Interim Results

QINETIQ

15 November 2018

Strategic progress – positioned for profitable growth
Results for six months to 30 September 2018

	Statutory results		Underlying* results	
	H1 2019	H1 2018	**H1 2019**	H1 2018
Revenue	**£420.3m**	£392.5m	**£420.3m**	£392.5m
Operating profit	**£47.3m**	£67.5m	**£51.1m**	£57.5m
Profit after tax	**£50.1m**	£64.1m	**£45.8m**	£51.1m
Earnings per share	**8.9p**	11.3p	**8.1p**	9.0p
Interim dividend per share	**2.1p**	2.1p	**2.1p**	2.1p
Total funded order backlog			**£1,882.1m**	£2,042.2m
Total orders in the period			**£298.1m**	£276.3m
Net cash flow from operations	**£50.9m**	£35.7m	**£50.9m**	£35.7m
Net cash	**£249.1m**	£194.7m	**£249.1m**	£194.7m

* Definitions of the Group's 'Alternative Performance Measures' can be found in the glossary.

Delivered organic growth in orders and revenue, operating profit in line with expectations
- 9% organic increase in orders
- 8% organic increase in revenue driven by growth in both EMEA Services and Global Products
- Stable underlying operating profit; prior period included £6.5m of non-recurring trading items, current period margin impacted by Global Products' phasing
- Strong cash performance with 100% underlying cash conversion pre-capex
- Interim dividend is 1/3 of prior year total dividend reflecting previously announced methodology

Driving growth through competitive campaign wins
- Won Engineering Delivery Partner; all engineering services for UK MOD's procurement agency
- Won battlefield communications programme worth up to £95m, our largest competitive win
- Won our first US robotics Program of Record worth up to $44m for route clearance systems
- Acquisition of EIS Aircraft Operations and 85% of Inzpire; enhancing operational training offer
- Grown international share of revenue from 26% to 31% over the last year

Priorities for the remainder of the year
- Conclude Long Term Partnering Agreement (LTPA) negotiations with UK MOD
- Win further campaigns and continue investment to drive sustainable profitable growth
- 90% of FY19 revenue under contract, maintaining expectations for Group performance

Steve Wadey, Group Chief Executive Officer said:

"Significant competitive campaign wins, strong organic revenue growth and appropriate deployment of capital demonstrate that our strategy is now really delivering. Our good first half means that we are well placed to meet our expectations for full year performance.

"We are now positioned for sustainable and profitable growth, reinforcing our market-leading role in the UK and using this to expand internationally. We continue to take steps to mitigate the effects of changes in the UK single source profit rate and expect this headwind to moderate in FY20 and beyond, enabling growing revenue to deliver increased profitability."

Interims results presentation:

There will be a webcast of the interim results at 0900 hours UK time on 15 November 2018. Registration for the webcast is available at: www.QinetiQ.com/investors where the presentation will also be available. An audiocast of the event through which participants will be able to ask questions will be available by dialling +44 20 3936 2999 Participant Access Code: 049366

About QinetiQ:

QinetiQ (QQ.L) is a leading science and engineering company operating primarily in the defence, security and critical infrastructure 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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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 judgement of the Directors, the use of adjusted performance measures (APMs) 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. The adjusted measures used by QinetiQ may differ from adjusted measures used by other companies. Details of QinetiQ's APMs are set out in the glossary to the document.

Year references (FY19, FY18, 2019, 2018) refer to the year ended 31 March. H1 2019 and H1 2018 refer to the six months ended 30 September.

Disclaimer

This document contains certain forward-looking statements relating to the business, strategy, financial performance and results of the Company and/or the industry in which it operates. Actual results, levels of activity, performance, achievements and events are most likely to vary materially from those implied by the forward-looking statements. The forward-looking statements concern future circumstances and results and other statements that are not historical facts, sometimes identified by the words 'believes',' expects', 'predicts', 'intends', 'projects', 'plans', 'estimates', 'aims', 'foresees', 'anticipates', 'targets', 'goals', 'due', 'could', 'may', 'should', 'potential', 'likely' and similar expressions, although these words are not the exclusive means of doing so. These forward-looking statements include, without limitation, statements regarding the Company's future financial position, income growth, impairment charges, business strategy, projected levels of growth in the relevant markets, projected costs, estimates of capital expenditures, and plans and objectives for future operations. Forward-looking statements contained in this announcement regarding past trends or activities should not be taken as a representation that such trends or activities will continue in the future. Nothing in this document should be regarded as a profit forecast.

The forward-looking statements, including assumptions, opinions and views of the Company or cited from third party sources, contained in this announcement are solely opinions and forecasts which are uncertain and subject to risks. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to be correct. Actual results may differ materially from those expressed or implied by these forward-looking statements. A number of factors could cause actual events to differ significantly and these are set out in the principal risks and uncertainties section of this document.

Most of these factors are difficult to predict accurately and are generally beyond the control of the Company. Any forward-looking statements made by, or on behalf of, the Company speak only as of the date they are made. Save as required by law, the Company will not publicly release the results of any revisions to any forward-looking statements in this document that may occur due to any change in the Directors' expectations or to reflect events or circumstances after the date of this document.

Chief Executive Officer's Review

We delivered a good performance in the first half of the year with 9% order growth and 8% revenue growth on an organic basis, and an increased proportion of our revenue coming from international customers. After adjusting for non-recurring trading items, we also reported stable underlying operating profit in line with our expectations. We have been able to offset margin pressure in EMEA Services through efficiency savings and revenue growth. Margins reduced to 10.2% in Global Products as a result of timing and mix of product sales; full year operating profit margin is expected to be in line with previous years. We have continued to maintain our discipline around cash as illustrated by our 100% underlying cash conversion during the period. With £249m of net cash, our balance sheet remains strong giving us the ability to execute on our strategy, by investing both organically and through carefully considered bolt-on acquisitions.

Our business winning campaigns have delivered three key competitive contract wins during the period, including the largest commercially competed contract ever won by QinetiQ.

We have made a good start to the year and our expectations for FY19 performance are unchanged.

We are working hard to overcome well flagged headwinds in the UK created by changes to the profit rate for non-competed work. As previously announced, we anticipate the changes in the Baseline Profit Rate (BPR) to create a £6m headwind to profitability in FY19. We have taken steps to mitigate the effects by moving more of our work on to long-term contracts and driving efficiencies. As a result of these actions, and anticipated changes to the profit rate, we expect the headwind to moderate in FY20 and beyond, enabling growing revenue to deliver increasing profitability.

Strategy

Underpinning this progress is our strategy. By leading and modernising UK test and evaluation, increasing our international presence and continuing to innovate we will deliver sustainable and profitable growth.

The three elements of our strategy are interlinked and mutually reinforcing, informing our decision making across the Company. To enable our strategy, we are continuing to transform our approach to winning, delivering and investment, with a particular focus on changes that improve employee engagement.

This strategy leverages our expertise in capability generation, threat representation and operational readiness which we use to help our customers develop technology into capability and ensure it works when critically needed.

Leading the modernisation of defence test and evaluation in the UK

We are modernising our approach to defence test and evaluation (T&E) in the UK. Test and evaluation is at the core of our business and by investing in contracts such as the Long Term Partnering Agreement (LTPA) we create a strong platform for future growth. The investment to modernise ensures that we continue to be a critical part of the defence T&E enterprise, not just within the UK, but with international customers too, supporting them to test, train and rehearse against increasingly complex threats. The £180m of investment is continuing under the December 2016 LTPA amendment which is recovered over the life of the contract, delivering appropriate returns in its own right as well as enabling future growth.

Negotiations are progressing well for the remaining scope of the LTPA not covered under the December 2016 amendment. As part of these negotiations, we will commit to delivering efficiencies and change to an output-based contract. We will also be responsible for the investment to renew capabilities and modernise the LTPA, improving T&E capabilities for UK customers, as well as attracting international and industrial users. Our objective is to secure the pricing to 2028 with a similar level of investment and recovery mechanism to the December 2016 amendment.

We believe investing into the LTPA creates a range of benefits to our customers and shareholders:

1) Supports our largest customer, the UK Ministry of Defence (MOD), to meet its strategic T&E capability requirements for the longer term;
2) Delivers capability assurance in a more cost effective manner, helping the UK MOD to meet its budgetary requirements;
3) Creates world-class facilities through further investment to attract a greater share of international capability assurance work;
4) Acts as a strong reference point, enhancing our credibility with international customers;
5) Delivers an appropriate return to our shareholders with clear contractual visibility and return on capital, and the ability to enhance returns further by increasing UK, international and industrial work.

Achievements have included:

- The modernisation of the air ranges agreed as part of the December 2016 amendment is making good progress. This includes the successful installation of new safety critical systems on St Kilda and the delivery of new tracking radar for the Hebrides which remains on schedule;
- Shortly after period end, we announced a strategic investment of 85% of the Inzpire Group Limited (Inzpire) to continue to enhance our defence operational training capabilities. In a short period of time, Inzpire has become one of the most trusted and respected names in UK defence providing critical training to the UK Royal Air Force (RAF) and Army. This complements our capabilities and further enhances our offer to international customers. Financially, Inzpire has a five-year track record of consistent revenue growth, and delivered £13.3m revenue and £2.0m of adjusted EBITDA in the financial year to 31 August 2018.

Building an international company

Our strategy recognises the unique value we are able to create for customers not just in the UK but internationally. Our ambition is to have 50% of our revenue from international customers over the next five to ten years. We continue to make rapid progress, growing the proportion of international revenue organically to 31% in the first half of the year, up from 26% 12 months ago.

Understanding our value chain, particularly in test and evaluation, enables us to accelerate our international growth aspirations. Our market penetration varies considerably between home countries and emerging markets, but the route by which we grow our in-country presence and use our range of innovative products and services to create and build customer relationships is fairly consistent:

1) We seed our presence in new markets through export sales of our services and products. These sales provide the opportunity to build new customer relationships, create brand awareness and establish our reputation as a technology innovator;
2) As our relationships mature, we develop trusted “customer friend” positions with our customers where we are able to offer independent engineering and advisory services developed through our experience in the UK;
3) This close customer proximity gives us unique insight into our customers’ challenges and their future requirements, providing us with opportunities to introduce and shape some of the test, evaluation and training capabilities that they require;
4) Ultimately, as these relationships deepen, we create opportunities to move into more mature research, development, test, evaluation, and training business models that may require some degree of indigenous capability development, permanent in-country presence and investment.

Well thought through bolt-on acquisitions and partnerships can support and accelerate this strategy. QinetiQ Target Systems (QTS), which provides targets, is a good example of a critical component of the T&E and training value chain, which we have developed accordingly. (Watch more about QTS products in action here https://youtu.be/fD_NWBSY650).

In October we completed the acquisition of EIS Aircraft Operations (EIS), a leading provider of airborne training services based in Germany. The acquisition delivers a number of strategic benefits to QinetiQ, including strengthening our capability integration, threat representation and operational readiness offering to customers, while providing a new route to the European defence market. QTS, EIS and Inzpire all complement our capabilities in test and evaluation and training, and accelerate the pace of our international growth.

Achievements have included:

- In an encouraging sign of our strategic progress, we grew our overall international revenue in H1 2019 to £129.7m (H1 2018: £101.3m);
- In the United States, we won our first robotics Program of Record for Route Clearance Interrogation System Type I (R-CIS 1) worth up to $44m;
- As previously announced, we were down-selected as one of two companies for the Engineering, Manufacturing and Development phase on the Common Robotics System (Individual), an opportunity potentially worth up to $429m in total.

Innovating for our customers advantage

We are well known for our technical innovation and we are complementing this with real commercial innovation too. Our commercial innovation, through our business winning campaigns, is beginning to deliver results. During the period we won a number of significant competitive campaigns including BATCIS, the largest competed contract ever won by QinetiQ.

These successes reflect the work we have been doing to build our capability in winning and delivery since we launched our new vision-based strategy. As an organisation, we have moved from being reactive to customer requests to proactively engaging with them to really understand the challenges they face. This change in culture within the Company means we are creating new opportunities to better support our customers and consequently grow as a business. By understanding our customer requirements, we are also better placed to manage the risk associated with contracts.

Achievements have included:

- In October, we announced that QinetiQ had signed the Engineering Delivery Partnership (EDP), a ten year framework contract which provides the default route for delivery of all engineering services to DE&S, the UK MOD's procurement agency. This innovative framework contract will help the UK MOD reduce the costs of its engineering services while ensuring it receives the best equipment and support. QinetiQ will deliver all of the engineering services required by DE&S, in partnership with Atkins, BMT and the best capabilities across the UK supply chain. EDP reflects our strong relationship with the UK MOD, widens our role further across the procurement cycle and complements our test and evaluation offering;
- Our increasing customer focus enabled us to win the competition for the Battlefield and Tactical Communications & Information Systems (BATCIS) contract, worth up to £95m over five years. BATCIS is our largest competitive win to date. The contract was awarded by Joint Forces Command (JFC) Information Systems and Services (ISS) organisation, an area of the UK MOD we have not worked with regularly before;
- We have established a Research, Experimentation and Innovation (RE&I) portfolio with the aim of creating linkages across our Company to best exploit commercially our range of technologies. By combining our technologies, we can create more compelling customer offers. This approach is already delivering results with the award of the Last Mile resupply contract for the UK MOD. Our TITAN platform combines technologies in robotics, autonomy, sensors and mission systems

to deliver vital supplies safely, autonomously and efficiently to forward operating bases (Watch TITAN in action here: https://youtu.be/TQ8GcvDPx4I).

With world-class technical capabilities, a clear strategy, an increasing customer focus and a strong balance sheet QinetiQ has never been better placed to deliver value for customers, rewarding careers for employees and sustainable profitable growth. By executing on our strategy, we are realising the potential within QinetiQ to drive returns for our shareholders.

Outlook – FY19

We have made a positive start to FY19 and, with 90% of FY19 revenue under contract, we are well positioned to meet our expectations for the full year.

The EMEA Services division delivered 3% organic revenue growth in H1 2019 and has 91% of FY19 revenue under contract. The division is expected to deliver modest revenue growth this year, although the lower baseline profit rate for single source contracts represents a continued headwind for operating margins.

The Group's Global Products division has shorter order cycles than EMEA Services and its performance is dependent on the timing of shipments of key orders. The division delivered 25% organic revenue growth in H1 2019 with 86% of FY19 revenue under contract and is on track to meet our expectations for further organic growth this year. Full year operating profit margin is expected to be in line with previous years.

As we continue to invest in our core capabilities to support growth, we expect full year capex to be at the upper end of our previous guidance of £80-100m for FY19 and full year working capital outflows, excluding non-recurring items, of £15-25m.

Overall our expectations for Group performance in FY19 are unchanged.

Outlook – FY20 and beyond

Based on changes to the profit rate for single source contracts and a greater proportion of longer duration contracts, we expect a reduction in the SSRO headwind to our EMEA Services division's profitability in FY20 and onwards, enabling growing revenue to deliver increased profitability.

Over the medium term, we expect to continue to invest in our organic capabilities and make strategic bolt-on acquisitions. We maintain a disciplined approach to investing, ensuring that we deploy our capital appropriately to drive returns for our shareholders.

Chief Financial Officer's Review

Overview of interim results

Orders for the period were £298.1m, compared to £276.3m in the same period a year ago. Excluding foreign exchange, orders grew organically by £24.5m (9%). This increase was driven by orders in the Cyber Information & Training (CIT) and Maritime, Land and Weapons (MLW) businesses following higher UK MOD commitments in the period, offset by some multi-year Global Product contracts won in the prior period.

As at 30 September 2018 the Group's total funded order backlog stood at £1.9bn, compared with £2.0bn in the prior period. The Group had 90% of FY19 revenue under contract, up from 69% at the beginning of this financial year. This compares with 89% at the same time last year.

Revenue was £420.3m (H1 2018: £392.5m), up 8% on an organic basis after adjusting for foreign exchange movements. Overall organic growth was principally due to the increase of revenue in Global Products which was up 25% on an organic basis, driven by strong performance in QinetiQ North America and QinetiQ Target Systems acquired in FY17. EMEA Services was up 3%.

Underlying operating profit was £51.1m (H1 2018: £57.5m), with the reduction due to ~£6.5m of non-recurring trading items in H1 2018. In the current year there were a number of trading gains/losses, including restructuring charges of £5.1m, that broadly net to nil.

Excluding the non-recurring trading items and the effect of foreign exchange, underlying operating profit was broadly flat. We were able to offset SSRO margin pressure through efficiency savings and revenue growth. Operating profit margin in Global Products fell during H1 2019 as the result of timing and mix of product sales during the period, in particular lower licence income coupled with lower profitability in OptaSense. Full year operating profit margin is expected to be in line with previous years.

Statutory operating profit, including the impact of specific adjusting items, was £47.3m (H1 2018: £67.5m). Current year specific adjusting items were a £3.8m loss at the operating profit level (H1 2018: £10.0m profit) and included a £2.6m impairment charge in respect of unutilised property. See note 3 for full details of all specific adjusting items.

Underlying profit after tax was £45.8m (H1 2018: £51.1m) with underlying net finance income of £0.2m (H1 2018: cost £0.3m) and an underlying tax charge of £5.5m (H1 2018: £6.1m).

Underlying earnings per share were 8.1p (H1 2018: 9.0p), with the decrease due primarily to non-recurring items in H1 2018. Statutory basic earnings per share for the total Group (including specific adjusting items) were 8.9p (H1 2018: 11.3p), as the prior period included profit on disposal of property and intellectual property.

Net cash flow from operations was £50.9m (H1 2018: £35.7m) with cash conversion of 100%.

Working capital outflow was £18.5m in H1 2019 compared with £26.2m in H1 2018. We anticipate a full year working capital outflow, excluding non-recurring items, of £15-25m. Pensions outflow fell to £2.3m following the cessation of regular deficit repair contributions to the defined benefit pension scheme.

Net capex increased to £48.3m (H1 2018: £31.0m) as we continue to invest in core contracts including the LTPA following the contract amendment announced in December 2016. Full year total capex is expected to be at the upper end of previous guidance of £80-100m.

At 30 September 2018, the Group had £249.1m net cash, compared to £266.8m net cash at 31 March 2018 and £194.7m net cash at 30 September 2017. The decrease from 31 March 2018 was primarily due to a dividend payment of £23.8m.

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.

An interim dividend of 2.1p (H1 2018: 2.1p) will be paid on 8 February 2019 to shareholders on the register at 11 January 2019. The interim dividend represents one third of the prior year total dividend reflecting our previously communicated methodology. The full year dividend will be set in May.

Trading environment

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

UK

Although Brexit does not represent a near-term risk to QinetiQ, due to our very limited exposure to European Union markets, more generally the UK trading environment remains mixed. This presents us with both opportunities and well flagged headwinds, principally driven by changes in the Baseline Profit Rate (BPR) which is set by the Single Source Regulations Office (SSRO). The UK Ministry of Defence (MOD) is aiming to achieve significant cost savings with further clarity expected in the Modernising Defence Programme (MDP) review, which is currently under way. Some of the nearer term pressure was relieved in the recent Budget, with the announcement of a further £1 billion over this year and next, which comes on top of £800m that was added to the defence budget earlier this year. QinetiQ, with its origins in the UK MOD itself, plays a key role in assuring the safety and performance of a range of critical UK defence capabilities. Our strategy to invest in our core UK test and evaluation capabilities ensures we remain relevant and can increase our UK market share and leverage it into international markets.

US

The United States remains the largest defence market in the world with a defence budget of over $700 billion. Expenditure is expected to remain robust as US Government seeks to retain its technological superiority in an increasingly hostile geopolitical environment. In such a large market, QinetiQ's offer is focused in attractive niches aligned with the US Department of Defense's (US DoD's) objective of increasing the use of unmanned systems. Demand for this is evidenced by the recapitalisation of a number of robotics programmes undertaken through formal Programs of Record. QinetiQ also has exposure to larger projects such as the next generation of US aircraft carriers through our expertise in electromagnetic aircraft launch and recovery equipment.

Australia

Australia is the smallest of our home countries and our business there has grown rapidly over the past few years. Australian economic growth is stable and the Government intends to steadily increase defence spending to achieve its target of 2% of GDP by 2021. This also supports their broader defence industry plan to create an indigenous defence industry and capability. We are well placed to support the Australian Government achieve these objectives through our in-country professional advisory, engineering consultancy, design, prototype and test capabilities. Strong relationships between the UK and Australian Governments will help us accelerate the deployment of our UK experience into the Australian market.

International markets

Our unique value proposition will deliver growth in a number of attractive international markets. We have identified Germany, France, Sweden, and Canada, as well as the Middle East region, as our priority markets where we are either helping to modernise existing defence capabilities or are building new indigenous defence capabilities. Our business in the Middle East, while only recently established, is making encouraging process. Countries in the region traditionally relied on procurement of platforms to create capability. They are now developing indigenous capabilities to integrate systems and develop effective training to achieve optimum operational readiness. QinetiQ is well placed to provide this support.

Business overview

EMEA Services

	H1 2019 £m	H1 2018 £m
Orders (incl. JVs)	**196.1**	153.9
Revenue	**319.9**	311.6
Underlying operating profit*	**40.9**	47.3
Underlying operating margin*(1)	**12.8%**	15.2%
Book to bill ratio(2)	**0.9x**	0.8x
Funded order backlog excl. LTPA	**683.7**	750.3
Total funded order backlog incl. LTPA	**1,674.6**	1,847.7

* Definitions of the Group's 'Alternative Performance Measures' can be found in the glossary.
(1) The H1 2018 margin excluding the £6.5m non-recurring trading items was 13.1%
(2) B2B ratio is orders won divided by revenue recognised, excluding the LTPA contract.

EMEA (Europe, Middle East and Australasia) Services combines world-leading expertise with unique facilities to provide capability integration and assurance. Our core value proposition is built upon our expertise in capability integration, threat representation and operational readiness underpinned by long-term contracts that provide good visibility of revenue and cash flows. The division is also a market leader in research and advice in specialist areas such as C4ISR, weapons and energetics, cyber security and procurement advisory services.

Financial performance

We reported orders of £196.1m (H1 2018: £153.9m), with the increase being due primarily to greater volumes of smaller value orders in Maritime, Land and Weapons (MLW) and Cyber, Information and Training (CIT) following greater UK MOD commitments during the period. Excluding foreign exchange, orders grew organically by 28%.

Revenue increased against the prior period by £8.3m, of which approximately half was driven through international growth. Excluding the impacts of currency movements, revenue grew 3% on an organic basis. At the start of H2, EMEA Services had 91% of its FY19 revenue under contract, consistent with 91% last year and up from 75% at the beginning of this year.

Underlying operating profit was £40.9m (H1 2018: £47.3m), due to a ~£6.5m benefit from non-recurring trading items in H1 2018. In the current year there were a number of trading gains/losses, including restructuring charges of £5.1m, that broadly net to nil. Excluding the non-recurring trading items, underlying operating profit was broadly flat, as we were able to offset SSRO margin pressure through efficiency improvements combined with increases in revenue.

Including the LTPA contract, approximately 75% of EMEA Services revenue is derived from single source contracts, an increased proportion of which is now contracted on a long-term basis. We expect that the proportion of our revenue exposed to further changes in the baseline profit rate will continue to fall once negotiations conclude for the remainder of the LTPA in FY19. Overall, we expect FY19 to represent the peak in SSRO headwind at £6m. Based on changes to the profit rate for single source contracts and the actions we have taken, we expect the headwind from the SSRO to moderate in FY20 and beyond.

H1 commentary

Air & Space

The Air & Space business de-risks complex aerospace programmes by evaluating systems and equipment, evaluating the risks and assuring safety.

- A key success has been winning the Engineering Delivery Partner (EDP) framework contract with the UK MOD. This was signed in early October and covers the provision of all engineering services to DE&S, the UK MOD's procurement agency. The Aurora team led by QinetiQ, with our partners Atkins and BMT, will lead the provision of engineering services with the aim of providing improved performance at reduced costs for the customer. The experience gained in delivering Strategic Enterprise for engineering services to the RAF gives us a platform to build on to ensure the successful delivery of EDP.
- We continued to add services to our Strategic Enterprise contract. During the period, we added work for Chinook and Typhoon mission systems assurance. Overall, more than £270m of work has been contracted under Strategic Enterprise since its signature in November 2015.
- The deployment of our investment into our test aircrew training is progressing well. Our new fleet of aircraft, consisting of four Airbus HS125 helicopters, two Pilatus PC21 aircraft and two Grob 120TP aircraft are all being delivered to schedule. We are complementing our new fleet of aircraft with a modernised syllabus and new ways of delivering courses to increase flexibility.
- Our ground-breaking Solar Electric Propulsion System will provide the engine power behind the BepiColombo mission to Mercury which launched on 20 October 2018. The BepiColombo spacecraft incorporates a 'Mercury Transfer Module' powered by QinetiQ's T6 ion thrusters and two observational modules from the Japanese and European space agencies. The spacecraft is due to commence its transit to Mercury in December 2018, with QinetiQ continuing to provide ground based testing to support the mission.

Maritime, Land & Weapons (MLW)

The MLW business delivers operational advantage to customers by providing independent research, evaluation and training services.

- Our investment in the MOD Aberporth air range, part of the December 2016 amendment to the LTPA, will enable the first live weapon firing in the UK from the RAF's new F35 Lightning II aircraft later this year. This creates a potential opportunity for us as the UK and other European nations assure new fleets of this aircraft.
- Improvements to the MOD Hebrides range will enable us to host Formidable Shield 2019 and deliver cutting edge scenarios that combine traditional weapons with complex electronic warfare trials. Large scale multi-national exercises, such as Formidable Shield, promote our test and evaluation capabilities to a wider audience of international customers.
- In addition to missile firings for a new Polish customer and further work from the German armed forces we have also hosted commanders from the UK Carrier Strike Group and the US Marine Corps as they prepare to deploy the new Queen Elizabeth class aircraft carriers.
- Shortly after period end, we were awarded a £9m extension to the Naval Combat System Integrated Support Services (NCSISS) contract to cover mission systems on the new UK Queen Elizabeth Class aircraft carriers.

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.

- In October, we announced a strategic investment in Inzpire, acquiring 85% of the business with an agreement to acquire the remaining 15% after two years for a total consideration of £23.5m. Inzpire is a highly regarded provider of training services to the Royal Air Force and British Army and the investment further enhances our capability in defence operational training. Whilst Inzpire will be operated as a stand-alone subsidiary, its capabilities are most closely aligned with our CIT business. With a leading position within the UK, the investment allows us to further leverage the capability in attractive markets internationally, complementing our acquisitions of QTS and EIS and supporting our strategic objectives.
- We were awarded a three year contract with options to extend for a further two years, worth up to £95m to support the UK MOD in delivering next generation battlefield tactical communications and information systems. The award, which is our largest competed contract win, is strategically important for QinetiQ, demonstrating our increasing customer focus and more strategic approach to business winning.
- We were awarded a £7m contract to assure the Falkland Islands Ground Based Air Defence (GBAD) systems. As part of this we will build and maintain a synthetic environment for testing the Sky Sabre 3-D radar surveillance system used by GBAD and provide the support for live fire testing.

International

Our International business leverages our expertise and the skills we have developed in the UK and applies them to opportunities in attractive markets globally.

- Our business in Australia continues to perform well delivering organic revenue and order growth, supported by a number of contract extensions within our professional services business.
- We are in a consortium, led by Nova Systems, that has been selected as one of only four Major Service Providers (MSPs). MSPs will be the primary route through which the Australian Government procures defence capabilities. We expect our involvement as an MSP to drive further growth of the business.
- Building on our UK work on the new Queen Elizabeth aircraft carrier, we were selected by Oman to deliver Ship Helicopter Operating Limit trials ahead of a Royal Navy and Omani Navy exercise. This is the first time QinetiQ has delivered such trials for an international customer.
- In October, we completed our acquisition of E.I.S. Aircraft Operations (EIS) based in Germany, which delivers cost effective aerial training services to defence customers. EIS has natural synergies with QinetiQ's existing air engineering, test aircrew training and unmanned target service capabilities which we will exploit to strengthen our position in defence operational training.

Global Products

	H1 2019 £m	H1 2018 £m
Orders	**102.0**	122.4
Revenue	**100.4**	80.9
Underlying operating profit*	**10.2**	10.2
Underlying operating margin*	**10.2%**	12.6%
Book to bill ratio	**1.0x**	1.5x
Funded order backlog	**207.5**	194.5

* Definitions of the Group's 'Alternative Performance Measures' can be found in the glossary.

Global Products delivers innovative solutions to meet customer requirements. The division is technology-based and has shorter order cycles than EMEA Services so can have a more lumpy financial profile.

Financial performance

Orders fell to £102.0m (H1 2018: £122.4m) against a strong comparator which included a number of significant multi-year contracts, notably the €24.2m spacecraft docking mechanism order with the European Space Agency.

Reported revenue was up 24% to £100.4m (H1 2018: £80.9m), driven by an £8.9m increase in QinetiQ North America due to robotic, survivability and maritime product programmes and £6.5m QTS Banshee target sales to India. Revenue was up 25% (£20.5m) on an organic basis, excluding foreign exchange.

At the beginning of H2, the division had 86% of its FY19 revenue under contract compared to 80% in the prior period and up from 51% at the beginning of the financial year.

Underlying operating profit remained flat at £10.2m (H1 2018: £10.2m), with an underlying operating profit margin of 10.2% (H1 2018: 12.6%). This was the result of timing and mix of product sales during the period, in particular lower licence income coupled with lower profitability in OptaSense. Full year operating profit margin is expected to be in line with previous years.

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.

- Our North American business was awarded the Route Clearance & Interrogation System (RCIS) robotics Program of Record. The contract, with a potential value of up to $44m, is for larger vehicles and evidences our leading position in robotic technology as well as our campaign based approach to business winning. We also secured a contract to convert large army vehicles into ones capable of remote operation. Our broader robotics portfolio continues to perform well including continued demand to upgrade, repair and service our Talon product range.
- As previously announced, we were pleased to be selected as one of two suppliers for the Engineering and Manufacturing Development (EMD) phase of Common Robotic System (Individual) program of record. The EMD phase will last approximately 10 months, during which time the US DoD will test and evaluate robots from the two suppliers. The total budget for the program is approximately $429m in the form of an indefinite-delivery / indefinite-quantity contract over seven years.

- We secured a major strategic milestone with an order for our innovative Dolphin underwater acoustic networking product. This disruptive technology allows for full-duplex underwater acoustic networking with many potential applications.
- Demand for light-weight and cost-effective survivability products, such as Q-Nets and Last Armor was also strong.

OptaSense

OptaSense provides innovative fibre sensing solutions to deliver decision ready data in multiple vertical markets.

- We were awarded the contract to protect a new pipeline for the Permian Basin in western Texas. OptaSense will provide advanced monitoring of the pipeline, including leak detection, and is a critical part in minimising the potential environmental impact of the new pipeline. In total, we now provide critical maintenance and safety monitoring of 30,000km of pipelines.
- We have continued to develop OptaSense technology, increasing the effective range of each sensor by approximately five times while also greatly enhancing the sensitivity. This further supports our offer for long distance, linear assets, such as roads, railways and national borders.
- We have successfully delivered Phase 0 of the 1,841km Trans Anatolian Natural Gas Pipeline (TANAP) project. TANAP represents the largest single system award for OptaSense.

Space Products

QinetiQ's Space Products business develops satellites, payload instruments, sub-systems and ground station services.

- We won a two-year contract with Effective Space Solutions to build, test and deliver docking mechanisms for two satellite-servicing SPACE DRONE spacecraft. The mechanism will provide a non-intrusive, safe and secure attachment between the SPACE DRONE spacecraft and existing satellites in orbit, and builds on QinetiQ's experience developing the International Berthing and Docking Mechanism (IBDM) for the European Space Agency. Effective Space is one of the first companies targeting a significant share of in-orbit services market for commercial satellite operators and government agencies.

EMEA Products

EMEA Products provides research services and bespoke technological solutions developed from intellectual property spun out from EMEA Services.

- QinetiQ Target System continued to deliver good growth and agreed a strategically significant framework contract with the US Target Management Office. In addition, QTS completed the first deliveries of targets to the Indian Army and Navy.
- We successfully launched our secure satellite communication product Bracer and have seen positive early interest. Bracer allows for highly secure but cost effective global communications on a "push to talk" and group basis using the Iridium Low Earth Orbiting satellite network.
- We have won a £2m order to develop Software Defined Multi-function LIDAR (SDML) for the UK MOD for incorporation onto Airbus's Zephyr programme. This product is world-leading and allows multiple functions such as communications, target acquisition and 3D mapping from a single small sensor.

Financial items

Net finance costs

Net finance income was £4.3m (H1 2018: £1.8m) primarily reflecting the defined benefit pension net finance income of £4.1m (H1 2018: £2.1m). The year on year increase reflects the growing pension surplus. The underlying net finance income was £0.2m (H1 2018: cost £0.3m).

Tax

The total tax charge was £2.6m (H1 2018: £5.2m). The underlying tax charge was £5.5m (H1 2018: £6.1m) with an underlying effective tax rate of 10.7% (H1 2018: 10.7%). 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, the future recognition of unrecognised tax losses and while the benefit of net RDEC retained by the Group remains in the tax line.

A £2.8m credit in respect of initial recognition of corporate tax deductions for certain equity-settled share based payment schemes has been classified as a specific adjusting item. Together with a £0.1m tax effect of the pre-tax specific adjusting items, the total specific adjusting items tax credit was £2.9m (H1 2018: £0.9m).

Earnings per share

Underlying earnings per share for the Group were 8.1p (H1 2018: 9.0p), with the decrease primarily due to non-recurring trading items in H1 2018. Statutory basic earnings per share for the total Group (including specific adjusting items) were 8.9p (H1 2018: 11.3p), as the prior period included profit on disposal of property and intellectual property.

Dividend

An interim dividend of 2.1p (H1 2018: 2.1p) will be paid on 8 February 2019 to shareholders on the register at 11 January 2019. The interim dividend represents one third of the prior year total dividend reflecting our previously communicated methodology. The full year dividend will be set in May.

Pensions

The net pension asset under IAS 19, before adjusting for deferred tax, was £353.8m (31 March 2018: £316.2m; 30 September 2017: £247.7m). The key driver for the increase in the net pension asset since 31 March 2018 was increasing discount rates which reduce the present value of scheme liabilities.

The key assumptions used in the IAS 19 valuation of the scheme are set out in note 11.

Post period end, the High Court ruled on a case involving Lloyds Banking Group in respect of equalising (between men and woman) Guaranteed Minimum Pensions ('GMPs'). QinetiQ's pension scheme will be impacted by this court ruling (which may still be appealed). A detailed assessment has not yet been completed to quantify the impact for QinetiQ but it is anticipated to increase liabilities (and hence reduce the net surplus) by approximately 1-4% of the Scheme's gross liabilities.

Committed facilities

In September 2018 the Group completed the re-financing of its revolving credit facilities, putting in place a new £275m facility with an 'accordion' facility to expand this up to a maximum of £400m. The facility has an initial term of five years but with two one-year options to extend the final maturity to 27 September 2025. The larger facility size, longer term and additional operational flexibility provide the maximum scope to execute our strategic growth plans. QinetiQ has introduced positive incentive language into the facility agreement to reinforce our environmental, social and governance policies, and sustainability agenda; this has the effect of providing a modest margin adjustment of +/- 0.02% if we exceed green-house gas emission targets over the life of the facility.

Foreign exchange

The Group's income and expenditure is largely settled in the functional currency of the relevant Group entity, mainly Sterling, US Dollar or Australian 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 rates affecting the Group were the Sterling to US Dollar and Australian Dollar exchange rates.

	6 months to 30 September 2018	**6 months to 30 September 2017**
£/US$ - average	1.32	1.29
£/US$ - closing	1.30	1.34
£/US$ - opening	1.40	1.25
£/A$ - average	1.80	1.69
£/A$ - closing	1.80	1.71
£/A$ - opening	1.83	1.64

IFRS 15 implementation

The adoption of accounting standard IFRS 15 for our FY19 financial year has not had a significant impact on QinetiQ's reported financial performance. This was as expected given the nature of our contracts and QinetiQ's historic method of accounting (using 'percentage of completion' accounting for service contracts as opposed to milestone accounting). Additional disclosures (e.g. in respect of backlog and contract assets and liabilities) are required, however, and these will be provided in the FY19 Annual Report.

IFRS 9 implementation

Following the adoption of IFRS 9 the Group updated its accounting policies to reflect new financial asset classification, measurement and recognition criteria. The Group assessed that certain financial assets will be reclassified from being measured at fair value through other comprehensive income to fair value through profit and loss. The changes to impairment and hedge accounting will not have a material impact on the results of the Group and these accounting policies have also been updated.

The adoption of IFRS 9 from 1 April 2018 for the Group resulted in changes in certain accounting policies, however no adjustments to comparative periods are required.

'Recent accounting developments adopted by the Group' within note 1 provides further insight into the implementation of both IFRS 15 and IFRS 9.

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. An explanation of these risks, together with details of risk management and mitigation, can be found in the annual report which will be available for download at:
https://www.qinetiq.com/investors.

A summary of the significant risks and uncertainties is set out below:

- Reduced spending in the core markets in which the Group operates;
- Failure to execute the international strategy or adequately to mitigate specific risks arising from international business;
- Failure to create a culture of innovation or to invest adequately in, or create value from, our innovation investment;
- A future skills shortage;
- Group performance is adversely affected by application of the Single Source Contract Regulations;
- A breach of data security, cyber-attacks or IT systems failure could have an adverse impact on our customers' operations;
- The Group operates in highly regulated environments and recognises that its operations have the potential to have an impact on a variety of stakeholders; and
- A material element of the Group's revenue is derived from one contract (the LTPA contract).

Condensed consolidated income statement

		6 months ended 30 September 2018 (unaudited)			6 months ended 30 September 2017 (unaudited)		
All figures in £ million	Note	**Underlying***	**Specific adjusting items***	**Total**	Underlying*	Specific adjusting items*	Total
Revenue	2	**420.3**	**-**	**420.3**	**392.5**	**-**	**392.5**
Operating costs excluding depreciation, impairment and amortisation		(359.3)	(0.2)	(359.5)	(325.8)	-	(325.8)
Other income		4.9	0.1	5.0	4.3	11.4	15.7
EBITDA (earnings before interest, tax, depreciation and amortisation)		**65.9**	**(0.1)**	**65.8**	**71.0**	**11.4**	**82.4**
Depreciation and impairment of property, plant and equipment		(13.3)	(2.6)	(15.9)	(11.7)	-	(11.7)
Amortisation of intangible assets		(1.5)	(1.1)	(2.6)	(1.8)	(1.4)	(3.2)
Operating profit/(loss)		**51.1**	**(3.8)**	**47.3**	**57.5**	**10.0**	**67.5**
Gain on sale of investment		-	1.1	1.1	-	-	-
Finance income	4	0.7	4.1	4.8	0.3	2.1	2.4
Finance expense	4	(0.5)	-	(0.5)	(0.6)	-	(0.6)
Profit before tax		**51.3**	**1.4**	**52.7**	**57.2**	**12.1**	**69.3**
Taxation (expense)/income	5	(5.5)	2.9	(2.6)	(6.1)	0.9	(5.2)
Profit for the period attributable to equity shareholders		**45.8**	**4.3**	**50.1**	**51.1**	**13.0**	**64.1**
Earnings per share							
Basic	6	8.1p		8.9p	9.0p		11.3p
Diluted	6	8.1p		8.8p	9.0p		11.3p

* Alternative performance measures are used to supplement the statutory figures. These are additional financial indicators used by management internally to assess the underlying performance of the Group. Definitions can be found in the glossary.

Condensed consolidated statement of comprehensive income

All figures in £ million	**6 months ended 30 September 2018 (unaudited)**	6 months ended 30 September 2017 (unaudited)
Profit for the period	**50.1**	**64.1**
Items that will not be reclassified to profit and loss:		
Actuarial gain recognised in defined benefit pension schemes	31.2	82.1
Tax on items that will not be reclassified to the income statement	(5.4)	(14.0)
Total items that will not be reclassified to the income statement	**25.8**	**68.1**
Items that may be reclassified to profit and loss :		
Movement in deferred tax on foreign currency translation	(0.4)	-
Foreign currency translation gains /(losses) for foreign operations	6.7	(5.0)
Increase/(decrease) in fair value of hedging derivatives	2.6	(1.5)
Movement on deferred tax on hedging derivatives	(0.2)	0.3
Recycling of gains to the income statement on disposal of investments	(1.1)	-
Fair value gains/(losses) on available for sale investments	0.7	(0.3)
Total items that may be reclassified to the income statement	**8.3**	**(6.5)**
Other comprehensive income for the period, net of tax	**34.1**	**61.6**
Total comprehensive income for the period, net of tax	**84.2**	**125.7**

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 2018	**5.7**	**40.8**	**147.6**	**(1.8)**	**(0.4)**	**552.2**	**744.1**	**0.2**	**744.3**
Profit for the period	-	-	-	-	-	50.1	50.1	-	50.1
Other comprehensive income for the period, net of tax	-	-	-	2.4	6.3	25.4	34.1	-	34.1
Purchase of own shares	-	-	-	-	-	(0.3)	(0.3)	-	(0.3)
Share-based payments charge	-	-	-	-	-	2.2	2.2	-	2.2
Tax on share-based payments	-	-	-	-	-	1.1	1.1	-	1.1
Dividends paid	-	-	-	-	-	(23.8)	(23.8)	-	(23.8)
At 30 September 2018 (unaudited)	**5.7**	**40.8**	**147.6**	**0.6**	**5.9**	**606.9**	**807.5**	**0.2**	**807.7**
At 1 April 2017	**5.7**	**40.8**	**147.6**	**-**	**10.3**	**328.0**	**532.4**	**0.2**	**532.6**
Profit for the period	-	-	-	-	-	64.1	64.1	-	64.1
Other comprehensive income/(expense) for the period, net of tax	-	-	-	(1.2)	(5.0)	67.8	61.6	-	61.6
Purchase of own shares	-	-	-	-	-	(0.4)	(0.4)	-	(0.4)
Share-based payments charge	-	-	-	-	-	1.3	1.3	-	1.3
Dividends paid	-	-	-	-	-	(22.6)	(22.6)	-	(22.6)
At 30 September 2017 (unaudited)	**5.7**	**40.8**	**147.6**	**(1.2)**	**5.3**	**438.2**	**636.4**	**0.2**	**636.6**

Condensed consolidated balance sheet

All figures in £ million	Note	**30 September 2018 (unaudited)**	30 September 2017 (unaudited)	31 March 2018 (audited)
Non-current assets				
Goodwill		105.0	104.8	101.5
Intangible assets		41.3	40.7	41.1
Property, plant and equipment		278.9	245.9	269.0
Other financial assets		-	-	0.3
Equity accounted investments		1.8	1.6	2.2
Retirement benefit surplus	11	353.8	247.7	316.2
Deferred tax asset		7.3	4.5	6.4
		788.1	**645.2**	**736.7**
Current assets				
Inventories		40.0	34.6	38.1
Other financial assets		-	16.1	16.9
Trade and other receivables		142.4	165.5	150.3
Assets held for sale		1.2	4.8	1.2
Investments		-	0.8	0.7
Cash and cash equivalents		251.0	181.1	254.1
		434.6	402.9	461.3
Total assets		**1,222.7**	**1,048.1**	**1,198.0**
Current liabilities				
Trade and other payables		(291.3)	(283.3)	(334.9)
Current tax		(0.2)	(31.1)	(8.9)
Provisions		(9.0)	(3.8)	(6.0)
Other financial liabilities		(1.6)	(1.7)	(2.6)
		(302.1)	**(319.9)**	**(352.4)**
Non-current liabilities				
Deferred tax liability		(78.3)	(54.5)	(66.4)
Provisions		(13.7)	(16.7)	(14.3)
Other financial liabilities		(0.3)	(0.8)	(1.9)
Other payables		(20.6)	(19.6)	(18.7)
		(112.9)	(91.6)	(101.3)
Total liabilities		**(415.0)**	**(411.5)**	**(453.7)**
Net assets		**807.7**	**636.6**	**744.3**
Capital and reserves				
Ordinary shares		5.7	5.7	5.7
Capital redemption reserve		40.8	40.8	40.8
Share premium account		147.6	147.6	147.6
Hedging reserve		0.6	(1.2)	(1.8)
Translation reserve		5.9	5.3	(0.4)
Retained earnings		606.9	438.2	552.2
Capital and reserves attributable to shareholders of the parent company		**807.5**	**636.4**	**744.1**
Non-controlling interest		0.2	0.2	0.2
Total shareholders' funds		**807.7**	**636.6**	**744.3**

Condensed consolidated cash flow statement

All figures in £ million	Note	**6 months ended 30 September 2018 (unaudited)**	6 months ended 30 September 2017 (unaudited)	Year ended 31 March 2018 (audited)
Underlying net cash inflow from operations		**50.9**	**35.7**	**126.5**
Add back specific adjusting items: proceeds from sale of intellectual property		-	-	5.9
Net cash inflow from operations	8	**50.9**	**35.7**	**132.4**
Tax paid		(4.8)	(12.5)	(15.7)
Interest received		0.7	0.3	0.7
Interest paid		(0.4)	(0.3)	(0.7)
Net cash inflow from operating activities		**46.4**	**23.2**	**116.7**
Purchases of intangible assets		(4.6)	(4.6)	(8.5)
Purchases of property, plant and equipment		(43.7)	(26.4)	(46.0)
Proceeds from sale of property, plant and equipment		4.4	7.5	23.1
Proceeds from sale of investment		1.5	-	-
Acquisition of business and investment in joint venture		(0.2)	(1.1)	(1.6)
Investments in available-for-sale investments		-	(5.0)	(5.0)
Proceeds from disposal of available-for-sale investments		15.7	-	-
Net cash outflow from investing activities		**(26.9)**	**(29.6)**	**(38.0)**
Purchase of own shares		(0.3)	(0.4)	(0.7)
Dividends paid to shareholders		(23.8)	(22.6)	(34.5)
Net cash outflow from financing activities		**(24.1)**	**(23.0)**	**(35.2)**
(Decrease)/increase in cash and cash equivalents		**(4.6)**	**(29.4)**	**43.5**
Effect of foreign exchange changes on cash and cash equivalents		1.5	(1.3)	(1.2)
Cash and cash equivalents at beginning of period		254.1	211.8	211.8
Cash and cash equivalents at end of period		**251.0**	**181.1**	**254.1**

Reconciliation of movement in net cash

All figures in £ million	Note	**6 months ended 30 September 2018 (unaudited)**	6 months ended 30 September 2017 (unaudited)	Year ended 31 March 2018 (audited)
(Decrease)/ increase in cash and cash equivalents		**(4.6)**	**(29.4)**	**43.5**
Add back net cash flows not impacting net cash		(15.7)	5.0	5.0
Change in net cash resulting from cash flows		**(20.3)**	**(24.4)**	**48.5**
Other movements including foreign exchange		2.6	(2.8)	(3.6)
(Decrease)/Increase in net cash as defined by the Group		**(17.7)**	**(27.2)**	**44.9**
Net cash as defined by the Group at beginning of period		266.8	221.9	221.9
Net cash as defined by the Group at end of period	7	**249.1**	**194.7**	**266.8**
Less: other financial asset and liabilities		1.9	(13.6)	(12.7)
Total cash and cash equivalents	7	**251.0**	**181.1**	**254.1**

Notes to the condensed interim financial statements

1. Significant accounting policies

Basis of preparation

QinetiQ Group plc is a public limited company, which is listed on the London Stock Exchange and is incorporated and domiciled in England.

The condensed consolidated interim financial statements of the Group for the six months ended 30 September 2018 comprise statements for the Company and its subsidiaries (together referred to as the 'Group') and were approved by the Board of Directors on 15 November 2018.

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 435 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 2018.

In the income statement, the Group presents specific adjusting items separately. In the judgement 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:

Item	Distorting due to irregular nature year on year	Distorting due to fluctuating nature (size and sign)	Does not reflect in-year operational performance of continuing business
Amortisation of intangible assets arising from acquisitions			✓
Pension net finance income/expense		✓	✓
Gains/losses on business divestments and disposal of property, investments and intellectual property	✓	✓	✓
Transaction costs in respect of business acquisitions	✓		✓
Impairment of goodwill and other intangible assets	✓		
Impairment of property	✓		
The tax impact of the above	✓	✓	✓
Other significant non-recurring tax movements	✓	✓	✓

All items treated as a specific adjusting item in the current and prior year are detailed in note 3.

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 2018 (with the exception of the implementation of IFRS 15 and IFRS 9).

Recent accounting developments adopted by the Group
The following IFRS and EU-endorsed standards and amendments have become applicable and have been adopted for the first time in the current reporting period by the Group. The Group updated its accounting policies where applicable.

IFRS 15 Revenue from Contracts with Customers
The Group adopted IFRS 15 using the cumulative effect transitional method without using the practical expedients for modified contracts in IFRS 15.C5(c). This method would require an adjustment to the opening balance of equity in the period of adoption without having to restate comparative amounts. However, following the conclusion that the impact is not material, no adjustment will be required for the Group on implementation of IFRS 15 during the current reporting period.

We have not identified any contracts in total, or part contracts (in the form of performance obligations), where we would need to move from recognising revenue over time to recognising revenue at a point in time. The majority of QinetiQ's contracts are largely either long-term service contracts where the customer benefits from QinetiQ's performance throughout the contract, or they are long-term design, build and delivery contracts which are highly bespoke and have no alternative use to QinetiQ (and QinetiQ have a right to payment for work performed to date). Therefore, it remains appropriate to recognise revenue over time using an input-based methodology (cost-to-cost). Where IFRS 15 has required the disaggregation of contracts into distinct performance obligations, this does not materially alter the revenue recognised compared to the long-term percentage completion methodology previously applied.

IFRS 15 requires the recognition of an asset in respect of incremental costs of obtaining a contract with a customer where it is expected these costs will be recovered. We have determined that this has minimal impact to the Group, as even though many of our contracts are single-sourced, we do not typically incur qualifying incremental costs (including third party expenses) in securing those contracts that would be considered recoverable.

Following the adoption of IFRS 15 the Group has updated its accounting policies and note disclosures to reflect new terminology and components of the standard. The Group has disclosed the disaggregation of revenue from contracts with customers as required by IAS 34 (Interim Financial Reporting) and IFRS 15 in note 2. All other accounting policy changes will be included in the Annual Report for the year ending 31 March 2019 as the impact of these are not material during the current reporting period. The Group continues to recognise revenue and profit recognition as one of its critical accounting policies due to the skill, knowledge and experience required from a variety of sources within the business to assess the status of a contract. Judgement is required when considering the likelihood of meeting the contractual requirements, particularly around technologically challenging contracts, and the resulting costs.

IFRS 9 Financial Instruments
IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities, and introduces a new impairment model for financial assets, as well as new rules for hedge accounting. The new standard replaces IAS 39 in its entirety and is effective for annual periods beginning on or after 1 January 2018. The Group adopted IFRS 9 in the current reporting period without restating comparative period figures. All components of the standard, including new rules for hedge accounting and impairment, are applied prospectively.

Following the adoption of IFRS 9 the Group has updated its accounting policies to reflect new financial asset classification, measurement and recognition criteria. The Group assessed that certain financial assets will be reclassified from being measured at fair value through other comprehensive income to fair value through profit and loss and presented within finance income or expense. The changes to impairment and hedge accounting will not have a material impact on the results of the Group and these accounting policies have also been updated.

The adoption of IFRS 9 from 1 April 2018 for the Group resulted in changes in certain accounting policies, however no adjustments to comparative periods were required.

Classification and measurement
The Group has various classes of financial assets and liabilities which must be appropriately classified into the IFRS 9 classification categories from 1 April 2018.

Available for sale investments previously classified as fair value through other comprehensive income under IAS 39 no longer meet the criteria to be classified as such and have been classified as fair value through profit and loss under IFRS 9. Previously recognised gains in other comprehensive income have been reclassified to retained earnings on initial application being 1 April 2018.

Derivative financial instruments designated as cash flow hedges under IAS 39 in the prior period shall continue to be classified as such and continue to qualify for hedge accounting under IFRS 9.

Trade and other receivables previously classified as loans and receivables and measured at amortised cost under IAS 39 are now classified as amortised cost and measured at amortised costs under IFRS 9. Loans and receivables no longer exist as a classification category under IFRS 9.

Trade and other payables previously classified and measured at amortised cost under IAS 39 shall continue to be classified and measured at amortised costs under IFRS 9.

Impairment of financial assets
The Group's trade receivables are subject to the new expected credit loss model under IFRS 9. In determining the recoverability of trade receivables, the Group considers any change in the credit quality of each trade receivable from the date credit was granted to the reporting date using forward looking information. The Group assessed credit risk to be limited as a result of the high percentage of revenue derived from UK and US government agencies. For non-government customers the Group considers the expected credit loss to be immaterial to the financial statements.

Hedge accounting
The new hedge accounting rules under IFRS 9 have not had a material impact on the Group's financial statements

Developments expected in future periods of which the impact is being assessed

IFRS 16 Leases
IFRS 16 is effective 1 January 2019, replacing IAS 17 in its entirety. The Group will not early adopt the standard in the current reporting period. Under IFRS 16 the Group will recognise a right-of-use asset and a lease liability for future lease payments, bringing added transparency to the balance sheet. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Within the income statement, depreciation on the right-of-use asset and interest expense on the lease liability will replace lease expense. The Group had future operating lease commitments of £28.2m at 31 March 2018 and management therefore expect a material impact on the Group accounts once IFRS 16 becomes effective. Management are currently in the process of assessing the full impact and determining which transition method will be applied.

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. 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 at least the next 12 months.

Comparative data

The comparative figures for the year ended 31 March 2018 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 2018 have been 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 2018 are available upon request from the Company's registered office at Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX.

2. Disaggregation of revenue and segmental analysis

Revenue by category and other income

For the six months ended 30 September

All figures in £ million	**H1 2019 (unaudited)**	H1 2018 (unaudited)
Service contracts with customers	369.7	347.4
Sale of goods contracts with customers	44.3	38.4
Royalties and licences	6.3	6.7
Revenue	**420.3**	**392.5**
Other income		
Share of joint ventures' and associates' loss after tax	(0.2)	(0.4)
Other income	5.1	4.7
Other income – underlying	**4.9**	**4.3**
Gain on sale of assets	0.1	11.4
Total other income	**5.0**	**15.7**

Revenue by customer geographical location

For the six months ended 30 September

All figures in £ million	**H1 2019 (unaudited)**	H1 2018 (unaudited)
US	48.2	38.2
Australia	27.3	27.7
Europe	25.5	18.7
Middle East	8.5	3.1
Rest of World	20.2	13.6
International	**129.7**	**101.3**
United Kingdom	290.6	291.2
Total revenue	**420.3**	**392.5**
Adjust to constant prior year exchange rates	3.0	-
Total revenue on an organic, constant currency basis	**423.3**	**392.5**
Organic revenue growth at constant currency	*8%*	*3%*

Revenue by major customer type

For the six months ended 30 September

All figures in £ million	**H1 2019 (unaudited)**	H1 2018 (unaudited)
UK Government	258.9	259.1
US Government	39.5	33.7
Other	121.9	99.7
Total Revenue	**420.3**	**392.5**

'Other' does not contain any customers with revenue in excess of 10% of total Group revenue.

Operating segments

For the six months ended 30 September

All figures in £ million	**H1 2019 (unaudited)**		H1 2018 (unaudited)	
	Revenue from external customers	**Underlying operating profit***	Revenue from external customers	Underlying operating profit*
EMEA Services	319.9	40.9	311.6	47.3
Global Products	100.4	10.2	80.9	10.2
Total operating segments	**420.3**	**51.1**	**392.5**	**57.5**
*Underlying operating margin**		*12.2%*		*14.6%*

* Definitions of the Group's 'Alternative Performance Measures' can be found in the glossary.

Reconciliation of segmental results to total profit

For the six months ended 30 September

All figures in £ million	Note	**H1 2019 (unaudited)**	H1 2018 (unaudited)
Underlying operating profit		51.1	57.5
Specific adjusting items (loss)/profit	3	(3.8)	10.0
Operating profit		**47.3**	**67.5**
Gain on sale of investment		1.1	-
Net finance income		4.3	1.8
Profit before tax		**52.7**	**69.3**
Taxation expense		(2.6)	(5.2)
Profit for the year attributable to equity shareholders		**50.1**	**64.1**

3. 'Specific adjusting items'

In the income statement, the Group presents specific adjusting items separately. In the judgement 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. The following specific adjusting items have been (charged)/credited in the consolidated income statement:

All figures in £ million	Note	**H1 2019 (unaudited)**	H1 2018 (unaudited)
Gain on sale of property		0.1	5.2
Gain on sale of intellectual property		-	6.2
Acquisition costs		(0.2)	-
Specific adjusting items before amortisation, depreciation and impairment		**(0.1)**	**11.4**
Impairment of property		(2.6)	-
Amortisation of intangible assets arising from acquisition		(1.1)	(1.4)
Specific adjusting items operating (loss)/profit		**(3.8)**	**10.0**
Defined benefit pension scheme net finance income		4.1	2.1
Gain on sale of investment		1.1	-
Specific adjusting items profit before tax		**1.4**	**12.1**
Specific adjusting items - tax	5	2.9	0.9
Total specific adjusting items profit after tax		**4.3**	**13.0**

Reconciliation of underlying profit for the period to total profit for the period

All figures in £ million	**H1 2019 (unaudited)**	H1 2018 (unaudited)
Underlying profit after tax	45.8	51.1
Total specific adjusting items profit after tax (see above)	4.3	13.0
Total profit for the period attributable to equity shareholders	**50.1**	**64.1**

4. Finance income and expense

All figures in £ million	**H1 2019 (unaudited)**	H1 2018 (unaudited)
Receivable on bank deposits	0.7	0.3
Finance income before specific adjusting items	**0.7**	**0.3**
Amortisation of recapitalisation fee	(0.1)	(0.2)
Interest on bank loans and overdrafts	(0.4)	(0.3)
Unwinding of discount on financial liabilities	-	(0.1)
Finance expense before specific adjusting items	**(0.5)**	**(0.6)**
Underlying net finance income/(expense)	**0.2**	**(0.3)**
Specific adjusting items:		
Defined benefit pension scheme net finance income	4.1	2.1
Net finance income	**4.3**	**1.8**

5. Taxation

	H1 2019 (unaudited)			H1 2018 (unaudited)		
All figures in £ million	**Underlying**	**Specific adjusting items**	**Total**	Underlying	Specific adjusting items	Total
Profit before tax	**51.3**	**1.4**	**52.7**	**57.2**	**12.1**	**69.3**
Taxation (expense)/income	(5.5)	2.9	(2.6)	(6.1)	0.9	(5.2)
Profit for the period attributable to equity shareholders	**45.8**	**4.3**	**50.1**	**51.1**	**13.0**	**64.1**
Effective tax rate	**10.7%**			**10.7%**		

The total tax charge is £2.6m (H1 2018: £5.2m). The underlying tax charge of £5.5m (H1 2018: £6.1m) is calculated by applying the expected effective tax rate of 10.7% for the year ending 31 March 2019 to the Group's underlying profit before tax for the six months to 30 September 2018 (H1 2018: 10.7%). 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 which are accounted under IAS12 within the tax line. 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 recognition of unrecognised tax losses and while the benefit of net RDEC retained by the Group remains in the tax line.

Tax losses and specific adjusting items
At 30 September 2018 the Group had unused tax losses and surplus interest costs of £123.7m which are available for offset against future profits. A deferred tax asset of £4.7m is recognised in respect of £18.3m of US net operating losses and £6.0m of UK losses. No deferred tax asset is recognised in respect of the remaining £99.4m of losses/interest costs due to uncertainty over the timing and extent of their utilisation. The Group has £64.6m of time-limited losses of which US capital losses of £28.2m will expire in 2020 and US net operating losses of £5.7m will expire in 2034, £21.9m in 2035 and £8.8m in 2036. Deferred tax has been calculated using the enacted future statutory tax rates.

A £2.8m credit in respect of initial recognition of corporate tax deductions for certain equity-settled share based payment schemes has been classified as a specific adjusting item. Together with a £0.1m tax effect of the pre-tax specific adjusting items, the total specific adjusting items tax credit was £2.9m (H1 2018: £0.9m).

Current tax liability
The current tax liability is £0.2m as at 30 September 2018 (31 March 2018: £8.9m).

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.

		H1 2019 (unaudited)	H1 2018 (unaudited)
Weighted average number of shares	**Million**	**565.7**	**564.9**
Effect of dilutive securities	Million	2.7	2.1
Diluted number of shares	**Million**	**568.4**	**567.0**

Underlying basic earnings per share figures are presented below, in addition to the basic and diluted earnings per share, because 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 (see note 3) and tax thereon.

Underlying EPS		H1 2019 (unaudited)	H1 2018 (unaudited)
Profit attributable to equity shareholders	£ million	50.1	64.1
Remove profit after tax in respect of specific adjusting items	£ million	(4.3)	(13.0)
Underlying profit after taxation	**£ million**	**45.8**	**51.1**
Weighted average number of shares	Million	565.7	564.9
Underlying basic EPS	**Pence**	**8.1**	**9.0**
Diluted number of shares	Million	568.4	567.0
Underlying diluted EPS	**Pence**	**8.1**	**9.0**

Basic and diluted EPS		H1 2019 (unaudited)	H1 2018 (unaudited)
Profit attributable to equity shareholders	£ million	50.1	64.1
Weighted average number of shares	Million	565.7	564.9
Basic EPS – total Group	**Pence**	**8.9**	**11.3**
Diluted number of shares	Million	568.4	567.0
Diluted EPS – total Group	**Pence**	**8.8**	**11.3**

7. Net cash

All figures in £ million	30 September 2018 (unaudited)	30 September 2017 (unaudited)	31 March 2018 (audited)
Current financial assets/(liabilities)			
Available-for-sale investment	-	15.6	15.7
Deferred financing costs	-	0.3	0.1
Derivative financial assets	-	0.2	1.1
Derivative financial liabilities	(1.6)	(1.7)	(2.6)
Total current net financial (liabilities)/assets	(1.6)	14.4	14.3
Non-current financial assets/(liabilities)			
Derivative financial assets	-	-	0.3
Derivative financial liabilities	(0.3)	(0.8)	(1.9)
Total non-current net financial liabilities	(0.3)	(0.8)	(1.6)
Total financial (liabilities)/assets (net)	**(1.9)**	**13.6**	**12.7**
Cash and cash equivalents	251.0	181.1	254.1
Total net cash as defined by the Group	**249.1**	**194.7**	**266.8**

8. Cash flows from operations

All figures in £ million	H1 2019 (unaudited)	H1 2018 (unaudited)	Year ended 31 March 2018 (audited)
Profit after tax for the period	50.1	64.1	138.1
Adjustments for:			
Taxation expense	2.6	5.2	6.7
Net finance income	(4.3)	(1.8)	(3.8)
Gain on sale of intellectual property	-	(6.2)	-
Gain on sale of investment	(1.1)	-	(0.6)
Gain on sale of property	(0.1)	(5.2)	(14.6)
Impairment of property	2.6	-	-
Transaction costs in respect of acquisition of business	0.2	-	-
Amortisation of purchased or internally developed intangible assets	1.5	1.8	3.7
Amortisation of intangible assets arising from acquisitions	1.1	1.4	2.6
Depreciation of property, plant and equipment	13.3	11.7	25.6
Loss on disposal of plant and equipment	0.9	0.1	2.9
Share of post-tax loss/(profit) of equity accounted entities	0.2	0.4	(0.3)
Share-based payments charge	2.4	1.3	2.4
Retirement benefit contributions in excess of income statement	(2.3)	(7.5)	(12.4)
Net movement in provisions	2.3	(3.4)	(3.7)
Increase in inventories	(0.3)	(6.4)	(10.8)
Decrease in receivables	5.4	7.8	19.0
Decrease in payables	(23.6)	(27.6)	(22.4)
Changes in working capital	(18.5)	(26.2)	(14.2)
Net cash inflow from operations	**50.9**	**35.7**	**132.4**

Reconciliation of net cash flow from operations to underlying net cash flow from operations to free cash flow

All figures in £ million	H1 2019 (unaudited)	H1 2018 (unaudited)	Year ended 31 March 2018 (audited)
Net cash flow from operations	50.9	35.7	132.4
Less: specific adjusting item: proceeds from sale of intellectual property	-	-	(5.9)
Underlying net cash flow from operations	**50.9**	**35.7**	**126.5**
Less: tax and net interest payments	(4.5)	(12.5)	(15.7)
Less: purchases of intangible assets and property, plant & equipment	(48.3)	(31.0)	(54.5)
Free cash flow	**(1.9)**	**(7.8)**	**56.3**

Underlying cash conversion ratio

	H1 2019 (unaudited)	H1 2018 (unaudited)	Year ended 31 March 2018 (audited)
Underlying operating profit - £ million	51.1	57.5	122.5
Underlying net cash flow from operations - £ million	50.9	35.7	126.5
Underlying cash conversion ratio - %	**100%**	**62%**	**103%**

9. 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 2018. 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 2018, are as follows:

all figures in £ million	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Available for sale investment	-	-	-	-
Liabilities:				
Current derivative financial instruments	-	(1.6)	-	(1.6)
Non-current derivative financial instruments	-	(0.3)	-	(0.3)
Total	**-**	**(1.9)**	**-**	**(1.9)**

The following table presents the Group's assets and liabilities that are measured at fair value as at 31 March 2018:

all figures in £ million	Level 1	Level 2	Level 3	Total
Assets:				
Available for sale investments	15.7	-	-	15.7
Current other investments	0.7	-	-	0.7
Current derivative financial instruments	-	1.1	-	1.1
Non-current derivative financial instruments	-	0.3	-	0.3
Liabilities:				
Current derivative financial instruments	-	(2.6)	-	(2.6)
Non-current derivative financial instruments	-	(1.9)	-	(1.9)
Total	**16.4**	**(3.1)**	**-**	**13.3**

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.

10. Dividends

An analysis of the dividends paid and proposed in respect of the period ended 30 September 2018 and comparative periods is provided below:

	Pence per ordinary share	**£m**	**Date paid/payable**
Interim 2019	**2.1**	**11.9**	**Feb 2019**
Interim 2018	2.1	11.9	Feb 2018
Final 2018	4.2	23.8	Sep 2018
Total for the year ended 31 March 2018	6.3	35.7	

The interim dividend is 2.1p (interim 2018: 2.1p). The dividend will be paid on 8 February 2019. The ex-dividend date is 10 January 2019 and the record date is 11 January 2019.

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 2018 (unaudited)	30 September 2017 (unaudited)	31 March 2018 (audited)
Equities – quoted	127.7	233.7	115.8
Equities – unquoted	60.5	67.8	58.9
Liability Driven Investment	969.7	920.5	1,050.9
Corporate bonds	308.9	327.1	311.3
Alternative bonds - quoted	201.8	136.8	197.9
Alternative bonds - unquoted	78.4	10.0	35.0
Property funds	144.9	131.3	138.7
Cash and other equivalents	75.9	86.1	80.2
Derivatives	(0.9)	-	1.8
Total market value of scheme assets	**1,966.9**	**1,913.3**	**1,990.5**
Present value of scheme liabilities	(1,613.1)	(1,665.6)	(1,674.3)
Net pension asset before deferred tax	**353.8**	**247.7**	**316.2**
Deferred tax liability	(64.9)	(47.0)	(58.6)
Net pension asset after deferred tax	**288.9**	**200.7**	**257.6**

Changes to the net pension asset

all figures in £ million	30 September 2018 (unaudited)	30 September 2017 (unaudited)	31 March 2018 (audited)
Opening net pension asset before deferred tax	316.2	156.0	156.0
Net finance income	4.1	2.1	4.2
Net actuarial gain	31.2	82.1	143.6
Contributions by the employer	2.7	7.9	13.4
Administration expenses	(0.4)	(0.4)	(1.0)
Closing net pension asset before deferred tax	**353.8**	**247.7**	**316.2**

Assumptions
The major assumptions used in the IAS 19 valuations of the scheme were:

	30 September 2018 (unaudited)	30 September 2017 (unaudited)	31 March 2018 (audited)
Discount rate applied to scheme liabilities	2.90%	2.70%	2.60%
CPI inflation assumption	2.35%	2.35%	2.25%
Assumed life expectancies in years:			
Future male pensioners (currently aged 60)	88	88	88
Future female pensioners (currently aged 60)	90	90	90
Future male pensioners (currently aged 40)	90	90	90
Future female pensioners (currently aged 40)	92	92	92

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

Key assumptions	**Change in assumption**	**Indicative impact on Scheme liabilities**	**Indicative impact on net pension asset**
Discount rate	Increase by 0.1%	Decrease by £30m	Decrease by £15m
Rate of inflation	Increase by 0.1%	Increase by £28m	Increase by £12m
Life expectancy	Increase by one year	Increase by £45m	Decrease by £45m

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 2018 this hedges against approximately 93% 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 £139.7m as at 30 June 2017. 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 IAS 19 accounting basis valuation uses corporate bond yields as the base.

Per the Scheme rules, the Company has an unconditional right to a refund of any surplus that may arise on cessation of the Scheme in the context of IFRIC 14 paragraphs 11(b) and 12 and therefore the full net pension asset can be recognised on the Group's balance sheet and the Group's minimum funding commitments to the Scheme do not give rise to an additional balance sheet liability.

The High Court recently (post period end) ruled on a case involving Lloyds Banking Group in respect of equalising (between men and woman) Guaranteed Minimum Pensions ('GMPs'). QinetiQ's pension scheme will be impacted by this court ruling (which may still be appealed). A detailed assessment has not yet been completed to quantify the impact for QinetiQ but it is anticipated to increase liabilities (and hence reduce the net surplus) by approximately 1-4% of the Scheme's gross liabilities.

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. Included in retained earnings at 30 September 2018 are 6,992,836 shares (31 March 2018: 7,934,634 shares).

In the six months to 30 September 2018 the Group granted/awarded 0.1 million new share-based awards to employees (30 September 2017: 0.1 million).

13. Related party transactions with equity accounted investments

During the period there were sales to associates and joint ventures of £6.3m (30 September 2017: £3.2m). At the period end there were outstanding receivables from associates and joint ventures of £5.3m (30 September 2017: £0.9m).

14. Capital commitments

The Group has the following capital commitments for which no provision has been made:

all figures in £ million	**30 September 2018 (unaudited)**	31 March 2018 (audited)
Contracted	32.1	76.2

Capital commitments at 30 September 2018 include £29.5m (31 March 2018: £74.3m) in relation to property, plant and equipment that will be wholly funded by a third party customer under a long-term contract arrangements. These primarily relate to investments under the LTPA contract.

15. Post balance sheet events

E.I.S Aircraft Operations (EIS)
QinetiQ has completed its acquisition of 100% of the share capital of EIS in October 2018 for €70m on a cash-free, debt-free basis. EIS is a leading provider of airborne training services based in Germany, delivering threat-representation and operational readiness for military customer. EIS has natural synergies with QinetiQ's existing air engineering, test aircrew training and unmanned target service capabilities which we will exploit to strengthen our position in defence operational training. EIS will continue to be led by its existing management team and will form part of QinetiQ's International business unit and will be reported within QinetiQ's EMEA Services division.

Inzpire Group Limited (Inzpire)
In October 2018 QinetiQ acquired 85% of the shares of Inzpire Group Limited with an arrangement to acquire the remaining 15% after two years for a total consideration of £23.5m. Inzpire is a highly regarded provider of training services to the Royal Airforce and British Army and the investment further enhances our capability in defence operational training. With a leading position within the UK, the investment allows us to further leverage the capability in attractive markets internationally, complementing our acquisitions of QTS and EIS and supporting our strategic objectives.

Following completion, Inzpire will continue to be led by its existing management team. It will be aligned to QinetiQ's CIT business unit and will be reported within QinetiQ's EMEA Services division.

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 2018.

By order of the Board

Mark Elliott
Chairman
15 November 2018

Steve Wadey
Chief Executive Officer
15 November 2018

David Smith
Chief Financial Officer
15 November 2018

Independent review report to QinetiQ Group plc

Report on the Condensed consolidated interim financial statements

Our conclusion

We have reviewed QinetiQ Group plc's Condensed consolidated interim financial statements (the "interim financial statements") in the interim results of QinetiQ Group plc for the 6 month period ended 30 September 2018. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

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What we have reviewed

The interim financial statements comprise:

- the Condensed consolidated balance sheet as at 30 September 2018;
- the Condensed consolidated income statement and Condensed consolidated statement of comprehensive income for the period then ended;
- the Condensed consolidated cash flow statement for the period then ended;
- the Condensed consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the interim results have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The interim results, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim results in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the interim results based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What a review of interim financial statements involves

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 United Kingdom. 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, 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.

We have read the other information contained in the interim results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
Southampton
15 November 2018

Glossary

C4ISR	Command, control, communications, computers, intelligence, surveillance and reconnaissance
CPI	Consumer Price Index
EBITDA	Earnings before interest, tax, depreciation and amortisation
EPS	Earnings per share
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
LTPA	Long Term Partnering Agreement: A 25-year contract (re-priced every five years) established in 2003 to manage the MOD's test and evaluation ranges. In December 2016 an amendment was signed that secured approximately half of the core LTPA revenue until 2028 (without further re-pricing). For the remaining scope of the LTPA our objective is to secure an extension to 2028 with a similar level of investment and recovery mechanism to the December 2016 amendment.
MOD	UK Ministry of Defence
SSRO	Single Source Regulations Office
T&E	Test and evaluation

Alternative performance measures ('APMs')

The Group uses various non-statutory measures of performance, or APMs. Such APMs are used by management internally to monitor and manage the Group's performance and also allow the reader to obtain a proper understanding of performance (in conjunction with statutory financial measures of performance). The APMs used by QinetiQ are set out below:

Measure	**Explanation**	**Note reference to calculation or reconciliation to statutory measure**
Organic growth	The level of year-on-year growth, expressed as a percentage, calculated at constant prior year foreign exchange rates, adjusting for business acquisitions and disposals to reflect equivalent composition of the Group	Note 2
Underlying operating profit	Operating profit as adjusted to exclude 'specific adjusting items'	Note 2
Underlying operating margin	Underlying operating profit expressed as a percentage of revenue	Note 2
Underlying net finance income/expense	Net finance income/expense as adjusted to exclude 'specific adjusting items'	Note 4
Underlying profit before/after tax	Profit before/after tax as adjusted to exclude 'specific adjusting items'	Note 3
Underlying effective tax rate	The tax charge for the year excluding the tax impact of 'specific adjusting items' expressed as a percentage of underlying profit before tax	Note 5
Underlying basic and diluted EPS	Basic and diluted earnings per share as adjusted to exclude 'specific adjusting items'	Note 6
Specific adjusting items	Amortisation of intangible assets arising from acquisitions; impairment of goodwill and intangible assets; property impairment; gains/losses on business divestments and disposal of property, investments and intellectual property; net pension finance income/expense; tax impact of the preceding items; and significant non-recurring tax movements	Note 3
Orders	The level of new orders (and amendments to existing orders) booked in the year. Includes share of orders won by joint ventures	N/A
Backlog, funded backlog or order book	The expected future value of revenue from contractually committed and funded customer orders	N/A
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 due to significant size and timing differences of LTPA order and revenue recognition which may distort the ratio calculation.	N/A
Net cash	Net cash as defined by the Group combines cash and cash equivalents with other financial assets and liabilities, primarily available for sale investments and derivative financial instruments.	Note 7
Underlying net cash flow from operations	Net cash flow from operations before cash flows of specific adjusting items	Note 8
Underlying operating cash conversion	The ratio of underlying net cash flow from operations to underlying operating profit	Note 8
Free cash flow	Underlying net cash flow from operations less net tax and interest payments less purchases of intangible assets and property, plant and equipment	Note 8