BAE Systems plc

PRELIMINARY ANNOUNCEMENT 2014

RESULTS IN BRIEF

	2014	2013
Sales[1]	**£16,637m**	£18,180m
Underlying EBITA[2]	**£1,702m**	£1,925m
Operating profit	**£1,300m**	£806m
Underlying earnings[3] per share	**38.0p**	42.0p
Basic earnings per share[4]	**23.4p**	5.2p
Order backlog[1,5]	**£40.5bn**	£42.7bn
Dividend per share	**20.5p**	20.1p
Operating business cash flow[6]	**£1,191m**	£147m
Net debt (as defined by the Group)[7]	**£(1,032)m**	£(699)m

Ian King, Chief Executive, said: *"In 2014, BAE Systems delivered a solid overall performance, in line with guidance. We continue to win significant new business with over £10bn of new orders from the UK and US for the third successive year. As a result, the large order backlog[1,5] of £40.5bn continues to provide good, multi-year visibility across many of our businesses.*

Looking ahead, defence spending remains a high priority in a number of international markets. In the UK, we benefit from long-term contracts, notwithstanding continued pressure on public spending. We believe US budgets are now relatively stable, with some early indications of a modest improvement in 2016.

These are competitive times and we will continue to invest in and develop the technology, skills and market positions needed to drive the business forward.

The Group is well positioned to continue to deliver shareholder value."

KEY POINTS

FINANCIAL

– Sales[1] were £16.6bn. The year-on-year reduction of £1.5bn reflected £0.6bn of adverse exchange rate translation, the expected volume reductions in Land & Armaments and the previous year's benefit from the one-off price settlement for Salam Typhoon.

– Underlying EBITA[2] was £1,702m. The year-on-year position was broadly unchanged after allowing for exchange rate translation and the one-off 2013 price settlement.

– Margin performance delivered a return on sales of 10.2%.

– Underlying earnings[3] per share increased from 37.6p to 38.0p after excluding the benefit from the price escalation settlement in 2013.

– £925m returned to shareholders in 2014, from share repurchase programme and dividends.

– Large order backlog[1,5] of £40.5bn.

OPERATIONAL

- Acceleration of capability expansion on the Typhoon aircraft with commitments to additional weapons integration and E-Scan radar.
- Major milestone achieved with naming and float-up of HMS Queen Elizabeth aircraft carrier. Over £1bn of Royal Navy contracts awarded.
- Contract award received for the US Armored Multi-Purpose Vehicle, creating a new franchise.
- Selected to provide the integrated flight control electronics and other systems for next-generation Boeing 777X aircraft.
- US-managed business streamlined to improve competitiveness.
- Operational progress made, but further charges taken, on US commercial shipbuild contracts.
- BAE Systems Applied Intelligence delivered organic sales growth of 10%, driven by growth in commercial cyber security. Order backlog increased 37%.
- SilverSky acquisition completed, enhancing the Group's strategy to grow the commercial cyber business.

OUTLOOK FOR 2015

Group outlook

In 2015, the Group's underlying earnings[3] per share are expected to be marginally higher than in 2014, including some reliance on anticipated naval and aircraft orders.

Segmental outlook

Electronic Systems:

- Sales[1] (in US$) are expected to be similar to 2014, with growth from commercial business offsetting small reductions in defence.
- Margins are expected to be at the top end of a 12% to 14% guidance range.

Cyber & Intelligence comprising the US Intelligence & Security sector (2014 79% of sales) and UK-headquartered Applied Intelligence:

- Mid-single digit sales[1] growth expected in 2015; with strong sales growth planned of around 30% in Applied Intelligence offsetting marginally lower sales in Intelligence & Security.
- Margins anticipated within an 8% to 10% range, but at the lower end after integration costs of SilverSky and continued investment in the Applied Intelligence business.

Platforms & Services (US):

- Sales[1] are expected to reduce by around 10%, or 8% like-for-like excluding the disposal of the South African land business.
- Margins are expected to be in a 6% to 8% range, reflecting continued margin dilution from sales trading on the Radford and commercial shipbuilding contracts.

Platforms & Services (UK):

- Sales[1] are expected to increase by approximately 5% with higher sales from Salam Typhoon deliveries and the Astute and Successor submarine programmes more than offsetting reduced trading on the Queen Elizabeth Class carrier programme.
- Margins expected to be at the lower end of a 10% to 12% range, reflecting the impact of increased UK pension service costs due to the lower discount rate.

Platforms & Services (International):

– Sales[1] in 2015 are expected to be approximately 10% higher than in 2014, including increased levels of support to the Salam Typhoon aircraft now in service and from higher volumes of weapon systems.

– Margins are expected to be similar to 2014.

HQ costs are expected to be a little higher than those in 2014. Underlying finance costs are expected to be similar to 2014. The effective tax rate is expected to be around 20% with some dependency on the geographic mix of profits.

This outlook is based on an exchange rate planning assumption of US$1.55/£1.

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Analyst and investor presentation

A presentation, for analysts and investors, of the Group's Results for 2014 will be available via webcast at 09:00 today. Details can be found on **www.baesystems.com/investors**, 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, we provide some of the world's most advanced, technology-led defence, aerospace and security solutions. We employ a skilled workforce of 83,400 people[1] in 40 countries. Working with customers and local partners, we develop, engineer, manufacture and support products and systems to deliver military capability, protect national security and people, and keep critical information and infrastructure secure.

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 9).
3. Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, non-recurring items and, in 2014, a credit in respect of the re-assessment of existing tax provisions (see note 4).
4. Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.
5. Comprises funded and unfunded unexecuted customer orders, and is stated after the elimination of intra-group orders.
6. Net cash inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
7. Comprises cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments) and cash received on customers' account (see page 10).

PRELIMINARY RESULTS STATEMENT

2014 has seen signs of greater stability and improving clarity emerge in markets where budgets have been constrained in recent years by the wider economic backdrop. In this challenging but stabilising environment, BAE Systems has delivered a solid overall performance in 2014, building on the good programme execution of recent years.

Defence and security continues as a high priority in a number of the Group's domestic and international markets, including the Kingdom of Saudi Arabia. The Group has also continued to win significant new business. Order intake of £4.3bn was achieved from international markets outside the US and the UK contributing to the £40.5bn order backlog at year end. That large order backlog provides good, multi-year visibility across many of the Group's businesses. In addition, the Group has achieved over £10bn of order intake in the US and UK each year over the last three years. These US and UK programmes provide the Group with the intellectual property which can be used to develop international and support businesses for the future.

US

In January 2014, a US bipartisan budget agreement provided a two-year window of defence funding visibility and some emerging stability. Only minor trading disruption was apparent in the last quarter of 2014 as the government operated under a Continuing Resolution until the mid-December passage of an omnibus appropriations bill for the 2015 fiscal year. This included stable Department of Defense funding compared with 2014, and included funding for ground vehicle programmes and for additional F-35 Lightning II aircraft.

US budgets are now relatively stable, with some early indications of a modest improvement in 2016.

On 1 February 2014, Jerry DeMuro was appointed as President and Chief Executive Officer of BAE Systems, Inc. Following his appointment, and recognising the need for continued competitive enhancement, the Group's US organisation was streamlined into three operating sectors with resultant reductions to administrative overhead.

The Group's Intelligence & Security business continued to face a challenging environment serving US government security community customers.

The Group's Electronic Systems activities benefited from the broad base of high-technology defence systems and equipment and continued good growth in commercial aircraft electronics. We have maintained our leadership position in the US electronic warfare market. The selection of BAE Systems to supply an advanced, integrated electronic flight control system for Boeing's new 777X programme was a notable achievement, expected to generate significant new business in future years. The award adds to established positions providing flight and engine controls across multiple commercial aircraft platforms.

There was strong margin performance in the Land & Armaments business and a number of order awards on programmes that sustain key combat vehicle industrial base capabilities. In December, BAE Systems was awarded a contract for the engineering and manufacturing development phase of the Armored Multi-Purpose Vehicle programme, which will sustain these capabilities in the longer term.

BAE Systems is a major provider of ship repair services to the US Navy. Consistent with the US Navy's increased focus on Asia-Pacific operations, the Group committed a $103m (£66m) investment to install new floating dry dock facilities in its San Diego shipyard.

Performance issues identified in 2013 in commercial shipbuilding continued to depress margins in the US Support Solutions business. There were also further charges taken in 2014. The operational challenges identified in 2013 on the Radford ammunition facility maintenance contract have been mitigated significantly during the year.

In November, the Group was disappointed to learn that the Republic of Korea had decided to terminate for convenience the US Air Force's Foreign Military Sales contract with BAE Systems to upgrade Korea's F-16 aircraft fleet.

UK

In the UK, the defence and security market has been stable. Notwithstanding the continued constraints on public spending in some sectors, BAE Systems continues to benefit from long-term contracts in the air and naval domains. Both major political parties in the UK are committed to carrying out a Strategic

Defence and Security Review after the general election in May. The Group benefits from a large order backlog of long-term committed programmes with many key decisions now addressed for several years.

We recognise that the economic environment in the UK remains challenging, placing further pressure on many areas of public spending, including the UK defence budget. Through a continued focus on cost control, programme execution and efficiency, the Group is working to deliver continuous improvements in affordability for the UK customer to ensure that the Group's large, long-term contracts deliver both value and world-class capability.

In the air domain, Typhoon production and the Group's extensive in-service military aircraft support and upgrade business in the UK provide a strong core of high-performing business. 2014 has seen a significant acceleration of capability expansion on to the Typhoon combat aircraft platform. Activity is underway to integrate additional weapons and sensors onto the aircraft for the four European partner nations and international customers. In November, the formal launch of a funded, multi-nation development programme for an advanced, electronically-scanned radar was a key milestone in the Typhoon platform's evolution.

Our participation in the F-35 Lightning II combat aircraft programme includes UK-manufactured rear fuselage and empennage assemblies as well as electronic systems content from the Group's US-based business. The Group expects significant growth in production volume with the planned acceleration of aircraft deliveries.

The outlook for the Group's UK maritime businesses is robust. The build of two Queen Elizabeth Class aircraft carriers is progressing well. The first of Class was named in a formal ceremony by Her Majesty The Queen on 4 July and subsequently floated out of the dock in which she was assembled, enabling assembly of blocks for the second vessel to commence as the first vessel continues outfitting alongside. BAE Systems welcomed the decision, announced by Prime Minister David Cameron at the NATO Summit held in the UK in October, to commit to the operation of both vessels, providing a continuous-at-sea UK carrier capability.

Actions continue to implement and finalise contracts for the restructuring of the Group's naval ships business following last year's agreement with the UK government. In August, the Group was awarded a contract for the build of three Offshore Patrol Vessels for the Royal Navy, sustaining shipbuilding skills between the Carrier programme and the start of manufacture for the anticipated Type 26 frigate programme. The Group continues to work on the Type 26 assessment phase and is discussing proposals with the UK Ministry of Defence for the future phases of the programme. The Type 26 programme will provide long-term clarity for UK complex warship manufacture, including at the Group's facilities on the River Clyde in Scotland.

Following the Scottish independence referendum in September, the people of Scotland decided to remain within the Union. The decision was welcomed, removing uncertainty for the Group's employees and its business based in Scotland.

In October, the Group agreed a multi-year Maritime Support Delivery Framework contract for the operation of the Royal Naval Base at Portsmouth and global support for half of the Royal Navy's surface fleet.

In December, a significant contract for the upgrade of the Spearfish torpedo was secured.

In the submarines business, Artful, the third of a planned seven Astute Class submarines, was launched in May. Alongside build of Astute Class boats, engineering work continues to accelerate as part of the assessment phase of the Successor submarine programme. The Successor programme is the potential replacement of Vanguard Class submarines, intended to enter service towards the end of the next decade.

Cyber security

BAE Systems continues to develop its strategy for commercial cyber security, with growth being delivered and a number of important contract wins in the year. Order backlog in the Applied Intelligence business grew by 37% in the year, building on the 60% increase in 2013.

We continue to target strong growth opportunities in commercial cyber security markets and the acquisition of SilverSky in December accelerates the Group's strategy to grow in the commercial cyber market, providing an established channel to US customers.

International
In Saudi Arabia, the Group delivered a further 11 Typhoon aircraft in the year and developed its position as a key part of the Kingdom's defence industrial base.

In February 2014, agreement was reached with the Saudi Arabian government on price escalation for the Salam Typhoon programme under the current 72-aircraft contract.

In June, we announced a reorganisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia and an enhancement of its existing relationship with Riyadh Wings Aviation Academy LLC (Riyadh Wings). The reorganisation brings together shareholdings of BAE Systems and Riyadh Wings in Saudi companies specialising in training, electronics and IT systems engineering under a single holding company. The reorganisation is intended to enhance the growth prospects of this portfolio of businesses and reinforce an ongoing commitment to increasing local employment.

In Australia, where BAE Systems is the largest defence contractor, the government approved, in May 2014, a commitment to grow defence spending within a decade to 2% of Gross Domestic Product.

The Group delivered the first of two Canberra Class Landing Helicopter Dock (LHD) vessels for the Royal Australian Navy and manufacture of the second ship is progressing well. Following the high level of activity on this programme, there is currently no material follow-on workload contracted. BAE Systems and the Australian government continue to discuss options to sustain industrial capabilities and meet future naval requirements following on from the high level of workload on the LHD programme.

BAE Systems is a 37.5% shareholder in the MBDA guided weapons joint venture. MBDA benefits from sales to equip a range of air and naval platforms across European and wider international applications. In December, MBDA received a €301m (£234m) contract to supply the air-to-air missiles for India's Jaguar aircraft fleet. The MBDA business has seen increased bidding interest on ground-based air defence systems in some regions.

M&A
In August, the Group announced an agreement for the proposed sale of its 75% holding in BAE Systems Land Systems South Africa Proprietary Limited to Denel (SOC) Limited for cash consideration of approximately 641 million Rand (£36m), subject to closing adjustments. The sale is expected to be completed in 2015.

As part of the reorganisation of the Group's interests in Saudi Arabia, in September, BAE Systems acquired an additional 59% shareholding in Saudi Development and Training Company for 440 million Saudi Riyal (£72m).

In September, the Group completed the $21m (£13m) acquisition of Signal Innovations Group, Inc., a small-scale, high-technology provider of imaging technologies and analytics to the US intelligence community.

In December, BAE Systems completed the acquisition of SilverSky for $232m (£149m).

In December, BAE Systems entered into an agreement with Esterline Corporation for the proposed acquisition of Eclipse Electronic Systems, Inc. for cash consideration of approximately $28m (£18m), subject to closing adjustments. The Texas-based business employs approximately 90 people and provides highly-advanced Intelligence, Surveillance and Reconnaissance products and services to the US defence and intelligence community. The proposed acquisition has not yet completed.

Balance sheet and capital allocation
Following the triennial funding valuations of all of the Group's UK pension schemes and subsequent discussions with trustees, new funding agreements have been concluded, with overall deficit funding remaining broadly consistent with 2014.

In February 2013, the Group initiated a share repurchase programme of up to £1bn over three years. As at 31 December 2014, BAE Systems had purchased 119 million shares for £495m under the programme.

The Group's balance sheet continues to be managed conservatively in line with the Group's policy to retain its investment grade credit rating and to ensure operating flexibility. Consistent with this approach, the Group meets its pension obligations, pursues organic investment opportunities, plans to pay dividends in line with its policy of long-term sustainable cover of around two times underlying earnings and to make accelerated returns of capital to shareholders when the balance sheet allows. Investment in value-enhancing acquisitions are considered where market conditions are right and where they deliver on the Group's strategy.

Directors and management

On 1 February 2014, Sir Roger Carr succeeded Sir Richard Olver as Chairman of the Board of BAE Systems plc and Sir Richard stepped down from the Board on that date.

Also on 1 February 2014, Linda Hudson retired as President and Chief Executive Officer of BAE Systems, Inc. and as an executive director of BAE Systems plc. On the same date, Jerry DeMuro was appointed as President and Chief Executive Officer of BAE Systems, Inc. and as an executive director of BAE Systems plc.

Paul Anderson, a non-executive director, retired from the Board on 31 December 2014 after six years of service.

Ian Tyler has now taken over the role of chairman of the Corporate Responsibility Committee.

Kevin Taylor, previously Group Strategy Director, has been appointed as Managing Director, Applied Intelligence, to lead the business as it enters the next phase of its strategy to target accelerated growth and further develop our technology for government and commercial customers. Kevin will remain an Executive Committee member.

Dividend

The Board has recommended a final dividend of 12.3p per share making a total of 20.5p per share for the year, an increase of 2% over 2013. At this level, the annual dividend is covered 1.85 times by underlying earnings (2013 2.1 times).

INCOME STATEMENT

	2014 £m	2013 £m
Sales[1]	**16,637**	18,180
Underlying EBITA[2]	**1,702**	1,925
Return on sales	***10.2%***	*10.6%*
Non-recurring items	**–**	6
EBITA	**1,702**	1,931
Amortisation of intangible assets	**(184)**	(189)
Impairment of intangible assets	**(170)**	(887)
Finance costs[1]	**(448)**	(392)
Taxation expense[1]	**(148)**	(287)
Profit for the year	**752**	176

Exchange rates – average	**2014**	2013
£/$	**1.647**	1.564
£/€	**1.241**	1.178
£/A$	**1.827**	1.623

Exchange rates – sensitivity analysis

Estimated impact on sales[1] of a ten cent movement in the average exchange rate	**£m**
$	**350**
€	**60**
A$	**40**

Segmental analysis

	Sales[1]		Underlying EBITA[2]	
	2014 £m	2013[3] £m	**2014 £m**	2013[3] £m
Electronic Systems	**2,415**	2,466	**373**	346
Cyber & Intelligence	**1,085**	1,243	**123**	115
Platforms & Services (US)	**3,266**	3,912	**147**	229
Platforms & Services (UK)	**6,623**	7,174	**772**	915
Platforms & Services (International)	**3,572**	4,063	**366**	429
HQ	**279**	306	**(79)**	(109)
Intra-group	**(603)**	(984)		
	16,637	18,180	**1,702**	1,925

Sales[1] reduced by £1.5bn to £16.6bn (2013 £18.2bn). The prior year included the £0.3bn retrospective benefit from the trading of the price escalation on the Salam Typhoon programme. The volume reductions of £0.4bn in the Land & Armaments business were as expected. Approximately £0.6bn of the reduction in sales[1] was due to exchange translation.

Underlying EBITA[2] reduced by £223m to £1,702m (2013 £1,925m), giving a return on sales of 10.2% (2013 10.6%). The prior year included a £183m retrospective benefit from the Salam price escalation settlement. Charges totalling £74m were taken in 2014 on US commercial shipbuilding programmes in the Support Solutions business. Adverse exchange translation amounted to £49m.

Non-recurring items in 2014 includes a £47m accounting gain on the Group's existing 40% shareholding in Saudi Development and Training Company following the acquisition of an additional 59% shareholding in the company offset by a £47m charge on classification of the Saudi Aircraft Accessories and Components Company (AACC) as held for sale.

Amortisation of intangible assets was £184m (2013 £189m).

Impairment of intangible assets includes goodwill impairment charges of £87m against the carrying value of Support Solutions reflecting the performance issues in the US commercial shipbuilding business and £74m against the carrying value of the South African business expected to be sold in 2015.

Finance costs[1] were £448m (2013 £392m). The underlying interest charge, excluding pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements, increased to £204m (2013 £179m), primarily from a higher level of net present value charges. Net interest expense on the Group's pension deficit was lower at £155m (2013 £195m) mainly reflecting the reduction in the deficit during 2013.

Taxation expense[1] reflects the Group's underlying effective tax rate for the period of 19% (2013 22%), partially offset by a £51m credit in respect of the re-assessment of existing tax provisions. The effective tax rate for 2015 is expected to be around 20%, with the final rate dependent on the geographical mix of profits.

EARNINGS PER SHARE

Underlying earnings[4] **per share** for the year was 38.0p (2013 42.0p). The prior year included a 4.4p retrospective benefit from the Salam price escalation settlement.

Basic earnings per share, in accordance with International Accounting Standard 33, Earnings per Share, was 23.4p (2013 5.2p). The increase on the prior year mainly reflects the £887m of impairment charges taken in 2013 which are excluded from underlying earnings[4] per share.

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Re-presented for the transfer of the UK Munitions business from Platforms & Services (US) to Platforms & Services (UK) from 1 January 2014.
4. Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, non-recurring items and, in 2014, a credit in respect of the re-assessment of existing tax provisions (see note 4).

CASH FLOW

Reconciliation of cash inflow from operating activities to net debt (as defined by the Group)

	2014 £m	2013 £m
Cash inflow from operating activities	**913**	205
Capital proceeds/(expenditure) (net) and financial investment	**215**	(153)
Dividends received from equity accounted investments	**63**	95
Operating business cash flow[5]	**1,191**	147
Interest	**(145)**	(166)
Taxation	**(92)**	(138)
Free cash flow	**954**	(157)
Acquisitions and disposals	**(230)**	4
Cash classified as held for sale	**(6)**	–
Share repurchase programme	**(283)**	(212)
Other net sale of own shares	**2**	–
Equity dividends paid	**(642)**	(638)
Dividends paid to non-controlling interests	**(14)**	(11)
Cash flow from matured derivative financial instruments	**8**	(47)
Movement in cash collateral	**10**	(10)
Movement in cash received on customers' account[6]	**1**	1
Foreign exchange translation	**(146)**	3
Other non-cash movements	**13**	(19)
Total cash outflow	**(333)**	(1,086)
Opening net (debt)/cash (as defined by the Group)	**(699)**	387
Closing net debt (as defined by the Group)	**(1,032)**	(699)

Operating business cash flow

	2014 £m	2013[7] £m
Electronic Systems	**246**	235
Cyber & Intelligence	**71**	118
Platforms & Services (US)	**201**	191
Platforms & Services (UK)	**173**	60
Platforms & Services (International)	**881**	(189)
HQ	**(381)**	(268)
Operating business cash flow[5]	**1,191**	147

COMPONENTS OF NET DEBT (AS DEFINED BY THE GROUP)

	2014 £m	2013 £m
Debt-related derivative financial instrument assets	**10**	6
Cash and cash equivalents	**2,314**	2,222
Less: Cash classified as held for sale	**(6)**	–
	2,318	2,228
Loans – non-current	**(2,868)**	(2,524)
Loans and overdrafts – current	**(482)**	(402)
Less: Cash received on customers' account[6]	**–**	(1)
	(3,350)	(2,927)
Net debt (as defined by the Group)	**(1,032)**	(699)

5. Net cash inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
6. Cash received on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance. It is included within trade and other payables in the consolidated balance sheet.
7. Re-presented for the transfer of the UK Munitions business from Platforms & Services (US) to Platforms & Services (UK) from 1 January 2014.

CASH FLOW

Cash inflow from operating activities was £913m (2013 £205m), which includes cash contributions in respect of pension deficit funding, over and above service costs, for the UK and US schemes totalling £391m (2013 £389m).

As anticipated, advances received in prior years continue to be consumed on the Omani Typhoon and Hawk, Saudi training aircraft, European Typhoon Tranche 2 and Indian Hawk programmes. Costs incurred are also being charged against provisions created in previous years on the Oman Offshore Patrol Vessel contract, rationalisation and settlement of a US contract pricing dispute. The first of two payments in respect of the Salam price escalation settlement was received as expected.

The **net cash proceeds from capital expenditure and financial investment** of £215m (2013 £153m outflow) includes the sale and leaseback of two properties in Saudi Arabia, for which £418m was received in the year.

Dividends received from equity accounted investments reduced by £32m to £63m (2013 £95m) reflecting a dividend received from the Group's 50% shareholding in Gripen International in 2013.

Interest payments were £21m lower at £145m (2013 £166m) primarily reflecting the timing of interest payments on US dollar bonds and lower facility fees.

Taxation payments reduced to £92m (2013 £138m) mainly due to settlement of a US contract pricing dispute and other US issues.

There was a cash outflow in respect of **acquisitions and disposals** reflecting the acquisition of SilverSky (£147m) and Signal Innovations Group (£12m) and an additional 59% shareholding in Saudi Development and Training Company (£71m).

The cash outflow in respect of the **share repurchase programme** of £283m (2013 £212m) represents shares purchased and cancelled under the programme announced in February 2013.

Equity dividends paid in 2014 include payments in respect of the 2013 final (£383m) and 2014 interim (£259m) dividends.

As a consequence of movements in US dollar and Euro exchange rates during the year, there has been a **cash inflow from matured derivative financial instruments** of £8m (2013 £47m outflow) from rolling hedges on balances with the Group's subsidiaries and equity accounted investments.

Foreign exchange translation, primarily in respect of the Group's US dollar-denominated borrowing, increased reported net debt by £146m.

NET DEBT (AS DEFINED BY THE GROUP)

The Group's **net debt** at 31 December 2014 is £1,032m, a net outflow of £333m from the net debt position of £699m at the start of the year.

A $500m (£298m) 4.95% bond and a £100m, 10¾% bond were repaid at maturity in June and December, respectively. These repayments had been largely pre-financed by the £0.4bn raised in the UK bond market in 2012.

In October, the Group issued $800m (£495m) 3.8% and $300m (£184m) 4.75% bonds maturing in 2024 and 2044, respectively, intended for general corporate purposes, including the repayment of debt securities at maturity in 2015 and 2016.

Cash and cash equivalents of £2,314m (2013 £2,222m) are held primarily for the repayment of £0.7bn of debt securities maturing in 2015 and 2016, the share repurchase programme, pension deficit funding, payment of the 2014 final dividend and management of working capital.

SEGMENTAL PERFORMANCE: ELECTRONIC SYSTEMS

Electronic Systems, with 12,500 employees[1], comprises the US and UK-based electronics activities, including electronic warfare systems and 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.

	2014	2013
Sales[1]	**£2,415m**	£2,466m
Underlying EBITA[2]	**£373m**	£346m
Return on sales	**15.4%**	14.0%
Cash inflow[3]	**£246m**	£235m
Order intake[1]	**£2,341m**	£2,697m
Order backlog[1,4]	**£3.9bn**	£3.7bn

OPERATIONAL AND STRATEGIC HIGHLIGHTS

– Maintained a leadership position in the US electronic warfare market
– Received a three-year contract from the US Army for third-generation Common Missile Warning Systems
– Next-generation Striker® II helmet-mounted display unveiled
– Two-year contract awarded to provide Tactical Signals Intelligence Payloads and associated equipment for the US Army's Gray Eagle unmanned aircraft
– Strengthened position in the high growth commercial aircraft electronics market, with wins on several Boeing aircraft, including 777X, and other aircraft
– Research and development expenditure[5] at 7% of sales[1] in 2014

OPERATIONAL PERFORMANCE

Electronic Combat

Electronic Systems maintains its leadership position in the US electronic warfare market. Initial design verification testing of the electronic warfare suite on the F-35 Lightning II programme was completed during the year. Low-Rate Initial Production (LRIP) Lots 7 and 8 deliveries continue, and the business has received initial funding on Lots 9 and 10, with anticipated negotiations in 2015.

The business is under contracts, from Boeing and Warner Robins Air Logistics Complex, totalling over $0.9bn (£0.6bn) to install the Digital Electronic Warfare System (DEWS) on 84 new F-15 aircraft and upgrade the DEWS on 70 existing F-15 aircraft for the Royal Saudi Air Force. System verification and flight testing continues on schedule in advance of initial fielding in the second half of 2015.

The US Air Force has defined its requirements for the next-generation electronic warfare system, Eagle Passive Active Warning Survivability System, for more than 400 existing F-15 aircraft. The programme will consist of the design, development, integration and delivery of a passive and active electronic warfare suite. The business has submitted a proposal to Boeing and, in competition, an award decision is expected in the third quarter of 2015.

Following successful US Defense Advanced Research Projects Agency flight demonstrations, Electronic Systems has received an $86m (£55m) contract to design, develop and deliver initial electronic sensors for the Long-Range Anti-Ship Missile in support of its initial fielding in 2018 on board B-1B aircraft.

In 2014, BAE Systems was not awarded the technology development contract for the Next-Generation Jammer.

Survivability & Targeting

Electronic Systems completed its $38m (£24m) Common Infrared Countermeasures technology development contract on a US Army helicopter programme. A proposal for the engineering and manufacturing development phase, together with options for two LRIP phases, was submitted in November and, in competition, an award decision is expected in 2015.

A three-year Indefinite Delivery, Indefinite Quantity (IDIQ) contract with the US Army, with a potential value of approximately $496m (£318m), was agreed in May for third-generation Common Missile

Warning Systems. The US Army has determined that this will be the baseline for export to international customers.

Electronic Systems continues to execute its $37m (£24m) Advanced Precision Kill Weapon System (APKWS™) Full-Rate Production Lot 3 contract with the US Navy, with more than 3,500 systems delivered to 31 December 2014. The APKWS laser-guided rocket achieved an Air Worthiness Release and successfully completed initial live testing on the US Army Apache D/E aircraft in 2014. The $45m (£29m) Full-Rate Production Lot 4 contract was finalised in December. The US Army is working closely with the US Navy to acquire APKWS for initial fielding in 2015.

Jordan and the US Navy have signed a Letter of Offer and Acceptance to progress the first international sale of the APKWS system. Other international opportunities were progressed, with the successful completion of a ground trial in Australia and, in November, the US Defense Security Cooperation Agency began the Congressional Notification process on a potential Foreign Military Sale to Iraq for up to 2,000 systems.

The business continues to perform on the Terminal High-Altitude Area Defence orders for 307 infrared missile seekers supporting both the US government and Foreign Military Sales worth $340m (£218m).

In May, Electronic Systems was awarded a five-year IDIQ contract with a potential value of approximately $445m (£285m) to support the US Army's Enhanced Night Vision Goggle III and Family of Weapon Sights – Individual programme. Following a protest by a competitor and re-competition, BAE Systems was awarded the contract in December. However, this new award has been further protested, with the next decision expected in March 2015.

Communications & Control
Electronic Systems continues to deliver on programmes in Korea, providing flight control systems, head-up displays, mission computers and automatic test equipment systems.

On the F-35 Lightning II programme, BAE Systems successfully completed Lot 7 deliveries of the vehicle management computer in support of Lockheed Martin's production programme. Lots 8 and 9 are under contract.

The next-generation Striker® II helmet-mounted display was unveiled at the Farnborough Airshow in July. The system is a digital upgrade of the current product, in service on Typhoon and Gripen aircraft, providing seamless day and night capability through an integrated digital night vision camera.

Intelligence, Surveillance & Reconnaissance
Electronic Systems continues to provide Airborne Surveillance capability for the US Air Force and US Army based on two wide-area, high-resolution imaging sensor systems – the Airborne Wide Area Persistent Surveillance System, which has been operational for more than 23,000 hours in theatre, and the Autonomous Real-time Ground Ubiquitous Surveillance – Imaging System.

The business provides state-of-the-art processing capabilities for the US Navy's P-8A Poseidon programme, which has entered Full-Rate Production and delivered 28 mission computer and display systems. Eight additional systems have been delivered to Boeing for its first international customer and four systems were procured by Australia.

Electronic Systems continues to provide Signals Intelligence capability for the US Army and other US Department of Defense customers. In June, BAE Systems was awarded a two-year IDIQ contract worth up to $70m (£45m) to provide Tactical Signals Intelligence Payloads and associated equipment for the US Army's Gray Eagle unmanned aircraft.

In December, BAE Systems entered into an agreement with Esterline Corporation for the proposed acquisition of Eclipse Electronic Systems, Inc. for cash consideration of approximately $28m (£18m), subject to closing adjustments. The Texas-based business provides highly-advanced Intelligence, Surveillance and Reconnaissance products and services to the US defence and intelligence community. The proposed acquisition has not yet completed.

Commercial Aircraft Solutions
BAE Systems is a major supplier to Boeing for flight controls, and cabin and flight deck systems. In July, Boeing selected BAE Systems to provide the integrated flight control electronics on its next-generation 777X programme, which is projected to be worth over $1bn (£0.6bn) over the life of the aircraft. Development of subsystems for the 737 MAX aircraft has also continued on schedule, with the fly-by-wire spoiler units delivered to Boeing for system integration.

FADEC Alliance, a joint venture between FADEC International (the Group's joint venture with Sagem) and GE Aviation, completed first flight of the full authority digital engine controls on the Leap engine which will power the Boeing 737 MAX and Airbus A320neo aircraft.

The business completed development of the flight control system for the Embraer Legacy 500 business jet and is currently developing active side-sticks for Gulfstream G500 and G600 business jets, as well as Embraer's KC-390 cargo aircraft for the Brazilian Air Force.

Several airlines and original equipment manufacturers have expressed interest in the IntelliCabin™ product, a next-generation cabin system that provides in-seat power, LED lighting and tablet-based, wireless in-flight entertainment systems. Development activities are on schedule for system availability in 2015.

HybriDrive® Solutions

BAE Systems has 4,500 propulsion systems in service in transit buses around the world and is delivering its HybriDrive Series-E system into major cities, including Hong Kong, Quebec, Paris, Seattle and Baltimore. The business continues to deliver systems to Washington, D.C., in the US and London in the UK, and will begin deliveries in 2015 to Boston and Honolulu.

FINANCIAL PERFORMANCE

Sales[1] compared to 2013 increased by 3% to just under $4bn (£2.4bn). The commercial areas of the business now amount to 21%, having seen sales[1] growth in the year of 7%. On the defence side, sales[1] increased by 2% in the year, largely from the F-35 Lightning II programme in the Electronic Warfare area.

The return on sales achieved was 15.4% (2013 14.0%) largely reflecting continued strong programme execution and risk retirement. There was a 0.5 percentage point non-recurring gain from a contract pricing settlement.

Cash[3] conversion of underlying EBITA[2] for the year was 66% but, excluding pension deficit funding, that conversion rate was 80%.

Despite the US budget pressures, order backlog[1,4] was sustained at $6.1bn (£3.9bn). The contract award for the Enhanced Night Vision Goggle programme has been protested again and is, therefore, not included within the reported order backlog[1,4].

LOOKING FORWARD

Whilst the longer-term outlook remains uncertain, the 2015 fiscal year omnibus appropriations legislation passed in December 2014 included stable Department of Defense funding and support for major programmes, including F-35 Lightning II aircraft.

Whilst further funding reductions and the resultant slow down or cancellation of ongoing and new programmes could impact the business, Electronic Systems remains well-positioned to address changing US Department of Defense priorities. Its focus remains on maintaining a diverse portfolio of defence and commercial products and capabilities, with both US and international customers, and sustained emphasis on cost reduction and research and development.

The business expects to benefit from its incumbent positions, particularly on the F-35 Lightning II programme, increased activity on international defence programmes and continued commercial aviation market growth.

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Net cash inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
4. Comprises funded and unfunded unexecuted customer orders.
5. Includes Group-funded and customer-funded expenditure.

SEGMENTAL PERFORMANCE: CYBER & INTELLIGENCE

Cyber & Intelligence, with 7,900 employees[1], comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber, secure government, and commercial and financial security activities.

	2014	2013
Sales[1]	**£1,085m**	£1,243m
Underlying EBITA[2]	**£123m**	£115m
Return on sales	**11.3%**	9.3%
Cash inflow[3]	**£71m**	£118m
Order intake[1]	**£1,163m**	£1,247m
Order backlog[1,4]	**£0.9bn**	£0.7bn

OPERATIONAL AND STRATEGIC HIGHLIGHTS

INTELLIGENCE & SECURITY

– US business impacted by US budget pressures and reductions in overseas operations
– First task order awards under the Geospatial Data Services contract
– Awarded a five-year contract for counter-terrorism analysis services
– Awarded a five-year purchase agreement to support IT applications for the Bureau of Labor Statistics
– Acquisition of Signal Innovations Group, a leading-edge technology company with activity-based intelligence expertise

APPLIED INTELLIGENCE

– Selected by a UK government customer as one of four strategic suppliers on a technology framework
– Important multi-year customer wins for NetReveal® OnDemand managed services
– Awarded multi-year framework contracts for Service Integration and Applications Management services
– Acquisition of SilverSky, a commercial cyber service provider, to enhance commercial cyber growth strategy

OPERATIONAL PERFORMANCE

Intelligence & Security

Whilst the US services market continued to experience challenges due to budget uncertainties, unpredictable and delayed acquisition and funding cycles, and the US withdrawal from Afghanistan, the Intelligence & Security business continues to focus on leveraging its core capabilities and domain expertise to pursue opportunities in intelligence analysis, special operations support, and Intelligence, Surveillance and Reconnaissance programmes, which remain priority activities in the US.

GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance)

BAE Systems continues to mature its capabilities in activity-based intelligence which provides the intelligence and defence communities with increasingly automated, efficient and reliable data processing and management tools to transform big data into actionable intelligence. The business received authorisation to proceed on a $32m (£21m) Engineering Change Proposal for activity-based intelligence services.

In 2014, the business delivered the first two software releases for testing of the Mobility Air Force Automated Flight Planning Service programme and passed final quality test on the Aero Advisory Notification Tool capability in support of the US Air Force's transition to a consolidated mission planning architecture. Development continues on the third release of the software.

The National Geospatial-Intelligence Agency awarded the business the first six task orders, totalling $56m (£36m), under the five-year Geospatial Data Services contract to assist in transforming the collection, maintenance and utilisation of geospatial intelligence data and products. The contract has an estimated total value of $335m (£215m).

In September, BAE Systems acquired Signal Innovations Group, a leading provider of imaging technologies and analytics to the US intelligence community.

Global Analysis and Operations
In the market for Full Motion Video and Intelligence, Surveillance and Reconnaissance analysis, the business has ongoing contracts worth over $400m (£257m), which includes the services of over 400 analysts supporting mission critical activities.

The business continues to provide security-cleared intelligence analyst support.

In August, BAE Systems won a five-year contract worth up to $145m (£93m) to provide an intelligence community customer with counter-terrorism analysis services.

IT Solutions
On the Solutions for the Information Technology Enterprise Indefinite Delivery, Indefinite Quantity (IDIQ) contract, with task orders worth $476m (£305m), the business has transitioned the customer from a costly regional support model to a less costly and more efficient enterprise support model.

In May, BAE Systems was awarded a position on the US Department of Homeland Security's Enterprise Acquisition Gateway for Leading Edge Solutions II multiple-award contract as one of 15 down-selected prime contractors to provide a broad range of IT solutions and services.

In August, BAE Systems was awarded a five-year purchase agreement valued at up to $126m (£81m) to operate, maintain and develop IT applications for the Bureau of Labor Statistics.

Applied Intelligence
Applied Intelligence continues to operate in competitive markets with fast-moving customer requirements. The business continues to grow through the provision of solutions which protect and enhance the operations of governments and commercial organisations in the areas of cyber security, financial crime prevention, communications intelligence and digital transformation, and is demonstrating its ability to win large, multi-year contracts.

Applied Intelligence continues to invest in building its skills base, with over 100 graduates joining the business in 2014, representing over one-third of BAE Systems' UK graduate intake. A Global Delivery Centre in Malaysia now supports product development and customer project delivery.

In December, BAE Systems acquired SilverSky, a provider of cloud-based hosting, protection and monitoring of information that operates in the fast-growing cyber security market largely focused on the US.

Cyber Security
The business continues to grow, building on its strong relationship with the UK government, with orders including a £7m multi-year contract to address the UK Ministry of Defence's complex information assurance challenges.

The IndustrialProtect™ solution to protect industrial control systems was launched in the US and Middle East and received a £3m order from a major global energy supplier.

New orders for the CyberReveal™ cyber threat monitoring solution have been received in the US and Europe.

Market interest in MobileProtect™, launched in 2013 alongside a five-year strategic partnership with Vodafone, continues to grow with multiple large enterprises currently trialling the service. In 2015, the business is targeting to achieve an additional 150,000 subscribers to the MobileProtect™ service.

Financial Crime
Applied Intelligence provides enterprise risk, fraud and compliance solutions internationally.

Applied Intelligence has won additional work with existing customers, including HSBC, which has procured NetReveal® Discovery, a suite of solutions that enable global financial crime investigations across borders. Demand for multi-year managed service solutions has increased, with NetReveal® OnDemand being selected by RSA in Canada to provide insurance fraud solutions under a five-year contract. Growth in the US continues with an order from a large US-based global personal and business payment provider.

Expansion is being achieved in other sectors, including healthcare with a £4m contract to provide Medicaid fraud prevention in Rhode Island and capital markets in the UK, Europe and Australia through a solution, launched in 2013, to protect against unauthorised trading, providing risk management controls to investment bank trading floors.

Communications Solutions

The business is a provider of end-to-end communications intelligence solutions to government and communications service providers and is addressing opportunities in Europe, the Middle East and Asia-Pacific regions. It continues to win new clients, most recently in Asia-Pacific, and is developing follow-on business with existing clients as a result of new products from continued product investment.

UK Services

Applied Intelligence provides consulting and systems integration services, with a particular focus on enabling digital transformation. The business continues to support UK government agencies in their intelligence missions and has been selected by a UK government customer as one of four strategic suppliers on a long-term framework that covers application development, systems integration and managed services.

Further success in the Service Integration and Applications Management market was achieved, with new and additional multi-year contracts worth £45m awarded, including new contracts with the Highways Agency and Skills Funding Agency.

FINANCIAL PERFORMANCE

In aggregate, sales[1] in the year reduced by 8%. The US business saw a 17% decrease driven largely by reduced budgets at the sector's two largest customers, along with further reductions in intelligence analyst support. Organic growth in the Applied Intelligence business was at 10%, almost all of which was from commercial customers. Completion of the SilverSky transaction occurred in mid-December and, therefore, only $4m (£3m) of sales trading has been recognised from that business.

Despite the top line performance, the margin achieved was 11.3% (2013 9.3%), with profitability in the Applied Intelligence business increasing ahead of plan.

Cash[3] conversion of underlying EBITA[2] for the year was at 58% due to the capital costs of the replacement Enterprise Resource Planning system and set-up of the Malaysian Global Delivery Centre in the Applied Intelligence business.

In aggregate, order backlog[1,4] increased to $1.4bn (£0.9bn). Despite the top line pressures, order backlog[1,4] in the US business grew by 7% largely on imagery analysis and cyber support awards. In the Applied Intelligence business, order book increased by 37% over the year, 22% organically and 15% from the SilverSky acquisition.

LOOKING FORWARD

In the US, whilst the longer-term outlook remains uncertain, the 2015 fiscal year omnibus appropriations legislation passed in December 2014 included stable Department of Defense funding.

Intelligence & Security has reduced costs to address government budgets, whilst pursuing growth opportunities, particularly in critical, mission-focused areas.

Recognising the continued challenges in the US market, a restructuring was announced in 2014 that realigned the Support Solutions business across the remaining US operating sectors. A Support Solutions business area which develops and maintains systems supporting critical missions for the US military was integrated with Intelligence & Security. This integrated portfolio provides critical mass and economies of scale over a full spectrum of services and capabilities to the US military and other government agencies.

Applied Intelligence has a growing order backlog and pipeline of opportunities, underpinning expected growth from both government and commercial customers. In order to most effectively deliver against these opportunities, the business restructured into three divisions with effect from 1 January 2015: UK Services; International Services and Solutions; and Commercial Solutions. In 2015, the acquired SilverSky business will be integrated into the Commercial Solutions division, accelerating the growth strategy.

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Net cash inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
4. Comprises funded and unfunded unexecuted customer orders.

SEGMENTAL PERFORMANCE: PLATFORMS & SERVICES (US)

Platforms & Services (US), with 16,900 employees[2], comprises the US-headquartered Land & Armaments business, with operations in the US, UK, Sweden and South Africa, and the US-based services and sustainment activities, including ship repair and munitions services.

	2014	2013[1]
Sales[2]	**£3,266m**	£3,912m
Underlying EBITA[3]	**£147m**	£229m
Return on sales	**4.5%**	5.9%
Cash inflow[4]	**£201m**	£191m
Order intake[2]	**£3,191m**	£3,315m
Order backlog[2,5]	**£5.8bn**	£6.1bn

OPERATIONAL AND STRATEGIC HIGHLIGHTS

LAND & ARMAMENTS

- In-year awards sustain vehicle programme positions
- Engineering and manufacturing development contract award worth up to $1.2bn (£0.8bn) on the US Army's Armored Multi-Purpose Vehicle programme
- Option worth $142m (£91m) exercised to continue Low-Rate Initial Production of M109A7 self-propelled howitzers
- Continued focus on cost reduction
- Sale of 75% interest in Land Systems South Africa business announced, with completion expected in 2015

SUPPORT SOLUTIONS

- $1.5bn (£1.0bn) of US Navy ship repair contracts awarded
- Performance impacted by $122m (£74m) of charges taken on commercial shipbuilding programmes
- Improved performance on the Radford Army Ammunition Plant contract, with operational challenges mitigated significantly during the year
- Korean F-16 upgrade contract terminated for convenience by the customer
- Restructuring announced in 2014 realigned Support Solutions across the remaining US operating sectors

OPERATIONAL PERFORMANCE

Land & Armaments

As the defence market stabilises, BAE Systems retains its focus on maintaining key programmes and building a strong domestic and international pipeline, whilst shaping the business portfolio and scaling operational resources for optimised competitiveness.

US Combat Vehicles

The business has focused on maintaining and enhancing its positions on vehicle programmes, with a number of significant contracts received during the year.

In December, the US Army awarded BAE Systems a contract worth up to $1.2bn (£0.8bn) for the engineering and manufacturing development and Low-Rate Initial Production of the Armored Multi-Purpose Vehicle. The initial award, valued at $383m (£246m), is for a 52-month base term during which the business will produce 29 vehicles, with an option to produce an additional 289.

In December, the business received a $34m (£22m) contract to convert 49 M3A3 Cavalry Bradley Fighting Vehicles to the M2A3 Infantry configuration, extending the Bradley production line through the first half of 2016.

The business received a $154m (£99m) follow-on contract for the upgrade of an additional 53 vehicles to the M88A2 HERCULES configuration, which will maintain the M88 production line to the end of 2016.

In November, the US Army exercised an option, valued at $142m (£91m), to continue Low-Rate Initial Production of the M109A7 self-propelled howitzer, with the first deliveries expected in the second quarter of 2015.

BAE Systems' significant experience with amphibious vehicle platforms has resulted in its selection as one of two contractors competing for the US Marine Corps Assault Amphibious Vehicle survivability upgrade programme. The business is also competing for the engineering and manufacturing development phase of the Amphibious Combat Vehicle 1.1 contract. Down-selects for both programmes are expected in 2015.

Work on the Joint Light Tactical Vehicle (JLTV) programme was transitioned successfully from the Sealy, Texas, plant, which closed in June. BAE Systems, as a strategic partner to Lockheed Martin on the JLTV programme, completed limited user testing of the engineering and manufacturing development vehicles in the fourth quarter of 2014 in support of the competitive pursuit of a Low-Rate Initial Production award.

Following the US Army's decision to discontinue the Ground Combat Vehicle programme, BAE Systems was awarded a follow-on bridge contract in June to continue related technology development efforts and maintain critical engineering talent.

Weapon Systems
The business was awarded a contract for four 57mm Mk3 naval guns for an international customer.

The business did not secure an order from India for M777 ultra-lightweight howitzers, but continues to pursue this prospect.

BAE Systems continues to develop its position in the advanced weapons market through its Electromagnetic Railgun programme, having competitively won contracts in excess of $100m (£64m) for land and sea-based demonstrators, pulse power modules and the next development phase of the hyper velocity projectile programme.

Following the Norwegian government's decision to withdraw from the Archer artillery system programme, the business signed a contract amendment with Sweden establishing a new technical and schedule baseline for the contract, which has initial deliveries planned for the second half of 2015.

BAE Systems Hägglunds
Work on the $865m (£555m) CV90 vehicles contract for the Norwegian Army remains on schedule, with series production of the 144 vehicles continuing until 2017.

BAE Systems has offered the CV90 Armadillo concept for the Danish Armoured Personnel Carrier programme. Four manufacturers submitted bids in December and an award decision is expected in the first half of 2015.

FNSS
FNSS, BAE Systems' Turkish joint venture, has continued production under the $559m (£359m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army.

Production continued under a $360m (£231m) contract to upgrade 32 M113 tracked armoured personnel carriers for the Royal Saudi Land Forces. The business is pursuing other armoured vehicle prospects elsewhere in the Middle East region.

Business disposal
BAE Systems expects to complete the disposal of its Land Systems South Africa business in 2015 following the agreement of a proposed sale of the company in 2014.

Support Solutions
Under Multi-Ship, Multi-Option (MSMO) contract vehicles with the US Navy, the US-based ship repair business received orders totalling $1.5bn (£1.0bn) for the repair, maintenance and modernisation of various vessels during the year. The business was awarded a new five-year MSMO contract at its Hawaii shipyard to support the maintenance and modernisation of a range of US Navy ships.

The commercial shipbuilding business continued to experience challenges, taking $122m (£74m) of charges against ongoing contracts in 2014.

BAE Systems manages the operations of the Holston and Radford Army Ammunition Plants, receiving in excess of $400m (£257m) of contracts in 2014 for explosives, propellant and facility modernisation. Following the operational challenges at the Radford plant identified during 2013, performance has improved reflecting the award of new contracts, pricing adjustments on existing contracts and operational efficiencies.

In 2012, BAE Systems was selected to upgrade the Republic of Korea's fleet of F-16 aircraft. The US government approved the selection in 2013 and, whilst the business was successfully executing phase one of the programme, in November, Korea requested the termination for convenience of the US Air Force's contract with BAE Systems. BAE Systems expects to recover all of its programme costs under normal terms of a termination for convenience. In response to the Korean government's claim for approximately $43m (£28m) under a bid guarantee on the programme, the Group has asked a US federal court to rule that it does not owe any monies to Korea.

Under the eight-year, $534m (£343m) US Air Force contract, received in 2013, to maintain the readiness of Minuteman III intercontinental ballistic missiles in the US, the business completed the nine-month transition period from the incumbent on schedule in June and performed a successful test launch in September, a major milestone for the programme.

In February 2014, the US Air Force Space Command awarded BAE Systems a further three-year contract extension to maintain its Solid State Phased Array Radar System, space radars used for missile warning and space surveillance operations, raising the cumulative value of the contract to approximately $540m (£346m). This contract is expected to complete in 2018.

In April, BAE Systems was informed that it had not been awarded the Automated Installation Entry III contract, which would have extended its current work in support of US Army installation security. BAE Systems' protest of the award was upheld and the contract is being re-solicited.

In August, BAE Systems was one of five companies awarded the ability to compete for task orders under an Indefinite Delivery, Indefinite Quantity contract to build to print a secure afloat network for the US Navy.

In September, the US Navy's Strategic Systems Programmes Office awarded BAE Systems a four-year, $72m (£46m) contract to continue the provision of logistics and supply systems support for the Trident II D-5 submarine-launched ballistic missile.

In December, the US Navy's Naval Air Systems Command awarded BAE Systems a five-year contract to provide full lifecycle engineering and technical support for communication and combat systems on land and at sea. The initial award is valued at $28m (£18m), with the total value of the five-year contract estimated at $147m (£94m).

Also in December, the US Navy awarded BAE Systems the nine-year DDG VI Radio Communications Systems contract to support radio and communications systems design and integration for 13 guided missile destroyers. The initial award is valued at $28m (£18m), with the total value of the nine-year contract estimated at $187m (£120m).

FINANCIAL PERFORMANCE

Land & Armaments

Sales[2] in the year declined to $2.3bn (£1.4bn). Bradley reset activity has more than halved, the Medium Mine Protected Vehicle (MMPV) production contract has completed and deliveries under US M777 lightweight howitzer contracts have largely traded out.

Despite the expected top line reductions, the business has delivered an improved margin of 10.3% (2013 8.8%) through good programme execution and cost reduction.

Cash flow[4] generation was again strong, with good cash conversion of working capital.

Order backlog[2,5] reduced from $5.0bn (£3.0bn) to $4.4bn (£2.8bn) largely from the trading out of deliveries on MMPV and M777. We have not recognised within order backlog the $0.8bn (£0.5bn) of Low-Rate Initial Production options under December's Armored Multi-Purpose Vehicle programme award.

Support Solutions

Sales[2] of $3.1bn (£1.9bn) were 1% lower than in 2013.

The year's margin has been materially impacted by cost overruns on the commercial shipbuild contracts. Charges taken in the first and second half year totalled $122m (£74m). The Radford munitions contract has now been stabilised, with no additional provisioning necessary.

Order backlog[2,5] decreased from $5.1bn (£3.1bn) to $4.6bn (£3.0bn) on the sales trading out under the five-year US Navy ship repair contracts. The re-competes for the Hawaiian and San Diego contracts were both successfully secured in the year.

LOOKING FORWARD

Whilst the longer-term outlook remains uncertain, the 2015 fiscal year omnibus appropriations legislation passed in December 2014 included stable Department of Defense funding and support for major programmes, including the Group's Bradley and M88 HERCULES vehicles, as well as requested funding for US Navy ship maintenance and the Armored Multi-Purpose Vehicle (AMPV) programme.

The business is investing to protect existing combat vehicle programmes and to establish new domestic and international programmes, such as the US Army's AMPV, amphibious vehicles and international combat vehicle opportunities to sustain the Group's US combat vehicle manufacturing base. The services and sustainment activities provide continuing opportunities for multi-year contracts on existing platforms.

Recognising the continued challenges in the US market, a restructuring was announced in 2014 that realigned the Support Solutions business across the remaining US operating sectors. A business area which develops and maintains systems supporting critical missions for the US military will be reported in Intelligence & Security in 2015. As a result of the realignment of Support Solutions, the reporting segment retains all of the Land & Armaments businesses, as well as Ship Repair, Ordnance Systems and Protection Systems from Support Solutions. This change will allow the business to deliver more comprehensive, integrated and cost-effective product and service offerings across a full range of naval, land and individual warfighter platforms.

1. Re-presented for the transfer of the UK Munitions business to Platforms & Services (UK) from 1 January 2014.
2. Including share of equity accounted investments.
3. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
4. Net cash inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
5. Comprises funded and unfunded unexecuted customer orders.

SEGMENTAL PERFORMANCE: PLATFORMS & SERVICES (UK)

Platforms & Services (UK), with 29,600 employees[2], comprises the Group's UK-based air, maritime, combat vehicle, munitions and shared services activities.

	2014	2013[1]
Sales[2]	**£6,623m**	£7,174m
Underlying EBITA[3]	**£772m**	£915m
Return on sales	**11.7%**	12.8%
Cash inflow[4]	**£173m**	£60m
Order intake[2]	**£5,386m**	£6,085m
Order backlog[2]	**£20.1bn**	£21.6bn

OPERATIONAL AND STRATEGIC HIGHLIGHTS

- Eurofighter partner nation commitment to the full integration of the Captor E-Scan radar onto Typhoon aircraft
- Major milestone achieved with floating of the aircraft carrier, HMS Queen Elizabeth
- £348m contract awarded to construct three new River Class Offshore Patrol Vessels for the Royal Navy
- First two Khareef Class corvettes for Oman achieved final acceptance and third achieved interim acceptance
- Awarded the five-year, £600m Maritime Support Delivery Framework contract for support to the Royal Navy
- £270m order received for the upgrade of Spearfish torpedoes
- Third Astute Class submarine, Artful, launched in May
- Announced potential management redundancies in the Military Air & Information business to align with its strategy and to improve competitiveness

OPERATIONAL PERFORMANCE

Military Air & Information

In the year, deliveries of Typhoon Tranche 2 aircraft to the four Eurofighter partner nations totalled 16, bringing the cumulative number of Tranche 2 aircraft delivered to 219 of the contracted 236. Eighteen Tranche 3 front fuselage sub-assemblies were manufactured in the year. During 2014, there have been certain issues regarding acceptance of Typhoon Tranche 3 aircraft. Whilst the UK customer has continued to accept the aircraft, acceptances by Germany, Italy and Spain are held pending the completion of further technical and safety reviews by the NATO Eurofighter and Tornado Management Agency, which are planned to be concluded during the first quarter of 2015.

Work on the Omani Typhoon and Hawk aircraft contract continues, with sub-assembly manufacture for both aircraft types commencing and first deliveries on schedule for 2017.

In July, BAE Systems was awarded a three-year, £72m contract by the UK Ministry of Defence to de-risk E-Scan radar development for the Royal Air Force's Typhoon aircraft fleet. In November, the four partner nations placed a contract with Eurofighter for the full integration of the Captor E-Scan radar onto Typhoon aircraft and, as the system integrator, this award is worth £365m.

BAE Systems continues to support its UK and European customers' Typhoon and Tornado aircraft and their operational commitments. The business supports its UK customer through availability-based service contracts. A £125m contract extension was received in the year to provide support to the Royal Air Force's Tornado GR4 fleet until the aircraft's planned retirement in 2019. In December, BAE Systems was awarded a £112m contract to extend the Typhoon Availability Service for the in-service support of the Royal Air Force's Typhoon fleet by 15 months.

On the F-35 Lightning II programme, BAE Systems has continued to deliver aircraft fuselages for the sixth and seventh Low-Rate Initial Production (LRIP) contracts, with a total of 45 assemblies delivered to Lockheed Martin in 2014. Contract award for LRIP 8 for 43 assemblies was received in the year and manufacturing commenced. Proposals for LRIP 9 and 10 have been submitted with negotiations to commence in 2015.

Support continues to be provided to users of Hawk trainer aircraft around the world. In 2014, the Indian Navy and Air Force received four and 15 Hawk aircraft, respectively, built under the Batch 2 licence for 57 aircraft by Hindustan Aeronautics Limited. A response to a proposal for an additional 20 Hawk aircraft for the Indian Air Force's aerobatic display team has been submitted.

Working jointly with Dassault Aviation, progress is being made in maturing and demonstrating critical technology and operational aspects for an Unmanned Combat Air System. In November, the signature of a two-year feasibility study, worth a total of £120m to the six participating companies, was announced by the UK and French governments to continue joint Future Combat Air System technology development. The contract value to BAE Systems is £34m.

Taranis, the stealthy unmanned combat air vehicle demonstrator designed and built by BAE Systems with UK industry partners and the Ministry of Defence, has successfully completed a second phase of flight testing. During these latest tests, Taranis flew in a fully stealthy configuration.

The business undertook a review to ensure that its organisational operating model was aligned with its strategy and to improve competitiveness, which resulted in the announcement of 440 potential management redundancies in October.

Maritime

The consolidation of BAE Systems' UK shipbuilding operations in Glasgow is progressing to plan, with shipbuilding operations at Portsmouth ceasing in the second half of 2014. The restructuring programme concludes in 2016.

BAE Systems has continued to negotiate contracts with the Ministry of Defence to enact the restructuring of its naval ships business. During the year, contracts were signed for the recovery of associated rationalisation costs and the revised target cost arrangements for the delivery of the Queen Elizabeth Class aircraft carriers. In August, BAE Systems was awarded a £348m contract to construct three new River Class Offshore Patrol Vessels for the Royal Navy, sustaining shipbuilding skills between the Carrier programme and the start of manufacture for the anticipated Type 26 frigate programme.

On the aircraft carrier programme, HMS Queen Elizabeth was officially named by Her Majesty The Queen and floated for the first time at Rosyth in July. The second ship block build programme is now 80% complete and assembly at Rosyth has commenced. Under the revised target cost arrangements, the industrial participants' fee includes a 50:50 risk share arrangement providing greater cost performance incentives.

The assessment phase contract for the Type 26 frigate continues, with over 700 employees now working on the programme. A contract for the demonstration phase of the programme, including procurement of long lead items, is expected to be placed in the first half of 2015, with a full manufacture contract anticipated in 2016.

The third Khareef Class corvette for the Royal Navy of Oman achieved interim acceptance in May, with final acceptance planned for 2015. The first two ships completed their final acceptance trials in Oman during the second half of the year.

The five-year, £600m Maritime Support Delivery Framework contract for the delivery of services at Portsmouth Naval Base and support to half of the Royal Navy's surface fleet was secured in the year.

In June, the Ministry of Defence awarded BAE Systems a £70m contract extension to manage the support, maintenance and upgrade of the Type 45 destroyers at Portsmouth Naval Base and on all their operations in the UK and globally through July 2014 to November 2016.

A £270m contract for upgrade of the Spearfish torpedo was secured in December.

Artful, the third of class attack submarine for the Royal Navy, was launched in May. Progress continues on the remaining four boats, with further funding of £207m received in the year.

Progress continues on the design and development phase of the Successor submarine programme, the potential replacement to the Vanguard Class fleet, with more than 1,400 people now employed on the programme. Initial long lead orders were placed during 2014. The Ministry of Defence has agreed to fund £389m of capital investment in preparation for the Successor manufacturing programme.

Combat Vehicles (UK)
Following delivery of all 60 Terrier combat engineering vehicles to the customer, 55 of these were completed to the final accepted build standard in the year, with the final five due for completion at the Telford site in 2015. The Newcastle facility closed at the end of 2014 following delivery of the Terrier vehicles.

Orders totalling £106m for ongoing support activity were received in the year.

Munitions
Following submission of the next five-year pricing proposal for its 15-year Munitions Acquisition Supply Solution partnering agreement with the Ministry of Defence, negotiations continue with a contract amendment expected in 2015.

Transformation of the Munitions facilities under the original £200m capital programme was completed during the year.

FINANCIAL PERFORMANCE

The year's sales[2] of £6.6bn were 8% lower than 2013, or 4% excluding last year's retrospective trading of price escalation on the Salam Typhoon programme. This reduction is largely due to a lower level of intra-group trading in 2014 and, therefore, has no impact to the total Group numbers.

Return on sales was at 11.7% (2013 12.8%).

Cash performance was better than expected with a cash inflow[4] of £173m (2013 £60m). Consumption of customer advances was at a lower level in the year than anticipated. Provisions were utilised against costs incurred on rationalisation and on the Oman Offshore Patrol Vessel programme.

Order backlog[2] reduced to £20.1bn (2013 £21.6bn) primarily from trading on the Typhoon aircraft, Indian Hawk and aircraft carrier programmes.

LOOKING FORWARD

Platforms & Services (UK) has a strong order backlog of long-term committed programmes and an enduring support business.

In Military Air & Information, sales are underpinned by aircraft production on Typhoon and F-35 Lightning II, and in-service support for existing and legacy combat and Hawk trainer aircraft. There are a number of opportunities to secure future Typhoon export sales.

In Maritime, sales are underpinned by the design and subsequent build of the Successor submarine and Type 26 frigates, and the build of the Queen Elizabeth Class aircraft carriers and Astute Class submarines. The through-life support of these platforms, plus the Type 45 destroyer, together with their associated command and combat systems, provides a sustainable business in technical services and mid-life upgrades.

Combat Vehicles (UK) continues to provide engineering support to a large installed base of vehicles across UK and export markets. The business is pursuing obsolescence and upgrade programmes for the Challenger 2 main battle tank and land bridging systems.

The Munitions business is underpinned by the 15-year Munitions Acquisition Supply Solution partnering agreement with the Ministry of Defence secured in 2008.

1. Re-presented for the transfer of the UK Munitions business from Land & Armaments from 1 January 2014.
2. Including share of equity accounted investments.
3. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
4. Net cash inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.

SEGMENTAL PERFORMANCE: PLATFORMS & SERVICES (INTERNATIONAL)

Platforms & Services (International), with 14,000 employees[1], comprises the Group's businesses in Saudi Arabia, Australia and Oman, together with its 37.5% interest in the pan-European MBDA joint venture.

	2014	2013
Sales[1]	**£3,572m**	£4,063m
Underlying EBITA[2]	**£366m**	£429m
Return on sales	**10.2%**	10.6%
Cash inflow/(outflow)[3]	**£881m**	£(189)m
Order intake[1]	**£3,398m**	£7,221m
Order backlog[1]	**£11.6bn**	£12.3bn

OPERATIONAL AND STRATEGIC HIGHLIGHTS

– 11 Typhoon aircraft delivered to Saudi Arabia under the Salam programme
– Continued support to the operational capabilities of the Royal Saudi Air Force and Royal Saudi Naval Forces under the Saudi British Defence Co-operation Programme
– Re-organisation of portfolio interests in industrial companies in the Kingdom of Saudi Arabia and enhanced relationship with Riyadh Wings
– Customer acceptance of the first of two Landing Helicopter Dock ships in Australia
– Four-year, A$190m (£100m) contract awarded to provide in-service support for the two Landing Helicopter Docks
– MBDA secured a UK/French government order worth €600m (£466m) for the joint development and production of the Future Anti-Ship Guided Weapon
– €301m (£234m) contract secured by MBDA for the Advanced Short Range Air-to-Air Missile (ASRAAM) for India's Jaguar aircraft fleet

OPERATIONAL PERFORMANCE

Saudi Arabia

On the Salam Typhoon programme, UK final assembly of the 72 aircraft continues. At 31 December 2014, 45 aircraft have been delivered to the customer. Work on enhancing Typhoon's capability is progressing to schedule.

The five-year Typhoon support contract received in 2013 is operating well with all contractual Key Performance Indicators met during the year. The first of 30 aircraft completed its scheduled maintenance and upgrade under a contract also received in 2013.

Through the Saudi British Defence Co-operation Programme (SBDCP), the business continues to support the operational capabilities of the Royal Saudi Air Force (RSAF) and Royal Saudi Naval Forces (RSNF). The modernisation of the RSAF's training aircraft fleet continues to programme, with the first deliveries of Pilatus PC-21 aircraft made in 2014 and Hawk aircraft progressing through manufacturing. Training delivery and support under five-year contracts awarded in 2012 continue.

The orders received in 2013 for the upgrade of Tornado aircraft and equipment procurement are proceeding to plan. During the year, the business received a contract for Typhoon role equipment.

Under the minehunter mid-life update programme, the second ship is scheduled for acceptance back into the RSNF fleet in 2015.

A planned re-organisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia was announced during the year, enhancing its existing relationship with Riyadh Wings Aviation Academy LLC. As part of the re-organisation, BAE Systems acquired an additional 59% shareholding in Saudi Development and Training Company. This re-organisation is being undertaken in support of BAE Systems' strategy to expand further its In-Kingdom Industrial Participation programme, and to promote training, development and employment opportunities for Saudi national personnel.

In 2014, the Group's In-Kingdom industrial partner, Advanced Electronics Company, was accredited as an approved maintenance and repair agent for Typhoon avionics equipment.

Australia
The customer has formally accepted and taken delivery of the first Landing Helicopter Dock warship, HMAS Canberra. The hull for the second ship arrived at the Williamstown shipyard in February 2014 and work is progressing towards delivery in the second half of 2015.

After delivery of the second Landing Helicopter Dock, there is then no contracted shipbuilding programme for the Williamstown shipyard. BAE Systems continues to engage with the Australian government with a view to sustaining appropriate shipbuilding capability.

In September, the business was awarded a four-year, A$190m (£100m) contract to provide in-service support for the two Landing Helicopter Docks. The majority of the work will be undertaken in Sydney, the home port of these warships, creating over 40 new jobs.

The customer has accepted the second and third ANZAC Class frigates to be modernised under the Anti-Ship Missile Defence programme. The fourth and fifth frigates continue to undergo refurbishment.

In October, the business was awarded a A$25m (£13m) contract to produce an additional three blocks for the Air Warfare Destroyer programme at its Williamstown shipyard. The additional blocks will bring the total number constructed by BAE Systems to 21, of which 11 have already been delivered.

In October, the Flight Training Centre at Tamworth, New South Wales, where BAE Systems trains Australian Defence Force pilots, achieved a significant milestone, reaching 250,000 flying hours. Since 1992, the centre has helped to train more than 5,000 students from the Australian Defence Force and other military and commercial operations throughout the Asia-Pacific region.

BAE Systems remains in negotiations with the Commonwealth to agree a revised schedule for the delayed delivery of the JP 2008 Phase 3F programme for enhanced satellite communications services to the Australian Defence Force. The business expects these negotiations to conclude in the first half of 2015.

Oman
The two major contracts in Oman, Typhoon and Hawk aircraft and Khareef Class corvettes, are being undertaken by Platforms & Services (UK).

On the Typhoon and Hawk aircraft programme, sub-assembly manufacture has commenced.

On the Khareef Class corvette programme, the first two ships achieved final acceptance and the third ship achieved interim acceptance.

See Platforms & Services (UK) for further information on the operational performance of these contracts.

BAE Systems has provided a substantial proportion of Oman's in-service military equipment and works closely with the Omani armed forces in supporting this equipment.

The business is making good progress in addressing its industrial participation obligations in Oman through delivery of an agreed training and knowledge transfer programme, which covers over 80% of the Group's total obligations. BAE Systems continues to work with the Omani government to develop plans to discharge its remaining commitments.

MBDA
In January 2014, the UK and French governments signed an agreement worth €600m (£466m) for the joint development and production of the MBDA Future Anti-Ship Guided Weapon – Anti-Navire Léger missile for their armed forces.

On the Meteor development programme, an updated certificate of design, recording the final design standard of the missiles, was submitted to the customer at the end of 2014. Deliveries, against almost 1,100 production-standard missiles ordered by the six partner nation customers, have now commenced.

In December, MBDA received a €301m (£234m) contract to supply the Advanced Short Range Air-to-Air Missile (ASRAAM) for India's Jaguar aircraft fleet.

Work continues towards securing German government commitment to a German/Italian collaborative programme (TLVS) to replace the current trilateral arrangement with the US which expired at the end of 2014. The programme will provide a new generation of air and missile defence with improved inter-operability, mobility and full 360-degree defence capability.

FINANCIAL PERFORMANCE

Sales[1] were £0.5bn lower at £3.6bn. The reduction against 2013 includes £143m in respect of exchange translation arising on the Australian dollar and Euro. The trading reductions were in the Australian business, as the Landing Helicopter Dock programme ramps down, last year's sales trading arising from the Salam price escalation and the higher Saudi equipment deliveries in 2013.

Underlying EBITA[2] of £366m (2013 £429m) generated a return on sales of 10.2% (2013 10.6%).

There was an operating cash inflow[3] of £881m (2013 £189m outflow), which includes a net £349m from the sale and leaseback, and initial rentals, of the two Saudi residential compounds. Some £200m of receivables were collected in December, earlier than expected, and there were down-payments received on Saudi equipment awards.

Order backlog[1] has reduced from last year end's high following the awards in 2013 of the five-year support contracts and equipment packages in Saudi Arabia.

LOOKING FORWARD

In the Kingdom of Saudi Arabia, the Group expects to sustain its long-term presence through delivering current programmes and industrialisation, and developing new business in support of the Saudi military forces. The planned re-organisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia is intended to increase growth prospects and reinforce an ongoing commitment to support the national objectives of local skills and technology development, increasing employment and developing an indigenous defence industry.

In Australia, the government has increased the defence budget by 8% for the 2014-15 fiscal year and remains on track to increase annual defence expenditure to 2% of Gross Domestic Product within a decade. Following delivery of the second Landing Helicopter Dock in 2015, the Williamstown shipyard needs a follow-on shipbuilding programme to sustain capability. In the longer-term, there are significant opportunities in the naval domain as Australia modernises its submarine and surface fleets to strengthen its ability to secure access to sea lines of communication across the Indo-Pacific region.

In Oman, the business continues to provide support to its products in service to position for future requirements.

MBDA continues to build on the effective partnerships it has established with its domestic customers and is pursuing actively a significant number of export opportunities, including substantial air defence requirements and weapons packages linked to prospective aircraft and naval procurements.

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Net cash inflow/(outflow) from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.

CONSOLIDATED INCOME STATEMENT
for the year ended 31 December

	Notes	2014 £m	2014 Total £m	2013 £m	2013 Total £m
Continuing operations					
Combined sales of Group and share of equity accounted investments	2		**16,637**		18,180
Less: share of sales of equity accounted investments	2		**(1,207)**		(1,316)
Revenue	2		**15,430**		16,864
Operating costs			**(14,387)**		(16,297)
Other income			**174**		128
Group operating profit			**1,217**		695
Share of results of equity accounted investments			**83**		111
Underlying EBITA[1]		**1,702**		1,925	
Non-recurring items		**–**		6	
EBITA		**1,702**		1,931	
Amortisation of intangible assets		**(184)**		(189)	
Impairment of intangible assets		**(170)**		(887)	
Financial expense of equity accounted investments		**(30)**		(8)	
Taxation expense of equity accounted investments		**(18)**		(41)	
Operating profit	2		**1,300**		806
Financial income		**241**		216	
Financial expense		**(659)**		(600)	
Finance costs	3		**(418)**		(384)
Profit before taxation			**882**		422
Taxation expense			**(130)**		(246)
Profit for the year			**752**		176
Attributable to:					
Equity shareholders			**740**		168
Non-controlling interests			**12**		8
			752		176
Earnings per share	4				
Basic earnings per share			**23.4p**		5.2p
Diluted earnings per share			**23.3p**		5.2p

1. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December

	2014			2013		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Profit for the year	**–**	**752**	**752**	–	176	176
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Remeasurements on retirement benefit schemes:						
Subsidiaries	**–**	**(2,023)**	**(2,023)**	–	918	918
Equity accounted investments	**–**	**(73)**	**(73)**	–	8	8
Tax on items that will not be reclassified to the income statement	**–**	**503**	**503**	–	(421)	(421)
Items that may be reclassified to the income statement:						
Currency translation on foreign currency net investments:						
Subsidiaries	**251**	**–**	**251**	(246)	–	(246)
Equity accounted investments	**13**	**–**	**13**	(3)	–	(3)
Reclassification of cumulative currency translation reserve on disposal	**–**	**–**	**–**	(8)	–	(8)
Fair value gain on available-for-sale financial assets	**–**	**4**	**4**	–	–	–
Amounts (charged)/credited to hedging reserve	**(92)**	**–**	**(92)**	53	–	53
Tax on items that may be reclassified to the income statement	**19**	**–**	**19**	(14)	–	(14)
Total other comprehensive income for the year (net of tax)	**191**	**(1,589)**	**(1,398)**	(218)	505	287
Total comprehensive income for the year	**191**	**(837)**	**(646)**	(218)	681	463
Attributable to:						
Equity shareholders	**191**	**(849)**	**(658)**	(212)	673	461
Non-controlling interests	**–**	**12**	**12**	(6)	8	2
	191	**(837)**	**(646)**	(218)	681	463

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December

	Attributable to equity holders of the parent						
	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 January 2014	89	1,249	4,868	(2,825)	3,381	37	3,418
Profit for the year	–	–	–	740	740	12	752
Total other comprehensive income for the year	–	–	191	(1,589)	(1,398)	–	(1,398)
Share-based payments	–	–	–	42	42	–	42
Net purchase of own shares	(2)	–	2	(281)	(281)	–	(281)
Ordinary share dividends	–	–	–	(642)	(642)	(14)	(656)
At 31 December 2014	**87**	**1,249**	**5,061**	**(4,555)**	**1,842**	**35**	**1,877**
At 1 January 2013	90	1,249	5,079	(2,698)	3,720	54	3,774
Profit for the year	–	–	–	168	168	8	176
Total other comprehensive income for the year	–	–	(212)	505	293	(6)	287
Share-based payments	–	–	–	49	49	–	49
Net purchase of own shares	(1)	–	1	(212)	(212)	–	(212)
Ordinary share dividends	–	–	–	(638)	(638)	(11)	(649)
Disposal of non-controlling interest	–	–	–	1	1	(8)	(7)
At 31 December 2013	89	1,249	4,868	(2,825)	3,381	37	3,418

CONSOLIDATED BALANCE SHEET

as at 31 December

	Notes	**2014 £m**	2013 £m
Non-current assets			
Intangible assets		**9,983**	9,735
Property, plant and equipment		**1,589**	1,936
Investment property		**129**	135
Equity accounted investments		**229**	283
Other investments		**7**	3
Other receivables		**347**	321
Retirement benefit surpluses	6	**162**	156
Other financial assets		**38**	42
Deferred tax assets		**1,327**	901
		13,811	13,512
Current assets			
Inventories		**690**	680
Trade and other receivables including amounts due from customers for contract work		**2,850**	3,038
Current tax		**7**	8
Other financial assets		**46**	81
Cash and cash equivalents		**2,308**	2,222
Assets held for sale	5	**76**	140
		5,977	6,169
Total assets		**19,788**	19,681
Non-current liabilities			
Loans		**(2,868)**	(2,524)
Other payables		**(932)**	(1,160)
Retirement benefit obligations	6	**(5,530)**	(3,665)
Other financial liabilities		**(79)**	(59)
Deferred tax liabilities		**(21)**	(7)
Provisions		**(436)**	(403)
		(9,866)	(7,818)
Current liabilities			
Loans and overdrafts		**(482)**	(402)
Trade and other payables		**(6,670)**	(7,074)
Other financial liabilities		**(107)**	(81)
Current tax		**(448)**	(497)
Provisions		**(315)**	(391)
Liabilities held for sale	5	**(23)**	–
		(8,045)	(8,445)
Total liabilities		**(17,911)**	(16,263)
Net assets		**1,877**	3,418
Capital and reserves			
Issued share capital		**87**	89
Share premium		**1,249**	1,249
Other reserves		**5,061**	4,868
Retained earnings – deficit		**(4,555)**	(2,825)
Total equity attributable to equity holders of the parent		**1,842**	3,381
Non-controlling interests		**35**	37
Total equity		**1,877**	3,418

Approved by the Board on 18 February 2015 and signed on its behalf by:

I G King	**P J Lynas**
Chief Executive	Group Finance Director

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December

	Notes	**2014 £m**	2013 £m
Profit for the year		**752**	176
Taxation expense		**130**	246
Share of results of equity accounted investments		**(83)**	(111)
Finance costs		**418**	384
Depreciation, amortisation and impairment		**657**	1,397
Profit on disposal of property, plant and equipment		**(20)**	(6)
Profit on disposal of investment property		**(12)**	(13)
Profit on disposal of businesses		**–**	(6)
Fair value gain		**(47)**	–
Cost of equity-settled employee share schemes		**42**	49
Movements in provisions		**(153)**	63
Decrease in liabilities for retirement benefit obligations		**(345)**	(337)
(Increase)/decrease in working capital:			
Inventories		**(1)**	(35)
Trade and other receivables		**197**	(275)
Trade and other payables		**(622)**	(1,327)
Cash inflow from operating activities		**913**	205
Interest paid		**(152)**	(177)
Taxation paid		**(92)**	(138)
Net cash inflow/(outflow) from operating activities		**669**	(110)
Dividends received from equity accounted investments		**63**	95
Interest received		**7**	11
Purchase of property, plant and equipment, and investment property		**(263)**	(236)
Purchase of intangible assets		**(59)**	(33)
Proceeds from sale of property, plant and equipment, and investment property		**539**	93
Proceeds from sale of intangible assets		**–**	28
Purchase of subsidiary undertakings		**(233)**	(1)
Cash and cash equivalents acquired from purchase of subsidiary undertakings		**3**	–
Equity accounted investment funding		**(2)**	(5)
Proceeds from sale of subsidiary undertakings (net of cash disposed)		**–**	5
Net cash inflow/(outflow) from investing activities		**55**	(43)
Net purchase of own shares		**(281)**	(212)
Equity dividends paid	7	**(642)**	(638)
Dividends paid to non-controlling interests		**(14)**	(11)
Cash inflow/(outflow) from matured derivative financial instruments		**8**	(47)
Cash inflow/(outflow) from movement in cash collateral		**10**	(10)
Cash inflow from loans		**679**	–
Cash outflow from repayment of loans		**(398)**	–
Net cash outflow from financing activities		**(638)**	(918)
Net increase/(decrease) in cash and cash equivalents		**86**	(1,071)
Cash and cash equivalents at 1 January		**2,222**	3,334
Effect of foreign exchange rate changes on cash and cash equivalents		**5**	(41)
Cash and cash equivalents at 31 December		**2,313**	2,222
Comprising:			
Cash and cash equivalents		**2,308**	2,222
Cash and cash equivalents (included within assets held for sale)	5	**6**	–
Overdrafts		**(1)**	–
Cash and cash equivalents at 31 December		**2,313**	2,222

NOTES TO THE ACCOUNTS

1. PREPARATION

The consolidated financial statements of BAE Systems plc have been prepared on a going concern basis and in accordance with EU-endorsed International Financial Reporting Standards (IFRS) and the Companies Act 2006 applicable to companies reporting under IFRS.

The consolidated financial statements are presented in pounds sterling and, unless stated otherwise, rounded to the nearest million. They have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and other relevant financial assets and financial liabilities (including derivative instruments).

Changes in accounting policies

With effect from 1 January 2014, the Group has adopted the following new standards and amendments to existing standards:

- IFRS 10, Consolidated Financial Statements
- IFRS 11, Joint Arrangements
- IFRS 12, Disclosure of Interests in Other Entities
- IAS 27, Separate Financial Statements (revised 2011)
- IAS 28, Investments in Associates and Joint Ventures (revised 2011)

With the exception of new disclosure requirements, none of these have impacted the consolidated financial statements of the Group.

There are no other EU-endorsed IFRSs or IFRIC interpretations that are not yet effective that are expected to have a material impact on the Group.

IFRS 15, Revenue from Contracts with Customers, issued in May 2014, is not yet EU endorsed. Management is in the process of reviewing the impact that this will have on the Group.

IFRS 9, Financial Instruments, issued in July 2014, is not yet EU endorsed. It is not expected to have a material impact on the Group.

2. SEGMENTAL ANALYSIS

Sales and revenue by reporting segment

	Combined sales of Group and share of equity accounted investments		Less: sales by equity accounted investments		Add: sales to equity accounted investments		Revenue	
	2014 £m	2013[1] £m	**2014 £m**	2013[1] £m	**2014 £m**	2013[1] £m	**2014 £m**	2013[1] £m
Electronic Systems	**2,415**	2,466	**(74)**	(61)	**74**	61	**2,415**	2,466
Cyber & Intelligence	**1,085**	1,243	**–**	–	**–**	–	**1,085**	1,243
Platforms & Services (US)	**3,266**	3,912	**(83)**	(68)	**–**	–	**3,183**	3,844
Platforms & Services (UK)	**6,623**	7,174	**(1,207)**	(1,176)	**1,104**	1,078	**6,520**	7,076
Platforms & Services (International)	**3,572**	4,063	**(793)**	(873)	**–**	–	**2,779**	3,190
HQ	**279**	306	**(279)**	(306)	**–**	–	**–**	–
	17,240	19,164	**(2,436)**	(2,484)	**1,178**	1,139	**15,982**	17,819
Intra-group sales/revenue	**(603)**	(984)	**–**	–	**51**	29	**(552)**	(955)
	16,637	18,180	**(2,436)**	(2,484)	**1,229**	1,168	**15,430**	16,864

Reporting segment result

	Underlying EBITA[2]		Non-recurring items[3]		Amortisation of intangible assets		Impairment of intangible assets		Reporting segment result	
	2014 £m	2013[1] £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013 £m	**2014 £m**	2013[1] £m
Electronic Systems	**373**	346	**–**	–	**(14)**	(15)	**(1)**	(4)	**358**	327
Cyber & Intelligence	**123**	115	**–**	–	**(58)**	(63)	**–**	(425)	**65**	(373)
Platforms & Services (US)	**147**	229	**–**	7	**(18)**	(21)	**(169)**	(458)	**(40)**	(243)
Platforms & Services (UK)	**772**	915	**–**	–	**(84)**	(84)	**–**	–	**688**	831
Platforms & Services (International)	**366**	429	**–**	(1)	**(10)**	(6)	**–**	–	**356**	422
HQ[4]	**(79)**	(109)	**–**	–	**–**	–	**–**	–	**(79)**	(109)
	1,702	1,925	**–**	6	**(184)**	(189)	**(170)**	(887)	**1,348**	855
Financial expense of equity accounted investments									**(30)**	(8)
Taxation expense of equity accounted investments									**(18)**	(41)
Operating profit									**1,300**	806
Finance costs									**(418)**	(384)
Profit before taxation									**882**	422
Taxation expense									**(130)**	(246)
Profit for the year									**752**	176

1. Re-presented for the transfer of the UK Munitions business from Platforms & Services (US) to Platforms & Services (UK) from 1 January 2014.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. In 2014, Platforms & Services (International) comprises a £47m gain upon acquisition of an additional 59% shareholding in Saudi Development and Training Company and control of the company, and a £47m charge against the carrying value of Aircraft Accessories and Components Company upon classification of the business as held for sale (see note 5).
4. In 2014, the HQ reporting segment includes a £30m benefit (2013 £nil) from re-assessment of a long-term liability. In 2013, there was a £32m charge in respect of a US contract pricing dispute.

3. FINANCE COSTS

	2014 £m	2013 £m
Interest income	**28**	48
Gain on remeasurement of financial instruments at fair value through profit or loss	**99**	51
Foreign exchange gains	**114**	117
Financial income	**241**	216
Interest expense on bonds and other financial instruments	**(177)**	(197)
Facility fees	**(4)**	(11)
Net present value adjustments	**(48)**	(20)
Net interest expense on retirement benefit obligations	**(147)**	(186)
Loss on remeasurement of financial instruments at fair value through profit or loss	**(75)**	(146)
Foreign exchange losses	**(208)**	(40)
Financial expense	**(659)**	(600)
Finance costs	**(418)**	(384)

Additional analysis

	2014 £m	2013 £m
Finance costs:		
Group	**(418)**	(384)
Share of equity accounted investments	**(30)**	(8)
	(448)	(392)
Analysed as:		
Underlying interest (expense)/income:		
Group	**(201)**	(180)
Share of equity accounted investments	**(3)**	1
	(204)	(179)
Other:		
Group:		
Net interest expense on retirement benefit obligations	**(147)**	(186)
Fair value and foreign exchange adjustments on financial instruments and investments	**(70)**	(18)
Share of equity accounted investments:		
Net interest expense on retirement benefit obligations	**(8)**	(9)
Fair value and foreign exchange adjustments on financial instruments and investments	**(19)**	–
	(448)	(392)

4. EARNINGS PER SHARE

	2014			2013		
	£m	**Basic pence per share**	**Diluted pence per share**	£m	Basic pence per share	Diluted pence per share
Profit for the year attributable to equity shareholders	**740**	**23.4**	**23.3**	168	5.2	5.2
(Deduct)/add back:						
Re-assessment of existing tax provisions	**(51)**			–		
Non-recurring items	**–**			(6)		
Net interest expense on retirement benefit obligations, post tax	**126**			153		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	**72**			14		
Amortisation and impairment of intangible assets, post tax	**156**			165		
Impairment of goodwill	**161**			865		
Underlying earnings, post tax	**1,204**	**38.0**	**37.9**	1,359	42.0	41.8

		Millions	**Millions**		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		**3,165**	**3,165**		3,234	3,234
Incremental shares in respect of employee share schemes			**10**			14
Weighted average number of shares used in calculating diluted earnings per share			**3,175**			3,248

5. HELD FOR SALE

In August, the Group announced an agreement for the proposed sale of its 75% holding in BAE Systems Land Systems South Africa Proprietary Limited (LSSA) for cash consideration of 641 million Rand (£36m), subject to closing adjustments. The proposed disposal, which is conditional upon receiving regulatory and other approvals, is expected to complete during 2015. Accordingly, LSSA is presented as held for sale at 31 December 2014.

As part of a planned reorganisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia, BAE Systems expects to complete the disposal of its 85.7% shareholding in Aircraft Accessories and Components Company (AACC) during 2015, subject to the satisfaction of certain regulatory approvals. Accordingly, AACC is presented as held for sale at 31 December 2014.

	LSSA[1] £m	AACC £m	Total £m
Intangible assets	19	–	19
Property, plant and equipment	9	–	9
Inventories	7	11	18
Receivables	12	9	21
Deferred tax assets	3	–	3
Cash and cash equivalents	6	–	6
Assets held for sale	**56**	**20**	**76**
Payables	(9)	(8)	(17)
Deferred tax liabilities	(2)	–	(2)
Provisions	(4)	–	(4)
Liabilities held for sale	**(15)**	**(8)**	**(23)**

1. The carrying value of LSSA includes a non-controlling interest of £5m.

6. RETIREMENT BENEFIT OBLIGATIONS

	UK £m	US and other £m	Total £m
Total IAS 19 deficit at 1 January 2014	(4,272)	(266)	(4,538)
Actual return on assets excluding amounts included in interest expense	1,240	208	1,448
Increase in liabilities due to changes in financial assumptions	(3,273)	(405)	(3,678)
Increase in liabilities due to changes in demographic assumptions	(341)	(283)	(624)
Experience gains/(losses)	435	(6)	429
Additional contributions in excess of service cost	275	–	275
Recurring contributions in excess of service cost	48	68	116
Past service cost – plan amendments	(3)	(1)	(4)
Net interest expense	(175)	(14)	(189)
Foreign exchange adjustments	–	(35)	(35)
Movement in US healthcare schemes	–	(12)	(12)
Total IAS 19 deficit at 31 December 2014	**(6,066)**	**(746)**	**(6,812)**
Allocated to equity accounted investments and other participating employers	1,444	–	1,444
Group's share of IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments and other participating employers at 31 December 2014	**(4,622)**	**(746)**	**(5,368)**
Represented by:			
Retirement benefit surpluses	89	73	162
Retirement benefit obligations	(4,711)	(819)	(5,530)
	(4,622)	**(746)**	**(5,368)**

Certain of the Group's equity accounted investments participate in the Group's defined benefit schemes as well as Airbus SAS, the Group's share of which was disposed of in 2006. As these schemes are multi-employer schemes, the Group has allocated a share of the IAS 19 pension deficit to its equity accounted investments and other participating employers using a consistent allocation method intended to reflect a reasonable approximation of their share of the deficit. The deficit allocation method for all schemes is based on the BAE Systems Pension Scheme's (Main Scheme) schedule of contributions agreed with the sponsoring employers and trustees as part of the triennial funding valuations performed in 2014. Following the completion of the triennial funding valuations, there will be discussions between the participating employers on the allocation of the deficit and the outcome of those discussions will be reflected in the allocation of the IAS 19 deficit. The Group's share of the IAS 19 pension deficit allocated to the equity accounted investments is included in the balance sheet within equity accounted investments. 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.

Funding

The majority of the UK and US defined benefit pension schemes are funded by the Group's subsidiaries, equity accounted investments and other participating employers. The individual pension schemes' funding requirements are based on actuarial measurement frameworks set out in their funding policies.

For funding valuation purposes, pension scheme assets are included at market value, whilst the liabilities are determined based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The separate actuarial valuations for funding purposes include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes. The latest valuations of the Main Scheme and BAE Systems 2000 Pension Plan were performed as at 31 March 2014 and showed a funding deficit of £2.6bn. The total net funding deficit in respect of all of the UK schemes was £2.7bn. Deficit recovery plans agreed with the trustees of the relevant schemes run until 2026.

The results of future triennial valuations and associated funding requirements will be impacted by the future performance of investment markets, and interest and inflation rates.

The total Group contributions made to the defined benefit schemes in the year ended 31 December 2014 were £548m (2013 £560m) excluding those amounts allocated to equity accounted investments and participating employers of £92m (2013 £86m). This includes additional contributions of £108m into the UK schemes relating to the share buyback programme (2013 £44m).

In 2015, the Group expects to make contributions at a similar level to the recurring contributions and deficit funding as made in 2014.

The Group incurred a charge in respect of cash contributions of £125m (2013 £130m) paid to defined contribution schemes for employees.

Sensitivity analysis
The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2014 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:

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

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 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 resulting from larger changes in the inflation assumption would be as follows:

	(Increase)/ decrease £bn
Inflation:	
0.5 percentage point increase	(1.8)
0.5 percentage point decrease	1.7
1.0 percentage point increase	(3.6)
1.0 percentage point decrease	3.3

Demographic assumptions
Changes in the life expectancy assumption, including the benefit of longevity swap arrangements, would have the following effect on the total IAS 19 deficit:

	(Increase)/ decrease £bn
Life expectancy:	
One-year increase	(0.9)
One-year decrease	0.9

7. EQUITY DIVIDENDS

	2014 £m	2013 £m
Prior year final 12.1p dividend per ordinary share paid in the year (2013 11.7p)	**383**	380
Interim 8.2p dividend per ordinary share paid in the year (2013 8.0p)	**259**	258
	642	638

After the balance sheet date, the directors proposed a final dividend of 12.3p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 1 June 2015 to shareholders registered on 17 April 2015. The ex-dividend date is 16 April 2015.

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 8 May 2015.

8. ACQUISITIONS

In 2014, BAE Systems acquired: Perimeter Internetworking Corp., trading as SilverSky; an additional 59% shareholding in Saudi Development and Training Company (SDT); and Signal Innovations Group, Inc. (SIG).

If the acquisitions had occurred on 1 January 2014, combined sales of Group and share of equity accounted investments would have been £16.7bn, revenue £15.5bn and profit £752m for the year ended 31 December 2014.

For all acquisitions made in the year, fair values remain provisional, but will be finalised within 12 months of acquisition.

Summary

Acquisition	Description	Acquisition date	Percentage share acquired	Consideration Currency	Consideration £m
SilverSky	Commercial cyber service provider in the US	11 December 2014	100%	$232m	149
SDT[1]	Provider of technical and professional training in Saudi Arabia	15 September 2014	59%	SAR440m	72
SIG	Provider of imaging technologies and analytics to the US intelligence community	30 September 2014	100%	$21m	13

1. The Group previously held a 40% interest in SDT and accounted for its share of the results and net assets of SDT under the equity method, in accordance with IAS 28, Investments in Associates and Joint Ventures (revised 2011).

Material acquisitions

		Consolidated results for the period from acquisition to 31 December 2014		
Acquisition	Support for residual goodwill[2]	Revenue £m	EBITA[3] £m	Profit after tax[4] £m
SilverSky	Complements Applied Intelligence's existing cyber, intelligence and security products and capabilities; Enhances existing knowledge and expertise in commercial markets, and better positions the Group to compete for new customers, particularly in the US; Increases penetration of target markets through existing sales and marketing capabilities; and Provides a skilled assembled workforce.	3	–	–
SDT	Complements existing training activities in the Kingdom of Saudi Arabia; Enhances existing knowledge and expertise, and better positions the Group to compete for future work from the existing customer base; and Creates the opportunity to access new customers in the Kingdom of Saudi Arabia and also in new geographies.	6[5]	2	2

2. Goodwill recognised is attributable to specific opportunities and synergies which do not translate into separately identifiable intangible assets, but represent a proportion of the assessed value within each acquired entity.
3. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.
4. Profit after tax includes amortisation charges on acquired intangible assets totalling £1m.
5. Intra-group.

The post-acquisition results above exclude acquisition-related costs of £3m incurred by the Group. These expenses relate to external legal fees and due diligence costs, and are included in operating costs.

Fair values
The acquisitions had the following effect on the Group's assets and liabilities:

	SilverSky £m	SDT £m	SIG £m	Total £m
Intangible assets	81	–	–	81
Property, plant and equipment	7	–	–	7
Inventories	–	1	–	1
Receivables	8	6	1	15
Deferred tax assets	14	–	–	14
Payables	(11)	(4)	–	(15)
Deferred tax liabilities	(31)	–	–	(31)
Cash and cash equivalents	2	1	–	3
Net assets acquired	**70**	**4**	**1**	**75**
Goodwill	**79**	**117**	**12**	**208**
Fair value of net assets acquired and goodwill arising	**149**	**121**	**13**	**283**
Cash consideration	149	72	12	233
Amounts payable in respect of purchase price adjustments	–	–	1	1
Consideration	**149**	**72**	**13**	**234**
Carrying value of existing 40% shareholding in SDT	–	2	–	2
Fair value gain on existing 40% shareholding in SDT	–	47	–	47
Fair value of net assets acquired and goodwill arising	**149**	**121**	**13**	**283**

The intangible assets acquired as part of the acquisition of SilverSky of £81m include customer relationships (£47m), software (£30m) and order backlog (£4m).

Receivables include trade receivables with a fair value and gross contractual value of £10m, which are expected to be fully recoverable.

The goodwill is not expected to be deductible for tax purposes.

9. 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 31 December.

Due to the variability of the valuation factors, the fair values presented at 31 December 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

	2014		2013	
	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	**7**	**7**	3	3
Other receivables[1]	**238**	**238**	211	211
Other financial assets	**38**	**38**	42	42
Other financial liabilities	**(79)**	**(79)**	(59)	(59)
Loans	**(325)**	**(325)**	(307)	(307)
Trade and other payables[1]	**(262)**	**(262)**	(237)	(237)
Current				
Other financial assets	**46**	**46**	81	81
Other financial liabilities	**(107)**	**(107)**	(81)	(81)
Financial instruments not measured at fair value:				
Non-current				
Loans	**(2,543)**	**(2,900)**	(2,217)	(2,367)
Current				
Cash and cash equivalents	**2,308**	**2,308**	2,222	2,222
Loans and overdrafts	**(482)**	**(494)**	(402)	(414)

1. Represents US deferred compensation plan assets and liabilities.

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 year.

Financial assets and liabilities in the Group's consolidated balance sheet 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.

The fair value of total loans and overdrafts estimated using market prices at 31 December 2014 is £3,719m (2013 £3,088m).

10. RELATED PARTY TRANSACTIONS

Transactions occur with the equity accounted investments in the normal course of business, are priced on an arm's-length basis and settled on normal trade terms. The more significant transactions are disclosed below:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Sales to related parties	**1,229**	1,168
Purchases from related parties	**209**	263

	31 December 2014 £m	31 December 2013 £m
Amounts owed by related parties	**92**	56
Amounts owed to related parties	**494**	563

In October, the Group sold a freehold property to MBDA SAS for cash consideration of £12m.

11. ANNUAL GENERAL MEETING

This year's Annual General Meeting will be held on 7 May 2015. Details of the resolutions to be proposed at that meeting will be included in the notice of Annual General Meeting that will be sent to shareholders at the end of March 2015.

12. OTHER INFORMATION

The financial information for the year ended 31 December 2014 contained in this preliminary announcement was approved by the Board on 18 February 2015. This announcement does not constitute statutory accounts of the Company within the meaning of section 435 of the Companies Act 2006, but is derived from those accounts.

Statutory accounts for the year ended 31 December 2013 have been delivered to the Registrar of Companies. Statutory accounts for the year ended 31 December 2014 will be delivered to the Registrar of Companies following the Company's Annual General Meeting.

The auditors have reported on those accounts. Their reports were not qualified, 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 a statement under section 498 (2) or (3) of the Companies Act 2006.

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.