QinetiQ Group plc

For release at 0700 hours on 17 November 2016

Continuing operational delivery and progress implementing strategy

QinetiQ is a leading science and engineering company operating primarily in the defence, security and aerospace markets. We work in partnership with customers to solve real world problems through innovative solutions, delivering operational and competitive advantage. **Today QinetiQ publishes its interim results for the half year ended 30 September 2016.**

	Note	H1 2017	H1 2016
Business Performance			
Orders		**£376.8m**	£228.4m
Revenue	2	**£361.8m**	£370.9m
Underlying operating profit*	2	**£51.9m**	£49.8m
Underlying operating margin*	2	**14.3%**	13.4%
Underlying profit after tax*	4	**£45.5m**	£43.2m
Underlying net cash flow from operations (post capex)*	6	**£50.9m**	£46.9m
Underlying cash conversion ratio*	6	**98%**	94%
Underlying earnings per share (eps)*	5	**7.9p**	7.3p
Net cash	7	**£271.2m**	£181.5m
Dividend per share	9	**2.0p**	1.9p
Statutory Reporting			
Operating profit	2	**£51.7m**	£48.9m
Profit attributable to shareholders		**£49.5m**	£42.0m
Total earnings per share	5	**8.6p**	7.1p

Headlines

- Delivered solid operational performance in H1 FY17
  - Stable revenue and profit with continued high cash conversion
  - 5% increase in interim dividend in line with commitment to a progressive dividend; £17m remaining of the share buyback programme
- Focus on delivery of FY17
  - 94% of FY17 revenue under contract, consistent with prior period (90%)
  - Maintaining expectations for Group performance in the current financial year
- Progress implementing strategy
  - Orders increase due to £109m 11-year renewal for UK Naval Combat System Integration Support Services (NCSISS) and $28m US aircraft carrier orders
  - Transformation programme on track to improve customer focus and competitiveness

Steve Wadey, Group Chief Executive Officer said:

"We have secured good order intake, delivered a solid operational performance and demonstrated encouraging progress in the implementation of our strategy to drive future growth. We are on track with transforming the company and have secured the renewal of NCSISS for 11 years creating a UK centre of excellence for maritime mission systems and taking a significant step forward in modernising vital test and evaluation services in the UK."

ENDS

* Definitions of underlying measures of performance can be found in the glossary

Basis of preparation

Throughout this Interim Report, certain measures are used to describe the Group's financial performance which are not recognised under IFRS or other generally accepted accounting principles (GAAP). The Group's Directors and management assess financial performance based on underlying measures of performance, which are adjusted to exclude certain 'specific adjusting items'. In the judgment of the Directors, the use of adjusted measures such as underlying operating profit and underlying earnings per share are more representative of ongoing trading, facilitate meaningful year-to-year comparison and, therefore, allow the reader to obtain a fuller understanding of the financial information.*

Other information

There will be a presentation of the interim results to analysts at 0900 hours UK time on 17 November 2016 at the London Stock Exchange, 10 Paternoster Square, EC4M 7LS. Registration for the webcast is available at: www.QinetiQ.com/investors where the presentation will also be available. An audiocast of the event will be available by dialling +44 (0)20 3059 8125 (confirmation: QinetiQ).

About QinetiQ:

QinetiQ is a leading science and engineering company operating primarily in the defence, security and aerospace markets. We work in partnership with our customers to solve real world problems through innovative solutions delivering operational and competitive advantage. Visit our website www.QinetiQ.com. Follow us on LinkedIn and Twitter @QinetiQ. Visit our blog www.QinetiQ-blogs.com.

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Disclaimer

All statements other than statements of historical fact included in this document, including, without limitation, those regarding the financial condition, results, operations and businesses of QinetiQ and its strategy, plans and objectives and the markets and economies in which it operates, are forward-looking statements. Such forward-looking statements, which reflect management's assumptions made on the basis of information available to it at this time, involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of QinetiQ or the markets and economies in which QinetiQ operates to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Nothing in this document should be regarded as a profit forecast.

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Group overview of H1 results

Orders were £376.8m (H1 2016: £228.4m), due to the award of a £109m 11-year renewal from the UK Ministry of Defence (MOD) for the Naval Combat System Integration Support Services (NCSISS) contract plus improved order flow in Global Products driven by $28m of orders for Advanced Launch and Recovery Equipment for next generation US aircraft carriers.

Revenue was £361.8m (H1 2016: £370.9m), down 3% on an organic basis after adjusting for foreign exchange movements and the divestment of the non-core Cyveillance business in December 2015. This was principally due to a reduction in revenues in Global Products which were down 8% on an organic basis illustrating the lumpy nature of the division's revenue profile. EMEA Services revenue fell by 1% on an organic basis. On 1 October 2016, the Group had 94% of FY17 revenue under contract, consistent with the prior period (90%) and up from 74% at the beginning of this financial year.

Underlying operating profit* was up 4% at £51.9m (H1 2016: £49.8m), assisted by a credit of £1.3m relating to the resolution of an overseas licensing dispute within Global Products. Underlying profit after tax* was £45.5m (H1 2016: £43.2m) with underlying net finance income* of £0.1m (H1 2016: cost £0.1m) and an underlying tax charge of £6.5m (H1 2016: £6.5m).

Underlying earnings per share* increased 8% to 7.9p (H1 2016: 7.3p) benefiting from the higher underlying profit after tax* and reduced number of shares due to the ongoing share buyback programme.

At 30 September 2016, the Group had £271.2m net cash, compared to £274.5m net cash at 31 March 2016 and higher than £181.5m net cash at 30 September 2015. The increase from 30 September 2015 was due primarily to disposal proceeds and net tax receipts in H2 FY16. Underlying operating cash conversion* remained strong at 98% (H1 2016: 94%), delivering an underlying cash flow of £50.9m (H1 2016: £46.9m) with capital expenditure of £9.7m (H1 2016: £16.0m). Capital expenditure is expected to increase in future as we intend to invest in the Long Term Partnering Agreement (LTPA) and other long-term contracts.

Priorities for capital allocation are:
1. Organic investment complemented by bolt-on acquisitions where there is a strong strategic fit;
2. The maintenance of necessary balance sheet strength;
3. A progressive dividend; and
4. The return of excess cash to shareholders.

The Group had bought back £29m of the previously announced £50m share repurchase at 30 September 2016 and £33m at 11 November 2016. We expect to complete the remaining £17m of the current share buyback programme in the second half of this financial year.

An interim dividend of 2.0p (H1 2016: 1.9p) will be paid on 10 February 2017 to shareholders on the register at 13 January 2017. The 5% increase in interim dividend reflects the Group's progressive dividend policy. The interim dividend is normally expected to represent approximately one third of the anticipated total dividend for the year.

Board changes

As previously announced, David Mellors, Chief Financial Officer (CFO), will leave QinetiQ on 31 December 2016 to become CFO of Cobham plc and will be replaced by David Smith. David Smith is currently CFO of Rolls Royce plc and was previously CFO of the technology group Edwards and Chief Executive Officer of Jaguar Land Rover. He will be in post no later than 1 March 2017 with Dr Malcolm Coffin, QinetiQ Group Financial Controller since October 2010, undertaking the CFO role on an interim basis.

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Trading environment

QinetiQ operates principally in three home markets: the United Kingdom, the United States and Australia.

UK

The new UK Government, established this summer following the referendum vote in favour of the UK leaving the EU, has reaffirmed its commitment to the outcome of the Strategic Defence and Security Review (SDSR) published at the end of 2015 which helped to clarify the UK's capability priorities. In the SDSR the MOD pledged to spend 2% of GDP on defence and to address capability gaps such as combat air and maritime surveillance. Investment in cyber security is also to rise over the next five years with a UK National Cyber Security Centre established in 2016.

New capabilities will be funded by 30% reductions in MOD civilian staff and in its 'built' estate, and by £11bn of savings over the next four years. The introduction of new capabilities and, in particular, extending the life of existing capabilities, provides QinetiQ with opportunities to deliver engineering, test and evaluation services as well as further opportunities for outsourcing, while recognising that in the short term there may continue to be some uncertainty and the potential for interruptions to order flow.

The Single Source Regulations Office (SSRO) is developing a new methodology for calculating the baseline profit rate in future years, potentially introducing multiple profit rates. This baseline rate acts as the starting point for agreeing the profit rates of new and renewed contracts, and suppliers can both under and over-perform the contracted rate depending on, for example, risk, capital servicing and project execution. Approximately 70% of our total EMEA Services revenue is derived from single source contracts, including the non-tasking element of the Long Term Partnering Agreement (LTPA) and we anticipate that the majority of our single source revenue will fall under the regulations within the next three years.

MOD spending on science and technology will continue to be protected at 1.2% of the defence budget with an increased emphasis on disruptive technologies and innovation, and a move away from some more traditional research programmes. On 16 September 2016, the Secretary of State for Defence launched a new Defence Innovation Initiative for the UK focused on ensuring that Britain remains a credible military force against major adversaries, using traditional lethal and non-lethal effects to respond to evolving threats with pace and agility. As part of the Initiative, a Defence and Security Accelerator will launch next year to administer an £800m Innovation Fund. In addition, an Innovation and Research Insight Unit will be established to inform the future direction of Science & Technology programmes for defence and security, drawing on industry, SMEs and academia for the latest intelligence. The Defence Innovation Initiative has a particular emphasis on partnership and the "Whole Force" – military, civil servants and industry people – working as one. At the launch of the initiative, the Secretary of State highlighted the QinetiQ-facilitated Unmanned Warrior exercise in October 2016 as "a signal of our desire to work with global partners."

US

In the US, Congress passed a Continuing Resolution to fund the US Government through the November Presidential elections and up to 9 December 2016. This creates the potential for some short-term delays but in the longer term defence spending is expected to rise with a 2% increase in the US base budget forecast through 2020. A renewed commitment by US military customers to unmanned ground vehicle products is reflected in plans to award new competitive Programs of Record over the next two years to enhance and sustain the US unmanned systems capability as a funded capability in the US Department of Defense (DoD) budget. The research and development (R&D) budget for defence is also expected to increase with the Defense Innovation Initiative, also known as the Third Offset Strategy, putting $18bn a year behind innovation and R&D.

Australia

Following its narrow re-election, the Australian Government remains committed to increasing defence expenditure to 2% of GDP and to improving defence capability in line with the Defence White Paper. This is likely to result in 6% growth in the Australian defence budget through 2020 and the replacement of the majority of its platforms over the next 15 years, revitalising the Australian defence industry.

International

Despite tight economic conditions, growth is projected in global defence markets and in adjacent budgets such as security of civil infrastructure due to continued concerns about unrest and insecurity.

Themes in our markets

We live in a time of unprecedented uncertainty, insecurity, and complexity with governments having to respond to increasing security threats with reducing budgets. Government customers need to deliver more with less so are seeking greater value for money from their suppliers and are looking for assistance in meeting their own efficiency challenges. They also need to innovate to respond to these fast evolving threats. They are seeking new approaches to innovation in both equipment and processes so that they can rapidly integrate new technologies into existing capabilities. Many customers are keen to capture the innovation that comes from universities and SMEs and are looking for assistance from organisations that can collaborate and help them connect their supply chains. Similarly governments are promoting multilateral approaches to developing new capabilities, encouraging suppliers to cooperate internationally.

QinetiQ has a solid foundation to build on because our capabilities and strengths are particularly well matched to emerging themes in global markets. These include the acquisition of new air and maritime platforms (notably in our UK and Australia home markets), persistent requirements in cyber security and Intelligence, Surveillance & Reconnaissance (ISR), growing demand for 'integrated' capabilities such as the teaming of manned and unmanned platforms, and greater use of autonomy in a wide range of military and civil applications. There is also a growing appetite for the rapid development, experimentation and deployment of new capabilities to respond to growing and diversifying threats that our more agile approach to test and evaluation (T&E) and technology insertion are well positioned to address. We are also experienced in delivering more for less and responding to new challenges through innovation in services, products and business models. In this dynamic market we need to act with pace and agility to stay ahead of the competition and meet customer needs.

Vision and strategy - *Becoming the chosen partner*

Our vision is to be: "The chosen partner around the world for mission-critical solutions, innovating for our customers' advantage." To realise our vision, we are implementing three mutually-reinforcing strategic priorities designed to grow the company by focusing on UK customers to modernise the defence test and evaluation enterprise, on international customers and on innovation. Being 'the chosen partner' requires that we embrace innovation in all its forms, and that we adopt a global mind-set. A particular focus of our strategy is smart partnering, choosing the right strategic partners with complementary capabilities to ours so that we can be competitive and win.

UK Test and Evaluation

Our first strategic priority is to be a leader in defence test and evaluation (T&E) by working in partnership with the MOD and prime contractors. As threats change we are modernising the overall delivery of T&E to enable the UK Armed Forces to deploy advanced military capability quickly and flexibly to meet rapidly evolving and sophisticated threats.

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In November last year we were awarded a £153m Strategic Enterprise contract that changed the way we deliver aircraft engineering services for the MOD to an output-based model, where we are paid and measured on deliverables. In the first half of this year, we added £20m of additional work into this Strategic Enterprise model, so that we are now providing engineering services for nine aircraft types, both fixed and rotary wing. There are further opportunities to expand this contract, working with partners to pool skills and bring collaborative teams together across industry.

At the end of September, we signed the 11-year, £109m contract extension for Naval Combat System Integration Support Services (NCSISS) to the MOD, under which we lead the T&E, integration and development of mission systems that keep the UK's surface warships at sea and fit to fight. This is a leading example of our strategy in action, with a focus on partnership with our customers and across the broader supply chain as we look to develop our Portsdown Technology Park site as the UK Centre of Excellence for maritime mission systems for the whole supply chain. While not delivering increased revenue in the short term, the extension of this contract for 11 years improves the security of future revenues and provides a platform to win incremental work.

Further work is underway with the Front Line Commands and prime contractors to develop the future vision for UK T&E to ensure it meets the needs of the UK defence plan, supports exports and international partnerships, and delivers the right outputs to enable future military capability. For example, in October 2016, we hosted Unmanned Warrior, a world-first demonstration of how over 50 unmanned systems can operate as part of a major multinational naval exercise on missions ranging from anti-submarine warfare to mine countermeasures. From inception to delivery, QinetiQ was instrumental in making Unmanned Warrior happen, providing logistics and range management expertise under the LTPA contract, a transportable command and control system, and leading the UK component of the demonstration to achieve the world's first deployment of autonomous vehicles operating in the air, on the water and under the surface.

International

Our second strategic priority is to grow QinetiQ as an international company through the development of our existing home markets, creation of new home markets and exporting UK products and services.

On 1 April 2016, a new International business unit was created incorporating our Australian, Swedish, Canadian, Commerce Decisions and Advisory Services operations. This business is completely focused on developing and expanding our international sales through partnership, organic and inorganic growth. While QinetiQ has managed international operations and delivered products to a diverse range of international customers for some time, so far our approach to the broader international market has lacked a unifying purpose and focus. The mission of our newly created International business as an 'enabler' for broader QinetiQ is designed to bring greater coherence, alignment, and focus to our activities and pursuits internationally, ensuring that we think globally so that we can add more value.

Iain Farley joined QinetiQ at the beginning of August 2016 to run the new International business from Expro Group International where he was Vice President for Business Development & Emerging Businesses. Iain worked previously in the oil and gas industry for Mobil, Schlumberger and Weatherford and has experience of building businesses in new markets, commercialising new technologies and forming partnerships and joint ventures.

As part of our international strategy, we are building our capabilities in our home markets (the US and Australia in addition to the UK) where we already have a presence and market share. During the period we engaged with key industrial and government partners, such as the US Defense Advanced Research Projects Agency (DARPA) and a number of US prime contractors to collaborate to create new business opportunities. We continue to implement our strategy in the Australian market where the Government is committed to increasing defence expenditure and upgrading military platforms.

We have also made progress in other existing markets such as Sweden, where Andreas Ward has been appointed as Managing Director. Andreas joined us from Saab, Sweden's leading defence and security company, where he worked for more than a decade, most recently as Vice President Nordic & Baltics, following 13 years in the Swedish Army. The evaluation of new home markets has commenced and over the next six months we expect to review key regions such as Asia, Europe, the Middle East, and North America to develop focused plans for specific countries, campaigns, and accounts which will then inform the prioritisation of resources and the identification of potential partners.

We have an opportunity to grow sales by exporting our products and services. In the last six months we have shared and agreed our priorities for export with the UK Government through the new Department for International Trade as well as the UK Trade and Investment's Defence and Security Organisation (UKTI DSO). We have commenced the development of our export capability as a team and are positioning for strategic bids in key new markets, for example, choosing to partner with BAE Systems, with the backing of the UK Government, for a competition in Chile to upgrade their Type 23 frigates.

Innovation

Our third strategic priority is to innovate – investing in and applying our core competence for customer advantage in defence and commercial markets. As customers demand more capability and as the boundaries between defence and civil security, military and commercial technologies, and domestic and foreign sources of capability become increasingly blurred, value-creating innovation is vital to maintaining our distinctiveness in the market-place and as a driver for future growth.

Critical know-how and technical innovation have been at the heart of QinetiQ's success to date, and will remain a key source of growth into the future. However, turning creativity and technical innovation into tangible value for our customers increasingly requires innovative thinking across the broader range of activities and operations. Innovative business models, new processes and commercial innovation are often as, if not more, value-creating for customers as new inventions or pure product innovations.

In 2015, we launched a new Internal Research and Development (IRAD) programme for QinetiQ led by Dr Jeremy Ward, Chief Technology Officer and guided by an Innovation Steering Board to ensure that projects are customer-driven and properly controlled. More than 40 projects are now underway, including projects to develop next-generation approaches to test and evaluation services, robotics and OptaSense applications in the rail industry. Around half of these projects are related directly to key growth campaigns, where we are using our investment and partnerships with companies such as MBDA on laser technology and Thales on Defence Operational Training to position ourselves for growth.

In September 2016, the MOD announced that it was finalising the agreement of a £30m contract with UK DRAGONFIRE, a UK industrial team led by MBDA and including QinetiQ, to conduct the Laser Capability Demonstrator Programme (Laser CDP) that will deliver a step change in the UK's capability in high energy defensive laser weapon systems. Once under contract we will provide the innovative high-powered laser technology for this programme and conduct trial engagements of land and maritime targets that are due to take place at the ranges that we manage under the LTPA in 2019.

In July 2016, QinetiQ, Thales and Textron AirLand announced that they will partner to bid for the MOD's Air Support to Defence Operational Training (ASDOT) programme. The team will propose an innovative, cost effective, technologically advanced service using the Textron AirLand Scorpion jet equipped with Thales and QinetiQ sensors to train all three armed services. The competitive contract is expected to be awarded in September 2018 with a service delivery start in January 2020, and is anticipated to be worth up to £1.2bn over 15 years. QinetiQ will provide the safe operation of aircraft – including maintenance, provision of pilots, and certification, as well as the integration of sensors, jamming pods and synthetic training capabilities.

Transformation programme - *Driving customer focus*

In April 2016, we launched a transformation programme, initially scoped for two years, to deliver the key changes that we need to put in place as a company to achieve growth. The objectives of the programme are to enhance customer focus, improve competitiveness and drive investment in sustainable growth.

Leadership and organisation

To respond to a changing market environment we have reorganised the company, establishing new businesses responsible for contract delivery as well as new functions to provide support, in particular the dynamic resourcing of people and assets from across QinetiQ to enable the business units to win and deliver work. Following the successful transition of systems and software engineers into this structure during H1, all of our scientists and engineers will transition during H2, and the reorganisation will be complete before the end of the financial year. This structure will be supported by an effective sales and operational planning process, enabling us to resource as one company.

During 2016, the leadership team has been strengthened by the appointment of new leaders for the International business and our Business Development and Human Resources functions, all from outside QinetiQ. A development programme is also underway for the top 100 leaders across the Group.

Operational excellence

Our future success will be built on operational excellence – doing what we say we are going to do, and underpinned by continued operational and financial discipline. In addition to our day-to-day focus on consistent operational delivery, safety is a top priority particularly during this period of change.

A new Strategy function has been established to help position QinetiQ for future growth by developing a pipeline of potential acquisitions and driving an Integrated Strategy Business Planning process. This ensures we have a clear long-term strategy supported by coherent plans and consistent actions.

Business winning

To improve our business winning capability in an increasingly challenging market, we have launched a programme to develop the skills of employees engaged in sales and bidding, bringing in experienced hires where required. We are also simplifying our processes to bid in a more agile and competitive way.

We have introduced a new proactive approach to bidding and winning strategically important corporate campaigns that will drive our future growth alongside a continued focus on our run-rate business. Based on horizon scanning of future customer needs, Group-level campaigns align with four main growth levers: major government-funded programmes, such as Ballistic Missile Defence and Carrier Strike; areas of QinetiQ strategic capability, such as modernised T&E, cyber security, and experimentation and rehearsal; major near-term competitions; and exploitation of promising capabilities we have previously invested in, such as airborne surveillance.

Over the last six months, we have selected more than 30 campaigns across the Group. We are now resourcing these campaigns with the best skills that are available across QinetiQ, and considering which companies we want to partner with to enhance our probability of winning, as well as what investment we need for success. This combination of focused investment and a strategic approach to partnering will help drive our future growth.

Investing in our future

By improving productivity, including a reduction of approximately 200 roles across the company this year, we are delivering efficiencies that will provide better value for money for customers and headroom for investment. This allows us to invest carefully in our business winning capability and in Research and Development particularly in support of our selected growth campaigns.

Our priorities for capital allocation remain: investing in organic capabilities, complemented by bolt-on acquisitions where there is a strong strategic fit; maintaining the necessary balance sheet strength; providing a progressive dividend to shareholders; and returning excess cash to shareholders. The strength of our balance sheet and the cash generative nature of our portfolio enables us to invest in our core competencies such as T&E, with capital expenditure expected to increase in future as we invest in the LTPA and other long-term contracts.

Outlook

The initial progress we have made, combined with our ongoing assessment of the market environment, and in particular feedback from customers reinforce that we have the right strategy in place to drive future growth.

In FY17, the UK Government's Strategic Defence and Security Review, together with ongoing defence transformation, are expected to continue to have an impact on the UK defence market. This will provide future opportunities for EMEA Services to build on its strong record of delivering more for less, while recognising that there may continue to be some uncertainty and the potential for interruptions to order flow. At 30 September 2016, revenue under contract for FY17 was in line with the prior year, and the division's performance as a whole is expected to remain steady this year.

The Group's Global Products division has shorter order cycles than EMEA Services. At 30 September 2016, FY17 revenue under contract was above that of a year ago, but the performance of Global Products remains dependent on the timing of shipments of key orders.

Overall, the Board's expectations for Group performance this financial year remain unchanged.

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Business overview

EMEA Services

	H1 2017 £m	H1 2016 £m
Orders	**284.3**	170.8
Revenue	**293.3**	301.4
Underlying operating profit*	**43.0**	42.7
Underlying operating margin*	**14.7%**	14.2%
Book to bill ratio(1)	**1.5x**	0.8x
Funded backlog(1)	**780.2**	631.3

(1) Excludes the £998m third term contractual renewal of the LTPA contract
B2B ratio is orders won divided by revenue recognised, excluding the LTPA contract.

EMEA Services combines world-leading expertise with unique facilities to provide technical assurance, test and evaluation and training services, underpinned by long-term contracts. The most significant of these is the Long Term Partnering Agreement (LTPA) for test, evaluation and training services which has delivered an improved service and significant savings for the MOD over the last 13 years. EMEA Services has significant scale and depth of expertise in the air, maritime and weapons domains, alongside differentiated capabilities in C4ISR and cyber, and a niche footprint in space and land.

Financial performance

Orders rose to £284.3m (H1 2016: £170.8m), principally due to the award of a £109m 11-year renewal from the UK Ministry of Defence (MOD) for the Naval Combat System Integration Support Services (NCSISS) contract.

Reported revenue decreased against the prior period by £8.1m, of which £5.7m was due to the December 2015 disposal of Cyveillance. Excluding this and the impacts of currency movements, revenue declined 1% on an organic basis with a largely consistent performance across the division. At the start of H2, EMEA Services had 93% of its FY17 revenue under contract, consistent with the prior period and up from 77% at the beginning of this year.

Underlying operating profit* was flat at £43.0m (H1 2016: £42.7m). The resulting underlying margin* increased to 14.7% (H1 2016: 14.2%) following the Cyveillance disposal and including £4.3m (H1 2016: £4.2m) of other income relating to letting of surplus space in the Group's property portfolio.

H1 commentary

Air & Space

With technology developments increasingly blurring boundaries between air and space systems, our Air & Space businesses were combined on 1 April 2016 to increase collaboration in our engineering capabilities to de-risk complex aerospace programmes.

The business is continuing to work in partnership with the MOD and the supply chain to deliver the Strategic Enterprise model which transforms the provision of aircraft test and evaluation and which has now been in place for a year. The model represents a new way of working under which we are measured and paid on results and outputs, not inputs, improving long-term planning, providing better visibility, and delivering considerable savings to the MOD. Under this model, contracts totalling £20m were won in the period to provide in-service support for Apache and Puma helicopters, as well as Tornado fast jets, and test and evaluation services for the Wildcat Future Air to Surface Guided Weapon programme. Since the end of H1 the business has won a contract to provide safety advice for the Merlin helicopter programme under the Strategic Enterprise model.

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During the period the business entered a teaming agreement with Thales and Textron to provide a cost effective and innovative offer to the MOD for the Air Support to Defence Operational Training Programme. It also successfully secured £2m of research funding to lead a group from industry, academia and SMEs to upgrade the scale models used in the Farnborough wind tunnel using technology adapted from F1 motor racing, leading to improved efficiency and increased capacity. The business also revealed an innovative new material, Titan Weave, that will help reduce the weight of aircraft, while being three times stronger than current materials used to protect against bird strikes and other impacts.

In October, as part of its ExoMars mission, the European Space Agency (ESA) attempted to place its Schiaparelli lander on the surface of Mars, equipped with a QinetiQ-built transceiver responsible for transmitting data back to Earth. The lander was lost, but QinetiQ's transceiver operated successfully, providing data that helped scientists to understand what happened to the spacecraft in its final moments. The business also continues to deploy significant resources to develop the gridded ion engine electric propulsion system for the flight module to be used on ESA's BepiColombo mission to Mercury.

Maritime, Land & Weapons

The Maritime, Land & Weapons business was created on 1 April 2016 combining businesses with a strong focus on test and evaluation at a time when customers are increasingly undertaking more complex, multi-domain trials. The business delivers operational advantage to customers by providing independent research, evaluation and training services.

Sustaining and growing its core technical advice and design support services to the UK Royal Navy is a strategic priority for the Maritime Land & Weapons business, and during the period it was awarded an 11-year contract extension worth £109m for the Naval Combat Systems Integration & Support Services based at Portsdown Technology Park. The contract is an important milestone in establishing the site as a UK Centre for Excellence for maritime mission systems integration and testing for the Royal Navy.

In the weapons domain, the business is a leading provider of independent research on weapons and energetics, coordinating the MOD's conventional weapons research programme through its leadership of the Weapons Science and Technology Centre. During the period it won an £8m contract to implement and evaluate vehicle survivability for Dstl, including installing a Soft-Kill Defensive Aids System on a Challenger 2 tank. International customers continue to want to use QinetiQ expertise for their own development, with the South Korean Agency for Defence Development committing to a £3m programme to test their latest warhead designs using the Long Test track at MOD Pendine.

In October 2016, the Maritime, Land & Weapons business led a team from across QinetiQ to deliver Unmanned Warrior for the Royal Navy, a demonstration by 40 companies of how autonomous vehicles under the water, on the surface and in the air, can be used for future operations such as mine hunting. The successful demonstration used LTPA sites at MOD Aberporth, MOD Hebrides and MOD BUTEC (British Underwater Test and Evaluation Centre). International delegations from around the world including the US, Canada and Australia visited the demonstration alongside senior MOD and UK Government Ministers. Next year, building on Unmanned Warrior and At Sea Demonstration 2015, another international exercise will be taking place at MOD Hebrides, Formidable Shield 2017.

Cyber, Information & Training (CIT)

The CIT business helps government and commercial customers respond to fast-evolving threats based on its expertise in training, secure communication networks and devices, intelligence gathering and surveillance sensors, and cyber security.

* Definitions of underlying measures of performance can be found in the glossary

Although competition is fierce, the SDSR and the focus on counter-terrorism are likely to drive increases in budgets for C4ISR and cyber security. The CIT business is the MOD's leading supplier of C4ISR research, and is well placed to compete for new enabling contracts, building and leading consortia of large companies, SMEs and academia. The business manages a network of more than 100 UK SMEs through these research framework contracts, fulfilling an 'innovation integrator' role that is becoming more and more important in defence and other sectors. It was awarded an innovative Open Source Intelligence (OSINT) contract bringing together expertise in technology horizon scanning, human sciences, commercial-off-the-shelf exploitation and experimentation as a service to help customers keep pace with the rapidly evolving technical and social media landscape.

Outside its traditional markets, CIT is continuing to see interest from regional and local government customers on innovation initiatives to support local business growth, and is delivering training and simulation services to customers in North America, Europe and the Middle East. During the period the business secured a number of contracts worth a total of £10m for secured navigation, working with the European GNSS Supervisory Authority to help enable the effective exploitation by users of Galileo constellation of satellites - the European Union version of GPS which goes live in 2017. This included the first demonstration of accessing the encrypted Public Regulated Service (PRS) via the Cloud. The business is also working in collaboration with Lloyds Register to improve the security on board cyber-enabled ships.

International

On 1 April 2016, a new International business was established incorporating operations with a significant international footprint and those with international potential, as well as to manage other opportunities via our international offices. The business includes QinetiQ Australia, QinetiQ Canada, Advisory Services (previously known as Procurement Advisory Services), Commerce Decisions and QinetiQ Sweden AB.

In August 2016, Iain Farley joined the business as Managing Director International from Expro Group International, having spent much of his career working overseas in the oil and gas industry for Mobil, Schlumberger and Weatherford. In September, Andreas Ward joined from Saab to be Managing Director for QinetiQ Sweden AB.

The Australian business provides impartial advice and services predominately to government customers. During the period the business has continued to position itself as a 'strategic partner' to the Australian Government as it implements its recapitalisation and defence acquisition reform programmes. QinetiQ Australia secured more than A$30m of wins. These included: support to tanker aircraft, the AP-3C Orion replacement, Navy guided weapons systems, ground-based air defence, the Australian Artillery Regiment, and a contract to extend the provision of technical advice at munitions manufacturing plants. The business also gained accreditation from Australia's Defence Aviation Safety Authority to approve structural changes on all Australian Defence Force aircraft, building on its Aircraft Structural Integrity (ASI) services contract which supports the airworthiness of military aircraft.

Our Canadian business is recently established but has already secured cost engineering and AWARD procurement software contracts. Additional consulting contracts are being pursued and the business is being positioned, through prime contractors and potential partners, for strategic campaigns.

Advisory Services helps customers deliver complex programmes by providing analytical services and the evidence required to make complex decisions. The business is successfully delivering a major contract to provide early stage advice and business case support to a Middle Eastern client for a complex engineering project.

Global Products

	H1 2017 £m	H1 2016 £m
Orders	**92.5**	57.6
Revenue	**68.5**	69.5
Underlying operating profit*	**8.9**	7.1
Underlying operating margin*	**13.0%**	10.2%
Book to bill ratio	**1.4x**	0.8x
Funded backlog	**171.8**	101.4

Global Products delivers innovative solutions to meet customer requirements and undertakes customer-funded research and development, developing intellectual property in partnership with key customers and through internal funding with potential for new revenue streams.

Financial performance

Orders grew to £92.5m (H1 2016: £57.6m) due mainly to improved order flow in QinetiQ North America, in particular $28m of orders for next generation US aircraft carriers.

Reported revenue was £68.5m (H1 2016: £69.5m). Excluding £4.5m of foreign exchange variance, there was an 8% decline in the organic revenue primarily due to lower robot shipments in the period and illustrating the lumpy nature of this division's revenue profile. At the beginning of H2, the division had 98% of its FY17 revenue under contract compared to 81% in the prior period and up from 64% at the beginning of the financial year, although the delivery of this is dependent of the timing of shipments in the remainder of FY17.

Underlying operating profit* increased to £8.9m (H1 2016: £7.1m) with an underlying operating profit margin* of 13.0% (H1 2016: 10.2%), assisted by a credit of £1.3m relating to the resolution of an overseas licensing dispute.

H1 commentary

QinetiQ North America

QinetiQ North America (QNA) develops and produces innovative military protection products, specialising in unmanned systems, survivability and maritime systems, along with products in related commercial markets.

The period saw a strong orders performance, driven by awards in robotics, air and ground armour, research & development, and in particular for Advanced Launch and Recovery Equipment (ALRE) for US aircraft carriers. The ALRE equipment includes control hardware and software for the Electromagnetic Aircraft Launch System (EMALS) and the Advanced Arresting Gear (AAG) to be installed on the next generation of US aircraft carriers. Demand for the reset and recapitalisation of robots previously used in operations has remained high, as has demand for capability upgrades such as detection of CBRNE (chemical, biological, radiological, nuclear and explosives). The business is also positioning for multi-year Programs of Record that will be funded out of the Department of Defense's base budget. Through both internal and external funding, QNA has added to the capability and strategic relevance of its robotic fleet, especially for the Talon family of robots, its flagship mid-size offering. In October 2016, it announced a strategic partnership with the Estonian company Milrem for Titan, a modular, hybrid military unmanned ground vehicle (UGV) for dismounted troop support.

Outside of robotics, the business launched in September a new meteorological product, iQ-3, that provides real-time atmospheric data in support of military requirements such as artillery fire support, tactical weather modelling, and air drop. Its LineWatch product, which accurately measures the current and voltage of power distribution lines, is being piloted by ten North American utility companies.

* Definitions of underlying measures of performance can be found in the glossary

In international markets, robots, vehicle protection, and soldier protection systems, remain highly relevant as security challenges and instability persist in the Middle East and elsewhere. In addition to product sales, QNA is building its base of contract R&D projects to drive technology development, explore new customer problems and expand its competitive offerings.

OptaSense

OptaSense is a Distributed Acoustic Sensing (DAS) business operating in multiple vertical markets. The business continues to make progress in infrastructure security, delivering ahead of schedule on the world's largest distributed fibre sensing project, for the 1,850km Trans-Anatolian Natural Gas Pipeline (TANAP) that runs from Azerbaijan, through Georgia and Turkey, to Europe. Following the establishment of an advisory board to provide expertise in key target markets, OptaSense has signed an agreement to work together with Siemens to pursue new opportunities in the rail sector. The business is also undertaking collaborative research with Stanford School of Earth, Energy and Environmental Sciences in California that includes the installation of a fibre-optic seismic array on the Stanford campus to better understand the complex geology of the Bay Area.

Space Products

QinetiQ's Space Products business develops satellites, payload instruments, sub-systems and ground station services. During the period QinetiQ's P200 satellite, the latest evolution of the Proba series of satellites, was listed in the NASA catalogue which will help facilitate the procurement of spacecraft by US federal agencies and their affiliates. The business also won a €2m contract with the European Space Agency (ESA) to develop the next generation computer and power management for the QinetiQ-built Proba series of satellites.

EMEA Products

EMEA Products provides research services and bespoke technological solutions developed from intellectual property spun out from EMEA Services. During the period, the US Defense Advanced Research Projects Agency (DARPA) invested a further $3m in QinetiQ's electric hub-drive technology that will improve mobility and survivability of future military ground vehicles. The new agreement builds on previous contract awards and will take the technology from concept design to the building and testing phase, including production of two fully working units.

Internationally, ASX airborne surveillance products have been delivered successfully and there has been further interest in wind farm radar impact assessments to help secure planning permissions in Europe and other regions, including South Africa. Following QinetiQ's success in developing advanced materials for the Department of National Defence in Canada, the UK Ministry of Defence has now placed an order for similar equipment as a technology demonstrator for the Royal Navy.

Subsidiaries Boldon James and Commerce Decisions are reported in EMEA Products. Boldon James further expanded its product portfolio with the introduction of several new enhancements to its data classification offering, which it provides to large military and commercial organisations.

* Definitions of underlying measures of performance can be found in the glossary

Financial items

Net finance costs

Net finance costs were flat at £0.5m (H1 2016: £0.6m) including the defined benefit pension net finance expense of £0.6m (H1 2016: £0.5m). The underlying net finance income* was £0.1m (H1 2016: cost £0.1m).

Tax

The total tax charge is £1.7m (H1 2016: £6.3m).

Underlying tax charge

The underlying tax charge* of £6.5m (H1 2016: £6.5m) is calculated by applying the expected effective tax rate of 12.5% for the year ending 31 March 2017 to the Group's underlying profit before tax for the six months to 30 September 2016 (September 2015: 13.1%). The effective tax rate continues to be below the UK statutory rate, primarily as a result of the benefit of research and development expenditure credits ('RDEC') in the UK. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to any tax legislation changes, the geographic mix of profits and the assumption that the benefit of net RDEC retained by the Group remains in the tax line. Future recognition of unrecognised tax losses will also affect future tax charges.

Tax losses and specific adjusting items tax

At 31 March 2016 the Group had unused tax losses of £154.8m which are available for offset against future profits. As at 30 September 2016 a deferred tax asset of £4.1m (representing UK non-trading losses of £22.0m) has been recognised on the balance sheet in respect of an element of these unused tax losses expected to be utilised in the foreseeable future. The income statement credit arising from recognition of this deferred tax asset is reported as a specific adjusting item. No deferred tax asset is recognised in respect of the other losses due to uncertainty over the timing and extent of their utilisation. Other deferred tax movements of £0.6m have been credited to the income statement as a specific adjusting item. This is in respect of changes in estimates in respect of the apportionment of book values between qualifying and non-qualifying property, plant and equipment. Together with a £0.1m tax effect of the items impacting specific adjusting items PBT, the total specific adjusting items tax income is £4.8m (H1 2016: £0.2m).

Current tax liability

The current tax liability is £27.5m as at 30 September (31 March 2016: £39.9m). The decrease in the liability is primarily due to part-settlement of a liability in respect of taxes payable as a result of the Group's acquisition of Dominion Technology Resources, Inc. (DTRI) in October 2008. The funds required to make this part-settlement were recovered from the vendors of DTRI (for which an offsetting receivable was held on the Group's balance sheet as at 31 March 2016). An insurance policy was taken out by the Group at the point of acquisition and if, subject to an appeal, the Tax Court's decision is upheld then the funds required to fully settle this dispute are expected to be provided by the insurers. As a result, an offsetting receivable for the residual balance is reported on the balance sheet as at 30 September 2016 (included within trade and other receivables).

Earnings per share

Underlying earnings per share* for the Group increased by 8% to 7.9p (H1 2016: 7.3p) benefiting from the higher profit before tax and reduced number of shares due to the ongoing buyback programme. Basic earnings per share for the total Group (including specific adjusting items) rose 21% to 8.6p (H1 2016: 7.1p), aided by the recognition of a deferred tax asset in respect of UK non-trade loan relationship losses.

* Definitions of underlying measures of performance can be found in the glossary

Dividend

An interim dividend of 2.0p (H1 2016: 1.9p) will be paid on 10 February 2017 to shareholders on the register at 13 January 2017. The 5% increase in interim dividend reflects the Group's progressive dividend policy. The interim dividend is normally expected to represent approximately one third of the anticipated total dividend for the year.

Pensions

The net pension liability under IAS 19, before adjusting for deferred tax, was £65.6m (31 March 2016: £37.7m; 30 September 2015: £20.4m). The key assumptions used in the IAS 19 valuation of the scheme were:

Assumption	**30 September 2016**	**31 March 2016**
Discount rate	2.3%	3.4%
CPI Inflation	2.2%	2.1%
Life expectancy - male (currently aged 40)	91	91
Life expectancy - female (currently aged 40)	93	93

Each assumption is selected by the Group in consultation with the Company actuary and takes account of industry practice amongst comparator listed companies. The sensitivity of the gross Scheme liabilities to each of the key assumptions is shown in the table below.

Key assumptions	**Change in assumption**	**Indicative impact on Scheme liabilities**
Discount rate – small movement*	Increase/decrease by 0.1%	Decrease/increase by £37m
Discount rate – large movement*	Increase by 1.0%	Decrease by £341m
Discount rate – large movement*	Decrease by 1.0%	Increase by £453m
Rate of inflation	Increase/decrease by 0.1%	Increase/decrease by £33m
Rate of mortality	Increase by one year	Increase by £50m

*Due to a compounding effect, it would not be accurate to extrapolate the 0.1% discount rate sensitivity to estimate a large increase or decrease in discount rates. Therefore, the table above also sets out the impact of a larger change in the discount rate (+1.0% and -1.0%), allowing for the compounding effect.

The impact of movements in Scheme liabilities will, to an extent, be offset by movements in the value of Scheme assets as the Scheme has assets invested in a Liability Driven Investment Portfolio. As at 30 September 2016 this hedges against approximately 45% of the interest rate risk and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis.

The market value of the assets at 30 September 2016 was £1,776.4m (31 March 2016: £1,410.4m; 30 September 2015: £1,399.5m) and the present value of scheme liabilities was £1,842.0m (31 March 2016: £1,448.1m; 30 September 2015: £1,419.9m). The latest triennial valuation of the scheme, on a funding basis, was a net surplus of £31m as at 30 June 2014, although if a funding valuation was carried out today the valuation could be a net deficit. There has been no change to the cash contributions required under the recovery plan, which continues to require £13m of company contributions per annum until 31 March 2018.

Cash flow, net cash and liquidity

Underlying operating cash conversion* increased to 98% (H1 2016: 94%), enhanced by lower than forecast capital expenditure in our core contracts. This is expected to be a timing difference as we are proactively seeking to invest capital in these contracts. The underlying operating cash conversion* delivered an underlying cash flow of £50.9m (H1 2016: £46.9m). Underlying operating cash conversion includes the £6.4m (H1 2016: £7.3m) pension repair payments for which there is no corresponding P&L charge as the full liabilities are on the balance sheet.

* Definitions of underlying measures of performance can be found in the glossary

We expect to pay approximately £7m during H2 relating to a court order over a very old overseas dispute over a contract signed in 2005. This payment must be made even though the Group expects to make a court appeal. The amount was fully provided in the Group's accounts in prior years.

The Group had bought back £29m of the previously announced £50m share repurchase at 30 September 2016 and £33m at 11 November 2016. We expect to complete the remaining £17m of the current share buyback programme in the second half of the financial year.

At 30 September 2016, the Group had £271.2m net cash, compared to £274.5m net cash at 31 March 2016. Net cash inflow from operating and investing activities in the six months to September 2016 was offset by dividend payments and payments in respect of the share repurchases noted above.

Total committed facilities, which are undrawn, amounted to £242.8m at 30 September 2016, with no maturity before 2019.

Foreign exchange

The Group's income and expenditure is largely settled in the functional currency of the relevant Group entity, mainly Sterling or US dollar. The Group has a policy in place to hedge all material transaction exposure at the point of commitment to the underlying transaction. Uncommitted future transactions are not routinely hedged. The Group continues its practice of not hedging income statement translation exposure.

The principal exchange rate affecting the Group was the Sterling to US Dollar exchange rate.

	6 months to 30 September 2016	**6 months to 30 September 2015**
£/US$ - average	1.38	1.54
£/US$ - closing	1.30	1.52
£/US$ - opening	1.44	1.49

* Definitions of underlying measures of performance can be found in the glossary

Condensed consolidated income statement

all figures in £ million	note	6 months ended 30 September 2016 (unaudited)			6 months ended 30 September 2015 (unaudited)		
		Underlying	**Specific adjusting items***	**Total**	Underlying	Specific adjusting items*	Total
Revenue		**361.8**	**-**	**361.8**	**370.9**	**-**	**370.9**
Operating costs excluding depreciation and amortisation		(301.0)	-	(301.0)	(313.8)	0.2	(313.6)
Other income		4.3	-	4.3	4.2	-	4.2
EBITDA (earnings before interest, tax, depreciation and amortisation)		**65.1**	**-**	**65.1**	**61.3**	**0.2**	**61.5**
Depreciation and impairment of property, plant and equipment		(12.0)	-	(12.0)	(10.2)	-	(10.2)
Amortisation of intangible assets		(1.2)	(0.2)	(1.4)	(1.3)	(1.1)	(2.4)
Operating profit/(loss)		**51.9**	**(0.2)**	**51.7**	**49.8**	**(0.9)**	**48.9**
Finance income	3	0.7	-	0.7	0.5	-	0.5
Finance expense	3	(0.6)	(0.6)	(1.2)	(0.6)	(0.5)	(1.1)
Profit/(loss) before tax		**52.0**	**(0.8)**	**51.2**	**49.7**	**(1.4)**	**48.3**
Taxation (expense)/income	4	(6.5)	4.8	(1.7)	(6.5)	0.2	(6.3)
Profit/(loss) for the year attributable to equity shareholders		**45.5**	**4.0**	**49.5**	**43.2**	**(1.2)**	**42.0**
Earnings per share							
Basic	5	7.9p		8.6p	7.3p		7.1p
Diluted	5	7.8p		8.5p	7.3p		7.1p

* Definitions of underlying measures of performance and specific adjusting items can be found in the glossary

Condensed consolidated statement of comprehensive income

all figures in £ million	6 months ended 30 September 2016 (unaudited)	6 months ended 30 September 2015 (unaudited)
Profit for the period	**49.5**	**42.0**
Items that will not be reclassified to the income statement:		
Actuarial (loss)/gain recognised in defined benefit pension schemes	(33.7)	12.2
Tax on items that will not be reclassified to the income statement	6.7	(2.4)
Total items that will not be reclassified to the income statement	**(27.0)**	**9.8**
Items that may be reclassified subsequently to the income statements:		
Foreign currency translation gains/(losses) for foreign operations	9.0	(2.6)
(Decrease)/increase in fair value of hedging derivatives	(0.6)	0.5
Movement on deferred tax on hedging derivatives	0.1	(0.1)
Fair value gains/(losses) on available for sale investments	0.4	(0.3)
Total items that may be reclassified to the income statement	**8.9**	**(2.5)**
Other comprehensive (expense)/income for period, net of tax	**(18.1)**	**7.3**
Total comprehensive income for period, net of tax	**31.4**	**49.3**

Condensed consolidated statement of changes in equity

all figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Hedge reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
At 1 April 2016	**5.9**	**40.6**	**147.6**	**-**	**(1.9)**	**132.4**	**324.6**	**0.2**	**324.8**
Profit for the period	-	-	-	-	-	49.5	49.5	-	49.5
Other comprehensive income/(expense) for the period, net of tax	-	-	-	(0.5)	9.0	(26.6)	(18.1)	-	(18.1)
Purchase of own shares	-	-	-	-	-	(0.4)	(0.4)	-	(0.4)
Purchase and cancellation of shares	(0.2)	0.2	-	-	-	(26.0)	(26.0)	-	(26.0)
Share-based payments charge	-	-	-	-	-	0.9	0.9	-	0.9
Dividends paid	-	-	-	-	-	(21.9)	(21.9)	-	(21.9)
At 30 September 2016	**5.7**	**40.8**	**147.6**	**(0.5)**	**7.1**	**107.9**	**308.6**	**0.2**	**308.8**
At 1 April 2015	**6.1**	**40.4**	**147.6**	**0.1**	**(6.8)**	**110.6**	**298.0**	**0.1**	**298.1**
Profit for the period	-	-	-	-	-	42.0	42.0	-	42.0
Other comprehensive income/(expense) for the period, net of tax	-	-	-	0.4	(2.6)	9.5	7.3	-	7.3
Purchase of own shares	-	-	-	-	-	(0.3)	(0.3)	-	(0.3)
Purchase and cancellation of shares	(0.2)	0.2	-	-	-	(44.0)	(44.0)	-	(44.0)
Share-based payments charge	-	-	-	-	-	3.3	3.3	-	3.3
Dividends paid	-	-	-	-	-	(21.2)	(21.2)	-	(21.2)
At 30 September 2015	**5.9**	**40.6**	**147.6**	**0.5**	**(9.4)**	**99.9**	**285.1**	**0.1**	**285.2**

Condensed consolidated balance sheet

all figures in £ million	note	30 September 2016 (unaudited)	30 September 2015 (unaudited)	31 March 2016 (audited)
Non-current assets				
Goodwill		77.7	105.5	73.1
Intangible assets		7.9	13.6	8.3
Property, plant and equipment		230.6	233.9	233.4
Other financial assets		0.4	0.8	0.6
Investments		1.0	0.4	0.9
Deferred tax asset		13.2	3.7	4.1
		330.8	**357.9**	**320.4**
Current assets				
Inventories		19.6	15.3	19.0
Other financial assets		11.1	10.7	10.8
Trade and other receivables		119.7	140.8	156.2
Investments		2.1	2.1	1.7
Cash and cash equivalents		260.8	170.1	263.5
		413.3	339.0	451.2
Total assets		**744.1**	**696.9**	**771.6**
Current liabilities				
Trade and other payables		(306.6)	(325.4)	(338.7)
Current tax	4	(27.5)	(30.9)	(39.9)
Provisions		(4.7)	(9.5)	(5.3)
Other financial liabilities		(0.4)	(0.1)	(0.2)
		(339.2)	**(365.9)**	**(384.1)**
Non-current liabilities				
Retirement benefit obligation	10	(65.6)	(20.4)	(37.7)
Provisions		(16.0)	(15.5)	(13.8)
Other financial liabilities		(0.7)	-	(0.2)
Other payables		(13.8)	(9.9)	(11.0)
		(96.1)	(45.8)	(62.7)
Total liabilities		**(435.3)**	**(411.7)**	**(446.8)**
Net assets		**308.8**	**285.2**	**324.8**
Capital and reserves				
Ordinary shares		5.7	5.9	5.9
Capital redemption reserve		40.8	40.6	40.6
Share premium account		147.6	147.6	147.6
Hedging and translation reserve		6.6	(8.9)	(1.9)
Retained earnings		107.9	99.9	132.4
Capital and reserves attributable to shareholders of the parent company		**308.6**	**285.1**	**324.6**
Non-controlling interest		0.2	0.1	0.2
Total shareholders' funds		**308.8**	**285.2**	**324.8**

Condensed consolidated cash flow statement

all figures in £ million	note	**6 months ended 30 September 2016 (unaudited)**	6 months ended 30 September 2015 (unaudited)	Year ended 31 March 2016 (audited)
Net cash inflow from operations	6	**60.6**	**62.9**	**133.4**
Tax (paid)/received		(8.8)	(0.4)	27.9
Interest received		0.6	0.4	0.9
Interest paid		(0.3)	(0.3)	(0.6)
Net cash inflow from operating activities		**52.1**	**62.6**	**161.6**
Purchases of intangible assets		(0.8)	(0.8)	(1.6)
Purchases of property, plant and equipment		(8.9)	(15.5)	(28.6)
Proceeds from sale of property, plant and equipment		-	0.3	0.4
Acquisition of business		-	-	(0.6)
Sale of investment in subsidiary		-	6.2	28.0
Net cash outflow from investing activities		**(9.7)**	**(9.8)**	**(2.4)**
Purchase of own shares		(26.3)	(45.3)	(48.6)
Dividends paid to shareholders		(21.9)	(21.2)	(32.3)
Capital element of finance lease rental payments		-	(1.4)	(1.4)
Capital element of finance lease rental receipts		-	1.5	1.5
Net cash outflow from financing activities		**(48.2)**	**(66.4)**	**(80.8)**
(Decrease)/increase in cash and cash equivalents		**(5.8)**	**(13.6)**	**78.4**
Effect of foreign exchange changes on cash and cash equivalents		3.1	(0.6)	0.8
Cash and cash equivalents at beginning of period		263.5	184.3	184.3
Cash and cash equivalents at end of period		**260.8**	**170.1**	**263.5**

Reconciliation of movement in net cash

all figures in £ million	note	**6 months ended 30 September 2016 (unaudited)**	6 months ended 30 September 2015 (unaudited)	Year ended 31 March 2016 (audited)
(Decrease)/increase in cash and cash equivalents		(5.8)	(13.6)	78.4
Add back net cash flows not impacting net debt		-	(0.1)	(0.1)
Change in net cash resulting from cash flows		**(5.8)**	**(13.7)**	**78.3**
Other movements including foreign exchange		2.5	(0.3)	0.7
(Decrease)/increase in net cash as defined by the Group		**(3.3)**	**(14.0)**	**79.0**
Net cash as defined by the Group at beginning of period		274.5	195.5	195.5
Net cash as defined by the Group at end of period	7	**271.2**	**181.5**	**274.5**
Less: other financial asset and liabilities		(10.4)	(11.4)	(11.0)
Total cash and cash equivalents		**260.8**	**170.1**	**263.5**

Notes to the condensed interim financial statements

1. Significant accounting policies

Basis of preparation

QinetiQ Group plc 'the Company' is a company domiciled in the United Kingdom. The condensed consolidated interim financial statements of the Group for the six months ended 30 September 2016 comprise statements for the Company and its subsidiaries (together referred to as the 'Group') and were approved by the Board of Directors on 16 November 2016.

These condensed Group interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU and the requirements of the Disclosure and Transparency Rules of the Financial Conduct Authority. They do not comprise statutory accounts within the meaning of Section 498 (2) or (3) of the Companies Act 2006. They do not include all of the information required for full annual financial statements and should be read in conjunction with the Group's financial statements for the year ended 31 March 2016.

In the income statement, the Group presents specific adjusting items separately. In the judgment of the Directors, for the reader to obtain a proper understanding of the financial information, specific adjusting items need to be disclosed separately because of their size and nature. Underlying measures of performance exclude specific adjusting items. Specific adjusting items include:

- amortisation of intangible assets arising from acquisitions;
- pension net finance expense;
- gains/losses on business divestments and disposal of property and investments;
- impairment of goodwill and other intangible assets;
- tax on the above items; and
- other significant non-recurring deferred tax movements.

All items treated as a specific adjusting item in the current and prior year are detailed in note 2.

The accounting policies adopted in the preparation of these condensed consolidated financial statements are consistent with the policies applied by the Group in its consolidated financial statements for the year ended 31 March 2016.

Going-concern basis

The Group meets its day-to-day working capital requirements through its available cash funds and its bank facilities. The market conditions in which the Group operates have been, and are expected to continue to be, challenging as spending from the Group's key customers in its primary markets in the UK and US remains under pressure. Despite these challenges, the Directors believe that the Group is well positioned to manage its overall business risks successfully. After making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going-concern basis in preparing its interim financial statements.

The Group is exposed to various risks and uncertainties, the principal ones being summarised in the 'Principal risks and uncertainties' section on page 31. Crystallisation of such risks, to the extent not fully mitigated, would lead to a negative impact on the Group's financial results but none are deemed sufficiently material to prevent the Group from continuing as a going concern for the next 12 months. The Group's current net cash and liquidity is discussed on page 16 of this report.

Comparative data

The comparative figures for the year ended 31 March 2016 do not contain all of the information required for full annual financial statements. The Group's full annual financial statements for the year ended 31 March

* Definitions of underlying measures of performance and specific adjusting items can be found in the glossary

Notes to the condensed interim financial statements (continued)

2016 have been reported on by the Group's auditors and delivered to the registrar of companies. The report of the auditors (i) was unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006. The Group's financial statements for the year ended 31 March 2016 are available upon request from the Company's registered office at Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX.

2. Segmental analysis

Operating segments and reconciliation of reported revenue to organic constant currency revenue

all figures in £ million	**6 months ended 30 September 2016 (unaudited)**		6 months ended 30 September 2015 (unaudited)	
	Revenue	**Underlying operating Profit(1)**	Revenue	Underlying operating Profit(1)
EMEA Services	293.3	43.0	301.4	42.7
Global Products	68.5	8.9	69.5	7.1
Total operating segments	**361.8**	**51.9**	**370.9**	**49.8**
Underlying operating margin*		***14.3%***		***13.4%***
Less: Revenue of divested business (Cyveillance)	-		(5.7)	
Adjust to constant prior year FX rates	(6.2)		-	
Revenue on an organic, constant currency basis	**355.6**		**365.2**	

The year on year change in revenue on an organic basis at constant currency and adjusting for divested businesses is a reduction of £9.6m (3% decline).

No measure of segmental assets and liabilities is reported as this information is not regularly provided to the chief operating decision maker.

Reconciliation of segmental results to total profit

all figures in £ million	**Note**	**6 months ended 30 September 2016 (unaudited)**	6 months ended 30 September 2015 (unaudited)
Underlying operating profit[1]		**51.9**	**49.8**
Specific adjusting items:			
Gain on sale of property		-	*0.2*
Amortisation of intangible assets arising from acquisitions		*(0.2)*	*(1.1)*
Operating profit		**51.7**	**48.9**
*Underlying net finance expense**		*0.1*	*(0.1)*
Specific adjusting item:			
Defined benefit pension scheme net finance expense		*(0.6)*	*(0.5)*
Net finance expense		(0.5)	(0.6)
Profit before tax		**51.2**	**48.3**
Taxation	**4**	(1.7)	(6.3)
Profit for the period attributable to equity shareholders		**49.5**	**42.0**

(1) The measure of profit presented to the chief operating decision maker is operating profit stated before specific adjusting items ('underlying operating profit'). The specific adjusting items are set out in the table above.

* Definitions of underlying measures of performance and specific adjusting items can be found in the glossary

Notes to the condensed interim financial statements (continued)

3. Finance income and expense

All figures in £ million	**6 months ended 30 September 2016 (unaudited)**	6 months ended 30 September 2015 (unaudited)
Receivable on bank deposits	0.7	0.5
Finance income	**0.7**	**0.5**
Amortisation of recapitalisation fee	(0.2)	(0.2)
Interest on bank loans and overdrafts	(0.3)	(0.3)
Unwinding of discount on financial liabilities	(0.1)	(0.1)
Finance expense before specific adjusting items*	(0.6)	(0.6)
Defined benefit pension scheme net finance expense	(0.6)	(0.5)
Finance expense	**(1.2)**	**(1.1)**
Net finance expense	**(0.5)**	**(0.6)**
Less: Defined benefit pension scheme net finance expense	0.6	0.5
Underlying net finance income/(expense)	**0.1**	**(0.1)**

4. Taxation

	6 months ended 30 September 2016 (unaudited)			6 months ended 30 September 2015 (unaudited)		
all figures in £ million	**Underlying**	**Specific adjusting items***	**Total**	Underlying	Specific adjusting items*	Total
Profit/(loss) before tax	**52.0**	**(0.8)**	**51.2**	**49.7**	**(1.4)**	**48.3**
Taxation (expense)/income	(6.5)	4.8	(1.7)	(6.5)	0.2	(6.3)
Profit/(loss) for the year attributable to equity shareholders	**45.5**	**4.0**	**49.5**	**43.2**	**(1.2)**	**42.0**
Effective tax rate	**12.5%**			**13.1%**		

The total tax charge is £1.7m (H1 2016: £6.3m). The underlying* tax charge of £6.5m (H1 2016: £6.5m) is calculated by applying the expected effective tax rate of 12.5% for the year ending 31 March 2017 to the Group's underlying profit before tax for the six months to 30 September 2016 (September 2015: 13.1%). The effective tax rate continues to be below the UK statutory rate, primarily as a result of the benefit of research and development expenditure credits ('RDEC') in the UK. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to any tax legislation changes, the geographic mix of profits and the assumption that the benefit of net RDEC retained by the Group remains in the tax line. Future recognition of unrecognised tax losses will also affect future tax charges.

Tax losses and specific adjusting items

At 31 March 2016 the Group had unused tax losses of £154.8m which are available for offset against future profits. As at 30 September 2016 a deferred tax asset of £4.1m (representing UK non-trading losses of £22.0m) has been recognised on the balance sheet in respect of an element of these unused tax losses expected to be utilised in the foreseeable future. The income statement credit arising from recognition of this deferred tax asset is reported as a specific adjusting item. No deferred tax asset is recognised in respect of the other losses due to uncertainty over the timing and extent of their utilisation. Other deferred tax movements of £0.6m have been credited to the income statement as a specific adjusting item. This is in respect of changes in estimates in respect of the apportionment of book values between qualifying and non-qualifying property, plant and

* Definitions of underlying measures of performance and specific adjusting items can be found in the glossary

equipment. Together with a £0.1m tax effect of the items impacting specific adjusting items PBT, the total specific adjusting items tax income is £4.8m (H1 2016: £0.2m).

Current tax liability

The current tax liability is £27.5m as at 30 September (31 March 2016: £39.9m). The decrease in the liability is primarily due to part-settlement of a tax liability in respect of taxes payable in respect of the Group's acquisition of Dominion Technology Resources, Inc. in October 2008. The funds required to make this part-settlement were recovered from the vendors of DTRI (for which an offsetting receivable was held on the Group's balance sheet as at 31 March 2016). An insurance policy was taken out by the Group at the point of acquisition and if, subject to an appeal, the Tax Court's decision is upheld then the funds required to fully settle this dispute will be provided by the insurers. Hence, an offsetting receivable for the residual balance is reported on the balance sheet as at 30 September 2016 (included within trade and other receivables).

5. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the period. The weighted average number of shares used excludes those shares bought by the Group and held as own shares. For diluted earnings per share the weighted average number of shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares arising from unvested share-based awards including share options. Underlying basic earnings per share* figures are presented below in addition to the basic and diluted earnings per share as the Directors consider this gives a more relevant indication of underlying business performance and reflects the adjustments to basic earnings per share for the impact of specific adjusting items, as defined in the Glossary.

Basic and diluted EPS

		6 months ended 30 September 2016 (unaudited)	6 months ended 30 September 2015 (unaudited)
Profit attributable to equity shareholders	£m	49.5	42.0
Weighted average number of shares	Million	578.9	589.6
Basic EPS	**Pence**	**8.6**	**7.1**
Profit attributable to equity shareholders	£m	49.5	42.0
Weighted average number of shares	Million	578.9	589.6
Effect of dilutive securities	Million	2.6	3.7
Dilutive number of shares	Million	581.5	593.3
Diluted EPS	**Pence**	**8.5**	**7.1**

Underlying basic EPS

		6 months ended 30 September 2016 (unaudited)	6 months ended 30 September 2015 (unaudited)
Profit attributable to equity shareholders	£m	49.5	42.0
(Profit)/loss after tax in respect of specific adjusting items*	£m	(4.0)	1.2
Underlying profit after taxation	£m	45.5	43.2
Weighted average number of shares	Million	578.9	589.6
Underlying basic EPS	**Pence**	**7.9**	**7.3**

* Definitions of underlying measures of performance and specific adjusting items can be found in the glossary

Notes to the condensed interim financial statements (continued)

Underlying diluted EPS*

		6 months ended 30 September 2016 (unaudited)	6 months ended 30 September 2015 (unaudited)
Profit attributable to equity shareholders	£m	49.5	42.0
(Profit)/loss after tax in respect of specific adjusting items*	£m	(4.0)	1.2
Underlying profit after taxation	£m	45.5	43.2
Weighted average number of shares	Million	578.9	589.6
Effect of dilutive securities	Million	2.6	3.7
Diluted number of shares	Million	581.5	593.3
Underlying diluted EPS	**Pence**	**7.8**	**7.3**

6. Cash flows from operations

All figures in £ million	6 months ended 30 September 2016 (unaudited)	6 months ended 30 September 2015 (unaudited)	Year ended 31 March 2016 (audited)
Profit after tax for the period	49.5	42.0	106.1
Adjustments for:			
Taxation expense/(income)	1.7	6.3	(8.4)
Net finance costs	0.5	0.6	1.3
Gain on business divestments	-	-	(23.7)
Impairment of goodwill	-	-	31.9
Amortisation of purchased or internally developed intangible assets	1.2	1.3	2.8
Amortisation of intangible assets arising from acquisitions	0.2	1.1	2.0
Depreciation and impairment of property, plant and equipment	12.0	10.2	23.0
Loss on disposal of property, plant and equipment	-	0.6	1.2
Share of post-tax profit of equity accounted entities	-	-	(0.5)
Share-based payments charge	1.2	3.3	4.7
Changes in retirement benefit obligations	(6.4)	(7.3)	(13.4)
Net movement in provisions	1.4	(0.3)	(0.3)
Decrease/(increase) in inventories	0.4	2.9	(0.2)
Decrease in receivables	41.5	27.7	13.8
Decrease in payables	(42.6)	(25.5)	(6.9)
Changes in working capital	(0.7)	5.1	6.7
Net cash inflow from operations	**60.6**	**62.9**	**133.4**

Reconciliation of net cash flow from operations to underlying net cash flow from operations (post capex)

All figures in £ million	6 months ended 30 September 2016 (unaudited)	6 months ended 30 September 2015 (unaudited)	Year ended 31 March 2016 (audited)
Net cash flow from operations	60.6	62.9	133.4
Purchases of intangible assets	(0.8)	(0.8)	(1.6)
Purchases of property, plant and equipment	(8.9)	(15.5)	(28.6)
Proceeds from sale of property, plant and equipment	-	0.3	0.4
Underlying net cash flow from operations (post capex)	**50.9**	**46.9**	**103.6**

* Definitions of underlying measures of performance and specific adjusting items can be found in the glossary

Notes to the condensed interim financial statements (continued)

Underlying cash conversion ratio

	6 months ended 30 September 2016 (unaudited)	6 months ended 30 September 2015 (unaudited)	Year ended 31 March 2016 (audited)
Underlying operating profit - £ million	51.9	49.8	108.9
Underlying net cash flow from operations (post capex) - £ million	50.9	46.9	103.6
Underlying cash conversion ratio - %	**98%**	**94%**	**96%**

7. Analysis of net cash and reconciliation to cash and cash equivalents

All figures in £ million	6 months ended 30 September 2016 (unaudited)	6 months ended 30 September 2015 (unaudited)	Year ended 31 March 2016 (audited)
Due within one year:			
Bank and cash	260.8	170.1	263.5
Available for sale investment	10.2	9.9	9.9
Recapitalisation fee	0.3	0.3	0.3
Derivative financial assets	0.6	0.5	0.6
Derivative financial liabilities	(0.4)	(0.1)	(0.2)
	271.5	180.7	274.1
Due after one year:			
Recapitalisation fee	0.3	0.7	0.5
Derivative financial assets	0.1	0.1	0.1
Derivative financial liabilities	(0.7)	-	(0.2)
	(0.3)	0.8	0.4
Total net cash as defined by the Group	**271.2**	**181.5**	**274.5**
Less: other financial asset and liabilities	(10.4)	(11.4)	(11.0)
Total cash and cash equivalents	**260.8**	**170.1**	**263.5**

8. Financial risk management

The interim financial statements do not include all financial risk management information and disclosures required in annual financial statements; they should be read in conjunction with the Group's annual financial statements as at 31 March 2016. There have been no changes in any risk management policies since the year end. The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1 – measured using quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – measured using 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). Level 2 derivatives comprise forward foreign exchange contracts which have been fair valued using forward exchange rates that are quoted in an active market; and

Level 3 – measured using inputs for the assets or liability that are not based on observable market data (i.e. unobservable inputs).

* Definitions of underlying measures of performance and specific adjusting items can be found in the glossary

Notes to the condensed interim financial statements (continued)

The Group's assets and liabilities that are measured at fair value, as at 30 September 2016, are as follows:

all figures in £ million	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Available for sale investment	10.2	-	-	10.2
Current other investments	2.1	-	-	2.1
Current derivative financial instruments	-	0.6	-	0.6
Non-current other investments	-	-	0.1	0.1
Non-current derivative financial instruments	-	0.1	-	0.1
Liabilities:				
Current derivative financial instruments	-	(0.4)	-	(0.4)
Non-current derivative financial instruments	-	(0.7)	-	(0.7)
Total	**12.3**	**(0.4)**	**0.1**	**12.0**

The following table presents the Group's assets and liabilities that are measured at fair value at 31 March 2016:

all figures in £ million	Level 1	Level 2	Level 3	Total
Assets:				
Available for sale investments	9.9	–	–	9.9
Current other investments	1.7	–	–	1.7
Current derivative financial instruments	–	0.6	–	0.6
Non-current other investments	–	–	0.1	0.1
Non-current derivative financial instruments	–	0.1	–	0.1
Liabilities:				
Current derivative financial instruments	–	(0.2)	–	(0.2)
Non-current derivative financial instruments	–	(0.2)	–	(0.2)
Total	**11.6**	**0.3**	**0.1**	**12.0**

For cash and cash equivalents, trade and other receivables and bank and current borrowings, the fair value of the financial instruments approximate to their carrying value as a result of the short maturity periods of these financial instruments. For trade and other receivables, allowances are made within the carrying value for credit risk. For other financial instruments, the fair value is based on market value, where available. Where market values are not available, the fair values have been calculated by discounting cash flows to net present value using prevailing market-based interest rates translated at the year-end rates, except for unlisted fixed asset investments where fair value equals carrying value. There have been no transfers between levels.

9. Dividends

An analysis of the dividends paid and proposed in respect of the period ended 30 September 2016 and comparative periods is provided below:

	Pence per ordinary share	**£m**	**Date paid/payable**
Interim 2017	**2.0**	**11.3**	**Feb 2017**
Interim 2016	1.9	11.1	Feb 2016
Final 2016	3.8	21.9	Sep 2016
Total for the year ended 31 March 2016	5.7	33.0	

The interim dividend is 2.0p (interim 2016: 1.9p). The dividend will be paid on 10 February 2017. The ex-dividend date is 12 January 2017 and the record date is 13 January 2017.

10. Post-retirement benefits

Set out below is a summary of the financial position of the Group's defined benefit pension scheme. The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods, and thus inherently uncertain, are as follows:

all figures in £ million	30 September 2016 (unaudited)	30 September 2015 (unaudited)	31 March 2016 (audited)
Equities – quoted	408.2	406.2	347.9
Equities – unquoted	71.7	69.1	66.1
LDI investment	626.2	313.8	362.8
Liquidity fund	69.9	–	–
Corporate bonds	345.4	302.5	314.2
Alternative bonds	124.3	177.6	176.6
Property	124.0	120.3	126.6
Cash and other	6.7	10.0	16.2
Total market value of scheme assets	**1,776.4**	**1,399.5**	**1,410.4**
Present value of scheme liabilities	(1,842.0)	(1,419.9)	(1,448.1)
Net pension liability before deferred tax	**(65.6)**	**(20.4)**	**(37.7)**
Deferred tax asset/(liability)	6.8	(1.6)	1.5
Net pension liability	**(58.8)**	**(22.0)**	**(36.2)**

Changes to the net pension liability before deferred tax

all figures in £ million	30 September 2016 (unaudited)	30 September 2015 (unaudited)	31 March 2016 (audited)
Opening net pension liability before deferred tax	(37.7)	(39.4)	(39.4)
Re-measurement gain/(loss) on scheme assets	352.9	(72.0)	(75.8)
Actuarial (loss)/gain on scheme liabilities	(386.6)	84.2	65.2
Contributions by the employer	7.0	7.9	14.6
Current service cost and administration costs	(0.6)	(0.6)	(1.2)
Net finance expense	(0.6)	(0.5)	(1.1)
Closing net pension liability before deferred tax	**(65.6)**	**(20.4)**	**(37.7)**

Assumptions

The major assumptions (weighted to reflect individual scheme differences) were:

	30 September 2016 (unaudited)	30 September 2015 (unaudited)	31 March 2016 (audited)
Discount rate applied to scheme liabilities	2.3%	3.7%	3.4%
CPI inflation assumption	2.2%	2.3%	2.1%
Assumed life expectancies in years:			
Future male pensioners (currently aged 60)	89	88	89
Future female pensioners (currently aged 60)	91	91	91
Future male pensioners (currently aged 40)	91	91	91
Future female pensioners (currently aged 40)	93	93	93

Notes to the condensed interim financial statements (continued)

The sensitivity of the gross Scheme liabilities to each of the key assumptions is shown in the table below:

Key assumptions	Change in assumption	Indicative impact on Scheme liabilities
Discount rate – small movement*	Increase/decrease by 0.1%	Decrease/increase by £37m
Discount rate – large movement*	Increase by 1.0%	Decrease by £341m
Discount rate – large movement*	Decrease by 1.0%	Increase by £453m
Rate of inflation	Increase/decrease by 0.1%	Increase/decrease by £33m
Rate of mortality	Increase by one year	Increase by £50m

*Due to a compounding effect, it would not be accurate to extrapolate the 0.1% discount rate sensitivity to estimate a large increase or decrease in discount rates. Therefore, the table above also sets out the impact of a larger change in the discount rate (+1.0% and -1.0%), allowing for the compounding effect.

The impact of movements in Scheme liabilities will, to an extent, be offset by movements in the value of Scheme assets as the Scheme has assets invested in a Liability Driven Investment Portfolio. As at 30 September 2016 this hedges against approximately 45% of the interest rate and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis.

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method (projected unit credit method) has been applied as when calculating the pension liability recognised within the statement of financial position. The methods and types of assumption did not change.

The accounting assumptions noted above are used to calculate the period end net pension liability in accordance with the relevant accounting standard, IAS 19 (revised) 'Employee benefits'. Changes in these assumptions have no impact on the Group's cash payments into the scheme. The payments into the scheme are reassessed after every triennial valuation. The latest triennial valuation of the Scheme was a net surplus of £31.0m as at 30 June 2014. The triennial valuations are calculated on a 'funding basis' and use a different set of assumptions, as agreed with the pension Trustees. The key assumption that varies between the two methods of valuation is the discount rate. The funding basis valuation uses the risk-free rate from UK gilts as the base for calculating the discount rate, whilst the IAS19 accounting basis valuation uses corporate bond yields as the base. Due to this use of different assumption a funding valuation of Scheme would probably have resulted in a higher net liability at period end if one had been performed.

11. Own shares and share-based awards

Own shares represent shares in the Company that are held by independent trusts and include treasury shares and shares held by the employee share ownership plan. A deduction has been made from retained earnings at 30 September 2016 in respect of 4,556,156 own shares (31 March 2016: 4,862,182).

In the six months to 30 September 2016 the Group granted/awarded 3.1 million new share-based awards to employees (30 September 2015: 3.8 million).

12. Related party transactions with equity accounted investments

During the period there were sales to associates of £1.7m (30 September 2015: £1.6m). At the period end there were outstanding receivables from associates of £0.3m (30 September 2015: £0.4m).

Principal risks and uncertainties

The Group continues to be exposed to a number of risks and uncertainties which management continue to assess, manage and mitigate to minimise their potential impact on the reported performance of the Group. Pages 42-49 of the 2016 Annual Report and Accounts detail the principal risks and uncertainties which have not materially changed and these are expected to continue to be relevant for the remaining six months of the year. A summary of the significant risks and uncertainties is set out below:

- Reduction in government defence and security spending;
- Complex market characteristics including a changing regulatory environment for single source contracts;
- A material element of the Group's revenue and operating profit is derived from one customer (the UK MOD), governed by complex pricing requirements;
- A high proportion of the Group's revenue is derived from fixed price contracts that would be adversely impacted by increases in costs;
- Change in the timing of orders receipts;
- Policies or attitudes may change towards Organisational Conflicts of Interest (OCI);
- A material element of the Group's revenue and operating profit is derived from one contract;
- Losing key capability and competencies through failure to recruit and retain employees;
- Failure of information technology systems and breaches of data security;
- Inherent risks from trading in a global marketplace;
- Failure to comply with laws and regulations, particularly trading restrictions and export controls;
- Tax liabilities may change as a result of changes in tax legislation;
- Financial position of the defined benefit pension scheme.

The Directors have considered the Financial Reporting Council's guidance around consideration of heightened country and currency risk in interim financial reports but the Group is not directly exposed to significant overseas sovereign and currency risks (other than translation risk), although it is exposed indirectly to increased counter-party risk. The Group attempts to mitigate risk by counter party monitoring and the avoidance of concentrations of counter party risk. The significant Group risks remain those referred to above.

Responsibility statements of the Directors in respect of the interim financial report

The Directors confirm to the best of our knowledge:

- the condensed set of financial statements has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU;
- the interim management report includes a fair review of the information required by:
  - (a) DTR 4.2.7R of the Disclosure and Transparency Rules, being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the year; and
  - (b) DTR 4.2.8R of the Disclosure and Transparency Rules, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last annual report that could do so.

The Directors of QinetiQ Group plc are listed in the QinetiQ Group plc Annual Report for 31 March 2016.

By order of the Board

Mark Elliott	Steve Wadey	David Mellors
Chairman	Chief Executive Officer	Chief Financial Officer
16 November 2016	16 November 2016	16 November 2016

Independent review report to QinetiQ Group plc

We have been engaged by the Company to review the condensed set of financial statements in the interim financial report for the six months ended 30 September 2016 which comprises the Condensed Consolidated Income Statement, the Condensed Consolidated Statement of Comprehensive Income, the Condensed Consolidated Statement of Changes in Equity, the Condensed Consolidated Balance Sheet, the Condensed Consolidated Cash Flow Statement and the related explanatory notes. We have read the other information contained in the interim financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the Disclosure and Transparency Rules of the UK's Financial Conduct Authority ('the UK FCA'). Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this 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 for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The interim financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the interim financial report in accordance with the Disclosure and Transparency Rules of the UK FCA.

The annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union (EU). The condensed set of financial statements included in this interim financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the interim financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim financial report for the six months ended 30 September 2016 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the Disclosure and Transparency Rules of the UK FCA.

Anthony Sykes
For and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square, London E14 5GL
16 November 2016

Glossary

Book to bill ratio	Ratio of funded orders received in the year to revenue for the year, adjusted to exclude revenue from the 25-year LTPA contract
EPS	Earnings per share
Funded backlog	The expected future value of revenue from contractually committed and funded customer orders (excluding the remaining revenue to come from the five-year third-term re-pricing of the LTPA contract)
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
LTPA	Long Term Partnering Agreement – 25 year contract established in 2003 to manage the MOD's test and evaluation ranges
MOD	UK Ministry of Defence
Organic Growth	The level of year-on-year growth, expressed as a percentage, calculated at constant foreign exchange rates, adjusting comparatives to incorporate the results of acquired entities and excluding the results for any disposals for the same duration of ownership as the current period
Specific adjusting items	Amortisation of intangible assets arising from acquisitions; impairment of goodwill and intangible assets; gains/losses on business divestments and disposal of property and investments; net pension finance expense; tax on the preceding items; creation of deferred tax asset in respect of recognition of tax losses; and other significant non-recurring deferred tax movements
Underlying basic earnings per share	Basic earnings per share as adjusted to exclude 'specific adjusting items'
Underlying effective tax rate	The tax charge for the period excluding the tax impact of 'specific adjusting items' expressed as a percentage of underlying profit before tax
Underlying net cash from operations (post capex)	Net cash inflow from operations before specific adjusting items less net cash outflow on purchase/sale of intangible assets and property, plant and equipment
Underlying net finance income/expense	Net finance income/expense as adjusted to exclude 'specific adjusting items'
Underlying operating cash conversion	The ratio of underlying net cash from operations (post-capex) to underlying operating profit
Underlying operating margin	Underlying operating profit expressed as a percentage of revenue
Underlying operating profit	Operating profit as adjusted to exclude 'specific adjusting items'
Underlying profit after tax	Profit after tax as adjusted to exclude 'specific adjusting items'