



Half-yearly
Report
2017

BAE Systems plc

Half-yearly Report 2017

Results in brief

Financial performance measures as defined by the Group¹

	Six months ended 30 June 2017	Six months ended 30 June 2016	Year ended 31 December 2016
Sales	£9,565m	£8,714m	£19,020m
Underlying EBITA	£945m	£849m	£1,905m
Underlying earnings per share	19.8p	17.4p	40.3p
Operating business cash flow	£277m	£(20)m	£1,004m
Net debt	£(1,741)m	£(2,036)m	£(1,542)m
Order intake	£10,650m	£7,053m	£22,443m
Order backlog	£42.3bn	£36.3bn	£42.0bn

Other financial highlights

	Six months ended 30 June 2017	Six months ended 30 June 2016	Year ended 31 December 2016
Group's share of the net pension deficit	£(5.9)bn	£(6.1)bn	£(6.1)bn
Dividend per share	8.8p ⁴	8.6p	21.3p

Financial performance measures defined in IFRS²

	Six months ended 30 June 2017	Six months ended 30 June 2016	Year ended 31 December 2016
Revenue	£9,012m	£8,278m	£17,790m
Operating profit	£865m	£776m	£1,742m
Basic earnings per share	17.5p	12.9p	28.8p
Net cash flow from operating activities	£341m	£77m ³	£1,229m

Charles Woodburn, Chief Executive, said: "BAE Systems' performance in the first half was consistent with our expectations and guidance for the year. We have a sound platform for medium-term growth underpinned by a clear and consistent strategy. Strong programme execution, technology and enhanced competitive positions will be key in driving the business forward, and we will continue to focus on efficiency and meeting our customers' affordability challenges. With the expected improvement in the defence budget outlook in a number of our markets, the Group is well placed to continue to generate good returns for shareholders."

Financial highlights

Financial performance measures as defined by the Group¹

- Sales increased to £9.6bn, up 4% on a constant currency basis⁵.
- Underlying EBITA increased by 11% to £945m, or 5% on a constant currency basis⁵.
- Underlying earnings per share increased by 14% to 19.8p.
- Operating business cash flow of £277m.
- Net debt of £1.7bn.
- Order intake increased by £3.6bn to £10.7bn and includes award of a production contract for the initial batch of three Type 26 frigates.
- Order backlog increased to £42.3bn after adverse exchange translation of £0.4bn.

Financial performance measures defined in IFRS²

- Revenue increased to £9.0bn, up 3% on a constant currency basis⁵.
- Operating profit increased by 11% to £865m, or 5% on a constant currency basis⁵.
- Basic earnings per share increased by 36% to 17.5p.
- Net cash flow from operating activities of £341m.

Other financial highlights

- Group's share of the pre-tax accounting net pension deficit reduced to £5.9bn (31 December 2016 £6.1bn).
- Interim dividend increased by 2% to 8.8p per share.

1. We monitor the underlying financial performance of the Group using alternative performance measures. These measures are not defined in International Financial Reporting Standards (IFRS) and, therefore, are considered to be non-GAAP (Generally Accepted Accounting Principles) measures. Accordingly, the relevant IFRS measures are also presented where appropriate. For alternative performance measure definitions see glossary on page 7.

2. International Financial Reporting Standards.

3. Re-presented to reclassify interest paid from operating to financing activities.

4. Interim dividend declared (see note 6).

5. Current period compared with prior period translated at current period exchange rates.

Operational and strategic highlights

- The full £3.7bn production contract for the initial batch of three Type 26 frigates was signed in June, with order intake of £2.8bn in the period.
- Received the full £1.4bn contract for the sixth Astute Class submarine from the Royal Navy in March and, in April, the fourth Astute boat, Audacious, was launched.
- Secured a \$542m (£417m) contract in January to provide 145 M777 ultra-lightweight howitzers to India.
- The first two Typhoon aircraft for Oman arrived in the Sultanate of Oman in June.
- Final four aircraft delivered on the Salam Typhoon programme.
- Typhoon support contracts in Saudi Arabia meeting contractual requirements.
- Secured further awards for APKWS™ laser-guided rockets worth \$240m (£185m).
- Following operational certification in February, the new San Diego dry dock accepted its first docking. The US ship repair business received orders of \$511m (£393m) in the first half of 2017.
- In February, the acquisition of IAP Research, Inc. was completed. This technology insertion enhances our position in advanced weapon systems, such as the electromagnetic railgun.
- In June, selected as the preferred tenderer for the Jindalee Operational Radar Network upgrade programme in Australia.
- In July, the UK High Court ruled that the UK government has been acting lawfully in granting defence export licences to the Kingdom of Saudi Arabia.

Guidance for 2017

In aggregate, we expect the Group's underlying earnings per share for 2017 to be 5% to 10% higher than full-year underlying earnings per share in 2016 of 40.3p.

This outlook remains unchanged despite moving the US\$ planning rate for the year from \$1.25 to \$1.28.

Whilst there is no change to the Group-level earnings guidance, some softening in the top line of, and an anticipated second-half restructuring charge in, Cyber & Intelligence (comprising the US Intelligence & Security sector and Applied Intelligence) are expected to be offset across the rest of the business. We expect the Applied Intelligence business to be close to an underlying break-even position by the year end excluding the anticipated restructuring charge.

In 2017, we continue to expect a small reduction in net debt compared with 31 December 2016.

This guidance is based on the measures used to monitor the underlying financial performance of the Group. Reconciliations from these measures to the financial performance measures defined in International Financial Reporting Standards for the six months ended 30 June 2017 are provided on pages 8 to 11.

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Analyst and investor presentation

A presentation, for analysts and investors, of the Group's first half results for 2017 will be available via webcast at 9.00am today (2 August 2017).

Details can be found on investors.baesystems.com, together with presentation slides and a pdf copy of this report. A recording of the webcast will be available for replay later in the day.

About BAE Systems

At BAE Systems, our advanced defence technology protects people and national security, and keeps critical information and infrastructure secure. We search for new ways to provide our customers with a competitive edge across the air, maritime, land and cyber domains. We employ a skilled workforce of 83,500 people¹ in over 40 countries, and work closely with local partners to support economic development by transferring knowledge, skills and technology.

1. Including share of equity accounted investments.

Interim management report

In the first half of 2017, BAE Systems delivered a solid performance consistent with our expectations and guidance for the year. We continue to take the actions necessary to address costs and to meet our customers' affordability challenges. Despite economic and political uncertainties, governments in our major markets continue to prioritise defence and security, with strong demand for our capabilities. We continue to invest in our business, our people and in the technology and skills we need to drive the business forward. With an improving outlook for defence budgets in a number of our markets, we are well placed to continue to generate good returns for shareholders.

US

The US Department of Defense fiscal year 2017 budget and 2018 budget proposal support the medium-term planning assumptions for our US businesses as we see the ramp up of production on a number of our long-term programmes.

Our US electronics business has strong franchise positions in the high-technology areas of electronic warfare, electro-optics and Intelligence, Surveillance and Reconnaissance. As the electronic warfare system supplier on the F-35 Lightning II combat aircraft programme, we are increasing production and are also well positioned to meet increases in production output over the coming years to meet the requirements of US and international customers.

The Eagle Passive Active Warning Survivability System electronic warfare upgrade for US Air Force F-15 aircraft is progressing through its engineering and manufacturing development phase. The Advanced Precision Kill Weapon System (APKWS™) laser-guided rocket is increasing production under the extant US Navy contract to meet growing demand from domestic and international customers.

The Group's US-based combat vehicles business is underpinned by the Armored Multi-Purpose Vehicle, M109A7 self-propelled howitzer and Bradley upgrade programmes. The business is also experiencing US and international demand on amphibious programmes. All 16 prototypes have been delivered to the US Marine corps under the Amphibious Combat Vehicle 1.1 programme. We are one of two competitors for this programme, with down-selection expected in 2018.

The contract for M777 howitzers to India under a Foreign Military Sale was signed in January. The first two guns have been shipped and are progressing through in-country testing. FNSS, the Turkish land systems business in which BAE Systems holds a 49% interest, continued to win business and holds an order book of \$1.1bn (£0.8bn) at 30 June.

One of the final two commercial ships is nearing completion and being marketed for sale following the original customer's decision not to purchase the vessel. Construction of the final ship is planned to be completed in the second half of the year. The US business has not contracted for any more commercial ship-build.

BAE Systems is the leading supplier of ship repair services to the US Navy and continues to adjust its workforce and facilities to meet evolving demand. Additional dry dock capacity at our San Diego shipyard became operational in February.

Whilst market conditions remain highly competitive and continue to evolve, our US-based Intelligence & Security business is focused on delivering on its contracts and maintaining a high level of bid activity. The implementation of additional IT services for customers in the intelligence community has been deferred to the second half of the year due to a delay in the acceptance of an intelligence community programme.

UK

The result of the UK general election on 8 June has given rise to the formation of a minority government, but one for which defence and security is expected to remain a priority. Negotiations on the terms of the UK's exit from the EU will provide greater clarity as to the economic outlook in the medium term.

In the air domain, Typhoon aircraft deliveries for the Royal Air Force continued alongside airframe sub-assembly deliveries to European partner nations and work under the Kuwaiti Air Force subcontract. The first two aircraft deliveries under the Oman Typhoon programme were achieved, with the

remaining deliveries scheduled for the second half of 2017 and 2018. The first two Hawk trainer aircraft for the Omani Royal Air Force have completed manufacture, with delivery of all eight aircraft scheduled for the second half of 2017.

Discussions with current and prospective operators of the Typhoon aircraft continue to support the Group's expectations for additional Typhoon contract awards. However, there can be no certainty as to the timing of these orders and, in any event, any new orders are unlikely to positively impact production delivery rates for at least 24 months. The balance of customer demand for aircraft and production rates will be under constant review with adjustments made as appropriate.

Typhoon's capabilities continue to be enhanced. Work on the integration of Storm Shadow, Meteor and Brimstone 2 missiles is progressing and this furthers development towards the Royal Air Force Centurion standard, which will enable transition of capability from Tornado to Typhoon as the UK Tornado fleet is scheduled to come out of service at the end of the decade. The Captor E-scan radar integration also continues.

UK-based production of rear fuselage assemblies for the F-35 Lightning II aircraft is increasing, with most of the advanced manufacturing investment in place to achieve the planned production volumes.

Unmanned air systems activity benefited from the announcement in 2016 by the UK and French governments of a new €2bn (£1.8bn) project to build an unmanned combat air system demonstrator following a successful joint study phase. The feasibility and definition phase is under way, and a proposal for the first phase of the demonstrator programme was submitted in March. Funding of £16m has been received to date.

In the maritime domain, there remains pressure on the Navy's near-term budgets. Submarine activity is increasing with the Astute and Dreadnought class submarines now both in production and major redevelopment of the Barrow, UK, site to deliver the Dreadnought programme under way. The first three Astute Class submarines are in operational service with the Royal Navy and the fourth, Audacious, was launched in April, with the remaining three in build.

The full £3.7bn production contract for the first batch of three Type 26 frigates was signed in June, with order intake of £2.8bn in the period after order intake in previous periods for long-lead items. The cut steel ceremony was held in July.

On the Queen Elizabeth Class aircraft carrier programme, assembly of the second ship is well under way and, in June, sea trials commenced on the first of the two ships. Activity to prepare the support solution in advance of the arrival of HMS Queen Elizabeth at HM Naval Base, Portsmouth, is continuing.

On the River Class Offshore Patrol Vessels for the Royal Navy, revised delivery dates have been agreed with the Ministry of Defence and the first vessel, HMS Forth, will commence sea trials in the third quarter. All five ships are now in build.

International

In Saudi Arabia, BAE Systems continues to address current and potential new requirements as part of long-standing agreements between the UK government and the Kingdom. Our In-Kingdom Industrial Participation programme also continues apace.

On the Salam Typhoon programme, the final four of the contracted 72 aircraft have been delivered. Deliveries continue under the Hawk training aircraft contracts for 44 aircraft. The Royal Saudi Air Force has achieved high utilisation and aircraft availability across its Typhoon, Tornado and training aircraft fleets.

In Australia, the business is underpinned by long-term support contracts. Following the announcement in 2016 that we were one of two down-selected on the Land 400 Phase 2 Combat Reconnaissance Vehicle programme, vehicle evaluation and testing is under way. In June, we were selected as the preferred tenderer for the Jindalee Operational Radar Network upgrade programme.

The MBDA joint venture has continued to win orders and, with its order book, forecasts sales growth over the medium term.

In India, BAE Systems has a long-standing relationship with Hindustan Aeronautics Limited (HAL) and an order for a third batch of HAL-built Hawk aircraft for the Indian Air Force remains under discussion.

Cyber security

Applied Intelligence achieved double-digit sales growth in the period. Following a review of market priorities and our competitive position, an increasingly focused investment programme in engineering capabilities and product development, in particular in our commercial cyber business, will support the future growth profile for the business. In the first half of the year, Applied Intelligence made a loss of £27m, but the business is expected to be close to an underlying break-even position across the year excluding an anticipated restructuring charge.

Sales growth is expected to continue, as cyber security is an increasingly important part of government security and a core element of stewardship for commercial enterprises in a sophisticated and persistent threat environment.

Balance sheet and capital allocation

The Group's balance sheet is managed conservatively in line with its policy to retain its investment grade credit rating and to ensure operating flexibility. Consistent with this approach, the Group expects to continue to meet its pension obligations, invest in research and technology and other organic investment opportunities, and plans to pay dividends in line with its policy of long-term sustainable cover of around two times underlying earnings. Investment in value-enhancing acquisitions will be considered where market conditions are right and where they deliver on the Group's strategy.

Pension schemes

The Group's share of the pre-tax accounting net pension deficit reduced to £5.9bn (31 December 2016 £6.1bn).

The UK triennial funding reviews commenced in April and, in conjunction with the trustees of the schemes and other stakeholders, we are currently in the process of agreeing the various technical provisions which form the basis of calculating the funding deficit. Once the deficit and the future investment strategy have been agreed, we will then enter into discussions as to the deficit funding arrangements. We aim to complete these by the end of the year and we have already engaged with the UK Pensions Regulator as we move through this process.

Research and technology

BAE Systems has developed some of the world's most innovative technologies and invests in research and development to generate future products and capabilities. We embrace disruptive technology, drive innovation and invest appropriately in research and development both on a self-funded basis and in conjunction with our customers, universities, and small and medium-sized enterprises. Company-funded research and development often leads to customer-funded development activity as requirements mature, with spend focused in areas such as defence and commercial electronics, military aircraft, precision weapons and cyber security.

Summary

Our business benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia. Our strategy is clear and well defined with governments in our major markets continuing to prioritise defence and security, with strong demand for our capabilities. As the overall business environment in our major markets improves and through execution of our strategy, we are well placed to maximise opportunities, deal with the challenges and continue to generate good shareholder returns.

Directors and the Board

With effect from 1 July, Charles Woodburn succeeded Ian King as Chief Executive. Ian King retired from the Company at the end of June having served for over 40 years, including leading BAE Systems as Chief Executive since 2008.

Dividend

The Board has declared a 2% increase in the interim dividend to 8.8p for the half year to 30 June 2017.

Glossary

We monitor the underlying financial performance of the Group using alternative performance measures. These measures are not defined in International Financial Reporting Standards (IFRS) and, therefore, are considered to be non-GAAP (Generally Accepted Accounting Principles) measures. Accordingly, the relevant IFRS measures are also presented where appropriate.

	Definition	Purpose
Financial performance measures as defined by the Group		
Sales	Revenue including the Group's share of revenue of equity accounted investments.	Allows management to monitor the sales performance of subsidiaries and equity accounted investments.
Underlying EBITA	Profit for the period before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items*.	Provides a measure of operating profitability that is comparable over time.
Underlying earnings per share	Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items*.	Provides a measure of underlying performance that is comparable over time.
Operating business cash flow	Net cash flow from operating activities excluding taxation after net capital expenditure, financial investment and dividends from equity accounted investments.	Allows management to monitor the operating cash generation of the Group.
Net debt	Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments).	Allows management to monitor the indebtedness of the Group.
Order intake	Funded orders received from customers including the Group's share of order intake of equity accounted investments.	Allows management to monitor the order intake of subsidiaries and equity accounted investments.
Order backlog	Funded and unfunded unexecuted customer orders including the Group's share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.	Supports future years' sales performance of subsidiaries and equity accounted investments.
Financial performance measures defined in IFRS		
Revenue	Income derived from the provision of goods and services by the Company and its subsidiary undertakings.	N/a
Operating profit	Profit for the period before finance costs and taxation expense. This measure includes finance costs and taxation expense of equity accounted investments.	N/a
Basic earnings per share	Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.	N/a
Net cash flow from operating activities	Net cash flow from operating activities in accordance with International Accounting Standard 7, Statement of Cash Flows.	N/a
Other financial measures		
Net pension deficit	Net International Accounting Standard 19, Employee Benefits, deficit excluding amounts allocated to equity accounted investments.	N/a
Dividend per share	Interim dividend paid and final dividend proposed per share.	N/a

* Items that are relevant to an understanding of the Group's performance with reference to their materiality and nature (see page 10).

Financial performance

Income statement

	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Financial performance measures as defined by the Group¹		
Sales	9,565	8,714
Underlying EBITA	945	849
Return on sales	9.9%	9.7%
Financial performance measures defined in IFRS²		
Revenue	9,012	8,278
Operating profit	865	776
Return on revenue	9.6%	9.4%
Reconciliation of sales to revenue		
Sales	9,565	8,714
<i>Deduct</i> Share of sales by equity accounted investments	(1,155)	(996)
<i>Add</i> Sales to equity accounted investments	602	560
Revenue	9,012	8,278
Reconciliation of underlying EBITA to operating profit		
Underlying EBITA	945	849
Non-recurring items	(4)	–
Amortisation of intangible assets	(41)	(43)
Financial expense of equity accounted investments	(26)	(15)
Taxation expense of equity accounted investments	(9)	(15)
Operating profit	865	776
Net finance costs	(151)	(248)
Taxation expense	(155)	(110)
Profit for the period	559	418

Segmental analysis

Financial performance measures as defined by the Group¹

	Sales		Underlying EBITA	
	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Electronic Systems	1,726	1,443	257	209
Cyber & Intelligence	923	833	35	18
Platforms & Services (US)	1,433	1,287	109	86
Platforms & Services (UK)	3,913	3,664	416	414
Platforms & Services (International)	1,771	1,739	176	158
HQ	128	104	(48)	(36)
Deduct Intra-group	(329)	(356)	–	–
	9,565	8,714	945	849

Financial performance measures defined in IFRS²

	Revenue		Operating profit/(loss)	
	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Electronic Systems	1,726	1,443	247	200
Cyber & Intelligence	923	833	20	–
Platforms & Services (US)	1,400	1,244	99	79
Platforms & Services (UK)	3,864	3,621	406	394
Platforms & Services (International)	1,381	1,449	161	146
HQ	–	–	(68)	(43)
Deduct Intra-group	(282)	(312)	–	–
	9,012	8,278	865	776

Exchange rates

	Six months ended 30 June 2017	Six months ended 30 June 2016
Average		
£/\$	1.259	1.433
£/€	1.162	1.283
£/A\$	1.669	1.954
Period end	30 June 2017	30 June 2016
£/\$	1.299	1.337
£/€	1.139	1.205
£/A\$	1.693	1.796
Year end		31 December 2016
£/\$		1.236
£/€		1.172
£/A\$		1.707
Sensitivity analysis		£m
Estimated impact on annual sales of a ten cent movement in the average exchange rate:		
\$		600
€		80
A\$		35

Sales in the first half increased to £9.6bn (2016 £8.7bn), up 4% on a constant currency basis³. Some second half bias in sales is expected this year.

Underlying EBITA was £945m (2016 £849m), 11% up on last year, or 5% on a constant currency basis³.

Revenue increased to £9.0bn (2016 £8.3bn), up 3% on a constant currency basis³.

Operating profit was £865m (2016 £776m), 11% up on last year, or 5% on a constant currency basis³.

Non-recurring items in 2017 of £4m (2016 £nil) represents a loss on the disposal of the BAE Systems San Francisco Ship Repair business.

Amortisation of intangible assets reduced to £41m (2016 £43m).

Net finance costs were £151m (2016 £248m). The underlying interest charge, excluding pension accounting, and fair value and foreign exchange adjustments on financial instruments and investments, was £111m (2016 £114m). There was a credit in respect of fair value and foreign exchange adjustments of £44m (2016 charge £48m) on exchange translation of US dollar-denominated bonds.

Taxation expense, including equity accounted investments, of £164m (2016 £125m) reflects the Group's effective tax rate for the period of 23% (2016 23%). The effective tax rate for the full year is expected to be around 22% with some dependency on the geographical mix of profits.

1. For alternative performance measure definitions see glossary on page 7.

2. International Financial Reporting Standards.

3. Current period compared with prior period translated at current period exchange rates.

Earnings per share

	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Financial performance measures as defined by the Group¹		
Underlying earnings	628	551
Underlying earnings per share	19.8p	17.4p
Financial performance measures defined in IFRS²		
Profit for the period attributable to equity shareholders	555	408
Basic earnings per share	17.5p	12.9p
Reconciliation of underlying earnings to profit for the period attributable to equity shareholders		
Underlying earnings	628	551
Non-recurring items	(4)	–
Amortisation and impairment of intangible assets, post tax	(32)	(33)
Net interest expense on retirement benefit obligations, post tax	(67)	(69)
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	30	(41)
Profit for the period attributable to equity shareholders	555	408
Non-controlling interests	4	10
Profit for the period	559	418

Underlying earnings per share for the period increased by 14% to 19.8p (2016 17.4p).

Basic earnings per share for the period increased by 36% to 17.5p (2016 12.9p). There was a credit in respect of fair value and foreign exchange adjustments on financial instruments and investments reflecting exchange translation of US dollar-denominated bonds compared with a charge in the prior period.

1. For alternative performance measure definitions see glossary on page 7.

2. International Financial Reporting Standards.

Cash flow

	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 ¹ £m
Financial performance measures as defined by the Group²		
Operating business cash flow	277	(20)
Financial performance measures defined in IFRS³		
Net cash flow from operating activities ¹	341	77
Reconciliation from operating business cash flow to net cash flow from operating activities		
Operating business cash flow	277	(20)
<i>Add back</i> Net capital expenditure and financial investment	202	186
<i>Deduct</i> Dividends received from equity accounted investments	(32)	(23)
<i>Deduct</i> Taxation	(106)	(66)
Net cash flow from operating activities¹	341	77
Net capital expenditure and financial investment	(202)	(186)
Dividends received from equity accounted investments	32	23
Interest received	6	4
Acquisitions and disposals	(5)	–
Net cash flow from investing activities	(169)	(159)
Interest paid	(107)	(107)
Net (purchase)/sale of own shares	(1)	1
Equity dividends paid	(404)	(397)
Dividends paid to non-controlling interests	(8)	(6)
Cash flow from matured derivative financial instruments	(43)	240
Cash flow from cash collateral	(5)	25
Net cash flow from financing activities¹	(568)	(244)
Net decrease in cash and cash equivalents	(396)	(326)
Foreign exchange translation	176	(339)
Other non-cash movements	21	51
Increase in net debt	(199)	(614)
Opening net debt	(1,542)	(1,422)
Net debt	(1,741)	(2,036)
	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 ¹ £m
Segmental analysis		
Financial performance measures as defined by the Group²		
Electronic Systems	118	105
Cyber & Intelligence	46	33
Platforms & Services (US)	38	(33)
Platforms & Services (UK)	107	(154)
Platforms & Services (International)	102	178
HQ	(134)	(149)
Operating business cash flow	277	(20)
Financial performance measures defined in IFRS³		
Electronic Systems	167	138
Cyber & Intelligence	56	43
Platforms & Services (US)	66	(19)
Platforms & Services (UK)	186	(55)
Platforms & Services (International)	106	185
HQ	(134)	(149)
<i>Deduct</i> Taxation ⁴	(106)	(66)
Net cash flow from operating activities¹	341	77

Operating business cash inflow was £277m (2016 outflow £20m), which includes cash contributions in respect of pension deficit funding, over and above service costs, for the UK and US schemes totalling £86m (2016 £148m).

Residual advances are being consumed on the Omani and European Typhoon production contracts. Costs are being incurred against provisions created in previous years as we close out the US commercial shipbuilding programmes. There was an operating cash flow benefit from accelerated receipts of approximately £250m received in December 2016, which reversed in the first half of 2017.

Net cash flow from operating activities¹ was £341m (2016 £77m).

Taxation payments increased to £106m (2016 £66m) primarily reflecting higher payments in the US due to higher US taxable profits and timing differences.

Net capital expenditure and financial investment increased to £202m (2016 £186m) largely reflecting purchases of software intangibles and the proceeds from the sale of investment property in the prior year.

Dividends received from equity accounted investments of £32m (2016 £23m) is primarily receipts from MBDA, FNSS and Advanced Electronics Company.

The cash outflow in respect of **acquisitions and disposals** in 2017 of £5m primarily reflects the purchase of IAP Research, Inc.

Equity dividends paid in 2017 represents the 2016 final dividend.

As a consequence of movements in US dollar and euro exchange rates, there was a **cash outflow from matured derivative financial instruments** of £43m (2016 inflow £240m) from rolling hedges on balances with the Group's subsidiaries and equity accounted investments.

Foreign exchange translation primarily arises in respect of the Group's US dollar-denominated borrowing.

1. Re-presented to re-classify interest paid from operating to financing activities.
2. For alternative performance measure definitions see glossary on page 7.
3. International Financial Reporting Standards.
4. Taxation is managed on a Group basis.

Net debt

	30 June 2017 £m	31 December 2016 £m
Components of net debt		
Cash and cash equivalents	2,360	2,769
Debt-related derivative financial instrument assets less liabilities	133	114
Loans – non-current	(4,230)	(4,425)
Loans and overdrafts – current	(4)	–
Net debt	(1,741)	(1,542)

The Group's **net debt** at 30 June 2017 is £1,741m, a net increase of £199m from the net debt position of £1,542m at the start of the year. There are no material debt maturities before 2019.

Cash and cash equivalents of £2,360m (31 December 2016 £2,769m) are held primarily for the repayment of debt securities, pension deficit funding, payment of the 2017 interim dividend and management of working capital.

Going concern

After making due enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for at least 12 months from the date of approval of this report and, therefore, continue to adopt the going concern basis in preparing the accounts.

Principal risks

The principal risks facing the Group for the remainder of the year are unchanged from those reported in the Annual Report 2016. The result of the UK general election on 8 June has given rise to the formation of a minority government, but one for which defence and security is expected to remain a priority. Negotiations on the terms of the UK's exit from the EU will provide greater clarity as to the economic outlook in the medium term.

The Group's principal risks are detailed on pages 60 to 63 of the Annual Report 2016, and relate to the following areas: defence spending; government customers; international markets; competition in international markets; laws and regulations; contract risk and execution; contract cash profiles; pension funding; information technology security; and people.

Segmental performance: Electronic Systems

Electronic Systems, with 14,200 employees¹, comprises the US and UK-based electronics activities, including electronic warfare systems, electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

Financial performance

Financial performance measures as defined by the Group ²	Six months ended	Six months ended	Year ended	Financial performance measures defined in IFRS ³	Six months ended	Six months ended	Year ended
	30 June 2017	30 June 2016	31 December 2016		30 June 2017	30 June 2016	31 December 2016
Sales	£1,726m	£1,443m	£3,282m	Revenue	£1,726m	£1,443m	£3,282m
Underlying EBITA	£257m	£209m	£494m	Operating profit	£247m	£200m	£474m
Return on sales	14.9%	14.5%	15.1%	Return on revenue	14.3%	13.9%	14.4%
Operating business cash flow	£118m	£105m	£469m	Cash flow from operating activities	£167m	£138m	£568m
Order intake	£1,848m	£1,470m	£3,322m				
Order backlog	£5.1bn	£4.7bn	£5.2bn				

- Sales increased by 5% to \$2.2bn (£1.7bn). There is a second-half weighting of deliveries of F-35 electronic warfare systems, Advanced Precision Kill Weapon System (APKWS™) laser-guided rockets and Terminal High-Altitude Area Defence systems.
- Return on sales was 14.9% (2016 14.5%).
- Cash conversion of underlying EBITA in the first half of the year reflects a build-up of inventory ahead of stronger sales expected in the second half and timing of receivables.
- Order backlog of \$6.6bn (£5.1bn) is broadly unchanged from the start of the year.

1. Including share of equity accounted investments.

2. For alternative performance measure definitions see glossary on page 7.

3. International Financial Reporting Standards.

Operational performance

Electronic Combat

BAE Systems has sustained its leadership position in the US electronic warfare market and production is ramping up across a number of programmes. Low-Rate Initial Production hardware deliveries for the F-35 Lightning II programme continue with Lot 10 and 11 deliveries. We have received initial Lot 12 funding with an anticipated final award value in excess of \$300m (£231m). We have also received a Request for Proposal for a potential block buy encompassing multiple lots.

The business is under contracts, from Boeing and Warner Robins Air Logistics Complex, totalling more than \$1.0bn (£0.8bn) to install the Digital Electronic Warfare System on select new F-15 aircraft, upgrade existing F-15 aircraft, and to provide spare units and modules for an international customer. The programme remains on schedule.

Following our selection by Boeing in 2015 to develop and manufacture the next-generation digital electronic warfare system for the US Air Force's Eagle Passive Active Warning Survivability System programme to upgrade up to 400 F-15 aircraft, we are currently executing the \$146m (£112m) engineering and manufacturing development contract.

In January, we were awarded a \$67m (£52m) modification to a competitively awarded contract for an electronic warfare system for the US Air Force Special Operations Command's fleet of C-130J aircraft. The total value of the contract, including all options, could exceed \$300m (£231m). In the multi-billion dollar electronic warfare market, this award extends our position to include our capabilities on large, fixed-wing aircraft.

We have been awarded an \$81m (£62m) contract for the Network Tactical Common Data Link programme to provide the US Navy with the ability to simultaneously transmit and receive real-time intelligence, surveillance and reconnaissance data across disparate networks.

Due to the sensitive nature of electronic combat systems and technology, many of our programmes are classified. As a world leader in electronic warfare, we continue to experience growth in these increasingly important areas.

Survivability, Targeting & Sensing

Our Advanced Precision Kill Weapon System (APKWS™) laser-guided rocket is experiencing growing demand, with deliveries exceeding 9,000 units to date. In addition to expanding its use in the US military, the system is generating strong international attention, with 17 nations expressing interest. In the first half of the year, orders totalling \$240m (£185m) were received.

We continue to perform well on the Terminal High-Altitude Area Defence programme and expect to receive a further production contract for Lots 9 and 10 in the second half of the year.

On the \$249m (£192m) Common Missile Warning System Indefinite Delivery, Indefinite Quantity contract, we continue to deliver to schedule.

Under the five year, \$434m (£334m) Enhanced Night Vision Goggle III and Family of Weapon Sights – Individual Indefinite Delivery, Indefinite Quantity contract, we are now progressing the production qualification testing.

On the US Army's Family of Weapon Sights – Crew Served programme, a seven-year contract with a potential value of up to \$384m (£296m), we are executing to plan, completing the Preliminary Design Review and Component Critical Design Review in the first half of the year.

The LiteHUD® head-up display has been selected by critical launch customers for integration on multiple platforms, including the Textron Scorpion jet.

Intelligence, Surveillance & Reconnaissance

Since winning the Geospatial Data Services Foundational GEOINT Content Management programme in 2014, we have been awarded orders valued at \$180m (£139m). The business is meeting all delivery requirements in assisting US intelligence community customers with the development of advanced geospatial intelligence data collection and processing solutions.

As a provider of signals intelligence capabilities for the US Army and other US Department of Defense customers, we are executing the \$132m (£102m) Tactical Signals Intelligence Payloads programme for the US Army's Gray Eagle unmanned aircraft.

Work continues on the US Navy's P-8A Poseidon maritime surveillance aircraft programme to provide state-of-the-art processing capabilities. The programme could be worth \$1.2bn (£0.9bn) over its life.

Controls & Avionics

BAE Systems is a major supplier of flight controls, and cabin and flight deck systems. The development of the integrated flight control electronics and remote electronic units for Boeing's next-generation 777X aircraft remains on schedule and systems integration testing is progressing to plan.

On the Boeing 737 MAX aircraft, a successful first flight was completed on the MAX9 with our spoiler controls, flight deck systems and utilities electronics. The development of our civil active inceptors is progressing, with Gulfstream G500 and Embraer KC390 aircraft flight tests, and we received industry recognition with the Aviation Week Laureate Award for Technology.

FADEC Alliance, a joint venture between FADEC International (our joint venture with Safran Electronics & Defense) and GE Aviation, is delivering on contracts to provide the full authority digital engine controls for: the Leap engine for the Airbus A320neo, the Boeing 737 Max and the Comac C919; the Passport 20 engine for the Bombardier Global 7000/8000; the GE9x engine for the Boeing 777X; and a new generation of advanced turboprop engines.

On the F-35 Lightning II programme, we are in production for vehicle management computer and active inceptor system equipment for Low-Rate Initial Production Lot 10 and are now under contract for Lot 11.

Power & Propulsion

We expect to deliver another 1,000 hybrid and electric transit bus systems in 2017. As the transit bus market continues to shift towards more electric bus systems, we have expanded our product portfolio to include a hybrid-electric system capable of emission-free driving up to half of the time and an

all-electric system providing zero-emission travel all of the time. Transit operators in major cities, such as Seattle, Boston, Quebec, London and Paris, are adopting our electric technologies to meet their green initiatives.

Looking forward

The US Department of Defense fiscal year 2017 budget and 2018 budget proposal support the medium-term planning assumptions for our US businesses as we see the ramp up of production on a number of our long-term programmes.

Electronic Systems is well positioned to address current and evolving priority programmes from its strong franchise positions in electronic warfare, electro-optics and Intelligence, Surveillance and Reconnaissance. Electronic Systems has a long-standing programme of research and development, and its focus remains on maintaining a diverse portfolio of defence and commercial products and capabilities for US and international customers.

The business expects to benefit from its franchise positions, particularly on the F-35 Lightning II and F-15 upgrade programmes, and its ability to apply innovative technology solutions that meet defence customers' changing requirements. In the commercial aviation market, Electronic Systems' technology innovations are enabling the business to renew long-standing customer positions and to compete for and win new business.

Segmental performance: Cyber & Intelligence

Cyber & Intelligence, with 11,400 employees¹, comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber security, secure government, and commercial and financial security activities.

Financial performance

	Financial performance measures as defined by the Group ²			Financial performance measures defined in IFRS ³			
	Six months ended 30 June 2017	Six months ended 30 June 2016	Year ended 31 December 2016	Six months ended 30 June 2017	Six months ended 30 June 2016	Year ended 31 December 2016	
Sales	£923m	£833m	£1,778m	Revenue	£923m	£833m	£1,778m
Underlying EBITA	£35m	£18m	£90m	Operating profit	£20m	–	£59m
Return on sales	3.8%	2.2%	5.1%	Return on revenue	2.2%	0.0%	3.3%
Operating business cash flow	£46m	£33m	£83m	Cash flow from operating activities	£56m	£43m	£106m
Order intake	£940m	£874m	£1,885m				
Order backlog	£2.2bn	£2.2bn	£2.4bn				

- Sales were almost unchanged on a constant currency basis⁴ at \$1.2bn (£0.9bn). Sales in the Intelligence & Security business were down 6%. Take up on the programme to provide additional IT services to the intelligence community is biased to the last quarter. Growth in the Applied Intelligence business was 21%, benefiting from increases in all three divisions, in particular in UK Services and International Services & Solutions.
- Return on sales was marginally improved at 3.8% (2016 2.2%). The loss in the first half at Applied Intelligence was £27m, only slightly lower than last half year. We are in the process of refocusing both the product portfolio and market priorities in the Commercial Solutions division.
- Cash flow conversion continues to improve on reduced working capital requirements in the Applied Intelligence business.
- Order backlog reduced slightly to \$2.9bn (£2.2bn). In the Intelligence & Security business, order backlog reduced on trading out of certain longer-term classified contracts.

1. Including share of equity accounted investments.

2. For alternative performance measure definitions see glossary on page 7.

3. International Financial Reporting Standards.

4. Current period compared with prior period translated at current period exchange rates.

Operational performance

Intelligence & Security

Global Analysis & Operations

In Full Motion Video and Intelligence, Surveillance and Reconnaissance analysis, we secured a new four-year, \$58m (£45m) contract to increase the number of expert full-motion video analysts we have supporting the intelligence community. We are pursuing additional task orders to further expand our work in motion-imagery analysis, analytic training, multi-media support and research under a new Indefinite Delivery, Indefinite Quantity contract with an estimated value of more than \$400m (£308m).

The US Department of Treasury awarded BAE Systems a position on its programme to support the Office of Terrorism and Financial Intelligence in safeguarding the country's financial system against national security threats. The maximum lifecycle value of all task orders to be awarded under the programme is estimated at \$135m (£104m).

We are fulfilling the second year of a five-year contract with an estimated ceiling value of \$75m (£58m) to provide the US Army with geospatial intelligence data analysis support services, and our experts are executing on the third year of a five-year contract worth up to \$143m (£110m) to provide counter-terrorism analysis services to the US government.

Integrated Electronics & Warfare Systems

We have nearly 1,000 employees working on a number of Strategic Weapon System programmes on contracts that cover multiple classes of US and UK submarines, as well as the US Air Force Intercontinental Ballistic Missile Integration Support Contract.

We are executing on the first year of a five-year, sole-source contract worth up to \$368m (£283m) to provide systems engineering services to the US Navy's Strategic Systems Programs office. The programme assists with weapons system integration and provides test engineering services and special test equipment for weapons systems on board US Ohio and UK Vanguard Class submarines, as well as future Ohio Class replacement and UK Dreadnought Class submarines.

The US Air Force issued a contract modification to the Integration Support Contract to increase the total ceiling value from \$918m (£707m) to \$1,011m (£778m). In addition to overall programme management and systems sustainment, our work on the contract includes cyber security assessment and defence.

We were selected for a position on a new nine-year Indefinite Delivery, Indefinite Quantity contract to support the US Army in developing next-generation technologies for space, high-altitude and missile defence.

IT Solutions

We are executing on several task orders to provide IT services to high-priority US government agencies under a ten-year, single-award Indefinite Delivery, Indefinite Quantity contract with a potential value of over \$1.0bn (£0.8bn). The total value of the task orders awarded to date is \$270m (£208m). The implementation of additional IT services for customers in the intelligence community has been deferred to the second half of the year due to a delay in the acceptance of an intelligence community programme.

We received a contract increase of \$160m (£123m) extending the period of performance of a major software development and IT support contract for a US intelligence community customer.

We are executing on the first year of a five-year, \$58m (£45m) task order awarded by the Defense Intelligence Agency to design, develop, engineer, install and sustain IT resources.

Work is under way on the first year of a new five-year, \$49m (£38m) contract with the US Air Force Research Laboratory to develop, deploy and maintain cross domain solutions for safeguarding the sharing of sensitive information between government networks.

Applied Intelligence

The business has delivered revenue growth driven by continued investment in product development, sales and marketing. We have continued to build our cyber skills, global engineering and delivery capabilities, including launching our Security Operations Centre and client-facing nerve centre in Fort Lauderdale, Florida, to deliver Managed Security Services to clients in North America. Our work in supporting counter-terrorism efforts to analyse intelligence that helps predict and prevent physical and cyber attacks remains highly relevant in today's environment.

Commercial Solutions

We have continued to grow our counter-fraud and regulatory compliance business with further contract wins for NetReveal™, including: an insurance claims fraud solution for the Irish operations of Zurich Insurance; a solution for a leading insurance firm in the US to identify suspicious activity and protect against identity fraud and theft; and a multi-year contract to deliver compliance services and support for a global bank based in Asia-Pacific.

As part of our regular commercial product review cycle, we are refocusing our threat analytics capability from being sold as a software product (CyberReveal™) towards Managed Detection and Response services as part of our Managed Security Services portfolio, reflecting how commercial customers are looking to buy their cyber defence solutions.

We have announced a partnership with O₂ to protect its customers from cyber crime, under which we will provide O₂'s enterprise customers with access to Managed Security Services, as well as threat intelligence, security testing and cyber incident response services.

UK Services

The business continues to be a key supplier to national security agencies in the UK, with a range of services contracts won in support of a variety of national security intelligence and cyber defence programmes. Demand for cyber services from large enterprises has continued, with contract awards including the provision of secure IT transformation services for a large financial institution.

The business has won a number of contracts to provide data and digital services, including: being selected by a UK telecommunications operator to undertake an assessment against the incoming EU General Data Protection Regulation; being selected by one of the world's largest building societies to help develop and implement an Enterprise Data Architecture strategy; and undertaking a technology transformation programme for a central UK government department.

International Services & Solutions

We have seen continued demand in Asia-Pacific and the Middle East for national security intelligence and national-scale cyber defence capabilities. A contract was secured to provide cyber defence capabilities for a Middle Eastern customer and there were a number of cyber consultancy contract wins with government agencies in Australia. The first half of the year saw go-live of the most complex data retention programme delivered by Applied Intelligence, for a global telecommunications operator based in Asia-Pacific, based around our DataRetain™ solution.

Looking forward

Intelligence & Security

The outlook for the US government services sector is stable, although market conditions remain highly competitive.

The Intelligence & Security business has continued to reduce costs to address government budget pressures, whilst pursuing growth opportunities, particularly in critical, mission-focused areas.

Applied Intelligence

Following a review of market priorities and our competitive position, an increasingly focused investment programme in engineering capabilities and product development, in particular in our commercial cyber business, will support the future growth profile for the business. Sales growth is expected to continue, as cyber security is an increasingly important part of government security and a core element of stewardship for commercial enterprises in a sophisticated and persistent threat environment.

The business continues to migrate towards a multi-year managed service and subscription-based model, providing enhanced predictability of revenues, and grow further the order backlog and pipeline of opportunities from commercial and government customers in North America, Europe, Asia-Pacific and the Middle East.

Segmental performance: Platforms & Services (US)

Platforms & Services (US), with 11,300 employees¹, has operations in the US, UK and Sweden. It produces combat vehicles, weapons and munitions, and delivers services and sustainment activities, including ship repair and the management of government-owned munitions facilities.

Financial performance

Financial performance measures as defined by the Group ²	Six months ended	Six months ended	Year ended	Financial performance measures defined in IFRS ³	Six months ended	Six months ended	Year ended
	30 June 2017	30 June 2016	31 December 2016		30 June 2017	30 June 2016	31 December 2016
Sales	£1,433m	£1,287m	£2,874m	Revenue	£1,400m	£1,244m	£2,783m
Underlying EBITA	£109m	£86m	£211m	Operating profit	£99m	£79m	£182m
Return on sales	7.6%	6.7%	7.3%	Return on revenue	7.1%	6.4%	6.5%
Operating business cash flow	£38m	£(33)m	£58m	Cash flow from operating activities	£66m	£(19)m	£129m
Order intake	£1,785m	£1,604m	£3,308m				
Order backlog	£4.7bn	£4.4bn	£4.6bn				

- Sales in the first half of the year were \$1.8bn (£1.4bn). There is a second-half bias in sales of amphibious combat vehicles to international customers, and Low-Rate Initial Production volumes on the M109A7 Paladin self-propelled howitzer programme are also ramping up.
- Return on sales for the first half year has improved to 7.6% (2016 6.7%). There has been a \$6m (£5m) incremental charge on the commercial shipbuilding contracts, with one ship nearing completion and being marketed for sale, and the final ship planned to be completed in the second half of the year.
- Operating business cash flow has been impacted by the utilisation of the provisions created against the commercial shipbuilding programmes and a build-up of inventory ahead of stronger sales expected in the second half. The investment in the new floating dry dock located at San Diego has completed, with the dock now in full operational service.
- Order backlog has increased to \$6.1bn (£4.7bn) primarily on the award of the \$542m (£417m) M777 ultra-lightweight howitzer contract for India.

1. Including share of equity accounted investments.

2. For alternative performance measure definitions see glossary on page 7.

3. International Financial Reporting Standards.

Operational performance

US Combat Vehicles

On the US Army's Armored Multi-Purpose Vehicle programme, we have commenced deliveries of the first 29 vehicles under the engineering and manufacturing development phase, which has a potential value of \$1.2bn (£0.9bn), including options for 289 vehicles in Low-Rate Initial Production.

We continue to perform on the \$670m (£516m) Low-Rate Initial Production phase of the US Army's M109A7 Paladin self-propelled howitzer programme. At 30 June, we had delivered 36 vehicle sets, together with one additional howitzer.

The business is executing a \$286m (£220m) Engineering Change Proposal to address the space, weight, power and cooling limitations of the Bradley family of vehicles and to prepare the vehicle for communication network upgrades. The US customer's production decision regarding the upgrade of approximately 500 vehicles over a three-year period from 2019 is expected in the second half of the year.

In March, we received a contract from the US Army worth up to \$112m (£86m) for technical support and sustainment of M88 recovery vehicles. We continue to execute the conversion of 36 vehicles to the M88A2 Heavy Equipment Recovery Combat Utility Lift Evacuation Systems (HERCULES) configuration and, in February, we received a \$36m (£28m) modification to add a further 11 vehicles to the contract.

Along with industry partner Iveco Defence, we completed deliveries of the first 16 Amphibious Combat Vehicle 1.1 prototypes to the US Marine Corps for testing under the \$158m (£122m) engineering and

manufacturing development phase of the programme. We are one of two competitors for this programme, with down-selection expected in 2018.

Internationally, we continue to work on multiple contracts for the Japanese Ministry of Defence totalling \$165m (£127m) for 30 new Assault Amphibious Vehicles (AAVs) and the upgrade of two AAVs. For Brazil, we are working on an \$82m (£63m) contract to provide 23 upgraded AAVs, a \$50m (£38m) contract to deliver 236 M113 upgrade kits and a \$54m (£42m) contract for 32 upgraded M109A5+ self-propelled howitzers.

Weapon Systems and Munition Operations

BAE Systems remains a leading provider of gun systems and precision strike capabilities. In February, we completed the acquisition of IAP Research, Inc., a US engineering company focused on the development and production of electromagnetic launchers, power electronics and advanced materials, further strengthening our position as a provider of advanced weapon systems, including the US Navy's electromagnetic railgun.

We continue to execute on a £183m contract to provide the gun system known as the Maritime Indirect Fire System for the Royal Navy's Type 26 frigate.

Following the contract modification received in 2016 from the Swedish government formalising its purchase of an additional 24 Archer systems, production continues with deliveries expected to begin in 2018.

In January, we received a \$542m (£417m) Foreign Military Sale contract from the US government to provide 145 M777 ultra-lightweight howitzers to the Indian Army. We will build the first 25 guns, with the remaining systems assembled in India by Mahindra & Mahindra, our selected supplier to establish an assembly, integration and test facility. The first two guns were shipped in the period and are progressing through in-country testing.

In the complex ordnance business, we continue to manage the US Army's Radford and Holston munitions facilities, operating near capacity. We are performing on modernisation contracts totalling \$129m (£99m) for waste water management at Holston and a \$146m (£112m) contract for the construction of a nitric acid recovery facility to produce larger quantities of insensitive munitions.

US Ship Repair and Modernisation

As a leading provider of US Navy ship repair and modernisation services, we secured firm orders across our US shipyards totalling approximately \$511m (£393m) in the first half of the year and remain well positioned to compete for future maritime projects.

We continue to adjust our workforce and facilities to meet evolving customer demand, including the new dry dock in our San Diego shipyard, which completed operational certification in February and welcomed the USS New Orleans as its first vessel for servicing.

One of the final two commercial ships is nearing completion and being marketed for sale following the original customer's decision not to purchase the vessel. Construction of the final ship is planned to be completed in the second half of the year. There has been a \$6m (£5m) incremental charge on the commercial shipbuilding contracts in the first half of the year.

BAE Systems Hägglunds

Series production continues on the \$865m (£666m) contract for the supply of CV90 Infantry Fighting Vehicles to Norway.

In the first half of the year, we received contracts from the Estonian government for upgrade and sustainment of 44 CV90s.

We are performing to schedule on the refurbishment and upgrade of Swedish CV90 vehicles, and sustainment and upgrade of Danish CV90s. We are integrating Mjölner mortar systems on 40 Swedish CV90s, and under way on testing and verification of Active Protection Systems on Dutch CV90s.

We continue to perform on a contract to produce 32 BvS10 military vehicles for Austria.

FNSS

FNSS, our land systems joint venture based in Turkey, continues to perform under its \$524m (£403m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army.

Production has completed on a contract to upgrade M113 tracked armoured personnel carriers for the Royal Saudi Land Forces, with the next contract phase expected to be signed in the second half of the year.

In support of an export contract to Oman awarded in 2015 for the PARS Wheeled Armoured Vehicle, work continues to deliver 8x8 and 6x6 vehicles in a number of configurations. The customer received the first vehicle in July.

Work has begun under a €278m (£244m) contract awarded in June 2016 to supply 260 Anti-Tank Vehicles to the Turkish Land Forces and an €84m (£74m) contract signed in December 2016 for air defence vehicles for the Turkish Land Forces.

In March, FNSS received a €155m (£136m) contract to provide 27 amphibious assault vehicles to the Turkish Ministry of National Defence.

Looking forward

The US Department of Defense fiscal year 2017 budget and 2018 budget proposal support the medium-term planning assumptions for our US businesses as we see the ramp up of production on a number of our long-term programmes.

The business is underpinned by strong positions on key franchise programmes. In the land domain, this includes the US Army's Armored Multi-Purpose Vehicle, M109A7 self-propelled howitzer and Bradley upgrade programmes, and the CV90 and BvS10 export programmes from our BAE Systems Hägglunds business.

FNSS has grown its order book with both domestic and international orders.

These long-term contracts and our franchise position in tracked vehicles, which offer opportunities in international markets, make the land business well placed for growth in the medium term.

In the maritime domain, the Group has a strong position on naval gun programmes and US Navy ship repair. Additional dry dock ship repair capacity has been established in San Diego to support the US Navy's rebalance to the Asia-Pacific region.

The business continues to pursue a range of domestic and international opportunities in combat and amphibious vehicles, weapons systems and maritime support services.

Segmental performance: Platforms & Services (UK)

Platforms & Services (UK), with 30,200 employees¹, comprises the Group's UK-based air, maritime, land and shared services activities.

Financial performance

Financial performance measures as defined by the Group ²	Six months ended	Six months ended	Year ended	Financial performance measures defined in IFRS ³	Six months ended	Six months ended	Year ended
	30 June 2017	30 June 2016	31 December 2016		30 June 2017	30 June 2016	31 December 2016
Sales	£3,913m	£3,664m	£7,806m	Revenue	£3,864m	£3,621m	£7,699m
Underlying EBITA	£416m	£414m	£810m	Operating profit	£406m	£394m	£780m
Return on sales	10.6%	11.3%	10.4%	Return on revenue	10.5%	10.9%	10.1%
Operating business cash flow	£107m	£(154)m	£199m	Cash flow from operating activities	£186m	£(55)m	£385m
Order intake	£4,753m	£2,207m	£8,024m				
Order backlog	£18.6bn	£16.3bn	£17.8bn				

- Sales in the first half of the year were up 7% at £3.9bn (2016 £3.7bn). Deliveries on the Saudi Typhoon programme have now completed, with the final four aircraft accepted in the first half. The first two Omani Typhoon aircraft were delivered in June and the F-35 Lightning II programme is ramping up to plan.
- Return on sales in the first half of the year was 10.6% (2016 11.3%). The first half of 2016 included the benefit on the Astute programme from the pricing of Batch 1 and initial profit recognition on later boats.
- There was an operating business cash inflow of £107m (2016 outflow £154m) in the period. Residual customer advances were consumed on Typhoon production contracts.
- Order backlog increased to £18.6bn (31 December 2016 £17.8bn) primarily on the awards for pricing of the sixth Astute Class submarine and the initial batch of three frigates to be built under the Type 26 programme.

1. Including share of equity accounted investments.

2. For alternative performance measure definitions see glossary on page 7.

3. International Financial Reporting Standards.

Operational performance

Military Air & Information

In the six months to 30 June, ten Typhoon aircraft were delivered from the UK final assembly facility, of which four were delivered to the Royal Air Force, the final four to Saudi Arabia and two to Oman. The remaining deliveries to Oman are scheduled for the second half of 2017 and 2018.

Good progress continues to be made on airframe manufacture for the contract to supply 28 Typhoon aircraft to Kuwait secured by Italian Eurofighter partner, Leonardo, in 2016.

Typhoon's capabilities continue to be enhanced. A further series of flight trials to mature the delivery of the Storm Shadow and Meteor weapons system enhancements was completed in the period. Development towards the Royal Air Force Centurion standard continues, which will enable transition of capability from Tornado to Typhoon as the UK Tornado fleet is scheduled to come out of service at the end of the decade.

We have continued to support our UK and European customers' Typhoon and Tornado aircraft and their operational commitments. Mobilisation of the ten-year partnership arrangement with the Ministry of Defence to support the UK Typhoon fleet has proceeded as planned with availability of aircraft being sustained at contractual levels.

On the F-35 Lightning II programme, we have completed 38 aft fuselage assembly deliveries for the Low-Rate Initial Production Lot 10 and 11 contracts. Full contract award has been secured on Lot 10. Negotiations are expected to conclude on Lot 11 in the second half of the year.

Good progress is being made on building the engineering and training facilities at RAF Marham in Norfolk, UK, in readiness for the arrival of the UK's first F-35 Lightning II aircraft in 2018.

Following the announcement that the UK had been chosen as a major European repair hub for the maintenance, repair, overhaul and upgrade of F-35 Lightning II avionics and components, we have established a joint venture with the UK Ministry of Defence and Northrop Grumman, and progress on establishing the repair facility and capability continues to plan.

Two Hawk aircraft have completed manufacture and are ready for acceptance by the Omani Royal Air Force prior to scheduled delivery in the second half of 2017. The remaining six aircraft are scheduled to be available for acceptance and delivery in the second half of 2017. Delivery of the initial support package has commenced.

Discussions continue with Hindustan Aeronautics Limited (HAL) for the supply of a further 32 aircraft kit sets which will result in aircraft built under licence by HAL for the Indian Air Force and Indian Navy.

Following an extensive review with our partner, Northrop Grumman, of the requirements and conditions of the US Air Force future trainer programme, both companies decided not to proceed with the competitive bid.

A contract extension for the Anglo-French unmanned combat air system feasibility and definition phase for £16m was received in January, with a proposal for the first phase of the demonstrator programme submitted in March.

Agreement in principle was reached for a \$155m (£119m) contract for collaboration on the first design and development phase of an indigenous fifth-generation fighter jet for the Turkish Air Force.

Maritime

On the aircraft carrier programme, sea trials on the first of the two ships, HMS Queen Elizabeth, commenced in June. We continue to work with the Ministry of Defence to prepare the support solution in advance of the ship's arrival at HM Naval Base, Portsmouth, later in 2017. On HMS Prince of Wales, large volume installation activities progress. Sea trials on the second ship are expected to commence in 2019.

We have continued to progress the heads of terms signed in 2016 with the Ministry of Defence and the full £3.7bn production contract was signed in June for the first batch of three Type 26 frigates, with £2.8bn of order intake in the period after order intake in previous periods for long-lead items. The cut steel ceremony was held in July. The programme currently employs over 1,000 employees.

On the Offshore Patrol Vessel programme, revised delivery dates have been agreed with the Ministry of Defence and the first vessel, HMS Forth, will now commence sea trials during the third quarter. All five ships are now under construction.

Under the Maritime Support Delivery Framework contract, in place until March 2019, we provide services at HM Naval Base, Portsmouth, and support to half of the Royal Navy's surface fleet. We remain on track to achieve target cost. The business was unsuccessful on a competitive bid to provide equipment procurement and equipment management services for the Queen Elizabeth Class aircraft carriers and Type 45 destroyers. We have, however, continued to manage the support, maintenance and upgrade of the Royal Navy's fleet of Type 45 destroyers.

Progress continues on the £270m Spearfish torpedo upgrade demonstration and manufacture phases, with the demonstration phase currently forecast to complete in 2019.

The first three Astute Class submarines are in operational service with the Royal Navy. Progress continues on the manufacture of the remaining four boats, with launch of Boat 4, Audacious, achieved in April. A full contract award for Boat 6 was secured in March for £1.4bn, with £0.6bn of order intake in the period after order intake in previous periods for long-lead items.

Functional and spatial design continues to advance on the Dreadnought Class submarine, the replacement for the Royal Navy's Vanguard Class submarine fleet, with funding in place for continued design, initial manufacture of the first boat, material commitment and facilities investment. The major programme of building works at the Barrow site continues with contracts in place totalling more than £390m.

Land (UK)

The business has continued to provide support to previously supplied armoured vehicles and bridging systems, with orders of £14m received in the period.

In the period, 54 40mm cased-telescopic cannons were delivered to the Ministry of Defence by CTA International, a joint venture between BAE Systems and Nexter, bringing cumulative deliveries to 87 of 515.

The business continues to provide UK and international customers with a full range of light and heavy munitions, with orders totalling £22m received. The business is one of two contenders delivering the first stage of the Challenger 2 Life Extension Project.

Looking forward

Platforms & Services (UK) has a strong order backlog of long-term committed programmes and an enduring support business. The result of the UK general election on 8 June has given rise to the formation of a minority government, but one for which defence and security is expected to remain a priority. Negotiations on the terms of the UK's exit from the EU will provide greater clarity as to the economic outlook in the medium term.

In Military Air & Information, as current export contracts for Typhoon and Hawk complete, and UK Tornado support ends, sales are underpinned by Typhoon and Hawk support, and F-35 Lightning II aircraft production and support. There can be no certainty as to the timing of future aircraft production orders and, in any event, any new orders for Typhoon are unlikely to positively impact production delivery rates for at least 24 months. The balance of customer demand for aircraft and production rates will be under constant review with adjustments made as appropriate.

In Maritime, there remains pressure on the Navy's near-term budgets and a highly-competitive environment in ship support and upgrade. Sales are underpinned by the manufacture of the Queen Elizabeth Class aircraft carriers, River Class Offshore Patrol Vessels and Type 26 frigates, and Astute and Dreadnought class submarines. The through-life support of surface ship platforms provides a sustainable business in technical services and mid-life upgrades.

The Land (UK) business continues to deliver support to armoured vehicle and bridging systems in UK and international markets, munitions under the 15-year Munitions Acquisition Supply Solution partnering agreement secured in 2008 and 40mm cased-telescopic cannons for the UK and French armies.

Segmental performance: Platforms & Services (International)

Platforms & Services (International), with 13,800 employees¹, comprises the Group's businesses in Saudi Arabia, Australia and Oman, together with its 37.5% interest in the pan-European MBDA joint venture.

Financial performance

	Financial performance measures as defined by the Group ²			Financial performance measures defined in IFRS ³			
	Six months ended 30 June 2017	Six months ended 30 June 2016	Year ended 31 December 2016	Six months ended 30 June 2017	Six months ended 30 June 2016	Year ended 31 December 2016	
Sales	£1,771m	£1,739m	£3,943m	Revenue	£1,381m	£1,449m	£3,037m
Underlying EBITA	£176m	£158m	£400m	Operating profit	£161m	£146m	£365m
Return on sales	9.9%	9.1%	10.1%	Return on revenue	11.7%	10.1%	12.0%
Operating business cash flow	£102m	£178m	£435m	Cash flow from operating activities	£106m	£185m	£473m
Order intake	£1,616m	£995m	£6,175m				
Order backlog	£12.9bn	£10.1bn	£13.1bn				

- Sales for the first half of the year were £1.8bn (2016 £1.7bn). There is a material second half-year weighting due to MBDA weapon system deliveries and higher levels of Typhoon support in Saudi Arabia.
- Underlying EBITA in the first half of the year was £176m (2016 £158m), with return on sales of 9.9% (2016 9.1%).
- There was an operating business cash inflow in the first half of the year of £102m (2016 £178m). There was an acceleration of customer receipts at the end of 2016.
- Order backlog is £12.9bn (31 December 2016 £13.1bn), with further bookings against the five-year Saudi support contracts being made in the first half of the year.

1. Including share of equity accounted investments.

2. For alternative performance measure definitions see glossary on page 7.

3. International Financial Reporting Standards.

Operational performance

Saudi Arabia

On the Salam Typhoon programme, with four aircraft deliveries in the period, all 72 contracted aircraft have been delivered to the customer. Typhoon capability expansion is progressing to schedule.

The Typhoon support contracts are operating well, meeting all contractual metrics. A contract amendment for a maximum of 20,000 additional flying hours was agreed in April.

Agreement was reached with the Saudi Arabian government in 2016 for BAE Systems to continue to provide support services to the Royal Saudi Air Force and Royal Saudi Naval Forces under the Saudi British Defence Co-operation Programme for a further five years to 31 December 2021. Further work is under way between the UK and Saudi Arabian governments to finalise the details of the follow-on contracts.

Through the Saudi British Defence Co-operation Programme, the business continues to support the operational capabilities of the Royal Saudi Air Force and Royal Saudi Naval Forces. The contract for Hawk aircraft signed in 2012 is progressing with 18 aircraft delivered and accepted at 30 June. Manufacturing for the second batch of 22 aircraft, awarded in 2015, continues on schedule. Under this programme, we will undertake the final assembly of these aircraft in Saudi Arabia, with the first major units planned to be delivered in the third quarter of the year.

The Royal Saudi Naval Forces' Minehunter mid-life update programme progresses. Acceptance of the third and final ship is expected in the fourth quarter of 2017.

Under the planned reorganisation of our portfolio of interests in a number of industrial companies in Saudi Arabia, Riyadh Wings Aviation Academy LLC acquired a 4.1% shareholding in a Group subsidiary, Overhaul and Maintenance Company, during 2016 and is expected to acquire a further interest up to a

maximum of 49%. The reorganisation supports our strategy to expand the customer base of our In-Kingdom Industrial Participation programme, promoting training, development and employment opportunities in line with the Kingdom's National Transformation Plan and Vision 2030.

The Saudi Arabian In-Kingdom Industrial Participation programme continues to progress. During the first half of 2017, there has been further capability and knowledge transfer across the Typhoon, Hawk and Tornado aircraft platforms, with additional transfer activities scheduled on all three platforms being progressively introduced through 2017.

Australia

We have continued to provide in-service support to the Navy's two Landing Helicopter Docks under a four-year support contract awarded in 2014. The final acceptance date for these vessels is currently under review with the Navy customer.

The sixth of seven Anzac Class frigates to be modernised under the current Anti-Ship Missile Defence programme has been accepted into service by the Commonwealth. The final frigate is scheduled for acceptance later in 2017. The next Anzac Class frigate capability upgrade programme is planned to commence in the fourth quarter of 2017.

The Warship Asset Management Alliance agreement continues to provide sustainment services to the Navy. The agreement of the scope of activities for the next five years of sustainment and upgrade is anticipated to be contracted later in 2017.

The funded Risk Reduction Design Study for the SEA 5000 Future Frigate programme has been completed and the full Request for Tender was received in March. Further Commonwealth funding to support the programme activities was received in the period.

Mobilisation activities for sustainment of the Regional F-35 Lightning II fleet continues to progress at our Williamstown facility and our existing Hawk Lead-in Fighter sustainment programme continues to meet its Key Performance Indicators. The upgrade of the Hawk fleet to meet the training requirements of the fifth-generation F-35 are progressing well, with 12 of the 33 aircraft modified and the Australian Air Force customer declaring achievement of initial operating capability.

Following down-select in 2016 as one of two tenderers for the Land 400 Phase 2 Combat Reconnaissance Vehicle programme, we continue to deliver against the Army's Risk Mitigation Activity contract. Final tender selection is anticipated in late 2018.

In June, the Commonwealth announced that we have been selected as the preferred tenderer for the Jindalee Operational Radar Network upgrade programme. Negotiations will now commence and, if successful, we expect to sign contracts in 2018. The expected value of the contract over the initial award term of ten years is approximately A\$1bn (£0.6bn).

Good technical progress has been made during the period on the delayed JP 2008 Phase 3F programme for enhanced satellite communications services. A revised delivery schedule and commercial settlement have been agreed in principle with the customer.

Oman

The Oman Typhoon and Hawk aircraft programme, being undertaken by Platforms & Services (UK), completed delivery of the first two Typhoon aircraft in the period to 30 June, as well as completing manufacture of two of the eight Hawk trainer aircraft for the Omani Royal Air Force, with the remaining Hawk deliveries scheduled for the second half of 2017. Separately, we continue to fulfil our legacy industrial participation obligations in Oman through delivery of an agreed training and knowledge transfer programme and, to date, over 4,000 training places in a range of disciplines have been taken up by Omani nationals.

MBDA

In March, MBDA secured the initial contract from the UK and French governments for the assessment phase of the Future Cruise/Anti-Ship Weapon, which will prepare for the replacement of the existing missiles deployed by the UK and French armed forces. This work follows on from the joint UK-France 2016 programme for the mid-life refurbishment of their current inventory of missiles.

The Meteor Beyond Visual Range Air-to-Air Missile, which is already in service on Gripen aircraft with the Swedish Air Force, has achieved qualification for both Typhoon and Rafale aircraft. The Advanced Short Range Air-to-Air Missile (ASRAAM) has successfully undertaken several qualification firings from the F-35B.

During the period, the German Ministry of Defence and MBDA have entered into the formal negotiation process for the German ground-based air defence system, TLVS, a key element of the German defence strategy.

Progress is being made in the finalisation of the financing package for the Qatari contracts signed in 2016, which will supply air defence systems and anti-ship missiles for the naval surface fleet along with coastal defence systems.

Success in both domestic and export markets has resulted in the requirement to expand MBDA's production capacities. A new manufacturing facility is fully operational in Bolton, UK, and a capacity enhancement is under way in Bourges, France.

Looking forward

In the Kingdom of Saudi Arabia, following agreement of the budget for the next five years of the Saudi British Defence Co-operation Programme, we expect to sustain our long-term presence through delivering current programmes, addressing potential new requirements and further industrialisation in support of the Saudi military forces. We are focused on our ongoing commitment to support the national objectives of local skills and technology, increasing employment and developing an indigenous defence industry, and will structure our business and portfolio of interests in Saudi Arabia to meet this long-term strategy.

In Australia, the business is now structured around long-term sustainment and upgrade activities, and we are now focusing on mobilisation skills and progressing opportunities with the Australian government to provide leading defence build and support capabilities.

MBDA has a strong order book that underpins future growth built on the effective partnerships it has established with its domestic customers and recent export success.

Responsibility statement of the directors in respect of the half-yearly financial report

Each of the directors (as detailed below) confirms that to the best of his/her knowledge:

- The condensed set of financial statements has been prepared in accordance with IAS 34, Interim Financial Reporting, as adopted by the European Union.
- The interim management report on pages 1 to 29 includes a fair review of the information required by:
 - (a) DTR 4.2.7R of the Disclosure Guidance and Transparency Rules (DTR), 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 financial year; and
 - (b) DTR 4.2.8R of the DTR, 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 the performance of the Company during that period; and any changes in the related party transactions described in the last annual report that could do so.

For and on behalf of the directors:

Sir Roger Carr

Chairman

1 August 2017

Directors

Sir Roger Carr	Chairman
Charles Woodburn	Chief Executive
Jerry DeMuro	President and Chief Executive Officer of BAE Systems, Inc.
Peter Lynas	Group Finance Director
Elizabeth Corley	Non-executive director
Harriet Green	Non-executive director
Chris Grigg	Non-executive director
Paula Rosput Reynolds	Non-executive director
Nick Rose	Non-executive director
Ian Tyler	Non-executive director

Independent review report to BAE Systems plc

Conclusion

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 which comprises the Condensed consolidated income statement, the Condensed consolidated statement of comprehensive income, the Condensed consolidated statement of changes in equity, the Condensed consolidated balance sheet, the Condensed consolidated cash flow statement and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 is not prepared, in all material respects, in accordance with IAS 34, Interim Financial Reporting, as adopted by the EU and the Disclosure Guidance and Transparency Rules (the DTR) of the UK's Financial Conduct Authority (the UK FCA).

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. We read the other information contained in the half-yearly financial report and consider whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

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.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FCA.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the EU. The directors are responsible for preparing the condensed set of financial statements included in the half-yearly financial report in accordance with IAS 34 as adopted by the EU.

Our responsibility

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

The purpose of our review work and to whom we owe our responsibilities

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the DTR of the UK FCA. Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

Ian Starkey

for and on behalf of KPMG LLP

Chartered Accountants

15 Canada Square

London E14 5GL

1 August 2017

Condensed consolidated income statement

	Notes	Six months ended 30 June 2017		Six months ended 30 June 2016	
		£m	£m	£m	£m
Continuing operations					
Sales	2	9,565		8,714	
<i>Deduct</i> Share of sales by equity accounted investments		(1,155)		(996)	
<i>Add</i> Sales to equity accounted investments		602		560	
Revenue	2		9,012		8,278
Operating costs			(8,213)		(7,563)
Other income			61		51
Group operating profit			860		766
Share of results of equity accounted investments			5		10
<i>Underlying EBITA</i>					
	2	945		849	
<i>Non-recurring items¹</i>		(4)		–	
<i>EBITA</i>		941		849	
<i>Amortisation of intangible assets</i>		(41)		(43)	
<i>Financial expense of equity accounted investments</i>		(26)		(15)	
<i>Taxation expense of equity accounted investments</i>		(9)		(15)	
Operating profit	2		865		776
<i>Financial income</i>					
		261		460	
<i>Financial expense</i>					
		(412)		(708)	
Net finance costs	3		(151)		(248)
Profit before taxation			714		528
Taxation expense			(155)		(110)
Profit for the period			559		418
Attributable to:					
Equity shareholders			555		408
Non-controlling interests			4		10
			559		418
Earnings per share					
	4				
Basic earnings per share			17.5p		12.9p
Diluted earnings per share			17.4p		12.8p

1. Non-recurring items represents loss on disposal of businesses.

Condensed consolidated statement of comprehensive income

	Six months ended 30 June 2017			Six months ended 30 June 2016		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings £m	Total £m
Profit for the period	–	559	559	–	418	418
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on retirement benefit schemes	–	170	170	–	(1,504)	(1,504)
Tax on items that will not be reclassified to the income statement	–	(38)	(38)	–	305	305
Equity accounted investments (net of tax)	–	6	6	–	(39)	(39)
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	(341)	–	(341)	687	–	687
Amounts credited to hedging reserve	63	–	63	82	–	82
Tax on items that may be reclassified to the income statement	(11)	–	(11)	(15)	–	(15)
Equity accounted investments (net of tax)	(4)	–	(4)	17	–	17
Total other comprehensive income for the period (net of tax)	(293)	138	(155)	771	(1,238)	(467)
Total comprehensive income for the period	(293)	697	404	771	(820)	(49)
Attributable to:						
Equity shareholders	(291)	693	402	769	(830)	(61)
Non-controlling interests	(2)	4	2	2	10	12
	(293)	697	404	771	(820)	(49)

Condensed consolidated statement of changes in equity

	Attributable to equity holders of the parent						Non-controlling interests £m	Total equity £m
	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m			
At 1 January 2017	87	1,249	6,685	(4,583)	3,438	26	3,464	
Profit for the period	–	–	–	555	555	4	559	
Total other comprehensive income for the period	–	–	(291)	138	(153)	(2)	(155)	
Share-based payments (inclusive of tax)	–	–	–	24	24	–	24	
Net purchase of own shares	–	–	–	(1)	(1)	–	(1)	
Ordinary share dividends	–	–	–	(404)	(404)	(8)	(412)	
At 30 June 2017	87	1,249	6,394	(4,271)	3,459	20	3,479	
At 1 January 2016	87	1,249	5,277	(3,624)	2,989	13	3,002	
Profit for the period	–	–	–	408	408	10	418	
Total other comprehensive income for the period	–	–	769	(1,238)	(469)	2	(467)	
Share-based payments	–	–	–	26	26	–	26	
Net sale of own shares	–	–	–	1	1	–	1	
Ordinary share dividends	–	–	–	(397)	(397)	(6)	(403)	
At 30 June 2016	87	1,249	6,046	(4,824)	2,558	19	2,577	

Condensed consolidated balance sheet

	Notes	30 June 2017 £m	31 December 2016 £m
Non-current assets			
Intangible assets		10,974	11,264
Property, plant and equipment		2,143	2,098
Investment property		114	110
Equity accounted investments		277	299
Other investments		6	6
Other receivables		334	351
Retirement benefit surpluses	5	206	223
Other financial assets		293	345
Deferred tax assets		1,150	1,251
		15,497	15,947
Current assets			
Inventories		773	744
Trade and other receivables including amounts due from customers for contract work		3,653	3,305
Current tax		21	5
Other financial assets		172	204
Cash and cash equivalents		2,360	2,769
Assets held for sale		23	2
		7,002	7,029
Total assets		22,499	22,976
Non-current liabilities			
Loans		(4,230)	(4,425)
Other payables		(1,072)	(1,027)
Retirement benefit obligations	5	(6,066)	(6,277)
Other financial liabilities		(101)	(102)
Deferred tax liabilities		(7)	(10)
Provisions		(365)	(372)
		(11,841)	(12,213)
Current liabilities			
Loans and overdrafts		(4)	–
Trade and other payables		(6,476)	(6,540)
Other financial liabilities		(151)	(212)
Current tax		(318)	(311)
Provisions		(211)	(234)
Liabilities held for sale		(19)	(2)
		(7,179)	(7,299)
Total liabilities		(19,020)	(19,512)
Net assets		3,479	3,464
Capital and reserves			
Issued share capital		87	87
Share premium		1,249	1,249
Other reserves		6,394	6,685
Retained earnings – deficit		(4,271)	(4,583)
Total equity attributable to equity holders of the parent		3,459	3,438
Non-controlling interests		20	26
Total equity		3,479	3,464

Condensed consolidated cash flow statement

	Notes	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 ¹ £m
Profit for the period		559	418
Taxation expense		155	110
Research and development expenditure credits		(14)	(6)
Share of results of equity accounted investments		(5)	(10)
Net finance costs		151	248
Depreciation, amortisation and impairment		167	159
Profit on disposal of property, plant and equipment, and investment property		(1)	(6)
Loss on disposal of businesses		4	–
Cost of equity-settled employee share schemes		29	26
Movements in provisions		(31)	(84)
Decrease in liabilities for retirement benefit obligations		(76)	(116)
(Increase)/decrease in working capital:			
Inventories		(74)	29
Trade and other receivables		(411)	(155)
Trade and other payables		(6)	(470)
Taxation paid		(106)	(66)
Net cash flow from operating activities¹		341	77
Dividends received from equity accounted investments		32	23
Interest received		6	4
Purchases of property, plant and equipment, and investment property		(166)	(166)
Purchases of intangible assets		(36)	(27)
Proceeds from sale of property, plant and equipment, and investment property		3	10
Purchase of subsidiary undertakings		(3)	–
Cash and cash equivalents disposed of with subsidiary undertakings		(2)	–
Equity accounted investment funding		(3)	(3)
Net cash flow from investing activities		(169)	(159)
Interest paid		(107)	(107)
Net (purchase)/sale of own shares		(1)	1
Equity dividends paid	6	(404)	(397)
Dividends paid to non-controlling interests		(8)	(6)
Cash flow from matured derivative financial instruments		(43)	240
Cash flow from cash collateral		(5)	25
Net cash flow from financing activities¹		(568)	(244)
Net decrease in cash and cash equivalents		(396)	(326)
Cash and cash equivalents at 1 January		2,771	2,537
Effect of foreign exchange rate changes on cash and cash equivalents		(19)	29
Cash and cash equivalents at end of period		2,356	2,240
Comprising:			
Cash and cash equivalents		2,360	2,240
Overdrafts		(4)	–
Cash and cash equivalents at end of period		2,356	2,240

1. Re-presented to reclassify interest paid from operating to financing activities.

Notes to the condensed half-yearly financial statements

1. Preparation

Basis of preparation and statement of compliance

These condensed consolidated half-yearly financial statements of BAE Systems plc (the Group) have been prepared in accordance with International Accounting Standard (IAS) 34, Interim Financial Reporting. The annual consolidated financial statements of the Group are prepared in accordance with EU-endorsed International Financial Reporting Standards (IFRSs). These condensed consolidated half-yearly financial statements do not comprise statutory accounts within the meaning of Section 435 of the Companies Act 2006 and should be read in conjunction with the Annual Report 2016. The comparative figures for the year ended 31 December 2016 are not the Group's statutory accounts for that financial year. Those accounts have been reported upon by the Group's auditors and delivered to the registrar of companies. The report of the auditors was unqualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and did not contain statements under Section 498 (2) or (3) of the Companies Act 2006.

The accounting policies adopted in the preparation of these condensed consolidated half-yearly financial statements to 30 June 2017 are consistent with the accounting policies applied by the Group in its consolidated financial statements as at, and for the year ended, 31 December 2016 as required by the Disclosure Guidance and Transparency Rules of the UK's Financial Conduct Authority, with the exception of the presentation of interest paid which is now classified as a financing cash flow.

Future changes in accounting policies

IFRS 9, Financial Instruments, is effective from 1 January 2018. The standard covers recognition, classification, measurement and impairment of financial assets and financial liabilities, together with a new hedge accounting model. It is not expected to have a material impact on the Group.

IFRS 15, Revenue from Contracts with Customers, is effective from 1 January 2018. The standard requires the identification of performance obligations in contracts with customers and allocation of the total contractual value to each of the performance obligations identified. Revenue is recognised as each performance obligation is satisfied either at a point in time or over time. The standard will replace IAS 11, Construction Contracts, and IAS 18, Revenue. An initial impact assessment has been undertaken which involved the review of all contract types across the Group. The assessment indicates that revenue on the Group's long-term contracts currently being recognised based on the completion of separately identifiable phases (milestones) will cumulatively be recognised earlier under IFRS 15, which reflects the continual transfer of the benefits of the Group's performance to the customer. It is expected that profit will continue to be recognised progressively as risks have been mitigated and retired and, accordingly, it is not expected that there will be a material impact on the in-year timing of profit recognition. The impact of the transitional arrangements is under review and will be the subject of an external communication in the second half. There is no impact on the timing of cash receipts, which are determined by the terms and conditions of contracts with the customers.

IFRS 16, Leases, issued in January 2016 with an effective date of 1 January 2019, is not yet EU endorsed. Currently, leases classified as operating leases are not recognised on the balance sheet. The impact of this standard will be to recognise a lease liability and corresponding asset on the Group's balance sheet in respect of the majority of leases currently classified as operating leases.

2. Segmental analysis

Sales and revenue by reporting segment

	Sales		Deduct: Share of sales by equity accounted investments		Add: Sales to equity accounted investments		Revenue	
	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Electronic Systems	1,726	1,443	(45)	(38)	45	38	1,726	1,443
Cyber & Intelligence	923	833	–	–	–	–	923	833
Platforms & Services (US)	1,433	1,287	(33)	(43)	–	–	1,400	1,244
Platforms & Services (UK)	3,913	3,664	(559)	(521)	510	478	3,864	3,621
Platforms & Services (International)	1,771	1,739	(390)	(290)	–	–	1,381	1,449
HQ	128	104	(128)	(104)	–	–	–	–
	9,894	9,070	(1,155)	(996)	555	516	9,294	8,590
Intra-group sales/revenue	(329)	(356)	–	–	47	44	(282)	(312)
	9,565	8,714	(1,155)	(996)	602	560	9,012	8,278

Operating profit/(loss) by reporting segment

	Underlying EBITA		Non-recurring items		Amortisation and impairment of intangible assets		Financial and taxation expense of equity accounted investments		Operating profit/(loss)	
	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Electronic Systems	257	209	–	–	(10)	(9)	–	–	247	200
Cyber & Intelligence	35	18	–	–	(15)	(18)	–	–	20	–
Platforms & Services (US)	109	86	(4)	–	(5)	(7)	(1)	–	99	79
Platforms & Services (UK)	416	414	–	–	(8)	(6)	(2)	(14)	406	394
Platforms & Services (International)	176	158	–	–	(3)	(3)	(12)	(9)	161	146
HQ	(48)	(36)	–	–	–	–	(20)	(7)	(68)	(43)
	945	849	(4)	–	(41)	(43)	(35)	(30)	865	776
Net finance costs									(151)	(248)
Profit before taxation									714	528
Taxation expense									(155)	(110)
Profit for the period									559	418

3. Net finance costs

	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Net finance costs:		
Group	(151)	(248)
Share of equity accounted investments	(26)	(15)
	(177)	(263)
Analysed as:		
Underlying interest expense:		
Group	(111)	(114)
Share of equity accounted investments	(18)	(6)
	(129)	(120)
Other:		
Group:		
Net interest expense on retirement benefit obligations	(84)	(86)
Fair value and foreign exchange adjustments on financial instruments and investments	44	(48)
Share of equity accounted investments:		
Net interest expense on retirement benefit obligations	(3)	(3)
Fair value and foreign exchange adjustments on financial instruments and investments	(5)	(6)
	(177)	(263)

4. Earnings per share

	Six months ended 30 June 2017			Six months ended 30 June 2016		
	£m	Basic pence per share	Diluted pence per share	£m	Basic pence per share	Diluted pence per share
Profit for the period attributable to equity shareholders	555	17.5	17.4	408	12.9	12.8
Add back/(deduct):						
Loss on disposal of businesses	4			–		
Amortisation and impairment of intangible assets, post tax ¹	32			33		
Net interest expense on retirement benefit obligations, post tax ¹	67			69		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax ¹	(30)			41		
Underlying earnings, post tax	628	19.8	19.7	551	17.4	17.3
		Millions	Millions		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		3,179	3,179		3,168	3,168
Incremental shares in respect of employee share schemes			16			8
Weighted average number of shares used in calculating diluted earnings per share			3,195			3,176

1. The tax impact is calculated using the effective tax rate of 23% (2016 23%).

5. Retirement benefits

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2017	(5,778)	(792)	(6,570)
Actual return on assets excluding amounts included in net interest expense	433	237	670
Increase in liabilities due to changes in financial assumptions	(270)	(182)	(452)
Experience losses	(13)	(15)	(28)
Additional contributions in excess of service cost	112	–	112
Recurring contributions below service cost	(17)	(9)	(26)
Past service cost – plan amendments	(1)	–	(1)
Net interest expense	(75)	(18)	(93)
Foreign exchange adjustments	–	34	34
Movement in US healthcare schemes	–	(3)	(3)
Total net IAS 19 deficit at 30 June 2017	(5,609)	(748)	(6,357)
Allocated to equity accounted investments	497	–	497
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 30 June 2017	(5,112)	(748)	(5,860)
Represented by:			
Retirement benefit surpluses	122	84	206
Retirement benefit obligations	(5,234)	(832)	(6,066)
	(5,112)	(748)	(5,860)

Deficit allocation

MBDA participates in the Group's defined benefit schemes and, as these are multi-employer schemes, the Group has allocated a share of the IAS 19 pension surpluses and deficits to MBDA based on the relative payroll contributions of active members, which is consistent with prior years. Whilst this methodology is intended to reflect a reasonable estimate of the share of the deficit, it may not accurately reflect the obligations of the participating employers.

In the event that an employer who participates in the Group's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Group considers the likelihood of this event arising as remote.

Principal actuarial assumptions

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the long-term nature of the obligation covered, may not necessarily occur in practice.

	UK		US	
	30 June 2017	31 December 2016	30 June 2017	31 December 2016
Financial assumptions				
Discount rate – past service (%)	2.6	2.7	3.9	4.2
Discount rate – future service (%)	2.7	2.7	n/a	n/a
Inflation (%)	3.1	3.2	n/a	n/a
Rate of increase in salaries (%)	3.1	3.2	n/a	n/a
Rate of increase in deferred pensions (%)	2.1/3.1	2.2/3.2	n/a	n/a
Rate of increase in pensions in payment (%)	1.6 – 3.7	1.7 – 3.7	n/a	n/a
Demographic assumptions				
Life expectancy of a male currently aged 65 (years)	86 – 89	86 – 89	87	87
Life expectancy of a female currently aged 65 (years)	89 – 90	89 – 90	89	89
Life expectancy of a male currently aged 45 (years)	88 – 91	88 – 91	87	87
Life expectancy of a female currently aged 45 (years)	91 – 92	91 – 92	89	89

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 30 June 2017 and keeping all other assumptions the same.

Financial assumptions

Changes in the following financial assumptions would have the following effect on the defined benefit pension obligation before allocation to equity accounted investments:

	(Increase)/ decrease in pension obligation £bn
Discount rate:	
0.1 percentage point increase	0.6
0.1 percentage point decrease	(0.6)
Inflation:	
0.1 percentage point increase	(0.5)
0.1 percentage point decrease	0.5

The sensitivity analysis does not allow for the impact of the Group's risk management activities in respect of interest rate and inflation risk on the valuation of the scheme assets. Across all of its pension schemes, the Group is hedged against approximately 35% and 40% of interest rate and inflation risk, respectively, measured relative to the funding liabilities. The Group's US schemes are not indexed with inflation. The table below shows the estimated impact of changes in the following financial assumptions allowing for the impact of the Group's risk management activities in respect of interest rate and inflation risk swaps, together with the impact on the matched asset portfolio. It does not reflect any natural matching that occurs in the wider asset portfolio:

	(Increase)/ decrease in pension obligation £bn	(Increase)/ decrease in scheme assets £bn
Discount rate:		
0.1 percentage point increase	0.6	(0.2)
0.1 percentage point decrease	(0.6)	0.2
Inflation:		
0.1 percentage point increase	(0.5)	0.2
0.1 percentage point decrease	0.5	(0.2)

The sensitivity of the valuation of the liabilities to changes in the inflation assumption presented above assumes that a 0.1 percentage point change to expectations of future inflation results in a 0.1 percentage point change to all inflation-related assumptions (rate of increase in salaries, rate of increase in deferred pensions and rate of increase in pensions in payment) used to value the liabilities. However, upper and lower limits exist on the

majority of inflation-related benefits such that a change in expectations of future inflation may not have the same impact on the inflation-related benefits, and hence will result in a smaller change to the valuation of the liabilities. Accordingly, extrapolation of the above results beyond the specific sensitivity figures shown may not be appropriate. To illustrate this, the (increase)/decrease in the defined benefit pension obligation before allocation to equity accounted investments resulting from larger changes in the inflation assumption would be as follows:

	(Increase)/ decrease in pension obligation £bn
Inflation:	
0.5 percentage point increase	(1.7)
0.5 percentage point decrease	1.6
1.0 percentage point increase	(3.5)
1.0 percentage point decrease	3.1

Demographic assumptions

Changes in the life expectancy assumption, including the benefit of longevity swap arrangements, would have the following effect on the total net IAS 19 deficit before allocation to equity accounted investments:

	(Increase)/ decrease in net deficit £bn
Life expectancy:	
One-year increase	(1.0)
One-year decrease	1.1

6. Equity dividends

	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Prior year final 12.7p dividend per ordinary share paid in the period (2016 12.5p)	404	397

The directors have declared an interim dividend of 8.8p per ordinary share (2016 8.6p), totalling £280m (2016 £273m). The dividend will be paid on 30 November 2017 to shareholders registered on 20 October 2017. The ex-dividend date is 19 October 2017.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 9 November 2017.

7. Fair value measurement

Fair value of financial instruments

Certain of the Group's financial instruments are held at fair value.

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the balance sheet date.

The fair values of financial instruments held at fair value have been determined based on available market information at the balance sheet date, and the valuation methodologies listed below:

- the fair values of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates;
- the fair values of both interest rate and cross-currency swaps are calculated by discounting expected future principal and interest cash flows and translating at the appropriate balance sheet rates; and
- the fair values of loans and overdrafts have been estimated by discounting the future cash flows to net present values using appropriate market-based interest rates prevailing at 30 June.

Due to the variability of the valuation factors, the fair values presented at 30 June may not be indicative of the amounts the Group would expect to realise in the current market environment.

Fair value hierarchy

The fair value measurement hierarchy is as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

Carrying amounts and fair values of certain financial instruments

	30 June 2017		31 December 2016	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:				
Non-current				
Available-for-sale financial assets	6	6	6	6
Other receivables ¹	301	301	296	296
Other financial assets	293	293	345	345
Other financial liabilities	(101)	(101)	(102)	(102)
Other payables ¹	(321)	(321)	(326)	(326)
Current				
Other financial assets	172	172	204	204
Other financial liabilities	(151)	(151)	(212)	(212)

Financial instruments not measured at fair value:

Non-current				
Loans ²	(4,230)	(4,693)	(4,425)	(4,805)
Current				
Cash and cash equivalents	2,360	2,360	2,769	2,769
Loans and overdrafts	(4)	(4)	–	–

1. Represents US deferred compensation plan assets and liabilities.

2. US\$500m of the US\$800m 3.8% bond, repayable 2024, has been converted to a floating rate bond by utilising interest rate swaps. These derivatives have been designated as fair value hedges. Changes in the fair value of the interest rate risk on the bond, and gains and losses on the derivatives are recognised in the income statement. The bond has been included in financial instruments not measured at fair value because its carrying value has only been adjusted for the fair value of the interest rate risk on a portion of the bond.

All of the financial assets and liabilities measured at fair value are classified as level 2 using the fair value hierarchy. There were no transfers between levels during the period.

Financial assets and liabilities are either held at fair value or their carrying value approximates to fair value, with the exception of loans, most of which are held at amortised cost.

8. Financial risk management

Currency risk

The Group's objective is to reduce its exposure to transactional volatility in earnings and cash flows from movements in foreign currency exchange rates, mainly the US dollar, euro, Saudi riyal and Australian dollar.

The Group is exposed to movements in foreign currency exchange rates in respect of foreign currency denominated transactions. All material firm transactional exposures are hedged and the Group aims, where possible, to apply hedge accounting to these transactions.

The Group is exposed to movements in foreign currency exchange rates in respect of the translation of net assets and income statements of foreign subsidiaries and equity accounted investments. The Group does not hedge the translation effect of exchange rate movements on the income statements or balance sheets of foreign subsidiaries and equity accounted investments it regards as long-term investments.

9. Related party transactions

Transactions with related parties are shown on page 174 of the Annual Report 2016.

	Six months ended 30 June 2017 £m	Six months ended 30 June 2016 £m
Sales to equity accounted investments	602	560
Purchases from equity accounted investments	173	205

	30 June 2017 £m	31 December 2016 £m
Amounts owed by equity accounted investments	162	69
Amounts owed to equity accounted investments ¹	731	750

1. Excludes £285m (31 December 2016 £285m) included within amounts due to long-term contract customers.

10. Annual General Meeting

The Annual General Meeting of BAE Systems plc will be held on 10 May 2018.

Cautionary statement:

All statements other than statements of historical fact included in this document, including, without limitation, those regarding the financial condition, results, operations and businesses of BAE Systems and its strategy, plans and objectives and the markets and economies in which it operates, are forward-looking statements. Such forward-looking statements which reflect management's assumptions made on the basis of information available to it at this time, involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of BAE Systems or the markets and economies in which BAE Systems operates to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. BAE Systems plc and its directors accept no liability to third parties in respect of this report save as would arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with Schedule 10A of the Financial Services and Markets Act 2000. It should be noted that Schedule 10A contains limits on the liability of the directors of BAE Systems plc so that their liability is solely to BAE Systems plc.