

BUSINESS

Defence group aims for take-off

A share offering beckons this autumn for QinetiQ, a business that is being built out of some of Britain's most famous military research laboratories. **Andrea Chipman reports.**

The low-rise, glass-and-steel research campus that houses QinetiQ in Farnborough, south-west of London, betrays few signs of the company's historic pedigree. It was on this site that the then Royal Aircraft Establishment (RAE) developed many military aircraft that flew in the Second World War, and contributed to the design of Concorde.

But now the company — whose name is pronounced 'kinetic' — is part of a rapid transformation that is converting the former defence labs into a unique, research-led defence company that is making money and will soon stand on its own two feet.

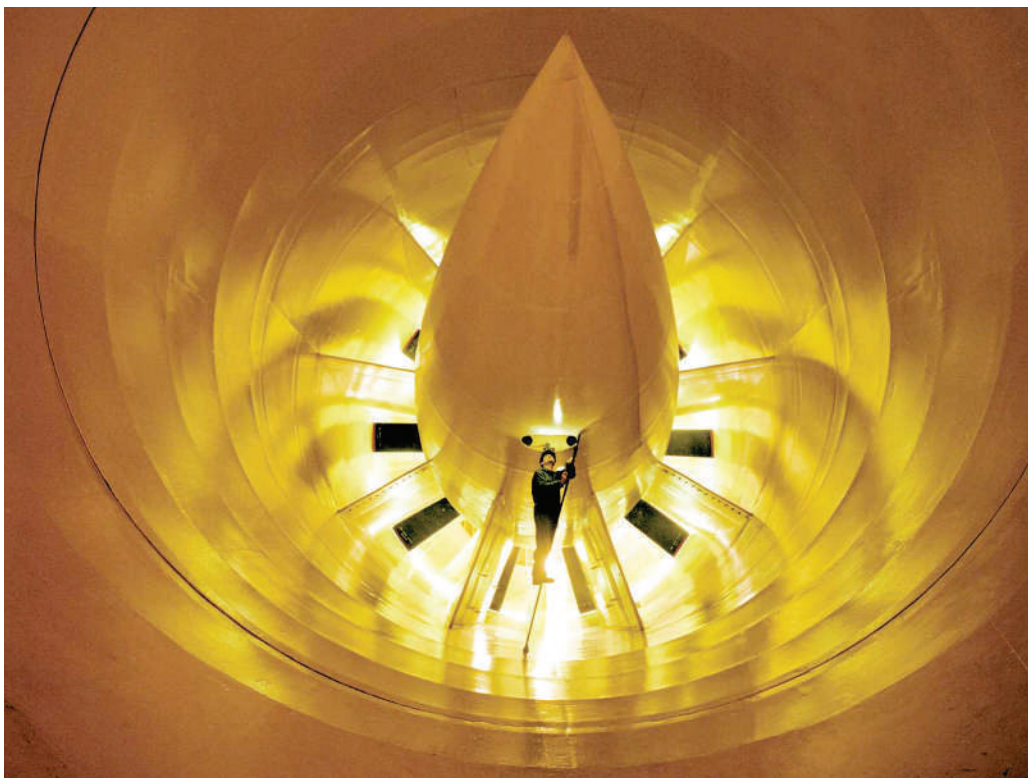
A stockmarket offering — which could take place as soon as November — would be the culmination of a 14-year process that has seen parts of the former labs converted into a dynamic defence contractor and consultancy firm, which draws on research in fields such as materials science and optics to strengthen its competitive position.

QinetiQ was founded in 2001 and is currently a public-private hybrid, with just over half of its shares held by the British Ministry of Defence, one-third by the Washington-based Carlyle Group, and the rest by management and staff. It has reduced its number of sites by half without any net loss of staff, the company says, and most of its 9,000 UK employees now work at its offices at Farnborough and in Malvern, Worcestershire.

And although research will remain central to the company's identity, it is already clear that other activities — primarily military contracting and consulting — will constitute the largest part of its business. Contracts with the Ministry of Defence still account for more than half of its annual sales, but the company has also built a strong presence in the United States by procuring several established contractors to the Pentagon and the Department of Homeland Security over the past year.

"The original plan was to commercialize the defence technology," says one person close to the company's thinking. "But that has been hard to do." QinetiQ will continue to carry out research, but this will increasingly be outweighed by more general defence contracting.

"At the moment, QinetiQ does have a privileged position," says Clive Forestier-Walker, a defence and aerospace analyst at London-



Big business: expertise in aviation provided part of the basis for QinetiQ's progress towards a share offer.

based Numis Securities, citing the company's work on research and development for the Ministry of Defence and as a consultant for defence contractors such as BAE Systems.

"The general view is that QinetiQ will be a highly rated company because of the sectors it is in," says another London-based analyst, who predicts that the company's defence and security interests will attract investors.

But QinetiQ is still looking for commercial uses for military technology. The materials-science unit at Farnborough, for instance, is looking at how stealth materials that were developed for use in military aircraft can find other applications. "Historically we've concentrated on defence projects, but this puts us in a strong position to find commercial work," says Chris Lawrence, a physicist who heads the company's smart-materials group.

One project at the unit's impressively equipped Farnborough laboratory is seeking to combine expertise in optics, infrared,

microwaves, acoustics, visible light and magnetism to develop devices that can be used in counterfeit deterrence and inventory control.

Another potential application of stealth materials is a thin-film material that uses microwave-absorber technology and could be used with radio frequency identification (RFID) tags. RFID can help companies secure and track retail merchandise, and is a growing market that could be worth more than US\$7 billion worldwide by 2008, according to the independent technology consultant IDTechEx.

QinetiQ is looking at ways of using the technology in 'wallpapers' that absorb stray mobile-phone signals, and prevent the scatter of radiowaves when tags are being scanned, Lawrence says. "Our knowledge of stealth technology has enabled us to think of various ways of either making something very eye-catching, or else hiding a message," he explains.

Business opportunities have already flowed

from the company's activities in nanotechnology. In 2000, QinetiQ's predecessor organization teamed up with Australian biotechnology firm pSivida to form a joint venture to develop BioSilicon, a form of nanostructured porous silicon with medical applications, including controlled drug delivery and brachytherapy, a localized treatment of cancer.

Meanwhile, its subsidiary QinetiQ Nanomaterials is marketing its proprietary process for producing bulk nanopowders from a range of pure metals and other materials, under the brand name Tesima.

Taking shape

QinetiQ's progress has been overseen by John Chisholm, an engineer and former founder and chief executive of CAP Scientific, a London-based software house. Chisholm was asked by the Ministry of Defence to supervise the merger in 1991 of several military research laboratories, including the RAE and the Royal Signals and Radar Establishment at Malvern, into the Defence Research Agency, which then became the Defence Evaluation and Research Agency, or DERA, in 1995.

In 2001, the government held onto the parts of the DERA labs that did the most classified work, and formed QinetiQ to run operations with commercial potential. The next year, it selected the Carlyle Group as a partner to take the new company into private ownership, and sold it a third of the shares for £150 million (US\$275).

Carlyle is a private investment company that has strong ties to the US national security establishment — former president George Bush used to serve on the board — and its involvement has clearly opened doors for QinetiQ as it has expanded aggressively into the United States, buying four defence contractors over the past year. For good measure, it just bought a 90% share of a Belgian space company, Verhaert.

With its fingers in a number of potentially profitable pies, QinetiQ now has to balance its various priorities: government contracts, private commercial contracts, consulting work and innovative research. Its multiple roles can mean that the company is at the same time advising BAE Systems and providing services for the Ministry of Defence and US defence and security agencies.

QinetiQ's unique position is seen by some observers as a strength, and financial analysts have predicted that the share offering will value the company at more than £1 billion. Foreigners can forget about swooping for control of the company, however; the Ministry of Defence will retain a special share that will prevent it falling under ownership of which it doesn't approve. ■

IN BRIEF

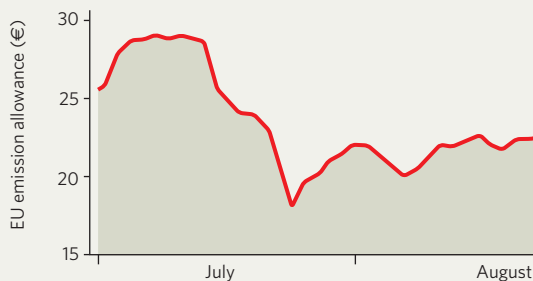
RNAi ON TARGET Drug maker Novartis has bought a major stake in Alnylam Pharmaceuticals — one of a clutch of companies that are pioneering the use of RNA interference in medicine. The biotechnology company, which is based in Cambridge, Massachusetts, will initially receive \$57 million from Novartis for about 20% of its stock, and the two companies will pursue a research collaboration that could provide up to \$650 million more to support Alnylam if its products achieve commercial success. RNA interference uses snippets of recombinant DNA to switch off disease-causing genes.

PCR SPAT BROADENS OUT Applied Biosystems, a manufacturer of polymerase chain reaction (PCR) machines for genetic sequencing, says it has won a court injunction to prohibit a rival from selling or maintaining similar equipment. The injunction from a court in New Haven, Connecticut, stops MJ Research and its parent, Bio-Rad, from making, selling or producing thermal cycler products for PCR machines. California-based Bio-Rad issued a statement saying that it thought it had agreed otherwise with Applied Biosystems, and that it is "dismayed" at the injunction.

CASH INJECTION GlaxoSmithKline is to buy ID Biomedical, the Canadian vaccine manufacturer, for \$1.4 billion. Both companies supply flu vaccines, and the deal seems to reflect growing commercial interest in vaccine manufacture. In a related development last week, Chiron's independent directors rejected a \$4.5 billion bid from Novartis to buy full control of the California-based vaccine maker, in which it already holds a large minority stake.

MARKET WATCH

EUROPEAN CARBON INDEX



After crashing drastically in July, the costs of options to emit carbon dioxide in Europe have been steadily rising again through August and early September.

Analysts blame the crash on a rush to the exits by speculators who had been investing in the options — and warn that further volatility could lie ahead, as more nations and investors join the embryonic market for the options.

At the European Energy Exchange (EEX) in Leipzig, Germany — one of five such exchanges now operating across the continent — the price of an allowance to emit one extra ton of CO₂ peaked at €29 (US\$36) in early July, before falling back to €18. Last week, the allowances were back up to €25, with some brokers predicting that they could soon rise beyond €30.

But investors should be ready for

future surprises, says Gabriele Rahn, a spokeswoman on energy trading at energy company Vattenfall, based in Hamburg, Germany. "The European-wide trade volume has come along nicely," she adds.

More than one million emission allowances per day are currently being traded across the five exchanges, Rahn says. But some countries have yet to start participating in the European Union's emission-trading scheme, which was set up in January. Once the latecomers, including Italy and Poland, join in, both trade volume and market volatility could increase again, she warns.

July's plunge caught analysts by surprise. According to one London-based broker, who declined to be identified, it came about after investors who had been buying the allowances in search of a short-term profit decided to get out.

Quirin Schiermeier