remained in place up to the date of approval of these financial statements; and
- the Group's internal control and risk management systems are regularly reviewed by the Board, and broadly comply with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published by the Financial Reporting Council.

The Board acknowledges, however, that the internal control systems can only provide reasonable, not absolute, assurance against material mismanagement or loss of the Group's assets. The Board will therefore continue to take steps to embed internal control and risk management further into the operations of the Group, and to deal with any areas of improvement which come to the attention of management and the Board.

## PRINCIPAL RISKS

The principal risks and uncertainties which could have a material impact on the Group's performance and could cause actual results to differ materially from expected and historical results have not changed significantly from those set out in the Group's 2015 Annual Report and Accounts and the 2016 Interim Report.

The principal risks to which the Group is exposed are set out below, together with details of their potential impact; the likelihood of occurrence (on a scale of 1 to 3, with 1 being the most likely); an indication of whether the risk exposure is increasing, decreasing or broadly unchanged; and the mitigating actions taken to manage the risk.

Principal risks are identified by the Risk Management Committee based on the likelihood of occurrence and the potential impact on the Group as a whole.

### HEALTH, SAFETY AND ENVIRONMENTAL RISKS

#### Health and safety

3

Likelihood of occurrence



Trend

|                           |   |
|---------------------------|---|
| <b>Risk description</b>   | <ul style="list-style-type: none"> <li>The Group's operations which utilise energetic materials are subject to inherent health and safety risks.</li> <li>Weak culture and individual behaviours may lead to bypassing of rules and procedures, and unsafe acts involving energetic operations.</li> <li>Upset conditions can occur during manufacturing operations which may expose employees to increased quantities of hazardous materials.</li> <li>The handling and disposal of energetics waste can result in unplanned ignitions.</li> </ul>   |
| <b>Potential impacts</b>  | <ul style="list-style-type: none"> <li>Incidents may occur which could result in harm to employees, the temporary shutdown of facilities or other disruption to manufacturing processes.</li> <li>The Group may be exposed to financial loss, regulatory action, and potential liabilities for workplace injuries and fatalities.</li> </ul>  |
| <b>Mitigation actions</b> | <ul style="list-style-type: none"> <li>The Board believes that responsibility for the delivery of world-class safety standards is an integral part of operational management accountability. The Board is committed to ensuring that the Group's leadership operates with health and safety as the top priority, and that the strength of the Group's safety culture and the quality of its protective systems deliver operations where all employees and visitors feel and are absolutely safe.</li> <li>A Group Safety Policy Manual was introduced during the year, which sets out the best practice standards expected of all of the Group's businesses. The internal audit programme will assess compliance against these standards in 2017.</li> <li>The Group's Safety Leadership Programme continues to be rolled-out across the Group, helping to improve culture and behaviours.</li> <li>All employees receive a booklet setting out the Group's statements of intent in relation to delivery of its health and safety strategy, and the behaviours required of them as individuals. All employees are encouraged to report potential hazards, and to raise any health and safety concerns through the appropriate channels.</li> <li>The Group continues to invest in state-of-the-art process safety systems and equipment. The Group's safety and loss prevention programmes require detailed pre-construction reviews of process changes and new operations, and safety audits of operations are undertaken on a regular basis.</li> <li>All businesses are expected to pro-actively manage their own risks but, in addition, the most significant site risks at each business and their associated mitigation programmes are reviewed quarterly by the Risk Management Committee.</li> <li>Health and safety is included on the agenda at every Board meeting, and is discussed at the monthly Group Executive Committee meeting. Further details on the Group's approach to health and safety are set out in the corporate responsibility review.</li> </ul> |

## HEALTH, SAFETY AND ENVIRONMENTAL RISKS continued

## Environmental laws and regulations

3

Likelihood of occurrence



Trend

## Risk description

- The Group's operations and ownership or use of real property are subject to a number of federal, state and local environmental laws and regulations, including those relating to discharge of hazardous materials, remediation of contaminated sites, and restoration of damage to the environment.
- At certain sites that the Group owns or operates, or formerly owned or operated, there is known or potential contamination for which there is a requirement to remediate or provide resource restoration.

## Potential impacts

- The Group could incur substantial costs, including remediation costs, resource restoration costs, fines and penalties, or be exposed to third-party property damage or personal injury claims, as a result of liabilities associated with past practices or violations of environmental laws or non-compliance with environmental permits.

## Mitigation actions

- All of the Group's businesses are certified to the environmental management system ISO 14001, which requires the setting of environmental goals and objectives focused on local aspects and impacts.
- The Group has monitoring programmes at certain sites, for which appropriate financial provision has been made. In certain circumstances, the Group procures environmental liability insurance, subject to applicable insurance conditions.

## MARKET RISKS

## Possible defence budget cuts

2

Likelihood of occurrence



Trend

## Risk description

- Defence spending depends on a complex mix of political considerations, budgetary constraints and the requirements of the armed forces to address specific threats and perform certain missions. Defence spending may therefore be subject to significant fluctuations from year to year.
- Given the large budget deficits and the prevailing economic conditions in many NATO countries, there may be continued downward pressure on defence budgets.

## Potential impacts

- The Group's financial performance may be adversely impacted by lower defence spending by its major customers.
- Short-term trading and cash constraints may impact on the Group's ability to invest in longer-term technologies and capabilities.


## Mitigation actions


- In recognition of the issues affecting the Group's traditional NATO markets, business development activities have been focused more on non-NATO markets in recent years, where defence expenditure is forecast to grow strongly over the next five to ten years. The Group continues to make progress on developing its routes to market in the Middle East, and during the year a local presence was established in the UAE.
- The Group continually assesses whether its planned organic growth strategies and product developments align with government priorities for future funding. Opportunities for development of commercial products are being explored in some areas.
- Actions have been taken to restructure and "right-size" the businesses, and reduce overheads, to ensure the businesses remain sustainable.
- Further site consolidation continues to be explored, within the constraints imposed by export control legislation and customer requirements.

## PRINCIPAL RISKS

continued

### MARKET RISKS continued

| Timing and value of orders |   | 2<br>Likelihood of occurrence | <br>Trend |
|----------------------------|---|-------------------------------|--|
| <b>Risk description</b>    | <ul style="list-style-type: none"> <li>The Group's profits and cash flows are dependent, to a significant extent, on the timing of award of defence contracts. In general, the majority of the Group's contracts are of a relatively short duration and, with the exception of framework contracts with key customers, do not cover multi-year requirements.</li> <li>The Group anticipates that delays in the placement of orders by NATO customers, as a result of budgetary constraints, may continue in the short to medium term.</li> </ul>  |                               |  |
| <b>Potential impacts</b>   | <ul style="list-style-type: none"> <li>An unmitigated delay in the receipt of orders could affect the Group's earnings and achievement of its budget, in any given financial year.</li> <li>If the Group's businesses are unable to continue trading profitably during periods of lower order intake, financial performance will deteriorate and assets may be impaired.</li> </ul>   |                               |  |
| <b>Mitigation actions</b>  | <ul style="list-style-type: none"> <li>To mitigate the order placement dynamics within NATO markets, the Group continues to focus on the expansion of its business in non-NATO markets, where defence expenditure is forecast to increase.</li> <li>Maximising order intake remains a key objective for the businesses, and they continue to address this through the strengthening of their sales and marketing resources. A Group-wide customer relationship management system has also been established. The businesses continue to pursue long-term, multi-year contracts with their major customers wherever possible.</li> <li>The Group has undertaken several restructuring projects over the last year, aimed at restoring the profitability of those Group businesses which have suffered most from order delays.</li> <li>Site optimisation plans continue to be refined to ensure that the Group utilises its manufacturing facilities as efficiently as possible, within the constraints imposed by export control legislation and customer requirements.</li> </ul> |                               |  |

| Contract-related risks    |   | 3<br>Likelihood of occurrence | <br>Trend |
|---------------------------|---|-------------------------------|--|
| <b>Risk description</b>   | <ul style="list-style-type: none"> <li>The Group's government contracts may be terminated at any time and may contain other unfavourable provisions.</li> <li>The Group may need to commit resources in advance of contracts becoming fully-effective, to ensure prompt fulfilment of orders or to enable conditions precedent to be met.</li> </ul>  |                               |  |
| <b>Potential impacts</b>  | <ul style="list-style-type: none"> <li>The Group may suffer financial loss if its contracts are terminated by customers, or a termination arising out of the Group's default may have an adverse effect on its ability to re-compete for future contracts and orders.</li> </ul>  |                               |  |
| <b>Mitigation actions</b> | <ul style="list-style-type: none"> <li>The Group negotiates with customers to ensure the most favourable contractual terms are agreed. Areas of significant judgment or enhanced risk require the review and approval of the executive directors.</li> <li>The Group endeavours to negotiate stage payments with its customers wherever possible, in order to minimise exposure to significant cash outflows on contracts which may be terminated at short notice.</li> </ul> |                               |  |

## MARKET RISKS continued

## Political risks

1

Likelihood of occurrence



Trend

|                           |   |
|---------------------------|---|
| <b>Risk description</b>   | <ul style="list-style-type: none"> <li>The Group is active in several countries that are suffering from political, social and economic instability.</li> <li>In addition, there is a significant risk of political unrest and changes in the political structure in certain non-NATO countries to which the Group currently sells.</li> </ul>   |
| <b>Potential impacts</b>  | <ul style="list-style-type: none"> <li>The Group's business in certain countries may be adversely affected in a way that is material to the Group's financial position and the results of its operations.</li> <li>Political changes could impact future defence expenditure strategy and the Group's ability to export products to certain countries.</li> <li>During periods of unrest, delays in obtaining export licences can result in delayed revenues.</li> </ul>  |
| <b>Mitigation actions</b> | <ul style="list-style-type: none"> <li>The Group's businesses strive to maintain relationships at all levels within the political structure of certain key countries, in order to ensure that they are aware of and can react to proposed changes, if and when they occur.</li> <li>Wherever possible, the businesses implement financing arrangements, such as letters of credit and advance payments, for contracts with high-risk customers, which are intended to mitigate the impact of a deterioration in the customer's financial position, and in certain circumstances they may also procure political risks insurance.</li> <li>The Group continues to explore opportunities for collaboration on the establishment of local manufacturing operations in certain countries, which may remove some of the uncertainty regarding export of products.</li> </ul> |

## OPERATIONAL RISKS

## Management resource

1

Likelihood of occurrence



Trend

|                           |  |
|---------------------------|--|
| <b>Risk description</b>   | <ul style="list-style-type: none"> <li>The Group requires competent management to lead it through the next stage of its development. In challenging markets and difficult times, there is an increased risk of loss of key personnel.</li> <li>As the shape of the Group's business also changes, with an increased focus in areas such as cyber, there is a need to ensure that the businesses build and retain an appropriate skill base to enable them to compete successfully in new markets and product areas.</li> </ul> |
| <b>Potential impacts</b>  | <ul style="list-style-type: none"> <li>If key personnel are not incentivised appropriately to remain within the Group, its operations may suffer from loss of management expertise and knowledge.</li> <li>Failure to recruit sufficient suitably-qualified personnel in key areas of the business may result in the Group failing to achieve its future growth aspirations.</li> </ul>  |
| <b>Mitigation actions</b> | <ul style="list-style-type: none"> <li>Incentivisation arrangements have been streamlined and improved in certain areas of the business, to ensure that employees are suitably incentivised to deliver key strategic objectives.</li> <li>Succession plans are being developed further throughout the business.</li> </ul>   |



## PRINCIPAL RISKS

continued

### OPERATIONAL RISKS continued

| Manufacturing risks       |   | 2<br>Likelihood of occurrence | ↓<br>Trend |
|---------------------------|---|-------------------------------|------------|
| <b>Risk description</b>   | <ul style="list-style-type: none"> <li>The Group's manufacturing activities may be exposed to business continuity risks, arising from plant failures, supplier interruptions or quality issues.</li> <li>Site consolidation plans may not be effectively implemented.</li> </ul>  |                               |            |
| <b>Potential impacts</b>  | <ul style="list-style-type: none"> <li>Interruptions to production and sales could result in financial loss, reputational damage and loss of future business.</li> <li>Failure to complete planned site consolidation activities may result in long-term inefficiencies, and increasing misalignment of organisational skills and market requirements.</li> </ul>   |                               |            |
| <b>Mitigation actions</b> | <ul style="list-style-type: none"> <li>The Group has established an Operational Excellence Programme, with one of the objectives being to improve the Group's "right-first-time" and on-time delivery performance.</li> <li>All of the Group's businesses are required to prepare business continuity plans.</li> <li>The Group continues to refine its requirements for reporting of key performance indicators, in order to provide better visibility on operational performance, and to facilitate the identification of potential production and quality issues at an early stage.</li> <li>The Group insures certain business interruption risks where appropriate.</li> <li>Detailed plans are developed for all restructuring and consolidation projects, and progress is monitored by the Group Executive Committee.</li> </ul> |                               |            |
| Technology risks          |   | 2<br>Likelihood of occurrence | ↓<br>Trend |
| <b>Risk description</b>   | <ul style="list-style-type: none"> <li>The Group may fail to maintain its position on key future programmes due to issues with capability development, technology transfer or cost-effective manufacture.</li> <li>The Group needs to continually add new products to its current range, through innovation and continuing emphasis on research and development. New product development may be subject to delays, or may fail to achieve the requisite standards to satisfy volume manufacturing requirements and the production of products against high reliability and safety criteria to meet customer specifications.</li> <li>The Group also needs to ensure that it continues to upgrade its existing product range to compete with emerging technologies.</li> </ul>   |                               |            |
| <b>Potential impacts</b>  | <ul style="list-style-type: none"> <li>Failure to obtain production contracts on major development programmes may significantly impact the future performance and value of individual businesses.</li> <li>Failure to complete planned product development and upgrades successfully may have financial and reputational impacts, and may result in obsolescence or loss of future business.</li> </ul>   |                               |            |
| <b>Mitigation actions</b> | <ul style="list-style-type: none"> <li>Close relationships are maintained with customers on all key future programmes, to ensure product and capability development aligns with customer requirements.</li> <li>The Group has introduced a focused product development and technology investment approach, in order to ensure that resources are applied appropriately across the Group in support of the five year plan. A Technology Review Board has been established to review all proposed research and development projects to ensure that key initiatives are being prioritised and to eliminate possible duplication of effort in different parts of the Group.</li> <li>Working groups have been established to drive and co-ordinate the Group's technology growth in certain key areas, such as cyber security.</li> </ul>   |                               |            |

## LEGAL AND COMPLIANCE RISKS

## Product liability and other customer claims

3

Likelihood of occurrence



Trend

## Risk description

- The Group may be subject to product liability and other claims from customers or third parties, in connection with (i) the non-compliance of products or services with the customer's requirements, due to faults in design or production; (ii) the delay or failed supply of the products or the services indicated in the contract; or (iii) possible malfunction or misuse of products.
- As many of the Group's products are single-use devices, it is often impossible to conduct functional testing without destroying the product; this increases the risk of possible product failure, either in use or during customers' own sample-based functional tests.

## Potential impacts

- Substantial claims could harm the Group's business and its financial position.
- In addition, any accident, product failure, incident or liability, even if fully insured, could negatively impact the Group's reputation among customers and the public, thereby making it more difficult for the Group to compete effectively.
- Material breaches in the performance of contractual obligations may also lead to contract termination and the calling of performance bonds.

## Mitigation actions

- The businesses maintain rigorous control of their production processes, monitoring critical parameters on a batch or unit basis. State-of-the-art techniques, including statistical process control or Six Sigma, are applied and, where appropriate, processes are automated to reduce the scope for human error. Detailed assessments of incoming components and materials are conducted to ensure compliance with specifications.
- Product liability claims from third parties for damage to property or persons are generally covered by the Group's insurance policies, subject to applicable insurance conditions.

## Compliance and corruption risks

3

Likelihood of occurrence



Trend

## Risk description

- The Group operates in over fifty countries worldwide, in a highly-regulated environment, and is subject to the applicable laws and regulations of each of these jurisdictions. The Group must ensure that all of its businesses, its employees and third parties providing services on its behalf comply with all relevant legal obligations.
- The nature of the Group's operations could also expose it to government investigations relating to import-export controls, money-laundering, false accounting, and corruption or bribery.
- The Group requires a significant number of permits, licences and approvals to operate its business, which may be subject to non-renewal or revocation.

## Potential impacts

- Non-compliance could result in administrative, civil or criminal liabilities, and could expose the Group to fines, penalties, suspension or debarment, and reputational damage.
- Loss of key operating permits and approvals could result in temporary or permanent site closures, and loss of business.

## Mitigation actions

- The Group has a central legal and compliance function which assists and monitors all Group businesses, supported by dedicated internal legal resource in the US.
- The Group operates under a Global Code of Business Principles, which stipulates the standard of acceptable business conduct required from all employees and third parties acting on the Group's behalf. The Group has also adopted a Bribery Act Compliance Manual, incorporating all of its anti-bribery policies and procedures.
- A significant proportion of the Group's management have received training in relation to ethics and anti-corruption.

## PRINCIPAL RISKS

continued

### REPUTATIONAL RISKS

#### Cyber-related risks

3

Likelihood of occurrence



Trend

|                           |   |
|---------------------------|---|
| <b>Risk description</b>   | <ul style="list-style-type: none"><li>Cyber security and related risks are key emergent areas of critical importance for all businesses, particularly for those involved in the defence and security sector. Threats can emanate from a wide variety of sources and could target various systems for a wide range of purposes, making response particularly difficult. The data and systems which need to be protected include customer-classified or sensitive information, commercially-sensitive information, employee-related data and safety-critical manufacturing systems.</li></ul>   |
| <b>Potential impacts</b>  | <ul style="list-style-type: none"><li>The Group may suffer from critical systems failures, or its intellectual property, or that of its customers, may fall into the hands of third parties.</li><li>In addition to business interruption and financial loss, the Group may suffer reputational damage, and its business of providing cyber-security services to customers may be irreparably damaged.</li></ul>  |
| <b>Mitigation actions</b> | <ul style="list-style-type: none"><li>A threat assessment has been completed, and an action plan to counter the Group's identified major threats has been initiated.</li><li>The Group adopts a number of cyber security defence measures, encompassing, as appropriate to the nature of the threat and sensitivity of data or systems being protected, hardware, software, system, process or people-based solutions. Where appropriate, government or commercial accreditation of networks and systems is obtained in support of the overall cyber security programme.</li><li>A review of the Group's IT and security systems is included within the internal audit programme.</li></ul> |

### FINANCIAL RISKS

- Details of the financial risks to which the Group is potentially exposed and details of mitigating factors are set out in the financial review and note 20 of the Group financial statements.

## CORPORATE RESPONSIBILITY REVIEW

The Group acknowledges its obligation to ensure the responsible operation of its business at all times, and is fully committed to sound and ethical business conduct in its interaction with key stakeholders (shareholders, employees, customers, business partners and suppliers), governments and regulators, communities and society, and the environment.

### The Group's approach

The Board has overall responsibility for establishing and maintaining the Group's policies in this area, and the Group Chief Executive is accountable to the Board for ensuring that the Group's businesses adhere to these policies.

The Board recognises that the long-term success of the Group will be enhanced by a positive interaction with all of its stakeholders, and has determined that the Group's corporate responsibility initiatives should be focused on the following key areas:

- health and safety;
- employee support and development;
- environmental protection; and
- ethical business conduct.

The Board intends that the Group's corporate responsibility approach will be fully embedded within its business units, and the senior management bonus plan incorporates specific objectives in the above areas.

Further details of the Group's approach are set out below.

### In the workplace

#### Health and safety

##### Policy and practices

The Board recognises that the highest levels of safety are required in order to protect employees, product users and the general public. The Board believes that all incidents and injuries are preventable, and that all employees have the right to expect to return home safely at the end of every working day.

The Group Chief Executive has overall responsibility for health, safety and environmental matters across the Group. The Group Director of Safety reports directly to the Group Chief Executive, and is responsible for the effective administration and implementation of the Group's health, safety and environment strategy. The Group Director of Safety is a member of the Group Executive Committee and reports on the performance of all businesses against agreed targets and objectives. The Group Chief Executive reports monthly to the Board on all key health and safety issues.

The Board requires that all businesses systematically manage their health and safety hazards, set objectives and monitor progress by regular measurement, audit and review. Each managing director is responsible for the management of health and safety within their business, and for providing adequate resources to satisfy the Board's requirements. All managing directors have health and safety related objectives incorporated within their annual bonus plan.

Managers and supervisors in the Group's businesses are required to enforce procedures, and to provide leadership and commitment to promote and embrace a positive health and safety culture. The Board emphasises the importance of individual responsibility for health and safety at all levels of the organisation, and expects employees to report potential hazards, to be involved in implementing solutions, and to adhere to rules and procedures.

A key element in the continual improvement of health and safety management is sharing best practice and lessons learnt from incidents across the Group's businesses and the wider industry. Accidents, incidents and near misses are investigated, with actions generated to prevent recurrence. Compliance audits are conducted and all findings are subject to corrective action reviews to ensure closure.

### Energetic events

There were two notable energetic incidents in the year. A fire in a mixer at the Chemring Australia facility propagated to an external air handling unit. At the Kilgore facility in Tennessee a fire in a MTV dryer hopper ignited a batch of composition that was being processed.

In both cases production was interrupted but all safety systems worked as they should and no-one was hurt.

### Strategy

The Group's safety improvement programmes fit into three strategic areas:

#### Physical

The Group continue to invest in engineering solutions to remove people from hazards. This includes the automation of operations, increasing the number of processes that are conducted remotely and further developing protection systems.

#### Systems

All of the Group's businesses are certified to the international health and safety management system OHSAS18001. The businesses receive regular customer and regulator audits in addition to internal audits. This year the first Group Safety Policy Manual was issued, which specifies good practice in many different areas of activity that goes well beyond pure legal compliance. The businesses now all have plans to meet these challenging new standards.

#### People

The Group continues to focus on leadership, culture and behaviours through the Safety Leadership Programme, which continues to be delivered at all levels across the Group.

# CORPORATE RESPONSIBILITY REVIEW

continued

## Lost time incidents

The number of lost time incidents is one of the key performance indicators monitored by the Group. The Group collects and reports lost time incident rates using the US Occupational Safety and Health Administration rules.

In 2016 the lost time incident rate reduced to the lowest on record.

The Group's historical lost time incident rate (number of lost time incidents per 100 employees per year) is as follows:

| 2016 | 2015 | 2014 | 2013 | 2012 |
|------|------|------|------|------|
| 0.35 | 0.57 | 0.43 | 0.83 | 0.52 |

One lost time incident during the year involved an energetic device. An employee at Chemring Ordnance in Florida received minor wounds to his hand when a device he was testing at the proofing ground malfunctioned. He fully recovered and this operation has been completely redesigned.

## Employees

The Board recognises the valuable contribution that the Group's employees continue to make to its success, and aims to provide a working environment that reflects and rewards this.

At 31 October 2016 the Group had 2,577 (2015: 2,849) employees based in four countries.

## Employment practices

The Group's policy is to provide equal opportunities for all employees, irrespective of race, nationality, gender, sexual orientation, marital status, religion or political belief, disability or age. The Group is committed to meeting, at a minimum, the labour rights and legislation requirements in each country in which it operates and, in practice, often exceeds these. The Group's employment practices policies are introduced at newly-acquired businesses at the earliest opportunity after they join the Group.

## Human rights

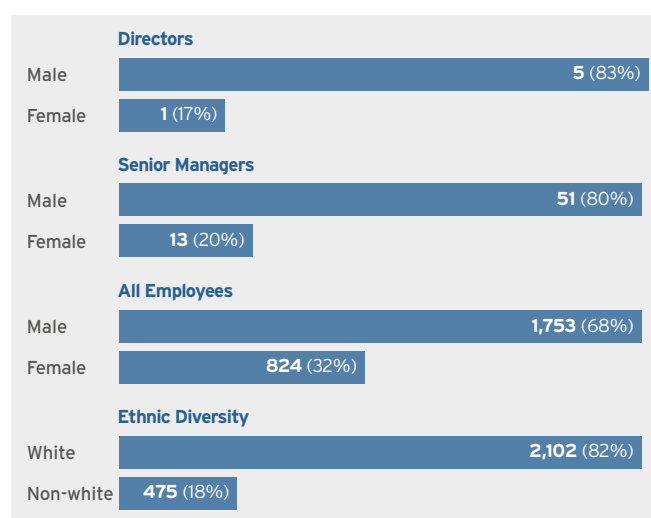
The Group does not have a stand-alone human rights policy but its practices and policies adhere to internationally-recognised human rights principles.

## Gender diversity

A breakdown by gender of the number of persons who are directors of the Company, senior managers and other employees is set out below.

The Board currently has one female member, and remains committed to a minimum of at least 25% female representation on the Board. The Board recognises the importance of promoting diversity across the Group.

Senior managers are generally directors and functional heads within head office and subsidiary companies.



## Development and training

The Group continues to address training and development requirements for employees at all levels within the organisation. All businesses consider training needs for their employees at a local level, in order to ensure that they have the right skill base to deliver their five year plan. The Board also reviews future management requirements and succession plans on an ongoing basis.

In the UK, Roke operates successful undergraduate placements, internships and graduate development programmes, which have received external recognition.

## Benefits

The Group aims to provide all employees with an attractive and competitive benefits package. US employees receive health care and selected other benefits.

The Board is keen to encourage employees to join share schemes in order that they can share in the future success of the Group, and savings-related share plans are therefore offered to UK employees.

## Communications

The Group pursues a policy of employee communication through meetings (including team briefings and works councils) and in-house magazines by which employees are made aware of the progress of the Group and the businesses in which they work. The businesses also engage their employees through representative bodies and trade unions.

A Group magazine, "Chemring-i", is published on a quarterly basis and is distributed to all employees.



## In the environment

### Policy and practices

All of the Group's businesses are certified to the environmental management system ISO 14001, which requires the setting of environmental goals and objectives focused on local aspects and impacts. In addition, expectations are set for energy, waste and water, and performance is monitored across the Group.

### Land quality

The Chemring Energetic Devices facility in Downers Grove, Illinois, USA, is located on a site which has "superfund" status under the US contaminated land regime. The business continues to work with consultants and the regulatory authorities to ensure that its legal obligations in relation to this site are fully satisfied.

The Group carries a £4.1 million (2015: £1.5 million) provision in respect of environmental liabilities, which the Board considers to be adequate (see note 21 of the Group financial statements).

### Incidents

There were no significant environmental incidents in the year.

### Performance

#### Greenhouse gas emissions

The Group is required to report on all of the emission sources of entities that fall within its consolidated financial statements, as specified under the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. The Group does not have responsibility for any emission sources of entities which are not included in its consolidated financial statements.

Absolute values have been converted to carbon dioxide equivalents using the UK Government Conversion Factors for Company Reporting 2016. The reporting period covered aligns with the Group's financial year ended 31 October 2016. The Group is not required to report on its Scope 3 emissions.

#### Scope 1 emissions

| Combustion of fuel in any premises, machinery or equipment operated, owned or controlled by the Group | Quantity (Mwh)    | Conversion factor | CO <sub>2</sub> e (tonnes) |
|---|-------------------|-------------------|----------------------------|
| Gas   | 32,840            | 0.184             | 6,042                      |
| Heating oil   | 6,929             | 0.268             | 1,857                      |
| Liquid petroleum gas  | 1,988             | 0.215             | 426                        |
| Fuels consumed by company-owned and leased vehicles excluding business travel and employee commuting  | Quantity (tonnes) | Conversion factor | CO <sub>2</sub> e (tonnes) |
| Diesel  | 117               | 3.108             | 364                        |
| Liquid petroleum gas  | 104               | 2.942             | 306                        |
| Petroleum   | 124               | 2.994             | 371                        |
| The operation or control of any manufacturing process by the Group                                    |                   |                   | CO <sub>2</sub> e (tonnes) |
| On-site waste incineration  |                   |                   | 4,601                      |
| <b>Total Scope 1 emissions</b>  |                   |                   | <b>13,967</b>              |

With reference to the six Kyoto substances, the Group does not emit hydrofluorocarbons, perfluorocarbons or sulphur hexafluoride. Values for carbon dioxide, methane and nitrous oxides are included in the above figures.

# CORPORATE RESPONSIBILITY REVIEW

continued

## Scope 2 emissions

| Purchased energy               | Quantity<br>(Mwh) | Conversion<br>factor | CO <sub>2</sub> e<br>(tonnes) |
|--------------------------------|-------------------|----------------------|-------------------------------|
| Electricity:                   |                   |                      |                               |
| - Australia                    | 1,084             | 0.81360              | 882                           |
| - Norway                       | 39,570            | 0.01372              | 543                           |
| - UK                           | 15,906            | 0.41205              | 6,554                         |
| - USA                          | 31,485            | 0.49845              | 15,694                        |
| <b>Total Scope 2 emissions</b> |                   |                      | <b>23,673</b>                 |

| Total greenhouse gas emissions | 2016<br>Tonnes | 2015<br>Tonnes | 2014<br>Tonnes |
|--------------------------------|----------------|----------------|----------------|
| Scope 1                        | <b>13,967</b>  | 15,907         | 22,717         |
| Scope 2                        | <b>23,673</b>  | 26,627         | 31,336         |
| <b>Total</b>                   | <b>37,640</b>  | 42,534         | 54,053         |

The Group uses revenue for intensity measurement, which it considers to be the most reliable comparator.

|   | 2016          | 2015   |
|---|---------------|--------|
| Total emissions (tonnes CO <sub>2</sub> )     | <b>37,640</b> | 42,534 |
| Group revenue (£m)                            | <b>477</b>    | 377    |
| <b>Total CO<sub>2</sub> per £m of revenue</b> | <b>79</b>     | 113    |

The UK businesses participate in the CRC Energy Efficiency Scheme, with the exception of Chemring Energetics UK, which operates under a Climate Change Agreement.

## Waste

|                             | 2016<br>Tonnes waste | 2015<br>Tonnes waste | 2014<br>Tonnes waste | 2013<br>Tonnes waste | 2012<br>Tonnes waste |
|-----------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| Recycled, non-hazardous     | <b>956</b>           | 968                  | 731                  | 2,240                | 1,804                |
| Recycled, hazardous         | <b>64</b>            | 287                  | 262                  | 226                  | 387                  |
| Not recycled, non-hazardous | <b>782</b>           | 748                  | 659                  | 1,080                | 1,028                |
| Not recycled, hazardous     | <b>942</b>           | 696                  | 401                  | 490                  | 469                  |
| <b>Total</b>                | <b>2,744</b>         | 2,699                | 2,053                | 4,036                | 3,688                |

## Water

|                                | 2016<br>m <sup>3</sup> | 2015<br>m <sup>3</sup> | 2014<br>m <sup>3</sup> | 2013<br>m <sup>3</sup> | 2012<br>m <sup>3</sup> |
|--------------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|
| <b>Total water consumption</b> | <b>682,185</b>         | 721,401                | 924,889                | 1,606,541              | 1,646,906              |

## In the community

### Helping others

The Board recognises that each of the Group's businesses has an important role to play in its local community.

The Board operates a charitable policy, which confirms its commitment to support selected charitable causes with a focus on the military and armed services, and those linked to the local communities in which the Group's businesses operate. Each business has its own locally held charity budget and, at a Group level, charitable donations are considered on a monthly basis by the Executive Committee. The Group continues to sponsor the British Army's Parachute Regiment display team, the Red Devils.

In addition to making cash donations, the Group also encourages and supports employees who undertake voluntary work in the local community, where appropriate. During the year, employees donated their time and services on a wide range of projects, several of which had an educational bias.

The Group is involved with a number of educational initiatives, notably including the sponsorship of various local schools. The Group has relationships with several universities, whereby funding is provided for students' research activities.

### Local impact

With regards to the impact of the Group's manufacturing activities on the local community, at locations where operations may inconvenience neighbours through product proofing, the businesses liaise with local residents to minimise any impact. The Group is also cognisant of the potential impact of its operations on the local environment, and is addressing this through its environmental strategy.

## In the marketplace

### Policy on the Sale of Goods and Services

The Board has adopted a Policy on the Sale of Goods and Services, which provides guidance to all stakeholders on the products and services that the Group will supply, to which customers and to which countries, and sets out a clear definition of what the businesses will not supply. All Group businesses are required to comply with this policy, which addresses both legal and reputational considerations with regards to certain products. The policy is reviewed and updated on a regular basis.

### Ethics and business conduct

The Group has adopted a Global Code of Business Principles, which requires its employees, its businesses and all third parties who act on the Group's behalf to comply with the Group's standards of acceptable business conduct and applicable laws and regulations in all of the countries in which the Group operates.

### Anti-bribery and corruption

The Group's Bribery Act Compliance Manual incorporates all of its anti-corruption policies and procedures, including the following:

- requirements for bribery risk assessments to be carried out as part of normal operating procedures;
- Group-wide policies and procedures on the appointment of all sales partners and other third party advisers, stipulating due diligence and contractual requirements, approval levels, and monitoring and review processes;
- regular training for management and employees working within commercial, sales and marketing, finance and human resource functions; and
- policies and procedures on the giving and receiving of gifts and hospitality.

The Group's US businesses have an ethical compliance programme to satisfy US Government requirements for ethical training for employees, compliance audits, confidential reporting line for employees, and related investigation procedures.

The Group has a whistleblowing policy and procedures in place which enable all employees to raise concerns, in confidence, about possible improprieties.

These arrangements reflect the requirements of the UK Bribery Act 2010.

## Strategic report

### Cautionary statement

This report contains forward-looking statements that are based on current expectations or beliefs, as well as assumptions about future events. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements often use words such as anticipate, target, expect, estimate, intend, plan, goal, believe, will, may, should, would, could, is confident, or other words of similar meaning. Undue reliance should not be placed on any such statements because they speak only as at the date of this document and, by their very nature, they are subject to known and unknown risks and uncertainties, and can be affected by other factors that could cause actual results, and Chemring's plans and objectives, to differ materially from those expressed or implied in the forward-looking statements.

There are a number of factors which could cause actual results to differ materially from those expressed or implied in forward-looking statements. Among the factors that could cause actual results to differ materially from those described in the forward-looking statements are; increased competition, the loss of or damage to one or more key customer relationships, changes to customer ordering patterns, delays in obtaining customer approvals for engineering or price level changes, the failure of one or more key suppliers, the outcome of business or industry restructuring, the outcome of any litigation, changes in economic conditions, currency fluctuations, changes in interest and tax rates, changes in raw material or energy market prices, changes in laws, regulations or regulatory policies, developments in legal or public policy doctrines, technological developments, the failure to retain key management, or the key timing and success of future acquisition opportunities or major investment projects.

Chemring is under no obligation to revise or update any forward-looking statement contained within these financial statements, regardless of whether those statements are affected as a result of new information, future events or otherwise, save as required by law and regulations.

The strategic report on pages 1 to 45 has been approved by the Board of directors and signed on its behalf by:

#### Michael Flowers

Group Chief Executive  
19 January 2017

## BOARD OF DIRECTORS



**Carl-Peter Forster**

Non-Executive Chairman

Committee Membership: Nomination (Chairman), Remuneration

**Length of service on Board (as at 19 January 2017):**

0 years, 8 months

**Experience:**

- Board experience at Chairman and Chief Executive level
- Extensive international experience within the industrial goods and engineering sectors
- Expertise in operational excellence and lean manufacturing

Carl-Peter Forster joined the Group as an independent non-executive director and Chairman-designate on 1 May 2016, and succeeded Peter Hickson as Chairman of the Board following Peter's retirement on 30 June 2016.

Carl-Peter formerly held senior leadership positions in some of the world's largest automotive manufacturers, including BMW, General Motors and Tata Motors (including Jaguar Land Rover). Carl-Peter is currently a non-executive director of IMI plc and Cosworth Ltd, and was previously a non-executive director of Rexam PLC and Rolls-Royce plc. He is also Chairman of the London Taxi Company, a member of the Board of Volvo Cars Corporation, and a member of the Board of Geely Automobile Holdings.



**Michael Flowers**

Group Chief Executive

**Length of service on Board (as at 19 January 2017):**

2 years, 7 months

**Experience:**

- Extensive senior management experience in the defence sector
- International experience in both service and manufacturing industries

Michael Flowers was appointed to the Board as Group Chief Executive on 24 June 2014, having previously been Group Director - Munitions, with responsibility for running and subsequently disposing of the Group's European munitions businesses.

Michael joined Chemring in 2006, and ran the Group's Australian operations for seven years. Prior to joining Chemring, Michael worked for BAE Systems in programme management roles, principally in the weapons systems and electronic warfare domains. Prior to his time with BAE Systems, Michael served as an officer in the Australian Army for twenty-two years, and was a graduate of the Australian Command and Staff College and the British Royal Military College of Science.



**Andrew Lewis**

Group Finance Director with effect from 19 January 2017

**Experience:**

- International experience in the defence sector
- Chartered Accountant

Andrew Lewis joined the Group on 9 January 2017 and will be appointed to the Board as Group Finance Director on 19 January 2017.

Andrew was formerly Group Finance Director of Avon Rubber p.l.c., where he also performed the Interim CEO role during 2015, following the retirement of the previous CEO.

Prior to joining Avon, Andrew was Group Financial Controller of Rotork plc and prior to that appointment, he was a Director at PricewaterhouseCoopers in Bristol and New Zealand.



**Sarah Ellard**

Group Legal Director & Company Secretary

**Length of service on Board (as at 19 January 2017):**

5 years, 4 months

**Experience:**

- Legal, compliance and governance expertise
- Chartered Secretary

Sarah Ellard was appointed as Group Legal Director on 7 October 2011, having been Group Company Secretary since 1998.

Prior to joining the Group, Sarah trained and worked at Ernst & Young LLP. She is a Fellow of the Institute of Chartered Secretaries and Administrators.



### Andrew Davies

Non-Executive Director

Committee Membership: Audit, Remuneration

**Length of service on Board (as at 19 January 2017):**

0 years, 8 months

**Experience:**

- Board experience at Chief Executive level
- Extensive knowledge of the international defence industry

Andrew Davies was appointed as an independent non-executive director on 17 May 2016.

Andrew has a wealth of relevant sector experience, having served in senior operational and strategic roles at executive committee level at BAE Systems plc for more than fourteen years. He is currently Chief Executive of Wates Group Ltd.



### Daniel Dayan

Non-Executive Director

Committee Membership: Audit, Nomination, Remuneration (Chairman)

**Length of service on Board (as at 19 January 2017):**

0 years, 10 months

**Experience:**

- Board experience at Chief Executive level and as a non-executive director
- Experience in manufacturing and engineering sectors

Daniel Dayan was appointed as an independent non-executive director and Chairman of the Remuneration Committee on 7 March 2016.

Daniel is also currently Chairman and CEO of LINPAC Group, and is non-executive Chairman of the Nonwovens Innovation and Research Institute Ltd.

Daniel has held a number of senior level executive and non-executive roles within the engineering and manufacturing sector, including a six-year appointment as Chief Executive of Fiberweb plc. He also previously served as a non-executive director of Stobart plc and as a trustee in the charity sector.



### Nigel Young

Senior Independent Non-Executive Director

Committee Membership: Audit (Chairman), Nomination, Remuneration

**Length of service on Board (as at 19 January 2017):**

3 years, 9 months

**Experience:**

- Previously Interim Chief Financial Officer of the Group from August 2012 to January 2013
- Finance experience from previous CFO positions
- Chartered Accountant

Nigel Young became a non-executive director and Chairman of the Audit Committee on 1 May 2013, following his appointment as Interim Chief Financial Officer in August 2012. He was appointed as Senior Independent Director in March 2016.

Nigel's previous appointments include Finance Director of ALVIS PLC, First Technology PLC, Babcock International Group PLC and Morgan Advanced Materials Plc. Nigel has also undertaken a number of interim finance roles, including one at McBride Plc. He is currently a non-executive director and Chairman of P2i Limited, a provider of liquid repellent nanotechnology, and is a trustee and Board member of certain development charities.

## DIRECTORS' REPORT

The directors present their annual report, together with the audited financial statements of the Group and the Company, for the year ended 31 October 2016.

The following information is incorporated into the directors' report by reference:

- strategic report on pages 1 to 45;
- corporate governance report on pages 52 to 59;
- Audit Committee report on pages 60 to 63;
- directors' remuneration report on pages 64 to 84;
- directors' responsibilities statement on page 51; and
- notes to the financial statements as detailed in this section.

### Business review

The strategic report on pages 1 to 45 provides a review of the Group's business development, performance and position during and at the end of the financial year, its strategy and likely future development, key performance indicators, and a description of the principal risks and uncertainties facing the business. Further information regarding financial risk management policies and financial instruments is given in note 20 to the Group financial statements.

There have been no significant events since the balance sheet date, other than as referred to in note 35 to the Group financial statements.

### Results and dividends

The profit attributable to the Group's shareholders for the year was £11.1 million (2015: £0.4 million loss).

The directors are recommending the payment of a final and total dividend for the year of 1.3p per ordinary share (2015: 2.4p).

### Directors and their interests

The present directors are shown on pages 46 and 47. Andrew Lewis will be appointed to the Board as Group Finance Director on 19 January 2017.

Ian Much resigned as a director on 21 March 2016. Andy Hamment resigned as a director on 30 April 2016. Peter Hickson resigned as a director and Chairman of the Board on 30 June 2016. Steve Bowers resigned as a director on 30 September 2016.

Daniel Dayan was appointed as a director on 7 March 2016. Carl-Peter Forster was appointed as a director and Chairman-designate on 1 May 2016, and was appointed Chairman of the Board on 1 July 2016. Andrew Davies was appointed as a director on 17 May 2016.

In accordance with the Company's Articles of Association, all directors are required to submit themselves for re-election every three years. However, in order to ensure compliance with the UK Corporate Governance Code, all directors voluntarily submit themselves for re-election at every Annual General Meeting.

Details of the service contracts entered into between the Company and the executive directors are set out in the directors' remuneration report on page 71. The non-executive directors do not have service contracts with the Company.

The Company has made qualifying third party indemnity provisions for the benefit of its directors, which were in effect throughout the year and remain in force at the date of this report. The directors have the benefit of a directors' and officers' liability insurance policy.

Other than in relation to their service contracts, none of the directors is or was beneficially interested in any significant contract to which the Group was a party during the year ended 31 October 2016.

Information required in relation to directors' shareholdings is set out in the directors' remuneration report on page 80.

### Substantial shareholdings

At 18 January 2017, the following substantial holdings in the ordinary share capital of the Company had been notified to the Company in accordance with Chapter 5 of the Disclosure and Transparency Rules of the Financial Conduct Authority:

| Name   | % Interest |
|--|------------|
| Schroders Plc  | 12.2       |
| Investco Limited   | 8.1        |
| FIL Limited  | 7.4        |
| UBS Global Asset Management  | 5.5        |
| Jupiter Asset Management Limited                                       | 5.4        |
| Old Mutual Asset Managers  | 5.1        |
| Majedie Asset Management Limited                                       | 5.0        |
| Thameside MBC re Greater Manchester Pension Fund                       | 5.0        |
| Neptune Investment Management Limited                                  | 5.0        |
| J P Morgan Chase & Co  | 4.9        |
| Investec Asset Management Limited                                      | 4.8        |
| Ameriprise Financial, Inc.   | 4.8        |
| AXA S.A. and its group of companies                                    | 4.8        |
| Standard Life Investments Limited                                      | 4.6        |
| BT Pension Scheme Trustees Limited as Trustee of the BT Pension Scheme | 3.8        |
| Hermes Equity Ownership Services Limited                               | 2.9        |
| Norges Bank  | 2.9        |

### Employees and employee consultation

Details of the Group's employment policies and employee consultation practices are set out in the corporate responsibility review on pages 41 and 42.

### Political donations

No political donations were made during the year (2015: £nil).



## Contractual arrangements

The Group contracts with a wide range of customers, comprising governments, armed forces, prime contractors and OEMs across the globe. The US Department of Defense is the largest single customer, and procures the Group's products under a significant number of separate contracts placed with individual Group businesses.

The Group's businesses utilise many suppliers across the world, and arrangements are in place to ensure that businesses are not totally reliant on single suppliers for key raw materials or components.

## Change of control

Individual Group businesses have contractual arrangements with third parties, entered into in the normal course, which may be amended or may terminate on a change of control of the relevant business, or in certain circumstances, following a takeover of the Group.

The most significant agreements entered into by the Group which contain provisions granting the counter parties certain rights in the event of a change of control of the Company are the revolving credit facility agreements entered into with the Group's banks, and the loan note agreements, pursuant to which the Company issued notes under a series of private placements. These agreements provide that, in the event of a change of a control, the Company must repay all outstanding borrowings, together with accrued interest and other sums owing under each agreement.

## Share capital and shareholder rights

### General

The Company's share capital consists of ordinary shares of 1p each and preference shares of £1 each, which are fully paid-up and quoted on the main market of the London Stock Exchange. Full details of the movements in the issued share capital of the Company during the financial year are provided in note 23 to the Group financial statements.

Details of the rights attaching to shares are set out in the Articles of Association (the "Articles"). All holders of ordinary shares are entitled to attend, speak and vote at any general meeting of the Company, and to appoint a proxy or proxies to exercise these rights. At a general meeting, every shareholder present in person, by proxy or (in the case of a corporate member) by corporate representative has one vote on a show of hands, and on a poll has one vote for every share held. The Notice of Annual General Meeting specifies deadlines for exercising voting rights and appointing a proxy or proxies to vote in respect of the resolutions to be passed at the Annual General Meeting.

There are no restrictions on the transfer of ordinary shares in the capital of the Company, other than certain restrictions which may from time to time be imposed by law. In accordance with the Market Abuse Regulation, certain employees are required to seek the approval of the Company to deal in its shares.

The cumulative preference shares carry an entitlement to a dividend at the rate of 7p per share per annum, payable in equal instalments on 30 April and 31 October each year. Holders of the preference shares have the right on a winding-up to receive, in priority to any other classes of shares, the sum of £1 per share together with any arrears of dividends.

The Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

The Company's Articles may only be amended by special resolution at a general meeting of shareholders.

## Issue of shares

Under the provisions of section 551 of the Companies Act 2006 (the "Act"), the Board is prevented from exercising its powers under the Articles to allot shares without an authority contained either in the Articles or in a resolution of the shareholders passed in general meeting. The authority, when given, can last for a maximum period of five years, but the Board proposes that renewal should be sought at each Annual General Meeting. An ordinary resolution, seeking such authority, will be proposed at the forthcoming Annual General Meeting.

Section 561 of the Act requires that an allotment of shares for cash may not be made unless the shares are first offered to existing shareholders on a pre-emptive basis in accordance with the terms of the Act. In accordance with general practice, to ensure that small issues of shares can be made without the necessity of convening a general meeting, the Board proposes that advantage be taken of the provisions of section 571 of the Act not to apply the Act's pre-emptive requirements. Accordingly, a special resolution will be proposed at the forthcoming Annual General Meeting which, if passed, will have the effect of granting the directors the power to allot not more than 5% of the issued ordinary share capital at the date of the Annual General Meeting free of the requirements of section 561 of the Act. No issue of these shares will be made which would effectively alter the control of the Company without the prior approval of the shareholders in general meeting.

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## Purchase of own shares

The Company did not purchase any of its ordinary shares (2015: nil) during the year. At 31 October 2016, the Company held a total of 2,198,814 ordinary shares in treasury (representing 0.8% of the ordinary shares in issue on 1 November 2016).

A special resolution will be proposed at the forthcoming Annual General Meeting to renew the Company's authority to purchase its own shares in the market up to a limit of 10% of its issued ordinary share capital. The maximum and minimum prices will be stated in the resolution at the date of the Annual General Meeting. The directors believe that it is advantageous for the Company to have this flexibility to make market purchases of its own shares. The directors of the Company may consider holding repurchased shares pursuant to the authority conferred by this resolution as treasury shares. This will give the Company the ability to reissue treasury shares quickly and cost effectively, and will provide the Company with additional flexibility in the management of its capital base. Any issues of treasury shares for the purposes of the Company's employee share schemes will be made within the 10% anti-dilution limit set by The Investment Association. The directors will only exercise this authority if they are satisfied that a purchase would result in an increase in expected earnings per share and would be in the interests of shareholders generally.

## Employee share schemes and plans

### Approach to share ownership

The Group actively encourages its employees to share in the future success of the Group, and therefore operates share-based arrangements to provide incentives and rewards to employees.

The Group operated four share-based plans during the year, as set out below. Further details of awards and vesting are provided in note 27 to the Group financial statements.

### The Chemring Group 2008 UK Sharesave Plan (the "UK Sharesave Plan")

The UK Sharesave Plan is open to all eligible UK employees. Employees may choose between three and five year savings periods, at the end of which the employee can choose to exercise the option or seek the return of their savings. A grant of options was made on 27 July 2016.

### The Chemring Group 2008 US Stock Purchase Plan (the "US Stock Purchase Plan")

The US Stock Purchase Plan is open to all eligible US employees. Participants enter into a two year savings contract, at the end of which they can choose to exercise the option or seek the return of their savings. No offer of options was made under the US Stock Purchase Plan during the year, following a low level of participation by employees when the plan was last offered in 2014.

### The Chemring Group Performance Share Plan (the "PSP")

The PSP expired on 22 March 2016 but was previously the primary long-term incentive plan for executive directors and senior employees. Discretionary awards were granted under the PSP over a fixed number of shares by reference to salary, with awards ordinarily vesting, subject to meeting performance criteria, on the third anniversary of the grant date. Awards remain outstanding under the PSP but no further awards can be made under the plan.

### The Chemring Group Performance Share Plan 2016 (the "2016 PSP")

A new long-term incentive plan, the 2016 PSP, was approved by the shareholders on 21 March 2016. No awards have yet been granted under this plan.

Approval will be sought at the forthcoming Annual General Meeting for the establishment of a new share-based incentive plan, the Chemring Incentive Plan (the "CIP"). If approved, the CIP is likely to replace the 2016 PSP.

### The Chemring Group Restricted Share Plan (the "RSP")

The RSP provides for the discretionary grant of deferred share awards to selected key employees. Executive directors are not eligible to participate. Awards typically vest on the second or third anniversary of the grant date, subject to meeting continuous service criteria. Awards under the RSP may only be satisfied with market-purchased shares.

### Going concern

Details of the conclusions arrived at by the directors in preparing the financial statements on a going concern basis are set out in the financial review on page 27.

### Close company provisions

As far as the directors are aware, the close company provisions of the Taxes Acts do not apply to the Group nor has there been any change in that respect since 31 October 2016.

### Additional information, as required by Listing Rules Requirement 9.8.4

The Annual Report is required to contain certain information under Listing Rules Requirement 9.8.4. Where this information has not been cross-referenced within the Group financial statements, it can be found in the following sections:

- capitalised interest (see notes 6 and 12);
- long-term incentive schemes (see directors' remuneration report);
- allocation of equity securities for cash (see note 23);
- contracts of significance (see note 34);
- election of independent directors (see corporate governance report);
- contractual arrangements (see directors' report);
- details of independent directors (see corporate governance report); and
- substantial shareholders (see directors' report).

No profit forecasts are issued by the Group and no directors have waived any current or future emoluments. Other than in relation to ordinary shares held in treasury, no shareholders have waived or agreed to waive dividends.

None of the shareholders is considered to be a Controlling Shareholder (as defined in Listing Rules 6.1.2.A) and the Group complies with the independence provisions of the Listing Rules.

## Provision of information to the auditor

Each director at the date of this report confirms that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware, and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

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

## Auditor

A resolution to reappoint Deloitte LLP as auditor and to authorise the directors to determine the auditor's remuneration will be proposed at the Annual General Meeting.

## Annual General Meeting

The resolutions to be proposed at the Annual General Meeting to be held on 17 March 2017, together with explanatory notes, appear in the separate Notice of Annual General Meeting sent to all shareholders.

## 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 are required to prepare the Group financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU") and Article 4 of the IAS Regulation, and they have also chosen to prepare the parent company financial statements under IFRSs as adopted by the EU. Under company law the directors must not approve the accounts 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 these financial statements, IAS 1 *Presentation of Financial Statements* requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements of IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions, disclose with reasonable accuracy at any time the financial position of the Group and 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.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## Directors' responsibility statement

Each of the directors, whose names and functions are listed on pages 46 and 47, confirms that to the best of their knowledge:

- the financial statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the strategic report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

This responsibility statement was approved by the Board of directors on 19 January 2017 and is signed on its behalf by:

### Michael Flowers

Group Chief Executive

### Sarah Ellard

Group Legal Director

### INTRODUCTION BY THE CHAIRMAN

**Carl-Peter Forster**

Chairman



The Board is committed to upholding high standards of corporate governance, protecting and growing shareholder value, and engaging in a fair and transparent manner with all of the Group's stakeholders. The Board takes responsibility for approving the Group's long-term goals and strategies, and provides overall financial and organisational control. The Board also ensures that the Group's businesses have appropriate and effective internal control and risk management systems.

2016 was a year of considerable change for the Board. Ian Much and Andy Hamment stood down as non-executive directors, and were succeeded by Daniel Dayan and Andrew Davies. I joined the Board in May 2016 and was appointed Chairman on 1 July 2016, following the retirement of Peter Hickson. Daniel and Andrew are both serving chief executives of other substantial companies, and bring valuable contemporary operational and management expertise to the Board. Andrew Davies also has a wealth of experience in the defence industry, which was previously identified by the Board as a pre-requisite for one of the new appointments made during the year. In recruiting Andrew Lewis as our new Group Finance Director, we were able to attract an executive Board member with extensive experience in driving operational improvements, which the Board believes will be one of the key focus areas in the coming years.

Given the significant changes to the Board in the year, a formal performance evaluation was not undertaken. It is my intention to progress this in the latter half of 2017, when the new Board will have been through a full annual corporate cycle.

Inevitably, the rights issue, which was completed in the early part of the year, necessitated significant engagement with shareholders and our finance providers. I have also met with a number of shareholders over the last eight months, and listened to their views on the Group and its activities. These have been shared with the Board and will continue to be reflected, as appropriate, in the development of our future strategy for the Group.

The Board members spent considerable time during the last year visiting the Group's various facilities around the world, in order to gain a deep understanding of the underlying issues and opportunities. As a Board, we also embarked on a process of strategically reviewing each of the individual businesses and the opportunities which we expect to maximise shareholder value over the coming years. As the findings substantiate, we shall share these with shareholders.

I am encouraged by the constructive interaction amongst the Board members and the valuable contribution the new directors have already made to the Board, and hope that we will build on this as we continue to improve the effectiveness of the refreshed Board over the next few years.

#### Compliance statement

In the year under review, the Company was required to apply the main and supporting principles of good governance set out in the UK Corporate Governance Code issued in September 2014 by the Financial Reporting Council (the "Code"). The detailed report below sets out how the Company applied these principles in practice.

The Company was in compliance with the provisions of the Code throughout the year ended 31 October 2016, with the exception, as referred to above, that a formal performance evaluation of the Board was not undertaken during the year.

**Carl-Peter Forster**  
Chairman

## The Board

### Composition of the Board and independence

The Board currently comprises two executive directors and four non-executive directors (including the Chairman). A new Group Finance Director, Andrew Lewis, will be appointed to the Board on 19 January 2017. The biographical details of individual directors, including details of their other business commitments, are set out on pages 46 and 47.

The roles of Chairman and Chief Executive are separate and clearly defined, in accordance with the requirements of the Code, with the division of responsibilities set out in writing and agreed by the Board.

The Board considers all of the current non-executive directors to be independent in judgment and character, and considered Carl-Peter Forster to be independent on his appointment as Chairman. Nigel Young was employed as the Group's Interim Chief Financial Officer for a period of six months from August 2012, prior to his appointment as a non-executive director but the Board does not consider that this short period of employment impacted his independence, and his contribution to the Board continues to be impartial and objective. Mr Young was appointed as Senior Independent Director following the retirement of Ian Much in March 2016.

The Board considers that the current balance of executive and non-executive influence on the Board is appropriate for the Company, taking into account its size and status.

### Matters reserved for approval of the Board

The Board has a formal schedule of matters reserved to it for consideration and approval, including:

#### Strategy and management

- Approval of the Group's five year plan and annual budget
- Approval of acquisitions, disposals and major capital expenditure
- Approval of changes to the Group's capital structure

#### Financial matters and internal controls

- Oversight of the Group's systems of financial control and risk management
- Approval of financial statements and results announcements
- Recommendation and declaration of dividends

#### Corporate governance

- Undertaking performance reviews of the Board and its committees
- Approval of policies on financing and treasury, ethical matters, and health and safety
- Receiving reports on the views of shareholders

## CORPORATE GOVERNANCE REPORT

continued

### Board responsibilities

The key responsibilities of the Board members are as follows:

|                                    |   |   |
|------------------------------------|---|---|
| <b>Chairman</b>                    | <ul style="list-style-type: none"> <li>Responsible for the leadership and governance of the Board as a whole</li> <li>Ensures that the Board is kept properly informed and is consulted on all decisions reserved to it</li> <li>Promotes constructive relations between the executive and non-executive directors</li> </ul>   | <ul style="list-style-type: none"> <li>Ensures that the training and development needs of directors are identified</li> <li>Ensures that the performance of the Board is evaluated on a regular basis</li> <li>Ensures that communication with shareholders is effective, and acts as a conduit to ensure that the views of shareholders are communicated to the Board</li> </ul> |
| <b>Group Chief Executive</b>       | <ul style="list-style-type: none"> <li>Responsible for the leadership and day-to-day management of the business</li> <li>Develops strategy for Board approval and ensures that the agreed strategy is implemented successfully</li> <li>Presents the annual budget and five year plan to the Board for approval and delivers agreed objectives</li> </ul>   | <ul style="list-style-type: none"> <li>Identifies new business opportunities, and potential acquisitions and disposals</li> <li>Manages the Group's risk profile, including the management of health and safety</li> <li>Ensures that the Board is fully informed of all key matters</li> </ul>   |
| <b>Non-executive directors</b>     | <ul style="list-style-type: none"> <li>Participate in the development of strategic objectives and monitor the performance of executive management in achieving the agreed objectives</li> <li>Monitor the Group's financial performance</li> <li>Consider the integrity of the Group's financial information, and whether the financial controls and risk management systems are robust and defensible</li> </ul> | <ul style="list-style-type: none"> <li>Determine the appropriate remuneration policy for the executive directors</li> <li>Meet periodically with the Group's senior management and visit operations</li> <li>Meet regularly without the executive directors being present</li> </ul>  |
| <b>Senior Independent Director</b> | <ul style="list-style-type: none"> <li>Provides support to the Chairman and acts as a trusted sounding board</li> <li>Reviews the Chairman's performance with the other non-executive directors</li> </ul>  | <ul style="list-style-type: none"> <li>Available to meet shareholders if they have concerns which cannot be resolved through the normal channels</li> </ul>   |
| <b>Company Secretary</b>           | <ul style="list-style-type: none"> <li>Secretary to the Board and its committees</li> <li>Under the direction of the Chairman, responsible for maintaining good information flows within the Board and its committees</li> <li>Develops Board and committee agendas, and collates and distributes papers</li> <li>Assists with the induction of new directors</li> </ul>  | <ul style="list-style-type: none"> <li>Keeps directors informed about changes to their duties and responsibilities</li> <li>Provides advice on legal, regulatory and corporate governance matters</li> <li>Available to all directors</li> </ul>  |



## Operation of the Board

### Board meetings and attendance

The Board meets at least eight times a year. The Board receives reports from the Group Chief Executive, the Group Finance Director, the Group Legal Director and the Group Director of Safety as standing agenda items at every scheduled Board meeting. Members of the senior leadership team and external advisers attend Board meetings by invitation, as appropriate.

The following table shows the attendance of directors, who served during the year, at meetings of the Board, the Audit Committee, the Nomination Committee and the Remuneration Committee:

| Board member                              | Board<br>(10 scheduled<br>meetings and<br>12 ad hoc<br>meetings) | Audit<br>Committee<br>(4 scheduled<br>meetings and<br>2 ad hoc<br>meetings) | Nomination<br>Committee<br>(3 scheduled<br>meetings) | Remuneration<br>Committee<br>(3 scheduled<br>meetings and<br>4 ad hoc<br>meetings) |
|---|--|---|--|--|
| Carl-Peter Forster (appointed 1 May 2016) | 6(6)   | –   | 2(2)   | 2(2)   |
| Steve Bowers (resigned 30 September 2016) | 20(22)   | –   | –  | –  |
| Andrew Davies (appointed 17 May 2016)     | 4(5)   | 1(2)  | 2(2)   | 1(2)   |
| Daniel Dayan (appointed 7 March 2016)     | 9(9)   | 3(3)  | 3(3)   | 3(3)   |
| Sarah Ellard                              | 22(22)   | –   | –  | –  |
| Michael Flowers                           | 20(22)   | –   | –  | –  |
| Andy Hamment (resigned 30 April 2016)     | 10(16)   | 4(4)  | –  | 5(5)   |
| Peter Hickson (resigned 30 June 2016)     | 19(19)   | –   | –  | 4(5)   |
| Ian Much (resigned 21 March 2016)         | 12(14)   | 3(3)  | 1(1)   | 4(4)   |
| Nigel Young                               | 21(22)   | 6(6)  | 3(3)   | 7(7)   |

The maximum number of meetings which each director could have attended is shown in brackets.

In addition to the scheduled meetings, twelve ad hoc Board meetings, two ad hoc Audit Committee meetings and four ad hoc Remuneration Committee meetings were convened to deal with matters arising between scheduled meetings.

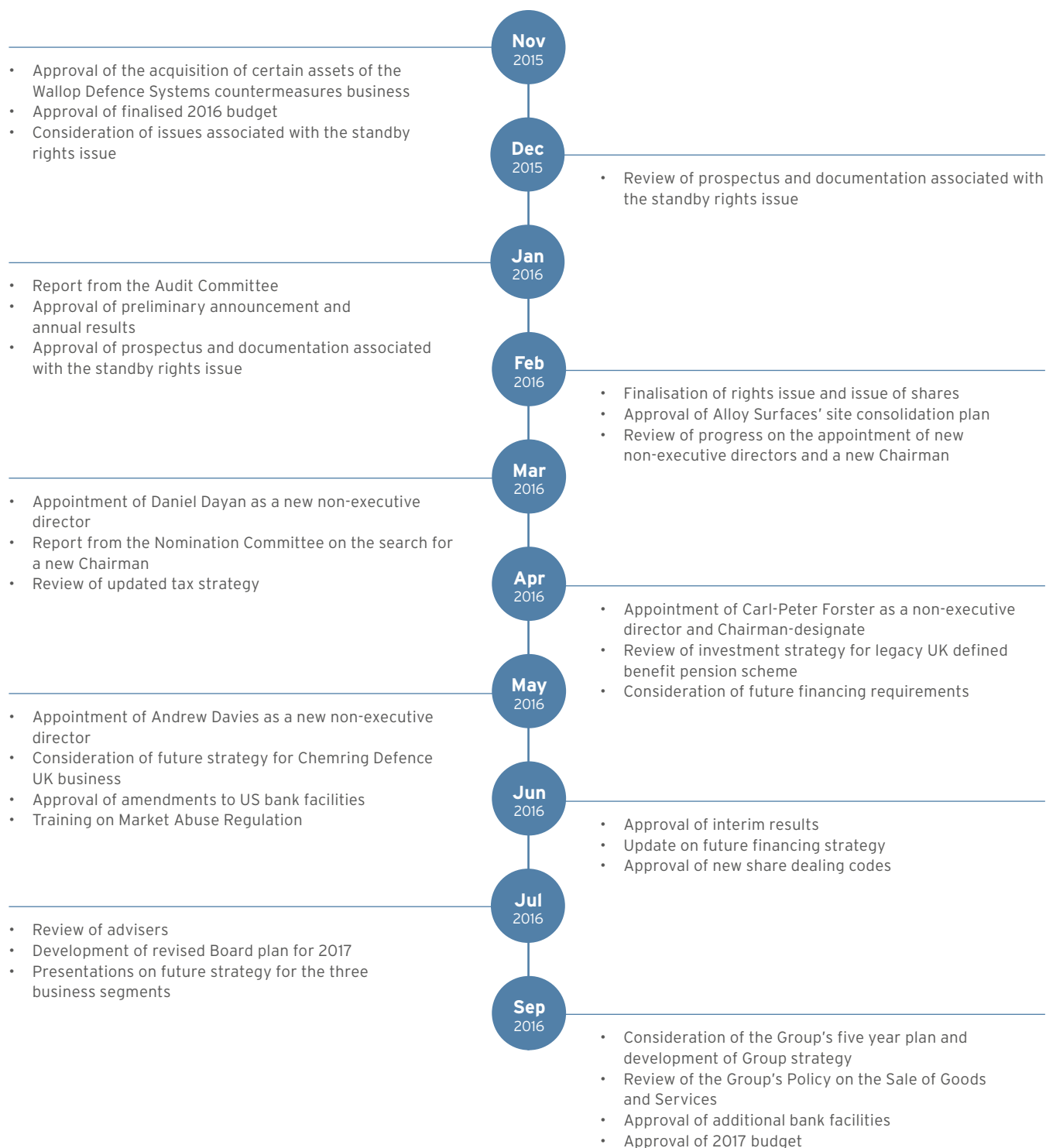
During the year, the Chairman met regularly with the non-executive directors without the executives being present.

# CORPORATE GOVERNANCE REPORT

continued

## Board activity throughout the year

In addition to its routine scheduled business, the Board also undertook the following activities during the year:



## Board effectiveness

### Appointments to the Board

External search consultancies are generally appointed to assist with the recruitment of new directors.

Catalyst Advisors LP were appointed during 2015 to assist with the search for new non-executive directors. A brief was prepared for Catalyst Advisors based on a review by the whole Board of the specific knowledge and expertise required of potential candidates. The Nomination Committee interviewed selected candidates, several of whom were invited to follow-up meetings with the Group Chief Executive and other members of the Board. Daniel Dayan and Andrew Davies were appointed to the Board as non-executive directors during the year as a result of this process.

The Miles Partnership was retained during the year to lead the search for a new Chairman for the Group. A brief was prepared for The Miles Partnership, with input from the whole Board, on the requisite skills and expertise required of the new Chairman. The process was managed during the early stages by Ian Much and Nigel Young, with assistance from Daniel Dayan following Mr Much's retirement. Short-listed candidates were invited to meet all members of the Board, following which the Board resolved to appoint Carl-Peter Forster as a non-executive director and Chairman-designate. Mr Forster was appointed Chairman on 1 July 2016.

Drax Executive were appointed in July 2016 to undertake the recruitment of a new Group Finance Director. The search process was led by Michael Flowers, with support from the Chairman and Nigel Young. The appointment of Andrew Lewis as the new Group Finance Director was announced in December 2016.

Catalyst Advisors LP, The Miles Partnership and Drax Executive have no other relationships with the Group.

### Diversity

The Board supports the principles set out in Lord Davies' Review into Women on Boards published in February 2011, and the Board also recognises the importance of promoting diversity across the Group. The Board currently includes one female member, and remains committed to a minimum target of at least 25% female representation on the Board, amongst senior management and across the Group in general.

### Re-election of directors

In accordance with the Company's Articles of Association, all directors are required to submit themselves for re-election every three years. However, in order to ensure compliance with the Code, all directors voluntarily submit themselves for re-election at each Annual General Meeting.

The papers accompanying the Notice of Annual General Meeting include a statement from the Chairman confirming that the performance of each non-executive director seeking re-election at the meeting continues to be effective and that each director continues to demonstrate commitment to their role.

### Induction

An internal induction programme on the Group's operations, and its strategic and business plans, is provided for newly-appointed directors. Directors are invited to meet key members of the senior management team at the earliest opportunity, and a series of site visits are arranged to facilitate their understanding of the Group's operations.

The Company Secretary also provides detailed information on the operation of the Board and its committees, directors' legal duties, and responsibilities on appointment.

### Training and development

The Company meets the cost of appropriate external training for directors, the requirement for which is kept under review by the Chairman.

Directors are continually updated on the Group's businesses and the matters affecting the markets in which they operate. The Company Secretary updates the Board on a regular basis with regards to regulatory changes affecting the directors and the Group's operations generally, and briefings are provided by the Group's advisers on key developments in areas such as financial reporting and executive remuneration practice.

### Independent advice

All directors are entitled to take independent professional advice in furtherance of their duties at the Company's expense, should the need arise. No director had reason to seek such advice during the year.

### Conflicts of interest

All directors have a duty under the Companies Act 2006 (the "2006 Act") to avoid a situation in which he or she has or can have a direct or indirect interest that conflicts or may possibly conflict with the interests of the Company. The Company's Articles of Association include provisions for dealing with directors' conflicts of interest in accordance with the 2006 Act. The Company has procedures in place to deal with situations where directors may have any such conflicts, which require the Board to:

- consider each conflict situation separately on its particular facts;
- consider the conflict situation in conjunction with the rest of their duties under the 2006 Act;
- keep records and Board minutes as to authorisations granted by directors and the scope of any approvals given; and
- regularly review conflict authorisation.

### Performance evaluation

The Board engaged in an externally-facilitated review of its performance during 2015, utilising the services of Lintstock Limited. The evaluation considered topics under the following headings:

- Board composition and expertise;
- Board dynamics;
- time management;
- Board support;
- strategic and operational oversight;
- risk management and internal control;
- succession planning and people management; and
- priorities for change.

# CORPORATE GOVERNANCE REPORT

continued

## Performance evaluation continued

The principal recommendations arising from the 2015 evaluation were kept under review during the year and further progress was made as detailed below:

| Recommendations of 2015 evaluation  | Actions taken during the year   |
|---|---|
| The Board should spend more time on strategic planning and reviewing the execution of strategic plans | Offsite strategy reviews were held in July and September 2016, the first of which was also attended by the Group Director of Strategy & Technology and the Executive Committee representatives for each of the three business segments      |
| At least one new non-executive director is required.  | Two new non-executive directors were appointed during the year  |
| The Board requires increased exposure to management and more site visits                              | All of the new directors visited a number of the Group's sites in the months after their appointment. The Board plan for 2017 provides for meetings to be held at several businesses, with dedicated time allocated to management briefings |
| Additional focus on risk management is required   | The Group's risk management framework has been updated, and additional time has been allocated to risk management on the Board agendas  |
| The Board should meet informally prior to Board meetings on a more frequent basis                     | Additional sessions have been scheduled in the 2017 Board calendar  |

Given the significant changes to the composition of the Board during the year, no new formal evaluation of the Board was undertaken. However, the Board kept under review the balance of skills, experience, independence and knowledge required of the Board, as the recruitment of the new Chairman and the new non-executive directors progressed during the year. The Chairman and non-executive directors reviewed the individual performance of the executive directors as part of the annual remuneration review.

## Board committees

The terms of reference of the Audit Committee, the Nomination Committee and the Remuneration Committee are published on the Company's website ([www.chemring.co.uk/investors/corporate-governance](http://www.chemring.co.uk/investors/corporate-governance)) and copies are available on request from the Company Secretary.

### Audit Committee

The Audit Committee comprises three independent non-executive directors. At the date of this report, the Audit Committee members were Nigel Young (Chairman), Andrew Davies and Daniel Dayan.

Nigel Young acted as Interim Chief Financial Officer for the Group between August 2012 and January 2013, and was formerly the finance director of several public companies. The remaining members of the Committee are serving executive directors of substantial companies, and have extensive business and financial management experience. The Board therefore considers that each member of the Audit Committee has the requisite recent and relevant financial experience to satisfy the requirements of the Code.

The Audit Committee convened for four scheduled meetings and two ad hoc meetings during the year.

The Audit Committee report is set out on pages 60 to 63.

### Remuneration Committee

The Remuneration Committee comprises four independent non-executive directors. At the date of this report, the Remuneration Committee members were Daniel Dayan (Chairman), Andrew Davies, Carl-Peter Forster and Nigel Young.

Three scheduled Remuneration Committee meetings were held during the year, together with four ad hoc meetings. Further details on the Remuneration Committee and its activities, and the Company's policies on directors' remuneration are set out in the directors' remuneration report on pages 64 to 84.

## Nomination Committee

The Nomination Committee comprises three independent non-executive directors. At the date of this report, the Nomination Committee members were Carl-Peter Forster (Chairman), Daniel Dayan and Nigel Young. Mr Forster is Chairman of the Nomination Committee but, in accordance with the Committee's terms of reference, is not permitted to chair meetings when the Committee is dealing with the appointment of his successor.

## Executive Committee

The Executive Committee is responsible for the executive day-to-day running of the Group, submission to the Board of strategic plans and budgets for the Group's operations, and monitoring the trading performance of the Group as a whole.

The current members of the Executive Committee are:

- Michael Flowers (Group Chief Executive)
- Rik Armitage (Group Director - Strategy & Technology)
- Terry Bridgewater (Group Director of Safety)
- Stuart Cameron (Managing Director - Chemring Energetics)
- David Cole (Managing Director - Roke)
- Steve Cummings (Interim President - Chemring Sensors & Electronic Systems)
- Simon Darling (Managing Director - Chemring Countermeasures UK)
- Sarah Ellard (Group Legal Director & Company Secretary)
- Andrew Lewis (Group Finance Director)
- Rupert Pittman (Group Director of Corporate Affairs)

Michael Flowers chairs the Executive Committee, which meets monthly.

#### Key responsibilities delegated to the Executive Committee by the Board

- Implementation of the Group's strategies and policies as determined by the Board
- Monitoring of operational and financial results against budget
- Allocation of resources across the Group within the overall plan approved by the Board
- Approval of R&D and capital expenditure within limits imposed by the Board
- Developing and implementing risk management systems

## Relations with shareholders and other providers of capital

### Shareholder engagement

The Company maintains an active dialogue with institutional shareholders through regular briefing meetings and formal presentations following the release of interim and annual results. Meetings are usually attended by the Group Chief Executive and the Group Finance Director, although the Chairman and the Senior Independent Director also meet with shareholders to discuss specific matters. The other non-executive directors are also offered the opportunity to meet with major shareholders and attend meetings if so requested by shareholders.

Communication with private investors is achieved largely through the medium of the interim results statement and the annual report.

The Company's website ([www.chemring.co.uk](http://www.chemring.co.uk)) provides financial, business and governance information on the Group.

The directors are provided with reports and other written briefings from the Company's brokers, and are regularly informed by the Company Secretary about changes to significant shareholdings.

It is the Company's policy that all directors should attend and make themselves available to take questions from shareholders or address any concerns at the Annual General Meeting. At other times of the year, the directors can be contacted via the Company's head office.

### Annual General Meeting

All substantial issues, including the adoption of the annual report and financial statements, are proposed on separate resolutions at the Annual General Meeting. In line with best practice guidelines, voting at the Annual General Meeting is conducted by way of a poll. This allows all votes to be counted, not just those of shareholders who attend the meeting. Poll results are published on the Company's website as soon as practicable following the conclusion of the meeting. The Notice of the Annual General Meeting is sent to shareholders at least twenty working days before the meeting.

### Engagement with other providers of capital

In addition to issuing shares, the Company also finances its activities through external bank loans and by the issue of loan notes. The Board recognises the importance of maintaining good relationships with the providers of this capital, and the Group Chief Executive and the Group Finance Director brief the banks and note holders on a regular basis on the Company and its performance. The Board receives regular reports on any issues impacting these relationships.

## Accountability

### Financial and business reporting

The statement of directors' responsibilities in respect of the financial statements and accounting records maintained by the Company is set out on page 51.

Having taken all the matters considered by the Board and brought to the attention of the Board during the year into account, the Board is satisfied that the annual report and accounts for the year ended 31 October 2016, taken as a whole, is fair, balanced and understandable. Furthermore, the Board believes that the disclosures set out on pages 2 to 15 provide the information necessary to assess the Company's performance, business model and strategy.

### Risk management and internal control

The Board is responsible for determining the nature and extent of the risks that it is willing to take to achieve its strategic objectives. The Board is also responsible for ensuring that the Group's risk management and internal control systems are effective across the businesses.

The Board undertakes an annual review of the effectiveness of the Group's systems of internal control, including financial, operational and compliance controls, and risk management systems. Further details of the review undertaken during the financial year ended 31 October 2016 are set out on pages 32 and 33.

### Going concern and long-term viability statement

Details of the conclusions arrived at by the directors in preparing the financial statements on a going concern basis and the assessment of the Group's long-term viability are set out in the financial review on page 27.

### Insurance

The Company maintains directors' and officers' liability insurance in respect of legal action against its directors.

# ANNUAL STATEMENT BY THE CHAIRMAN OF THE AUDIT COMMITTEE

**Nigel Young**

Chairman



The Audit Committee continues to play a very important role in the governance of the Group's financial affairs, both through monitoring the integrity of the Group's financial reporting and reviewing material financial reporting judgements.

2016 was another busy year for the Audit Committee.

Preparation for the rights issue, which was finally completed in February 2016, coincided with the finalisation of the 2015 financial statements. The Committee's review of the Group's going concern status and consideration of the new requirements for the long-term viability statement to be included in the 2015 financial statements was therefore undertaken alongside completion of the working capital review for the rights issue prospectus. The Committee worked closely with Deloitte to ensure a consistent approach to our financial reporting across both activities.

With our significant audit risks remaining broadly consistent year-on-year, both the 2015 full year audit and the 2016 interim review proceeded smoothly, and the Committee remains satisfied with the performance of Deloitte as our external auditor.

Following the appointment of KPMG to provide internal audit services for the Group in 2015, further progress has been made on broadening the scope of our internal audit function to include a more comprehensive review of non-financial controls. In particular, KPMG's subject-matter experts undertook focused reviews of our working capital management processes across the Group during the year and provided a number of useful recommendations. KPMG have now undertaken at least one internal audit at each of our businesses, and it is pleasing to note that the number of new audit findings arising in KPMG's second visits has reduced at most businesses.

The Committee considered the updated Guidance on Audit Committees published by the Financial Reporting Council in April 2016, and we have updated our terms of reference to reflect its recommendations. We have also adopted a revised policy on the provision of non-audit services by the external auditor to reflect the latest regulatory requirements and the Ethical Standard.

Further details of the Committee's activities during the year are set out below.

**Nigel Young**  
Chairman



## Operation of the Audit Committee

The Audit Committee monitors the integrity of the Group's financial statements and the effectiveness of the external audit process.

### Key responsibilities

- Making recommendations on the appointment, reappointment and remuneration of the external auditor
- Ensuring that an appropriate relationship between the Group and the external auditor is maintained, and overseeing the provision of non-audit services
- Reviewing and monitoring the external auditor's independence and objectivity
- Reviewing the effectiveness of the Group's internal controls and risk management systems
- Considering the effectiveness of the Group's internal audit function and monitoring internal audit activities
- Reviewing arrangements by which the Group's employees may confidentially raise concerns about possible improprieties
- Providing guidance to the Board in its consideration of whether the annual report and accounts are fair, balanced and understandable

The Committee is authorised to seek any information it requires from any employee of the Group in order to perform its duties, and to obtain any outside legal or other professional advice it requires at the Company's expense.

The Committee reviews its terms of reference and its effectiveness annually, and recommends to the Board any changes required as the result of the review.

### Meetings

Meetings of the Committee are attended, at the invitation of the Chairman, by the external auditor, the Chairman of the Board, the Group Chief Executive, the Group Finance Director, the internal auditors and representatives from the Group finance function. The Committee meets with the external and internal auditors on a regular basis without the executive directors being present. The Company Secretary acts as secretary to the Committee and minutes of meetings are circulated to all Board members.

A verbal report on key issues discussed by the Committee is provided to the Board after every meeting.

The Committee plans to meet four times in the current financial year.

The Chairman of the Committee meets regularly with the Group Finance Director, the external audit lead partner and the internal audit lead partner outside of scheduled meetings.

## Principal activities of the Audit Committee during the year

|                       |   |
|-----------------------|---|
| <b>November 2015</b>  | <ul style="list-style-type: none"> <li>• Approval of the appointment of Deloitte LLP as reporting accountants on the working capital report required for the rights issue prospectus</li> </ul>   |
| <b>January 2016</b>   | <ul style="list-style-type: none"> <li>• Review of the Group's preliminary announcement and annual results for the year ended 31 October 2015, including the Group's going concern status and the viability statement</li> <li>• Consideration of the auditor's report on the results of the full year audit</li> <li>• Review of the auditor's report on their insights and recommendations arising from the full year audit</li> <li>• Consideration of KPMG's internal audit report</li> </ul> |
| <b>April 2016</b>     | <ul style="list-style-type: none"> <li>• Consideration of the auditor's plan for the half year results review</li> <li>• Consideration of KPMG's internal audit report</li> <li>• Annual review of the Committee's terms of reference</li> <li>• Consideration of the Group Legal Director's ethics and compliance report</li> <li>• Review of the Group's whistleblowing policy and procedures</li> </ul>  |
| <b>June 2016</b>      | <ul style="list-style-type: none"> <li>• Review of the Group's half year results, including the going concern status</li> <li>• Consideration of the auditor's report on the results of the interim review</li> <li>• Consideration of KPMG's internal audit report</li> </ul>  |
| <b>September 2016</b> | <ul style="list-style-type: none"> <li>• Review of audit services for the year ended 31 October 2016</li> <li>• Consideration of the auditor's plan for the full year audit</li> <li>• Annual review and approval of updated policy on the provision of non-audit services by the external auditor</li> <li>• Approval of updated terms of reference for the Committee</li> <li>• Consideration of KPMG's internal audit report</li> </ul>  |

## AUDIT COMMITTEE REPORT

continued

### Significant issues considered by the Audit Committee during the year in relation to the financial statements

|   |   |
|---|---|
| <b>Revenue recognition, and contract accounting policies and procedures</b> | <p>The Committee reviews the Group's revenue recognition and contracting accounting policies and procedures on an ongoing basis, to ensure that they remain appropriate and that the Group's internal controls are operating effectively in this area.</p> <p>The Committee considered the key assumptions underlying the accounting treatment of all contracts which were subject to contract accounting during the year, and approved the treatment where appropriate. The level of revenue and profit recognised in respect of those contracts which were material to the Group's half and full year results was also reviewed in detail by the Committee.</p>   |
| <b>Impairment of goodwill and other intangible assets</b>                   | <p>The Committee considered the management's review of the carrying value of goodwill and intangible assets held on the Group's balance sheet as at 31 October 2015 and 30 April 2016, against the latest forecasts for each of the applicable businesses.</p>  |
| <b>Capitalised research and development costs</b>                           | <p>The Committee continued to monitor the level of research and development costs capitalised during the year, and the periods over which such costs are to be capitalised, as well as the subsequent impairment review based on predicted product launch and performance.</p>  |
| <b>Going concern and long-term viability</b>                                | <p>In order to satisfy itself that the Group has sufficient financial resources to enable it to continue trading for the foreseeable future, the Committee regularly reviews the adequacy of the Group's financing facilities against future funding requirements and working capital projections. The Committee received regular reports from the Group Finance Director on the Group's financial covenant compliance position throughout the year.</p> <p>Based on its review of the Group's forecasts, the successful completion of the rights issue in February 2016 and detailed discussions with the external auditor, the Committee recommended to the Board the adoption of the going concern basis for the preparation of both the 2015 financial statements and the 2016 interim results.</p> <p>The Group was also required to make a statement on its long-term viability in the 2015 financial statements. The Committee considered the period over which the Group's viability would be assessed and having concluded that a three-year period was appropriate, the Committee undertook a review of the analysis and projections which supported the viability assessment prior to submission to the Board.</p> |

### External audit

The Audit Committee is responsible for making recommendations to the Board on the appointment, reappointment and removal of the Company's external auditor. The Committee also undertakes an annual assessment of the auditor's independence and objectivity, taking into account relevant professional and regulatory requirements and the relationship with the auditor as a whole, including the provision of any non-audit services.

#### Audit effectiveness and tendering

Deloitte LLP has been the Company's auditor for many years, and Anna Marks has been the lead audit partner for the last four years. Deloitte LLP was reappointed at the last Annual General Meeting in March 2016. In the opinion of the Committee, the relationship with the auditor currently works well, and having reviewed their independence and effectiveness, the Committee has not considered it necessary to date to require Deloitte LLP to re-tender for the audit work. Accordingly, the Committee has recommended to the Board that Deloitte LLP be proposed for reappointment as auditor at the forthcoming Annual General Meeting.

In assessing the effectiveness of the external auditors during the year, the Committee reviewed and considered:

- the arrangements for ensuring the external auditor's independence and objectivity;
- the external auditor's fulfilment of the agreed audit plan and any variations from the plan;
- the robustness and perceptiveness of the auditor in their handling of the key accounting and audit judgements;
- the content of the external auditor's reports and internal control recommendations; and
- the feedback received on the conduct of the external audits from key people involved in the audit process.'

The Committee will keep under review the timing of its next external audit tender process but does not currently intend that the audit will be put out to tender during 2017. Under current regulations, the Group will be required to re-tender the external audit by 2020.

There are no contractual or similar obligations to restrict the choice of external auditor.

## Auditor independence

The Committee keeps under review the level of any non-audit services which are provided by the external auditor, to ensure that this does not impair their independence and objectivity.

The Committee has adopted a policy which states that the external auditor should not be appointed to provide any non-audit services to the Group, unless the Committee agrees that their appointment would be in the best interests of the Company's shareholders in particular circumstances and would not create any direct conflict with their role as external auditor. In approving any such appointment, the Committee is also required to consider:

- whether the provision of the proposed services might compromise the auditor's independence or objectivity;
- whether the non-audit services will have a direct or material effect on the Group's audited financial statements;
- whether the skills and experience of the external auditor make it the most suitable supplier of the non-audit services; and
- the level of fees proposed for the non-audit services relative to the audit fees.

The external auditor is required to provide the Committee with a written confirmation of independence for all duly-approved engagements for non-audit services.

The policy adopted by the Committee expressly prohibits the provision of certain non-audit services by the external auditors, in line with regulatory requirements and UK ethical guidance.

During the year, Deloitte LLP provided the following additional services to the Group:

- acting as reporting accountant on the prospectus for the rights issue completed in February 2016;
- compliance services relating to corporation tax returns and other overseas regulatory tax returns; and
- tax advisory services relating to advice given on the Group's tax structures.

The rights issue was a very significant transaction for the Group, and the Committee considered that Deloitte LLP's pre-existing knowledge of the Group would be very beneficial in undertaking the work required of the reporting accountant.

Details of the amounts paid to the external auditor during the year for audit and other services are set out in note 3 to the Group financial statements.

With effect from 1 November 2016, Deloitte LLP ceased to provide any tax-related services to the Group.

The Committee, in conjunction with the Group Finance Director, ensures that the Group maintains relationships with a sufficient choice of appropriately qualified alternative audit firms for the provision of non-audit services.

## Internal audit

The Audit Committee is responsible for reviewing the work undertaken by the Group's internal auditors, assessing the adequacy of the internal audit resource, and recommending changes for increasing the scope of the internal audit activities.

The Group's internal audit programme incorporates an annual rolling review of all businesses, and focuses on both financial and non-financial controls and procedures. The Committee approves the annual internal audit plan and receives regular reports from the internal auditors.

KPMG LLP has been appointed by the Committee to provide internal audit services for the Group. The KPMG internal audit programme covers financial and commercial processes, governance issues, and key corporate risks. The internal audit plan for 2016 included specific focus on:

- enterprise risk management across the Group;
- the systems and controls adopted by each business in relation to working capital;
- IT and cyber security policies and risk management;
- the effectiveness of implementation of new ERP systems at certain businesses; and
- the key financial and operating controls at each business.

The scope of the internal audits undertaken by KPMG LLP at the Group's US businesses was broadened during the year, in order to provide a more consistent audit approach across all of the Group's businesses.

KPMG LLP presents its internal audit reports to the Committee on a quarterly basis. The management of each business is responsible for implementing the recommendations made by the internal auditors, and the Committee reviews progress on a regular basis.

Having undertaken a review of the effectiveness of KPMG LLP in fulfilling the internal audit function, the Committee is satisfied that the quality, experience and expertise of KPMG LLP meets the Company's requirements, and KPMG LLP has therefore been reappointed to provide internal audit services for the Group in 2017.

# ANNUAL STATEMENT BY THE CHAIRMAN OF THE REMUNERATION COMMITTEE

**Daniel Dayan**

Chairman of the Remuneration Committee



### Introduction and policy review

I am very pleased to have taken on the role of Chairman of the Remuneration Committee, having succeeded Ian Much who stepped down in March 2016. Indeed, during the year the Committee's membership has changed quite substantially as part of the overall Board refreshment process, with Chemring's new Chairman, Carl-Peter Forster, Andrew Davies and myself as new Committee members joining Nigel Young.

The Committee is mindful of the fact that shareholder approval was obtained at the 2016 Annual General Meeting for a revised directors' remuneration policy. However, due to its largely new membership, the Committee felt it appropriate to review this policy. This review was undertaken in the context of Chemring's performance, the equity issue in early 2016, and the need to ensure that the remuneration policy was supporting the performance and management actions that the Committee believes necessary and appropriate.

The Committee believes that Chemring's remuneration policy should:

- be clearly and directly linked to Chemring's evolving underlying strategy and current/future challenges;
- encourage and reward the delivery of sustainable long-term returns to shareholders;
- genuinely align our shareholders' long-term interests with those of management via the use of equity;
- be simple to understand and operate consistently across the senior executive population; and
- provide appropriate, but not excessive, reward opportunity.

Having conducted its review, the Committee believes that, while the current policy reflects standard practice, it does not deliver fully against these objectives. This is primarily due to the structure of our Performance Share Plan ("PSP"). For example, the nature of the defence business, which materially influences our financial performance, is in turn heavily influenced by factors outside management's control, making it difficult to set robust long-term financial targets such as EPS over a three-year period, which has been used as a performance metric for 50% of awards granted under our PSP. Also, while the remaining 50% of PSP awards have been subject to relative TSR targets, Chemring's TSR has been measured against a group of generally much larger global defence sector companies, some quoted in the very different US market, few of which are on reflection close comparators to Chemring. Furthermore, there are other financial KPIs that are very important measures of our success over and above EPS that are not currently captured in the PSP.

All these issues have resulted in PSP awards being attributed little value by recipients which, in turn, means that the plan provides poor alignment of shareholders' and management's interests. As a result, Chemring is effectively operating a second incentive plan (i.e. in addition to the annual bonus), which serves little constructive purpose in its current form, adds complexity and incurs additional costs for little benefit.

Following the review, the Committee developed a proposal for a new remuneration policy and consulted extensively with major shareholders and with the Investment Association. Following some changes as a result of the consultation, the Committee has finalised a proposed new policy, which shareholders will be asked to approve at the 2017 Annual General Meeting.

### Key features of the proposed new policy

The Committee believes that the structure and quantum of the executive directors' fixed pay (i.e. salary, pension, other benefits) is broadly appropriate and no policy changes are envisaged. The directors' base salaries have been increased by 2.7% with effect from 1 January 2017, in line with the average salary increase for UK employees.

In terms of bonus and PSP, for 2017 and onwards the Committee proposes to cease making awards under the PSP for the reasons set out above. Instead, shareholder approval is being sought at the 2017 Annual General Meeting for the establishment of a new “Chemring Incentive Plan” (“CIP”), which will be the sole cash and share-based incentive arrangement operated for the executive directors and certain other members of the senior management team.

The main features of the CIP are set out in the policy section of this report and in the explanation to resolution 14 that is to be tabled at the 2017 Annual General Meeting. However, in summary:

- the CIP will replace both the current annual bonus plan and PSP for executive directors, thereby significantly simplifying our pay structure;
- the maximum award level under the CIP will be 250% of salary for the Group Chief Executive and 200% for the other executive directors (i.e. a reduction on the current combined incentive opportunity for the Group Chief Executive and other executive directors of 275% and 250% respectively);
- at the beginning of each financial year, a range of stretching annual targets will be set, the achievement of which will be measured at the end of the relevant year. For the 2017 performance year, the following targets and weightings will be used for the executive directors:
  - underlying EPS – 35%
  - net cash flow from operating activities – 30%
  - return on capital employed – 25%
  - personal/strategic objectives – 10%
- for CIP awards made to other members of the senior executive team with head office roles, the targets will be substantially the same as for the executive directors. For business unit heads, whose current annual bonus opportunity is primarily focused on their respective business’s performance, a substantial portion of their CIP award will be based on the same Group-based targets as the executive directors, thereby aligning their rewards with the performance of both their business and the Group;
- once the CIP outturn has been decided at the end of the year, 30% of any award to the executive directors will be paid in cash. The remaining 70% will be deferred into shares. Therefore, there will be no increase in cash annual incentive opportunity under the CIP;
- the deferred share element will vest in full three years later, albeit subject to a further two-year holding period, thereby ensuring that the shares are effectively “locked-in” to the CIP for a full five-year period;
- in addition, the deferred share element of the CIP award will be subject to a performance underpin measured over the three-year deferral period which, if not met, will result in the Remuneration Committee reducing the number of shares subject to the award (potentially down to zero). For the first operation of the CIP in 2017, the underpin will require that Chemring’s underlying EPS grows in real terms over the three-year deferral period; and
- this underpin will also operate in conjunction with Chemring’s existing malus and clawback provisions which can be applied in certain circumstances (e.g. misconduct, misstatement of accounts, error in calculating performance against the targets).

In addition to establishing the CIP, the Committee will increase the shareholding requirement for the executive directors from the current 100% of salary so that, going forward, executive directors will be expected to build up and maintain a shareholding equivalent to 200% of salary by retaining at least 50% of the net number of any shares vesting under the old PSP or the CIP until the guideline holding has been met.

We believe that the new CIP will deliver a number of significant benefits for shareholders, predominantly through ensuring remuneration helps focus management appropriately on the key tasks ahead, by:

- a far closer linkage between pay, Chemring’s underlying strategy, and meeting the Group’s current and future challenges;
- encouraging and rewarding the delivery of sustainable long-term returns to shareholders through the very significant five-year share deferral/holding period (together with the enhanced ownership guidelines);
- a greater alignment of our shareholders’ long-term interests with those of management via the more targeted use of equity coupled to a lower overall reward opportunity; and
- a simpler and more transparent approach to remuneration, which is consistent across the senior executive group.

No other substantive changes are proposed to the existing policy, which is set out in full in the next section of this report.

### Other Committee activities during the year

In addition to conducting the policy review, the Committee undertook a number of other activities in connection with remuneration during the year, details of which are set out on page 73. In addition, the Committee:

- agreed the remuneration-related elements of the termination of Steve Bowers’ employment (described more fully on page 80); and
- set the annual fees of Carl-Peter Forster upon his appointment as Chairman.

Also, following the year end, the Committee agreed the remuneration-related elements of the recruitment of Andrew Lewis as the new Group Finance Director (further details of which are provided in the report).

### Conclusion

I hope you find this report helpful and informative, and agree that the changes we are proposing to our policy, which have been the subject of an extensive prior consultation with some of our major shareholders, are appropriate and very much in the long-term interests of our shareholders. I look forward to receiving your support for the three remuneration-related resolutions (i.e. the vote on the new policy, new CIP and implementation report), which will be tabled at our forthcoming Annual General Meeting.

### Daniel Dayan

Chairman of the Remuneration Committee

## DIRECTORS' REMUNERATION REPORT

continued

### PART A - REMUNERATION POLICY

This report sets out the information required by Part 4 of Schedule 8 to the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended) (the "Regulations"). The report also satisfies the relevant requirements of the Listing Rules of the Financial Conduct Authority, and describes how the Board has applied the principles and complied with the provisions relating to directors' remuneration in the UK Corporate Governance Code.

Part A of this report represents the directors' remuneration policy. Part B constitutes the implementation sections of the report (the "Annual Report on Remuneration"). The auditors have reported on certain sections of Part B and stated whether, in their opinion, those parts have been properly prepared in accordance with the Companies Act 2006. Those sections of Part B which have been subject to audit are clearly indicated.

The Remuneration Committee has been established by the Board and is responsible for the remuneration of the executive directors and the Chairman. The Committee's terms of reference are available in full on the Company's website or from the Company Secretary on request.

In determining remuneration for the executive directors, the Remuneration Committee seeks to maintain a competitive package of rewards, required to promote the long-term success of the Company, without (i) being excessive by reference to market rates across comparator companies and (ii) neither encouraging nor rewarding inappropriate risk-taking. Performance-related elements should be transparent, stretching and rigorously applied, form a significant proportion of the total remuneration package of each executive director, and align the interests of executives with those of shareholders, by ensuring that a significant proportion of remuneration is performance-related and delivered in shares.

The table below summarises the Committee's future policy on the remuneration of executive directors which, if approved by shareholders at the forthcoming Annual General Meeting on 17 March 2017, will replace the existing policy for which shareholder approval was obtained at the 2016 Annual General Meeting, and will become binding immediately thereafter. The material differences between the existing and proposed new policy (which has also been designed with due account taken of the UK Corporate Governance Code) are explained in the statement by the Committee Chairman and in the table below. It is currently intended that the policy will remain valid until the 2020 Annual General Meeting.

Further details of the full policy are set out on pages 69 to 72.



| Element               | Purpose and link to strategy  | Operation  | Maximum  | Performance assessment   |
|-----------------------|---|--|--|--|
| <b>Salary</b>         | <ul style="list-style-type: none"> <li>Reflects the performance of the individual, their skills and experience over time, and the responsibilities of the role that assists with recruitment and retention</li> <li>Provides an appropriate level of basic fixed income, avoiding excessive risk arising from over-reliance on variable income</li> </ul> | <ul style="list-style-type: none"> <li>Normally reviewed annually with effect from 1 January</li> <li>Benchmarked periodically against companies with similar characteristics and companies within the same sector</li> <li>Salaries take account of complexity of the role, market competitiveness, Group performance and the increases awarded to the wider workforce</li> </ul> | <ul style="list-style-type: none"> <li>Salary increases will normally be in line with those received by the wider workforce</li> <li>More significant increases may be awarded at the discretion of the Committee, for example where there is a change in responsibilities, to reflect individual development and performance in the role. No significant increases are currently foreseen and, in any case, a cap of 10% per annum would apply to any increase</li> </ul>                 | <ul style="list-style-type: none"> <li>None, although overall individual and company performance is a factor considered when setting and reviewing salaries</li> </ul> |
| <b>Pension</b>        | <ul style="list-style-type: none"> <li>Provides retirement benefits that reward sustained contribution</li> </ul>   | <ul style="list-style-type: none"> <li>Ongoing pension provision is in the form of a cash supplement, subject to auto-enrolment in the Group's stakeholder scheme</li> <li>Longer-serving employees have accrued benefits under the Group's defined benefit scheme, which was closed to future accrual for the executive directors on 6 April 2010</li> </ul>                      | <ul style="list-style-type: none"> <li>20% of base salary cash supplement contribution paid in lieu of occupational pension scheme membership</li> <li>However, from 1 January 2014, all UK employees, including the executive directors, were subject to auto-enrolment into the Group's defined contribution stakeholder scheme, with an employer contribution of 4% of base salary. If executives do not opt out of this scheme, their cash supplement will be reduced by 4%</li> </ul> | <ul style="list-style-type: none"> <li>N/A</li> </ul>  |
| <b>Other benefits</b> | <ul style="list-style-type: none"> <li>Provides a competitive package of benefits that assists with recruitment and retention</li> </ul>  | <ul style="list-style-type: none"> <li>Main benefits currently provided to UK executives are a car allowance, life assurance, permanent health insurance and private medical insurance</li> <li>Executive directors are eligible for other benefits which may also be introduced for the wider workforce on broadly similar terms</li> </ul>                                       | <ul style="list-style-type: none"> <li>Cash allowance in lieu of company car of up to £25,000 per annum</li> <li>Other benefits will be in line with market. The value of each benefit is based on the cost to the Company and is not pre-determined. A cap of £30,000 per annum for each executive director applies to these other benefits</li> <li>Any reasonable business-related expenses (including tax thereon) can be reimbursed if determined to be a taxable benefit</li> </ul>  | <ul style="list-style-type: none"> <li>N/A</li> </ul>  |

## DIRECTORS' REMUNERATION REPORT

continued

| Element  | Purpose and link to strategy   | Operation  | Maximum   | Performance assessment   |
|--|--|--|---|--|
| <b>Incentive/performance-related pay (both annual and long-term incentive) provided under the Chemring Incentive Plan (as explained in the Chairman's letter on page 65)</b> | <ul style="list-style-type: none"> <li>• Incentivises annual delivery of predominantly financial (but also strategic and personal) goals that are set to support key strategic goals</li> <li>• Significant share deferral element with the ability to receive dividend equivalents helps align executives' rewards with shareholders' long-term interests</li> <li>• Maximum awards only payable for achieving demanding targets</li> </ul> | <ul style="list-style-type: none"> <li>• 30% paid in cash following the relevant year end</li> <li>• 70% deferred into shares which vest three years later subject to continued employment (save in "good leaver" scenarios) and satisfaction of a further performance underpin</li> <li>• Shares then subject to a further two-year post-vesting holding period</li> <li>• Non-pensionable</li> <li>• Executives are entitled to receive the value of dividend payments that would otherwise have been paid on the deferred shares during the vesting and holding period</li> <li>• Malus/clawback mechanisms can apply in the event of misconduct, error in calculation of performance, or a material misstatement of the Group's financial results</li> <li>• All awards are subject to the discretions given to the Committee in the plan rules</li> <li>• The CIP is a discretionary arrangement and the Committee retains a standard power to apply its judgement to adjust outcomes should it consider that to be appropriate, and/or to ensure that the outcome appropriately reflects underlying performance and/or shareholder experience</li> </ul> | <ul style="list-style-type: none"> <li>• Overall plan maximum of 250% of salary</li> <li>• Current intended maximum levels are: Group Chief Executive - 250% of salary, other executive directors - 200% of salary</li> </ul> | <ul style="list-style-type: none"> <li>• Size of cash/share award is based on performance against annual targets which are supportive of the achievement of the Group's longer-term goals</li> <li>• Mix of financial and personal/strategic targets can be used, although personal/strategic objectives will account for no more than 10% of each award and will also only be payable subject to the Committee's assessment of underlying business performance (e.g. levels of profitability and cash flow, health and safety performance etc.)</li> <li>• Vesting of the deferred share element is also subject to satisfaction of an additional underpin measured over the three-year vesting period</li> <li>• For each financial element, a lower performance threshold will be defined. Performance below the threshold will result in zero payment in respect of that element. A target level will be defined at which 50% of the relevant portion of the award is payable, and a stretching maximum level will be defined at which 100% will be paid in respect of that element</li> </ul> |
| <b>All-employee share schemes</b>  | <ul style="list-style-type: none"> <li>• All employees, including executive directors, are encouraged to acquire shares by participating in the Group's all-employee share plans - the UK Sharesave Plan and the US Stock Purchase Plan</li> </ul>   | <ul style="list-style-type: none"> <li>• The UK Sharesave Plan and US Stock Purchase Plans have standard terms</li> </ul>  | <ul style="list-style-type: none"> <li>• Participation limits are those set by the relevant tax authorities from time-to-time</li> </ul>  | <ul style="list-style-type: none"> <li>• N/A</li> </ul>  |

### Notes:

1. A description of how the Company intends to implement the policy set out in this table for the forthcoming year is set out in the annual report on remuneration on pages 73 to 84.
2. The remuneration policy for the executive directors and other senior executives is designed with regard to the policy for employees across the Group as a whole. However, there are some differences in the structure of the remuneration policy for senior executives. In general, these differences arise from the development of remuneration arrangements that are market-competitive for the various categories of individuals. They also reflect the fact that, in the case of the executive directors and other senior executives, a greater emphasis tends to be placed on performance-related pay in the market.
3. All-employee share plans do not have performance conditions. Executive directors are eligible to participate in the UK Sharesave Plan on the same terms as other employees.
4. As described on page 80, the Company operates share ownership guidelines requiring executive directors to acquire and hold a specified level of shareholding.
5. The Committee may make minor amendments to the policy set out above for regulatory, exchange control, tax or administrative purposes or to take account of a change in legislation, without obtaining shareholder approval for that amendment.
6. The Regulations and related investor guidance encourages companies to disclose a cap within which each element of the directors' remuneration policy will operate. Where maximum amounts for elements of remuneration have been set within the policy, these will operate simply as caps and are not indicative of any aspiration.
7. While the Committee does not consider it to form part of benefits in the normal usage of that term, it has been advised that corporate hospitality, whether paid for by the Company or another, and business travel for directors and in exceptional circumstances their families, may technically come within the applicable rules, and so the Committee expressly reserves the right for the Committee to authorise such activities within its agreed policies (and to discharge any related tax liability).

## Committee discretions

The Committee operates the Group's variable incentive plans according to their respective rules and in accordance with HMRC rules where relevant. To ensure the efficient administration of these plans, the Committee will apply certain operational discretions. These include the following:

- selecting the participants in the plans on an annual basis;
- determining the timing of grants of awards and/or payment;
- determining the quantum of awards and/or payments (within the limits set out in the policy table above);
- determining the extent of vesting based on the assessment of performance;
- making the appropriate adjustments required in certain circumstances (e.g. change of control, rights issues, corporate restructuring events and special dividends);
- determining "good leaver" status for incentive plan purposes and applying the appropriate treatment; and
- undertaking the annual review of weighting of performance measures, and setting targets from year to year.

In circumstances where the Committee believes that incentive targets are no longer appropriate (e.g. following a material acquisition or divestment), the Committee will have the ability to adjust appropriately the measures and/or targets and alter weightings, provided that the revised conditions or targets are not materially less difficult to satisfy (taking account of the relevant circumstances).

## Selection of performance metrics and targets

The performance-related elements of remuneration take into account the Group's risk policies and systems, and are designed to align the senior executives' interests with those of shareholders. The Committee reviews the metrics used and targets set for all of the Group's senior executives (not just the executive directors) every year, in order to ensure that they are aligned with the Group's strategy and to ensure an appropriate level of consistency of arrangements amongst the senior executive team. All financial targets will (where appropriate) be set on a sliding scale. Non-financial targets are set based on individual and management team responsibilities.

A summary of the targets to be used in 2017 under the CIP can be found on page 83. The Committee retains discretion to set different targets and introduce additional metrics in line with the Group's strategy for future awards providing that, in the opinion of the Committee, the new targets are no less challenging in light of the prevailing circumstances than those set previously. If substantially different targets to those used previously are proposed, major shareholders will be consulted.

## How employees' pay is taken into account

In addition to determining the remuneration arrangements for the executive directors, the Committee considers and approves the base salaries for thirteen other senior executives, and reviews salaries for the next tier of management at each of the Group's businesses. The Committee also receives information on general pay levels and policies across the Group. The Committee, therefore, has due regard to salary levels across the Group in applying its remuneration policy. However, reflecting standard industry practice, the Committee does not consult with employees in relation to the design and operation of the executive remuneration policy (although the Committee will continue to monitor developments in this area).

In addition, the Committee is cognisant of the requests from, amongst others, the Investment Association, for companies to publish ratios comparing Chief Executive to employee pay. The Company has prepared this analysis internally, and it has been reviewed and considered by the Committee. The Committee has not, however, published this data in this report as it is concerned that no common methodology has yet been established amongst UK companies and their investors for these comparisons; the Committee's expectation is that it will publish ratios showing comparisons in future years when, as can be expected, UK regulations or guidance develop a common methodology.

## How the executive directors' remuneration policy relates to the wider Group

The remuneration policy described above provides an overview of the structure that operates for the most senior executives in the Group. Lower aggregate incentive quanta are applied at below executive level, with levels driven by market comparatives and the impact of the role.

Employees are provided with a competitive package of benefits, which typically includes participation in the Group's defined contribution pension arrangements.

Participation in the CIP will be offered to the most senior executives and those identified as having the greatest potential to influence performance within the Group. However, in order to encourage wider employee share ownership, the Company also operates a Sharesave Plan in the UK and a Stock Purchase Plan in the US, in which all UK and US employees are eligible to participate on completion of six months' service.

## How shareholders' views are taken into account

The Remuneration Committee considers shareholder feedback received on the directors' remuneration report each year and guidance from shareholder representative bodies more generally. Shareholders' views are key inputs when shaping remuneration policy, with the Company's major shareholders being consulted in advance in connection with proposed changes to policy. Extensive consultation has been undertaken over the last few months with major shareholders and shareholder representative bodies on the proposed updated policy and the CIP.

# DIRECTORS' REMUNERATION REPORT

continued

## Legacy arrangements

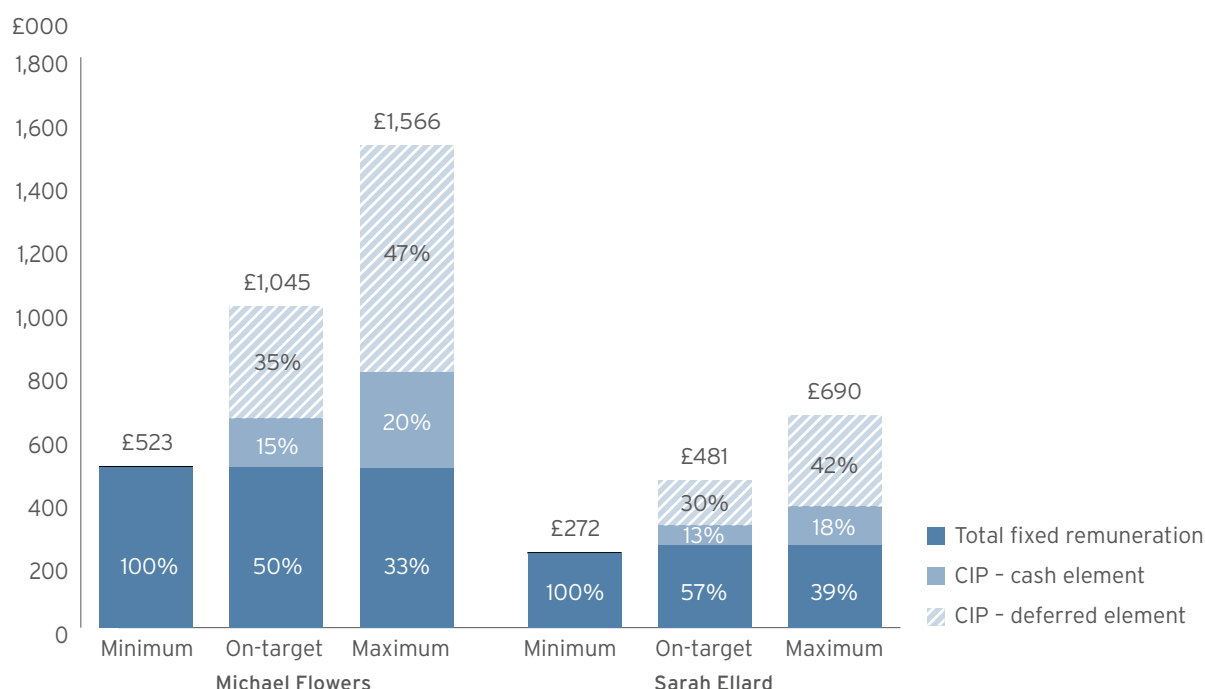
For the avoidance of doubt, by approval of the updated policy, authority will be given to the Company to honour any commitments entered into with current or former directors (such as the payment of a pension or the unwinding of legacy share schemes) permitted under the current policy or which have been disclosed to shareholders in previous directors' remuneration reports. Details of any payments to former directors will be set out in the annual report on remuneration as they arise.

## External appointments

The Company's policy is to permit an executive director to serve as a non-executive director elsewhere when this does not conflict with the individual's duties to the Company, and where an executive director takes such a role they may be entitled to retain any fees which they earn from that appointment.

## Potential remuneration scenarios for executive directors

The chart below details the hypothetical composition of each executive director's remuneration package and how it could vary at different levels of performance under the policy set out above. As a new joiner, Andrew Lewis has not been included in the chart below.



### Assumptions:

1. Minimum = fixed pay only (2017 salary plus benefits plus pension cash supplement).  
On target = fixed pay plus target CIP outturn (assumed as 50% of maximum for the purposes of these charts i.e. 125% of salary for the Group Chief Executive and 100% of salary for the other executive directors).  
Maximum = fixed pay plus maximum CIP outturn of 250% of salary for the Group Chief Executive and 200% for the other executive directors.
2. Any CIP outturn is shown as 30% payable in cash immediately following the year end and 70% payable in deferred shares that vest three years later (subject to the performance underpin and a further two-year holding period).
3. As required by the Regulations, no account is taken of the impact that future share price growth might have on the value of remuneration delivered in shares.
4. Salary levels (on which other elements of the packages are calculated) are based on those applying from 1 January 2017. Note that Sarah Ellard's remuneration reflects her current contractual office-based hours, and may be increased or decreased pro-rata should these change in future.
5. The value of taxable benefits is based on an estimated cost of £23,000 for Michael Flowers and £21,000 for Sarah Ellard.
6. Pension provision is 20% of salary for each director.
7. The executive directors may participate in all-employee share schemes on the same basis as other employees. The value that may be received under these schemes is subject to tax-approved limits. For simplicity, the value that may be received from participating in these schemes has been excluded from the above chart.

## Policy on payments for loss of office

All new executive directors appointed will have service contracts which are terminable on a maximum of twelve months' notice. Provisions permitting the Company to make any termination payments by instalments, and requiring directors to mitigate their loss in such circumstances, will be included in each contract. The Remuneration Committee will exercise discretion in determining whether termination payments should be paid by instalments, taking account of the reason for the departure of the director and their prior performance. Other than in gross misconduct situations, the Company would expect to honour the contractual entitlements of terminated directors.

Under the CIP, the following treatment applies on cessation:

- **Year of cessation** – other than in certain “good leaver” circumstances (including, but not limited to, redundancy or ill-health), the right to receive any outturn under the CIP lapses unless the individual remains employed and is not under notice at the award date (i.e. the date following the relevant year end when performance against the targets is assessed). Any CIP outturn paid to a “good leaver” would be based on an assessment of their individual and the Company’s performance over the year, and would normally be pro-rated for the proportion of the year worked. The extent to which any CIP outturn is paid in cash and deferred shares (and the terms of any such deferral) will be determined by the Committee.
- **Past CIP awards** – other than in “good leaver” circumstances during the three-year vesting period, any unvested deferred shares previously granted under the CIP lapse on cessation. For good leavers during this period, awards will vest either on cessation or on the normal vesting date, subject to the Committee’s assessment of performance against the underpin and may be subject to a pro-rata reduction at the discretion of the Committee. Any CIP shares/awards subject to a post-vesting holding period on any cessation will continue to be subject to the holding period (unless the Committee determines otherwise).

If there is a change of control of the Company, unvested deferred share awards granted under the CIP will vest subject to a pro-rata reduction and the Committee’s assessment of performance against the underpin, in both cases unless the Committee determines otherwise. The Committee will determine the treatment of rights to receive any outturn under the CIP relating to the year in which the change of control occurs, having regard to individual and/or Company performance over the relevant portion of the year and the portion of the year that had elapsed up to the change of control. Any shares vesting as the result of a change of control of the Company will not be subject to a post-vesting holding period.

With regards to the PSP (under which it is not currently intended that further grants will be made), the rules provide that other than in certain “good leaver” circumstances, awards lapse on cessation of employment. Where an individual is a “good leaver”, the Committee’s policy for the PSP awards made from 2014 onwards is normally to permit awards to remain outstanding until the end of the original performance period, when a pro-rata reduction will be made to take account of the proportion of the vesting period that lapsed prior to termination of employment, although the Committee has discretion to partly or completely disapply pro-rating in exceptional circumstances. The Committee has discretion to deem an individual to be a “good leaver”. In doing so, it will take account of the reason for their departure and the performance of the individual.

The treatment of leavers under the Sharesave Plan and the Stock Purchase Plan will follow the normal approach as set out in the relevant rules.

The Committee will have authority to enter into settlement agreements, pay any statutory entitlements and settle potential claims against the Company (e.g. for unfair dismissal, discrimination or whistleblowing) that arise on termination. The Committee may also authorise the provision of outplacement services and settle legal fees where considered appropriate.

## Executive directors’ service agreements and loss of office payments

The executive directors who served during the year have, or had, rolling service contracts, details of which are summarised in the table below:

| Provision                   | Detailed terms  |
|-----------------------------|---|
| <b>Contract dates</b>       | Michael Flowers – 23 June 2014 (effective 24 June 2014)<br>Steve Bowers (resigned 30 September 2016) – 2 January 2013 (effective 7 January 2013)<br>Sarah Ellard – 2 November 2011 (effective 7 October 2011)   |
| <b>Notice period</b>        | Twelve months from both the Company and from the executive  |
| <b>Termination payments</b> | Contracts may be terminated without notice by the payment of a sum equal to the sum of salary due for the unexpired notice period plus the fair value of any contractual benefits (including pension)<br>Payments may be made in instalments and in these circumstances there is a requirement to mitigate loss |

Andrew Lewis’ service contract, which was executed on 12 December 2016 and became effective on 9 January 2017, has the same terms as those which apply to the other executive directors.

The Company’s policy on service agreements reflects the approach described above (e.g. notice periods will normally be twelve months or less).

The executive directors’ service contracts are available for inspection at the Company’s registered office.

## Recruitment of executive directors

Salaries for new hires (including internal promotions) will be set to reflect their skills and experience, the Company’s intended pay positioning, and the market rate for the applicable role. Consistent with the Regulations, any caps contained within the policy for fixed pay do not apply to new recruits, although the Committee would not envisage exceeding these caps in practice.

Where it is appropriate to offer a below-market salary initially, the Committee will have the discretion to allow phased salary increases over a period of time for newly-appointed directors, even though this may involve increases in excess of the rate for the wider workforce and inflation.

Benefits will (where appropriate) be provided in line with those offered to other executive directors, taking account of local market practice, with relocation expenses or arrangements provided if necessary. Tax equalisation may also be considered if an executive is adversely affected by taxation due to their employment with the Company. Legal fees and other costs incurred by the individual may also be paid by the Company.

The aggregate incentive opportunity offered to new recruits will normally be no higher than that offered under the existing incentive plans to the incumbent executive directors. Different performance measures and targets may be set initially, taking into account the responsibilities of the individual and their date of joining. Any incentive quantum offered above the limits set out in the existing incentive plans and policy will (save as set out below) be contingent on the Company receiving shareholder approval for an amendment to its approved policy at its next general meeting.

## DIRECTORS' REMUNERATION REPORT

### continued

Current entitlements of a new joiner from their previous employer (e.g. benefits, bonus and share schemes) may be bought out on terms that take due account of the nature of the entitlements in terms of (for example) time horizon, fair value and performance conditions. The Group's existing incentive arrangements will be used to the extent possible, although awards may also be granted outside of these arrangements if necessary, and as permitted under the Listing Rules, reflecting the above parameters. Such awards will not, in accordance with the Regulations, be subject to the limits of the remuneration policy for incentive pay.

In the case of an internal hire, any outstanding variable pay awarded in relation to the previous role will be allowed to pay out according to its terms of grant (adjusted as relevant to take into account the Board appointment).

### Policy for non-executive directors

| Element   | Purpose and link to strategy   | Operation   | Maximum | Performance assessment |
|---|--|---|---------|------------------------|
| <b>Non-executive directors' and Chairman's fees</b> | Takes account of recognised practice and set at a level that is sufficient to attract and retain high-calibre non-executives | <ul style="list-style-type: none"> <li>The Chairman is paid a single fee for all his responsibilities. The non-executives are paid a basic fee. The Chairs of the Remuneration Committee and the Audit Committee each receive additional fees to reflect their extra responsibilities. This approach may also be extended to the Senior Independent Director</li> <li>When reviewing fee levels, account is taken of market movements in non-executive director fees, Board committee responsibilities, ongoing time commitments, the general economic environment and the level of increases awarded to the wider workforce</li> <li>Fee increases, if applicable, are normally effective from April of each year</li> <li>Non-executive directors do not participate in any pension, bonus or share incentive plans</li> <li>Non-executive directors may be compensated for travel, accommodation or hospitality-related expenses in connection with their roles and the tax thereon</li> <li>In exceptional circumstances, additional fees may be paid where there is a substantial increase in the time commitment required of non-executive directors</li> </ul> | N/A     | N/A                    |

### Non-executive directors' letters of appointment

Non-executive directors do not receive compensation for loss of office but are appointed for a fixed term of three years, renewable for further three-year terms if both parties agree and subject to annual re-election by shareholders. The Chairman's appointment may be terminated on six months' notice by either party and the other non-executive directors' appointments may be terminated on three months' notice by either party. The non-executive directors' letters of appointment are available for inspection at the Company's registered office.

The following table provides further details of the terms of appointment for the non-executive directors who served during the year:

| Name               | Date original term commenced | Date current term commenced | Expected expiry date of current term |
|--------------------|------------------------------|-----------------------------|--------------------------------------|
| Carl-Peter Forster | 1 May 2016                   | 1 May 2016                  | 30 April 2019                        |
| Andrew Davies      | 17 May 2016                  | 17 May 2016                 | 16 May 2019                          |
| Daniel Dayan       | 7 March 2016                 | 7 March 2016                | 6 March 2019                         |
| Nigel Young        | 1 May 2013                   | 1 May 2016                  | 30 April 2019                        |
| Peter Hickson*     | 1 July 2010                  | 1 July 2013                 | N/A                                  |
| Andy Hamment*      | 1 July 2013                  | 1 July 2013                 | N/A                                  |
| Ian Much*          | 1 December 2004              | 1 December 2013             | N/A                                  |

\* Messrs Hickson, Hamment and Much all stepped down from the Board during the year.

## PART B - ANNUAL REPORT ON REMUNERATION

This part of the report has been prepared in accordance with Part 3 of Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended), and 9.8.6R of the Listing Rules. The annual report on remuneration will be put to an advisory shareholder vote at the 2017 Annual General Meeting. The information on pages 74 to 84 has been audited.

### The Remuneration Committee and its advisers

#### Members of the Remuneration Committee

The following individuals were members of the Remuneration Committee during the year:

| Name                       | From            | To            |
|----------------------------|-----------------|---------------|
| Daniel Dayan (Chairman)    | 7 March 2016    | Present       |
| Carl-Peter Forster         | 1 May 2016      | Present       |
| Andrew Davies              | 17 May 2016     | Present       |
| Nigel Young                | 1 May 2013      | Present       |
| Ian Much (former Chairman) | 1 December 2004 | 21 March 2016 |
| Andy Hamment               | 1 July 2013     | 30 April 2016 |
| Peter Hickson              | 1 July 2010     | 30 June 2016  |

The Group Legal Director & Company Secretary acts as secretary to the Committee, and the Group Chief Executive and the Group Finance Director attend meetings by invitation, but no executive director or other employee is present during discussions relating directly to their own remuneration.

#### Meetings

The Remuneration Committee met for three scheduled meetings during the year. In addition, four additional ad hoc meetings were convened to deal with matters arising between scheduled meetings. Details of the attendance of the Committee members at scheduled meetings are set out on page 55 of the corporate governance report.

#### Principal activities of the Remuneration Committee during the year

|                       |  |
|-----------------------|--|
| <b>November 2015</b>  | <ul style="list-style-type: none"> <li>Review of current market practice on executive remuneration arrangements</li> <li>Consideration of structure of new Performance Share Plan</li> </ul>   |
| <b>December 2015</b>  | <ul style="list-style-type: none"> <li>Approval of financial targets and personal objectives for the 2016 bonus plan</li> <li>Consideration of salary levels for the executive directors and the senior management team</li> </ul>           |
| <b>January 2016</b>   | <ul style="list-style-type: none"> <li>Consideration of bonus outturn for the 2015 financial year</li> <li>Grant of 2016 awards under the Performance Share Plan</li> <li>Approval of the directors' remuneration report for 2015</li> </ul> |
| <b>March 2016</b>     | <ul style="list-style-type: none"> <li>Approval of changes to the pension arrangements for UK "high earner" employees to reflect revised taxation of UK pensions</li> </ul>  |
| <b>April 2016</b>     | <ul style="list-style-type: none"> <li>Approval of remuneration package for new Chairman</li> <li>Approval of adjustments to outstanding share awards to reflect the recently-completed rights issue</li> </ul>                              |
| <b>September 2016</b> | <ul style="list-style-type: none"> <li>Review of remuneration policy</li> <li>Initial consideration of structure of new incentive plan</li> </ul>  |
| <b>October 2016</b>   | <ul style="list-style-type: none"> <li>Initial consideration of remuneration package for potential new Group Finance Director</li> </ul>   |

#### Advisers

At the start of the year, New Bridge Street (an Aon Hewitt company, part of Aon plc) were the Committee's retained advisers for remuneration and incentive plan related matters, and the setting of remuneration for new appointments. New Bridge Street had been appointed by the Committee and was a signatory to the Remuneration Consultants' Group Code of Conduct, which sets out guidelines to ensure that its advice is independent and free from undue influence. The Company received no other services from New Bridge Street during the year. However, the Group's UK flexible benefits scheme is administered by Aon Consulting (Benefits) Limited, part of Aon plc. The fees paid to New Bridge Street in 2016 were £47,300.

During the year, FIT Remuneration Consultants LLP ("FIT") was appointed by the Committee as its retained adviser in place of New Bridge Street. FIT is also a signatory to the Remuneration Consultants' Group Code of Conduct. The Committee has reviewed the nature of the services provided by FIT and is satisfied that no conflict of interest exists in the provision of these services. The Company received no other services from FIT during the year. The total fees paid to FIT in respect of services to the Committee during the year were £25,792. Fees were determined based on the scope and nature of the projects undertaken for the Committee.

The Committee reviews the performance and independence of its advisers on an annual basis.

The Committee consults internally with the Group Chief Executive (Michael Flowers) and the Group Legal Director & Company Secretary (Sarah Ellard).



## DIRECTORS' REMUNERATION REPORT

continued

### Directors' emoluments

The emoluments of all the directors who served during the year are shown below:

| Name                            | Year        | Salaries/<br>fee<br>£'000 | Taxable<br>benefits <sup>1</sup><br>£'000 | Bonus<br>(cash and<br>deferred<br>shares) <sup>2</sup><br>£'000 | PSP<br>£'000 | Pension<br>benefits <sup>3</sup><br>£'000 | Total<br>£'000 |
|---------------------------------|-------------|---------------------------|---|---|--------------|---|----------------|
| <b>Executives</b>               |             |                           |   |   |              |   |                |
| Michael Flowers                 | <b>2016</b> | <b>406</b>                | <b>21</b>                                 | <b>347</b>  | –            | <b>81</b>                                 | <b>855</b>     |
|                                 | 2015        | 405                       | 21  | –   | –            | 81  | 507            |
| Steve Bowers <sup>4</sup>       | <b>2016</b> | <b>283</b>                | <b>17</b>                                 | –   | –            | <b>57</b>                                 | <b>357</b>     |
|                                 | 2015        | 308                       | 18  | –   | –            | 61  | 387            |
| Sarah Ellard                    | <b>2016</b> | <b>204</b>                | <b>23</b>                                 | <b>141</b>  | –            | <b>41</b>                                 | <b>409</b>     |
|                                 | 2015        | 219                       | 19  | –   | –            | 44  | 282            |
| <b>Non-executives</b>           |             |                           |   |   |              |   |                |
| Carl-Peter Forster <sup>5</sup> | <b>2016</b> | <b>100</b>                | –   | –   | –            | –   | <b>100</b>     |
|                                 | 2015        | –                         | –   | –   | –            | –   | –              |
| Andrew Davies <sup>6</sup>      | <b>2016</b> | <b>25</b>                 | –   | –   | –            | –   | <b>25</b>      |
|                                 | 2015        | –                         | –   | –   | –            | –   | –              |
| Daniel Dayan <sup>7</sup>       | <b>2016</b> | <b>43</b>                 | –   | –   | –            | –   | <b>43</b>      |
|                                 | 2015        | –                         | –   | –   | –            | –   | –              |
| Nigel Young <sup>8</sup>        | <b>2016</b> | <b>63</b>                 | –   | –   | –            | –   | <b>63</b>      |
|                                 | 2015        | 63                        | –   | –   | –            | –   | 63             |
| Andy Hamment <sup>9</sup>       | <b>2016</b> | <b>27</b>                 | –   | –   | –            | –   | <b>27</b>      |
|                                 | 2015        | 55                        | –   | –   | –            | –   | 55             |
| Peter Hickson <sup>10</sup>     | <b>2016</b> | <b>125</b>                | <b>1</b>                                  | –   | –            | –   | <b>126</b>     |
|                                 | 2015        | 187                       | 2   | –   | –            | –   | 189            |
| Ian Much <sup>11</sup>          | <b>2016</b> | <b>25</b>                 | –   | –   | –            | –   | <b>25</b>      |
|                                 | 2015        | 63                        | –   | –   | –            | –   | 63             |
| <b>Total remuneration</b>       | <b>2016</b> | <b>1,301</b>              | <b>62</b>                                 | <b>488</b>  | –            | <b>179</b>                                | <b>2,030</b>   |
|                                 | 2015        | 1,300                     | 60  | –   | –            | 186                                       | 1,546          |

#### Notes:

1. Comprises a fully-expensed company car for Sarah Ellard (annual lease cost £10,186) up to 19 August 2016 and cash allowance of £19,350 per annum thereafter; car-related cash allowance of £20,000 per annum up to 31 May 2016 and £21,500 per annum thereafter for Michael Flowers; and car-related cash allowance of £18,000 per annum up to 31 May 2016 and £19,350 per annum thereafter for Steve Bowers; plus private medical insurance for each of the executive directors.
2. 40% of any bonus is delivered as an award of deferred shares. Bonuses had accrued but had not yet been paid at the date of this report.
3. The executive directors receive a cash supplement of 20% of salary in lieu of occupational pension scheme membership.
4. Steve Bowers left the Board on 30 September 2016. Details of his termination arrangements can be found on page 80.
5. Carl-Peter Forster joined the Board on 1 May 2016.
6. Andrew Davies joined the Board on 17 May 2016.
7. Daniel Dayan joined the Board on 7 March 2016. Daniel received additional fees of £5,833 included in the above figures, in relation to his part year Chairmanship of the Remuneration Committee.
8. Nigel Young receives an additional fee of £10,000 per annum, in respect of his Chairmanship of the Audit Committee. This fee was increased from £8,000 to £10,000 with effect from 7 March 2016 (to coincide with the appointment of a new Remuneration Committee Chairman); however, the increase was not paid until after the year end. The above figures reflect the previous fee of £8,000 per annum.
9. Andy Hamment left the Board on 30 April 2016.
10. Peter Hickson left the Board on 30 June 2016.
11. Ian Much left the Board on 21 March 2016. Ian received additional fees of £3,127 included in the above figures, in relation to his part year Chairmanship of the Remuneration Committee.

Amounts shown above in the salaries and fees column relate to base salary in the case of executive directors and fees in the case of non-executive directors.

## Base salary and benefits paid during the year

The executive directors' salaries were reviewed in December 2015 but no increases were approved, as a result of the performance of the Company during 2015. The salaries of the executive directors during the year were therefore as follows:

| Executive                       | Salary during the year ended<br>31 October 2016 |
|---------------------------------|---|
| <b>Michael Flowers</b>          | <b>£406,000</b>                                 |
| <b>Steve Bowers</b>             | <b>£309,000</b>                                 |
| <b>Sarah Ellard<sup>1</sup></b> | <b>£203,539</b>                                 |

### Note:

1. Sarah Ellard's salary was reduced from £222,995 to £203,539 with effect from 7 September 2015, to reflect a reduction in her contractual office-based working hours.

The Company introduced cash allowances in lieu of company cars in 2013. The allowances are reviewed every three years and inflationary increases applied as appropriate. Allowances were reviewed with effect from 1 June 2016 and a 7.5% increase was approved by the Committee. Consequently, the cash allowance paid to the Group Chief Executive was increased from £20,000 to £21,500 per annum and from £18,000 to £19,350 per annum for the other executive directors. The cash allowances will next be reviewed in 2019.

## Details of variable pay opportunity in the year

### Annual bonus

As reported last year, 75% of the 2016 bonus opportunity was based on financial targets (namely operating profit and cash flow), with 25% based on personal objectives. No bonus is payable in respect of the personal objectives unless the Committee is satisfied that this is justified by the Group's underlying performance, including *inter alia* levels of profitability and cash flow.

The Committee has consistently set highly-challenging targets for the achievement of maximum bonuses. The financial targets for the 2016 bonus plan, compared with actual performance, were as follows:

| Metric                     | Weighting<br>(75% of overall<br>bonus) | Performance | Target | Actual | Payout<br>(as % of salary) |              |
|----------------------------|--|-------------|--------|--------|----------------------------|--------------|
|                            |  |             |        |        | Michael Flowers            | Sarah Ellard |
| <b>Operating profit</b>    | 50%                                    | Threshold   | £45.9m | £48.5m | 11.9%                      | 9.6%         |
|                            |  | Target 1    | £51.0m |        |                            |              |
|                            |  | Target 2    | £53.2m |        |                            |              |
|                            |  | Maximum     | £54.7m |        |                            |              |
| <b>Operating cash flow</b> | 50%                                    | Threshold   | £52.3m | £77.6m | 46.9%                      | 37.5%        |
|                            |  | Target 1    | £58.1m |        |                            |              |
|                            |  | Target 2    | £60.6m |        |                            |              |
|                            |  | Maximum     | £62.3m |        |                            |              |

The personal objectives set in respect of the 2016 bonus plan (25% of overall bonus) are set out below:

| Executive              | Personal objectives                          | Key aspects of performance against individual objectives   | Payout<br>(as % salary) |
|------------------------|--|--|-------------------------|
| <b>Michael Flowers</b> | • <i>Health and safety</i>                   | • Expansion of scope of internal audit programme<br>• Development of mitigation plan for hazardous exposures<br>• Achieved a lost time incident rate of less than 0.75 | 26.6%                   |
|                        | • <i>Financing</i>                           | • Completed rights issue   |                         |
|                        | • <i>Strategy development</i>                | • Development of updated strategy and organisation for business segments and Group   |                         |
|                        | • <i>Operational performance improvement</i> | • Reduction in inventory values to less than 20% of annual revenue   |                         |
|                        | • <i>Business development</i>                | • Established Group-wide customer relationship management system<br>• Secured three workstreams on US Next Generation Chemical Detection programme                     |                         |
|                        | • <i>Kilgore improvement programme</i>       | • Improved health and safety performance<br>• Introduced new incident investigation procedure  |                         |
|                        | • <i>Governance and compliance</i>           | • Enhanced anti-bribery compliance programme   |                         |

## DIRECTORS' REMUNERATION REPORT

continued

| Executive           | Personal objectives                   | Key aspects of performance against individual objectives                                  | Payout (as % salary) |
|---------------------|---------------------------------------|---|----------------------|
| <b>Steve Bowers</b> | • <i>Financing</i>                    | • Completed rights issue<br>• Development of Group financing strategy                     | 0%                   |
|                     | • <i>Working capital</i>              | • Reduction in inventory values to less than 20% of annual revenue                        |                      |
|                     | • <i>Internal audit</i>               | • Enhanced scope of US internal audit programme   |                      |
|                     | • <i>Finance organisation</i>         | • Strengthened global finance functions   |                      |
| <b>Sarah Ellard</b> | • <i>Financing</i>                    | • Completed rights issue  | 22.5%                |
|                     | • <i>Governance and compliance</i>    | • Enhanced anti-bribery compliance programme<br>• Implemented new Board Governance Manual |                      |
|                     | • <i>Acquisitions and divestments</i> | • Completed acquisition and integration of Wallop Defence Systems' countermeasures assets |                      |
|                     | • <i>Group property portfolio</i>     | • Relocated London office facility  |                      |
|                     | • <i>Litigation and claims</i>        | • Achieved settlement of Kilgore insurance claim<br>• Resolved legacy litigation matters  |                      |

Based on the above performance, bonuses are payable to the executive directors under the 2016 bonus plan as follows:

| Executive              | Maximum bonus (% of salary) | Bonus paid in respect of financial targets (% of salary) | Bonus paid in respect of personal objectives (% of salary) | Total bonus payment <sup>1</sup> |
|------------------------|-----------------------------|--|--|----------------------------------|
| <b>Michael Flowers</b> | 125                         | 58.8   | 26.6   | £346,724                         |
| <b>Sarah Ellard</b>    | 100                         | 47.1   | 22.5   | £141,663                         |

**Note:**

1. 40% of bonuses payable are satisfied by way of an award of deferred shares, vesting of which is subject only to continued service.

No bonus is payable to Steve Bowers for 2016.

### Performance Share Plan

#### Vesting of 2014 PSP awards

The PSP awards granted on 28 April 2014 and 8 July 2014 were made subject to the following performance conditions:

| Measure   | Threshold vesting          | Full vesting                        |
|---|----------------------------|-------------------------------------|
| Total compound earnings per share growth per annum over three financial years (50% of award)  | 5% p.a. (25% vests)        | 10% p.a. (100% vests)               |
| Rank of the Company's total shareholder return against the total shareholder return of the members of the comparator group (50% of award) | Median ranking (25% vests) | Upper quartile ranking (100% vests) |

Based on the above, all these PSP awards will lapse.

Details of the awards granted to the executive directors on these dates are provided below:

| Executive                       | Vesting date  | Number of shares at grant | Rights issue adjustment during year | Number of shares to vest | Number of shares to lapse | Value of dividends |
|---------------------------------|---------------|---------------------------|-------------------------------------|--------------------------|---------------------------|--------------------|
| <b>Michael Flowers</b>          | 28 April 2017 | 94,827                    | 13,429                              | Nil                      | 108,256                   | Nil                |
|                                 | 8 July 2017   | 186,046                   | 26,348                              | Nil                      | 212,394                   | Nil                |
| <b>Steve Bowers<sup>1</sup></b> | 28 April 2017 | 193,965                   | 27,469                              | Nil                      | 221,434                   | Nil                |
| <b>Sarah Ellard</b>             | 28 April 2017 | 139,978                   | 19,824                              | Nil                      | 159,802                   | Nil                |

**Note:**

1. Awards made to Steve Bowers lapsed on cessation of his employment on 30 September 2016.

## PSP awards granted in the year

The following conditional awards of shares were granted to the executive directors under the PSP during the year:

| Executive                       | Date of grant   | Value of award | Closing share price on date of grant <sup>1</sup> | Number of conditional shares awarded | Rights issue adjustment during year | Total number of shares post rights issue adjustment | Face value | % that vests at threshold | Vesting determined by  |
|---------------------------------|-----------------|----------------|---|--------------------------------------|-------------------------------------|---|------------|---------------------------|--|
| <b>Michael Flowers</b>          | 25 January 2016 | 150% of salary | 138.4p  | 388,516                              | 55,022                              | 443,538   | £537,706   | 25%                       | EPS growth (50%) and relative TSR performance (50%), as detailed below |
| <b>Steve Bowers<sup>2</sup></b> | 25 January 2016 | 150% of salary | 138.4p  | 295,693                              | 41,876                              | 337,569   | £409,239   | 25%                       |  |
| <b>Sarah Ellard</b>             | 25 January 2016 | 150% of salary | 138.4p  | 194,774                              | 27,584                              | 222,358   | £269,567   | 25%                       |  |

### Notes:

1. Pre rights issue grant share price.
2. Awards made to Steve Bowers lapsed on cessation of his employment on 30 September 2016.

Award levels were calculated based on the closing share price on the trading day immediately preceding the date of grant. The face value of each award shown above is based on the closing share price on the date of grant.

The performance conditions applying to the awards made in 2016 are based as to one half of each award on the Company's compound EPS growth over three financial years, and as to the other half of each award on the Company's TSR performance over the same three-year performance period.

The EPS performance condition will be measured as follows:

| Total compound earnings per share growth over the three-year performance period | % of earnings per share part that may vest    |
|---|---|
| Less than 5% p.a.   | 0%  |
| 5% p.a.   | 25%   |
| Between 5% p.a. and 10% p.a.  | On a straight-line basis between 25% and 100% |
| 10% p.a. or more  | 100%  |

### Note:

1. Earnings per share is calculated on a fully-diluted and normalised basis, as specified by the Committee prior to grant.

The TSR performance condition will be measured as follows:

| Rank of the Company's total shareholder return against the total shareholder return of the members of the comparator group | % of total shareholder return part that may vest |
|--|--|
| Below median   | 0%   |
| Median   | 25%  |
| Between median and upper quartile  | On a straight-line basis between 25% and 100%    |
| Upper quartile or above  | 100%   |

The comparator group for the 2016 awards comprises BAE Systems, Cobham, Cohort, Esterline Technologies, FLIR Systems, L3 Communications, Leonardo Finmeccanica, Orbital ATK, QinetiQ Group, Raytheon, Rheinmetall, Rockwell Collins, and Ultra Electronics.

## DIRECTORS' REMUNERATION REPORT

continued

### Performance conditions for outstanding awards

|   | Measure   | Director   | Awards to executive directors | Threshold vesting          | Full vesting                        |
|---|---|--|-------------------------------|----------------------------|-------------------------------------|
| <b>Awards made on 28 April 2014, 8 July 2014, 26 January 2015 and 25 January 2016</b> | Total compound earnings per share growth per annum over three financial years (50% of award) <sup>1</sup>                                 | Michael Flowers<br>Steve Bowers <sup>2</sup><br>Sarah Ellard | 150% of salary                | 5% p.a. (25% vests)        | 10% p.a. (100% vests)               |
|   | Rank of the Company's total shareholder return against the total shareholder return of the members of the comparator group (50% of award) |  |                               | Median ranking (25% vests) | Upper quartile ranking (100% vests) |

**Notes:**

1. Earnings per share is calculated on a fully-diluted and normalised basis, as specified by the Committee prior to grant.
2. Awards made to Steve Bowers lapsed on cessation of his employment on 30 September 2016.

### Summary of outstanding PSP awards

| Executive                       | Number of shares under award |   |                         |                        |                        |                    | Date of vesting | Closing share price on date of grant (p) <sup>3</sup> |
|---------------------------------|------------------------------|---|-------------------------|------------------------|------------------------|--------------------|-----------------|---|
|                                 | At 1 November 2015           | Rights issue adjustment during the year | Awarded during the year | Lapsed during the year | Vested during the year | At 31 October 2016 |                 |   |
| <b>Michael Flowers</b>          | 79,7961                      | 11,300                                  | –                       | (91,096)               | –                      | –                  | –               | 282.0   |
|                                 | 94,8272                      | 13,429                                  | –                       | –                      | –                      | 108,256            | 28 April 2017   | 229.0   |
|                                 | 186,0462                     | 26,348                                  | –                       | –                      | –                      | 212,394            | 8 July 2017     | 199.0   |
|                                 | 261,935                      | 37,096                                  | –                       | –                      | –                      | 299,031            | 26 January 2018 | 230.5   |
|                                 | –                            | 55,022                                  | 388,516                 | –                      | –                      | 443,538            | 25 January 2019 | 138.4   |
|                                 | <b>622,604</b>               | <b>143,195</b>                          | <b>388,516</b>          | <b>(91,096)</b>        | –                      | <b>1,063,219</b>   |                 |   |
| <b>Steve Bowers<sup>4</sup></b> | 149,564                      | –                                       | –                       | (149,564)              | –                      | –                  | –               | 283.6   |
|                                 | 193,965                      | 27,469                                  | –                       | (221,434)              | –                      | –                  | –               | 229.0   |
|                                 | 199,354                      | 28,233                                  | –                       | (227,587)              | –                      | –                  | –               | 230.5   |
|                                 | –                            | 41,876                                  | 295,693                 | (337,569)              | –                      | –                  | –               | 138.4   |
|                                 | <b>542,883</b>               | <b>97,578</b>                           | <b>295,693</b>          | <b>(936,154)</b>       | –                      | –                  |                 |   |
| <b>Sarah Ellard</b>             | 114,2131                     | –                                       | –                       | (114,213)              | –                      | –                  | –               | 283.6   |
|                                 | 139,9782                     | 19,824                                  | –                       | –                      | –                      | 159,802            | 28 April 2017   | 229.0   |
|                                 | 143,867                      | 20,374                                  | –                       | –                      | –                      | 164,241            | 26 January 2018 | 230.5   |
|                                 | –                            | 27,584                                  | 194,774                 | –                      | –                      | 222,358            | 25 January 2019 | 138.4   |
|                                 | <b>398,058</b>               | <b>67,782</b>                           | <b>194,774</b>          | <b>(114,213)</b>       | –                      | <b>546,401</b>     |                 |   |

**Notes:**

1. Awards lapsed due to the performance conditions not being met.
2. As explained above, these awards will lapse due to the performance conditions not being met.
3. Pre rights issue grant share price.
4. All of Steve Bowers' awards lapsed upon cessation of his employment on 30 September 2016.

## Sharesave awards

### Summary of outstanding Sharesave awards

| Executive                       | Number of shares under option |                         |   |                        |                           |                    | Original exercise price | Adjusted post rights issue exercise price | Exercise date                  |
|---------------------------------|-------------------------------|-------------------------|---|------------------------|---------------------------|--------------------|-------------------------|---|--------------------------------|
|                                 | At 1 November 2015            | Awarded during the year | Rights issue adjustment during the year | Lapsed during the year | Exercised during the year | At 31 October 2016 |                         |   |                                |
| <b>Michael Flowers</b>          | 11,042                        | –                       | 1,563                                   | (12,605)               | –                         | –                  | 163p                    | 142p                                      | –                              |
|                                 | –                             | 17,142                  | –                                       | –                      | –                         | 17,142             | 105p                    | –   | 1 October 2019 – 31 March 2020 |
|                                 | <b>11,042</b>                 | <b>17,142</b>           | <b>1,563</b>                            | <b>(12,605)</b>        | <b>–</b>                  | <b>17,142</b>      |                         |   |                                |
| <b>Steve Bowers<sup>1</sup></b> | 6,276                         | –                       | 888                                     | (7,164)                | –                         | –                  | 239p                    | 209p                                      | –                              |
|                                 | 9,202                         | –                       | 1,303                                   | (10,505)               | –                         | –                  | 163p                    | 142p                                      | –                              |
|                                 | <b>15,478</b>                 | <b>–</b>                | <b>2,191</b>                            | <b>(17,669)</b>        | <b>–</b>                  | <b>–</b>           |                         |   |                                |

**Note:**

1. All of Steve Bowers' awards lapsed upon cessation of his employment on 30 September 2016.

## Deferred share awards

### Summary of outstanding deferred share awards

| Executive                       | Number of shares under award |                         |                                     |                        |                        |                    | Date of vesting <sup>2</sup> | Closing share price on date of grant (p) <sup>1</sup> |
|---------------------------------|------------------------------|-------------------------|-------------------------------------|------------------------|------------------------|--------------------|------------------------------|---|
|                                 | At 1 November 2015           | Awarded during the year | Rights issue adjustment during year | Lapsed during the year | Vested during the year | At 31 October 2016 |                              |   |
| <b>Michael Flowers</b>          | 14,606                       | –                       | 2,068                               | –                      | –                      | 16,674             | 27 January 2018              | 226.5   |
|                                 | <b>14,606</b>                | <b>–</b>                | <b>2,068</b>                        | <b>–</b>               | <b>–</b>               | <b>16,674</b>      |                              |   |
|                                 |                              |                         |                                     |                        |                        |                    |                              |   |
| <b>Steve Bowers<sup>3</sup></b> | 19,097                       | –                       | 2,704                               | (21,801)               | –                      | –                  | –                            | 229.0   |
|                                 | 29,727                       | –                       | 4,210                               | (33,937)               | –                      | –                  | –                            | 226.5   |
|                                 | <b>48,824</b>                | <b>–</b>                | <b>6,914</b>                        | <b>(55,738)</b>        | <b>–</b>               | <b>–</b>           |                              |   |
| <b>Sarah Ellard</b>             | 12,600                       | –                       | 1,784                               | –                      | –                      | 14,384             | 23 January 2017              | 229.0   |
|                                 | 18,973                       | –                       | 2,687                               | –                      | –                      | 21,660             | 27 January 2018              | 226.5   |
|                                 | <b>31,573</b>                | <b>–</b>                | <b>4,471</b>                        | <b>–</b>               | <b>–</b>               | <b>36,044</b>      |                              |   |

**Notes:**

1. Pre rights issue grant share price.
2. Vesting of deferred bonus share awards is subject only to continued service.
3. All of Steve Bowers' awards lapsed upon cessation of his employment on 30 September 2016.

## DIRECTORS' REMUNERATION REPORT

continued

### Directors' shareholdings

Shareholding guidelines apply to executive directors and other participants in the PSP. If the new policy is approved by shareholders at the Annual General Meeting, executive directors will be expected to build-up and maintain a shareholding in the Company equivalent to 200% of basic salary, by retaining 50% of the after-tax gain on vested PSP awards and CIP awards until such time as the guidelines have been met.

The interests of the directors in the ordinary shares of the Company at 31 October 2016 are shown below. All are beneficial holdings.

| Executive                 | Legally owned<br>(number of<br>shares) | Value of<br>legally owned<br>shares as % of<br>salary <sup>1</sup> | Guideline<br>met | Unvested and subject to performance conditions<br>under the PSP |               |               |                                | Deferred<br>bonus share<br>awards | Sharesave<br>options |
|---------------------------|--|--|------------------|---|---------------|---------------|--------------------------------|-----------------------------------|----------------------|
|                           |  |  |                  | 2014<br>award   | 2015<br>award | 2016<br>award | Total at<br>31 October<br>2016 |                                   |                      |
| <b>Michael Flowers</b>    | 165,982                                | 59%  | No               | 320,650   | 299,031       | 443,538       | 1,063,219                      | 16,674                            | 17,142               |
| <b>Sarah Ellard</b>       | 36,021                                 | 26%  | No               | 159,802   | 164,241       | 222,358       | 546,401                        | 36,044                            | –                    |
| <b>Carl-Peter Forster</b> | 20,000                                 | –  | –                | –   | –             | –             | –                              | –                                 | –                    |
| <b>Andrew Davies</b>      | –                                      | –  | –                | –   | –             | –             | –                              | –                                 | –                    |
| <b>Daniel Dayan</b>       | 60,500                                 | –  | –                | –   | –             | –             | –                              | –                                 | –                    |
| <b>Nigel Young</b>        | –                                      | –  | –                | –   | –             | –             | –                              | –                                 | –                    |

**Note:**

1. Based on the number of shares legally owned, prevailing base salary and share price of 145p at 31 October 2016.

The directors' share interests at 31 October 2016 include shares held by the directors' adult children, as required by the Companies Act 2006.

There have been no changes to the directors' interests in shares since 31 October 2016.

### Pension

The following table sets out the pension benefits earned by the executive directors. Only Sarah Ellard previously accrued benefits during her former membership of the Chemring Group Staff Pension Scheme.

| Executive              | Total benefit accrued<br>at 31 October 2015         |                     |              | Total benefit accrued<br>at 31 October 2016                       |                     |              | Increase in<br>transfer value<br>during year<br>(less members'<br>contributions)<br>£000 | Value of<br>benefit for<br>single figure<br>£000 |
|------------------------|---|---------------------|--------------|---|---------------------|--------------|--|--|
|                        | Cash in lieu of<br>pension<br>contributions<br>£000 | Pension<br>£000p.a. | Cash<br>£000 | Transfer value<br>of accrued<br>benefit at<br>31 Oct 2015<br>£000 | Pension<br>£000p.a. | Cash<br>£000 | Transfer value<br>of accrued<br>benefit at<br>31 Oct 2016 <sup>5</sup><br>£000           |  |
| <b>Michael Flowers</b> | 81  | –                   | –            | –   | –                   | –            | –  | 81   |
| <b>Steve Bowers</b>    | 57  | –                   | –            | –   | –                   | –            | –  | 57   |
| <b>Sarah Ellard</b>    | 41  | 24                  | 72           | 461   | 24                  | 72           | 461  | 41   |

**Notes:**

- The executive directors receive a 20% cash supplement in lieu of pension.
- Transfer values represent liabilities of the applicable scheme, and do not represent sums paid to individuals.
- Transfer values have been calculated in accordance with the Occupational Pension Scheme (Transfer Value) Regulations 1996.
- Sarah Ellard left pensionable service on 6 April 2010 and therefore has not accrued additional pension over the year. The accrued benefits shown are the benefits at the date of exit.
- The scheme provided pension at a rate of 1/80th of final pensionable salary plus a cash lump sum of 3/80ths for each year of membership. Final pensionable salary was capped at the HMRC notional earnings cap, and the scheme assumed a normal retirement age of 65. Early retirement is permissible from age 55 but accrued benefits are reduced accordingly using the early retirement factors in force at the date of early retirement.

### Loss of office payments

The principles governing compensation for loss of office are set out on page 70.

The main provisions relating to the departure of Steve Bowers (which comply with the Company's policy) are as follows:

- Mr Bowers continued to receive base salary, pension and benefits up to 30 September 2016 when his employment ceased;
- unvested PSP, Sharesave and deferred share awards lapsed in full; and
- no other payment of any kind was made to Mr Bowers on cessation of his employment.

### Payments to past directors

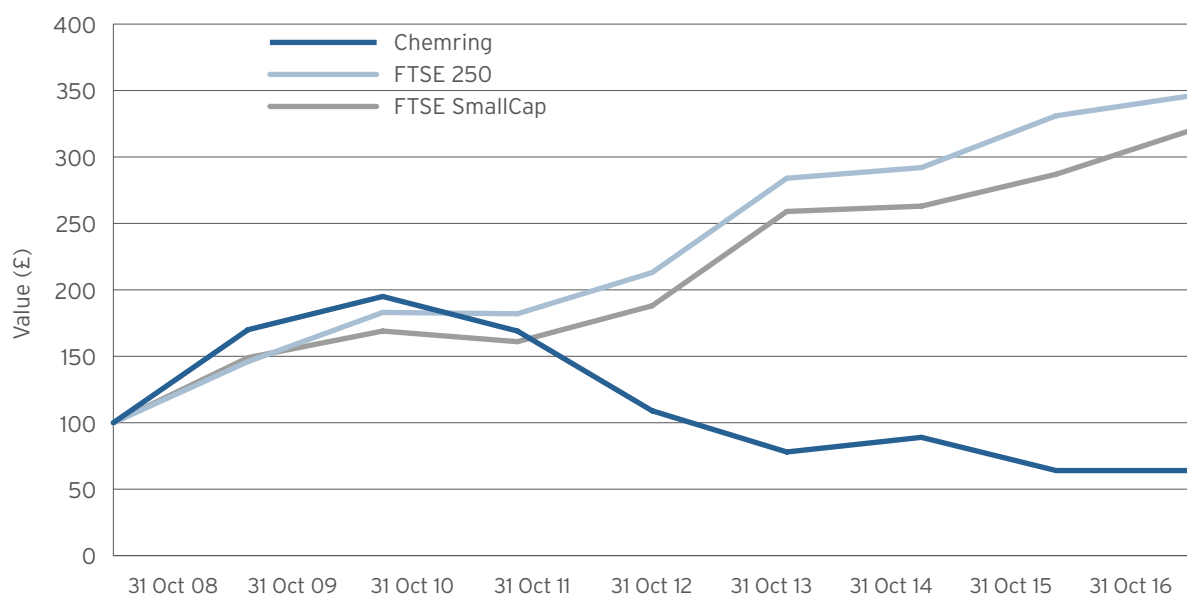
There were no payments made to past directors during the year.



## Total shareholder return

The following graph shows the Company's cumulative total shareholder return over the last eight financial years relative to the FTSE 250 and FTSE Small Cap Indexes. The FTSE Small Cap has been selected by the Committee for this comparison because it provides the most appropriate measure of performance of listed companies of a similar size to the Company. The FTSE 250 has been shown in previous years and has been included this year for the purpose of continuity.

This graph shows the value, by 31 October 2016, of £100 invested in Chemring Group PLC on 31 October 2008 compared with the value of £100 invested in the FTSE 250 and FTSE SmallCap. The other points are the values at intervening financial year ends.



Source: Thomson Reuters

## Chief Executive remuneration table

The total remuneration figures for the Group Chief Executive during each of the last eight financial years are shown in the table below. Mark Papworth replaced David Price as Group Chief Executive on 5 November 2012, and Michael Flowers replaced Mark Papworth on 24 June 2014.

The total remuneration figures for 2012 and 2014 include the payments for loss of office made to David Price and Mark Papworth respectively.

The total remuneration figure for each year includes the annual bonus based on that year's performance and, where applicable, vested PSP awards based on the three-year performance period ending in the relevant year. The annual bonus payout and PSP award vesting level as a percentage of the maximum opportunity are also shown for each of these years.

|                                   |       | David Price |       |         | Mark Papworth | Mark Papworth/<br>Michael Flowers | Michael Flowers |       |
|-----------------------------------|-------|-------------|-------|---------|---------------|-----------------------------------|-----------------|-------|
|                                   | 2009  | 2010        | 2011  | 2012    | 2013          | 2014                              | 2015            | 2016  |
| Total remuneration (£000)         | 1,309 | 1,391       | 1,239 | 1,325   | 785           | 841                               | 507             | 855   |
| Annual bonus (% of maximum)       | 94%   | 62%         | 0%    | 0%      | 40%           | 50%                               | 0%              | 68.3% |
| PSP awards vesting (% of maximum) | 100%  | 100%        | 100%  | 54.375% | 0%            | 0%                                | 0%              | 0%    |

## Percentage change in the Group Chief Executive's remuneration

The table below shows the percentage change in the Group Chief Executive's total remuneration (excluding the value of any PSP awards and pension benefits receivable in the year) between the 2015 and 2016 financial years, compared to that of the average for all eligible employees of the Group.

|                            | Salary | Benefits | Annual bonus |
|----------------------------|--------|----------|--------------|
| Group Chief Executive      | 0.0    | 0.0      | N/A          |
| Average of other employees | 12.7   | 8.9      | 75.9         |

## DIRECTORS' REMUNERATION REPORT

continued

### Relative importance of spend on pay

The following table shows the Company's actual spend on pay (for all employees) relative to dividends and retained profits.

|                  | 2016<br>£m | 2015<br>£m | % change |
|------------------|------------|------------|----------|
| Staff costs      | 139.1      | 123.4      | 12.7     |
| Dividends        | –          | 7.9        | (100.0)  |
| Retained profits | 121.8      | 85.7       | 42.1     |

The dividends figures relate to amounts payable in respect of the relevant financial year.

### Shareholder voting on the directors' remuneration report at the 2016 Annual General Meeting

At the Annual General Meeting held on 21 March 2016, resolutions relating to the directors' remuneration policy and report received the following votes from shareholders:

|  | Total number<br>of votes | % of<br>votes cast |
|--|--------------------------|--------------------|
| <b>Directors' remuneration policy</b>                              |                          |                    |
| For  | 215,625,426              | 91.12%             |
| Against  | 21,014,549               | 8.88%              |
| <b>Total votes cast (for and against excluding withheld votes)</b> | <b>236,639,975</b>       | <b>100.0%</b>      |
| Votes withheld <sup>1</sup>  | 2,094,082                | 0.88%              |
| <b>Total votes cast (including withheld votes)</b>                 | <b>238,734,057</b>       | <b>100.0%</b>      |

|  | Total number<br>of votes | % of<br>votes cast |
|--|--------------------------|--------------------|
| <b>Directors' remuneration report</b>                              |                          |                    |
| For  | 232,325,243              | 98.12%             |
| Against  | 4,313,575                | 1.82%              |
| <b>Total votes cast (for and against excluding withheld votes)</b> | <b>236,638,818</b>       | <b>100.0%</b>      |
| Votes withheld <sup>1</sup>  | 2,095,153                | 0.85%              |
| <b>Total votes cast (including withheld votes)</b>                 | <b>238,733,971</b>       | <b>100.0%</b>      |

**Note:**

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

### Application of the remuneration policy for 2017

#### Base salary

The executive directors' salaries were reviewed in December 2016. The salary increases, which took effect from 1 January 2017, are set out below. The percentage increase applied to the executive directors' salaries was consistent with the average salary increase for UK employees.

|                        | Salary as at<br>1 January 2017 | Percentage<br>increase |
|------------------------|--------------------------------|------------------------|
| <b>Michael Flowers</b> | £416,962                       | 2.7%                   |
| <b>Sarah Ellard</b>    | £209,035                       | 2.7%                   |

The salary of the new Group Finance Director, Andrew Lewis, was set at £325,000 on appointment.

## Pension/benefits

No changes are proposed to the structure of pension and benefits provision for 2017.

## Fees for the Chairman and non-executive directors

As detailed in the remuneration policy, the Company's approach to setting the non-executive directors' remuneration takes account of recognised practice, and is set at a level that is sufficient to attract and retain high-calibre non-executives. Details of the fees that will apply for 2017 are set out below.

|   | Fee as at<br>1 January 2017 | Percentage<br>increase |
|---|-----------------------------|------------------------|
| Chairman's fee                          | £200,000                    | 0%                     |
| Other non-executive directors' base fee | £55,000                     | 0%                     |
| Audit Committee Chair fee               | £10,000                     | 0%                     |
| Remuneration Committee Chair fee        | £10,000                     | 0%                     |

## Operation of the Chemring Incentive Plan

If shareholder approval is obtained for the new policy and related establishment of the CIP, the CIP will be operated as follows in 2017:

### Maximum opportunity

The maximum award that can be made following the year end, which will be based on performance against the targets set out below, will be 250% of salary for Michael Flowers and 200% of salary for other executive directors.

### Targets

The following metrics and weightings will be used for the executive directors:

| Metric                        | Weighting | Rationale/link to strategy  |
|-------------------------------|-----------|---|
| Underlying EPS                | 35%       | Focuses on driving profitability, with the impact of any share issuance taken into account  |
| Net cash flow                 | 30%       | Encourages a focus on cash generation, including changes in working capital as well as profitability and capital investment   |
| Return on capital employed    | 25%       | Measures how profitably and efficiently capital is employed in the business   |
| Personal/strategic objectives | 10%       | Personal/strategic business-critical objectives that support delivery of long-term strategy, including health and safety performance given the nature of many of the Group's operations |

Therefore, all the metrics have been chosen to reflect and support the achievement of the Company's underlying strategic goals.

The Committee does not believe that it would be in shareholders' interests to prospectively disclose the actual CIP targets in advance due to issues of commercial sensitivity. However, detailed retrospective disclosure will be provided of the both the financial and personal/strategic targets used in the prior year in each directors' remuneration report, with an explanation also provided as to how the Company performed against the targets and resulting payouts.

The targets have been set taking account of short, medium and long-term internal and external forecasts relating to the Company's performance and reflecting the Board's expectation of year-on-year improvement. Therefore, they are challenging and have been set in light of Chemring's long-term strategy, notwithstanding the fact that they measure performance over one year.

The personal/strategic targets have been set to reflect performance in the following key areas:

- Health and safety
- Operational improvement
- Capability and infrastructure
- Development of business segment strategies
- Financing strategy
- Governance and compliance
- Human resource management

No award will be payable in respect of the personal/strategic objectives unless the Committee is satisfied that this is justified by the Group's underlying performance (e.g. levels of profitability and cash flow).

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## DIRECTORS' REMUNERATION REPORT

**continued**

### Cash/share split

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30% of any outturn will be payable in cash as soon as practicable following the year end. The remaining 70% will be deferred into shares that will vest three years later subject (i) to the satisfaction of the underpin described below and (ii) to a further two-year post-vesting holding period.

### Underpin and malus/clawback

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In addition, the deferred share element of the CIP award will be subject to a performance underpin measured over the three-year deferral period which, if not met, will result in the Remuneration Committee reducing the number of shares subject to the award (potentially down to zero). For the first operation of the CIP in 2017, the underpin will require that the Company's underlying EPS grows in real terms over the three-year deferral period.

This underpin will also operate in conjunction with the Company's existing malus and clawback provisions which can be operated in certain circumstances (e.g. misconduct, misstatement of accounts, error in calculating performance against the targets).

### Approval of the directors' remuneration report

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The directors' remuneration report was approved by the Board on 19 January 2017.

Signed on behalf of the Board

**Daniel Dayan**

Chairman of the Remuneration Committee

## FINANCIAL STATEMENTS

For the year ended 31 October 2016

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## CONSOLIDATED INCOME STATEMENT

For the year ended 31 October 2016

|   |      | 2016                         |   |             | 2015                         |   |             |
|---|------|------------------------------|---|-------------|------------------------------|---|-------------|
|   | Note | Underlying performance<br>£m | Non-underlying items <sup>1</sup><br>£m | Total<br>£m | Underlying performance<br>£m | Non-underlying items <sup>1</sup><br>£m | Total<br>£m |
| <b>Continuing operations</b>                  |      |                              |   |             |                              |   |             |
| Revenue                                       | 1,2  | 477.1                        | –                                       | 477.1       | 377.3                        | –                                       | 377.3       |
| Operating profit/(loss)                       | 2,3  | 48.5                         | (22.3)                                  | 26.2        | 34.4                         | (28.9)                                  | 5.5         |
| Finance income                                | 2,5  | –                            | –                                       | –           | –                            | –                                       | –           |
| Finance expense                               | 2,6  | (14.5)                       | (3.7)                                   | (18.2)      | (14.6)                       | –                                       | (14.6)      |
| <b>Profit/(loss) before tax</b>               | 2    | <b>34.0</b>                  | <b>(26.0)</b>                           | <b>8.0</b>  | 19.8                         | (28.9)                                  | (9.1)       |
| Tax (charge)/credit on profit/(loss)          | 2,7  | (7.1)                        | 5.6                                     | (1.5)       | (4.1)                        | 7.9                                     | 3.8         |
| <b>Profit/(loss) after tax</b>                |      | <b>26.9</b>                  | <b>(20.4)</b>                           | <b>6.5</b>  | 15.7                         | (21.0)                                  | (5.3)       |
| <b>Discontinued operations</b>                |      |                              |   |             |                              |   |             |
| Profit after tax from discontinued operations | 28   | –                            | 4.6                                     | 4.6         | –                            | 4.9                                     | 4.9         |
| <b>Profit/(loss) after tax</b>                |      | <b>26.9</b>                  | <b>(15.8)</b>                           | <b>11.1</b> | 15.7                         | (16.1)                                  | (0.4)       |

|  |      | 2016                   |                                   |       | 2015 <sup>2</sup>      |                                   |        |
|--|------|------------------------|-----------------------------------|-------|------------------------|-----------------------------------|--------|
|  | Note | Underlying performance | Non-underlying items <sup>1</sup> | Total | Underlying performance | Non-underlying items <sup>1</sup> | Total  |
| <b>Earnings/(loss) per ordinary share<sup>2</sup></b>    |      |                        |                                   |       |                        |                                   |        |
| <b>Continuing operations</b>                             |      |                        |                                   |       |                        |                                   |        |
| Basic  | 9    | 10.3p                  | (7.8)p                            | 2.5p  | 7.1p                   | (9.5)p                            | (2.4)p |
| Diluted  | 9    | 10.1p                  | (7.7)p                            | 2.4p  | 7.0p                   | (9.4)p                            | (2.4)p |
| <b>Continuing operations and discontinued operations</b> |      |                        |                                   |       |                        |                                   |        |
| Basic  | 9    | 10.3p                  | (6.1)p                            | 4.2p  | 7.1p                   | (7.3)p                            | (0.2)p |
| Diluted  | 9    | 10.1p                  | (5.9)p                            | 4.2p  | 7.0p                   | (7.2)p                            | (0.2)p |

1 Further information about non-underlying items is set out in notes 2 and 3.

2 Comparative restated for rights issue. See note 9 for further information.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 October 2016

|   | Note | 2016<br>£m  | 2015<br>£m |
|---|------|-------------|------------|
| <b>Profit/(loss) after tax attributable to equity holders of the parent as reported</b> |      | <b>11.1</b> | (0.4)      |
| <b>Items that will not be reclassified subsequently to profit or loss</b>               |      |             |            |
| Actuarial losses on defined benefit pension schemes                                     | 29   | (3.8)       | –          |
| Movement on deferred tax relating to pension schemes                                    | 22   | 0.8         | –          |
|   |      | (3.0)       | –          |
| <b>Items that may be reclassified subsequently to profit and loss</b>                   |      |             |            |
| Exchange differences on translation of foreign operations                               |      | 33.0        | (2.6)      |
| Current tax on items taken directly to equity   |      | 0.8         | 0.6        |
| Deferred tax on exchange differences on translation of foreign operations               | 22   | 4.7         | (0.6)      |
|   |      | 38.5        | (2.6)      |
| <b>Total comprehensive income/(loss) attributable to equity holders of the parent</b>   |      | <b>46.6</b> | (3.0)      |



## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 October 2016

|  | Share capital<br>£m | Share premium account<br>£m | Special capital reserve<br>£m | Revaluation reserve<br>£m | Translation reserve<br>£m | Retained earnings<br>£m | Own shares<br>£m | Total<br>£m  |
|--|---------------------|-----------------------------|-------------------------------|---------------------------|---------------------------|-------------------------|------------------|--------------|
| At 1 November 2015                                       | 2.0                 | 230.7                       | 12.9                          | 1.2                       | (32.3)                    | 85.7                    | (9.6)            | 290.6        |
| Profit after tax   | –                   | –                           | –                             | –                         | –                         | 11.1                    | –                | 11.1         |
| Other comprehensive income                               | –                   | –                           | –                             | –                         | 11.6                      | 17.6                    | –                | 29.2         |
| Tax relating to components of other comprehensive income | –                   | –                           | –                             | –                         | –                         | 6.3                     | –                | 6.3          |
| Total comprehensive income                               | –                   | –                           | –                             | –                         | 11.6                      | 35.0                    | –                | 46.6         |
| Ordinary shares issued                                   | 0.8                 | 74.4                        | –                             | –                         | –                         | –                       | –                | 75.2         |
| Share-based payments (net of settlement)                 | –                   | –                           | –                             | –                         | –                         | 1.0                     | –                | 1.0          |
| Transfers between reserves                               | –                   | –                           | –                             | (0.1)                     | –                         | 0.1                     | –                | –            |
| <b>At 31 October 2016</b>                                | <b>2.8</b>          | <b>305.1</b>                | <b>12.9</b>                   | <b>1.1</b>                | <b>(20.7)</b>             | <b>121.8</b>            | <b>(9.6)</b>     | <b>413.4</b> |
|  | Share capital<br>£m | Share premium account<br>£m | Special capital reserve<br>£m | Revaluation reserve<br>£m | Translation reserve<br>£m | Retained earnings<br>£m | Own shares<br>£m | Total<br>£m  |
| At 1 November 2014                                       | 2.0                 | 230.7                       | 12.9                          | 1.2                       | (32.6)                    | 95.7                    | (9.6)            | 300.3        |
| Loss after tax   | –                   | –                           | –                             | –                         | –                         | (0.4)                   | –                | (0.4)        |
| Other comprehensive income/(loss)                        | –                   | –                           | –                             | –                         | 0.3                       | (2.9)                   | –                | (2.6)        |
| Tax relating to components of other comprehensive income | –                   | –                           | –                             | –                         | –                         | –                       | –                | –            |
| Total comprehensive income/(loss)                        | –                   | –                           | –                             | –                         | 0.3                       | (3.3)                   | –                | (3.0)        |
| Dividends paid   | –                   | –                           | –                             | –                         | –                         | (7.9)                   | –                | (7.9)        |
| Share-based payments (net of settlement)                 | –                   | –                           | –                             | –                         | –                         | 1.2                     | –                | 1.2          |
| At 31 October 2015                                       | 2.0                 | 230.7                       | 12.9                          | 1.2                       | (32.3)                    | 85.7                    | (9.6)            | 290.6        |

## CONSOLIDATED BALANCE SHEET

As at 31 October 2016

|   |       | 2016         |                | 2015         |                |
|---|-------|--------------|----------------|--------------|----------------|
|   | Note  | £m           | £m             | £m           | £m             |
| <b>Non-current assets</b>                           |       |              |                |              |                |
| Goodwill  | 10    | 132.9        |                | 121.2        |                |
| Development costs                                   | 11    | 40.9         |                | 36.1         |                |
| Other intangible assets                             | 11    | 77.1         |                | 74.2         |                |
| Property, plant and equipment                       | 12    | 179.9        |                | 168.0        |                |
| Deferred tax  | 22    | 59.6         |                | 47.5         |                |
|   |       |              | 490.4          |              | 447.0          |
| <b>Current assets</b>                               |       |              |                |              |                |
| Inventories   | 14    | 104.8        |                | 96.2         |                |
| Trade and other receivables                         | 15    | 114.2        |                | 93.1         |                |
| Cash and cash equivalents                           | 16,32 | 63.1         |                | 7.6          |                |
| Derivative financial instruments                    | 20    | 0.5          |                | 0.5          |                |
|   |       |              | 282.6          |              | 197.4          |
| <b>Total assets</b>                                 |       |              | <b>773.0</b>   |              | <b>644.4</b>   |
| <b>Current liabilities</b>                          |       |              |                |              |                |
| Borrowings  | 17,32 | (29.5)       |                | –            |                |
| Obligations under finance leases                    | 17,18 | (0.1)        |                | (0.5)        |                |
| Trade and other payables                            | 19    | (107.3)      |                | (96.2)       |                |
| Provisions  | 21    | (4.5)        |                | (5.1)        |                |
| Current tax   |       | (3.1)        |                | (7.9)        |                |
| Derivative financial instruments                    | 20    | (2.5)        |                | (1.6)        |                |
|   |       |              | (147.0)        |              | (111.3)        |
| <b>Non-current liabilities</b>                      |       |              |                |              |                |
| Borrowings  | 17,32 | (121.0)      |                | (161.3)      |                |
| Trade and other payables                            | 19    | (4.0)        |                | (1.7)        |                |
| Provisions  | 21    | (11.7)       |                | (16.3)       |                |
| Deferred tax  | 22    | (58.5)       |                | (45.1)       |                |
| Preference shares                                   | 17,23 | (0.1)        |                | (0.1)        |                |
| Retirement benefit obligations                      | 29    | (17.3)       |                | (17.7)       |                |
| Derivative financial instruments                    | 20    | –            |                | (0.3)        |                |
|   |       |              | (212.6)        |              | (242.5)        |
| <b>Total liabilities</b>                            |       |              | <b>(359.6)</b> |              | <b>(353.8)</b> |
| <b>Net assets</b>                                   |       |              | <b>413.4</b>   |              | <b>290.6</b>   |
| <b>Equity</b>                                       |       |              |                |              |                |
| Share capital                                       | 23    | 2.8          |                | 2.0          |                |
| Share premium account                               |       | 305.1        |                | 230.7        |                |
| Special capital reserve                             |       | 12.9         |                | 12.9         |                |
| Revaluation reserve                                 |       | 1.1          |                | 1.2          |                |
| Translation reserve                                 |       | (20.7)       |                | (32.3)       |                |
| Retained earnings                                   |       | 121.8        |                | 85.7         |                |
|   |       | 423.0        |                | 300.2        |                |
| Own shares  | 25    | (9.6)        |                | (9.6)        |                |
| Equity attributable to equity holders of the parent |       | 413.4        |                | 290.6        |                |
| <b>Total equity</b>                                 |       | <b>413.4</b> |                | <b>290.6</b> |                |

These financial statements of Chemring Group PLC (registered number 86662) were approved and authorised for issue by the Board of directors on 19 January 2017.

Signed on behalf of the Board

**Michael Flowers**  
Director

**Sarah Ellard**  
Director

## CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 October 2016

|   | Note  | 2016<br>£m    | 2015<br>£m |
|---|-------|---------------|------------|
| <b>Cash flows from operating activities</b>                 |       |               |            |
| Cash generated from continuing operations                   | 30    | <b>76.4</b>   | 35.4       |
| Cash generated from discontinued operations                 |       | <b>–</b>      | –          |
|   | 30    | <b>76.4</b>   | 35.4       |
| Acquisition and disposal related costs                      |       | <b>(0.3)</b>  | (0.7)      |
| Business restructuring and incident costs                   |       | <b>(2.8)</b>  | (7.6)      |
| Claim related costs   |       | <b>(5.0)</b>  | (0.1)      |
|   |       | <b>68.3</b>   | 27.0       |
| Tax paid  |       | <b>(3.1)</b>  | (1.3)      |
| <b>Net cash inflow from operating activities</b>            |       | <b>65.2</b>   | 25.7       |
| <b>Cash flows from investing activities</b>                 |       |               |            |
| Purchases of intangible assets                              |       | <b>(6.7)</b>  | (8.9)      |
| Purchases of property, plant and equipment                  |       | <b>(10.3)</b> | (8.2)      |
| Acquisition of subsidiary undertaking, net of cash acquired |       | <b>(2.5)</b>  | –          |
| Proceeds on disposal of property, plant and equipment       |       | <b>0.1</b>    | –          |
| <b>Net cash outflow from investing activities</b>           |       | <b>(19.4)</b> | (17.1)     |
| <b>Cash flows from financing activities</b>                 |       |               |            |
| Net proceeds of share issue                                 |       | <b>75.4</b>   | –          |
| Dividends paid  | 8     | <b>–</b>      | (7.9)      |
| Finance expense paid  |       | <b>(11.9)</b> | (11.8)     |
| Accelerated interest costs                                  |       | <b>(3.7)</b>  | –          |
| Loan note repayment costs                                   |       | <b>(1.4)</b>  | –          |
| Capitalised facility fees paid                              |       | <b>(0.5)</b>  | (1.8)      |
| Repayments of borrowings                                    |       | <b>(48.8)</b> | (0.3)      |
| Repayments of obligations under finance leases              |       | <b>(0.3)</b>  | (0.9)      |
| <b>Net cash inflow/(outflow) from financing activities</b>  |       | <b>8.8</b>    | (22.7)     |
| <b>Increase/(decrease) in cash and cash equivalents</b>     |       | <b>54.6</b>   | (14.1)     |
| Cash and cash equivalents at beginning of year              |       | <b>7.6</b>    | 21.8       |
| Effect of foreign exchange rate changes                     |       | <b>0.9</b>    | (0.1)      |
| <b>Cash and cash equivalents at end of year</b>             | 16,32 | <b>63.1</b>   | 7.6        |

## NOTES TO THE GROUP FINANCIAL STATEMENTS

### 1. Revenue

All of the Group's revenue is derived from the sale of goods, including revenue recognised in respect of contract-accounted arrangements, and the provision of services. The following table provides an analysis of the Group's revenue by destination:

| Revenue by destination       | 2016<br>£m   | 2015<br>£m   |
|------------------------------|--------------|--------------|
| <b>Continuing operations</b> |              |              |
| UK                           | 79.7         | 63.9         |
| USA                          | 230.1        | 171.4        |
| Europe                       | 26.2         | 37.8         |
| Asia Pacific                 | 37.5         | 49.0         |
| Middle East                  | 101.6        | 54.0         |
| Rest of the world            | 2.0          | 1.2          |
|                              | <b>477.1</b> | <b>377.3</b> |

Revenue from contract accounting for continuing operations within these figures amounted to £9.4 million (2015: £12.8 million).

The directors consider the only countries that are significant in accordance with IFRS 8 *Operating Segments* are the USA and the UK.

### 2. Business segments

IFRS 8 *Operating Segments* requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the Group Chief Executive and the Board to allocate resources to the segments and to assess their performance. For management purposes, the Group's operating and reporting structure clusters similar businesses together within the following three operating segments – Countermeasures, Sensors & Electronics, and Energetic Systems. These segments are the basis on which the Group reports its segmental information. The principal activities of each segment are as follows:

|                                  |   |
|----------------------------------|---|
| <b>Countermeasures</b>           | Development and manufacture of expendable countermeasures for air, sea and land platforms, and land-based electronic warfare equipment.   |
| <b>Sensors &amp; Electronics</b> | Development and manufacture of IED detection equipment, chemical and biological threat detection equipment, IED electronic countermeasures, network protection technologies and explosive ordnance disposal equipment.  |
| <b>Energetic Systems</b>         | Development, procurement and manufacture of signals and illumination devices and payloads, cartridge/propellant actuated devices, pyrotechnic devices for satellite launch and deployment, missile and ammunition components, 40mm ammunition, propellants, warheads, fuses, separation sub-systems, actuators and energetic materials. |

A segmental analysis of revenue and operating profit is set out below:

| Revenue                            | 2016<br>£m   | 2015<br>£m   |
|------------------------------------|--------------|--------------|
| <b>Continuing operations</b>       |              |              |
| Countermeasures                    | 138.3        | 125.8        |
| Sensors & Electronics              | 96.9         | 99.1         |
| Energetic Systems                  | 241.9        | 152.4        |
|                                    | <b>477.1</b> | <b>377.3</b> |
| <b>Underlying operating profit</b> |              |              |
| <b>Continuing operations</b>       |              |              |
| Countermeasures*                   | 12.8         | 17.5         |
| Sensors & Electronics              | 11.4         | 9.3          |
| Energetic Systems                  | 31.7         | 15.1         |
|                                    | <b>55.9</b>  | <b>41.9</b>  |
| Unallocated corporate costs        | (7.4)        | (7.5)        |
|                                    | <b>48.5</b>  | <b>34.4</b>  |

\*The year ended 31 October 2016 includes £2.8 million of insurance proceeds in relation to a business interruption claim following an earlier energetic incident.

## NOTES TO THE GROUP FINANCIAL STATEMENTS

continued

### 2. Business segments continued

|  | Continuing<br>Underlying<br>£m | Continuing<br>Total<br>£m | Discontinued<br>Underlying<br>£m | Discontinued<br>Total<br>£m | Total<br>Underlying<br>£m | Total<br>£m |
|--|--------------------------------|---------------------------|----------------------------------|-----------------------------|---------------------------|-------------|
| <b>Year ended 31 October 2016</b>  |                                |                           |                                  |                             |                           |             |
| <b>Underlying operating profit</b>   | 48.5                           | 48.5                      | –                                | –                           | 48.5                      | 48.5        |
| Acquisition (costs) and disposal related credits (note 28)                           | –                              | (0.3)                     | –                                | 4.7                         | –                         | 4.4         |
| Business restructuring and incident costs  | –                              | (5.4)                     | –                                | –                           | –                         | (5.4)       |
| Claim related credit   | –                              | 0.6                       | –                                | –                           | –                         | 0.6         |
| Intangible amortisation arising from business combinations (note 11)                 | –                              | (14.8)                    | –                                | –                           | –                         | (14.8)      |
| Loan note repayment costs  | –                              | (1.4)                     | –                                | –                           | –                         | (1.4)       |
| Loss on the movement in the fair value of derivative financial instruments (note 20) | –                              | (1.0)                     | –                                | –                           | –                         | (1.0)       |
| <b>Non-underlying items</b>  | –                              | (22.3)                    | –                                | 4.7                         | –                         | (17.6)      |
| <b>Operating profit</b>  | 48.5                           | 26.2                      | –                                | 4.7                         | 48.5                      | 30.9        |
| Finance income   | –                              | –                         | –                                | –                           | –                         | –           |
| Finance expense  | (14.5)                         | (14.5)                    | –                                | –                           | (14.5)                    | (14.5)      |
| Non-underlying accelerated interest costs  | –                              | (3.7)                     | –                                | –                           | –                         | (3.7)       |
| <b>Profit before tax</b>   | 34.0                           | 8.0                       | –                                | 4.7                         | 34.0                      | 12.7        |
| Tax  | (7.1)                          | (1.5)                     | –                                | (0.1)                       | (7.1)                     | (1.6)       |
| <b>Profit after tax</b>  | 26.9                           | 6.5                       | –                                | 4.6                         | 26.9                      | 11.1        |

|  | Continuing<br>Underlying<br>£m | Continuing<br>Total<br>£m | Discontinued<br>Underlying<br>£m | Discontinued<br>Total<br>£m | Total<br>Underlying<br>£m | Total<br>£m |
|--|--------------------------------|---------------------------|----------------------------------|-----------------------------|---------------------------|-------------|
| <b>Year ended 31 October 2015</b>  |                                |                           |                                  |                             |                           |             |
| Underlying operating profit  | 34.4                           | 34.4                      | –                                | –                           | 34.4                      | 34.4        |
| Acquisition (costs) and disposal related credits (note 28)                           | –                              | (0.5)                     | –                                | 4.9                         | –                         | 4.4         |
| Business restructuring and incident costs  | –                              | (6.4)                     | –                                | –                           | –                         | (6.4)       |
| Claim related costs  | –                              | (8.5)                     | –                                | –                           | –                         | (8.5)       |
| Intangible amortisation arising from business combinations (note 11)                 | –                              | (14.0)                    | –                                | –                           | –                         | (14.0)      |
| Gain on the movement in the fair value of derivative financial instruments (note 20) | –                              | 0.5                       | –                                | –                           | –                         | 0.5         |
| <b>Non-underlying items</b>  | –                              | (28.9)                    | –                                | 4.9                         | –                         | (24.0)      |
| <b>Operating profit</b>  | 34.4                           | 5.5                       | –                                | 4.9                         | 34.4                      | 10.4        |
| Finance income   | –                              | –                         | –                                | –                           | –                         | –           |
| Finance expense  | (14.6)                         | (14.6)                    | –                                | –                           | (14.6)                    | (14.6)      |
| <b>Profit/(loss) before tax</b>  | 19.8                           | (9.1)                     | –                                | 4.9                         | 19.8                      | (4.2)       |
| Tax  | (4.1)                          | 3.8                       | –                                | –                           | (4.1)                     | 3.8         |
| <b>Profit/(loss) after tax</b>   | 15.7                           | (5.3)                     | –                                | 4.9                         | 15.7                      | (0.4)       |

The accounting policies of the reportable segments are the same as the Group's accounting policies described in the accounting policies section.

Segmental profit represents the profit earned by each segment, before allocation of corporate costs including directors' salaries, non-underlying items, finance income and expense, and tax. This is the measure reported to the Group Chief Executive for the purpose of resource allocation and assessment of segment performance.

Segmental analyses of depreciation and amortisation are set out below. All depreciation is reflected in both underlying and total measures of operating profit. The analysis of amortisation is shown for both the underlying and total operating profit measures.

|                             | 2016<br>£m  | 2015<br>£m  |
|-----------------------------|-------------|-------------|
| <b>Depreciation</b>         |             |             |
| Countermeasures             | 9.6         | 8.0         |
| Sensors & Electronics       | 2.2         | 2.5         |
| Energetic Systems           | 5.3         | 4.8         |
| Unallocated corporate items | 1.3         | 1.0         |
|                             | <b>18.4</b> | <b>16.3</b> |

## 2. Business segments continued

|                             | 2016                                     |                                     | 2015                                     |                                     |
|-----------------------------|--|-------------------------------------|--|-------------------------------------|
|                             | Within underlying operating profit<br>£m | Within total operating profit<br>£m | Within underlying operating profit<br>£m | Within total operating profit<br>£m |
| <b>Amortisation</b>         |  |                                     |  |                                     |
| Countermeasures             | 1.8                                      | 2.0                                 | 1.6                                      | 1.6                                 |
| Sensors & Electronics       | 4.4                                      | 11.5                                | 3.6                                      | 10.8                                |
| Energetic Systems           | 0.6                                      | 8.1                                 | 1.0                                      | 7.8                                 |
| Unallocated corporate items | 0.1                                      | 0.1                                 | 0.2                                      | 0.2                                 |
|                             | <b>6.9</b>                               | <b>21.7</b>                         | 6.4                                      | 20.4                                |

### Intra-group transactions

There are no material intra-group transactions included within the revenue and profit values disclosed in this note.

### Acquisition (costs) and disposal related credits

Disposal related credits of £4.7 million (2015: £4.9 million) primarily relate to the expiry of certain tax, environmental and property liabilities arising from the disposal of several businesses in prior years. For further information on the acquisition costs and disposal related credits see note 28.

### Business restructuring and incident costs

In 2016, business restructuring and incident costs of £5.4 million principally comprise of restructuring costs in relation to Chemring Defence UK and across the US businesses, partly offset by insurance proceeds in relation to a property damage claim following an earlier energetic incident.

In 2015, restructuring costs of £6.4 million included £4.6 million relating to restructuring of the UK Sensors & Electronics businesses, £1.3 million relating to restructuring of the US Sensors & Electronics businesses, and £0.5 million relating to simplification and integration activities at other business units.

In 2016 there was a £2.6 million difference between the business restructuring and incident costs recognised in the income statement and the outflow appearing in the cash flow statement due to the timing of payments and non-cash movements.

### Claim related credit/(costs)

In 2016, the claim related credit of £0.6 million relates to the final settlement of the claim brought by the US Department of Justice relating to historical supplies of product by Kilgore. This claim is being settled over a five year period commencing 2016.

In 2015, claim related costs of £8.5 million comprised £4.2 million in relation to a claim brought by the US Department of Justice relating to historical supplies of product by Kilgore, which has now been settled, and £4.3 million in respect of the settlement of claims regarding the manufacture of certain components for the Next Generation Light Anti-Tank Weapon ("NLAW") combat weapon by Chemring Energetics. The estimated value of these claim related costs were reflected as a non-underlying item due to their scale and unusual nature. The cash payment associated with settlement of the NLAW claim occurred in November 2015.

### Non-underlying items

An analysis of non-underlying items by segment is set out below:

|  | 2016<br>£m  | 2015<br>£m |
|--|-------------|------------|
| <b>Non-underlying items by segment</b> |             |            |
| Countermeasures                        | 1.1         | 4.4        |
| Sensors & Electronics                  | 7.9         | 13.1       |
| Energetic Systems                      | 10.8        | 11.3       |
| Discontinued operations                | (4.7)       | (4.9)      |
| Unallocated                            | 6.2         | 0.1        |
|  | <b>21.3</b> | 24.0       |

Unallocated items include £3.7 million (2015: £nil) of accelerated interest due on early repayment of loan notes, £1.4 million (2015: £nil) of loan note repayment costs and a £1.0 million loss (2015: £0.5 million gain) on the movement in fair value of derivative financial instruments.

# NOTES TO THE GROUP FINANCIAL STATEMENTS

continued

## 2. Business segments continued

### Information on major customers

Included in segmental revenues for continuing operations are revenues of £147.6 million (2015: £110.6 million), which arose from sales to the Group's largest customer. The largest customer had sales reported in all of the Group's business segments. This was the only individual customer where direct sales accounted for more than 10% of Group revenue from continuing and discontinued operations for the year.

The Group does not disclose assets or liabilities by segment in the monthly management accounts provided to the Executive Committee or the Board. The Improvements to IFRSs amendment document issued in April 2009 only requires to be disclosed that information that is provided to the chief operating decision maker as a key decision-making tool. The Group has adopted this amendment in order to clarify that the chief operating decision maker does not use this information as a key decision tool. IFRS 8 *Operating Segments* requires a geographic analysis of non-current assets, and a disclosure of non-current assets by location is therefore shown below:

| Non-current assets by location | 2016<br>£m   | 2015<br>£m   |
|--------------------------------|--------------|--------------|
| UK                             | 249.1        | 244.4        |
| USA                            | 209.1        | 177.1        |
| Europe                         | 5.4          | 4.3          |
| Australia                      | 26.8         | 21.2         |
|                                | <b>490.4</b> | <b>447.0</b> |

## 3. Operating profit

An analysis of operating profit from continuing operations is set out below:

|   | 2016<br>£m    | 2015<br>£m    |
|---|---------------|---------------|
| Revenue   | 477.1         | 377.3         |
| Cost of sales   | (353.7)       | (272.5)       |
| Administrative expenses   | (74.9)        | (70.4)        |
| Acquisition and disposal related costs (note 28)  | (0.3)         | (0.5)         |
| Business restructuring and incident costs (note 2)  | (5.4)         | (6.4)         |
| Claim related credit/(costs) (note 2)   | 0.6           | (8.5)         |
| Intangible amortisation arising from business combinations (note 11)                        | (14.8)        | (14.0)        |
| Loan note repayment   | (1.4)         | –             |
| (Loss)/gain on the movement in the fair value of derivative financial instruments (note 20) | (1.0)         | 0.5           |
| <b>Non-underlying items</b>   | <b>(22.3)</b> | <b>(28.9)</b> |
| <b>Operating profit</b>   | <b>26.2</b>   | <b>5.5</b>    |

Operating profit is stated after charging/(crediting):

|   | 2016<br>£m | 2015<br>£m |
|---|------------|------------|
| Research and development costs  |            |            |
| - customer-funded   | 43.4       | 38.2       |
| - internally-funded   | 7.7        | 9.2        |
| Amortisation  |            |            |
| - arising from business combinations  | 14.8       | 14.0       |
| - development costs   | 6.8        | 6.2        |
| - patents and licences  | 0.1        | 0.2        |
| Depreciation of property, plant and equipment   |            |            |
| - owned assets  | 18.3       | 16.2       |
| - leased assets   | 0.1        | 0.1        |
| Loss on disposal of non-current assets  | 0.2        | 0.3        |
| Operating lease rentals   |            |            |
| - plant and machinery   | 1.3        | 0.8        |
| - other   | 0.6        | 0.8        |
| Government grants   | (0.3)      | (0.1)      |
| Foreign exchange losses   | 3.3        | 0.7        |
| Staff costs (note 4)  | 139.1      | 123.4      |
| Cost of inventories recognised as an expense  | 205.1      | 144.4      |
| Acquisition costs and disposal related (credits) (note 28)                                  |            |            |
| - continuing operations   | 0.3        | 0.5        |
| - discontinued operations   | (4.7)      | (4.9)      |
| Business restructuring and incident costs (note 2)  | 5.4        | 6.4        |
| Claim related (credit)/costs (note 2)   | (0.6)      | 8.5        |
| Loss/(gain) on the movement in the fair value of derivative financial instruments (note 20) | 1.0        | (0.5)      |
| Loan note repayment costs   | 1.4        | –          |
| Auditor's remuneration  | 1.8        | 1.5        |



### 3. Operating profit continued

A detailed analysis of the auditor's remuneration on a worldwide basis is set out below:

|  | 2016<br>£m | 2015<br>£m |
|--|------------|------------|
| <b>Auditor's remuneration</b>                                      |            |            |
| Fees payable to the Company's auditor and its associates for:      |            |            |
| - the audit of the Company's annual accounts                       | 0.4        | 0.4        |
| - the audit of the Company's subsidiaries, pursuant to legislation | 0.5        | 0.4        |
|  | 0.9        | 0.8        |
| <b>Other services</b>  |            |            |
| Audit-related assurance services                                   | 0.1        | 0.1        |
| Other assurance services   | 0.5        | –          |
| Tax services – compliance  | 0.3        | 0.4        |
| Tax services – advisory  | –          | 0.2        |
|  | 0.9        | 0.7        |
|  | 1.8        | 1.5        |

Included in the fees for the audit of the Company's annual accounts is £0.2 million (2015: £0.2 million) in respect of the parent company.

A description of the work of the Audit Committee is set out in the Audit Committee report on pages 60 to 63, and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditor. No services were provided by the auditor pursuant to contingent fee arrangements.

### 4. Staff costs

The average monthly number of employees, including executive directors, was:

|                                     | 2016<br>Number | 2015<br>Number |
|-------------------------------------|----------------|----------------|
| Production                          | 2,263          | 2,353          |
| Administration, sales and marketing | 441            | 445            |
|                                     | 2,704          | 2,798          |

At the year end, the number of employees was 2,577 (2015: 2,849). The costs incurred in respect of employees, including share-based payments, were:

|                            | 2016<br>£m | 2015<br>£m |
|----------------------------|------------|------------|
| Wages and salaries         | 118.9      | 105.0      |
| Social security costs      | 13.0       | 11.4       |
| Other pension costs        | 6.2        | 5.8        |
| Share-based payment charge | 1.0        | 1.2        |
|                            | 139.1      | 123.4      |

### 5. Finance income

|                      | 2016<br>£m | 2015<br>£m |
|----------------------|------------|------------|
| Bank interest income | –          | –          |

## NOTES TO THE GROUP FINANCIAL STATEMENTS

continued

### 6. Finance expense

|   | 2016<br>£m  | 2015<br>£m  |
|---|-------------|-------------|
| Bank overdraft and loan interest                          | 1.2         | 2.3         |
| Loan notes interest                                       | 9.6         | 9.8         |
| Finance lease interest                                    | 0.1         | 0.1         |
| Amortisation of debt finance costs                        | 2.8         | 2.1         |
| Interest cost of retirement benefit obligations (note 29) | 0.8         | 0.9         |
| Capitalised interest on qualifying assets (note 12)       | –           | (0.6)       |
| <b>Finance expense</b>                                    | <b>14.5</b> | <b>14.6</b> |

Borrowing costs capitalised in the cost of qualifying assets were calculated by applying a rate of 7% in 2015 to expenditure on such assets.

Tax relief of approximately £nil (2015: £0.1 million) has been recognised on the capitalised interest and included in the tax charge.

Non-underlying items include £3.7 million (2015: £nil) of accelerated interest costs due on early repayment of loan notes. Including this non-underlying item, the total finance expense for continuing operations was £18.2 million (2015: £14.6 million).

### 7. Tax

|  | 2016<br>£m   | 2015<br>£m |
|--|--------------|------------|
| Current tax credit/(charge)                          | 5.3          | (2.8)      |
| Deferred tax (charge)/credit (note 22)               | (6.8)        | 6.6        |
| <b>Tax (charge)/credit for continuing operations</b> | <b>(1.5)</b> | <b>3.8</b> |

Income tax in the UK is calculated at 20.0% (2015: 20.4%) of the taxable profit for the year. Tax for other jurisdictions is calculated at the rates prevailing in those jurisdictions.

The tax credit for continuing operations can be reconciled to the income statement as follows:

|   | 2016<br>£m   | 2015<br>£m   |
|---|--------------|--------------|
| <b>Profit/(loss) before tax from continuing operations</b>        | <b>8.0</b>   | <b>(9.1)</b> |
| Tax at the UK corporation tax rate of 20.0% (2015: 20.4%)         | (1.6)        | 1.9          |
| Expenses not deductible for tax purposes                          | –            | (3.1)        |
| Changes in tax rates  | (0.2)        | 0.1          |
| Research and development tax relief                               | –            | (0.3)        |
| Tax losses not recognised/carried forward                         | –            | (5.1)        |
| Prior period adjustments  | 5.4          | (1.2)        |
| Adjustment to provision for interest restriction (see note 22)    | (10.6)       | (0.4)        |
| Overseas profits taxed at rates different to the UK standard rate | 5.5          | 11.9         |
| <b>Tax (charge)/credit for continuing operations</b>              | <b>(1.5)</b> | <b>3.8</b>   |

In addition to the tax credit in the income statement, a tax credit of £6.3 million (2015: £nil) has been recognised in equity in the year.

In 2016 the prior year adjustment arises primarily as a result of the recognition of additional losses in the UK and US groups.

The effective rate of tax on the profit before tax of the Group is 12.6% (2015: 90.5%), and the effective rate of tax on the underlying profit before tax of the Group is 20.9% (2015: 20.7%). The increase in the effective rate of tax on the results of the Group is primarily due to the geographic mix of profits, changes to the amounts of deferred tax assets considered recoverable in respect of both tax losses and US interest limitations, prior year adjustments and the recent changes in UK corporation tax rates.

### Factors affecting the tax charge in future years

The Group's future tax charge and effective tax rate could be affected by several factors including; tax reform in countries around the world, including any arising from the implementation of the OECD's BEPS actions and European Commission initiatives such as the proposed anti-tax avoidance directive, tax and financial reporting directive or as a consequence of state aid investigations, future corporate acquisitions and disposals and any restructuring of our business.

## 8. Dividends

|  | 2016<br>£m | 2015<br>£m |
|--|------------|------------|
| <b>Dividends paid on ordinary shares of 1p each</b>                    |            |            |
| Final dividend for the year ended 31 October 2015: £nil (2014: 1.7p)   | –          | 3.2        |
| Interim dividend for the year ended 31 October 2016: £nil (2015: 2.4p) | –          | 4.7        |
| <b>Total dividends</b>   | <b>–</b>   | <b>7.9</b> |

The final dividend of 1.3p per ordinary share will be paid on 18 May 2017 to all shareholders registered at the close of business on 28 April 2017. The ex-dividend date will be 27 April 2017. The total dividend for the year will therefore be 1.3p (2015: 2.4p). The final dividend is subject to approval by the shareholders at the Annual General Meeting and, accordingly, has not been included as a liability in the financial statements for the year ended 31 October 2016.

|  | 2016<br>£m | 2015<br>£m |
|--|------------|------------|
| <b>Dividends declared on ordinary shares of 1p each</b>                |            |            |
| Interim dividend for the year ended 31 October 2016: £nil (2015: 2.4p) | –          | 4.7        |
| Final dividend for the year ended 31 October 2016: 1.3p (2015: £nil)   | <b>3.6</b> | –          |
| <b>Total dividends declared</b>  | <b>3.6</b> | <b>4.7</b> |

## 9. Earnings per share

On 24 February 2016, 85,915,828 new ordinary shares were issued pursuant to the rights issue, with four new ordinary shares issued for every nine existing ordinary shares held. As a result, the total share capital increased to 279,226,442 ordinary shares. For the calculation of earnings per share, the weighted average number of shares in issue for periods prior to the rights issue has been increased by 14.2% to reflect the bonus element of the rights issue.

Earnings per share are based on the average number of shares in issue, excluding own shares held, of 261,386,484 (2015 as restated: 220,675,049) and the profit on continuing operations after tax of £6.5 million (2015: £5.3 million loss). Diluted earnings per share has been calculated using a diluted average number of shares in issue, excluding own shares held, of 266,191,422 (2015 as restated: 220,675,049) and the profit on continuing operations after tax of £6.5 million (2015: £5.3 million loss).

No dilution has been recognised for the purposes of basic earnings per share in 2015 due to there being a loss per share for the year ended 31 October 2015. Dilution has, however, been recognised in the calculation of underlying earnings per share for the year ended 31 October 2016 using a diluted average number of shares in issue, excluding own shares held, of 266,191,422 (2015 as restated: 225,030,669).

The earnings and number of shares used in the calculations are as follows:

|   | 2016<br>Ordinary shares<br>Number<br>000s | 2015<br>Ordinary shares<br>Number<br>000s |
|---|---|---|
| <b>Weighted average number of shares used to calculate basic earnings/(loss) per share</b>          | <b>261,386</b>                            | 193,298                                   |
| Effect of rights issue  | –   | 27,377                                    |
| <b>Restated weighted average number of shares used to calculate basic earnings/(loss) per share</b> | <b>261,386</b>                            | 220,675                                   |
| Additional shares issuable other than at fair value in respect of options outstanding               | <b>4,805</b>                              | –   |
| <b>Weighted average number of shares used to calculate diluted earnings/(loss) per share</b>        | <b>266,191</b>                            | 220,675                                   |
| Additional shares issuable other than at fair value in respect of options outstanding               | –   | 4,356                                     |
| <b>Weighted average number of shares used to calculate diluted underlying earnings per share</b>    | <b>266,191</b>                            | 225,031                                   |

## Continuing operations

|                                      | 2016          |               | 2015        |               |
|--------------------------------------|---------------|---------------|-------------|---------------|
|                                      | Basic<br>£m   | Diluted<br>£m | Basic<br>£m | Diluted<br>£m |
| <b>Underlying profit after tax</b>   | <b>26.9</b>   | <b>26.9</b>   | 15.7        | 15.7          |
| Non-underlying items                 | <b>(20.4)</b> | <b>(20.4)</b> | (21.0)      | (21.0)        |
| <b>Total profit/(loss) after tax</b> | <b>6.5</b>    | <b>6.5</b>    | (5.3)       | (5.3)         |

|                                      | 2016           |                  | 2015*          |                  |
|--------------------------------------|----------------|------------------|----------------|------------------|
|                                      | Basic<br>Pence | Diluted<br>Pence | Basic<br>Pence | Diluted<br>Pence |
| <b>Earnings/(loss) per share</b>     | <b>2.5</b>     | <b>2.4</b>       | (2.4)          | (2.4)            |
| <b>Underlying earnings per share</b> | <b>10.3</b>    | <b>10.1</b>      | 7.1            | 7.0              |

## NOTES TO THE GROUP FINANCIAL STATEMENTS

continued

### 9. Earnings per share continued

#### Continuing and discontinued operations

|                                      | 2016           |                  | 2015           |                  |
|--------------------------------------|----------------|------------------|----------------|------------------|
|                                      | Basic<br>£m    | Diluted<br>£m    | Basic<br>£m    | Diluted<br>£m    |
| <b>Underlying profit after tax</b>   | <b>26.9</b>    | <b>26.9</b>      | 15.7           | 15.7             |
| Non-underlying items                 | (15.8)         | (15.8)           | (16.1)         | (16.1)           |
| <b>Total profit/(loss) after tax</b> | <b>11.1</b>    | <b>11.1</b>      | (0.4)          | (0.4)            |
|                                      | 2016           |                  | 2015*          |                  |
|                                      | Basic<br>Pence | Diluted<br>Pence | Basic<br>Pence | Diluted<br>Pence |
| <b>Profit/(loss) per share</b>       | <b>4.2</b>     | <b>4.2</b>       | (0.2)          | (0.2)            |
| <b>Underlying earnings per share</b> | <b>10.3</b>    | <b>10.1</b>      | 7.1            | 7.0              |

\*Restated, after effects of the rights issue. The number of shares in issue differs from the number held by third parties due to the fact that the Company holds its own shares in treasury. Further information on the Company's own shares held is set out in note 25.

#### Reconciliation of basic profit after tax to underlying profit after tax

Underlying basic earnings are defined as earnings before acquisition and disposal related costs, business restructuring and incident costs, profit/loss on disposal of businesses, items deemed to be of an exceptional nature, impairment of goodwill and acquired intangibles, impairment of assets held for sale, intangible amortisation arising from business combinations and gains/losses on the movement in the fair value of derivative financial instruments, net of related tax effects. The directors consider this measure of earnings allows a more meaningful comparison of earnings trends. A reconciliation of the total and adjusted measures of profit/(loss) after tax is set out below:

|   | 2016<br>£m  | 2015<br>£m |
|---|-------------|------------|
| <b>Profit/(loss) after tax</b>  | <b>11.1</b> | (0.4)      |
| Exclude:  |             |            |
| Acquisition cost and disposal related credits                                     | (4.4)       | (4.4)      |
| Business restructuring and incident costs   | 5.4         | 6.4        |
| Claim related (credit)/costs  | (0.6)       | 8.5        |
| Intangible amortisation arising from business combinations                        | 14.8        | 14.0       |
| Non-underlying accelerated interest costs   | 3.7         | –          |
| Loan note repayment costs   | 1.4         | –          |
| Loss/(gain) on the movement in the fair value of derivative financial instruments | 1.0         | (0.5)      |
| Tax on non-underlying items   | (5.5)       | (7.9)      |
| Non-underlying items  | 15.8        | 16.1       |
| <b>Underlying profit after tax</b>  | <b>26.9</b> | 15.7       |

### 10. Goodwill

|  | £m           |
|--|--------------|
| <b>Cost</b>                              |              |
| At 1 November 2014 as restated           | 175.3        |
| Foreign exchange adjustments as restated | 3.7          |
| At 1 November 2015 as restated           | 179.0        |
| Foreign exchange adjustments             | 27.5         |
| At 31 October 2016                       | 206.5        |
| <b>Accumulated impairment losses</b>     |              |
| At 1 November 2014 as restated           | (55.6)       |
| Foreign exchange adjustments as restated | (2.2)        |
| At 1 November 2015 as restated           | (57.8)       |
| Foreign exchange adjustments             | (15.8)       |
| At 31 October 2016                       | (73.6)       |
| <b>Carrying amount</b>                   |              |
| <b>At 31 October 2016</b>                | <b>132.9</b> |
| At 31 October 2015                       | 121.2        |

The restatement relates to previously fully impaired goodwill of £61.7 million that had been disposed of in an earlier period.

## 10. Goodwill continued

Goodwill acquired in a business combination is allocated at acquisition to the cash-generating units ("CGUs") that are expected to benefit from that business combination. The carrying amount of the goodwill has been allocated to the Group's principal CGUs.

The Group tests goodwill at least annually for impairment. Tests are conducted more frequently if there are indications that goodwill might be impaired. The recoverable amounts of the CGUs are determined from value-in-use calculations. The key assumptions for the value-in-use calculations have been individually estimated for each CGU and include the discount rates and expected changes to cash flows during the period for which management has detailed plans, which are underpinned by the winning and execution of key contracts.

Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to each of the CGUs. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital of 8.1% (2015: 8.8%) which have been adjusted for a premium specific to each of the CGUs to account for differences in currency risk, country risk and other factors affecting specific CGUs, have been used to discount projected cash flows. These premiums range from 2% to 4% (2015: 2% to 5%).

Expected changes to cash flows during the period for which management has detailed plans relate to revenue forecasts, expected contract outcomes and forecast operating margins in each of the operating companies. The relative value ascribed to each varies between CGUs as the budgets are built up from the underlying operating companies within each CGU, but the key assumption for each CGU is that demand from the US and UK governments and customers in our other principal markets for the product offering in each company will recover from its current low base to a level seen historically in the case of Chemring Sensors & Electronic Systems, Inc. CGU and will continue at a similar or slightly enhanced level in the case of Chemring Energetics UK Limited, Roke Manor Research Limited and Chemring Energetic Devices, Inc. CGUs. The final year growth rate assumption in the value-in-use calculation is 0.5% and is based on management's view of industry growth forecasts.

The calculations have used the Group's forecast figures for the next five years. This is based on data derived from the five year plan that has been approved by the Board. At the end of five years, the calculations assume the performance of the CGUs will grow at a nominal annual rate of 0.5% in perpetuity. Growth rates are based on management's view of industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes.

The pre-tax discount rates used for value-in-use calculations and the carrying value of goodwill by the principal CGUs are:

|   | 2016<br>%   | 2015<br>% | 2016<br>£m   | 2015<br>£m |
|---|-------------|-----------|--------------|------------|
| Roke Manor Research Limited                 | <b>13.1</b> | 14.3      | <b>28.4</b>  | 28.4       |
| Chemring Energetics UK Limited              | <b>11.8</b> | 12.9      | <b>18.1</b>  | 18.1       |
| Chemring Sensors & Electronic Systems, Inc. | <b>15.3</b> | 17.4      | <b>38.5</b>  | 30.4       |
| Chemring Energetic Devices, Inc.            | <b>15.4</b> | 17.8      | <b>17.0</b>  | 13.5       |
| Other                                       |             |           | <b>30.9</b>  | 30.8       |
|   |             |           | <b>132.9</b> | 121.2      |

The pre-tax discount rates used for other CGUs ranged from 13.0% to 17.5% (2015: 14.4% to 18.3%).

The weighted average cost of capital is derived using beta values of a comparator group of defence companies adjusted for funding structures as appropriate. The beta values of this group have reduced during the year leading to generally lower pre-tax discount rates being used compared to the year ended 31 October 2015.

Following a detailed review, no impairment losses were recognised in the years ended 31 October 2016 and 31 October 2015.

Stress testing was performed on the forecasts to consider the impact of severe but plausible reasonable worst case scenarios in the first two years, including significant delays to major contracts and new product launches followed by a 10% fall in the forecast cash flows. Under these circumstances, Chemring Sensors & Electronic Systems, Chemring Technology Solutions and Chemring Defence UK would require impairment charges of up to £3.8 million, £1.1 million and £2.9 million respectively against goodwill, but no impairment would be required for any of the other CGUs in these scenarios.

A 1% addition to the discount rate for each CGU was also separately modelled, and would not result in any CGUs requiring any impairment.

The Chemring Sensors & Electronic Systems CGU is expected to grow its annual cash flows strongly over the next two years, benefiting from operational improvements and new product growth.

Setting long-term growth rates beyond the five year forecast period to zero would not result in any CGUs requiring any impairment.

## NOTES TO THE GROUP FINANCIAL STATEMENTS

continued

### 11. Other intangible assets

|                              | Development costs<br>£m | Acquired order book<br>£m | Acquired technology<br>£m | Acquired customer relationships<br>£m | Patents and licences<br>£m | Total<br>£m |
|------------------------------|-------------------------|---------------------------|---------------------------|---------------------------------------|----------------------------|-------------|
| <b>Cost</b>                  |                         |                           |                           |                                       |                            |             |
| At 1 November 2014           | 47.8                    | 17.0                      | 83.5                      | 90.3                                  | 1.4                        | 192.2       |
| Additions                    | 8.9                     | –                         | –                         | –                                     | –                          | –           |
| Disposals                    | (2.7)                   | (17.5)                    | –                         | –                                     | –                          | (17.5)      |
| Transfer between categories  | 0.1                     | –                         | –                         | –                                     | –                          | –           |
| Foreign exchange adjustments | 0.4                     | 0.5                       | 2.3                       | 2.8                                   | 0.1                        | 5.7         |
| At 1 November 2015           | 54.5                    | –                         | 85.8                      | 93.1                                  | 1.5                        | 180.4       |
| Additions                    | 6.7                     | –                         | 0.5                       | 1.6                                   | –                          | 2.1         |
| Disposals                    | (4.0)                   | –                         | (4.7)                     | (28.1)                                | (0.9)                      | (33.7)      |
| Foreign exchange adjustments | 7.2                     | –                         | 19.5                      | 20.9                                  | 0.4                        | 40.8        |
| At 31 October 2016           | 64.4                    | –                         | 101.1                     | 87.5                                  | 1.0                        | 189.6       |
| <b>Amortisation</b>          |                         |                           |                           |                                       |                            |             |
| At 1 November 2014           | (14.6)                  | (16.7)                    | (37.4)                    | (51.5)                                | (0.7)                      | (106.3)     |
| Charge                       | (6.2)                   | (0.3)                     | (7.7)                     | (6.0)                                 | (0.2)                      | (14.2)      |
| Disposals                    | 2.5                     | 17.5                      | –                         | –                                     | –                          | 17.5        |
| Foreign exchange adjustments | (0.1)                   | (0.5)                     | (1.0)                     | (1.6)                                 | (0.1)                      | (3.2)       |
| At 1 November 2015           | (18.4)                  | –                         | (46.1)                    | (59.1)                                | (1.0)                      | (106.2)     |
| Charge                       | (6.8)                   | –                         | (8.6)                     | (6.2)                                 | (0.1)                      | (14.9)      |
| Disposals                    | 3.5                     | –                         | 4.7                       | 28.1                                  | 0.9                        | 33.7        |
| Foreign exchange adjustments | (1.8)                   | –                         | (10.8)                    | (14.0)                                | (0.3)                      | (25.1)      |
| At 31 October 2016           | (23.5)                  | –                         | (60.8)                    | (51.2)                                | (0.5)                      | (112.5)     |
| <b>Carrying amount</b>       |                         |                           |                           |                                       |                            |             |
| <b>At 31 October 2016</b>    | <b>40.9</b>             | <b>–</b>                  | <b>40.3</b>               | <b>36.3</b>                           | <b>0.5</b>                 | <b>77.1</b> |
| At 31 October 2015           | 36.1                    | –                         | 39.7                      | 34.0                                  | 0.5                        | 74.2        |

Acquired intangibles are recognised at fair value on acquisition and are amortised over their estimated useful lives. Fair values for acquired intangibles are assessed by reference to future estimated cash flows, discounted at an appropriate rate to present value, or by reference to the amount that would have been paid in an arm's length transaction between two knowledgeable and willing parties. Other intangible assets are recognised at cost and are amortised over their estimated useful economic lives, which are set out in the accounting policies section.

The acquired order book was disposed of during the year ended 31 October 2015 as a result of it being fully written down.

Included within the development costs of £40.9 million, individually material balances relate to CENTURION £3.6 million (2015: £3.8 million), electronic attack £3.7 million (2015: £2.2 million), Perception £2.9 million (2015: £3.6 million), Joint Biological Tactical Detection System £6.7 million (2015: £3.7 million) and Next Generation Chemical Detector £8.2 million (2015: £5.3 million). Development costs are amortised over their useful economic lives, estimated to be between three and fifteen years, with the remaining amortisation periods for these assets ranging up to thirteen years.

Acquired technology of £40.3 million includes individually material balances relating to Chemring Sensors & Electronic Systems £4.8 million (2015: £4.4 million), Chemring Energetic Devices £13.0 million (2015: £12.9 million) and Roke £3.1 million (2015: £3.6 million). The remaining amortisation periods for these assets are seven years, three years and six years respectively.

Acquired customer relationships of £36.3 million include individually material balances relating to Chemring Energetic Devices £7.9 million (2015: £6.8 million), Chemring Ordnance £10.4 million (2015: £3.9 million), Chemring Sensors & Electronics £4.9 million (2015: £4.5 million) and Roke £4.4 million (2015: £5.5 million). The remaining amortisation periods for these assets are ten years, five years and four years respectively.

## 12. Property, plant and equipment

|                              | Land and<br>buildings<br>£m | Plant and<br>equipment<br>£m | Total<br>£m  |
|------------------------------|-----------------------------|------------------------------|--------------|
| <b>Cost or valuation</b>     |                             |                              |              |
| At 1 November 2014           | 88.9                        | 119.2                        | 208.1        |
| Additions                    | 2.0                         | 7.3                          | 9.3          |
| Disposals                    | (0.2)                       | (4.7)                        | (4.9)        |
| Transfer between categories  | 15.1                        | (14.8)                       | 0.3          |
| Foreign exchange adjustments | (0.8)                       | (1.1)                        | (1.9)        |
| At 1 November 2015           | 105.0                       | 105.9                        | 210.9        |
| Additions                    | 1.6                         | 8.7                          | 10.3         |
| Disposals                    | (0.2)                       | (4.4)                        | (4.6)        |
| Foreign exchange adjustments | 15.5                        | 22.1                         | 37.6         |
| At 31 October 2016           | 121.9                       | 132.3                        | 254.2        |
| <b>Depreciation</b>          |                             |                              |              |
| At 1 November 2014           | (6.0)                       | (25.0)                       | (31.0)       |
| Charge                       | (3.1)                       | (13.2)                       | (16.3)       |
| Disposals                    | 0.2                         | 4.6                          | 4.8          |
| Transfer between categories  | (0.1)                       | (0.2)                        | (0.3)        |
| Foreign exchange adjustments | –                           | (0.1)                        | (0.1)        |
| At 1 November 2015           | (9.0)                       | (33.9)                       | (42.9)       |
| Charge                       | (3.5)                       | (14.9)                       | (18.4)       |
| Disposals                    | 0.1                         | 4.2                          | 4.3          |
| Transfer between categories  | 0.1                         | (0.1)                        | –            |
| Foreign exchange adjustments | (3.9)                       | (13.4)                       | (17.3)       |
| At 31 October 2016           | (16.2)                      | (58.1)                       | (74.3)       |
| <b>Carrying amount</b>       |                             |                              |              |
| <b>At 31 October 2016</b>    | <b>105.7</b>                | <b>74.2</b>                  | <b>179.9</b> |
| At 31 October 2015           | 96.0                        | 72.0                         | 168.0        |

The carrying amount of the Group's plant and equipment includes £0.2 million (2015: £3.7 million) in respect of assets held under finance leases. During the year, £nil (2015: £0.6 million) of interest was capitalised, as set out in note 6. In the year, £1.2 million (2015: £0.7 million) of capitalised interest was charged as depreciation on completion of the relevant projects. This results in a net book value for capitalised interest of £13.5 million (2015: £14.7 million).

Land and buildings were revalued at 30 September 1997 by Chestertons Chartered Surveyors, independent valuers not connected with the Group, on the basis of depreciated replacement cost for two pyrotechnic sites and on open market for the remainder, which represent level 2 measurements in the fair value hierarchy.

|   | 2016<br>£m   | 2015<br>£m |
|---|--------------|------------|
| 30 September 1997 depreciated replacement cost          | 5.8          | 5.8        |
| Freehold at cost  | 116.1        | 99.2       |
| <b>Cost of land and buildings as at 31 October 2016</b> | <b>121.9</b> | 105.0      |

If stated under historical cost principles, the comparable amounts for the total of land and buildings would be:

|                              | 2016<br>£m   | 2015<br>£m |
|------------------------------|--------------|------------|
| Cost                         | 119.9        | 103.0      |
| Accumulated depreciation     | (15.5)       | (8.3)      |
| <b>Historical cost value</b> | <b>104.4</b> | 94.7       |

All other tangible fixed assets are stated at historical cost.

At 31 October 2016, the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £2.5 million (2015: £1.5 million).



## NOTES TO THE GROUP FINANCIAL STATEMENTS

### continued

### 13. Subsidiary undertakings

All subsidiary undertakings have been reflected in these financial statements. The subsidiary undertakings held at 31 October 2016, all 100% owned by the Group, are shown below. All of these subsidiary undertakings are wholly controlled by Chemring Group PLC.

|   | Country of incorporation (or registration) and operation | Operating segment        |
|---|--|--------------------------|
| <b>Subsidiary undertaking</b>                 |  |                          |
| Chemring Australia Pty Limited                | Australia  | Countermeasures          |
| B.D.L Systems Limited                         | England  | Dormant                  |
| Celco Industries (USA) Limited                | England  | Dormant                  |
| Chemring Countermeasures Limited              | England  | Countermeasures          |
| Chemring Defence UK Limited                   | England  | Energetic Systems        |
| Chemring Energetics Limited                   | England  | Non-trading              |
| Chemring Europe Limited                       | England  | Non-trading              |
| Chemring Finance Europe Investments Limited   | England  | Non-trading              |
| Chemring Finance Europe Limited               | England  | Non-trading              |
| Chemring International Limited                | England  | Non-trading              |
| Chemring Investments Limited                  | England  | Non-trading              |
| Chemring Limited                              | England  | Dormant                  |
| Chemring North America Unlimited              | England  | Holding Company          |
| Chemring Prime Contracts Limited              | England  | Energetic Systems        |
| Chemring Technology Solutions Limited         | England  | Sensors & Electronics    |
| CHG Design Limited                            | England  | Dormant                  |
| CHG Overseas Investments Limited              | England  | Non-trading              |
| CHG Overseas Limited                          | England  | Holding Company          |
| Chemring UAE Limited                          | England  | Non-trading              |
| Coated Electrodes UK Limited                  | England  | Dormant                  |
| Greys Exports Limited                         | England  | Dormant                  |
| Haley and Weller Limited                      | England  | Dormant                  |
| Karma Industries No 1 Limited                 | England  | Dormant                  |
| Karma Industries No 2 Limited                 | England  | Dormant                  |
| Kembrey Corporate Trustee Limited             | England  | Dormant                  |
| Kembrey Electronics Limited                   | England  | Dormant                  |
| Kembrey Engineering Limited                   | England  | Dormant                  |
| Kembrey Group Limited                         | England  | Dormant                  |
| Kembrey Industries Limited                    | England  | Dormant                  |
| Kembrey Limited                               | England  | Dormant                  |
| Kembrey Technologies Limited                  | England  | Dormant                  |
| Leaffield Engineering Limited                 | England  | Non-trading              |
| Nobel Energetics Limited                      | England  | Dormant                  |
| Parkway No 3 Limited                          | England  | Dormant                  |
| Parkway No 7 Limited                          | England  | Dormant                  |
| Parkway No 8 Limited                          | England  | Dormant                  |
| Parkway No 9 Limited                          | England  | Dormant                  |
| Parkway No 10 Limited                         | England  | Non-trading              |
| Protox Environmental Systems Limited          | England  | Dormant                  |
| PW Defence Limited                            | England  | Dormant                  |
| Richmond EEI Limited                          | England  | Dormant                  |
| Richmond Electronics & Engineering Limited    | England  | Dormant                  |
| Ripault Drivex Limited                        | England  | Dormant                  |
| Roke Manor Research Limited                   | England  | Sensors & Electronics    |
| Sarclad Rolltex Limited                       | England  | Dormant                  |
| Schermuly Limited                             | England  | Dormant                  |
| Chemring Luxembourg Finance SARL              | Luxembourg   | Holding Company          |
| Chemring Luxembourg Holding SARL              | Luxembourg   | Holding Company          |
| 3d-Radar AS                                   | Norway   | Sensors & Electronics    |
| Chemring Nobel AS                             | Norway   | Energetic Systems        |
| Chemring Energetics UK Limited                | Scotland   | Energetic Systems        |
| Allied Technology LLC                         | USA  | Holding Company          |
| Alloy Surfaces Company, Inc.                  | USA  | Countermeasures          |
| ASC Realty LLC                                | USA  | Property Holding Company |
| Chemring Energetic Devices, Inc.              | USA  | Energetic Systems        |
| Chemring Military Products, Inc.              | USA  | Energetic Systems        |
| Chemring North America Administration, Inc.   | USA  | Dormant                  |
| Chemring North America Group, Inc.            | USA  | Holding Company          |
| Chemring Ordnance, Inc.                       | USA  | Energetic Systems        |
| CHG Flares, Inc.                              | USA  | Holding Company          |
| CHG Group, Inc.                               | USA  | Head Office              |
| Kilgore Flares Company LLC                    | USA  | Countermeasures          |
| Chemring Sensors and Electronic Systems, Inc. | USA  | Sensors & Electronics    |
| Technical Ordnance, Inc.                      | USA  | Non-trading              |
| Titan Dynamics Systems, Inc.                  | USA  | Dormant                  |
| <b>Associated undertaking</b>                 |  |                          |
| Chemring Asia Services Pvt Limited (*)        | India  | Non-trading              |

\* The Group owns 49% of the issued share capital. The associate did not trade during the year.

## 14. Inventories

|                  | 2016<br>£m   | 2015<br>£m  |
|------------------|--------------|-------------|
| Raw materials    | 37.7         | 28.7        |
| Work in progress | 38.6         | 51.7        |
| Finished goods   | 28.5         | 15.8        |
|                  | <b>104.8</b> | <b>96.2</b> |

There are no significant differences between the replacement cost of inventory and the fair values shown above. The Group recognised £3.2 million (2015: £2.3 million) as a write down of inventories to net realisable value.

## 15. Trade and other receivables

|                                | 2016<br>£m   | 2015<br>£m  |
|--------------------------------|--------------|-------------|
| Trade receivables              | 83.6         | 67.1        |
| Allowance for doubtful debts   | (0.9)        | (1.0)       |
|                                | <b>82.7</b>  | <b>66.1</b> |
| Contract receivables           | 7.0          | 15.2        |
| Other receivables              | 2.5          | 5.0         |
| Prepayments and accrued income | 22.0         | 6.8         |
|                                | <b>114.2</b> | <b>93.1</b> |

All amounts shown above are due within one year.

The average credit period taken by customers on sales of goods, calculated using a countback basis, is 24 days (2015: 34 days). No interest is charged on receivables from the date of invoice to payment.

The Group's policy is to provide in full for trade receivables outstanding for more than 120 days beyond agreed terms, unless there are facts and circumstances that support recoverability.

Within the trade receivables balance at 31 October 2016, £8.6 million was due from Pacem Solutions, LLC in respect of sales in the year ended 31 October 2014. The directors believe this amount to be recoverable. As all remaining significant overdue receivables are covered by the allowance for doubtful debts, an ageing analysis has not been shown. The majority of the trade receivables balance was not yet due at the year end based on the credit terms provided to customers.

The directors consider that the carrying amount of trade and other receivables approximates to their fair values.

Of the trade receivables balance at the end of the year, £19.6 million was due from Pacem Solutions, LLC, £7.7 million was due from Royal Saudi Air Force, £6.1 million was due from Global Ordnance, LLC, £4.8 million was due from the Australian DMO, £4.5 million was due from Lockheed Martin and £4.2 million was due from UDC USA. There are no other customers who represent more than 5% of the total trade receivables.

Prepayments increased significantly in the year, principally in Energetic Systems. This was mainly due to advance supplier payments made by Chemring Ordnance in order to secure continuing production with supplies needed for the 40mm and other Middle East contracts.

## 16. Cash and cash equivalents

Bank balances and cash comprise cash held by the Group and short-term deposits with an original maturity of three months or less. The carrying amount of these assets approximates to their fair value.

Included within cash is £nil (2015: £0.1 million) of restricted cash.

## NOTES TO THE GROUP FINANCIAL STATEMENTS

continued

### 17. Borrowings

|  |                         | 2016<br>£m   | 2015<br>£m   |
|--|-------------------------|--------------|--------------|
| <b>Within current liabilities</b>              |                         |              |              |
| Loan notes                                     | - US dollar denominated | 29.5         | –            |
| Finance leases                                 | - Sterling denominated  | 0.1          | 0.5          |
| <b>Borrowings due within one year</b>          |                         | <b>29.6</b>  | <b>0.5</b>   |
| <b>Within non-current liabilities</b>          |                         |              |              |
| Loan notes                                     | - Sterling denominated  | 5.3          | 8.1          |
|  | - US dollar denominated | 115.7        | 153.2        |
| Preference shares                              |                         | 0.1          | 0.1          |
| <b>Borrowings due after more than one year</b> |                         | <b>121.1</b> | <b>161.4</b> |
|  |                         | <b>150.7</b> | <b>161.9</b> |

Analysis of borrowings by currency:

|           | 2016<br>£m   | 2015<br>£m   |
|-----------|--------------|--------------|
| Sterling  | 5.5          | 8.7          |
| US dollar | 145.2        | 153.2        |
|           | <b>150.7</b> | <b>161.9</b> |

The weighted average interest rates paid were as follows:

|                 | 2016<br>%      | 2015<br>%      |
|-----------------|----------------|----------------|
| Bank overdrafts | 2.9            | 3.1            |
| UK bank loans   | 2.9            | 3.1            |
| Loan notes      | 7.6            | 7.6            |
|                 | <b>6.0–7.0</b> | <b>4.7–7.0</b> |

An analysis of borrowings by maturity is as follows:

|                            | 2016                                  |                     |                           |              | 2015                                  |                     |                           |              |
|----------------------------|---------------------------------------|---------------------|---------------------------|--------------|---------------------------------------|---------------------|---------------------------|--------------|
|                            | Bank<br>loans and<br>overdrafts<br>£m | Loan<br>notes<br>£m | Other<br>borrowings<br>£m | Total<br>£m  | Bank<br>loans and<br>overdrafts<br>£m | Loan<br>notes<br>£m | Other<br>borrowings<br>£m | Total<br>£m  |
| Borrowings falling due:    |                                       |                     |                           |              |                                       |                     |                           |              |
| - within one year          | –                                     | 29.5                | 0.1                       | 29.6         | –                                     | –                   | 0.5                       | 0.5          |
| Borrowings falling due:    |                                       |                     |                           |              |                                       |                     |                           |              |
| - within one to two years  | –                                     | 53.8                | –                         | 53.8         | –                                     | 28.4                | –                         | 28.4         |
| - within two to five years | –                                     | 67.2                | –                         | 67.2         | –                                     | 132.9               | –                         | 132.9        |
| - after five years         | –                                     | –                   | 0.1                       | 0.1          | –                                     | –                   | 0.1                       | 0.1          |
|                            | –                                     | 121.0               | 0.1                       | 121.1        | –                                     | 161.3               | 0.1                       | 161.4        |
| <b>Total borrowings</b>    | <b>–</b>                              | <b>150.5</b>        | <b>0.2</b>                | <b>150.7</b> | <b>–</b>                              | <b>161.3</b>        | <b>0.6</b>                | <b>161.9</b> |

Other borrowings comprise finance leases and preference shares.

The Group has a £100.0 million, four year revolving credit facility with a syndicate of three banks expiring in July 2018; the facility was increased from £70.0 million during the year. In addition, the Group has ancillary UK facilities of £60.4 million in respect of bonding and trade finance requirements, and a \$15.0 million facility to fulfil US trade finance and working capital requirements. None of the borrowings in the current or the prior year were secured.

## 17. Borrowings continued

There have been no breaches of the terms of the loan agreements during the current or prior year.

The Group has the following undrawn borrowing facilities available, in respect of which all conditions precedent have been met. Interest costs under these facilities are charged at floating rates.

|                                     | 2016<br>£m   | 2015<br>£m  |
|-------------------------------------|--------------|-------------|
| <b>Undrawn borrowing facilities</b> | <b>108.0</b> | <b>78.5</b> |

The Group is subject to two key financial covenants, which are tested quarterly. These covenants relate to the leverage ratio, being the ratio between underlying earnings before interest, tax, depreciation and amortisation ("underlying EBITDA") and debt, and the interest cover ratio between underlying EBITDA and finance costs. The calculation of these ratios involve the translation of non-sterling denominated debt using average, rather than closing, rates of exchange. The revolving credit facility and the loan notes have differing covenant compliance calculations.

In respect of the revolving credit facility, leverage is measured by reference to net debt. The maximum permitted ratio of net debt to underlying EBITDA under the revolving credit facilities is 3.00x. The permitted ratio at October 2015 and January 2016 was amended to 3.90x with the agreement of the revolving credit facility syndicate in January 2016.

The provisions of the private placement loan notes contain two leverage tests, each of which are tested quarterly. The first test measures leverage by reference to total gross debt. The maximum permitted ratio of gross debt to underlying EBITDA is 3.75x. This was amended to 4.00x for the October 2015 and January 2016 tests. The second test measures leverage by reference to adjusted debt, which is calculated as total gross debt less certain disposal proceeds that had previously been offered to the noteholders but had not been accepted. The value of such proceeds at 31 October 2016 was £nil (2015: £4.6 million). The maximum permitted ratio of adjusted debt to underlying EBITDA is 3.00x. For the tests at October 2015 and January 2016 this was also amended to 4.00x.

The Group complied with these covenants throughout the year, and the result of covenant tests at the year end are detailed below:

|   | 2016         | 2015  |
|---|--------------|-------|
| <b>Covenant ratios - revolving credit facility</b>          |              |       |
| Maximum allowed ratio of net debt to underlying EBITDA      | <b>3.00x</b> | 3.90x |
| Actual ratio of net debt to underlying EBITDA               | <b>1.15x</b> | 2.83x |
| Minimum allowed ratio of underlying EBITDA to finance costs | <b>4.00x</b> | 3.50x |
| Actual ratio of underlying EBITDA to finance costs          | <b>6.82x</b> | 4.75x |
| <b>Covenant ratios - loan note agreements</b>               |              |       |
| Maximum allowed ratio of adjusted debt to underlying EBITDA | <b>3.00x</b> | 4.00x |
| Actual ratio of adjusted debt to underlying EBITDA          | <b>1.89x</b> | 2.84x |
| Maximum allowed ratio of total debt to underlying EBITDA    | <b>3.75x</b> | 4.00x |
| Actual ratio of total debt to underlying EBITDA             | <b>1.89x</b> | 2.92x |
| Minimum allowed ratio of underlying EBITDA to finance costs | <b>3.50x</b> | 3.50x |
| Actual ratio of underlying EBITDA to finance costs          | <b>6.54x</b> | 4.67x |

# NOTES TO THE GROUP FINANCIAL STATEMENTS

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## 18. Obligations under finance leases

|   | Minimum lease payments |            | Present value of minimum lease payments |            |
|---|------------------------|------------|---|------------|
|   | 2016<br>£m             | 2015<br>£m | 2016<br>£m                              | 2015<br>£m |
| Amounts payable under finance leases:                             |                        |            |   |            |
| - within one year   | 0.1                    | 0.5        | 0.1                                     | 0.5        |
| - within two to five years  | –                      | –          | –                                       | –          |
| Present value of lease obligations                                | 0.1                    | 0.5        | 0.1                                     | 0.5        |
| Less amounts due within one year shown within current liabilities |                        |            | (0.1)                                   | (0.5)      |
| <b>Amounts due for settlement after one year</b>                  |                        |            | –                                       | –          |

Finance lease obligations attract interest rates of between 2% and 3% above base rate. Lease obligations are denominated in sterling and US dollars.

The fair value of the Group's leases approximates to their carrying amounts.

The Group's obligations under finance leases are secured by the lessors' title to the underlying leased assets.

## 19. Trade and other payables

|                                       | 2016<br>£m   | 2015<br>£m  |
|---------------------------------------|--------------|-------------|
| <b>Within current liabilities</b>     |              |             |
| Trade payables                        | 53.5         | 46.7        |
| Other payables                        | 17.7         | 16.1        |
| Interest payable                      | 4.1          | 4.4         |
| Other tax and social security         | 3.0          | 3.7         |
| Advance payments                      | 12.4         | 11.5        |
| Accruals and deferred income          | 16.6         | 13.8        |
|                                       | <b>107.3</b> | <b>96.2</b> |
| <b>Within non-current liabilities</b> |              |             |
| Other payables                        | 4.0          | 1.7         |

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. Advance payments are amounts received from customers on larger contracts to fund working capital. The directors consider that the carrying amount of payables approximates to their fair value.

The average credit period taken on purchases of goods is 106 days (2015: 92 days). No interest is charged on trade payables from the date of invoice to payment.

## 20. Financial instruments and risk management

The Group uses financial instruments to manage financial risk wherever it is appropriate to do so. The main risks addressed by financial instruments are foreign exchange rate risk and liquidity risk. The Group's policies in respect of the management of these risks, which remained unchanged throughout the year, are set out below.

The Group's global activities expose it to the financial risks of changes in foreign currency exchange rates. The Group enters into forward foreign exchange contracts to manage its exposure to transactional foreign currency risks.

### Foreign exchange risk management

The Group undertakes certain transactions denominated in foreign currencies, giving rise to exposures to exchange rate fluctuations. Foreign exchange risk can be subdivided into two components, transactional risk and translation risk:

|                           |   |
|---------------------------|---|
| <b>Transactional risk</b> | The Group's policy is to hedge transactional currency exposures through the use of forward foreign exchange contracts. The measurement and control of this risk is monitored on a Group-wide basis.   |
| <b>Translation risk</b>   | The Group translates the results and net assets of overseas operations in accordance with the accounting policy within the Accounting Policies section. The translation risk on net assets is mitigated by the transfer of currencies between Group companies and the appropriate use of foreign currency borrowings. |

## 20. Financial instruments and risk management continued

The sterling equivalents of the carrying amounts of the Group's foreign currency denominated monetary assets and liabilities at the year end were as follows:

|                           | 2016           |              |                 |                   | 2015      |       |                 |                   |
|---------------------------|----------------|--------------|-----------------|-------------------|-----------|-------|-----------------|-------------------|
|                           | US dollar      | Euro         | Norwegian krone | Australian dollar | US dollar | Euro  | Norwegian krone | Australian dollar |
| Monetary assets (£m)      | <b>85.1</b>    | –            | <b>7.8</b>      | <b>6.4</b>        | 41.9      | –     | 5.2             | 2.1               |
| Monetary liabilities (£m) | <b>(184.8)</b> | <b>(0.3)</b> | <b>(3.6)</b>    | <b>(2.4)</b>      | (179.9)   | (0.3) | (2.3)           | (2.7)             |

Foreign currency denominated net assets are partially hedged by foreign currency borrowings. The borrowings detailed below were designated as hedging instruments in net investment hedges. The decrease resulted from a £48.8 million pay down of loan notes following the rights issues, offset by fluctuations in foreign exchange rates.

|                 | 2016         |      |                 |                   | 2015      |      |                 |                   |
|-----------------|--------------|------|-----------------|-------------------|-----------|------|-----------------|-------------------|
|                 | US dollar    | Euro | Norwegian krone | Australian dollar | US dollar | Euro | Norwegian krone | Australian dollar |
| Borrowings (£m) | <b>148.1</b> | –    | –               | –                 | 153.7     | –    | –               | –                 |

The Group uses forward foreign exchange contracts to hedge its currency risk, most with a maturity of less than one year from inception. The exchange rates which have the most significant effect on the Group are those relating to the US dollar and the Euro.

The following table details the forward foreign exchange contracts outstanding:

|           | Average exchange rate |      | Expiring within one year |         | Expiring within one to two years |         |
|-----------|-----------------------|------|--------------------------|---------|----------------------------------|---------|
|           | 2016                  | 2015 | 2016 £m                  | 2015 £m | 2016 £m                          | 2015 £m |
| US dollar | <b>1.26</b>           | 1.56 | <b>41.7</b>              | 53.6    | <b>0.2</b>                       | 6.6     |
| Euro      | –                     | 1.37 | –                        | 0.5     | –                                | –       |

The principal amounts of the Group's US dollar loan notes have been accounted for as a net investment hedge of the US businesses. This hedge was effective throughout the year and the losses arising on translation of the loan notes were taken to reserves alongside the gains on retranslation of the US businesses. The Norwegian and Australian businesses have no net investment hedge. The retranslation of these businesses is taken directly to reserves.

### Foreign currency sensitivity analysis

The following table details the Group's sensitivity to a 10 cent movement in the relevant foreign currencies against sterling with regards to its income statement. This sensitivity represents management's assessment of a reasonably possible change in foreign exchange rates. This sensitivity analysis only includes translation of the results of foreign currency denominated companies and so does not reflect the impact on the results of sterling or other currency companies that have transactions in US dollars.

|                                     | +10 cents        |         | –10 cents        |         |
|-------------------------------------|------------------|---------|------------------|---------|
|                                     | US dollar impact |         | US dollar impact |         |
|                                     | 2016 £m          | 2015 £m | 2016 £m          | 2015 £m |
| Revenue                             | <b>(19.0)</b>    | (11.6)  | <b>22.0</b>      | 13.2    |
| Underlying operating profit         | <b>(2.0)</b>     | (0.6)   | <b>2.3</b>       | 0.6     |
| Interest                            | <b>0.6</b>       | 0.6     | <b>(0.7)</b>     | (0.7)   |
| <b>Underlying profit before tax</b> | <b>(1.4)</b>     | –       | <b>1.6</b>       | (0.1)   |

### Interest rate risk

The Group finances its operations through a combination of retained profits, bank and loan note borrowings, and finance leases.

The UK borrowings are denominated in sterling and US dollars, and at the shorter end are subject to floating rates of interest.

At 31 October 2016, the Group had outstanding fixed interest loan notes in the US totalling £153.4 million (2015: £166.5 million). On 21 November 2016, the Group repaid \$36.0 million of outstanding loan notes out of existing cash resources. The remaining loan notes are repayable in November 2017 (£5.3 million and \$61.2 million) and November 2019 (\$83.6 million). The loan notes provide a natural hedge against the Group's investment in its US businesses.

## NOTES TO THE GROUP FINANCIAL STATEMENTS

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### 20. Financial instruments and risk management continued

As the Group has predominantly fixed interest rate debt, a change in interest rates would not have an immediate significant impact on the income statement. An increase/(decrease) in interest rates of 1% would cause the Group's finance expense to increase/(decrease) by £0.3 million.

#### Liquidity risk

The table below details the maturity profile of the Group's derivative financial instruments and loans (excluding finance leases, preference shares and capitalised facility fees):

|                            | 2016                      |                            |             | 2015                      |                            |             |
|----------------------------|---------------------------|----------------------------|-------------|---------------------------|----------------------------|-------------|
|                            | Derivative payables<br>£m | Loans and overdrafts<br>£m | Total<br>£m | Derivative payables<br>£m | Loans and overdrafts<br>£m | Total<br>£m |
| Falling due:               |                           |                            |             |                           |                            |             |
| - within one year          | 43.1                      | 29.5                       | 72.6        | 54.1                      | –                          | 54.1        |
| - within one to two years  | 0.2                       | 55.4                       | 55.6        | 6.6                       | 31.6                       | 38.2        |
| - within two to five years | –                         | 68.5                       | 68.5        | –                         | 134.9                      | 134.9       |
|                            | 43.3                      | 153.4                      | 196.7       | 60.7                      | 166.5                      | 227.2       |

The profile of the Group's financial assets by underlying currency and balance sheet classification is as follows:

|                                  | 2016<br>£m | 2015<br>£m |
|----------------------------------|------------|------------|
| Sterling                         | 68.7       | 51.2       |
| US dollar                        | 129.6      | 68.8       |
| Australian dollar                | 5.8        | 1.4        |
| Euro                             | 0.9        | 0.1        |
| Other currencies                 | 8.5        | 6.0        |
|                                  | 213.5      | 127.5      |
| Overdraft offset                 | (57.7)     | (33.1)     |
|                                  | 155.8      | 94.4       |
|                                  | 2016<br>£m | 2015<br>£m |
| Cash at bank and in hand         | 63.1       | 7.6        |
| Trade receivables                | 82.7       | 66.1       |
| Contract receivables             | 7.0        | 15.2       |
| Other receivables                | 2.5        | 5.0        |
| Derivative financial instruments | 0.5        | 0.5        |
|                                  | 155.8      | 94.4       |

The majority of cash balances held in the UK and the US have a right of offset against overdraft balances.

The foreign currency balances are predominantly attributable to overseas business units and therefore do not result in significant exposure to transactional risks for the Group. Included within cash is £nil (2015: £0.1 million) of restricted cash.

The profile of the Group's financial liabilities by underlying currency and balance sheet classification is as follows:

|                  | 2016                |                  |             | 2015                |                  |             |
|------------------|---------------------|------------------|-------------|---------------------|------------------|-------------|
|                  | Floating rate<br>£m | Fixed rate<br>£m | Total<br>£m | Floating rate<br>£m | Fixed rate<br>£m | Total<br>£m |
| Sterling         | –                   | 65.8             | 65.8        | –                   | 76.5             | 76.5        |
| US dollar        | –                   | 236.3            | 236.3       | –                   | 211.6            | 211.6       |
| Other currencies | –                   | 7.9              | 7.9         | –                   | 1.1              | 1.1         |
|                  | –                   | 310.0            | 310.0       | –                   | 289.2            | 289.2       |
| Overdraft offset |                     | (57.7)           | (57.7)      |                     |                  | (33.1)      |
|                  |                     |                  | 252.3       |                     |                  | 256.1       |



## 20. Financial instruments and risk management continued

|   | 2016<br>£m | 2015<br>£m |
|---|------------|------------|
| Loan notes  | 150.5      | 161.3      |
| Preference shares (note 23)                                   | 0.1        | 0.1        |
| Obligations under finance leases (note 18)                    | 0.1        | 0.5        |
|   | 150.7      | 161.9      |
| Trade payables  | 53.5       | 46.7       |
| Accruals  | 13.7       | 9.1        |
| Interest payable  | 4.1        | 4.4        |
| Other payables  | 21.7       | 20.5       |
| Other tax and social security                                 | 3.0        | 3.7        |
| Corporation tax   | 3.1        | 7.9        |
| Derivative financial instruments due within one year          | 2.5        | 1.6        |
| Derivative financial instruments due after more than one year | –          | 0.3        |
|   | 252.3      | 256.1      |

The weighted average interest rate of fixed rate financial liabilities at 31 October 2016 was 6.6% (2015: 6.0%) and the weighted average period of funding was two years (2015: three years).

### Derivative financial instruments

The Group has forward foreign exchange contracts with fair values of £2.5 million liability (2015: £1.9 million liability) and £0.5 million asset (2015: £0.5 million asset). The net value of these derivative financial instruments is a liability of £2.0 million (2015: £1.4 million).

The following table details the fair value of derivative financial instrument liabilities recognised in the balance sheet:

|   | 2016<br>£m   | 2015<br>£m   |
|---|--------------|--------------|
| Included in current assets                | 0.5          | 0.5          |
| Included in current liabilities           | (2.5)        | (1.6)        |
| Included in non-current liabilities       | –            | (0.3)        |
| <b>Forward foreign exchange contracts</b> | <b>(2.0)</b> | <b>(1.4)</b> |

The following table details the loss/(gain) on the movement in the fair value of derivative financial instruments recognised in the income statement:

|  | 2016<br>£m | 2015<br>£m   |
|--|------------|--------------|
| <b>Loss/(gain) on the movement in the fair value of derivative financial instruments</b> | <b>1.0</b> | <b>(0.5)</b> |

### Fair value hierarchy

IFRS 7 *Financial Instruments: Disclosures* requires companies that carry financial instruments at fair value in the balance sheet to disclose their level of visibility, determining into which category those financial instruments fall under the fair value hierarchy.

The fair value measurement hierarchy is as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – inputs for the asset or liability that are not based on observable market data (i.e. as unobservable inputs).

## NOTES TO THE GROUP FINANCIAL STATEMENTS

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### 20. Financial instruments and risk management continued

The following tables present the Group's assets and liabilities that are measured at fair value:

|                                    | 2016          |               |             | 2015          |               |             |
|------------------------------------|---------------|---------------|-------------|---------------|---------------|-------------|
|                                    | Level 1<br>£m | Level 2<br>£m | Total<br>£m | Level 1<br>£m | Level 2<br>£m | Total<br>£m |
| <b>Assets</b>                      |               |               |             |               |               |             |
| Forward foreign exchange contracts | –             | 0.5           | 0.5         | –             | 0.5           | 0.5         |
| <b>Total assets</b>                | –             | 0.5           | 0.5         | –             | 0.5           | 0.5         |

|                                    | 2016          |               |             | 2015          |               |             |
|------------------------------------|---------------|---------------|-------------|---------------|---------------|-------------|
|                                    | Level 1<br>£m | Level 2<br>£m | Total<br>£m | Level 1<br>£m | Level 2<br>£m | Total<br>£m |
| <b>Liabilities</b>                 |               |               |             |               |               |             |
| Borrowings                         | –             | (150.5)       | (150.5)     | –             | (161.3)       | (161.3)     |
| Forward foreign exchange contracts | –             | (2.5)         | (2.5)       | –             | (1.9)         | (1.9)       |
| <b>Total liabilities</b>           | –             | (153.0)       | (153.0)     | –             | (163.2)       | (163.2)     |

There were no assets or liabilities that were classed under Level 3 on the fair value hierarchy. The fair value of derivative financial instruments is estimated by discounting the future contracted cash flow, using readily available market data.

#### Credit risk

The Group's principal financial assets are bank balances and cash, and trade and other receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets. Whilst the Group does not have any significant credit risk exposure to any single counterparty in respect of bank balances and cash, the credit risk on liquid funds and derivative financial instruments is monitored on an ongoing basis using credit ratings assigned by international credit rating agencies, the credit default swap market and market capitalisation.

The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful debts, based on prior experience and an assessment of the current economic environment. Trade receivables are attributable to a small number of customers spread across a diverse geographical area. Customers are mainly multinational organisations or government agencies with whom the Group has long-term business relationships. The Group's principal customers are government defence departments, such as the US Department of Defense, the UK Ministry of Defence and the Kingdom of Saudi Arabia Ministry of Defence and Aviation, US and UK defence prime contractors, such as Lockheed Martin, BAE Systems and General Dynamics, and distributors of products for their onward sale to end users.

Counterparties are monitored on an ongoing basis for credit risk and, at the balance sheet date, the risk was deemed to be low. Ongoing credit evaluation is performed on the financial condition of accounts receivable and action is taken to minimise credit risk.

The Group's accounting policies and control procedures require letters of credit to be put in place for the majority of contracts with overseas customers.

The Group's pricing risk is primarily in relation to the cost of raw materials and is not considered significant. Pricing risk is managed through negotiations with suppliers and, where appropriate, the agreement of fixed-price supply contracts.

#### Capital management

The Board seeks to maintain a strong capital base so as to maintain investor, creditor and market confidence, and to sustain future development of the business. From time to time, the Group purchases its own shares on the market; the timing of these purchases depends on market prices. Primarily, such shares are intended to be used for satisfying awards under the Group's share-based incentive schemes. Buy and sell decisions are made on a specific transaction basis by the Board.

Neither the Company nor any of its subsidiaries are subject to externally-imposed capital requirements.

## 21. Provisions

|                              | Legal provision<br>£m | Environmental provision<br>£m | Warranty provision<br>£m | Restructuring provision<br>£m | Disposal provision<br>£m | Other provision<br>£m | Total<br>£m |
|------------------------------|-----------------------|-------------------------------|--------------------------|-------------------------------|--------------------------|-----------------------|-------------|
| At 1 November 2015           | 7.9                   | 1.5                           | 0.1                      | –                             | 11.8                     | 0.1                   | 21.4        |
| Provided                     | –                     | 1.6                           | –                        | 1.1                           | –                        | –                     | 2.7         |
| Foreign exchange adjustments | 0.5                   | 0.4                           | –                        | 0.2                           | 2.2                      | –                     | 3.3         |
| Paid                         | (0.3)                 | (0.1)                         | –                        | –                             | (0.2)                    | (0.1)                 | (0.7)       |
| Released                     | (0.6)                 | –                             | –                        | –                             | (6.2)                    | –                     | (6.8)       |
| Reclassification             | (4.4)                 | 0.7                           | –                        | –                             | –                        | –                     | (3.7)       |
| <b>At 31 October 2016</b>    | <b>3.1</b>            | <b>4.1</b>                    | <b>0.1</b>               | <b>1.3</b>                    | <b>7.6</b>               | <b>–</b>              | <b>16.2</b> |

These provisions are classified on the balance sheet as follows:

|                                     | 2016<br>£m  | 2015<br>£m  |
|-------------------------------------|-------------|-------------|
| Included in current liabilities     | 4.5         | 5.1         |
| Included in non-current liabilities | 11.7        | 16.3        |
|                                     | <b>16.2</b> | <b>21.4</b> |

It is not possible to estimate more accurately the expected timing of any resulting outflows of economic benefits.

The legal provision represents the estimated legal liabilities faced by the Group at the balance sheet date. Further details of the Group's contingent liabilities are set out in note 33.

The environmental provision is held in respect of potential liabilities associated with the Group's facility in Downers Grove, Illinois, USA.

The restructuring provision relates to the closure of a Countermeasures facility in Philadelphia, USA.

The disposal provision relates to estimated liabilities faced by the Group in respect of Mecar and Simmel under the terms of their respective sale agreements. The risk of economic outflow relating to these reduces with the passage of time.

The reclassification relates to items where the timing of the payments has been more clearly established and consequently the amounts have been transferred to trade and other payables.

## 22. Deferred tax

The following are the principal deferred tax liabilities/(assets) recognised by the Group and movements thereon:

|                           | Accelerated tax depreciation<br>£m | Pensions<br>£m | Interest deductions<br>£m | Tax losses<br>£m | Acquired intangibles<br>£m | Other<br>£m  | Total<br>£m  |
|---------------------------|------------------------------------|----------------|---------------------------|------------------|----------------------------|--------------|--------------|
| At 1 November 2014        | 14.9                               | (4.4)          | (6.6)                     | (0.9)            | 14.4                       | (13.8)       | 3.6          |
| (Credit)/charge to income | (1.1)                              | 0.9            | (9.4)                     | (2.8)            | (2.2)                      | 8.0          | (6.6)        |
| Charge/(credit) to equity | 0.2                                | –              | (0.2)                     | 0.4              | (0.3)                      | 0.5          | 0.6          |
| At 1 November 2015        | 14.0                               | (3.5)          | (16.2)                    | (3.3)            | 11.9                       | (5.3)        | (2.4)        |
| Charge/(credit) to income | 1.8                                | 1.0            | 7.3                       | (4.1)            | (2.6)                      | 3.4          | 6.8          |
| Charge/(credit) to equity | 0.8                                | (0.8)          | (5.7)                     | –                | 0.5                        | (0.3)        | (5.5)        |
| <b>At 31 October 2016</b> | <b>16.6</b>                        | <b>(3.3)</b>   | <b>(14.6)</b>             | <b>(7.4)</b>     | <b>9.8</b>                 | <b>(2.2)</b> | <b>(1.1)</b> |

The Finance (No.2) Act 2015 and the Finance Act 2016, which provided for reductions in the main rate of UK corporation tax from 20% to 19% effective from 1 April 2017 and to 17% effective from 1 April 2020, were substantively enacted on 26 October 2015 and 19 September 2016 respectively.

The closing UK deferred tax asset as at 31 October 2016 has been calculated at the rates which will be in force when the assets and liabilities are expected to reverse.

The Group's deferred tax provision at the balance sheet date includes an asset of £14.6 million in relation to amounts carried forward under the US interest limitation regulations. These carried forward amounts are available for offset in future periods in accordance with the regulations, subject to available US taxable profits. Management prepare long term forecasts for the upcoming five year period for all entities in the Group and have used these to determine the amount of the deferred tax asset which should be recognised at the balance sheet date. Due to the inherent uncertainties associated with preparing long term forecasts, particularly in the current global environment, the final outcome may vary significantly, whilst a range of outcomes is reasonably possible, the extent of this range is potential additional assets of up to £17.8 million or a reduction in the asset of up to £14.6 million.

## NOTES TO THE GROUP FINANCIAL STATEMENTS

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### 22. Deferred tax continued

Certain deferred tax assets and liabilities have been offset in accordance with the Group's accounting policy. Deferred tax balances after offset are analysed on the balance sheet as follows:

|                         | 2016<br>£m | 2015<br>£m |
|-------------------------|------------|------------|
| Non-current liabilities | 58.5       | 45.1       |
| Non-current assets      | (59.6)     | (47.5)     |
|                         | (1.1)      | (2.4)      |

At the balance sheet date, the Group had unrecognised tax losses of £8.0 million (2015: £26.3 million) potentially available for offset against future profits in certain circumstances, the increase arising primarily as a result of the current year tax losses arising in the UK. No deferred tax asset has been recognised in respect of this amount because of the unpredictability of future taxable qualifying profit streams.

### 23. Share capital

|  | 2016<br>£m | 2015<br>£m |
|--|------------|------------|
| <b>Issued and fully paid</b>                               |            |            |
| 281,425,256 (2015: 195,504,091) ordinary shares of 1p each | 2.8        | 2.0        |

During the year, 5,337 ordinary shares (2015: 8,166) were issued for cash to employees under the Group's approved savings-related share schemes.

On 24 February 2016, 85,915,828 new ordinary shares were issued pursuant to the rights issue, with four new ordinary shares issued for every every nine existing ordinary shares held.

The Company's share capital also includes 62,500 7% cumulative preference shares of £1 each, which are all issued and fully paid-up, and are classified for accounting purposes within non-current liabilities. The cumulative preference shares carry an entitlement to a dividend at the rate of 7p per share per annum, payable in equal instalments on 30 April and 31 October each year. Holders of the preference shares have the right on a winding-up to receive, in priority to any other classes of shares, the sum of £1 per share together with any arrears of dividends.

### 24. Reserves

The share premium account, the special capital reserve and the revaluation reserve are not distributable.

Included within retained earnings are £3.0 million (2015: £1.9 million) relating to the share-based payment reserve and £nil (2015: £1.9 million) of the Company's own shares held by the Group's Employee Share Ownership Plan Trust.

### 25. Own shares

|                                  | 2016<br>£m | 2015<br>£m |
|----------------------------------|------------|------------|
| At beginning and end of the year | 9.6        | 9.6        |

The own shares reserve represents the cost of shares in the Company purchased in the market and held by the Group to satisfy awards under the Group's share-based incentive schemes, details of which are set out in note 27. No ordinary shares (2015: nil) were acquired during the year and no ordinary shares (2015: nil) were distributed following the vesting of awards under the PSP. The total number of ordinary shares held in treasury at 31 October 2016 was 2,198,814 (2015: 2,198,814), with an average cost of 439.0p (2015: 439.0p) per share.

This represents 0.8% (2015: 1.1%) of the total issued and fully-paid ordinary share capital.

## 26. Obligations under non-cancellable operating leases

|  | 2016<br>£m | 2015<br>£m |
|--|------------|------------|
| Minimum lease payments under operating leases recognised in the income statement | 1.9        | 1.6        |

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, falling due as follows:

|                              | 2016<br>£m | 2015<br>£m |
|------------------------------|------------|------------|
| Within one year              | 2.7        | 3.0        |
| In the second to fifth years | 5.2        | 6.0        |
| Over five years              | 0.4        | 0.2        |
|                              | 8.3        | 9.2        |

Operating lease payments represent rentals payable by the Group. Leases are negotiated for an average term of three years and rentals are fixed for the lease period, with an option to extend for a further period at the then prevailing market rate.

## 27. Share-based payments

The Group operates share-based compensation arrangements to provide incentives to the Group's senior management and eligible employees. The Group recognised a net charge of £1.0 million (2015: £1.2 million) in respect of share-based payments during the year.

Details of the four schemes which operated during the year are set out below.

### The Chemring Group Performance Share Plan (the "PSP")

Under the PSP, conditional awards of ordinary shares are made at nil cost to employees. Awards ordinarily vest on the third anniversary of the award date. The scheme commenced in March 2006.

|  | Number of conditional shares |                  |
|--|------------------------------|------------------|
|  | 2016                         | 2015             |
| Outstanding at beginning of the year         | 3,966,720                    | 3,186,452        |
| Adjustment relating to rights issue          | 704,701                      | –                |
| Awarded                                      | 2,313,385                    | 1,560,801        |
| Lapsed                                       | (2,481,214)                  | (780,533)        |
| <b>Outstanding at end of the year</b>        | <b>4,503,592</b>             | <b>3,966,720</b> |
| <b>Subject to vesting at end of the year</b> | <b>–</b>                     | <b>–</b>         |

The following PSP awards were outstanding at 31 October 2016:

| Date of award   | Number of ordinary shares under award | Vesting price per share<br>Pence | Date when awards due to vest |
|-----------------|---------------------------------------|----------------------------------|------------------------------|
| 28 April 2014   | 1,062,603                             | nil                              | 28 April 2017                |
| 8 July 2014     | 212,394                               | nil                              | 8 July 2017                  |
| 26 January 2015 | 1,296,490                             | nil                              | 26 January 2018              |
| 25 January 2016 | 1,673,526                             | nil                              | 25 January 2019              |
| 7 March 2016    | 258,579                               | nil                              | 7 March 2019                 |

## NOTES TO THE GROUP FINANCIAL STATEMENTS

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### 27. Share-based payments continued

The Group has applied a discount to the share-based payment, to reflect the anticipated achievement of the stipulated targets for each PSP award based on the predicted figures within the Group's financial projections and the expected number of leavers over the life of the PSP awards.

The PSP awards made in the year ended 31 October 2016 had targets based on earnings per share growth and total shareholder return. The PSP awards made in the year ended 31 October 2016 have been valued using the following modelling inputs:

|                                      | Date awarded    |              |
|--------------------------------------|-----------------|--------------|
|                                      | 25 January 2016 | 7 March 2016 |
| Share price at valuation as restated | 138p            | 134p         |
| Exercise price                       | nil             | nil          |
| Risk-free rate                       | 0.66%           | 0.44%        |
| Expected volatility                  | 36.37%          | 38.55%       |
| Fair value                           | 107p            | 85.5p        |

The weighted average fair value of awards made during the year was 102.4p (2015: 181.5p).

No awards vested in the year ended 31 October 2016 or the year ended 31 October 2015. The charge recognised in respect of PSP awards is based on their fair value at the grant date.

#### The Chemring Group Restricted Share Plan (the "RSP")

Under the RSP, deferred awards of ordinary shares are made at nil cost to employees. Awards ordinarily vest on the second or third anniversary of the award date. The first awards under the RSP were made in February 2013.

|  | Number of deferred shares |                |
|--|---------------------------|----------------|
|  | 2016                      | 2015           |
| Outstanding at beginning of the year         | 130,000                   | 579,378        |
| Awarded                                      | 50,000                    | –              |
| Lapsed                                       | –                         | (7,437)        |
| Exercised                                    | (130,000)                 | (441,941)      |
| <b>Outstanding at end of the year</b>        | <b>50,000</b>             | <b>130,000</b> |
| <b>Subject to vesting at end of the year</b> | <b>–</b>                  | <b>–</b>       |

The following RSP awards were outstanding at 31 October 2016:

| Date of award | Number of ordinary shares under award | Vesting price per share Pence | Date when awards due to vest |
|---------------|---------------------------------------|-------------------------------|------------------------------|
| 7 March 2016  | 50,000                                | nil                           | 7 March 2019                 |

The Group has applied a discount to the share-based payment relating to the RSP, to reflect the expected number of leavers over the life of the RSP awards.

The weighted average fair value of awards made during the year ended 31 October 2016 was 134.5p.

#### The Chemring Group 2008 UK Sharesave Plan (the "UK Sharesave Plan")

Options were granted during the year on 27 July 2016.

|   | 2016                    |                                       | 2015                    |                                       |
|---|-------------------------|---------------------------------------|-------------------------|---------------------------------------|
|   | Number of share options | Weighted average exercise price Pence | Number of share options | Weighted average exercise price Pence |
| Outstanding at beginning of the year          | 1,302,225               | 186.4                                 | 1,122,986               | 191.5                                 |
| Adjustment relating to the rights issue       | 172,519                 | 186.4                                 | –                       | –                                     |
| Granted                                       | 1,031,147               | 105.0                                 | 329,532                 | 174.0                                 |
| Exercised                                     | (5,337)                 | 163.0                                 | (8,166)                 | 214.0                                 |
| Lapsed  | (772,517)               | 163.5                                 | (142,127)               | 191.7                                 |
| <b>Outstanding at end of the year</b>         | <b>1,728,037</b>        | <b>128.1</b>                          | <b>1,302,225</b>        | <b>186.4</b>                          |
| <b>Subject to exercise at end of the year</b> | <b>53,441</b>           | <b>255.9</b>                          | <b>157,551</b>          | <b>238.2</b>                          |

## 27. Share-based payments continued

The following options were outstanding at 31 October 2016:

| Date of award | Number of ordinary shares under award | Exercise price per share Pence | Dates between which options may be exercised |
|---------------|---------------------------------------|--------------------------------|--|
| 29 July 2011  | 10,656                                | 444.0                          | 1 October 2016 – 31 March 2017               |
| 30 July 2012  | 49,279                                | 195.0                          | 1 October 2017 – 31 March 2018               |
| 30 July 2013  | 42,785                                | 209.0                          | 1 October 2016 – 31 March 2017               |
| 30 July 2013  | 44,117                                | 209.0                          | 1 October 2018 – 31 March 2019               |
| 30 July 2014  | 232,441                               | 142.0                          | 1 October 2017 – 31 March 2018               |
| 30 July 2014  | 96,631                                | 142.0                          | 1 October 2019 – 31 March 2020               |
| 30 July 2015  | 180,467                               | 152.0                          | 1 October 2018 – 31 March 2019               |
| 30 July 2015  | 45,656                                | 152.0                          | 1 October 2020 – 31 March 2021               |
| 27 July 2016  | 910,010                               | 105.0                          | 1 October 2019 – 31 March 2020               |
| 27 July 2016  | 115,995                               | 105.0                          | 1 October 2021 – 31 March 2022               |

The weighted average fair value of options granted in the year was 26.0p (2015: 43.0p).

The weighted average fair value of options exercised in the year was 41.3p (2015: 63.1p).

The weighted average share price on exercise of the options during the year was 146.6p (2015: 224.0p).

The fair values of the share options in the UK Sharesave Plan are based on the difference between the exercise price and the share price on the grant date of the option.

### The Chemring Group 2008 US Stock Purchase Plan (the "US Stock Purchase Plan")

The US Stock Purchase Plan mirrors the UK Sharesave Plan, subject to certain legal and tax differences due to the differing jurisdictions. No options were granted during the year.

|   | 2016                    |                                       | 2015                    |                                       |
|---|-------------------------|---------------------------------------|-------------------------|---------------------------------------|
|   | Number of share options | Weighted average exercise price Pence | Number of share options | Weighted average exercise price Pence |
| Outstanding at beginning of the year          | 36,199                  | 174.0                                 | 77,689                  | 215.9                                 |
| Granted                                       | –                       | –                                     | –                       | –                                     |
| Lapsed  | (36,199)                | 174.0                                 | (41,490)                | 262.0                                 |
| <b>Outstanding at end of the year</b>         | <b>–</b>                | <b>–</b>                              | <b>36,199</b>           | <b>174.0</b>                          |
| <b>Subject to exercise at end of the year</b> | <b>–</b>                | <b>–</b>                              | <b>–</b>                | <b>–</b>                              |



## NOTES TO THE GROUP FINANCIAL STATEMENTS

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### 28. Acquisitions and disposals

On 4 May 2016, the Group acquired patents, equipment, stock and selected contracts relating to Esterline's UK-based subsidiary, Wallop Defence Systems Limited, for an initial cash consideration of £2.5 million. Additional payments of up to £9.0 million, which are conditional on the receipt of specific orders in the future, may be made over the next three years. The assets to be purchased relate to air countermeasures and pyrotechnic products, which will be manufactured at Chemring Countermeasures Limited.

| Recognised amounts of identifiable assets acquired and liabilities assumed (provisional) | £m         |
|--|------------|
| Inventory  | 0.2        |
| Property, plant and equipment  | 0.2        |
| Identifiable intangible assets   | 2.1        |
| <b>Total consideration</b>   | <b>2.5</b> |
| Satisfied by:  |            |
| Cash   | 2.5        |
| <b>Total consideration transferred</b>   | <b>2.5</b> |
| Net cash outflow arising on acquisition  |            |
| Cash consideration   | 2.5        |
| Less: cash and cash equivalents acquired   | -          |
| <b>Cash outflow from investing activities</b>  | <b>2.5</b> |

Acquisition related costs (included in administrative expenses in the consolidated income statement for the year ended 31 October 2016) amounted to £0.2 million.

There were no disposals during the year. The following acquisition costs and (credits) relating to previous disposals were comprised as follows:

|   | 2016<br>£m   | 2015<br>£m   |
|---|--------------|--------------|
| <b>Continuing operations</b>                    |              |              |
| Chemring Energetic Devices' Clear Lake disposal | 0.1          | -            |
| Acquisition of Wallop Defence Systems' assets   | 0.2          | 0.5          |
|   | <b>0.3</b>   | <b>0.5</b>   |
| <b>Discontinued operations</b>                  |              |              |
| Chemring Defence Germany disposal               | -            | (0.5)        |
| European munitions businesses disposal          | (4.1)        | (3.8)        |
| Disposed property dilapidations                 | (0.6)        | -            |
| Marine business disposal                        | -            | (0.6)        |
|   | <b>(4.7)</b> | <b>(4.9)</b> |
|   | <b>(4.4)</b> | <b>(4.4)</b> |

The tax impact of discontinued operations was a £0.1 million credit (2015: £nil).

Included in the amounts above are costs of £0.3 million (2015: £0.5 million) relating to continuing operations.

### 29. Pensions

In the UK, the Group operates a defined benefit scheme (the "Chemring Group Staff Pension Scheme"). In Norway, Chemring Nobel operates a defined benefit scheme (the "Chemring Nobel Scheme"). The Group's other UK and overseas pension arrangements are all defined contribution schemes, with a combined cost of £6.2 million (2015: £5.8 million).

The Chemring Group Staff Pension Scheme is a funded scheme and the assets of the scheme are held in a separate trustee administered fund. The scheme was closed to future accrual on 6 April 2012. A full actuarial valuation of the Chemring Group Staff Pension Scheme as at 6 April 2015 has been completed and updated to 31 October 2016 by a qualified actuary, using the projected unit credit method. The main assumptions for the scheme are detailed below. The deficit of the Chemring Group Staff Pension Scheme was £17.3 million at 31 October 2016 (2015: £17.8 million).

Under the funding plan agreed with the trustees following the 2015 actuarial valuation, the Company has agreed to eliminate the deficit indicated by that valuation over a period of four years. This funding plan provides for contributions of £5.0 million per annum to be paid in monthly instalments until 2019. The Company and the trustees monitor funding levels annually, and a new funding plan is agreed with the trustees every three years, based on actuarial valuations. The Group considers that the current contribution rates agreed with the trustees are sufficient to eliminate the calculated deficit over the agreed period.

## 29. Pensions continued

The Group has provided a bank guarantee and letters of credit totalling £8.5 million (2015: £13.5 million) to the Chemring Group Staff Pension Scheme, comprising a £1.3 million letter of credit and a £7.2 million bank guarantee, which may only be drawn upon certain events of default by the Company. The value of the bank guarantee and letters of credit has reduced during the year as deficit reduction payments have been made by the Company.

The Chemring Nobel Scheme is an unfunded scheme. The actuarial liability has been calculated at 31 October 2016 by a qualified actuary using the projected unit credit method. The main assumptions used were a discount rate of 2.0% and rate of increase in deferred pensions of 3.0%. The net surplus of the Chemring Nobel Scheme was £nil at 31 October 2016 (2015: £0.1 million).

Chemring Group PLC is the principal employer of all schemes and due to the similarity of the schemes, the schemes have been netted-off in the table below.

The amount recognised in the balance sheet in respect of the Group's defined benefit schemes is as follows:

|  | 2016<br>£m    | 2015<br>£m    |
|--|---------------|---------------|
| Present value of funded and unfunded obligations                         | (94.7)        | (81.1)        |
| Fair value of schemes' assets  | 77.4          | 63.4          |
| <b>Net retirement benefit obligation recognised in the balance sheet</b> | <b>(17.3)</b> | <b>(17.7)</b> |

An analysis of the retirement benefit obligation recognised in the balance sheet by scheme is as follows:

|  | 2016<br>£m    | 2015<br>£m    |
|--|---------------|---------------|
| Chemring Group Staff Pension Scheme                                      | (17.3)        | (17.8)        |
| Chemring Nobel Scheme  | –             | 0.1           |
| <b>Net retirement benefit obligation recognised in the balance sheet</b> | <b>(17.3)</b> | <b>(17.7)</b> |

Amounts recognised in the income statement in respect of the Group's defined benefit schemes were as follows:

|  | 2016<br>£m   | 2015<br>£m   |
|--|--------------|--------------|
| <b>Amounts included within finance expense</b>       |              |              |
| Expected return on schemes' assets                   | 2.2          | 2.1          |
| Discount on schemes' liabilities                     | (3.0)        | (3.0)        |
| <b>Net charge recognised in the income statement</b> | <b>(0.8)</b> | <b>(0.9)</b> |

Amounts recognised in the statement of comprehensive income were as follows:

|   | 2016<br>£m   | 2015<br>£m |
|---|--------------|------------|
| Actuarial gains on schemes' assets  | 10.0         | 0.5        |
| Actuarial losses on schemes' liabilities                                  | (13.8)       | (0.5)      |
| <b>Actuarial loss recognised in the statement of comprehensive income</b> | <b>(3.8)</b> | <b>–</b>   |

Changes in the present value of the defined benefit obligations were as follows:

|  | 2016<br>£m    | 2015<br>£m    |
|--|---------------|---------------|
| Opening defined benefit obligations        | (81.1)        | (80.9)        |
| Discount on schemes' liabilities           | (3.0)         | (3.0)         |
| Actuarial losses on schemes' liabilities   | (13.8)        | (0.5)         |
| Benefits paid                              | 3.2           | 3.3           |
| <b>Closing defined benefit obligations</b> | <b>(94.7)</b> | <b>(81.1)</b> |

## NOTES TO THE GROUP FINANCIAL STATEMENTS

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### 29. Pensions continued

The Chemring Group Staff Pension Scheme had 1,071 members at the end of the year (2015: 1,092). Of these members 51.1% (2015: 49.0%) were pensioners drawing benefits from the scheme and the balance were deferred members. The duration of the liability is long with pension payments expected to be made for at least the next 40 years.

Changes in the fair value of the schemes' assets were as follows:

|  | 2016<br>£m  | 2015<br>£m  |
|--|-------------|-------------|
| Opening fair value of schemes' assets        | 63.4        | 59.1        |
| Expected return on schemes' assets           | 2.2         | 2.1         |
| Actuarial gains on schemes' assets           | 10.0        | 0.5         |
| Contributions from sponsoring companies      | 5.0         | 5.0         |
| Benefits paid                                | (3.2)       | (3.3)       |
| <b>Closing fair value of schemes' assets</b> | <b>77.4</b> | <b>63.4</b> |

The pension schemes' assets are analysed as follows:

|          | 2016<br>£m  | 2015<br>£m  | 2016<br>%    | 2015<br>%    |
|----------|-------------|-------------|--------------|--------------|
| Equities | 52.3        | 41.5        | 67.6         | 65.5         |
| Bonds    | 25.1        | 21.9        | 32.4         | 34.5         |
|          | <b>77.4</b> | <b>63.4</b> | <b>100.0</b> | <b>100.0</b> |

The expected rate of return on the schemes' assets was 2.7% (2015: 3.7%). This was determined by reference to relevant published indices.

The schemes' assets are invested in accordance with their statements of investment principles after taking professional advice from the schemes' investment advisers. The investment strategy seeks to maintain broadly 70% of the schemes' assets invested in equities and 30% in fixed interest funds.

|  | 2016<br>£m    | 2015<br>£m    | 2014<br>£m    | 2013<br>As restated<br>£m | 2012<br>£m    |
|--|---------------|---------------|---------------|---------------------------|---------------|
| Present value of funded and unfunded obligations | (94.7)        | (81.1)        | (80.9)        | (76.7)                    | (71.6)        |
| Fair value of schemes' assets                    | 77.4          | 63.4          | 59.1          | 51.6                      | 44.6          |
| <b>Deficit in the schemes</b>                    | <b>(17.3)</b> | <b>(17.7)</b> | <b>(21.8)</b> | <b>(25.1)</b>             | <b>(27.0)</b> |

The history of actuarial gains and losses is as follows:

|  |        |       |       |       |       |
|--|--------|-------|-------|-------|-------|
| Actuarial losses on schemes' liabilities | (13.8) | (0.5) | (5.1) | (4.4) | (5.7) |
| Percentage of schemes' liabilities       | 14.6%  | 0.6%  | 6.3%  | 5.7%  | 8.0%  |
| Actuarial gains on schemes' assets       | 10.0   | 0.5   | 0.3   | 5.9   | 3.0   |
| Percentage of schemes' assets            | 12.9%  | 0.8%  | 0.5%  | 11.4% | 6.7%  |

Analysis of movement in the deficit in the schemes during the year:

|   | 2016<br>£m    | 2015<br>£m    |
|---|---------------|---------------|
| Opening deficit in the schemes          | (17.7)        | (21.8)        |
| Contributions from sponsoring companies | 5.0           | 5.0           |
| Other finance costs                     | (0.8)         | (0.9)         |
| Actuarial gains on schemes' assets      | 10.0          | 0.5           |
| Actuarial loss on schemes' liabilities  | (13.8)        | (0.5)         |
| <b>Closing deficit in the schemes</b>   | <b>(17.3)</b> | <b>(17.7)</b> |

## 29. Pensions continued

The principal assumptions used in the actuarial valuation of the Chemring Group Staff Pension Scheme were as follows:

|  | 2016<br>%  | 2015<br>% |
|--|------------|-----------|
| Discount rate  | <b>2.7</b> | 3.7       |
| Rate of increase in salaries                               | <b>n/a</b> | n/a       |
| Rate of increase in deferred pensions                      | <b>3.4</b> | 3.3       |
| Rate of increase in pensions in payment (where applicable) | <b>3.4</b> | 3.3       |
| Inflation  | <b>3.6</b> | 3.4       |
| - RPI  |            |           |
| - CPI  | <b>2.7</b> | 2.5       |
| Expected return on scheme assets                           | <b>2.7</b> | 3.7       |

In determining defined benefit obligations, the Group uses mortality assumptions which are based on published mortality tables. For the Chemring Group Staff Pension Scheme, the actuarial table currently used is SAPS Normal Health pensioner tables with future improvements in line with CMI 2013 and 1.25% long term trend rate.

This results in the following life expectancies at age 65:

|                    |          | 2016        | 2015 |
|--------------------|----------|-------------|------|
| Future pensioners  | - male   | <b>88.1</b> | 88.7 |
|                    | - female | <b>90.6</b> | 91.4 |
| Current pensioners | - male   | <b>86.5</b> | 86.5 |
|                    | - female | <b>88.8</b> | 89.4 |

The most significant assumptions in the pension valuation are the discount rate applied to the liabilities, the inflation rate to be applied to pension payments and the mortality rates. If the discount rate used in determining retirement benefit obligations were to change by 0.1% then it is predicted that the deficit in the scheme would change by approximately £1.6 million. A change in the rate of inflation by 0.1% is predicted to change the deficit by approximately £1.1 million and a one year change to the longevity assumption would change the deficit by approximately £3.1 million. The principal risks to the schemes are that the investments do not perform as well as expected, the discount rate continues to fall driven by lower market interest rates and that the rate of improvement in mortality assumed is insufficient and life expectancies continue to rise.

The Group anticipates contributions to the defined benefit schemes for the year ending 31 October 2017 will be £5.0 million (2016: £5.0 million).

## 30. Cash generated from underlying operations

|   | 2016<br>£m   | 2015<br>£m |
|---|--------------|------------|
| Operating profit from continuing operations                                       | <b>26.2</b>  | 5.5        |
| Operating profit from discontinued operations                                     | <b>4.7</b>   | 4.9        |
|   | <b>30.9</b>  | 10.4       |
| Amortisation of development costs   | <b>6.8</b>   | 6.2        |
| Intangible amortisation arising from business combinations                        | <b>14.8</b>  | 14.0       |
| Amortisation of patents and licences  | <b>0.1</b>   | 0.2        |
| Loss on disposal of non-current assets  | <b>0.2</b>   | 0.3        |
| Depreciation of property, plant and equipment                                     | <b>18.4</b>  | 16.3       |
| Loss/(gain) on the movement in the fair value of derivative financial instruments | <b>1.0</b>   | (0.5)      |
| Share-based payment expense   | <b>1.0</b>   | 1.2        |
| Employer contributions to retirement benefit obligations                          | <b>(5.0)</b> | (5.0)      |
| Operating cash flows before movements in working capital                          | <b>68.2</b>  | 43.1       |
| Decrease/(increase) in inventories  | <b>13.6</b>  | (19.1)     |
| Increase in trade and other receivables   | <b>(5.8)</b> | (3.1)      |
| (Decrease)/increase in trade and other payables                                   | <b>(1.1)</b> | 9.3        |
| Decrease in provisions  | <b>(0.3)</b> | (5.3)      |
|   | <b>74.6</b>  | 24.9       |
| Add back non-underlying items:  |              |            |
| Acquisition and disposal related credits  | <b>(4.4)</b> | (4.4)      |
| Business restructuring and incident costs   | <b>5.4</b>   | 6.4        |
| Claim related(credit)/costs   | <b>(0.6)</b> | 8.5        |
| Loan note repayment costs   | <b>1.4</b>   | -          |
| <b>Cash generated from underlying operations</b>                                  | <b>76.4</b>  | 35.4       |
| Analysed as:  |              |            |
| Continuing operations   | <b>76.4</b>  | 35.4       |

## NOTES TO THE GROUP FINANCIAL STATEMENTS

continued

### 31. Reconciliation of net cash flow to movement in net debt

|   | 2016<br>£m    | 2015<br>£m     |
|---|---------------|----------------|
| Increase/(decrease) in cash and cash equivalents          | 54.6          | (14.1)         |
| Decrease in debt and lease financing due to cash flows    | 49.6          | 3.0            |
| Decrease/(increase) in net debt resulting from cash flows | 104.2         | (11.1)         |
| Effect of foreign exchange rate changes                   | (34.7)        | (5.5)          |
| Amortisation of debt finance costs                        | (2.8)         | (2.1)          |
| Movement in net debt                                      | 66.7          | (18.7)         |
| Net debt at beginning of the year                         | (154.3)       | (135.6)        |
| <b>Net debt at end of the year</b>                        | <b>(87.6)</b> | <b>(154.3)</b> |

### 32. Analysis of net debt

|                          | At 1<br>November<br>2015<br>£m | Cash flows<br>£m | Non-cash<br>changes<br>£m | Exchange<br>rate effects<br>£m | At 31<br>October<br>2016<br>£m |
|--------------------------|--------------------------------|------------------|---------------------------|--------------------------------|--------------------------------|
| Cash at bank and in hand | 7.6                            | 54.6             | –                         | 0.9                            | 63.1                           |
| Debt due within one year | –                              | –                | (29.5)                    | –                              | (29.5)                         |
| Debt due after one year  | (161.3)                        | 49.2             | 26.7                      | (35.6)                         | (121.0)                        |
| Finance leases           | (0.5)                          | 0.4              | –                         | –                              | (0.1)                          |
| Preference shares        | (0.1)                          | –                | –                         | –                              | (0.1)                          |
|                          | (154.3)                        | 104.2            | (2.8)                     | (34.7)                         | (87.6)                         |

### 33. Contingent liabilities

The Group enters into contracts which have offset commitments. These requirements are valued at the time of the contract being awarded. The cost of the offsets are reviewed throughout the contract life and provided for within the contract costings to the extent of the potential liability.

At 31 October 2016, the Group had contingent liabilities in respect of bank and contractual performance guarantees and other matters arising in the ordinary course of business. Where it is expected that a material liability will arise in respect of these matters, appropriate provision is made within the financial statements. As the conditions of these guarantees are currently being met, no obligating event is foreseeable and therefore no provision has been made.

The Group is, from time to time, party to legal proceedings and claims, and is involved in correspondence relating to potential claims, which arise in the ordinary course of business. The Group is currently engaged in pre-action correspondence with the Defense Contract Audit Agency of the US Department of Defense in relation to disputed pricing calculations on certain contracts fulfilled by Alloy Surfaces.

In light of the current status of these matters, the directors do not consider the outcome of all the proceedings, actions and claims in which it is currently involved, either individually or in aggregate, will have a material adverse effect upon the Group's financial position. A provision of £3.1 million (2015: £7.9 million) exists to cover estimated settlement and legal costs for the Group with regards to pending and probable legal actions.

The Group has a £2.5 million deductible per claim under its material damage and business interruption insurance policy, subject to a maximum aggregate deductible of £3.5 million in any one year.

### 34. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions with the Group's pension schemes are disclosed in note 29.

#### Trading transactions

There were no trading activities between the Group and its associate in the comparative period.

#### Remuneration of key management personnel

For the purposes of remuneration disclosure, key management personnel includes only the executive directors and excludes the other senior business managers and members of the Executive Committee. Their remuneration is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*. Further information on the remuneration of individual directors is provided in the audited part of the directors' remuneration report on pages 73 to 84.

The directors of the Company had no material transactions with the Company during the year, other than in connection with their service agreements. The remuneration of the executive directors is determined by the Remuneration Committee, having regard to the performance of the individuals and market trends. The remuneration of the non-executive directors is determined by the Board, having regard to the practice of other companies and the particular demands of the Group.

|   | 2016<br>£m | 2015<br>£m |
|---|------------|------------|
| <b>Remuneration of key management personnel</b> | <b>2.0</b> | 1.9        |

Further detail can be found in the directors' remuneration report on pages 64 to 84.

### 35. Events since the end of the year

On 21 November 2016, the Group repaid \$36.0 million of outstanding loan notes out of existing cash resources.

On 13 December 2016 the Group announced the appointment of Andrew Lewis as Group Finance Director. He was previously Group Finance Director of Avon Rubber p.l.c. Andrew joined Chemring on 9 January 2017 and will join the Board of Chemring on 19 January 2017, following the publication of the Group's final results for the year ended 31 October 2016.

## PARENT COMPANY BALANCE SHEET

As at 31 October 2016

|   |       | 2016    |         | 2015    |         |
|---|-------|---------|---------|---------|---------|
|   | Note  | £m      | £m      | £m      | £m      |
| <b>Non-current assets</b>                               |       |         |         |         |         |
| Property, plant and equipment                           | 1     | 0.4     |         | 0.2     |         |
| Investments in subsidiaries                             | 2     | 511.3   |         | 511.3   |         |
| Deferred tax asset                                      | 4, 10 | 6.7     |         | 8.2     |         |
| Amounts owed by subsidiary undertakings                 | 4     | 376.2   |         | 400.6   |         |
|   |       |         | 894.6   |         | 920.3   |
| <b>Current assets</b>                                   |       |         |         |         |         |
| Trade and other receivables                             | 4     | 22.5    |         | 7.3     |         |
| Cash and cash equivalents                               |       | 27.7    |         | 2.7     |         |
|   |       |         | 50.2    |         | 10.0    |
| <b>Total assets</b>                                     |       |         | 944.8   |         | 930.3   |
| <b>Current liabilities</b>                              |       |         |         |         |         |
| Trade and other payables                                | 5     |         | (164.1) |         | (124.2) |
| <b>Non-current liabilities</b>                          |       |         |         |         |         |
| Trade and other payables                                | 5     | (165.4) |         | (263.4) |         |
| Provisions  | 6     | (1.6)   |         | (2.1)   |         |
| Preference shares                                       | 7     | (0.1)   |         | (0.1)   |         |
| Retirement benefit obligations                          | 11    | (6.3)   |         | (6.6)   |         |
|   |       |         | (173.4) |         | (272.2) |
| <b>Total liabilities</b>                                |       |         | (337.5) |         | (396.4) |
| <b>Net assets</b>                                       |       |         | 607.3   |         | 533.9   |
| <b>Equity</b>   |       |         |         |         |         |
| Share capital   | 8     |         | 2.8     |         | 2.0     |
| Share premium account                                   |       |         | 305.1   |         | 230.7   |
| Special capital reserve                                 |       |         | 12.9    |         | 12.9    |
| Retained earnings                                       |       |         | 296.1   |         | 297.9   |
|   |       |         | 616.9   |         | 543.5   |
| Own shares  | 9     |         | (9.6)   |         | (9.6)   |
| Equity attributable to the equity holders of the parent |       |         | 607.3   |         | 533.9   |
| <b>Total equity</b>                                     |       |         | 607.3   |         | 533.9   |

These financial statements of Chemring Group PLC (registered number 86662) were approved and authorised for issue by the Board of directors on 19 January 2017.

Signed on behalf of the Board

**Michael Flowers**  
Director

**Sarah Ellard**  
Director



## PARENT COMPANY STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 October 2016

|   | 2016<br>£m   | 2015<br>£m |
|---|--------------|------------|
| <b>(Loss)/profit after tax attributable to equity holders of the parent as reported</b>   | <b>(1.5)</b> | 22.5       |
| <b>Items that will not be reclassified to profit or loss</b>                              |              |            |
| Actuarial losses on pension scheme, net of deferred tax                                   | (1.3)        | –          |
| <b>Total comprehensive (loss)/income attributable to the equity holders of the parent</b> | <b>(2.8)</b> | 22.5       |

## PARENT COMPANY STATEMENT OF CHANGES IN EQUITY

For the year ended 31 October 2016

|  | Share capital<br>£m | Share<br>premium<br>account<br>£m | Special<br>capital<br>reserve<br>£m | Retained<br>earnings<br>£m | Own shares<br>£m | Total<br>£m  |
|--|---------------------|-----------------------------------|-------------------------------------|----------------------------|------------------|--------------|
| At 1 November 2015                       | 2.0                 | 230.7                             | 12.9                                | 297.9                      | (9.6)            | 533.9        |
| Loss after tax                           | –                   | –                                 | –                                   | (1.5)                      | –                | (1.5)        |
| Other comprehensive losses               | –                   | –                                 | –                                   | (1.3)                      | –                | (1.3)        |
| Total comprehensive losses               | –                   | –                                 | –                                   | (2.8)                      | –                | (2.8)        |
| Ordinary shares issued                   | 0.8                 | 74.4                              | –                                   | –                          | –                | 75.2         |
| Share-based payments (net of settlement) | –                   | –                                 | –                                   | 1.0                        | –                | 1.0          |
| <b>At 31 October 2016</b>                | <b>2.8</b>          | <b>305.1</b>                      | <b>12.9</b>                         | <b>296.1</b>               | <b>(9.6)</b>     | <b>607.3</b> |

|  | Share capital<br>£m | Share<br>premium<br>account<br>£m | Special<br>capital<br>reserve<br>£m | Retained<br>earnings<br>£m | Own shares<br>£m | Total<br>As restated*<br>£m |
|--|---------------------|-----------------------------------|-------------------------------------|----------------------------|------------------|-----------------------------|
| At 1 November 2014                       | 2.0                 | 230.7                             | 12.9                                | 282.1                      | (9.6)            | 518.1                       |
| Profit after tax                         | –                   | –                                 | –                                   | 22.5                       | –                | 22.5                        |
| Other comprehensive income               | –                   | –                                 | –                                   | –                          | –                | –                           |
| Total comprehensive income               | –                   | –                                 | –                                   | 22.5                       | –                | 22.5                        |
| Dividends paid                           | –                   | –                                 | –                                   | (7.9)                      | –                | (7.9)                       |
| Share-based payments (net of settlement) | –                   | –                                 | –                                   | 1.2                        | –                | 1.2                         |
| At 31 October 2015                       | 2.0                 | 230.7                             | 12.9                                | 297.9                      | (9.6)            | 533.9                       |

### Profit attributable to shareholders

In accordance with the concession granted under section 408 of the Companies Act 2006, the profit and loss account of Chemring Group PLC has not been presented separately in these financial statements. There is no material difference between the results disclosed and the results on an unmodified historical cost basis. The Company reported a loss for the year ended 31 October 2016 of £1.5 million (2015: £22.5 million profit).

The auditor's remuneration for audit and other services is disclosed in note 3 to the Group financial statements.

A final dividend of 1.3p per ordinary share has been proposed. See note 8 to the Group financial statements.

# NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

## 1. Property, plant and equipment

|                           | Land and buildings<br>£m | Plant and equipment<br>£m | Total<br>£m |
|---------------------------|--------------------------|---------------------------|-------------|
| <b>Cost</b>               |                          |                           |             |
| At 1 November 2014        | 0.1                      | 1.2                       | 1.3         |
| Additions                 | –                        | 0.1                       | 0.1         |
| At 1 November 2015        | 0.1                      | 1.3                       | 1.4         |
| Additions                 | 0.1                      | 0.3                       | 0.4         |
| Disposals                 | (0.1)                    | (1.2)                     | (1.3)       |
| At 31 October 2016        | 0.1                      | 0.4                       | 0.5         |
| <b>Depreciation</b>       |                          |                           |             |
| At 1 November 2014        | –                        | 1.1                       | 1.1         |
| Charge                    | –                        | 0.1                       | 0.1         |
| At 1 November 2015        | –                        | 1.2                       | 1.2         |
| Charge                    | –                        | 0.1                       | 0.1         |
| Disposals                 | –                        | (1.2)                     | (1.2)       |
| At 31 October 2016        | –                        | 0.1                       | 0.1         |
| <b>Net book value</b>     |                          |                           |             |
| <b>At 31 October 2016</b> | <b>0.1</b>               | <b>0.3</b>                | <b>0.4</b>  |
| At 31 October 2015        | 0.1                      | 0.1                       | 0.2         |

The Company had no capital commitments as at 31 October 2016 or 31 October 2015. Land and buildings represent leasehold improvements.

## 2. Investments

|   | Shares in subsidiary<br>undertakings<br>£m | Loans to subsidiary<br>undertakings<br>£m | Total<br>£m  |
|---|--|---|--------------|
| <b>Cost</b>   |  |   |              |
| At 1 November 2014                                      | 548.6                                      | 6.3                                       | 554.9        |
| Additions   | –  | 0.3                                       | 0.3          |
| At 31 October 2015 and 31 October 2016                  | 548.6                                      | 6.6                                       | 555.2        |
| <b>Impairment</b>                                       |  |   |              |
| At 1 November 2014, 31 October 2015 and 31 October 2016 | 43.9                                       | –   | 43.9         |
| <b>Carrying amount</b>                                  |  |   |              |
| <b>At 31 October 2016</b>                               | <b>504.7</b>                               | <b>6.6</b>                                | <b>511.3</b> |
| At 31 October 2015                                      | 504.7                                      | 6.6                                       | 511.3        |

## 3. Investments in Group undertakings

Details of the Group undertakings at 31 October 2016 are set out in note 13 to the Group financial statements.

The directors consider that the carrying value of the investments does not exceed their fair value.

#### 4. Trade and other receivables

|   | 2016<br>£m   | 2015<br>£m   |
|---|--------------|--------------|
| <b>Within current assets</b>            |              |              |
| Other receivables                       | 21.2         | 5.1          |
| Corporation tax recoverable             | 0.5          | 1.7          |
| Prepayments and accrued income          | 0.8          | 0.5          |
|   | <b>22.5</b>  | <b>7.3</b>   |
| <b>Within non-current assets</b>        |              |              |
| Deferred tax asset (see note 10)        | 6.7          | 8.2          |
| Amounts owed by subsidiary undertakings | 376.2        | 400.6        |
|   | <b>382.9</b> | <b>408.8</b> |

An asset of £0.5 million (2015: £0.5 million) is recognised within other receivables in respect of the fair value of derivative financial instruments, as set out in note 20 to the Group financial statements. The directors consider that the carrying value of the trade and other receivables approximates to their fair value.

#### 5. Trade and other payables

|  | 2016<br>£m   | 2015<br>£m   |
|--|--------------|--------------|
| <b>Within current liabilities</b>  |              |              |
| Derivative financial instruments (note 20 to the Group financial statements) | 2.5          | 1.5          |
| Trade payables   | 0.9          | 0.9          |
| Amounts owed to subsidiary undertakings                                      | 125.9        | 113.7        |
| Other payables   | 1.0          | –            |
| Other tax and social security  | 0.2          | 0.2          |
| Accruals and deferred income   | 4.1          | 7.9          |
| Loan notes   | 29.5         | –            |
|  | <b>164.1</b> | <b>124.2</b> |
| <b>Within non-current liabilities</b>  |              |              |
| Derivative financial instruments (note 20 to the Group financial statements) | –            | 0.3          |
| Loan notes   | 121.0        | 161.3        |
| Amounts owed to subsidiary undertakings                                      | 44.4         | 101.8        |
|  | <b>165.4</b> | <b>263.4</b> |

An analysis of borrowings by maturity is as follows:

|                            | 2016<br>£m   | 2015<br>£m   |
|----------------------------|--------------|--------------|
| Borrowings falling due:    |              |              |
| – less than one year       | 29.5         | –            |
| – within one to two years  | 53.8         | 28.4         |
| – within two to five years | 67.2         | 132.9        |
|                            | <b>150.5</b> | <b>161.3</b> |

The interest incurred on the above borrowings is detailed within notes 6 and 17 to the Group financial statements.

## NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

continued

### 6. Provisions

|                           | Environmental provision<br>£m | Disposal provision<br>£m | Legal provision<br>£m | Total<br>£m |
|---------------------------|-------------------------------|--------------------------|-----------------------|-------------|
| At 1 November 2015        | –                             | 0.7                      | 1.4                   | 2.1         |
| Released                  | –                             | (0.5)                    | (0.6)                 | (1.1)       |
| Paid                      | –                             | (0.1)                    | –                     | (0.1)       |
| Reclassification          | 0.7                           | –                        | –                     | 0.7         |
| <b>At 31 October 2016</b> | <b>0.7</b>                    | <b>0.1</b>               | <b>0.8</b>            | <b>1.6</b>  |

It is not possible to estimate more accurately the expected timing of any resulting outflows of economic benefits. The environmental provision relates to estimated liabilities in respect of the sale of the Marine business in 2012. The legal provision relates to a legacy property lease.

### 7. Preference shares

|   | <b>2016<br/>£m</b> | 2015<br>£m |
|---|--------------------|------------|
| Cumulative preference shares (62,500 shares of £1 each) | <b>0.1</b>         | 0.1        |

The cumulative preference shares carry an entitlement to a dividend at the rate of 7p per share per annum, payable in equal instalments on 30 April and 31 October each year. Holders of the preference shares have the right on a winding-up to receive, in priority to any other classes of shares, the sum of £1 per share together with any arrears of dividends.

### 8. Share capital

|  | <b>2016<br/>£m</b> | 2015<br>£m |
|--|--------------------|------------|
| <b>Issued, allotted and fully paid</b>                     |                    |            |
| 281,425,256 (2015: 195,504,091) ordinary shares of 1p each | <b>2.8</b>         | 2.0        |

During the year, 5,337 ordinary shares (2015: 8,166) were issued for cash to employees under the Group's approved savings-related share schemes.

On 24 February 2016, 85,915,828 new ordinary shares were issued pursuant to the rights issue, with four new ordinary shares issued for every nine existing ordinary shares held.

The preference shares are presented as a liability and accordingly are excluded from called-up share capital in the balance sheet.

#### Share-based incentive schemes

Full details of the schemes are set out in note 27 to the Group financial statements.

### 9. Own shares

|                                  | <b>2016<br/>£m</b> | 2015<br>£m |
|----------------------------------|--------------------|------------|
| At beginning and end of the year | <b>9.6</b>         | 9.6        |

The own shares reserve represents the cost of shares in Chemring Group PLC purchased in the market and held by the Group to satisfy awards under the Group's share-based incentive schemes (see note 27 to the Group financial statements). During the year, no ordinary shares (2015: nil) were acquired and no ordinary shares (2015: nil) were distributed following the vesting of awards under the Chemring Group Performance Share Plan. The total number of ordinary shares held in treasury at 31 October 2016 was 2,198,814 (2015: 2,198,814), with an average cost of 439.0p (2015: 439.0p) per share. This represents 0.8% (2015: 1.1%) of the total issued and fully-paid ordinary share capital.

## 10. Deferred tax asset

|   | 2016<br>£m | 2015<br>£m |
|---|------------|------------|
| At beginning of the year                  | 8.2        | 8.5        |
| Charge to income statement                | (1.5)      | (0.3)      |
| <b>At the end of the year as restated</b> | <b>6.7</b> | 8.2        |
| <b>The amount provided represents:</b>    |            |            |
| Other timing differences                  | 6.7        | 8.2        |

The Company has considered the recoverability of the deferred tax asset and concluded that the expected future activities of the Company are sufficient to support this value.

## 11. Pensions

The Company has assumed its share of the assets and liabilities of the Group's defined benefit pension scheme.

An analysis of the provision balance is shown below:

|                           | Total<br>£m |
|---------------------------|-------------|
| At 1 November 2014        | 8.1         |
| Contributions             | (2.0)       |
| Other finance costs       | 0.5         |
| At 1 November 2015        | 6.6         |
| Contributions             | (2.1)       |
| Other finance costs       | 0.3         |
| Actuarial movements       | 1.5         |
| <b>At 31 October 2016</b> | <b>6.3</b>  |

Further details are set out in note 29 to the Group financial statements.

## 12. Staff costs

|   | 2016<br>Number | 2015<br>Number |
|---|----------------|----------------|
| Average monthly number of total employees (including executive directors) | 25             | 27             |

The costs incurred in respect of these employees (including share-based payments) were:

|                       | 2016<br>£m | 2015<br>£m |
|-----------------------|------------|------------|
| Wages and salaries    | 4.1        | 3.4        |
| Social security costs | 0.7        | 0.5        |
| Other pension costs   | 0.4        | 0.4        |
|                       | <b>5.2</b> | 4.3        |

Disclosures in respect of directors' emoluments can be found in the directors' remuneration report on pages 64 to 84.

## GROUP ACCOUNTING POLICIES

### 1. General information

Chemring Group PLC is a company incorporated in England and Wales under registration number 86662. The address of the registered office is Roke Manor, Old Salisbury Lane, Romsey, Hampshire, SO51 0ZN. The nature of the Group's operations and its principal activities are set out in note 2 and in the directors' report on pages 48 to 51. These financial statements are the consolidated financial statements of Chemring Group PLC and its subsidiaries (the "Group").

The financial statements are presented in pounds sterling, being the currency of the primary economic environment in which the Group operates, and rounded to the nearest £0.1 million. Foreign operations are included in accordance with the policy set out in the accounting policies section.

#### Going concern

The directors have, at the time of approving the financial statements, a reasonable expectation that the Group and the Company have adequate resources to continue to adopt the going concern basis of accounting in preparing these financial statements. Further detail is contained in the statement on going concern on page 27.

### 2. New and revised standards

#### New and revised standards and interpretations in issue but not yet effective

At the date of authorisation of these financial statements, the following standards and interpretations that are potentially relevant to the Group and which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the European Union):

- *Classification and Measurement of Share-based Payment Transactions*, amendments to IFRS 2 (effective year ending 31 October 2019);
- IFRS 9 *Financial Instruments Novation of Derivatives and Continuation of Hedge Accounting* (effective year ending 31 October 2019);
- *Investment Entities: Applying the Consolidation Exception*, amendments to IFRS 10, IFRS 12 and IAS 28 (effective year ending 31 October 2017);
- IFRS 11 (amended) *Accounting for Acquisitions of an Interest in a Joint Operation* (effective year ending 31 October 2017);
- IFRS 15 *Revenue from Contracts with Customers* (effective year ending 31 October 2019);
- IAS 7 *Statement of Cash Flows* (effective year ending 31 October 2018);
- IAS 12 *Recognition of Deferred Tax Assets for Unrealised Losses* (effective year ending 31 October 2018);
- *Clarification of Acceptable Methods of Depreciation and Amortisation*, amendments to IAS 16 and IAS 38 (effective year ending 31 October 2017);
- IFRS 16 *Leases* (effective year ending 31 October 2020);
- IAS 27 (amended) *Equity Method in Separate Financial Statements* (effective year ending 31 October 2017); and
- Annual Improvements to IFRSs 2014-2016 Cycle (effective year ending 31 October 2018).

The directors do not expect the adoption of these standards and interpretations will have a material impact on the financial statements of the Group in future periods except as follows:

- IFRS 9 *Financial Instruments* will impact both the measurement and disclosure of financial instruments;
- IFRS 15 *Revenue from Contracts with Customers* will impact the validity and timing of revenue recognised under contract accounting. This may particularly affect contracts with variable consideration or specific contract terms allowing the customer to modify or curtail its requirements; and
- IFRS 16 *Leases* will impact the measurement, recognition, presentation and disclosure of leases, particularly operating leases where the term is longer than twelve months.

Beyond this information, it is not practicable to provide a reasonable estimate of the effect of these standards until a detailed review has been conducted during 2017.

## GROUP ACCOUNTING POLICIES

continued

### 3. Accounting policies

#### Basis of preparation

These financial statements have been prepared in accordance with IFRS adopted for use in the EU and therefore comply with Article 4 of the EU IAS Regulation. These financial statements have also been prepared in accordance with IAS, IFRS and related IFRIC interpretations, subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board ("IASB") that have been endorsed by the European Union (collectively referred to as IFRS). These are subject to ongoing review and endorsement by the European Union or possible amendment by interpretive guidance from the IASB and the IFRIC, and are therefore still subject to change.

The financial statements are prepared under the historical cost convention, except as described below under the heading of 'Derivative financial instruments and hedge accounting'.

The particular accounting policies adopted have been applied consistently throughout the current and previous years and are described below.

#### Basis of consolidation

The Group financial statements consolidate those of the Company and all of its subsidiaries. A subsidiary undertaking is an entity over which the Group has the power to govern the financial and operating policies so as to obtain benefits from its activities. The results of subsidiaries acquired are consolidated from the date on which control passes to the Group and the results of disposed subsidiaries are consolidated up to the date on which control passes from the Group.

The Company considers that it has the power to govern the financial and operating policies of the US entities falling within the Special Security Agreement and these entities have therefore been consolidated in these financial statements.

The Company and all of its subsidiaries make up their financial statements to the same date. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

#### Operating profit

Operating profit is stated before the share of results of associates and before finance income and expense. The use of underlying measures, in addition to total measures, is considered by the Board to improve comparability of business performance between periods. Underlying measures referred to are stated before costs relating to acquisitions and disposals, business restructuring and incident costs, profit/loss on disposal of businesses, items deemed to be of an exceptional nature, impairment of goodwill and acquired intangibles, impairment of assets held for sale, amortisation of acquired intangibles and gains/losses on the movement in the fair value of derivative financial instruments.

#### Operating cash conversion

Cash conversion of underlying operating profit is defined as cash generated from underlying operations, less purchases of intangible assets and property, plant and equipment and proceeds on disposal of property, plant and equipment, as a proportion of underlying operating profit.

#### Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other revenue-related taxes.

#### Sale of goods

Revenue from the sale of goods is recognised when all of the following conditions are satisfied:

- the Group has transferred to the buyer the significant risks and rewards of ownership, typically on formal acceptance;
- the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the Group; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

#### Rendering of services

Revenue from a contract to provide services, including customer funded research and development, is recognised by reference to the stage of completion of the contract. Stage of completion is typically estimated by either completion of relevant milestones or proportion of contract costs incurred for work performed to date, as appropriate.

## GROUP ACCOUNTING POLICIES

continued

### 3. Accounting policies *continued*

#### Contract accounting

Contract accounting may be applied to appropriate contracts that are significantly large, built specifically for a particular customer order and have an expected duration of over twelve months.

When the outcome can be estimated reliably, revenue and costs are recognised by reference to the stage of completion at the balance sheet date. This is normally measured by the proportion of contract costs incurred for work performed to date against the estimated total contract costs, except where this would not be representative of the actual stage of completion. Variations in contract work, claims and incentive payments are included to the extent that the amounts can be measured reliably and their receipt is considered probable.

When the outcome of such contracts cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred where it is probable they will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

#### Investment income

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established, provided that the economic benefits will flow to the Group and the amount of income can be measured reliably.

Interest income is recognised when it is probable that the economic benefits will flow to the Group and the amount of income can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

#### Acquisitions and disposals

On acquisition of a subsidiary, associate or jointly controlled entity, the cost is measured as the fair value of the consideration. The assets, liabilities and contingent liabilities of subsidiary undertakings that meet the IFRS 3 (Revised) *Business Combinations* recognition criteria are measured at the fair value at the date of acquisition, except that:

- deferred tax assets or liabilities, and liabilities or assets relating to employee benefit arrangements, are recognised and measured in accordance with IAS 12 *Income Taxes* and IAS 19 (Revised) *Employee Benefits* respectively;
- liabilities or equity instruments related to the replacement by the Group of an acquiree's share-based payment awards are measured in accordance with IFRS 2 *Share-based Payments*; and
- assets (or disposal groups) that are classified as held for sale, in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, are measured in accordance with that standard.

Where cost exceeds fair value of the net assets acquired, the difference is recorded as goodwill.

Where the fair value of the net assets exceeds the cost, the difference is recorded directly in the income statement. The accounting policies of subsidiary undertakings are changed where necessary to be consistent with those of the Group.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see below), or additional assets or liabilities recognised, to reflect new information obtained about facts and circumstances that existed as at the acquisition date that, if known, would have affected the amounts recognised as at that date.

The measurement period runs from the date of acquisition to the date the Group obtains complete information about facts and circumstances that existed as at the acquisition date, subject to a maximum period of one year.

In accordance with IFRS 3 (Revised) *Business Combinations*, acquisition and disposal related items are recognised through the income statement. Acquisition and disposal related items refer to credits and costs associated with the acquisition and disposal of businesses, together with the costs of aborted bids and the establishment of joint ventures.



### 3. Accounting policies *continued*

#### Intangible assets

##### Goodwill

The purchased goodwill of the Group is regarded as having an indefinite useful economic life and, in accordance with IAS 36 *Impairment of Assets*, is not amortised but is subject to annual tests for impairment. On disposal of a subsidiary, associate or jointly controlled entity, the amount attributable to goodwill is included in the determination of the profit or loss on disposal.

##### Acquired intangibles

The Group recognises separately from goodwill, intangible assets that are separable or arise from contractual or other legal rights and whose fair value can be measured reliably. These intangible assets are amortised at rates calculated to write down their cost or valuation to their estimated residual values by equal instalments over their estimated useful economic lives, which are:

- technology – average of ten years
- customer relationships – average of ten years
- order books – average of two years

##### Development costs

Development costs that qualify as intangible assets are capitalised as incurred and, once the relevant intangible asset is ready for use, are amortised on a straight-line basis over their estimated useful lives, averaging five years (2015: five years).

The carrying value of development assets is assessed for recoverability at least annually or when a trigger is identified.

##### Patents and licences

Patents and licences are measured initially at purchase cost and are amortised on a straight-line basis over their estimated useful lives, averaging seven years (2015: seven years).

##### Property, plant and equipment

Other than historically revalued land and buildings, property, plant and equipment is held at cost less accumulated depreciation and any recognised impairment loss. Borrowing costs on significant capital expenditure projects are capitalised and allocated to the cost of the project.

No depreciation is provided on freehold land. On other assets, depreciation is provided at rates calculated to write down their cost or valuation to their estimated residual values by equal instalments over their estimated useful economic lives, which are:

- freehold buildings – up to fifty years
- leasehold buildings – the period of the lease
- plant and equipment – up to ten years

##### Investments in associates

The results and the assets and liabilities of associates are accounted for using the equity method of accounting. Any excess of the cost of investment over the Group's share of the fair value of identifiable assets and liabilities within the associate at the date of acquisition is accounted for as goodwill that is included in the carrying value of the investment and is assessed for impairment as part of that investment.

##### Impairment of non-current assets

Assets that have indefinite lives are allocated to the Group's cash-generating units and tested for impairment at least annually. Assets that are subject to depreciation or amortisation are reviewed for impairment whenever changes in circumstances indicate that the carrying value may not be recoverable. To the extent that the carrying value exceeds the recoverable amount, an impairment loss is recorded for the difference as an expense in the income statement. The recoverable amount used for impairment testing is the higher of the value-in-use and the asset's fair value less costs of disposal. For the purpose of impairment testing, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

## GROUP ACCOUNTING POLICIES

continued

### 3. Accounting policies *continued*

#### Inventories

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

Provision is made for slow-moving, obsolete and defective items where appropriate.

#### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to prepare for their intended use, are added to the cost of those assets, until such time as the assets are ready for their intended use. Once the assets are ready for their intended use, these capitalised borrowing costs are depreciated in line with the underlying asset.

All other borrowing costs are recognised in the income statement in the period in which they are incurred.

#### Government grants

Government grants are not recognised until there is reasonable assurance that the Group will comply with the conditions attaching to them and that the grants will be received.

Government grants for staff retraining costs are recognised as income over the periods necessary to match them with the related costs and are deducted in reporting the related expense.

Government grants relating to property, plant and equipment are treated as deferred income and released to the income statement over the expected useful economic lives of the assets concerned.

#### Tax

The tax expense represents the sum of current tax and deferred tax.

Current tax is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years, and it excludes items of income or expense that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax represents amounts expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable taxable profits will be available in the future against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities, when they relate to income taxed by the same tax authority, and when the Group intends to settle its current tax assets and liabilities on a net basis.

### 3. Accounting policies *continued*

#### Special capital reserve

The special capital reserve was created as part of a capital reduction scheme involving the cancellation of the share premium account which was approved by the Court in 1986, in accordance with the requirements of the Companies Act 1985.

#### Foreign currencies

The individual financial statements of each Group company are presented in its functional currency, being the currency of the primary economic environment in which it operates. For the purpose of these Group financial statements, the results and financial position of each Group company are expressed in pounds sterling, which is the functional currency of the Company, and the presentation currency for these financial statements.

In preparing the financial statements of each Group company, transactions in foreign currencies, being currencies other than the entity's functional currency, are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items and on the retranslation of monetary items are included in the income statement for the period.

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward foreign exchange contracts which are accounted for as derivative financial instruments (see below for details of the Group's accounting policies in respect of such derivative financial instruments).

For the purpose of presenting these financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

#### Financial instruments

Financial assets and liabilities are recognised in the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

#### Financial assets

##### Trade receivables

Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

##### Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of change in value.

#### Financial liabilities and derivative financial instruments

##### Financial liabilities

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into.

##### Bank borrowings

Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption, and direct issue costs are accounted for on an accruals basis in the income statement using the effective interest method, and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

##### Trade payables

Trade payables are not interest bearing and are stated at their nominal value.

## GROUP ACCOUNTING POLICIES

continued

### 3. Accounting policies *continued*

#### Derivative financial instruments and hedge accounting

The Group's activities expose it to the financial risks of foreign currency transactions, and it uses forward foreign exchange contracts to hedge its exposure to these transactional risks. The Group does not use derivative financial instruments for speculative purposes.

Derivative financial instruments are recognised at fair value on the date the derivative contract is entered into and are revalued to fair value at each balance sheet date. The fair values of derivative financial instruments are calculated by external valuers.

The method by which any gain or loss is recognised depends on whether the instrument is designated a hedging instrument or not. To be designated as a hedging instrument, the instrument must be documented as such at inception, and must be assessed at inception and on an ongoing basis to be highly effective in offsetting changes in fair values or cash flows of hedged items.

Hedge accounting principles are used for forward foreign exchange contracts where appropriate, with movements in fair value taken to equity for cash flow hedges and to the income statement for fair value hedges, until such time as the underlying amounts of the contract mature. At maturity or disposal of the net investment, the amounts held in equity will be recycled to the income statement. Changes in fair value of any ineffective portion of net investment hedges and interest rate swap contracts are recognised in the income statement immediately.

Where derivative financial instruments do not meet the criteria for hedge accounting, the changes in fair value are immediately recognised in the income statement.

#### Hedges of net investments in foreign operations

Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in the statement of comprehensive income and accumulated in the translation reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

#### Embedded derivative financial instruments

Embedded derivative financial instruments that are not closely related to the host contract are treated as separate derivative financial instruments, with unrealised gains and losses reported in the income statement.

#### Retirement benefit costs

Payments to defined contribution retirement benefit schemes are charged as an administrative expense in the period to which they relate. For defined benefit schemes, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised in the statement of comprehensive income in full in the period in which they occur.

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The discount on scheme liabilities less the expected return on scheme assets on defined benefit obligations is included within finance expense.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the scheme.

#### Leased assets

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The asset is recorded in the balance sheet as property, plant and equipment, and is depreciated over the shorter of its estimated useful economic life and the lease term. Future instalments under such leases, net of finance charges, are recognised as a liability. The finance element of the instalments is charged to the income statement at a constant rate of interest on the remaining balance of the obligation.

All other leases are operating leases, for which rental charges are recognised in the income statement on a straight-line basis over the life of the lease.

### 3. Accounting policies *continued*

#### Share-based compensation

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

For grants made under the Group's share-based compensation schemes, the fair value of an award is measured at the date of grant and reflects any market-based vesting conditions. Non-market based vesting conditions are excluded from the fair value of the award. At the date of grant, the Company estimates the number of awards expected to vest as a result of non-market based vesting conditions, and the fair value of this estimated number of awards is recognised as an expense in the income statement on a straight-line basis over the vesting period. At each balance sheet date, the impact of any revision to vesting estimates is recognised in the income statement over the vesting period. Proceeds received, net of any directly attributable transaction costs, are credited to share capital and share premium.

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

#### Provisions

Provisions are recognised when the Group has a present obligation, either legal or constructive, as a result of a past event, it is probable that the Group will be required to settle that obligation, and a reliable estimate can be made of the amount of the obligation. The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the estimated cash flows to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

#### Environmental provisions

Where the Group is liable for decontamination work or the restoration of sites to their original condition, an estimate is made of the costs needed to complete these works, discounted back to present values, relying upon independent third party valuers where appropriate.

#### Restructuring provisions

A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring and not those associated with the ongoing activities of the entity.

#### Warranty provisions

Provisions for the expected cost of warranty obligations under local sale of goods legislation are recognised at the date of sale of the relevant products, based upon the best estimate of the expenditure required to settle the Group's obligations.

#### Disposal provisions

Disposal provisions relate to estimated liabilities faced by the Group in respect of discontinued operations and other disposed entities under the terms of their respective sale agreements.

#### Contingent liabilities

The Group exercises judgement in recognising exposures to contingent liabilities related to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgement may be necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and/or to quantify the possible range of the financial settlement.

#### Non-GAAP information

In the analysis of the Group's financial performance and position, operating results and cash flows, information is presented to provide readers with additional information that is prepared on a non-GAAP basis and which is regularly reviewed by management. The principal non-GAAP information presented is the underlying measure of earnings. This is considered by the directors to allow a more meaningful comparison of earnings trends. A further description of underlying earnings can be found in note 9 of these financial statements.

#### Post balance sheet events

In accordance with IAS 10 *Events after the Balance Sheet Date*, the Group continues to disclose events that it considers material, non-disclosure of which can influence the economic decisions of users of the financial statements.

### 4. Chemring Group PLC accounting policies

#### FRS 101 *Reduced Disclosure Framework*

The financial statements have been prepared in accordance with FRS 101 *Reduced Disclosure Framework*.

The Company operates a multi-employer defined benefit scheme including employees of other Group companies. Following FRS 101, the scheme assets and liabilities have been allocated across the Group companies using a method that management considers to be the most appropriate, based on scheme membership.

The following exemptions from the requirements of IFRS have been applied in the preparation of these financial statements, in accordance with FRS 101:

- share-based payments;
- business combinations;
- financial instruments;
- fair value measurements;
- presentation of comparative information in respect of certain assets;
- IFRSs issued but not yet effective;
- related party transactions;
- assumptions and sensitivities for impairment review; and
- cash flow.

#### Investment in Group undertakings

Investments are stated at cost less any provision for impairment in value.

### 5. Critical accounting judgements and sources of estimation uncertainty

When applying the Group's accounting policies, management must make assumptions and estimates concerning the future that affect the carrying amounts of assets and liabilities at the balance sheet date and the amounts of revenue and expenses recognised during the period. Such assumptions and estimates are based upon factors including historical experience, the observance of trends in the industries in which the Group operates, and information available from the Group's customers and other external sources.

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year include:

#### Revenue recognition

When accounting for the revenue recognised on the sale of goods, depending on the nature of the contract terms, there can be judgement applied to determining if substantially all the risks and rewards have transferred to the customer and therefore the point at which revenue should be recognised. This is the case for bill and hold arrangements which are common in the defence industry when selling product into government agencies, who will typically contract on ex-works terms.

The Group has contracts that fall into different accounting periods. In assessing the allocation of revenues and costs to individual accounting periods, and the consequential assets and liabilities, the Group estimates the total revenues and costs forecast to arise in respect of the contract and the stage of completion based on an appropriate measure of performance as described under the revenue recognition policy on pages 129 and 130. The Group utilises assumptions and projections, principally relating to future material, labour and overhead costs. As a consequence there is a risk that total contract costs will exceed those originally estimated and the margin will decrease. Changes to initial assumptions, which are reviewed on a regular basis, may result in revisions to estimated costs and anticipated margins. These are recognised in the period in which the estimated costs are revised. The determination of appropriate accounting policies for recognising revenue and costs in respect of these contracts requires judgement, in particular (i) whether contract accounting is the most appropriate method of recognising revenue on these contracts; and (ii) the appropriate measure of stage of completion of the contract.

Revenue from contract accounting for continuing operations amounted to £9.4 million (2015: £12.8 million).

## 5. Critical accounting judgements and sources of estimation uncertainty *continued*

### Goodwill impairment

Determining whether goodwill is impaired requires an estimation of the value-in-use of the cash-generating units to which goodwill has been allocated. The value-in-use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit, and to determine a suitable discount rate in order to calculate present value (see note 10). In reviewing the carrying value of goodwill of the Group's businesses, the Board has considered the separate plans and cash flows of these businesses consistent with the requirements of IAS 36 *Impairment of Assets*. The plans and cash flows of these businesses reflect current and anticipated conditions in the defence industry.

### Tax

The largest category of deferred tax asset which contains significant estimation uncertainty and which requires management judgement in assessing its recoverability relates to US interest limitations and tax losses carried forward (see note 22).

Applicable accounting standards permit the recognition of deferred tax assets only to the extent that it is probable that future taxable profits will be available to utilise the tax losses carried forward. The assessment of future taxable profits involves significant estimation uncertainty, principally relating to an assessment of management's projections of future taxable income based on business plans and ongoing tax planning strategies. These projections include assumptions about the future strategy of the Group, the economic and regulatory environment in which the Group operates, future tax legislation, and customer behaviour, amongst other variables.

### Legal

The Group is subject to legal proceedings and other claims arising in the ordinary course of business. The Group is required to assess the likelihood of any adverse judgements or outcomes, as well as potential ranges of probable losses. A determination of the amount of reserves required for these matters is based on a careful analysis of each individual issue with the assistance of outside legal counsel. However, actual claims incurred could differ from their estimated value and the risk of economic outflow relating to these reduces with the passage of time.

### Pension

The Group's defined benefit pension schemes are assessed annually in accordance with IAS 19. The accounting valuation, which is based on assumptions determined with independent actuarial advice, resulted in a net deficit of £17.3 million before deferred taxation being recognised on the balance sheet at 31 October 2016 (2015: £17.7 million). The size of the deficit is sensitive to the market value of the assets held by the schemes and to actuarial assumptions, which include price inflation, pension and salary increases, the discount rate used in assessing actuarial liabilities, mortality and other demographic assumptions and the levels of contributions. Further details are included in note 29.

### Capitalised development costs

IAS 38 *Intangible Assets* requires that development costs, arising from the application of research findings or other technical knowledge to a plan or design of a new substantially improved product, are capitalised, subject to certain criteria being met. Determining the technical feasibility and estimating the future cash flows generated by the products in development requires judgements which may differ from the actual outcome. In particular this can depend on the judgement applied to future milestone events to secure long term positions on production contracts, for example Programs of Record for the US DoD. The total capitalised development intangible asset is set out in note 11, which shows a carrying asset of £40.9 million at 31 October 2016.

# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CHEMRING GROUP PLC

## Opinion on financial statements of Chemring Group PLC

### In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 October 2016 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements that we have audited comprise:

- the consolidated income statement;
- the consolidated and company statements of comprehensive income;
- the consolidated and company balance sheets;
- the consolidated cash flow statement;
- the consolidated and company statements of changes in equity; and
- the related notes 1 to 35 of the consolidated financial statements and 1 to 12 of the company financial statements.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

## Summary of our audit approach

|  |   |
|--|---|
| <i>Key risks</i>                           | The key risks that we identified in the current year were: <ul style="list-style-type: none"><li>• Revenue recognition</li><li>• Valuation of goodwill and intangibles</li><li>• Provisioning for taxation</li><li>• Undue bias in provisions</li></ul>   |
| <i>Materiality</i>                         | The materiality that we used in the current year was £2.1 million (2015: £2.1 million) which was determined on the basis of using 7.5% of a 3 year average for continuing underlying pre-tax profit measure reported by the Group. Underlying pre-tax profit is the measure that management believes is of most interest to users of the financial statements and is defined in note 3. |
| <i>Scoping</i>                             | We focused our Group audit scope primarily on the audit work at 14 locations which represent the principal business units and account for 97% of the Group's net assets, 96% of the Group's revenue and 95% of the Group's underlying profit before tax, which was broadly consistent with the prior year.  |
| <i>Significant changes in our approach</i> | In the current year we have not included the risk in respect of the going concern assumption in light of the Group's successful rights issue in the year and improved trading performance.  |



## Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group

As required by the Listing Rules we have reviewed the directors' statement regarding the appropriateness of the going concern basis of accounting contained within the accounting policies section to the financial statements and the directors' statement on the longer-term viability of the Group contained within the strategic report on page 27.

We are required to state whether we have anything material to add or draw attention to in relation to:

- the directors' confirmation on page 27 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures on pages 34 to 40 that describe those risks and explain how they are being managed or mitigated;
- the directors' statement in the accounting policies section to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and
- the directors' explanation on page 27 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

**We confirm that we have nothing material to add or draw attention to in respect of these matters.**

**We agreed with the directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.**

## Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards.

**We confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.**

## Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

In the current year we have not included the risk in respect of the going concern assumption in light of the Group's successful rights issue in the year and improved trading performance.

continued

## Revenue recognition

### Risk description

- A. Judgements are taken in recognising revenue relating to the delivery of goods, most notably due to the differing contractual and shipping terms with regards to the transfer of risk and reward and the appropriate point at which revenue should be recognised. The key risk arises regarding sales recognised where goods have not been received by the customer or where the risks have not fully transferred. The timing of sales for the Group often leads to significant sales being reported in the periods close to reporting dates.
- B. Subject to meeting specific criteria, Chemring adopts long-term contract accounting for certain of its contracts. Whilst the volume and significance of these contracts continue to decline across the Group, a number of judgements are undertaken which specifically impact the extent to which revenue is recognised. Specifically there is a risk that original estimates made regarding the total contract cost are incorrect resulting in changes to the margin.

We have considered the judgements involved in adopting long term contract accounting and, due to the bespoke nature of these contracts, we have assessed that the forecasting of costs to complete is a significant judgement. Consequently, we have identified a key risk in the area relating to the accuracy of this estimate.

Refer to page 136 (critical accounting judgements and key sources of estimation uncertainty - revenue recognition); pages 129 and 130 (accounting policies - revenue recognition); and page 62 (Audit Committee report - significant issues considered).

### How the scope of our audit responded to the risk

- A. Our audit work assessed the adequacy of the design and implementation of controls around revenue recognition. In response to the risk arising from differing contractual terms, we reviewed contractual evidence to understand how the specific terms were recorded and the appropriate revenue recognition policies applied. We then performed a sample test of sales recognised either side of the year end to substantiate that the appropriate terms of the relevant contracts had been followed and that the risks and rewards associated with the contract had passed to the customer. We used external evidence such as shipping documentation, export licences, letters of credit or client acceptance documentation to confirm that revenue had been recognised in the appropriate period.
- B. Our audit work assessed the adequacy of the design and implementation of controls over long-term contract accounting. For a sample of contracts we have verified the cost to complete through meetings with the project manager to discuss the scope of work, the progress, and any potential risks up to completion, and by agreement to evidence of committed spend, budgeted rates or actual costs incurred to date. We have also performed recalculations in order to confirm that revenues recognised are appropriate. We understood and challenged management's assumptions by referring to evidence including signed contracts terms and latest project status reports, and assessed the reliability of management estimates through consideration of the historical accuracy of prior period management estimates and considering the extent to which any other evidence, including industry reports around major programmes and our knowledge of the Aerospace and Defence industry, contrasted with the assumptions made.

## Valuation of goodwill and/or intangibles

### Risk description

- A. The assessment of the valuation of goodwill arising on historical acquisitions, is a judgemental process due to management's assertions regarding their recoverable amount. The Group recognised goodwill of £132.9 million at 31 October 2016. There are a number of key judgements in determining the recoverable amount, including growth rates in future cash flow forecasts, timing of contract wins and conversion into revenue, launch of new products and associated revenues, and discount rates applied to these forecasts.
- B. The valuation of intangibles arising from internal capitalised development costs is judgemental due to the uncertainty of forecast future revenue and profits used to support their carrying value. There is a risk that changes in the market may mean that these costs, whilst appropriate to capitalise, are not supported by future opportunities. The carrying value at 31 October 2016 was £40.9 million.

Refer to page 137 (critical accounting judgements and key sources of estimation uncertainty – goodwill impairment); page 131 (accounting policies – intangible assets); and page 62 (Audit Committee report – significant issues considered).

### How the scope of our audit responded to the risk

- A. Our audit work assessed the adequacy of the design and implementation of controls over monitoring the carrying value of goodwill. We challenged the assumptions used by management in their annual impairment assessment by benchmarking to independently available data, peer group analysis, our by using our understanding of the secured orders underpinning the Group's short-term cash flow forecasts and our assessment of the longer term growth rates employed. In addition, valuation specialists within the audit team provided a challenge over the discount rate applied to these cash flows through the use of external data and benchmarking. Having audited the assumptions within management's annual impairment assessment, we checked the arithmetic accuracy of the impairment model using these assumptions to confirm their conclusions with respect to the recoverability of the carrying value of goodwill and other intangibles.
- B. We reviewed the design and implementation of controls over the monitoring of capital development projects and the impairment review process. We gained an understanding of the project plan and progress made to date through enquiries with non-finance personnel, evidencing the status of secured orders and income, routes to market and the identification of potential customers to help us assess whether carrying values were supportable. This involved review of documentation with third parties, understanding contract progress, ongoing customer interest and future risks with the commercial and business development team and allowed us to critically assess the recoverability of the related assets.

# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CHEMRING GROUP PLC

continued

## Provisioning for taxation

|   |  |
|---|--|
| <b>Risk description</b>                                 | <p>Provisioning for taxation requires complex judgements to be taken in respect of the various tax jurisdictions in which the Group operates. The provisions are judgemental as a result of their nature and technical complexity. The key risk is in relation to whether tax provisions impacting the effective tax rate have been recognised at the correct value including specific tax provisions and those against deferred tax asset balances.</p> <p>Refer to page 137 (critical accounting judgements and key sources of estimation uncertainty – tax); and page 132 (accounting policies – tax); and page 96 (notes to the Group financial statements – tax).</p>                           |
| <b>How the scope of our audit responded to the risk</b> | <p>Our audit work assessed the adequacy of the design and implementation of controls over accounting for taxation. We evaluated the appropriateness of management's assumptions and estimates in their assessment and valuation of the tax risks within the Group including review of correspondence on the status of tax compliance and tax audits in the various jurisdictions in which the Group operates, and benchmarking against our assessment of the range of potential outcomes in respect of the uncertain tax treatments adopted. We involved tax specialists within the audit team to provide detailed knowledge and expertise in assessing tax treatments in certain jurisdictions.</p> |

## Appropriateness and completeness of provisions

|   |   |
|---|---|
| <b>Risk description</b>                                 | <p>Management recognises provisions in respect of product failures, environmental matters and legal claims. The outcomes of these claims are subject to management judgement including determining their significance and the potential liability. Provisions total £16.2 million at 31 October 2016.</p> <p>Refer to page 137 (critical accounting judgements and key sources of estimation uncertainty – legal); page 135 (accounting policies – provisions and contingent liabilities); and pages 111 and 120 (notes to the Group financial statements – provisions and contingent liabilities).</p>   |
| <b>How the scope of our audit responded to the risk</b> | <p>Our audit work assessed the adequacy of the design and implementation of controls in relation to how provisions are identified and valued. We recalculated and challenged management's estimates for the provisions through our understanding of the potential liability as set out in contract terms or third party information where applicable.</p> <p>For product failures, we challenged the level of provisioning by verifying the actual failure costs incurred to date and the products in circulation subject to customer dispute using external evidence, such as correspondence with third parties.</p> <p>In response to litigation and environmental risks, we reviewed internally prepared health and safety reports, circularised the Group's external legal advisors, and held specific discussions with external advisors that are providing services to the Group in relation to certain claims and reviewed legal costs incurred in the year to confirm the completeness of legal cases to which the Group is party. Through external evidence including submitted legal advice and discussion with management, we sought to challenge the basis for management's expectations over likely outcomes and their subsequent quantification of the related provisions.</p> <p>We have assessed the latest available information and the accuracy and reliability of the sources of that information to determine if the amounts provided are appropriate.</p> |

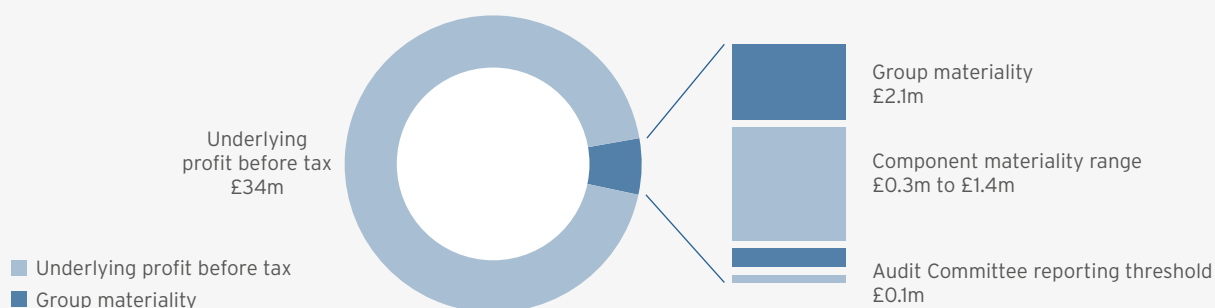
These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

## Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

|  |  |
|--|--|
| <i>Group materiality</i>                   | £2.1 million (2015: £2.1 million).   |
| <i>Basis for determining materiality</i>   | <p>We derived materiality by using 7.5% of a three year average for continuing underlying pre-tax profit measure reported by the Group. Underlying pre-tax profit is the measure that we believe is of most interest to users of the financial statements and is defined in note 3.</p> <p>This equates to 6.2% of underlying pre-tax profit (2015: 10%), under 1% of revenue (2015: under 1%), and under 1% of net assets (2015: under 1%).</p>   |
| <i>Rationale for the benchmark applied</i> | As a result of the volatile business performance in recent years we have included consideration of alternative benchmarks in reaching our conclusion. This serves to reduce the volatility that one-off significant contracts can have on the Group's trading result. The result is that materiality has been maintained at a similar level year on year using a consistent approach that is understood by shareholders and the Audit Committee given it has previously been reported in the 2015 Annual Report. |



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £100,000 (2015: £41,500), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. The threshold has been increased in the current period based on our assessment of what constitutes a clearly trivial audit difference. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CHEMRING GROUP PLC

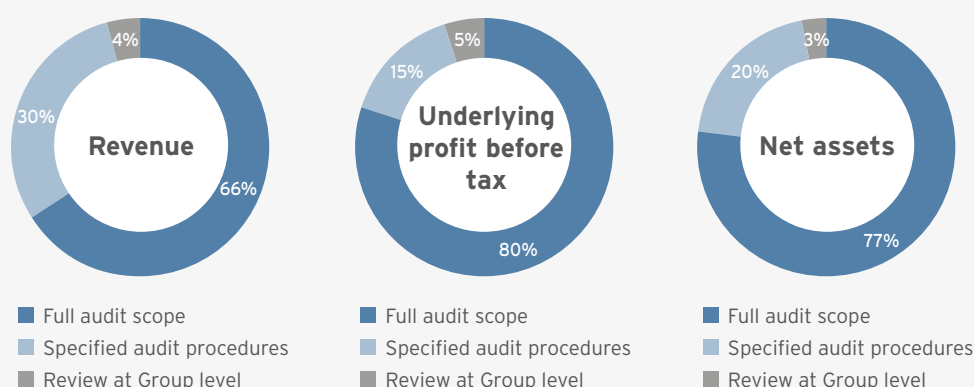
continued

## An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we focused our Group audit scope primarily on the audit work at 14 locations (2015: 14 locations). 9 (2015: 9) of these were subject to a full audit, whilst the remaining 5 (2015: 5) were subject to either an audit of specified account balances or specified audit procedures where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations at those locations. These 14 locations represent the principal business units and account for 97% (2015: 97%) of the Group's net assets, 96% (2015: 93%) of the Group's revenue and 95% (2015: 97%) of the Group's underlying profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above. Our audit work at the 14 locations was executed at levels of materiality applicable to each individual entity which were lower than Group materiality and ranged from £0.3 million to £1.4 million (2015: £0.5 million to £1.5 million).

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The Group audit team continued to follow a programme of planned visits that has been designed so that the Senior Statutory Auditor or a senior member of the Group audit team visits each of the locations where the Group audit scope was focused at least once every three years and the most significant of them at least once a year. We visited all full audit scope locations with the exception of Chemring Australia Pty, Ltd. which was visited in the prior year. Of the 5 locations subject to specified audit procedures we visited Chemring Detection Systems, Inc. and Non-Intrusive Inspection Technology, Inc. Every year, regardless of whether we have visited or not, we include the component audit team in our team briefing, direct the scope of their work for the purposes of our Group audit, discuss their local risk assessment, and review documentation of the findings from their work.



## Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006;
- 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 the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report and the directors' report.

## Matters on which we are required to report by exception

### Adequacy of explanations received and accounting records

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns.

**We have nothing to report in respect of these matters.**

### Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the directors' remuneration report to be audited is not in agreement with the accounting records and returns.

**We have nothing to report arising from these matters.**

### Corporate governance report

Under the Listing Rules we are also required to review part of the corporate governance report relating to the Company's compliance with certain provisions of the UK Corporate Governance Code.

**We have nothing to report arising from our review.**

### Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

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

**We confirm that we have not identified any such inconsistencies or misleading statements.**

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

### Respective responsibilities of directors and auditor

As explained more fully in the directors' responsibilities statement, 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). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- Whether the accounting policies are appropriate to the Group's and the parent 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.

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.

### Anna Marks ACA (Senior statutory auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditor

Reading, UK

19 January 2017

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## CORPORATE INFORMATION AND WEBSITE

### Headquarters and registered office

Roke Manor  
Old Salisbury Lane  
Romsey  
Hampshire  
SO51 0ZN

**T: +44 (0)1794 833901**

**F: +44 (0)1794 833955**

### Registration number

86662

### Registrars

Computershare Investor Services plc  
The Pavilions  
Bridgwater Road  
Bristol  
BS13 8AE

**Website: [www.chemring.co.uk](http://www.chemring.co.uk)**

### Find out more online

For more information about Chemring Group PLC, please visit [www.chemring.co.uk](http://www.chemring.co.uk) where the latest shareholder information can be accessed, including:

- Current share price
- Key financial information
- Financial calendar
- Shareholder services and notices
- Corporate governance
- RSS news feeds
- Results and presentations
- Analysts' forecasts
- Regulatory news

Chemring Group PLC's Annual Report and Accounts 2016 and the Notice for the Annual General Meeting can also be viewed and downloaded at [www.chemring.co.uk/investors](http://www.chemring.co.uk/investors)

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## NOTES



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Chemring Group PLC  
Roke Manor  
Old Salisbury Lane  
Romsey  
Hampshire SO51 0ZN  
Tel: +44(0)1794 833901  
Email: [info@chemring.co.uk](mailto:info@chemring.co.uk)  
[www.chemring.co.uk](http://www.chemring.co.uk)