

For release at 0700 hours on 19 November 2015

## Interim Results for the half year ended 30 September 2015

	H1 2016	H1 2015
<u>Business Performance</u>		
Orders	<b>£228.4m</b>	£320.5m
Revenue	<b>£370.9m</b>	£365.6m
Underlying operating profit*	<b>£49.8m</b>	£49.3m
Underlying operating margin*	<b>13.4%</b>	13.5%
Underlying profit before tax*	<b>£49.7m</b>	£46.0m
Underlying net cash flow from operations (post capex)*	<b>£46.9m</b>	£57.0m
Underlying cash conversion ratio*	<b>94%</b>	116%
Underlying earnings per share (eps)*	<b>7.3p</b>	6.3p
Net cash	<b>£181.5m</b>	£205.7m
Dividend per share	<b>1.9p</b>	1.8p
<u>Statutory Reporting</u>		
Operating profit from continuing operations	<b>£48.9m</b>	£48.0m
Profit attributable to shareholders	<b>£42.0m</b>	£32.9m
Total earnings per share	<b>7.1p</b>	5.1p

### Headlines

- Good trading result in challenging markets
  - Solid revenue and operating profit performance
  - Continued high cash conversion
- Reduced order intake during H1 against a strong comparator period
  - Approximately two thirds of the orders reduction due to timing of multi-year contract awards
  - £153m 5-year UK MOD renewal for aircraft engineering services awarded after period end
  - Some de-scoping and delay to orders in tough and uncertain markets
  - 90% of FY16 revenue under contract at start of H2, consistent with prior period
- Continued focus on shareholder returns
  - 16% increase in underlying eps\* due to lower finance costs and reduced share count
  - 6% increase in interim dividend in line with commitment to a progressive dividend
  - £50m share buyback over next 12 months, consistent with capital allocation policy
- QinetiQ has core competencies well matched to emerging themes in global markets
  - Priorities to improve customer focus and competitiveness

Steve Wadey, Group Chief Executive Officer said:

*“This is a good trading result in a challenging market environment and our expectations for Group performance in the current financial year remain unchanged.”*

*“Whilst markets are tough and uncertain, I am convinced that we have the core competencies required to help our customers deliver both more for less and respond to increasing security threats through innovation. To address this, I have identified clear priorities to improve our customer focus and competitiveness that will build a stronger future for QinetiQ.”*

ENDS.

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

## **Other information**

There will be a presentation of the interim results to analysts at 0900 hours UK time on 19 November 2015 at the London Stock Exchange, 10 Paternoster Square, EC4M 7LS. Registration for the webcast is available at: [www.QinetiQ.com/investors](http://www.QinetiQ.com/investors) where the presentation will also be available. An audiocast of the event will be available on the following numbers (confirmation: QinetiQ):

- UK / International: +44 (0)20 3059 8125
- US: +1 855 287 9927

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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.*

## **Group overview of H1 results**

Orders fell to £228.4m against a strong prior period (H1 2015: £320.5m). The market environment was challenging with budgets under pressure and some de-scoping and delay to orders. Additionally, approximately two thirds of the orders reduction from the prior period was due to the timing of multi-year contract awards and the impact of this on near-term revenue is expected to be limited. Some significant multi-year orders were awarded after period end including a £153m five-year renewal for engineering support to the UK MOD for the A400M Atlas, Typhoon and Tornado aircraft under a new output-based model.

Revenue grew 1% to £370.9m (H1 2015: £365.6m). On 1 October 2015, the Group had 90% of FY16 revenue under contract, consistent with the prior period and up from 77% at the beginning of this financial year.

Underlying operating profit\* was flat at £49.8m (H1 2015: £49.3m). Underlying profit before tax\* increased 8% to £49.7m (H1 2015: £46.0m) with underlying net finance costs\* falling to £0.1m (H1 2015: £3.3m) as a result of repayment of the private placement debt in the prior year.

Underlying earnings per share\* increased 16% to 7.3p (H1 2015: 6.3p) benefiting from the higher underlying profit before tax\* and reduced number of shares following the completion of the £150m share buyback programme.

Underlying operating cash conversion\* remained strong at 94% (H1 2015: 116%), delivering an underlying cash flow from continuing operations\* of £46.9m (H1 2015: £57.0m) after a higher investment in capital expenditure on the Long Term Partnering Agreement (LTPA). At 30 September 2015, the Group had £181.5m net cash, compared to £195.5m net cash at 31 March 2015.

QinetiQ's priorities for capital allocation will continue to be: organic investment complemented by bolt-on acquisitions where there is a strong strategic fit, the maintenance of balance sheet strength, a progressive dividend, and the return of excess cash to shareholders. The £150m share buyback, which commenced on 28 May 2014, was completed by 30 September 2015 with 72.5m shares purchased in total. A further £50m share repurchase was initiated today in line with the Group's capital allocation policy. It will be executed over the next 12 months provided there are no other significant and better opportunities for investment within the business during this period.

An interim dividend of 1.9p (H1 2015: 1.8p) will be paid on 12 February 2016 to shareholders on the register at 15 January 2016. The 6% 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.

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

## **Leadership**

Steve Wadey joined QinetiQ as Chief Executive Officer (CEO) on 27 April 2015. He was previously the Managing Director of MBDA UK and Technical Director for the MBDA Group.

Over the first six months, he has focused on the topics most important to the future of the company, spending the vast majority of his time with the company's three key stakeholders – our customers, employees and shareholders.

## **Trading environment**

### **UK**

The trading environment is tough in the short term, particularly in the UK.

The UK Government's Strategic Defence and Security Review (SDSR) will be published shortly, and its publication will help bring clarity on the UK's capability priorities and the associated allocation of the UK defence budget. Whilst the conclusions of the SDSR are not yet known, efficiency and innovation are likely to be key themes.

Also underway is a public consultation by the recently established Single Source Regulations Office (SSRO) on the proposed approach to calculating the baseline profit rate for single source contracts which is expected to conclude in early 2016. The regulations apply to new single source contracts, plus existing single source contracts when they come up for renewal. Our combination of capabilities is unique in the UK and, consequently, approximately 70% of total EMEA Services revenue is derived from single source contracts, including the non-tasking element of the Long Term Partnering Agreement (LTPA).

### **US**

In the US, the defence downturn is reaching the bottom, however, the defence spending cycle is long. New Programs of Record for capabilities such as ground robots are still at least a year away, and so in the near term most opportunities are likely to be for the reset and recapitalisation of products previously used on operations. Our US products business is responding to the changes in its markets with a greater focus on these Programs of Record, contract-funded research and development, as well as commercial and international markets.

The Department of Defense is increasingly concerned that its 'technological superiority' has been steadily eroding. It has launched the Defence Innovation Initiative, also known as the Third Offset Strategy, "an ambitious effort to identify and invest in innovative ways to sustain and advance America's military dominance for the 21st Century." This will put new resources behind innovation and in particular research and development in technology areas such as advanced sensors, communications, munitions and high energy lasers, space, missile defence, cyber capabilities and unmanned vehicles; all areas in which QinetiQ has some particular strengths.

### **Australia**

In Australia, the Government needs to modernise its defence equipment and plans to replace the majority of its platforms over the next 15 years, supported by an increase in defence expenditure to 2% of GDP. In line with the recommendations of the First Principles Review, the Government is also pursuing a defence transformation programme similar to that which has been underway in the UK since the beginning of the decade.

## **Emerging themes in our markets**

A number of the strategic themes are common in our home markets of the UK, US and Australia as well as for many customers around the world.

Governments are having to respond to increasing security threats with reducing budgets. They need to deliver more with less; i.e. more “efficiency” will be required as the British Secretary of State for Defence said in a recent speech. So not only are Government customers seeking greater value for money from their suppliers, they are also looking for assistance in meeting their own “efficiency” challenges. Companies like QinetiQ, with a track record of delivering more for less, are well positioned to help.

But the Secretary of State also said: “Being efficient won’t be enough. We also need to innovate.” Governments are seeking models for innovation in both equipment and processes so that they can rapidly integrate new technologies into existing capabilities to respond to fast-evolving threats. Many customers are keen to capture the innovation that comes from universities and small and medium sized companies and are looking for assistance from organisations that can help them connect their supply chains. Similarly governments are promoting multilateral approaches to developing new capabilities, encouraging suppliers to cooperate internationally.

QinetiQ already delivers an ‘innovation integrator’ role, building networks to bring together Government, industry, SMEs and academia in collaborating teams and thereby facilitating innovation at every stage of the procurement process. Our Cyber Information and Training (CIT) business, for example, is the MOD’s leading supplier of C4ISR research, managing framework contracts for the MOD that involve more than 100 UK SMEs.

## **Immediate priorities**

There is no denying that global markets are challenging, but they also present opportunities. QinetiQ is well positioned to help customers meet the dual challenges of budget pressures and increasing global security threats. They are looking for suppliers that not only have a track record of delivering more for less but can also be their chosen partner to help them meet new challenges and secure an advantage through innovation.

QinetiQ is a company that is built on the expertise of its people whose inherent capabilities in information, knowledge and technology are critical to meeting current and future global challenges. Not only are our core competencies well matched to changing global defence dynamics, they are also applicable to other sectors such as security and space. We are building a map of these core competencies to improve how we integrate them across the company and exploit them for the benefit of our customers. We are also investing in core competencies such as test and evaluation to win market share, with capital expenditure likely to increase further as we continue to invest in the LTPA contract.

Customer requirements are not only changing, they are also getting more demanding. There is a need to improve our business winning skills in order to thrive in an increasingly challenging market, so we have instigated a programme to develop the skills of our sales teams. We also need to improve our market knowledge; for example in August we appointed Jamie Pollard as CEO for OptaSense® to bring an in-depth understanding of the oil and gas sector in which he has worked for more than 20 years. We have launched a new process for bidding and winning strategically important corporate campaigns which uses the best skills from across the company. Customers outside our UK, US and Australian home markets are unlikely to know QinetiQ, so we are also improving the visibility of our brand – particularly in European countries such as Belgium and Sweden where we already have a presence.

The key enabler to the themes across our markets is innovation, not just novel technologies but also innovation in products, services and business models. By working in partnership with our customers we can propose innovative solutions to meet their emerging needs. For example, the £153m outputs-based contract renewal

signed shortly after period end represents a new way of doing business with MOD that delivers more for less, improves long-term planning providing better visibility, and supports the retention of the skills base required to deliver future programmes. This summer, we launched a new Internal Research and Development (IRAD) programme for QinetiQ led by our Chief Technology Officer and guided by an Innovation Steering Board to ensure that projects are customer-driven and properly controlled. A number of projects are already underway using investment funded through cost savings in the business. QinetiQ's Organic-Plus framework of 'Core', 'Explore' and 'Test for Value' is a useful maturity model for managing our innovation pipeline, helping to identify and control each stage in the process.

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. We can improve the efficiency of our operations and the way in which we deliver projects to make us more competitive. The productivity savings that are made in project delivery and our 'back office' can be re-invested in innovation and the front end of the business to make a more direct contribution to winning new work.

In addition to optimising trading in the short term, we are positioning QinetiQ for the future through an integrated business planning process. The output will be a robust plan that puts the emphasis firmly on effective delivery and efficiency. We have also established a Leadership Community at QinetiQ for the first time, bringing together the top 100 leaders every month to ensure we are focused on our business performance.

A key part of building for the future will be capital discipline. We intend to maintain our priorities for capital allocation as follows:

1. Invest in our organic capabilities, complemented by bolt-on acquisitions where there is a strong strategic fit;
2. Maintain the necessary balance sheet strength;
3. Provide a progressive dividend to shareholders;
4. Return excess cash to shareholders.

As a result of these priorities, we have announced a further share buyback of £50m to be executed over the next twelve months provided there are no other significant and better opportunities for investment within the business during this period.

Given the timing of the SDSR, our immediate priorities are to engage with customers to understand its impact and the emerging opportunities, and to ensure we deliver our expected performance this financial year. In parallel, we will continue to build a robust plan for the future that is both practical and grounded.

## **FY16 Outlook**

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, whilst recognising that in FY16 there will continue to be uncertainty and the potential for interruptions to order flow. However, revenue under contract for this financial year is as anticipated at this stage, 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. Although the performance of Global Products remains dependent on the timing and shipment of key orders, revenue under contract for this financial year is as anticipated at this stage.

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

## **Business overview**

### **EMEA Services**

	<b>H1 2016</b>	H1 2015
	<b>£m</b>	£m
Orders <sup>(1)</sup>	<b>170.8</b>	249.5
Revenue	<b>301.4</b>	297.1
Underlying operating profit*	<b>42.7</b>	42.6
Underlying operating margin*	<b>14.2%</b>	14.3%
Book to bill ratio <sup>(1)</sup>	<b>0.8x</b>	1.2x
Funded backlog <sup>(1)</sup>	<b>631.3</b>	703.0

(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.

### **Overview**

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 12 years. EMEA Services is also a market leader in research and advice in specialist areas such as C4ISR, cyber security and procurement advisory services. The division is well aligned to the UK Front Line Commands (Navy, Army, Air and Joint Forces) which now have considerable responsibility for shaping future capability. In particular, Joint Forces Command, with its own procurement arm and a multi-billion pound budget, provides a more focused channel for our cyber security, C4ISR, and training offerings.

### **Financial performance**

Orders fell to £170.8m against a strong prior period (H1 2015: £249.5m). The market environment was challenging with budgets under pressure and some orders deferred or delayed. Additionally, £58m of the orders reduction in EMEA Services from the prior period was due to the timing of multi-year contracts and the impact of this on near-term revenue is expected to be limited.

Revenue grew 2% on an organic basis. At the start of H2, EMEA Services had 92% of its FY16 revenue under contract, consistent with the prior year and up from 80% at the beginning of this year.

Underlying operating profit\* was flat at £42.7m (H1 2015: £42.6m). The resulting underlying margin\* also remained broadly flat at 14.2% (H1 2015: 14.3%).

### **H1 commentary**

QinetiQ's **Air** business de-risks complex aviation programmes. The business is working in partnership with the MOD and the supply chain to develop a new model to transform the provision of aircraft test and evaluation. Shortly after period end, it was awarded two contract renewals under this new model, worth a combined £153m over five years, to deliver technical services to fast jets and heavy lift aircraft. This new way of working improves long-term planning providing better visibility, and delivers considerable savings to the MOD. This award complements a £13m contract won in the period to assist the MOD in bringing the Delta Test variant of the A400M Atlas into UK service, and a £5m contract to evaluate flight control system upgrades to Boeing's Chinook helicopter. In international markets, the business was awarded a five year extension to the contract under which it manages and assists in the delivery of training at the Swedish Flight Physiological Centre. The Air business also delivers turnkey services for customers using Remotely Piloted Air Systems (RPAS) to meet growing demand particularly from international organisations such as the United Nations. Following last year's opening

of the Snowdonia Aerospace Centre at Llanbedr in Wales, the business is to demonstrate the use of Remotely Piloted Aircraft in tackling environmental issues in a project for the Welsh Government.

QinetiQ's **Weapons** business supplies independent research, evaluation, training and through-life support services for the weapons and land domains. Its strong competitive position is built on the breadth of technical services it offers, ranging from research and extending across the whole lifecycle. The business coordinates the MOD's conventional weapons research programme through its leadership of the Weapons Science and Technology Centre; during the period it was awarded a new research framework contract for trials, testing and analysis in cyber and electronic warfare. It also won a £5m contract from Raytheon to develop and qualify a new generation of the Paveway precision-guided bomb for the Typhoon aircraft due to enter service with the RAF in 2019. In addition to research, core capabilities include test and evaluation, delivered mainly under the LTPA, and targets services. Its targets offering was augmented in the period by the introduction of the new Firejet target which will underpin future expansion in international markets. During October, the Weapons business led a team from across QinetiQ to deliver an international at sea demonstration at the Hebrides range, the largest in Europe. The exercise attracted nine ships from eight nations, culminating in the first ever launch of a ballistic rocket into space from the UK and its subsequent engagement by an SM3 missile launched by a US guided missile destroyer.

The **Maritime** business delivers operational advantage to naval clients worldwide through the provision of independent technical advice and support, particularly in the areas of platform performance, stealth, command information systems and systems integration, with the majority of its revenue underpinned by four core MOD contracts. Sustaining and developing its core UK naval business is a strategic priority for the business and during the period it was awarded a new contract to deliver acceptance trials for the four new MARS class tankers. Its combination of expert people and specialist testing facilities is also attractive to international customers and the Maritime business is targeting international markets, principally through the supply of mission systems for offshore patrol vessels, corvettes and frigates. The business is also pursuing selected growth campaigns with a focus on emerging technologies such as autonomous systems. During the period it was selected to develop and deliver a containerised command system to control multiple unmanned systems for demonstration by the UK Royal Navy in 2016.

The **Cyber, Information and Training (CIT)** business was formed last year through the integration of the Group's cyber, C4ISR and training capabilities to meet the needs of the UK MOD's Joint Forces Command as well as other government and commercial customers. Two subsidiaries that also offer cyber security capability were not integrated into CIT: Cyveillance®, a cyber intelligence business, and Boldon James, a provider of secure messaging solutions which is reported in Global Products. Although competition is fierce, budgets for C4ISR and cyber security are expected to grow as recent funding rounds have either protected or enhanced spending. The CIT business is the MOD's leading supplier of C4ISR research, growing its research revenues in the period and winning new work to improve information systems for deployed headquarters. 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. Large framework contracts are also being used increasingly by the UK Government for the delivery of technology services and during the period the business was awarded a position with Northrop Grumman on a seven year framework contract to deliver cyber security support to the UK Government. CIT is also going to market in partnership with established prime contractors outside the UK, most notably in the US training and simulation market. Finally, the business is providing secure receiver processing for the encrypted Public Regulated Service (PRS) on the Galileo constellation of satellites – the European Union version of GPS which goes live in 2017. During the period it launched a new receiver that will utilise the PRS service for use by governments, the military and emergency services across Europe.

**QinetiQ Australia** provides impartial advice and services predominantly to government customers. The business is underpinned by two long-term contracts with the Commonwealth Government of Australia’s Department of Defence – the Defence Science and Technology Group (DST Group) Specialist Engineering Support contract and the Aircraft Structural Integrity (ASI) contract which supports the airworthiness of military aircraft. These contracts position the business well for ‘strategic support partner’ style contracts which the Australian Government is using increasingly as it implements its recapitalisation and defence acquisition reform programmes that follow the First Principles Review.

**Procurement Advisory Services** provides tender assessment, cost and analytical services principally to support complex procurement programmes in highly regulated markets. Procurement Advisory Services leads QinetiQ’s presence in Canada; it has now delivered contracts to the Defence, Transport and Cabinet Office equivalents of governments in the UK, Australia, Canada and the Middle East.

## Global Products

	H1 2015	H1 2014
	£m	£m
Orders	57.6	71.0
Revenue	69.5	68.5
Underlying operating profit*	7.1	6.7
Underlying operating margin*	10.2%	9.8%
Book to bill ratio	0.8x	1.0x
Funded backlog	101.4	99.6

## Overview

Global Products delivers innovative solutions to meet customer requirements and undertakes contract-funded research and development, developing intellectual property in partnership with key customers with potential for new revenue streams. Global Products has shorter order cycles and a more lumpy revenue profile than EMEA Services. To reduce the volatility of its revenue profile over time, QinetiQ is seeking to increase its portfolio of products and to find new markets and applications for its existing offerings.

## Financial performance

Orders fell to £57.6m (H1 2015: £71.0m) due to reduced demand for military products driven by lower levels of operational spending in the US and the timing of recapitalisation orders for the robot fleet, partially offset by a small increase in orders for OptaSense®, the Distributed Acoustic Sensing business.

Revenue was £69.5m (H1 2015: £68.5m). At the beginning of H2, the division had 81% of its FY16 revenue under contract, an increase from 60% at the beginning of the year.

Underlying operating profit\* grew 6% to £7.1m (H1 2015: £6.7m) with an underlying operating profit margin\* of 10.2% (H1 2015: 9.8%), benefiting from a reduction in overhead costs in the US products business.

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

## H1 commentary

The **US products business** principally delivers land systems, which account for approximately three quarters of its revenue, but the business is also expanding into the commercial, maritime and transportation markets often via contract-funded research and development (R&D). It is the world's leading provider of military robots, employing experts in unmanned systems based in Massachusetts and Pennsylvania. The US Government is repairing, restocking, and adding capability to its ground robots such as CBRNE (chemical, biological, radiological, nuclear, and explosives) while preparing for future multi-year Programs of Record. Revenues generated by sales of unmanned systems were higher in the first half of the year than in the prior period, principally for the maintenance, repair and overhaul, or reset of robots previously used on operations. This demonstrates continued customer intent to keeping QinetiQ's TALON® and Dragon Runner™ platforms as a principal part of Explosive Ordnance Disposal missions and positions the business well for future Programs of Record. Demand for survivability products continues to be impacted by reduced operational budgets, but the business shipped armour for the C-130 aircraft as well as ground vehicles during the period. Shortly after period end, the business was awarded an initial \$16m contract by General Atomics to deliver control hardware and software for the Electromagnetic Aircraft Launch Control System (EMALS) and Advanced Arresting Gear (AAG) for the US Navy's next generation aircraft carrier, the CVN-79 John F. Kennedy. The US products business is also building on its base of contract-funded R&D projects both as an alternative revenue stream and as a source of future intellectual property, which now represents about twenty per cent of its revenues.

In August, Jamie Pollard was appointed as CEO of **OptaSense®**, the Distributed Acoustic Sensing (DAS) business, bringing over 20 years' experience of leading and growing businesses within Schlumberger, a world-leading oilfield services company. In addition, an advisory board has been established for OptaSense comprising industry experts including Hansjorg Hess, a former Deutsche Bahn and Siemens Rail executive. At the end of September, the business successfully completed the 18-month development project with Deutsche Bahn, which concluded that DAS technology has the potential to significantly reduce the cost of sensing in the rail industry. OptaSense also won a contract with a Class 1 US Railroad operator to deliver a software platform in preparation for a wider rollout of DAS technology. In upstream oil and gas, the product development agreement with Shell continues to deliver significant technical progress and a fourth generation OptaSense system was launched recently. Although growth has been constrained by the low oil price, the business signed a strategic marketing agreement with Weatherford. In infrastructure security, OptaSense signed a two-year framework agreement to deliver up to 200 units to protect critical national infrastructure for a customer in the Middle East.

QinetiQ's **Space Products** business provides satellites, payload instruments, sub-systems and ground station services. The business is currently developing the computer and avionics for ESA's Proba 3 satellites, to be launched in 2018 to study the Sun.

Other **EMEA product** orders placed during the first half of the year included a contract to develop an electric hub-drive for military ground vehicles for the US Defense Advanced Research Projects Agency (DARPA) worth \$2m, with an option for a further \$3m. During the period Boldon James launched a new data classification system for businesses. Commerce Decisions won its first contract through its Australian arm and was selected to deliver bid evaluation criteria that will be used to assess prospective warship designers for the Canadian Surface Combatant.

## **Financial items**

### **Net finance costs**

Net finance costs fell to £0.6m (H1 2015: £3.6m). The underlying net finance costs\* fell to £0.1m (H1 2015: £3.3m), benefiting from the repayment of private placement debt in the prior year.

### **Tax**

The continuing operations underlying\* tax charge is calculated by applying the expected effective tax rate of 13.1% for the year ending 31 March 2016 to the Group's underlying profit before tax for the six months to 30 September 2015 (September 2014: 12.0%). The effective tax rate continues to be below the statutory rate in the UK, primarily as a result of the benefit of research and development relief in the UK and the availability of brought-forward losses. 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, the assumption that the benefit of R&D tax relief remains in the tax line, and the level of R&D relief retained by the Group.

The 2013 Finance Act allows the continued super-deduction approach for R&D expenditure until 1 April 2016, when R&D Expenditure Credit ('RDEC') treatment becomes mandatory. The expected effective tax rate for the year of 13.1% assumes a super-deduction approach. The Company is considering whether or not to elect into the RDEC scheme earlier. The impact on the effective tax rate for the year ending 31 March 2016 is being assessed.

At 31 March 2015 the Group had unused tax losses of £291.6m (2014: £213.9m) which are available for offset against future profits. A deferred tax asset of £25.2m (representing UK trading losses of £126m) is held in respect of an element of these unused tax losses expected to be utilised in the foreseeable future. No deferred tax asset is recognised in respect of the other losses due to uncertainty over the timing and extent of their utilisation.

The current tax liability is £30.9m as at 30 September 2015 (31 March 2015: £15.3m). The increase in the liability is primarily due to a potential tax liability crystallising in the US following a court decision in respect of taxes payable in respect of the Group's acquisition of Dominion Technology Resources, Inc. in October 2008. An insurance policy was taken out by the Group at the point of acquisition and if, subject to an appeal, the court's decision is final then the funds required to settle this dispute will be provided by the insurers. Hence, an offsetting receivable is reported on the balance sheet as at 30 September 2015 (included within trade and other receivables).

### **Earnings per share**

Underlying earnings per share\* for the continuing Group increased by 16% to 7.3p (H1 2015: 6.3p) benefiting from the higher profit before tax and reduced number of shares following the buyback programme. Basic earnings per share for the total Group (including discontinued operations) rose 39% to 7.1p (H1 2015: 5.1p).

### **Dividend**

An interim dividend of 1.9p (H1 2015: 1.8p) will be paid on 12 February 2016 to shareholders on the register at 15 January 2016. The 6% 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.

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

## Cash flow, net cash and liquidity

Underlying operating cash conversion\* remained strong at 94% (H1 2015: 116%), delivering an underlying cash flow from continuing operations\* of £46.9m (H1 2015: £57.0m).

At 30 September 2015 the Group had £181.5m net cash, compared to £195.5m net cash at 31 March 2015. The £150m share buyback that commenced on 28 May 2014 was completed by 30 September 2015 with 72.5m shares purchased in total. A further £50m share repurchase was initiated today in line with the Group's capital allocation policy. It will be executed over the next 12 months provided there are no other significant and better opportunities for investment within the business during this period. Total committed facilities amounted to £231.0m at 30 September 2015, 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 2015	6 months to 30 September 2014
£/US\$ - average	1.54	1.68
£/US\$ - closing	1.52	1.62
£/US\$ - opening	1.49	1.67

## Pensions

The net pension liability under IAS 19, before adjusting for deferred tax, was £20.4m (31 March 2015: £39.4m; 30 September 2014: £22.8m). The key assumptions used in the IAS 19 valuation of the scheme were:

Assumption	30 September 2015	30 September 2014
Discount rate	3.7%	3.8%
CPI Inflation	2.3%	2.4%
Life expectancy - male (currently aged 40)	91	90
Life expectancy - female (currently aged 40)	93	92

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 each of the key assumptions is shown in the table below.

Assumption	Change in assumption	Indicative effect on scheme liabilities (before deferred tax)
Discount rate	Increase / decrease by 0.1%	Decrease / increase by £27m
Inflation	Increase / decrease by 0.1%	Increase / decrease by £25m
Life expectancy	Increase by 1 year	Increase by £34m

The market value of the assets at 30 September 2015 was £1,399.5m (31 March 2015: £1,454.6m; 30 September 2014: £1,373.4m) and the present value of scheme liabilities was £1,419.9m (31 March 2015: £1,494.0m; 30 September 2014: £1,396.2m). 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.

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

## Condensed consolidated income statement

	note	6 months ended 30 September 2015 (unaudited)			6 months ended 30 September 2014 (unaudited)		
		Underlying	Specific adjusting items*	Total	Underlying	Specific adjusting items*	Total
all figures in £ million							
<b>Revenue</b>		<b>370.9</b>	-	<b>370.9</b>	365.6	-	365.6
Other operating costs excluding depreciation and amortisation		<b>(313.8)</b>	<b>0.2</b>	<b>(313.6)</b>	(308.0)	-	(308.0)
Other income		<b>4.2</b>	-	<b>4.2</b>	3.7	-	3.7
<b>EBITDA (earnings before interest, tax, depreciation and amortisation)</b>		<b>61.3</b>	<b>0.2</b>	<b>61.5</b>	61.3	-	61.3
Depreciation and impairment of property, plant and equipment		<b>(10.2)</b>	-	<b>(10.2)</b>	(11.5)	-	(11.5)
Amortisation of intangible assets		<b>(1.3)</b>	<b>(1.1)</b>	<b>(2.4)</b>	(0.5)	(1.3)	(1.8)
<b>Operating profit/(loss)</b>		<b>49.8</b>	<b>(0.9)</b>	<b>48.9</b>	49.3	(1.3)	48.0
Finance income	4	<b>0.5</b>	-	<b>0.5</b>	0.7	-	0.7
Finance expense	4	<b>(0.6)</b>	<b>(0.5)</b>	<b>(1.1)</b>	(4.0)	(0.3)	(4.3)
<b>Profit/(loss) before tax</b>		<b>49.7</b>	<b>(1.4)</b>	<b>48.3</b>	46.0	(1.6)	44.4
Taxation expense	5	<b>(6.5)</b>	<b>0.2</b>	<b>(6.3)</b>	(5.5)	(0.7)	(6.2)
<b>Profit/(loss) from continuing operations</b>		<b>43.2</b>	<b>(1.2)</b>	<b>42.0</b>	40.5	(2.3)	38.2
<b>Discontinued operations</b>							
Profit/(loss) before tax - discontinued operations	3	-	-	-	1.2	(6.3)	(5.1)
Tax in respect of discontinued operations	3	-	-	-	(0.5)	0.3	(0.2)
<b>Profit/(loss) from discontinued operations</b>		-	-	-	0.7	(6.0)	(5.3)
<b>Profit/(loss) for the year attributable to equity shareholders</b>		<b>43.2</b>	<b>(1.2)</b>	<b>42.0</b>	41.2	(8.3)	32.9
<b>Earnings per share</b>							
Basic – continuing operations	6	<b>7.3p</b>		<b>7.1p</b>	6.3p		5.9p
Basic – total Group	6	<b>7.3p</b>		<b>7.1p</b>	6.4p		5.1p
Diluted – continuing operations	6	<b>7.3p</b>		<b>7.1p</b>	6.2p		5.9p
Diluted – total Group	6	<b>7.3p</b>		<b>7.1p</b>	6.3p		5.1p

\* 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 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
<b>Profit for the period</b>	<b>42.0</b>	32.9
<i>Items that will not be reclassified to the income statement:</i>		
Actuarial gain/(loss) recognised in defined benefit pension schemes	12.2	(8.3)
Tax on items that will not be reclassified to the income statement	(2.4)	1.7
<b>Total items that will not be reclassified to the income statement</b>	<b>9.8</b>	(6.6)
<i>Items that may be reclassified subsequently to the income statements:</i>		
Foreign currency translation differences for foreign operations	(2.6)	2.5
Increase in fair value of hedging derivatives	0.5	0.1
Reclassification of hedging derivatives to the income statement	-	0.1
Movement on deferred tax on hedging derivatives	(0.1)	-
Fair value (losses)/gains on available for sale investments	(0.3)	0.2
Recycling of currency translation differences to the income statement on disposal of foreign subsidiary	-	(40.9)
<b>Total items that may be reclassified to the income statement</b>	<b>(2.5)</b>	(38.0)
<b>Other comprehensive income/(expense) for period, net of tax</b>	<b>7.3</b>	(44.6)
<b>Total comprehensive income/(expense) for period, net of tax</b>	<b>49.3</b>	(11.7)

## 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 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)
<b>At 30 September 2015</b>	<b>5.9</b>	<b>40.6</b>	<b>147.6</b>	<b>0.5</b>	<b>(9.4)</b>	<b>99.9</b>	<b>285.1</b>	<b>0.1</b>	<b>285.2</b>
At 1 April 2014	6.6	39.9	147.6	0.1	23.1	160.7	378.0	0.1	378.1
Profit for the period	-	-	-	-	-	32.9	32.9	-	32.9
Other comprehensive income/(expense) for the period, net of tax	-	-	-	0.2	(38.4)	(6.4)	(44.6)	-	(44.6)
Purchase of own shares	-	-	-	-	-	(0.3)	(0.3)	-	(0.3)
Purchase and cancellation of shares	(0.2)	0.2	-	-	-	(40.7)	(40.7)	-	(40.7)
Share-based payments – settlement	-	-	-	-	-	0.6	0.6	-	0.6
Share-based payments charge	-	-	-	-	-	2.5	2.5	-	2.5
Dividends paid	-	-	-	-	-	(20.6)	(20.6)	-	(20.6)
At 30 September 2014	6.4	40.1	147.6	0.3	(15.3)	128.7	307.8	0.1	307.9

## Condensed consolidated balance sheet

all figures in £ million	note	30 September 2015 (unaudited)	30 September 2014 (unaudited)	31 March 2015 (audited)
<b>Non-current assets</b>				
Goodwill		105.5	101.4	107.2
Intangible assets		13.6	14.7	15.3
Property, plant and equipment		233.9	224.0	229.6
Other financial assets		0.8	1.9	0.9
Investments		0.4	0.5	0.4
Deferred tax asset		3.7	6.7	12.9
		<b>357.9</b>	349.2	366.3
<b>Current assets</b>				
Inventories		15.3	15.8	18.5
Other financial assets		10.7	2.5	12.3
Trade and other receivables		140.8	134.5	159.2
Investments		2.1	2.3	2.3
Cash and cash equivalents		170.1	204.4	184.3
		<b>339.0</b>	359.5	376.6
<b>Total assets</b>		<b>696.9</b>	708.7	742.9
<b>Current liabilities</b>				
Trade and other payables		(325.4)	(317.6)	(352.3)
Current tax	5	(30.9)	(3.0)	(15.3)
Provisions		(9.5)	(3.8)	(3.0)
Other financial liabilities		(0.1)	(2.4)	(1.9)
		<b>(365.9)</b>	(326.8)	(372.5)
<b>Non-current liabilities</b>				
Retirement benefit obligation	11	(20.4)	(22.8)	(39.4)
Deferred tax liability		-	(17.8)	-
Provisions		(15.5)	(22.3)	(22.4)
Other financial liabilities		-	(0.7)	(0.1)
Other payables		(9.9)	(10.4)	(10.4)
		<b>(45.8)</b>	(74.0)	(72.3)
<b>Total liabilities</b>		<b>(411.7)</b>	(400.8)	(444.8)
<b>Net assets</b>		<b>285.2</b>	307.9	298.1
<b>Capital and reserves</b>				
Ordinary shares		5.9	6.4	6.1
Capital redemption reserve		40.6	40.1	40.4
Share premium account		147.6	147.6	147.6
Hedging and translation reserve		(8.9)	(15.0)	(6.7)
Retained earnings		99.9	128.7	110.6
<b>Capital and reserves attributable to shareholders of the parent company</b>		<b>285.1</b>	307.8	298.0
Non-controlling interest		0.1	0.1	0.1
<b>Total shareholders' funds</b>		<b>285.2</b>	307.9	298.1

## Condensed consolidated cash flow statement

all figures in £ million	note	6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)	Year ended 31 March 2015 (audited)
<b>Underlying net cash inflow from continuing operations before cash flows in respect of specific adjusting items</b>	8	62.9	67.7	143.9
Net cash outflow relating to restructuring		-	-	(0.6)
Disposal-related pension contribution		-	(6.0)	(6.0)
Cash generated from discontinued operations		-	1.8	1.8
<b>Net cash inflow from operations</b>		62.9	63.5	139.1
Tax (paid)/received		(0.4)	(0.8)	8.8
Interest received		0.4	0.2	1.0
Interest paid		(0.3)	(35.8)	(36.4)
<b>Net cash inflow from operating activities</b>		62.6	27.1	112.5
Purchases of intangible assets		(0.8)	(2.9)	(4.2)
Purchases of property, plant and equipment		(15.5)	(7.8)	(24.8)
Proceeds from sale of property, plant and equipment		0.3	-	-
Investment in available for sale investments		-	-	(10.0)
Acquisition of business		-	(3.3)	(3.7)
Sale of investment in subsidiary		6.2	79.6	79.6
<b>Net cash (outflow)/inflow/ from investing activities</b>		(9.8)	65.6	36.9
Repayment of bank borrowings		-	(147.1)	(147.1)
Payment of bank loan arrangement fee		-	(1.3)	(1.3)
Purchase of own shares		(45.3)	(40.4)	(106.8)
Dividends paid to shareholders		(21.2)	(20.6)	(31.7)
Capital element of finance lease rental payments		(1.4)	(1.4)	(2.8)
Capital element of finance lease rental receipts		1.5	1.5	3.0
<b>Net cash outflow from financing activities</b>		(66.4)	(209.3)	(286.7)
<b>Decrease in cash and cash equivalents</b>		(13.6)	(116.6)	(137.3)
Effect of foreign exchange changes on cash and cash equivalents		(0.6)	(0.2)	0.4
Cash and cash equivalents at beginning of period		184.3	322.2	322.2
Cash and cash equivalents disposed		-	(1.0)	(1.0)
<b>Cash and cash equivalents at end of period</b>		170.1	204.4	184.3

## Reconciliation of movement in net cash

all figures in £ million	note	6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)	Year ended 31 March 2015 (audited)
Decrease in cash and cash equivalents		(13.6)	(116.6)	(137.3)
Add back net cash flows not impacting net debt		(0.1)	148.3	158.2
<b>Change in net cash resulting from cash flows</b>		(13.7)	31.7	20.9
Cash and cash equivalents disposed		-	(1.0)	(1.0)
Other movements including foreign exchange		(0.3)	4.5	5.1
<b>(Decrease)/increase in net cash</b>		(14.0)	35.2	25.0
Net cash at beginning of period		195.5	170.5	170.5
<b>Net cash at end of period</b>	9	181.5	205.7	195.5

# 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 2015 comprise statements for the Company and its subsidiaries (together referred to as the 'Group') and were approved by the Board of Directors on 18 November 2015.

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 2015.

The Group separately presents 'specific adjusting items' in the income statement which in the judgement of the Directors need to be disclosed separately from the 'underlying' financial measures, by virtue of their size and incidence, to provide a more relevant indication of underlying business. Specific adjusting items relate to gains/losses in respect of disposal of businesses and property, amortisation of intangible assets created on acquisition, impairment of goodwill or property, pension net finance income/expense, and tax thereon. 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 2015.

### 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 26. 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 12 of this report.

### Comparative data

The comparative figures for the year ended 31 March 2015 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 2015 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 2015 are available upon request from the Company's registered office at Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX.

## Notes to the condensed interim financial statements (continued)

### 2. Segmental analysis

#### Operating segments

all figures in £ million	6 months ended 30 September 2015 (unaudited)		6 months ended 30 September 2014 (unaudited)	
	Revenue	Operating Profit <sup>(1)</sup>	Revenue	Operating Profit <sup>(1)</sup>
EMEA Services	301.4	42.7	297.1	42.6
Global Products	69.5	7.1	68.5	6.7
<b>Total operating segments – continuing operations</b>	<b>370.9</b>	<b>49.8</b>	<b>365.6</b>	<b>49.3</b>

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	6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
<b>Operating profit before specific adjusting items<sup>(1)</sup> – underlying operating profit</b>	<b>49.8</b>	<b>49.3</b>
Specific adjusting items:		
Gain on sale of property	0.2	-
Amortisation of intangible assets arising from acquisitions	(1.1)	(1.3)
<b>Operating profit</b>	<b>48.9</b>	<b>48.0</b>
<i>Underlying net finance expense*</i>	<i>(0.1)</i>	<i>(3.3)</i>
<i>Specific adjusting item: Defined benefit pension scheme net finance expense</i>	<i>(0.5)</i>	<i>(0.3)</i>
Net finance expense	(0.6)	(3.6)
<b>Profit before tax</b>	<b>48.3</b>	<b>44.4</b>
Taxation	(6.3)	(6.2)
<b>Profit for the period from continuing operations</b>	<b>42.0</b>	<b>38.2</b>
<b>Discontinued operations</b>		
Loss from discontinued operations, net of tax	-	(5.3)
<b>Profit for the period attributable to equity shareholders</b>	<b>42.0</b>	<b>32.9</b>

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

## Notes to the condensed interim financial statements (continued)

### 3. Discontinued operations

Cash was received in the six months to 30 September 2015 in respect of the prior year disposal of the Group's US Services division. Net cash proceeds of £79.6m were received in the year to 31 March 2015. Additional deferred consideration of up to \$50m remained receivable as at 31 March 2015. Actual gross profit delivered by the disposed business resulted in deferred consideration of \$9.2m (£6.2m) being received in the six months to 30 September 2015. This was in line with expectations as at 31 March 2015 and there was no income statement impact in respect of this deferred consideration in the six months to 30 September 2015. No further consideration remains outstanding.

### 4. Finance income and expense – continuing operations

All figures in £ million	6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
Receivable on bank deposits	0.5	0.6
Finance lease income	-	0.1
<b>Finance income</b>	<b>0.5</b>	<b>0.7</b>
Amortisation of recapitalisation fee	(0.2)	(0.5)
Interest on bank loans and overdrafts	(0.3)	(0.6)
Interest on US-dollar private placement debt	-	(2.6)
Finance lease expense	-	(0.1)
Unwinding of discount on financial liabilities	(0.1)	(0.2)
Finance expense before specific adjusting items*	(0.6)	(4.0)
Defined benefit pension scheme net finance expense	(0.5)	(0.3)
<b>Finance expense</b>	<b>(1.1)</b>	<b>(4.3)</b>
<b>Net finance expense – continuing operations</b>	<b>(0.6)</b>	<b>(3.6)</b>

### 5. Taxation

The continuing operations underlying\* tax charge is calculated by applying the expected effective tax rate of 13.1% for the year ending 31 March 2016 to the Group's underlying profit before tax for the six months to 30 September 2015 (September 2014: 12.0%). The effective tax rate continues to be below the statutory rate in the UK, primarily as a result of the benefit of research and development relief in the UK and the availability of brought-forward losses. 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, the assumption that the benefit of R&D tax relief remains in the tax line, and the level of R&D relief retained by the Group.

The 2013 Finance Act allows the continued super-deduction approach for R&D expenditure until 1 April 2016, when R&D Expenditure Credit ('RDEC') treatment becomes mandatory. The expected effective tax rate for the year of 13.1% assumes a super-deduction approach. The Company is considering whether or not to elect into the RDEC scheme earlier. The impact on the effective tax rate for the year ending 31 March 2016 is being assessed.

At 31 March 2015 the Group had unused tax losses of £291.6m (2014: £213.9m) which are available for offset against future profits. A deferred tax asset of £25.2m (representing UK trading losses of £126m) is held in

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

## Notes to the condensed interim financial statements (continued)

respect of an element of these unused tax losses expected to be utilised in the foreseeable future. No deferred tax asset is recognised in respect of the other losses due to uncertainty over the timing and extent of their utilisation.

The current tax liability is £30.9m as at 30 September (31 March 2015: £15.3m). The increase in the liability is primarily due to a tax liability crystallising in the US following a court decision in respect of taxes payable in respect of the Group's acquisition of Dominion Technology Resources, Inc. in October 2008. An insurance policy was taken out by the Group at the point of acquisition and if, subject to an appeal, the court's decision is final then the funds required to settle this dispute will be provided by the insurers. Hence, an offsetting receivable is reported on the balance sheet as at 30 September 2015 (included within trade and other receivables).

### 6. 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 – continuing operations

		6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
Profit attributable to equity shareholders	£m	42.0	38.2
Weighted average number of shares	Million	589.6	645.6
<b>Basic EPS – continuing operations</b>	<b>Pence</b>	<b>7.1</b>	5.9
Profit attributable to equity shareholders	£m	42.0	38.2
Weighted average number of shares	Million	589.6	645.6
Effect of dilutive securities	Million	3.7	4.6
Dilutive number of shares	Million	593.3	650.2
<b>Diluted EPS – continuing operations</b>	<b>Pence</b>	<b>7.1</b>	5.9
<b>Basic and diluted EPS – total Group</b>			
		6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
Profit attributable to equity shareholders	£m	42.0	32.9
Weighted average number of shares	Million	589.6	645.6
<b>Basic EPS – total Group</b>	<b>Pence</b>	<b>7.1</b>	5.1
Profit attributable to equity shareholders	£m	42.0	32.9
Weighted average number of shares	Million	589.6	645.6
Effect of dilutive securities	Million	3.7	4.6
Dilutive number of shares	Million	593.3	650.2
<b>Diluted EPS – total Group</b>	<b>Pence</b>	<b>7.1</b>	5.1

## Notes to the condensed interim financial statements (continued)

### Underlying\* basic EPS – continuing operations

		6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
Profit attributable to equity shareholders	£m	42.0	38.2
Loss after tax in respect of specific adjusting items*	£m	1.2	2.3
Underlying profit after taxation	£m	43.2	40.5
Weighted average number of shares	Million	589.6	645.6
<b>Underlying basic EPS – continuing operations</b>	<b>Pence</b>	<b>7.3</b>	6.3

### Underlying\* diluted EPS – continuing operations

		6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
Profit attributable to equity shareholders	£m	42.0	38.2
Loss after tax in respect of specific adjusting items*	£m	1.2	2.3
Underlying profit after taxation	£m	43.2	40.5
Weighted average number of shares	Million	589.6	645.6
Effect of dilutive securities	Million	3.7	4.6
Diluted number of shares	Million	593.3	650.2
<b>Underlying diluted EPS – continuing operations</b>	<b>Pence</b>	<b>7.3</b>	6.2

### Underlying\* basic EPS – total Group

		6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
Profit attributable to equity shareholders	£m	42.0	32.9
Loss after tax in respect of specific adjusting items*	£m	1.2	8.3
Underlying profit after taxation	£m	43.2	41.2
Weighted average number of shares	Million	589.6	645.6
<b>Underlying basic EPS – total Group</b>	<b>Pence</b>	<b>7.3</b>	6.4

### Underlying\* diluted EPS – total Group

		6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)
Profit attributable to equity shareholders	£m	42.0	32.9
Loss after tax in respect of specific adjusting items*	£m	1.2	8.3
Underlying profit after taxation	£m	43.2	41.2
Weighted average number of shares	Million	589.6	645.6
Effect of dilutive securities	Million	3.7	4.6
Diluted number of shares	Million	593.3	650.2
<b>Underlying diluted EPS – total Group</b>	<b>Pence</b>	<b>7.3</b>	6.3

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

## Notes to the condensed interim financial statements (continued)

### 7. Dividends

An analysis of the dividends paid and proposed in respect of the period ended 30 September 2015 and comparative periods is provided below:

	Pence per ordinary share	£m	Date paid/payable
<b>Interim 2016</b>	<b>1.9</b>	<b>11.1</b>	<b>Feb 2016</b>
Interim 2015	1.8	11.1	Feb 2015
Final 2015	3.6	21.2	Sep 2015
Total for the year ended 31 March 2015	5.4	32.3	

The interim dividend is 1.9p (interim 2015: 1.8p). The dividend will be paid on 12 February 2016. The ex-dividend date is 14 January 2016 and the record date is 15 January 2016.

### 8. Cash flows from operations

All figures in £ million	6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)	Year ended 31 March 2015 (audited)
Profit after tax for the period	42.0	32.9	104.7
Adjustments for:			
Taxation expense/(income)	6.3	6.4	(11.8)
Net finance costs	0.6	3.6	4.1
Loss on business divestments and disposal of investments	-	5.5	12.9
Reversal of unutilised restructuring provisions	-	-	(1.0)
Amortisation of purchased or internally developed intangible assets	1.3	0.5	1.5
Amortisation of intangible assets arising from acquisitions	1.1	2.1	3.6
Profit on disposal of land and property	(0.2)	-	-
Depreciation and impairment of property, plant and equipment	10.2	11.8	22.0
Loss on disposal of plant and equipment	0.8	0.4	1.2
Share of post-tax profit of equity accounted entities	-	-	0.1
Share-based payments charge	3.3	2.9	3.6
Changes in retirement benefit obligations	(7.3)	(8.0)	(7.9)
Net movement in provisions	(0.3)	(1.1)	(1.6)
	<b>57.8</b>	<b>57.0</b>	<b>131.4</b>
Decrease in inventories	2.9	4.2	2.6
Decrease in receivables	27.7	57.2	27.3
Decrease in payables	(25.5)	(54.9)	(22.2)
Changes in working capital	5.1	6.5	7.7
<b>Cash generated from operations</b>	<b>62.9</b>	<b>63.5</b>	<b>139.1</b>
Add back: net cash outflow relating to restructuring	-	-	0.6
Add back: disposal-related pension contribution	-	6.0	6.0
Less: cash generated from discontinued operations	-	(1.8)	(1.8)
<b>Net cash flow from continuing operations before cash flows in respect of specific adjusting items</b>	<b>62.9</b>	<b>67.7</b>	<b>143.9</b>

## Notes to the condensed interim financial statements (continued)

### 9. Analysis of net cash

All figures in £ million	6 months ended 30 September 2015 (unaudited)	6 months ended 30 September 2014 (unaudited)	Year ended 31 March 2015 (audited)
Due within one year:			
Bank and cash	170.1	204.4	184.3
Available for sale investment	9.9	-	10.0
Recapitalisation fee	0.3	0.3	0.3
Finance lease receivables	-	2.1	1.5
Finance lease payables	-	(2.0)	(1.4)
Derivative financial assets	0.5	0.1	0.5
Derivative financial liabilities	(0.1)	(0.3)	(0.5)
	180.7	204.6	194.7
Due after one year:			
Recapitalisation fee	0.7	1.0	0.8
Finance lease receivables	-	0.6	-
Finance lease payables	-	(0.7)	-
Derivative financial assets	0.1	0.2	0.1
Derivative financial liabilities	-	-	(0.1)
	0.8	1.1	0.8
<b>Total net cash as defined by the Group</b>	<b>181.5</b>	<b>205.7</b>	<b>195.5</b>

### 10. 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 2015. 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).

The Group's assets and liabilities that are measured at fair value, as at 30 September 2015, are as follows:

## Notes to the condensed interim financial statements (continued)

all figures in £ million	Level 1	Level 2	Level 3	Total
Assets:				
Available for sale investment	9.9	-	-	9.9
Current other investments	2.1	-	-	2.1
Current derivative financial instruments	-	0.5	-	0.5
Non-current other investments	-	-	0.1	0.1
Non-current derivative financial instruments	-	0.1	-	0.1
Liabilities:				
Current derivative financial instruments	-	(0.1)	-	(0.1)
<b>Total</b>	<b>12.0</b>	<b>0.5</b>	<b>0.1</b>	<b>12.6</b>

The following table presents the Group's assets and liabilities that are measured at fair value at 31 March 2015:

all figures in £ million	Level 1	Level 2	Level 3	Total
Assets:				
Available for sale investments	10.0	-	-	10.0
Current other investments	2.3	-	-	2.3
Current derivative financial instruments	-	0.5	-	0.5
Non-current other investments	-	-	0.1	0.1
Non-current derivative financial instruments	-	0.1	-	0.1
Liabilities:				
Current derivative financial instruments	-	(0.5)	-	(0.5)
Non-current derivative financial instruments	-	(0.1)	-	(0.1)
<b>Total</b>	<b>12.3</b>	<b>-</b>	<b>0.1</b>	<b>12.4</b>

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.

### 11. 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 2015 (unaudited)	30 September 2014 (unaudited)	31 March 2015 (audited)
Total market value of scheme assets	1,399.5	1,373.4	1,454.6
Present value of scheme liabilities	(1,419.9)	(1,396.2)	(1,494.0)
<b>Net pension liability before deferred tax</b>	<b>(20.4)</b>	<b>(22.8)</b>	<b>(39.4)</b>
Deferred tax (liability)/asset	(1.6)	0.1	1.6
<b>Net pension liability</b>	<b>(22.0)</b>	<b>(22.7)</b>	<b>(37.8)</b>

## Notes to the condensed interim financial statements (continued)

Changes to the net pension liability before deferred tax

all figures in £ million	30 September 2015 (unaudited)	30 September 2014 (unaudited)	31 March 2015 (audited)
Opening net pension liability before tax	(39.4)	(22.2)	(22.2)
Actuarial gain/(loss) on scheme assets	12.2	(8.3)	(24.5)
Contributions by the employer	7.9	8.6	9.2
Current service cost and administration costs	(0.6)	(0.6)	(1.3)
Net finance expense	(0.5)	(0.3)	(0.6)
<b>Closing net pension liability before deferred tax</b>	<b>(20.4)</b>	<b>(22.8)</b>	<b>(39.4)</b>

### Assumptions

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

	30 September 2015 (unaudited)	30 September 2014 (unaudited)	31 March 2015 (audited)
Discount rate applied to scheme liabilities	3.7%	3.8%	3.2%
CPI inflation assumption	2.3%	2.4%	2.1%
Assumed life expectancies in years:			
Future male pensioners (currently aged 60)	88	88	88
Future female pensioners (currently aged 60)	91	90	91
Future male pensioners (currently aged 40)	91	90	91
Future female pensioners (currently aged 40)	93	92	93

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. A triennial valuation, on a 'funding basis' as at 30 June 2014, was a net surplus of £31m, although it is expected that if a funding valuation was carried out at present the valuation could be a net deficit. The 'funding basis' of calculating scheme funding requirements uses certain assumptions that are different to those used in an IAS 19 'accounting basis' valuation. The key assumption that varies between the two types 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 'accounting basis' valuation uses corporate bond yields as the base. Due to the different assumptions used the 'funding basis' valuations of the scheme can be significantly different to the 'accounting basis' value reported above.

### 12. 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 2015 in respect of 4,141,745 own shares (31 March 2015: 5,443,881).

In the six months to 30 September 2015 the Group granted/awarded 3.8 million new share-based awards to employees (30 September 2014: 4.3 million).

### 13. Related party transactions with equity accounted investments

During the period there were sales to associates of £1.6m (30 September 2014: £1.6m). At the period end there were outstanding receivables from associates of £0.4m (30 September 2014: nil).

## 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 32-37 of the 2015 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;
- Operating in a highly competitive marketplace;
- 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;
- Financial position of the defined benefit pension scheme;
- Tax liabilities may change as a result of changes in tax legislation.

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 2015.

By order of the Board

Mark Elliott  
Chairman  
18 November 2015

Steve Wadey  
Chief Executive Officer  
18 November 2015

David Mellors  
Chief Financial Officer  
18 November 2015

## 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 2015 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 2015 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, Statutory Auditor  
Chartered Accountants  
15 Canada Square, London E14 5GL  
18 November 2015

## Glossary

<b>Book to bill ratio</b>	Ratio of funded orders received in the year to revenue for the year, adjusted to exclude revenue from the 25-year LTPA contract	<b>Underlying basic earnings per share</b>	Basic earnings per share as adjusted to exclude 'specific adjusting items'
<b>C4ISR</b>	Command, control, communications, computers, intelligence, surveillance and reconnaissance	<b>Underlying effective tax rate</b>	The tax charge for the period excluding the tax impact of 'specific adjusting items' expressed as a percentage of underlying profit before tax
<b>EPS</b>	Earnings per share	<b>Underlying net cash from operations (post capex)</b>	Net cash inflow from operations before specific adjusting items less net cash outflow on purchase/sale of intangible assets and property, plant and equipment
<b>Funded backlog</b>	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)	<b>Underlying net finance expense</b>	Net finance expense as adjusted to exclude 'specific adjusting items'
<b>IAS</b>	International Accounting Standards	<b>Underlying operating cash conversion</b>	The ratio of underlying net cash from operations (post-capex) to underlying operating profit
<b>IFRS</b>	International Financial Reporting Standards	<b>Underlying operating margin</b>	Underlying operating profit expressed as a percentage of revenue
<b>LTPA</b>	Long-Term Partnering Agreement – 25 year contract established in 2003 to manage the MOD's test and evaluation ranges	<b>Underlying operating profit</b>	Operating profit as adjusted to exclude 'specific adjusting items'
<b>MOD</b>	UK Ministry of Defence	<b>Underlying profit before tax</b>	Profit before tax as adjusted to exclude 'specific adjusting items'
<b>Organic Growth</b>	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 or discontinued operations for the same duration of ownership as the current period		
<b>Specific adjusting items</b>	Amortisation of intangibles arising from acquisitions; pension scheme net finance expense; gain/loss on disposal of investments/businesses/property; and tax thereon		