Half-yearly Report 2018

BAE Systems plc
Half-yearly Report 2018

Results in brief

Financial performance measures as defined by the Group[1]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[3])	Year ended 31 December 2017 (restated[3])
Order intake	**£9,701m**	£10,650m	£20,257m
Order backlog	**£39.7bn**	£38.7bn	£38.7bn
Sales	**£8,818m**	£9,467m	£18,487m
Underlying EBITA	**£874m**	£967m	£1,974m
Underlying earnings per share	**19.8p**	20.2p	42.1p
Operating business cash flow	**£(436)m**	£277m	£1,752m
Net debt	**£(1,921)m**	£(1,741)m	£(752)m

Financial performance measures defined in IFRS[2]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[3])	Year ended 31 December 2017 (restated[3])
Revenue	**£8,161m**	£8,915m	£17,224m
Operating profit	**£792m**	£885m	£1,419m
Basic earnings per share	**14.8p**	17.9p	26.0p
Net cash flow from operating activities	**£(397)m**	£341m	£1,897m

Pension and dividend

	Six months ended 30 June 2018	Six months ended 30 June 2017	Year ended 31 December 2017
Group's share of the net pension deficit	**£(3.0)bn**	£(5.9)bn	£(3.9)bn
Dividend per share	**9.0p[4]**	8.8p[4]	21.8p

Charles Woodburn, Chief Executive, said: "*We have made good progress in the first half strengthening the outlook through significant wins on the Australian SEA 5000 and US Amphibious Combat Vehicle programmes. These, combined with the launch of the UK Combat Air Strategy, provide good momentum into the second half and beyond. Operationally, there have been some notably strong performances in our Electronic Systems and Air sectors, but also some disappointments on certain long-standing programmes in Maritime and Platforms & Services (US), where we have now taken steps to strengthen management and improve programme execution. In this transition earnings year, our Group earnings guidance is maintained and, with a large order book and a positive outlook for defence budgets in a number of key markets, we have a strong foundation to deliver growth and sustainable cash flow.*"

Guidance for 2018

In aggregate, we expect the Group's underlying earnings per share for 2018 to be in line with the full-year underlying earnings per share for 2017, with some small additional benefit from exchange translation.*

** Compared with the Group's actual performance for 2017 as re-presented to reflect the impact of the adoption of IFRS 15 from 43.5p to 42.1p and assuming a US$1.35 to sterling exchange rate.*

Whilst there is no change to Group-level earnings guidance, some programme execution issues encountered on certain long-standing programmes in Platforms & Services (US) and Maritime in the first half are expected to be covered primarily by higher earnings in the Electronic Systems business and the Cyber & Intelligence sector.

This guidance is based on the measures used to monitor the underlying financial performance of the Group. Reconciliations from these measures to the financial performance measures defined in International Financial Reporting Standards for the six months ended 30 June 2018 are provided on pages 9-13.

Financial highlights

Financial performance measures as defined by the Group[1]

- Order backlog increased to £39.7bn, with £9.7bn of orders in the first half. Order backlog does not yet include the initial contract on the SEA 5000 programme, or the contract for the supply of Typhoon and Hawk aircraft to Qatar, both of which are expected in the second half of the year.
- Sales at £8.8bn, down 3% on a constant currency basis[5], as a result of reduced Typhoon production activity.
- Underlying EBITA at £874m, down 6% on a constant currency basis[5].
- Underlying earnings per share decreased by 2% to 19.8p, or up 2% on a constant currency basis[5]. The Group's effective tax rate for the first half of the year was 16.5%, compared to a rate of 23% in the same period last year.

Financial performance measures defined in IFRS[2]

- Revenue decreased to £8.2bn, down 5% on a constant currency basis[5].
- Operating profit decreased by 11% to £792m, or 7% on a constant currency basis[5].
- Basic earnings per share decreased by 17% to 14.8p.

Pension and dividend

- The Group's share of the pre-tax accounting net pension deficit reduced to £3.0bn (31 December 2017 £3.9bn).
- Interim dividend increased by 2% to 9.0p per share.

1. We monitor the underlying financial performance of the Group using alternative performance measures. These measures are not defined in International Financial Reporting Standards (IFRS) and, therefore, are considered to be non-GAAP (Generally Accepted Accounting Principles) measures. Accordingly, the relevant IFRS measures are also presented where appropriate. For alternative performance measure definitions see glossary on page 7.
2. International Financial Reporting Standards.
3. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.
4. Interim dividend declared (see note 6).
5. Current period compared with prior period translated at current period exchange rates.

Operational and strategic key points

Air

- In March, the UK government signed a Memorandum of Intent with the Kingdom of Saudi Arabia to aim to finalise discussions for the purchase of 48 Typhoon aircraft.
- In March, contracts worth A$1.0bn (£0.6bn) were agreed for the upgrade and sustainment of the Jindalee Operational Radar Network upgrade programme in Australia.
- In June, the Commonwealth of Australia selected the Group as the preferred tenderer for the design and build of nine ships for the Future Frigate programme for the Royal Australian Navy.
- In July, the UK government announced its Combat Air Strategy, under which the UK government and industry will jointly invest in next-generation combat air systems.
- BAE Systems and the Government of the State of Qatar signed a contract in December 2017 for the supply of 24 Typhoon aircraft to the Qatar Emiri Air Force along with a bespoke support and training package, which was extended to include nine Hawk aircraft, along with an initial support package. This contract was subject to financing conditions and receipt by the Company of first payment. Discussions have progressed and a number of milestones achieved, including the issuing of a Royal Decree relating to Qatar's financing of the contract. Financing discussions are in progress and, when successfully concluded, it is anticipated first payment would be received in the third quarter of 2018.

Maritime

- Andrew Wolstenholme has been appointed to lead Maritime with a clear focus on programme schedule and cost performance.
- In March, the Group secured the full £1.5bn contract for delivery of the seventh Astute Class submarine and a further £0.9bn of funding on the Dreadnought programme from the Ministry of Defence.
- The first of the five Offshore Patrol Vessels (OPV), HMS Forth, completed sea trials in December 2017, although short-term performance issues on the programme are being addressed which are expected to result in cost growth, with a loss provision of £15m being recognised in the first half.

Maritime performance was also impacted by more conservative margin trading on the Aircraft Carrier programme.

Electronic Systems

– Further awards for APKWS® laser-guided rockets were secured worth $399m (£302m).
– Demand for our products in the Electronic Systems business is growing and the portfolio is well aligned with the new US National Defense Strategy published earlier this year and our customer requirements. The business has a record order backlog at 30 June 2018 of $7.1bn (£5.3bn).

Platforms & Services (US)

– In June, a contract worth $198m (£150m) was secured for the US Marine Corps Amphibious Combat Vehicle programme, with options for a total of 204 vehicles worth up to $1.2bn (£0.9bn).
– The US Ship Repair business received orders totalling $607m (£460m) in the first half of 2018. A further charge has been taken in the first half of the year on the final commercial ship. The Group has taken the decision not to pursue new contracts for the Mobile, Alabama, shipyard, resulting in non-recurring impairment and other charges of $45m (£33m) in the first half of the year.
– Challenges with a subcontractor on the Radford facilities programme have required a charge to be taken in the first half of the year. Other than for this item and the Commercial Shipbuilding charges, return on sales performance for the Platforms & Services (US) business would have been in line with the 2017 half year for this segment.

Cyber & Intelligence

– In our Applied Intelligence business, the restructuring actions taken to return the business to profitability are taking hold and the business achieved a much improved first half performance.

For further information please contact:

Investors
Martin Cooper,
Investor Relations Director

Telephone: +44 (0)3300 488830

Email: **investors@baesystems.com**

Media Relations
Kristina Anderson,
Director, Media Relations

Telephone: +44 (0)7540 628673

Email: **kristina.anderson@baesystems.com**

Analyst and investor presentation

A presentation, for analysts and investors, of the Group's first half results for 2018 will be available via webcast at 9.00am today (1 August 2018).

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

About BAE Systems

At BAE Systems, our advanced defence technology protects people and national security, and keeps critical information and infrastructure secure. We search for new ways to provide our customers with a competitive edge across the air, maritime, land and cyber domains. We employ a skilled workforce of 83,900 people[1] in over 40 countries, and work closely with local partners to support economic development by transferring knowledge, skills and technology.

1. Including share of equity accounted investments.

Interim management report

In this transition earnings year, production on a number of programmes is ramping up with operational focus on the appropriate actions to ensure the challenges are met and delivery improvements made to meet the increased volume of activity across our Submarines, US Combat Vehicles and Electronic Systems businesses.

Governments in our key markets continue to prioritise defence and security, and there is a strong demand for our capabilities. Key business wins have been secured in the US on the Amphibious Combat Vehicle for the US Marine Corps and in Australia on selection as the preferred tenderer for the design and build of nine ships for the Future Frigate programme. These will strengthen our order backlog and core franchise positions, further enhancing the growth outlook for the Group.

Execution on the three strategic priorities is key to the successful delivery of the order backlog, to deliver future growth and in evolving the business to become a stronger, smarter and sharper organisation.

Operational Excellence

Raising the bar across the organisation to drive for flawless execution of the order book remains the priority for the Group. Whilst areas of the business are performing strongly and the restructuring actions taken to return the Applied Intelligence business to profitability are gaining traction, there have been some disappointments on certain long-standing programmes in our Maritime and Platforms & Services (US) businesses. Steps have been taken to address these operational issues. In Maritime, Andrew Wolstenholme has been appointed to lead that business with a clear focus on programme schedule and cost performance. In Platforms & Services (US), management has been strengthened to address the specific issues and to maintain the necessary focus on programme execution as production ramps up in combat vehicles.

Competitiveness

The new sector structure announced in 2017 is increasingly embedded. Within procurement, global and national category managers are now in place and efficiencies are being sought through supply chain rationalisation and enhanced data analytics.

Technological Innovation

The accelerating pace of technological change is a disruptive force and a key driver of competitive advantage and, increasingly, a determinant for customers in awarding new business. Through the Chief Technology Officer role the Group is driving greater collaboration across the business and with industry partners and academia. Technology plans are now in place that support the sector strategies. The Group is aiming to increase self-funded Research and Development spend over time, as well as working with our customers in developing technologies for use today and into the future. This increase will be achieved through a blend of self- and jointly-funded customer programmes and through a pipeline of investment opportunities and targeted bolt-on acquisitions.

US Market

The US Department of Defense fiscal year 2018 budget and the President's proposal for 2019 maintain the positive momentum in support for military readiness and modernisation. The Group's US portfolio remains well aligned with customer priorities and growth areas, providing greater certainty to our medium-term planning assumptions.

Our US Electronic Systems business has strong franchise positions in the high-technology areas of electronic warfare, C4ISR systems and survivability targeting and sensing, and is well positioned with the US National Defense Strategy. These capabilities are also being leveraged on international as well as domestic programmes. Within Electronic Systems, the Controls and Avionics, and Power and Propulsion Solutions businesses provide adjacencies into the commercial markets where we are able to fold back capabilities from our defence base. The business is focused on investment in emerging technologies and leveraging customer funding to maintain, develop and grow our franchises.

The Group's US-based combat vehicles business is well positioned for growth, underpinned by the Armored Multi-Purpose Vehicle, M109A7 self-propelled howitzer and Bradley upgrade programmes, which are all ramping up production. This is furthered with our competitive win on the Amphibious Combat Vehicle 1.1 programme. Additionally there are a number of prospects in international markets which, if secured, would drive further growth into the next decade.

We are a leading supplier of ship repair services and naval guns to the US Navy. These franchises are well supported by the growth outlook in US Navy budgets. Current utilisation levels are high in ship repair across our facilities and we continue to adjust our workforce and facilities to meet demand.

In our US-based Intelligence & Security business, whilst market conditions remain highly competitive and continue to evolve, focus is on maintaining a high level of bid activity and delivering on contracts.

UK Market

In the UK, where our business is centred on our long-term contracted positions in Air and Maritime, defence and security remains a priority for the UK government. The recently announced UK Combat Air Strategy is a significant milestone for our Air sector and sends a strong signal of intent about the UK's commitment to retaining a leading position in Combat Air. The strategy will enable long-term planning in a key strategic part of the business as UK government and industry jointly invest in cutting-edge, next-generation combat air systems.

The first phase of the Modernising Defence Programme was announced in July and sets the context, and the direction of travel, for further work the Ministry of Defence will now do in further phases. This statement re-emphasises the UK's commitment to strong defence and security.

The final agreement of the terms of the UK's exit from the EU after March 2019 will be important to enable companies to prepare for potential changes in the regulatory environment. As there is relatively limited UK-EU trading and movement of EU nationals within our UK businesses, the resulting Brexit impact on the business is likely to be limited, depending on the terms of any transition and final agreements for the UK's future relationship with the EU.

BAE Systems will support the UK government in achieving its aim to ensure that the UK maintains its key role in European security and defence post-Brexit, and to strengthen bilateral relationships with key partners in Europe. This will be important for ongoing collaboration in the development of defence capabilities.

Typhoon's capabilities continue to be enhanced with delivery of the Royal Air Force Centurion standard expected by the end of 2018, which will enable transition of capability from Tornado to Typhoon as the UK Tornado fleet is scheduled to come out of service at the end of the decade.

Typhoon production is currently focused on the remaining partner nation deliveries and sub-assembly build on the Kuwait programme. The Qatar Typhoon programme, once effective, would sustain production into the next decade. Securing any additional orders would further extend production.

Production of rear fuselage assemblies for the F-35 Lightning II aircraft is increasing with the step up to full-rate production on track for 2020. The first four UK F-35 aircraft arrived at RAF Marham in June and initial operational services were stood up. As the UK and global fleets grow, securing a long-term support position on F-35 is a key focus for the Air business.

In the Maritime sector, there remains pressure on the Royal Navy's near-term budgets. Securing the full contract for the delivery of Astute Boat 7 and additional funding for the Dreadnought programme in March furthered our long-term contracted positions. Managing the ramp-up of work on Dreadnought and Type 26, alongside the delivery of the Astute programme, the HMS Prince of Wales aircraft carrier and the remaining Offshore Patrol Vessels, has given a number of challenges that are being addressed through strengthening of the management teams.

International Markets

In an uncertain global environment and complex threat environment, our defence and security capabilities remain highly relevant. There are good prospects in international markets for our products and services in Air, Land, Cyber & Intelligence and Maritime.

In Saudi Arabia, BAE Systems continues to address current and potential new requirements as part of long-standing agreements between the UK government and the Kingdom. The Memorandum of Intent signed between the Kingdom of Saudi Arabia and the UK government in March, continues to progress towards reaching an Agreement for a further 48 Typhoon aircraft, support and transfer of technology and capability. This will enable BAE Systems to continue with the Industrialisation of Defence capabilities in the Kingdom of Saudi Arabia, in support of the Saudi Arabian government's National Transformation Plan and Vision 2030. The final assembly of the Typhoon would follow on from the Hawk programme where the first In-Kingdom final-assembled Hawk aircraft is expected to be delivered to the Royal Saudi Air Force in 2019.

BAE Systems and the Government of the State of Qatar signed a contract in December 2017 for the supply of 24 Typhoon aircraft to the Qatar Emiri Air Force along with a bespoke support and training package, which was extended to include nine Hawk aircraft, along with an initial support package. This contract was subject to financing conditions and receipt by the Company of first payment. Discussions have progressed and a number of milestones achieved, including the issuing of a Royal Decree relating to Qatar's financing of the contract. Financing discussions are in progress and, when successfully concluded, it is anticipated first payment would be received in the third quarter of 2018.

In Oman, two of the contracted Typhoon aircraft were delivered in the first half of the year with the final two of the 12 aircraft delivered in July.

On Typhoon and Hawk, discussions with current and prospective customers continue, supporting the Group's aspirations for additional contract awards. However, there can be no certainty as to the timing of these orders.

In Australia, the Group was bidding on two significant production contracts. Whilst we were unsuccessful in our bid for the Land 400 Phase 2 combat vehicle programme, in June, the Commonwealth of Australia selected the Group as the preferred tenderer for its announced A$35bn (£20bn) programme for the design and build of nine Future Frigates for the Royal Australian Navy. The Company has commenced negotiations with Australia's Department of Defence on the initial contract for the design and development phase, which is expected to be in place by the year end. Production of the first ship is expected to start in the early 2020s in South Australia. This shipbuilding contract will transform the existing Australian business which is underpinned by long-term support contracts and was further enhanced in March by securing the A$1bn (£0.6bn) Jindalee Operational Radar Network contract.

The MBDA joint venture has continued to win orders on domestic and export programmes. The business will grow from executing on its current order book and with a number of key bids and development programmes underway it is well placed to benefit from defence spend increases in a number of European countries and from export opportunities.

Cyber security domain

In our Applied Intelligence business, the restructuring actions taken to return the business to profitability are taking hold and the business achieved a much improved first half performance. The commercial market remains highly competitive, however Cyber security is an increasingly important part of government security and a core element of stewardship for commercial enterprises in a sophisticated and persistent threat environment. The services and products we offer are expected to drive growth and profitability as the market develops, and as our revised organisational structure is embedded.

Balance sheet and capital allocation

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

Pension schemes

The Group's share of the pre-tax accounting net pension deficit reduced to £3.0bn (31 December 2017 £3.9bn).

Summary

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

Directors and the Board

With effect from 1 January 2018, Revathi Advaithi was appointed to the Board as a non-executive director.

Dividend

The Board has declared a 2% increase in the interim dividend to 9.0p for the half year to 30 June 2018.

Glossary

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

	Definition	Purpose
Financial performance measures as defined by the Group		
Sales	Revenue including the Group's share of revenue of equity accounted investments.	Allows management to monitor the sales performance of subsidiaries and equity accounted investments.
Underlying EBITA	Operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBITA) and non-recurring items*.	Provides a measure of operating profitability that is comparable over time.
Underlying earnings per share	Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items*.	Provides a measure of underlying performance that is comparable over time.
Operating business cash flow	Net cash flow from operating activities excluding taxation and including net capital expenditure, financial investment and dividends from equity accounted investments.	Allows management to monitor the operational cash generation of the Group.
Net debt	Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments).	Allows management to monitor the indebtedness of the Group.
Order intake	Funded orders received from customers including the Group's share of order intake of equity accounted investments.	Allows management to monitor the order intake of subsidiaries and equity accounted investments.
Order backlog	Funded and unfunded unexecuted customer orders including the Group's share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.	Supports future years' sales performance of subsidiaries and equity accounted investments.

Financial performance measures defined in IFRS		
Revenue	Income derived from the provision of goods and services by the Company and its subsidiary undertakings.	N/a
Operating profit	Profit for the period before finance costs and taxation expense. This measure includes finance costs and taxation expense of equity accounted investments.	N/a
Basic earnings per share	Basic earnings per share in accordance with International Accounting Standard 33 Earnings per Share.	N/a
Net cash flow from operating activities	Net cash flow from operating activities in accordance with International Accounting Standard 7 Statement of Cash Flows.	N/a
Other financial measures		
Net pension deficit	Net International Accounting Standard 19 Employee Benefits, deficit excluding amounts allocated to equity accounted investments.	N/a
Dividend per share	Interim dividend paid and final dividend proposed per share.	N/a

* Items that are not relevant to an understanding of the Group's underlying performance (see page 11).

Financial performance

Income statement

	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 (restated[3]) £m
Financial performance measures as defined by the Group[1]		
Sales	**8,818**	9,467
Underlying EBITA	**874**	967
Return on sales	**9.9%**	10.2%
Financial performance measures defined in IFRS[2]		
Revenue	**8,161**	8,915
Operating profit	**792**	885
Return on revenue	**9.7%**	9.9%
Reconciliation of sales to revenue		
Sales	**8,818**	9,467
Deduct Share of sales by equity accounted investments	**(1,319)**	(1,154)
Add Sales to equity accounted investments	**662**	602
Revenue	**8,161**	8,915
Reconciliation of underlying EBITA to operating profit		
Underlying EBITA	**874**	967
Non-recurring items	**(33)**	(4)
Amortisation of intangible assets	**(33)**	(41)
Financial expense of equity accounted investments	**(6)**	(26)
Taxation expense of equity accounted investments	**(10)**	(11)
Operating profit	**792**	885
Net finance costs	**(221)**	(151)
Taxation expense	**(86)**	(161)
Profit for the period	**485**	573

Segmental analysis

With effect from 1 January 2018, the Group revised its reporting segments to reflect the organisational changes announced in 2017. The five principal reporting segments are Electronic Systems; Cyber & Intelligence; Platforms & Services (US); Air; and Maritime. These align with the strategic direction of the Group. Financial information for 2017 has been re-presented to reflect these new reporting segments.

Financial performance measures as defined by the Group[1]

	Sales		Underlying EBITA	
	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 (restated[3]) £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 (restated[3]) £m
Electronic Systems	**1,819**	1,820	**260**	272
Cyber & Intelligence	**815**	917	**48**	38
Platforms & Services (US)	**1,382**	1,505	**56**	114
Air	**3,305**	3,720	**459**	478
Maritime	**1,447**	1,488	**93**	110
HQ	**163**	152	**(42)**	(45)
Deduct Intra-group	**(113)**	(135)	**–**	–
	8,818	9,467	**874**	967

Financial performance measures defined in IFRS[2]

	Revenue		Operating profit/(loss)	
	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 (restated[3]) £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 (restated[3]) £m
Electronic Systems	**1,819**	1,820	**252**	262
Cyber & Intelligence	**815**	917	**41**	23
Platforms & Services (US)	**1,328**	1,472	**20**	104
Air	**2,839**	3,318	**438**	459
Maritime	**1,432**	1,475	**88**	105
HQ	**25**	23	**(47)**	(68)
Deduct Intra-group	**(97)**	(110)	**–**	–
	8,161	8,915	**792**	885

Exchange rates

Average	**Six months ended 30 June 2018**	Six months ended 30 June 2017
£/$	**1.376**	1.259
£/€	**1.137**	1.162
£/A$	**1.785**	1.669

Period end	**30 June 2018**	30 June 2017
£/$	**1.320**	1.299
£/€	**1.131**	1.139
£/A$	**1.787**	1.693

Year end	31 December 2017
£/$	1.353
£/€	1.126
£/A$	1.730

Sensitivity analysis	**£m**
Estimated impact on annual sales of a ten cent movement in the average exchange rate:	
$	**550**
€	**90**
A$	**35**

Sales in the first half decreased to £8.8bn (2017 £9.5bn[3]), down 3% on a constant currency basis[4], as a result of reduced Typhoon activity.

Underlying EBITA was £874m (2017 £967m[3]), 10% down on last year, or 6% on a constant currency basis[4].

Revenue decreased to £8.2bn (2017 £8.9bn[3]), down 5% on a constant currency basis[4].

Operating profit was £792m (2017 £885m[3]), 11% down on last year, or 7% on a constant currency basis[4].

Non-recurring items in 2018 of £33m (2017 £4m) represent an impairment of the Mobile, Alabama, shipyard (£28m) and costs incurred as a result of the decision to no longer pursue contracts for the Mobile shipyard (£5m). The 2017 charge of £4m represents a loss on the disposal of the BAE Systems San Francisco Ship Repair business.

Amortisation of intangible assets reduced to £33m (2017 £41m).

Net finance costs were £221m (2017 £151m). The underlying interest charge, excluding pension accounting, and fair value and foreign exchange adjustments on financial instruments and investments, was £101m (2017 £111m). There was a charge in respect of fair value and foreign exchange adjustments of £68m (2017 credit £44m) on exchange translation of US dollar-denominated bonds.

Taxation expense, including equity accounted investments, of £96m (2017 £172m[3]) reflects the Group's effective tax rate for the period of 16.5% (2017 23%). The effective tax rate for the full year is expected to be around 18% with some dependency on the geographical mix of profits.

1. For alternative performance measure definitions see glossary on page 7.
2. International Financial Reporting Standards.
3. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.
4. Current period compared with prior period translated at current period exchange rates.

Earnings per share

	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 (restated[3]) £m
Financial performance measures as defined by the Group[1]		
Underlying earnings	**631**	642
Underlying earnings per share	**19.8p**	20.2p
Financial performance measures defined in IFRS[2]		
Profit for the period attributable to equity shareholders	**471**	569
Basic earnings per share	**14.8p**	17.9p
Reconciliation of underlying earnings to profit for the period attributable to equity shareholders		
Underlying earnings	**631**	642
Non-recurring items, post tax	**(28)**	(4)
Amortisation and impairment of intangible assets, post tax	**(28)**	(32)
Net interest expense on retirement benefit obligations, post tax	**(44)**	(67)
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	**(60)**	30
Profit for the period attributable to equity shareholders	**471**	569
Non-controlling interests	**14**	4
Profit for the period	**485**	573

Underlying earnings per share for the period decreased by 2% to 19.8p (2017 20.2p[3]).

Basic earnings per share for the period decreased by 17% to 14.8p (2017 17.9p[3]). The decrease is a result of the lower operating profit and increased finance costs, partly offset by the impact of the lower effective tax rate.

1. For alternative performance measure definitions see glossary on page 7.
2. International Financial Reporting Standards.
3. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Cash flow

	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 £m
Financial performance measures as defined by the Group[1]		
Operating business cash flow	**(436)**	277
Financial performance measures defined in IFRS[2]		
Net cash flow from operating activities	**(397)**	341
Reconciliation from operating business cash flow to net cash flow from operating activities		
Operating business cash flow	**(436)**	277
Add back Net capital expenditure and financial investment	**186**	202
Deduct Dividends received from equity accounted investments	**(16)**	(32)
Deduct Taxation	**(131)**	(106)
Net cash flow from operating activities	**(397)**	341
Net capital expenditure and financial investment	**(186)**	(202)
Dividends received from equity accounted investments	**16**	32
Interest received	**11**	6
Cash flow in respect of acquisitions, disposals and held for sale assets	**(5)**	(5)
Net cash flow from investing activities	**(164)**	(169)
Interest paid	**(107)**	(107)
Net sale/(purchase) of own shares	**1**	(1)
Equity dividends paid	**(415)**	(404)
Dividends paid to non-controlling interests	**–**	(8)
Cash flow from matured derivative financial instruments	**(60)**	(43)
Cash flow from cash collateral	**(8)**	(5)
Cash flow from loans	**(7)**	–
Net cash flow from financing activities	**(596)**	(568)
Net decrease in cash and cash equivalents	**(1,157)**	(396)
Foreign exchange translation	**(83)**	176
Other non-cash movements	**64**	21
Less cash flow from loans	**7**	–
Increase in net debt	**(1,169)**	(199)
Opening net debt	**(752)**	(1,542)
Net debt	**(1,921)**	(1,741)

Segmental analysis

	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 £m
Financial performance measures as defined by the Group[1]		
Electronic Systems	**117**	118
Cyber & Intelligence	**63**	46
Platforms & Services (US)	**(46)**	38
Air	**(167)**	4
Maritime	**(196)**	255
HQ	**(207)**	(184)
Operating business cash flow	**(436)**	277
Financial performance measures defined in IFRS[2]		
Electronic Systems	**174**	167
Cyber & Intelligence	**69**	56
Platforms & Services (US)	**(30)**	66
Air	**(125)**	38
Maritime	**(153)**	295
HQ	**(201)**	(175)
Deduct Taxation[3]	**(131)**	(106)
Net cash flow from operating activities	**(397)**	341

Operating business cash outflow was £436m (2017 inflow £277m), primarily resulting from the reversal of timing benefits from 2017 and working capital outflows. The outflow also includes cash contributions in respect of pension deficit funding, over and above service costs, for the UK schemes totalling £139m (2017 £86m).

Net cash outflow from operating activities was £397m (2017 inflow £341m).

Taxation payments increased to £131m (2017 £106m).

Net capital expenditure and financial investment decreased marginally to £186m (2017 £202m) largely on timing of purchases of plant and equipment.

Dividends received from equity accounted investments of £16m (2017 £32m) is primarily receipts from FNSS, FADEC and Advanced Electronics Company.

Equity dividends paid in 2018 represents the 2017 final dividend.

As a consequence of movements in US dollar and euro exchange rates, there was a **cash outflow from matured derivative financial instruments** of £60m (2017 £43m) from rolling hedges on balances with the Group's subsidiaries and equity accounted investments.

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

1. For alternative performance measure definitions see glossary on page 7.
2. International Financial Reporting Standards.
3. Taxation is managed on a Group basis.

Net debt

	30 June 2018 £m	31 December 2017 £m
Components of net debt		
Cash and cash equivalents	**2,115**	3,271
Debt-related derivative financial instrument assets – non-current	**63**	79
Debt-related derivative financial instrument assets – current	**64**	–
Loans – non-current	**(3,401)**	(4,069)
Loans and overdrafts – current	**(758)**	(14)
Debt-related derivative financial instrument liabilities – current	**(4)**	(19)
Net debt	**(1,921)**	(752)

The Group's **net debt** at 30 June 2018 is £1,921m, a net increase of £1,169m from the net debt position of £752m at the start of the year.

Cash and cash equivalents of £2,115m (31 December 2017 £3,271m) are held primarily for the repayment of debt securities, pension deficit funding, payment of the 2018 interim dividend and management of working capital.

Going concern

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

Principal risks

The principal risks facing the Group for the remainder of the year are unchanged from those reported in the Annual Report 2017. The final agreement of the terms of the UK's exit from the EU will provide greater clarity as to the economic outlook in the medium term.

The Group's principal risks are detailed on pages 68 to 71 of the Annual Report 2017, and relate to the following areas: defence spending; government customers; international markets; competition in international markets; laws and regulations; contract risk and execution; contract awards and cash profiles; pension funding; information technology security; and people.

Segmental performance: Electronic Systems

Electronic Systems, with 15,500 employees[1], comprises the US and UK-based electronics activities, including electronic warfare systems, electro-optical sensors, military and commercial digital engine and flight controls, precision guidance and seeker solutions, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

Financial performance

Financial performance measures as defined by the Group[2]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Order intake	**£2,230m**	£1,848m	£4,175m
Order backlog	**£5.3bn**	£4.3bn	£4.8bn
Sales	**£1,819m**	£1,820m	£3,598m
Underlying EBITA	**£260m**	£272m	£541m
Return on sales	**14.3%**	14.9%	15.0%
Operating business cash flow	**£117m**	£118m	£450m

Financial performance measures defined in IFRS[3]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Revenue	**£1,819m**	£1,820m	£3,598m
Operating profit	**£252m**	£262m	£521m
Return on revenue	**13.9%**	14.4%	14.5%
Cash flow from operating activities	**£174m**	£167m	£569m

– Order backlog grew again to $7.1bn (£5.3bn), following awards for 17,500 APKWS® units and F-35 LRIP 13 funding.

– Sales of $2.5bn (£1.8bn) are up 9% over last year. Growth in the defence businesses was 11% as the F-35 and APKWS® programmes ramp up and classified activity expands.

– Return on sales was 14.3%.

– Cash conversion of EBITA in the first half of the year reflects the usual second half bias and we therefore expect an improved conversion level over the full year.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 7.
3. International Financial Reporting Standards.
4. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Operational performance

Electronic Combat

BAE Systems has sustained its leadership position in the US electronic warfare market and production is ramping up across a number of programmes.

On the F-35 Lightning II programme, Lots 10 and 11 Low-Rate Initial Production hardware deliveries continue, and we have received initial Lot 12 and 13 funding, with an anticipated final award value exceeding $600m (£454m). We are also executing an Electronic Warfare Performance Based Logistics contract from Lockheed Martin to provide material availability and support for the F-35 programme over a five-year period.

The business is under contracts from Boeing and Warner Robins Air Logistics Complex totalling more than $1.0bn (£0.8bn) to install the Digital Electronic Warfare System (DEWS) on new F-15 aircraft, upgrade existing F-15 aircraft, and to provide spare units and modules for an international customer. We are also executing a $311m (£236m) contract to provide DEWS to support the sale of new F-15 aircraft to another international customer. Following our 2015 selection by Boeing to develop and manufacture the next-generation digital electronic warfare system for the US Air Force's Eagle Passive Active Warning Survivability System programme to upgrade up to 400 F-15 aircraft, we are currently executing the $191m (£145m) engineering and manufacturing development contract, achieving our first partial system delivery in April.

We continue to execute $87m (£66m) worth of modifications to a competitively-awarded contract for an electronic warfare system for the US Air Force Special Operations Command's fleet of C-130J aircraft, which extends our position to include our electronic warfare capabilities on large, fixed-wing aircraft.

Production of our sensor technology for the Long Range Anti-Ship Missile continues following a $40m (£30m) order from prime contractor Lockheed Martin. We provided the sensor technology that supported several successful launches of the missile, demonstrating its ability to address the US Navy's requirement for versatile, multi-platform precision munitions that enable distributed operations. The next production award is anticipated by year end.

For over a decade, we have provided lifecycle support as the prime mission system integrator for the US Air Force's EC-130H Compass Call stand-off electronic attack platform, and we will continue to sustain the existing EC-130H electronics as we develop, manufacture, procure, integrate and sustain the electronics for this programme. We are also now under contract to cross-deck the mission electronics onto a new Gulfstream G550 business jet for the US Air Force.

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

Survivability, Targeting & Sensing

Our Advanced Precision Kill Weapon System (APKWS®) laser-guided rocket is experiencing growing demand, with over 15,000 units delivered to date. In addition to expanding its US military use, the system is generating strong international attention, with 20 nations expressing interest. Further awards totalling $399m (£302m) have been received so far this year. Production capacity is set to increase from 10,000 units per annum to 20,000 per annum to meet the increased demand.

We continue to execute on the Terminal High-Altitude Area Defence programme, with a $40m (£30m) production contract received for long-lead material on Lots 9 and 10. Additional units are expected under future contracts in response to increasing demand.

On the $527m (£399m) Common Missile Warning System programme, we continue to deliver to schedule.

The US Army's Family of Weapon Sights – Crew Served programme is in development testing. This seven-year contract awarded in 2016 has a potential value of up to $384m (£291m).

The LiteHUD® Head-Up Display has been selected by critical launch customers for integration on multiple platforms including the Textron Scorpion jet.

We are developing a next-generation missile warning system for the US Army under the Limited Interim Missile Warning System programme awarded in 2017.

C4ISR Systems

As a leading provider of space-qualified subsystems and components, we continue to experience growth in the areas of integrated on-board processors, reconfigurable processing payloads and secure communications.

We continue to execute the Network Tactical Common Data Link programme to provide the US Navy with the ability to simultaneously transmit and receive real-time intelligence, surveillance and reconnaissance data over multiple data links for a system to be fielded on various surface ship types.

Since winning the Geospatial Data Services Foundational GEOINT Content Management programme in 2014, we have been awarded orders valued at $240m (£182m) and are meeting delivery requirements in assisting US intelligence community customers with the development of advanced geospatial intelligence data collection and processing solutions.

As a provider of signals intelligence capabilities, we are executing the $132m (£100m) Tactical Signals Intelligence Payloads programme for the US Army's Gray Eagle unmanned aircraft. The system completed a critical assessment milestone in the first quarter of the year and user acceptance is scheduled by year end.

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

Controls & Avionics

BAE Systems is a major supplier of full-authority digital engine controls (FADECs), fly-by-wire flight controls, vehicle management systems, mission systems, and cabin and flight deck systems. The development of the integrated flight control electronics and remote electronic units for Boeing's next-generation 777X aircraft remains on schedule, with all hardware in qualification and systems integration testing progressing to plan.

Flight testing of the Boeing 737 MAX 7 aircraft is continuing with our spoiler controls, flight deck systems and utilities electronics, with entry into service planned for 2019.

Development of our civil active inceptors for the Gulfstream G500 and Embraer KC390 aircraft is complete and certification documentation has been released. A derivative of the active inceptors, the LinkEdge™ (Active Parallel Actuation Subsystem), is being developed for the Chinook CH-47 and has successfully completed its Hardware Critical Design Review.

FADEC Alliance, a joint venture between GE Aviation and FADEC International (our joint venture with Safran Electronics & Defense), has broadened its agreement with GE Aviation to include collaboration on system architectures and technologies for future engines. Under the agreement, FADEC Alliance will develop, produce, and support FADECs for all future GE Aviation commercial engines. The GE9x FADEC for the Boeing 777X remains on schedule to complete certification testing in 2018.

On the F-35 Lightning II programme, Low-Rate Initial Production Lot 11 is ongoing for the vehicle management computer and active inceptor system equipment, and development has commenced on the competitively-awarded F-35 Vehicle Management Computer Technology Refresh.

Power & Propulsion Solutions

As the transit bus market continues to move towards cleaner vehicles in order to meet increasingly stringent emissions targets, the demand for our products is growing. Our hybrid-electric propulsion systems are giving transit operators in cities such as Vancouver, San Francisco, Boston, Montreal and London a practical and affordable solution to meet their current goals, and demonstrating a significant step towards totally emission-free operations. We are also among the early providers of Battery-Electric propulsion solutions into the transit market, with Paris recently becoming the latest city to commit to vehicles powered by our technology.

Looking forward

Electronic Systems is well positioned to address current and evolving priority programmes from our strong franchise positions in electronic warfare, precision guidance and seeker solutions. We have a long-standing programme of research and development, and our focus remains on maintaining a diverse portfolio of defence and commercial products and capabilities for US and international customers.

The business expects to benefit from our strong programme positions, particularly on F-35 Lightning II and F-15 upgrades, and specific products such as APKWS®, which position the business well for the medium term.

In the commercial aviation market, our technology innovations ensure we are able to maintain our long-standing customer positions and to compete for, and win, new business.

Segmental performance: Cyber & Intelligence

Cyber & Intelligence, with 10,100 employees[1], comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber security, secure government, and commercial and financial security activities.

Financial performance

Financial performance measures as defined by the Group[2]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Order intake	**£864m**	£940m	£1,859m
Order backlog	**£2.0bn**	£2.3bn	£2.1bn
Sales	**£815m**	£917m	£1,818m
Underlying EBITA	**£48m**	£38m	£58m
Return on sales	**5.9%**	4.1%	3.2%
Operating business cash flow	**£63m**	£46m	£116m

Financial performance measures defined in IFRS[3]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Revenue	**£815m**	£917m	£1,818m
Operating profit	**£41m**	£23m	£(361)m
Return on revenue	**5.0%**	2.5%	(19.9)%
Cash flow from operating activities	**£69m**	£56m	£127m

- Order backlog reduced to $2.6bn (£2.0bn). In the US Intelligence & Security sector, order backlog was adjusted for the closed out options under a previously awarded IT services contract.
- In aggregate, sales of $1.1bn (£0.8bn) were down 6% on a constant currency basis[5].
- Sales in the US business were down 4% on a constant currency basis[5], the customer's decision to pursue a more federated approach to desktop IT services having had an impact.
- In Applied Intelligence, sales declined by 10% as pursuit of sales growth has been stepped back and refocused in order to enhance profits.
- The aggregate return on sales for the sector improved to 5.9%.
- The US business delivered a 9.0% return on sales in the first half, and as expected, Applied Intelligence reduced reported losses from £23m in the first half of last year to £4m this year. The Applied Intelligence business remains on track for a break even position by year end.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 7.
3. International Financial Reporting Standards.
4. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.
5. Current period compared with prior period translated at current period exchange rates.

Operational performance

Intelligence & Security

Air Force Solutions

The business is focused on providing the US Air Force and combatant commands with innovative solutions to help modernise, maintain, test, and cyber-harden aircraft, radars, missile systems, and mission applications that detect and deter threats to national security.

On the US Air Force Intercontinental Ballistic Missile Integration Support Contractor programme the total lifecycle value and ceiling of the contract has increased to over $1.0bn (£0.8bn). Our work includes programme management, systems engineering, integration and testing, sustainment, and cyber security assessment and defence.

Having provided obsolescence management services to the US Air Force since 1991, we secured a new three-year, $37m (£28m) contract for obsolescence management services to help mitigate redesigns caused by changes in part availability.

Integrated Defense Solutions

In the US Army, Navy and federal civilian markets, we provide systems engineering, integration, and sustainment services for C4ISR systems and enterprise IT networks that enhance mission effectiveness. These solutions are deployed across platforms and networks in the land, air, sea, and cyber domains.

In the first quarter of the year, we were awarded a five-year, $90m (£68m) US Navy contract to continue providing engineering and technical support for a variety of fixed, airborne, and mobile intelligence collection platforms. We also secured a four-year, $44m (£33m) contract to provide munitions handling and management support for the US Navy's Pacific fleet.

We are into the third year of a five-year, sole-source contract to provide systems engineering services to the US Navy's Strategic Systems Programs office. This programme carries a maximum contract value of $368m (£279m) and provides support for weapons systems on board US Ohio Class and UK Vanguard Class submarines, as well as future Ohio Class replacement and UK Dreadnought Class submarines.

We are executing the first year of a five-year, $41m (£31m) contract with the US Department of Homeland Security, National Protection and Programs Directorate to provide data analytics, risk scoring, cyber security, and governance support to help federal civilian agencies comply with government cyber security regulations.

Intelligence Solutions

Across the US civilian and military intelligence communities, our business provides innovative mission-enabling solutions and services to enhance the collection, analysis, and processing of intelligence. The business also develops and deploys high-assurance networks that facilitate the secure exchange of data amongst intelligence agencies in support of national security.

With the shift in the US government's IT strategy to pursue a more federated desktop approach, in April we announced a strategic collaboration with Dell EMC to market the first scalable, hybrid cloud solution of its kind to the US government. The solution offers the highest available assurance within the government cloud market, and enables organisations to adopt a baseline solution and add customisable options and services later.

We secured a 20-month Department of Defense contract with an estimated total value of more than $60m (£45m) to continue providing mission-critical intelligence analysis support for forward-deployed soldiers.

During the first half, we were awarded two additional task orders valued at approximately $50m (£38m) under the 2017 Indefinite Delivery, Indefinite Quantity contract to provide motion-imagery analysis, analytic training, multi-media support and research support services to the US intelligence community. A third task order awarded in the period is currently under protest, though we continue to perform as directed by the customer.

Applied Intelligence

With effect from 1 January 2018, the Applied Intelligence business has restructured to focus on a more targeted portfolio of products and services, delivering for customers within three core business units: Government; Financial Services; and Technology & Commercial. The business continues to progress towards a break-even position by the end of the year, following the actions taken to drive benefits in reduced headcount, operational efficiency and relocation of activities to lower cost international delivery operations centres. The restructuring programme is now substantially complete.

Government

The Government business is focused on delivering national security and intelligence solutions to the UK government and allied international governments. The business also delivers enterprise level data and digital services to UK government departments.

The first half of the year saw the closure of a significant order with a value of £23m with a UK government department to extend the provision of a multi-year enterprise level service integration and management programme. A number of orders were also closed for the provision of ongoing national security services with key UK and international customers.

Financial Services
The Financial Services business delivers anti-fraud and regulatory compliance solutions to banking and insurance customers across Europe, North America, the Middle East, Africa and Asia-Pacific.

There continues to be strong demand for our anti-fraud and regulatory compliance products. In the first half, a number of deals were closed in Europe and Asia Pacific as we continue to expand our offering to existing and new customers. Continued investment in product engineering and sales is intended to fuel future growth.

Technology & Commercial
The Technology & Commercial business provides security advisory and managed security services to a range of commercial customers in the UK and North America.

Looking forward

Intelligence & Security
The outlook for the US government services sector is stable, although market conditions remain highly competitive and continue to evolve as the market goes through a number of consolidations.

Whilst the shift in the US government's IT strategy to a more federated approach impacts revenue in 2018, the announced strategy could present new opportunities for the business.

Applied Intelligence
The restructuring is delivering a greater focus and higher levels of operational efficiency to accelerate improvements in competitiveness and profitability.

Sales growth is expected in the medium term as cyber security is an increasingly important part of government security and a core element of stewardship for commercial enterprises.

Segmental performance: Platforms & Services (US)

Platforms & Services (US), with 11,700 employees[1], has operations in the US, UK and Sweden. It produces combat vehicles, weapons and munitions, and delivers services and sustainment activities, including ship repair and the management of government-owned munitions facilities.

Financial performance

Financial performance measures as defined by the Group[2]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Order intake	**£1,479m**	£1,785m	£3,542m
Order backlog	**£4.6bn**	£4.2bn	£4.2bn
Sales	**£1,382m**	£1,505m	£2,951m
Underlying EBITA	**£56m**	£114m	£237m
Return on sales	**4.1%**	7.6%	8.0%
Operating business cash flow	**£(46)m**	£38m	£222m

Financial performance measures defined in IFRS[3]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Revenue	**£1,328m**	£1,472m	£2,848m
Operating profit	**£20m**	£104m	£213m
Return on revenue	**1.5%**	7.1%	7.5%
Cash flow from operating activities	**£(30)m**	£66m	£286m

– Order backlog has increased to $6.0bn (£4.6bn), primarily on the award of the Amphibious Combat Vehicle contract for the US Marine Corps, M109A7 Paladin Integrated Management and Bradley.

– Sales were broadly unchanged at $1.9bn (£1.4bn). As expected, there is a significant second half sales bias with combat vehicle production activity ramp up, particularly on M109A7 Paladin Integrated Management and Amphibious Combat Vehicle programmes, as well as the contract for Indian Army M777 lightweight howitzers in Weapon Systems and Munition Operations.

– Return on sales for the first half was 4.1%. Challenges with a subcontractor on the Radford facilities construction programme, and further cost growth on the final ship under the Commercial Shipbuilding contracts, have both required charges to be taken in the first half. Other than for those two items, return on sales performance would have been in line with the previous half year.

– Non-recurring impairment and other charges of $45m (£33m) have been recognised in the first half of the year relating to the Mobile, Alabama, shipyard as a result of the decision to no longer pursue new contracts for the site.

– First half cash flow reflects the utilisation of the provisions created against the US Commercial Shipbuilding programmes and working capital build ahead of stronger second half deliveries.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 7.
3. International Financial Reporting Standards.
4. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Operational performance

US Combat Vehicles

In June, BAE Systems and industry teammate Iveco Defence Vehicles were selected to supply Amphibious Combat Vehicles (ACV) for the US Marine Corps under the competitively-awarded ACV 1.1 programme phase. The production contract is for an initial $198m (£150m) for 30 vehicles, with options for a total of 204 vehicles worth up to $1.2bn (£0.9bn).

In February, we submitted our proposal to the US Army for the Mobile Protected Firepower programme, a light tank designed to operate in the Infantry Brigade Combat Team. The Army is expected to down select to two competitors for the engineering and manufacturing development phase later this year.

On the US Army's Armored Multi-Purpose Vehicle programme, we have completed deliveries of the first 29 vehicles under the engineering and manufacturing development phase. The contract has a potential value of $1.2bn (£0.9bn), including options for 289 vehicles in Low-Rate Initial Production (LRIP). We anticipate a contract for long-lead material for LRIP in the second half of the year.

We are executing on a $414m (£314m) contract received in December 2017 for the third LRIP option for 48 M109A7 self-propelled howitzers and M992A3 ammunition carriers under the Paladin Integrated Management programme. In January we received a $149m (£113m) contract for long-lead material to support the first year of full-rate production of 60 vehicle sets. Additional options could cover 120 vehicle sets over two years and if exercised would bring the total contract value to about $1.7bn (£1.3bn).

The business is executing a $286m (£217m) engineering and manufacturing development contract to address the space, weight, power and cooling limitations of the Bradley family of vehicles and to prepare the vehicle for communication network upgrades. In June we received a $348m (£264m) contract, initially funded at $132m (£100m), to upgrade 164 vehicles to the Bradley A4 configuration.

We continue to work on US Army contracts awarded in 2017 for upgrades and sustainment of M88 recovery vehicles, to include upgrades to the Heavy Equipment Recovery Combat Utility Lift Evacuation Systems (HERCULES) configuration. We anticipate an award for the next phase of the HERCULES upgrade programme in the second half.

Internationally, work continues on multiple contracts for Assault Amphibious Vehicles (AAVs). In June, we were awarded a Foreign Military Sales contract valued at $84m (£64m) to deliver 36 AAVs to Taiwan. As at 30 June, 25 of 30 AAVs have been delivered to Japan, with the remaining five being delivered early in the third quarter, under contracts totalling $165m (£125m). All 23 of the AAVs ordered by Brazil under an $82m (£62m) Foreign Military Sales contract have now been completed and 21 await formal delivery.

Weapon Systems and Munition Operations

We are executing on a $47m (£36m) contract modification from the US Navy in December 2017 to deliver four additional Mk45 Gun Systems upgraded to increase firepower and extend range. We also received contracts to provide additional 57mm Mk110 guns systems for the Navy's Littoral Combat Ship programme, and the US Coast Guard's National Security Cutter Legend Class and Offshore Patrol Cutter programmes.

In March, we received a contract to provide eight payload tubes for two block V version Virginia-class submarines, each featuring a new payload module for increased firepower.

The business is executing under a 2017 contract to deliver 155mm BONUS ammunition to the Swedish Army and is delivering 24 additional ARCHER artillery systems under a 2016 contract with the Swedish government.

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

Under the $542m (£411m) Foreign Military Sale contract to provide 145 M777 lightweight howitzers to the Indian Army, we are building the first 25 guns in our facilities, with the remaining systems assembled in India by Mahindra Defence Systems, our selected supplier to establish an assembly, integration and test facility in India. Five guns have been shipped.

In the complex ordnance manufacturing business, we continue to manage the US Army's Radford and Holston munitions facilities under previously awarded contracts. At Holston, we are progressing on modernisation contracts totalling $135m (£102m) for waste water management and a $146m (£111m) contract for the construction of a nitric acid recovery facility to produce larger quantities of insensitive munitions. At Radford, operational challenges and cost overruns on the nitrocellulose facility modernisation programme have been encountered and these have impacted the financial performance of the sector.

We are saddened to report that an accident involving a flash fire on 11 June in a nitrocellulose drying facility in Radford resulted in one fatality and injuries to two other employees. The cause of the fire is under investigation.

US Ship Repair and Modernisation

As a leading provider of US Navy ship repair and modernisation services, we secured firm orders across our US shipyards in the first half totalling approximately $607m (£460m), including recent awards to modernise the USS Howard in our San Diego, California, yard, and the USS Cole in our Norfolk, Virginia, yard.

In Commercial Shipbuilding, construction of the final commercial ship is nearing completion and sea trials are expected in the coming months. Necessary repairs on the vessel have led to a further charge being recognised in the first half of the year. No new contracts will be pursued for the Mobile, Alabama, shipyard, and non-recurring impairment and other charges of $45m (£33m) have been recognised in the first half of the year.

BAE Systems Hägglunds
In January, we unveiled the MkIV version of the CV90 Infantry Fighting Vehicle. The MkIV includes substantial upgrades to the drivetrain and suspension, as well as to its electronics.

We continue to advance local industrial cooperation arrangements with Czech companies in support of an anticipated bid of the CV90 for the country's next fleet of infantry fighting vehicles.

We continue to refurbish Swedish CV90 vehicles under a contract awarded in 2016, and are integrating Mjölner mortar systems on 40 Swedish CV90s under a separate contract.

We are on schedule under the contract to produce 32 BvS10 military vehicles for Austria.

FNSS
FNSS, our land systems joint venture based in Turkey, continues to perform under its $524m (£397m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army.

Programme deliveries are on schedule under the contract to Oman awarded in 2015 for the PARS Wheeled Armoured Vehicle to deliver 8x8 and 6x6 vehicles in a number of configurations.

Work progresses under multiple domestic contracts to Turkish Armed Forces. These include a €278m (£246m) contract to supply 260 Anti-Tank Vehicles, an €84m (£74m) contract for air defence vehicles, and a €155m (£137m) contract to provide 27 amphibious assault vehicles.

Looking forward

Our Combat Vehicles business is underpinned by strong positions on key franchise programmes. These include the US Army's Armored Multi-Purpose Vehicle, M109A7 self-propelled howitzer and Bradley upgrade programmes, and the CV90 and BvS10 export programmes from our BAE Systems Hägglunds business.

Following the securing of the Amphibious Combat Vehicles programme, we continue to pursue a range of domestic and international opportunities in combat and amphibious vehicles as well as weapon systems.

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

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

The Group remains a leading provider of gun systems and precision strike capabilities and, in the complex ordnance manufacturing business, we continue to manage the US Army's Radford and Holston munitions facilities under long-term contracts.

Segmental performance: Air

Air, with 26,700 employees[1], comprises the Group's UK-based air activities for European and International markets and US Programmes and our businesses in Saudi Arabia and Australia, together with a 37.5% interest in the pan-European MBDA joint venture.

Financial performance

Financial performance measures as defined by the Group[2]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Order intake	**£2,699m**	£2,479m	£6,128m
Order backlog	**£18.9bn**	£19.3bn	£19.5bn
Sales	**£3,305m**	£3,720m	£7,210m
Underlying EBITA	**£459m**	£478m	£967m
Return on sales	**13.9%**	12.8%	13.4%
Operating business cash flow	**£(167)m**	£4m	£832m

Financial performance measures defined in IFRS[3]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Revenue	**£2,839m**	£3,318m	£6,312m
Operating profit	**£438m**	£459m	£918m
Return on revenue	**15.4%**	13.8%	14.5%
Cash flow from operating activities	**£(125)m**	£38m	£888m

– Order backlog stands at £18.9bn, marginally down on trading of the long-term Typhoon support contracts for the UK, Saudi Arabia and Oman.

– Sales were down 11% at £3.3bn. As expected production activity on Typhoon for the European, Saudi and Oman contracts has largely completed. The F-35 programme is ramping up to plan and Middle East support volumes continue to grow.

– The adoption of IFRS 15 has introduced a change in method of revenue recognition, with sales now being linked to cost and activity rather than customer deliveries. However, profit will continue to be recognised progressively based on the mitigation and retirement of risk.

– The high return on sales of 13.9% is largely reflective of the new IFRS 15 approach, with some profit trading coming through on contracts with minimal sales. A sustainable return on sales expectation for the Air Sector remains as per our guidance.

– The cash outflow of £167m in the period reflects full consumption of the £300m early receipts seen in 2017 against the Saudi Support programme, and utilisation of the advances on the residual Typhoon export contracts.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 7.
3. International Financial Reporting Standards.
4. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Operational performance

European & International markets

BAE Systems and the Government of the State of Qatar signed a contract in December 2017 for the supply of 24 Typhoon aircraft to the Qatar Emiri Air Force along with a bespoke support and training package, which was extended to include nine Hawk aircraft, along with an initial support package. This contract was subject to financing conditions and receipt by the Company of first payment. Discussions have progressed and a number of milestones achieved, including the issuing of a Royal Decree relating to Qatar's financing of the contract. Financing discussions are in progress and, when successfully concluded, it is anticipated first payment would be received in the third quarter of 2018.

During the period two Typhoon aircraft were delivered to the Omani Air force, and the final two were delivered in July. The five-year availability service contract for the aircraft continues to deliver against contractual milestones.

Progress continues on the Kuwait Typhoon contract, secured by Italian Eurofighter partner, Leonardo, with 25 of 28 airframes now in work. BAE Systems' deliveries are expected to commence in 2019.

In the period, nine of the remaining 37 Tranche 3 Typhoon aircraft were delivered, three to the UK customer and six to European customers.

Delivery of the Royal Air Force Centurion standard is planned for the end of 2018, which enables the transition of air capabilities from Tornado to Typhoon. Integration of the Captor E-Scan radar continues to progress with the first flight of the hardware in the period.

Support to our UK and European customers' Typhoon and Tornado aircraft and their operational commitments continues to be delivered. In the UK under the ten-year partnership arrangement with the Ministry of Defence to support its Typhoon fleet, provision of flying hours is being sustained above contractual levels.

The long-term support contract for the Royal Air Force's UK fleet of Hawk fast jet trainer aircraft has met all contractual milestones in the period. Support continues to be provided to users of Hawk trainer aircraft around the world.

Mobilisation of the contract for collaboration on the first design and development phase of an indigenous fifth-generation fighter jet for the Turkish Air Force has progressed as planned.

Following the 2017 announcement of a potential workforce reduction of 1,400 employees in the business, a net headcount reduction of approximately 170 was effected in the period, together with mitigation of a further 219 roles.

The recently announced UK Combat Air Strategy is a significant milestone for our Air sector and sends a strong signal of intent about the UK's commitment to retaining a leading position in Combat Air. The strategy will enable long-term planning in a key strategic part of the business as UK government and industry jointly invest in cutting-edge, next-generation combat air systems.

US Programmes

On the F-35 programme, price agreement was secured on Lot 11 with contract award expected in the second half of the year. In the period, 40 rear fuselage assemblies were manufactured for the Low-Rate Initial Production Lot 10 and Lot 11 contracts. Negotiations are anticipated in the second half of the year on Lots 12-14 which will see an expected ramp-up to full-rate production by 2020.

At RAF Marham in Norfolk, the Lightning Operating Centre was completed and handed over and the initial operational service stood up ahead of the arrival of the UK's first four F-35 aircraft in June.

Good progress has been made in mobilising the resources to run the joint venture established with the UK Ministry of Defence and Northrop Grumman for the European repair hub for the maintenance, repair, overhaul and upgrade of F-35 avionics and components.

Saudi Arabia

The Memorandum of Intent signed between the Kingdom of Saudi Arabia and the UK government in March continues to progress towards reaching an Agreement for a further 48 Typhoon aircraft, support and transfer of technology and capability. This will enable BAE Systems to continue with the Industrialisation of Defence capabilities in the Kingdom of Saudi Arabia. Final assembly of all 48 Typhoon aircraft will be In-Kingdom.

On the original Salam Typhoon programme all 72 contracted Typhoon aircraft have been delivered to the customer.

The Typhoon support contracts continue to operate well, with a contract for the ongoing support expected in the second half of the year.

Further contracts have been received in the period under the Saudi British Defence Co-operation Programme five-year support services Agreement to 2021 for the Royal Saudi Air Force and Royal Saudi Naval Forces.

The first In-Kingdom final-assembled Hawk aircraft is expected to be delivered to the Royal Saudi Air Force in early 2019. A further seven major units of the second contracted batch of 22 Hawk aircraft have been delivered on schedule to meet Saudi Arabia's final assembly programme.

The Royal Saudi Naval Forces accepted the third and final ship in the Minehunter mid-life update programme in April. A training services contract for the Royal Saudi Naval Forces has been contracted in the period.

Work continues to reorganise our portfolio of interests in a number of industrial companies in Saudi Arabia. Riyadh Wings Aviation Academy LLC currently owns 4.1% of Overhaul and Maintenance Company, a Group subsidiary, and is expected to acquire a further interest up to a maximum of 49%. The reorganisation supports our strategy to expand the customer base of our In-Kingdom Industrial Participation programme, promoting training, development and employment opportunities in line with the Kingdom's National Transformation Plan and Vision 2030.

Australia

In March, the Commonwealth of Australia agreed upgrade and sustainment contracts worth A$1.0bn (£0.6bn) for the Jindalee Operational Radar Network, to be delivered over an initial ten-year term.

In June, the Commonwealth of Australia selected the Group as the preferred tenderer for the design and build of nine ships for the Future Frigate programme for the Royal Australian Navy, under the overall A$35bn (£20bn) programme announced by the government, which includes government-furnished equipment and costs associated with the programme. We have commenced negotiations with Australia's Department of Defence on the initial four-year design and development contract, which is expected to be in place by the year end and is expected to have a value in the region of around A$2bn (£1.1bn). The production scope is then expected to be negotiated for the first batch of ships with work on the first ship expected to start in early 2020s in South Australia.

The company was notified in March that it was unsuccessful in its bid for the Land 400 Phase 2 Combat Reconnaissance Vehicle programme.

Mobilisation activity for sustainment of the Regional F-35 fleet continues to progress at our Williamtown facility, with the first two aircraft to be supported expected to arrive in Australia at the end of the year.

We have continued to provide in-service support to the Royal Australian Navy's two Landing Helicopter Docks under the support contract which was extended to run until June 2019. Trials have identified a number of areas where rectifications are in process, with final acceptance of the vessels under the acquisition contract expected by the end of the year.

The sustainment and upgrade of the Anzac fleet under the Warship Asset Management Alliance progresses to plan, with the upgrade programme running through to 2023.

The Hawk Mk127 Lead-In Fighter Project team continues to maintain the high level of aircraft availability required to meet the training programme, and the Capability Assurance Programme to upgrade the Hawk fleet to meet the F-35 training requirements remains ahead of schedule. Five Hawk aircraft were modified in the period, bringing the total to 25 of the contracted 33.

MBDA

During the first half of 2018, MBDA secured new contracts for additional Taurus stand-off missiles in South Korea and for further five-year support to the Aster system in France, Italy and the UK. A contract to provide Marte Extended Range anti-ship missiles to Qatar was also signed, however, this is not yet in force.

The contract announced in 2017 for the supply of Brimstone and Meteor missiles to Qatar for the 24 Typhoon aircraft is dependent on the customer securing financing and receipt by MBDA of first payment. Financing discussions are in progress and, when successfully concluded, it is anticipated first payment would be received in the third quarter of 2018.

Negotiations on both technical specification and contract terms between the German Ministry of Defence and the MBDA and Lockheed Martin partners continue for the proposed German ground-based air defence system, TLVS.

MBDA made good progress on development programmes with key test firings successfully achieved on both Sea Venom anti-ship missile and Land Ceptor air defence missile system.

The Sea Ceptor naval air defence missile system entered into service with the Royal Navy in May 2018 on its Type 23 frigates.

Looking forward

In the UK, as current export contracts for Typhoon and Hawk complete, and UK Tornado support ends, sales are underpinned by our workshare on Typhoon for Kuwait, Typhoon and Hawk support, and F-35 Lightning II production and support. UK-based production of rear fuselage assemblies for F-35 will increase over the next three years to reach its expected peak rate for the next decade. We play a significant role in the F-35 sustainment programme in support of Lockheed Martin.

Defence and security remain priorities for the UK government, and this was reaffirmed in the Modernising Defence Programme and the recently announced UK Combat Air Strategy which provides the base to enable long-term planning and investment in a key strategic part of the business. Discussions continue with current and prospective customers in relation to potential further contract awards for Typhoon and Hawk.

The UK support operations are underpinned by a long-term partnering arrangement with the Ministry of Defence. In Saudi Arabia, the In-Kingdom Industrial Participation programme continues to make good progress consistent with our long-term strategy, as well as the Saudi Arabian government's National Transformation Plan and Vision 2030.

In Australia, the business is structured around long-term sustainment and upgrade activities, and is expected to expand into ship production following the down select in June 2018 of the SEA 5000 Future Frigate programme.

MBDA has a strong order book which is driving increasing production and sales. Development programmes continue to improve the long-term capabilities of the business.

Segmental performance: Maritime

Maritime, with 15,800 employees[1], comprises the Group's UK-based maritime and land activities.

Financial performance

Financial performance measures as defined by the Group[2]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Order intake	**£2,422m**	£3,767m	£4,671m
Order backlog	**£9.5bn**	£9.1bn	£8.5bn
Sales	**£1,447m**	£1,488m	£2,877m
Underlying EBITA	**£93m**	£110m	£251m
Return on sales	**6.4%**	7.4%	8.7%
Operating business cash flow	**£(196)m**	£255m	£278m

Financial performance measures defined in IFRS[3]

	Six months ended 30 June 2018	Six months ended 30 June 2017 (restated[4])	Year ended 31 December 2017 (restated[4])
Revenue	**£1,432m**	£1,475m	£2,845m
Operating profit	**£88m**	£105m	£240m
Return on revenue	**6.1%**	7.1%	8.4%
Cash flow from operating activities	**£(153)m**	£295m	£396m

– Order backlog has increased to £9.5bn following the awards for Astute Boat 7 pricing and further funding under the Dreadnought programme.

– Sales in the Maritime businesses for the first half of the year of £1.4bn are little changed from 2017. While activity levels on the Carrier programme are reducing, this is largely offset by increases on the Submarine programmes.

– Underlying EBITA in the first half of the year was £93m, with a return on sales of 6.4% against our guidance of 8-9%. We have taken a charge of £15m against the five ship Offshore Patrol Vessels contract and are now trading the Carrier at a more conservative level than planned.

– There was an operating cash outflow of £196m including a reversal of the £100m VAT timing benefit seen in 2017. Funding of the UK munitions contract is scheduled for December.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 7.
3. International Financial Reporting Standards.
4. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Operational performance

Maritime

On the Aircraft Carrier programme, large volume installation activities continue to progress on HMS Prince of Wales, with commissioning of systems planned through 2018 and sea trials beginning in 2019. Work continues to support HMS Queen Elizabeth, which includes capability insertion in advance of fixed wing flight trials in the second half of 2018. However, cost growth on the programme has resulted in a more conservative trading of contract profitability in the period.

The first batch of three Type 26 frigates continues in production. The programme currently employs over 1,000 people and activities will build progressively during 2018 on transition from completion of the detailed design through to production readiness.

The first of the five Offshore Patrol Vessels (OPV), HMS Forth, completed sea trials in December 2017. However, ongoing quality issues on the ship have had to be resolved resulting in unanticipated cost growth and a £15m loss provision in the period.

The Ministry of Defence has extended the Maritime Support Delivery Framework contract to 31 March 2020, under which BAE Systems manages and maintains HM Naval Base, Portsmouth, and supports more than half of the Royal Navy's surface fleet. During the first half of the year we were selected as the prime contractor to deliver the Type 45 Power Improvement Programme, which we are doing in collaboration with Cammell Laird and BMT.

Progress continues on the £270m Spearfish torpedo upgrade programme, with the demonstration phase forecast to complete in 2020.

The first three Astute Class submarines are in operational service with the Royal Navy. Progress continues on the manufacture of the remaining four boats. A full contract award for the seventh boat was secured in March.

Functional and spatial design and limited production on the first of class continues to advance on the Dreadnought Class submarine programme, the replacement for the Royal Navy's Vanguard Class submarines. The contract for Delivery Phase 2 was signed in March 2018 with £0.9bn of order intake.

The major programme of building works at the Barrow site continues, with contracts in place totalling more than £500m.

The Dreadnought Alliance Agreement detailing the organisational, governance and commercial arrangements between the three parties, the Submarine Delivery Authority, BAE Systems and Rolls-Royce has been agreed, allowing for the formal stand-up of the Alliance from April 2018.

The proposed reduction in our Maritime Services business workforce of around 375 roles has now been completed.

Land
The business continues to provide UK and international customers with a full range of light and heavy munitions, and support to previously supplied armoured vehicles and bridging systems.

During the first half of the year, 50 40mm cased-telescopic cannons were delivered to the Ministry of Defence by CTA International, a joint venture between BAE Systems and Nexter, bringing cumulative deliveries to 210 of 515. This is the first entirely new medium calibre cannon and ammunition system qualified by the British Army since the late 1960s. Also during the period an order for £72m was received to deliver 110 Case Telescoped Armament Systems to the French Army under their 6x6 combat armoured reconnaissance vehicle programme.

The business is one of two contenders delivering the design stages of the Challenger 2 Life Extension Programme and the British Army's bridging system.

Looking forward

Maritime
In Maritime, there remains pressure on the Navy's near-term budgets and a highly-competitive environment in ship support and upgrade.

Within submarines, the business is executing the Astute Class programme, with four boats still in build. On the Dreadnought programme, production of the first boat of four commenced in 2016. Investment continues in the Barrow facilities in order to provide the capabilities for support of these long-term programmes through the next decade.

In shipbuilding, sales are underpinned by the contracts to manufacture the Queen Elizabeth Class aircraft carriers, Type 26 frigates and River Class Offshore Patrol Vessels.

The through-life support of surface ship platforms provides a sustainable business in technical services and mid-life upgrades.

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

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

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

– The condensed set of financial statements has been prepared in accordance with IAS 34 Interim Financial Reporting, as adopted by the European Union.

– The interim management report on pages 1 to 30 includes a fair review of the information required by:

(a) DTR 4.2.7R of the Disclosure Guidance and Transparency Rules (DTR), being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the financial year; and

(b) DTR 4.2.8R of the DTR, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or the performance of the Company during that period; and any changes in the related party transactions described in the last annual report that could do so.

For and on behalf of the directors:

Sir Roger Carr

Chairman
31 July 2018

Directors

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

Independent review report to BAE Systems plc

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2018 which comprises the Condensed consolidated income statement, the Condensed consolidated statement of comprehensive income, the Condensed consolidated statement of changes in equity, the Condensed consolidated balance sheet, the Condensed consolidated cash flow statement and the related explanatory notes 1 – 11. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Financial Reporting Council. Our work has been undertaken so that we might state to the Company those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" as adopted by the European Union.

Our responsibility

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

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2018 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Deloitte LLP
Statutory Auditor
London
United Kingdom

31 July 2018

Condensed consolidated income statement (unaudited)

	Notes	**Six months ended 30 June 2018** £m	**Six months ended 30 June 2018** £m	Six months ended 30 June 2017 (restated[1]) £m	Six months ended 30 June 2017 (restated[1]) £m
Continuing operations					
Sales	2	**8,818**		9,467	
Deduct Share of sales by equity accounted investments		**(1,319)**		(1,154)	
Add Sales to equity accounted investments		**662**		602	
Revenue	2		**8,161**		8,915
Operating costs			**(7,454)**		(8,100)
Other income			**47**		61
Group operating profit			**754**		876
Share of results of equity accounted investments			**38**		9
Underlying EBITA	2	**874**		967	
Non-recurring items[2]		**(33)**		(4)	
EBITA		**841**		963	
Amortisation of intangible assets		**(33)**		(41)	
Financial expense of equity accounted investments		**(6)**		(26)	
Taxation expense of equity accounted investments		**(10)**		(11)	
Operating profit	2		**792**		885
Financial income		**138**		261	
Financial expense		**(359)**		(412)	
Net finance costs	3		**(221)**		(151)
Profit before taxation			**571**		734
Taxation expense			**(86)**		(161)
Profit for the period			**485**		573
Attributable to:					
Equity shareholders			**471**		569
Non-controlling interests			**14**		4
			485		573
Earnings per share	4				
Basic earnings per share			**14.8p**		17.9p
Diluted earnings per share			**14.7p**		17.8p

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.
2. Non-recurring items represent impairment and other charges relating to the Mobile, Alabama, shipyard (2017 loss on disposal of businesses).

Condensed consolidated statement of comprehensive income (unaudited)

	Six months ended 30 June 2018			Six months ended 30 June 2017 (restated[1])		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Profit for the period	**–**	**485**	**485**	–	573	573
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on retirement benefit schemes	**–**	**893**	**893**	–	170	170
Tax on items that will not be reclassified to the income statement	**–**	**(154)**	**(154)**	–	(38)	(38)
Equity accounted investments (net of tax)	**–**	**30**	**30**	–	6	6
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	**158**	**–**	**158**	(346)	–	(346)
Amounts credited to hedging reserve	**(5)**	**–**	**(5)**	63	–	63
Tax on items that may be reclassified to the income statement	**1**	**–**	**1**	(11)	–	(11)
Equity accounted investments (net of tax)	**3**	**–**	**3**	(5)	–	(5)
Total other comprehensive income for the period (net of tax)	**157**	**769**	**926**	(299)	138	(161)
Total comprehensive income for the period	**157**	**1,254**	**1,411**	(299)	711	412
Attributable to:						
Equity shareholders	**155**	**1,240**	**1,395**	(297)	707	410
Non-controlling interests	**2**	**14**	**16**	(2)	4	2
	157	**1,254**	**1,411**	(299)	711	412

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Condensed consolidated statement of changes in equity (unaudited)

	Attributable to equity holders of BAE Systems plc						
	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
Balance at 31 December 2017 as originally presented	87	1,249	6,098	(2,693)	4,741	43	4,784
Change in accounting policy[1]	–	–	(8)	65	57	–	57
Restated total equity at 1 January 2018	87	1,249	6,090	(2,628)	4,798	43	4,841
Profit for the period	–	–	–	471	471	14	485
Total other comprehensive income for the period	–	–	155	769	924	2	926
Share-based payments (inclusive of tax)	–	–	–	32	32	–	32
Net sale of own shares	–	–	–	1	1	–	1
Ordinary share dividends	–	–	–	(415)	(415)	–	(415)
At 30 June 2018	**87**	**1,249**	**6,245**	**(1,770)**	**5,811**	**59**	**5,870**
Balance at 1 January 2017 as originally presented	87	1,249	6,685	(4,583)	3,438	26	3,464
Change in accounting policy[1]	–	–	–	92	92	–	92
Restated total equity at 1 January 2017	87	1,249	6,685	(4,491)	3,530	26	3,556
Profit for the period	–	–	–	569	569	4	573
Total other comprehensive income for the period	–	–	(297)	138	(159)	(2)	(161)
Share-based payments (inclusive of tax)	–	–	–	24	24	–	24
Net purchase of own shares	–	–	–	(1)	(1)	–	(1)
Ordinary share dividends	–	–	–	(404)	(404)	(8)	(412)
At 30 June 2017	87	1,249	6,388	(4,165)	3,559	20	3,579

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Condensed consolidated balance sheet (unaudited)

	Notes	30 June 2018 £m	31 December 2017 (restated[1]) £m
Non-current assets			
Intangible assets		**10,523**	10,378
Property, plant and equipment		**2,217**	2,230
Investment property		**105**	101
Equity accounted investments		**382**	324
Other investments		**6**	6
Other receivables		**434**	387
Retirement benefit surpluses	5	**421**	302
Other financial assets		**170**	226
Deferred tax assets		**518**	684
		14,776	14,638
Current assets			
Inventories		**799**	733
Trade, other and contract receivables		**4,726**	4,244
Current tax		**67**	20
Other financial assets		**160**	89
Cash and cash equivalents		**2,115**	3,271
Assets held for sale		**51**	26
		7,918	8,383
Total assets		**22,694**	23,021
Non-current liabilities			
Loans		**(3,401)**	(4,069)
Other payables		**(1,249)**	(1,723)
Retirement benefit obligations	5	**(3,385)**	(4,222)
Other financial liabilities		**(117)**	(133)
Deferred tax liabilities		**(2)**	(4)
Provisions		**(462)**	(435)
		(8,616)	(10,586)
Current liabilities			
Loans and overdrafts		**(758)**	(14)
Trade and other payables		**(6,777)**	(6,755)
Other financial liabilities		**(74)**	(104)
Current tax		**(282)**	(305)
Provisions		**(317)**	(400)
Liabilities held for sale		–	(16)
		(8,208)	(7,594)
Total liabilities		**(16,824)**	(18,180)
Net assets		**5,870**	4,841
Capital and reserves			
Issued share capital		**87**	87
Share premium		**1,249**	1,249
Other reserves		**6,245**	6,090
Retained earnings – deficit		**(1,770)**	(2,628)
Total equity attributable to equity holders of BAE Systems plc		**5,811**	4,798
Non-controlling interests		**59**	43
Total equity		**5,870**	4,841

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Condensed consolidated cash flow statement (unaudited)

	Notes	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 (restated[1]) £m
Profit for the period		**485**	573
Taxation expense		**86**	161
Research and development expenditure credits		**(10)**	(14)
Share of results of equity accounted investments		**(38)**	(9)
Net finance costs		**221**	151
Depreciation, amortisation and impairment		**188**	167
Profit on disposal of property, plant and equipment, and investment property		**(1)**	(1)
Loss in respect of held for sale assets and disposal of businesses		**5**	4
Cost of equity-settled employee share schemes		**28**	29
Movements in provisions		**(69)**	58
Decrease in liabilities for retirement benefit obligations		**(123)**	(76)
Increase in working capital:			
Inventories		**(56)**	(74)
Trade, other and contract receivables		**(462)**	(427)
Trade and other payables		**(520)**	(95)
Taxation paid		**(131)**	(106)
Net cash flow from operating activities		**(397)**	341
Dividends received from equity accounted investments		**16**	32
Interest received		**11**	6
Purchases of property, plant and equipment, and investment property		**(140)**	(166)
Purchases of intangible assets		**(49)**	(36)
Proceeds from sale of property, plant and equipment, and investment property		**4**	3
Purchase of subsidiary undertakings		**–**	(3)
Cash flow in respect of held for sale assets and business disposals		**(3)**	(2)
Purchase of equity accounted investment		**(2)**	–
Equity accounted investment funding		**(1)**	(3)
Net cash flow from investing activities		**(164)**	(169)
Interest paid		**(107)**	(107)
Net sale/(purchase) of own shares		**1**	(1)
Equity dividends paid	6	**(415)**	(404)
Dividends paid to non-controlling interests		**–**	(8)
Cash flow from matured derivative financial instruments		**(60)**	(43)
Cash flow from cash collateral		**(8)**	(5)
Cash flow from repayment of loans		**(7)**	–
Net cash flow from financing activities		**(596)**	(568)
Net decrease in cash and cash equivalents		**(1,157)**	(396)
Cash and cash equivalents at 1 January		**3,264**	2,771
Effect of foreign exchange rate changes on cash and cash equivalents		**8**	(19)
Cash and cash equivalents at end of period		**2,115**	2,356
Comprising:			
Cash and cash equivalents		**2,115**	2,360
Overdrafts		**–**	(4)
Cash and cash equivalents at end of period		**2,115**	2,356

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

Notes to the condensed half-yearly financial statements

1. Preparation

Basis of preparation and statement of compliance

These condensed consolidated half-yearly financial statements of BAE Systems plc (the Group) have been prepared in accordance with International Accounting Standard (IAS) 34 Interim Financial Reporting. The annual consolidated financial statements of the Group are prepared in accordance with EU-endorsed International Financial Reporting Standards (IFRSs). These condensed consolidated half-yearly financial statements do not comprise statutory accounts within the meaning of Section 435 of the Companies Act 2006 and should be read in conjunction with the Annual Report 2017. The comparative figures for the year ended 31 December 2017 are not the Group's statutory accounts for that financial year. Those financial statements have been reported upon by the Group's then-auditor and delivered to the registrar of companies. The report of the auditor was unqualified, did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and did not contain statements under Section 498 (2) or (3) of the Companies Act 2006. The financial statements for 2017 were reported upon by KPMG LLP. Following the Annual General Meeting on 10 May 2018, Deloitte LLP succeeded KPMG LLP as the Company's auditor.

The accounting policies adopted in the preparation of these condensed consolidated half-yearly financial statements to 30 June 2018 are consistent with the accounting policies applied by the Group in its consolidated financial statements as at, and for the year ended, 31 December 2017 as required by the Disclosure Guidance and Transparency Rules of the UK's Financial Conduct Authority, with the exception of the adoption of new and amended standards as set out below.

With effect from 1 January 2018, the Group revised its reporting segments to reflect the organisational changes announced in 2017. The five principal reporting segments are Electronic Systems; Cyber & Intelligence; Platforms & Services (US); Air; and Maritime. These align with the strategic direction of the Group. Financial information for 2017 has been re-presented to reflect these new reporting segments.

New and amended standards adopted by the Group

A number of new or amended standards became applicable for the current reporting period and the Group changed its accounting policies and, where applicable, made retrospective adjustments as a result of adopting:

- IFRS 9 Financial Instruments, and
- IFRS 15 Revenue from Contracts with Customers.

The impact of the adoption of these standards and the new accounting policies is disclosed in note 10.

Following the adoption of IFRS 15 Revenue from Contracts with Customers, the Group continues to recognise revenue and profit recognition as one of its critical accounting policies, owing to the complexity, judgement and estimation in its application and impact on the financial statements. Note 10 provides more details on the Group's application of IFRS 15 and its new accounting policy for the new standard.

Impact of standards issued but not yet applied by the Group

IFRS 16 Leases is effective 1 January 2019, replacing IAS 17 Leases. Whilst lessor accounting is similar to IAS 17, lessee accounting is significantly different. Under IFRS 16 the Group will recognise within the balance sheet a right-of-use asset and a lease liability for future lease payments in respect of all leases, unless the underlying assets are of low value or the lease term is 12 months or less. Within the income statement, rental expense on the impacted leases will be replaced with depreciation on the right-of-use asset and interest expense on the lease liability. As set out in note 32 of the BAE Systems Annual Report 2017, the Group had operating lease commitments totalling £1.6bn at 31 December 2017 and therefore IFRS 16 will have a material impact on the Group. The implications of the standard are currently under review and the Group has not yet determined which transition option will be applied.

2. Segmental analysis

Sales and revenue by reporting segment[1]

	Sales		Deduct: Share of sales by equity accounted investments		Add: Sales to equity accounted investments		Revenue	
	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 (restated[2]) £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 (restated[2]) £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 (restated[2]) £m
Electronic Systems	**1,819**	1,820	**(42)**	(45)	**42**	45	**1,819**	1,820
Cyber & Intelligence	**815**	917	**–**	–	**–**	–	**815**	917
Platforms & Services (US)	**1,382**	1,505	**(54)**	(33)	**–**	–	**1,328**	1,472
Air	**3,305**	3,720	**(1,069)**	(930)	**603**	528	**2,839**	3,318
Maritime	**1,447**	1,488	**(16)**	(17)	**1**	4	**1,432**	1,475
HQ	**163**	152	**(138)**	(129)	**–**	–	**25**	23
	8,931	9,602	**(1,319)**	(1,154)	**646**	577	**8,258**	9,025
Intra-group sales/revenue	**(113)**	(135)	**–**	–	**16**	25	**(97)**	(110)
	8,818	9,467	**(1,319)**	(1,154)	**662**	602	**8,161**	8,915

Operating profit/(loss) by reporting segment[1]

	Underlying EBITA		Non-recurring items		Amortisation and impairment of intangible assets		Financial and taxation expense of equity accounted investments		Operating profit/(loss)	
	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 (restated[2]) £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 (restated[2]) £m	**Six months ended 30 June 2018 £m**	Six months ended 30 June 2017 (restated[2]) £m
Electronic Systems	**260**	272	**–**	–	**(8)**	(10)	**–**	–	**252**	262
Cyber & Intelligence	**48**	38	**–**	–	**(7)**	(15)	**–**	–	**41**	23
Platforms & Services (US)	**56**	114	**(33)**	(4)	**(4)**	(5)	**1**	(1)	**20**	104
Air	**459**	478	**–**	–	**(6)**	(4)	**(15)**	(15)	**438**	459
Maritime	**93**	110	**–**	–	**(5)**	(4)	**–**	(1)	**88**	105
HQ	**(42)**	(45)	**–**	–	**(3)**	(3)	**(2)**	(20)	**(47)**	(68)
	874	967	**(33)**	(4)	**(33)**	(41)	**(16)**	(37)	**792**	885
Net finance costs									**(221)**	(151)
Profit before taxation									**571**	734
Taxation expense									**(86)**	(161)
Profit for the period									**485**	573

1. Reporting segments have been re-presented to reflect the organisational changes which took effect on 1 January 2018.
2. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

3. Net finance costs

	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 £m
Net finance costs:		
Group	**(221)**	(151)
Share of equity accounted investments	**(6)**	(26)
	(227)	(177)
Analysed as:		
Underlying interest expense:		
Group	**(101)**	(111)
Share of equity accounted investments	**–**	(18)
	(101)	(129)
Other:		
Group:		
Net interest expense on retirement benefit obligations	**(52)**	(84)
Fair value and foreign exchange adjustments on financial instruments and investments	**(68)**	44
Share of equity accounted investments:		
Net interest expense on retirement benefit obligations	**(2)**	(3)
Fair value and foreign exchange adjustments on financial instruments and investments	**(4)**	(5)
	(227)	(177)

4. Earnings per share

	Six months ended 30 June 2018			Six months ended 30 June 2017 (restated[2])		
	£m	**Basic pence per share**	**Diluted pence per share**	£m	Basic pence per share	Diluted pence per share
Profit for the period attributable to equity shareholders	**471**	**14.8**	**14.7**	569	17.9	17.8
Add back/(deduct):						
Non-recurring items, post tax[1]	**28**			4		
Amortisation and impairment of intangible assets, post tax[1]	**28**			32		
Net interest expense on retirement benefit obligations, post tax[1]	**44**			67		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax[1]	**60**			(30)		
Underlying earnings, post tax	**631**	**19.8**	**19.7**	642	20.2	20.1

	Millions	**Millions**	Millions	Millions
Weighted average number of shares used in calculating basic earnings per share	**3,190**	**3,190**	3,179	3,179
Incremental shares in respect of employee share schemes		**13**		16
Weighted average number of shares used in calculating diluted earnings per share		**3,203**		3,195

1. The tax impact, where applicable, is calculated using the effective tax rate of 16.5% (2017 23%).
2. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 10 for details regarding the restatement.

5. Retirement benefits

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2018	(3,680)	(566)	(4,246)
Actual return on assets excluding amounts included in net interest expense	(222)	(227)	(449)
Decrease in liabilities due to changes in assumptions and experience	1,204	243	1,447
Contributions in excess of/(below) service cost	150	(10)	140
Past service cost – plan amendments	(5)	–	(5)
Net interest expense	(45)	(11)	(56)
Foreign exchange adjustments	–	(10)	(10)
Movement in US healthcare schemes	–	2	2
Total net IAS 19 deficit at 30 June 2018	**(2,598)**	**(579)**	**(3,177)**
Allocated to equity accounted investments	213	–	213
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 30 June 2018	**(2,385)**	**(579)**	**(2,964)**
Represented by:			
Retirement benefit surpluses	327	94	421
Retirement benefit obligations	(2,712)	(673)	(3,385)
	(2,385)	**(579)**	**(2,964)**

Deficit allocation

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

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

Principal actuarial assumptions

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

	UK		US	
	30 June 2018	31 December 2017	**30 June 2018**	31 December 2017
Financial assumptions				
Discount rate – past service (%)	**2.8**	2.6	**4.2**	3.7
Discount rate – future service (%)	**2.9**	2.7	**4.2**	3.7
Inflation (%)	**3.0**	3.1	**n/a**	n/a
Rate of increase in salaries (%)	**3.0**	3.1	**n/a**	n/a
Rate of increase in deferred pensions (%)	**2.0/3.0**	2.1/3.1	**n/a**	n/a
Rate of increase in pensions in payment (%)	**1.6-3.6**	1.6-3.7	**n/a**	n/a
Demographic assumptions				
Life expectancy of a male currently aged 65 (years)	**86-88**	86-88	**87**	87
Life expectancy of a female currently aged 65 (years)	**88-90**	88-90	**89**	89
Life expectancy of a male currently aged 45 (years)	**88-90**	88-90	**87**	87
Life expectancy of a female currently aged 45 (years)	**90-92**	90-92	**89**	89

The Group has updated the UK demographic assumptions to use Continuous Mortality Investigation (CMI) 2017 data, reflecting the latest available projections published by the actuarial profession.

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 30 June 2018 and keeping all other assumptions the same.

Financial assumptions

The estimated impact of changes in the discount rate and inflation assumptions on the defined benefit pension obligation, together with the estimated impact on scheme assets, is shown in the table below. The estimated impact on scheme assets takes into account the Group's risk management activities in respect of interest rate and inflation risk. The sensitivity analysis on the defined benefit obligation is measured on an IAS 19 accounting basis and, therefore, does not reflect the natural hedging in the discount rate used for funding valuation purposes.

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

The sensitivity of the valuation of the liabilities to changes in the inflation assumption presented above assumes that a 0.1 percentage point change to expectations of future inflation results in a 0.1 percentage point change to all inflation-related assumptions (rate of increase in salaries, rate of increase in deferred pensions and rate of increase in pensions in payment) used to value the liabilities. However, upper and lower limits exist on the majority of inflation-related benefits such that a change in expectations of future inflation may not have the same impact on the inflation-related benefits, and hence will result in a smaller change to the valuation of the liabilities. Accordingly, extrapolation of the above results beyond the specific sensitivity figures shown may not be appropriate. To illustrate this, the (increase)/decrease in the defined benefit pension obligation before allocation to equity accounted investments resulting from larger changes in the inflation assumption would be as follows:

	(Increase)/ decrease in pension obligation £bn
Inflation:	
0.5 percentage point increase	(1.3)
0.5 percentage point decrease	1.4
1.0 percentage point increase	(2.8)
1.0 percentage point decrease	2.6

Demographic assumptions

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

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

6. Equity dividends

	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 £m
Prior year final 13p dividend per ordinary share paid in the period (2017 12.7p)	**415**	404

The directors have declared an interim dividend of 9.0p per ordinary share (2017 8.8p), totalling £287m (2017 £280m). The dividend will be paid on 30 November 2018 to shareholders registered on 19 October 2018. The ex-dividend date is 18 October 2018.

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 for receipt no later than 9 November 2018.

7. Fair value measurement

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

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

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

– the fair values of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates; and

– 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.

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

Fair value hierarchy
The fair value measurement hierarchy is as follows:

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

– Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

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

Carrying amounts and fair values of certain financial instruments

	30 June 2018		31 December 2017	
	Carrying amount £m	**Fair value £m**	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:				
Non-current				
Available-for-sale financial assets	**6**	**6**	6	6
Other financial assets	**170**	**170**	226	226
Other financial liabilities	**(117)**	**(117)**	(133)	(133)
Current				
Other financial assets	**160**	**160**	89	89
Other financial liabilities	**(74)**	**(74)**	(104)	(104)
Financial instruments not measured at fair value:				
Non-current				
Loans[1]	**(3,401)**	**(3,617)**	(4,069)	(4,478)
Current				
Loans and overdrafts	**(758)**	**(780)**	(14)	(14)

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

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

Financial assets and liabilities are either held at fair value or their carrying value approximates to fair value, with the exception of loans, most of which are held at amortised cost. The fair value of loans presented in the table above is derived from market prices.

8. Financial risk management

Currency risk

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

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

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

9. Related party transactions

Transactions with related parties are shown on page 193 of the Annual Report 2017.

	Six months ended 30 June 2018 £m	Six months ended 30 June 2017 £m
Sales to equity accounted investments	**662**	602
Purchases from equity accounted investments	**172**	173

	30 June 2018 £m	31 December 2017 £m
Amounts owed by equity accounted investments	**75**	86
Amounts owed to equity accounted investments	**907**	927

10. Change in accounting policies

This note explains the impact of the adoption of IFRS 9 Financial Instruments, and IFRS 15 Revenue from Contracts with Customers, on the Group's financial statements and also discloses the new accounting policies that have been applied from 1 January 2018, where they are different from those applied in earlier periods.

Impact on financial statements

As a result of changes in the Group's accounting policies, prior year financial statements have been restated for the adoption of IFRS 15 Revenue from Contracts with Customers. As explained below, IFRS 9 was adopted without restating comparative information.

The following tables show the adjustments recognised for each individual line item. Line items that are not affected by the changes have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. The adjustments are explained in more detail by standard below.

Consolidated balance sheet (extract)	As previously reported 31 December 2017 £m	Impact of IFRS 15 £m	Restated 31 December 2017 £m
Non-current assets			
Equity accounted investments	384	(60)	324
Deferred tax assets	724	(40)	684
	14,738	**(100)**	**14,638**
Current assets			
Inventories	723	10	733
Trade and other receivables including amounts due from customers for contract work	3,586	(3,586)	–
Trade, other and contract receivables	–	4,244	4,244
	7,715	**668**	**8,383**
Total assets	**22,453**	**568**	**23,021**
Non-current liabilities			
Trade and other payables	(1,722)	(1)	(1,723)
Provisions	(413)	(22)	(435)
	(10,563)	**(23)**	**(10,586)**
Current liabilities			
Trade and other payables	(6,322)	(433)	(6,755)
Provisions	(345)	(55)	(400)
	(7,106)	**(488)**	**(7,594)**
Total liabilities	**(17,669)**	**(511)**	**(18,180)**
Net assets	**4,784**	**57**	**4,841**
Other reserves	6,098	(8)	6,090
Retained earnings	(2,693)	65	(2,628)
Total equity attributable to equity holders of BAE Systems plc	**4,741**	**57**	**4,798**
Non-controlling interests	43	–	43
Total equity	**4,784**	**57**	**4,841**

Income statement (extract) – six months to 30 June 2017

	As previously reported 30 June 2017 £m	Impact of IFRS 15 £m	Restated 30 June 2017 £m
Sales	**9,565**	**(98)**	**9,467**
Deduct Share of sales of equity accounted investments	(1,155)	1	(1,154)
Add Sales to equity accounted investments	602	–	602
Revenue	**9,012**	**(97)**	**8,915**
Operating costs	(8,213)	113	(8,100)
Other income	61	–	61
Group operating profit	**860**	**16**	**876**
Share of results of equity accounted investments	5	4	9
Underlying EBITA	945	22	967
Non-recurring items	(4)	–	(4)
EBITA	941	22	963
Amortisation of intangible assets	(41)	–	(41)
Financial expense of equity accounted investments	(26)	–	(26)
Taxation expense of equity accounted investments	(9)	(2)	(11)
Operating profit	**865**	**20**	**885**
Financial income	261	–	261
Financial expense	(412)	–	(412)
Net finance costs	(151)	–	(151)
Profit before taxation	**714**	**20**	**734**
Taxation expense	(155)	(6)	(161)
Profit for the period	**559**	**14**	**573**
Attributable to:			
Equity shareholders	555	14	569
Non-controlling interests	4	–	4
	559	**14**	**573**
Earnings per share			
Basic earnings per share	17.5p	0.4p	**17.9p**
Diluted earnings per share	17.4p	0.4p	**17.8p**
Underlying EBITA	945	22	967
Underlying finance costs	(129)	–	(129)
Underlying tax	(184)	(8)	(192)
Non-controlling interests	(4)	–	(4)
Underlying earnings	**628**	**14**	**642**
Underlying earnings per share	19.8p	0.4p	20.2p

Statement of comprehensive income (extract) – six months to 30 June 2017	As previously reported 30 June 2017 £m	Impact of IFRS 15 £m	Restated 30 June 2017 £m
Items that may be reclassified to the income statement			
Subsidiaries:			
Currency translation on foreign currency net investments	(341)	(5)	(346)
Amounts credited to hedging reserve	63	–	63
Tax on items that may be reclassified to the income statement	(11)	–	(11)
Equity accounted investments (net of tax)	(4)	(1)	(5)
Other comprehensive income for the period (net of tax)	**(155)**	**(6)**	**(161)**
Total comprehensive income for the period	**404**	**8**	**412**
Attributable to:			
Equity shareholders	402	8	410
Non-controlling interests	2	–	2
	404	**8**	**412**

IFRS 9 Financial instruments – impact of adoption

IFRS 9 replaces the provisions of IAS 39 that relate to recognition, classification and measurement of financial assets and financial liabilities, de-recognition of financial instruments, impairment of financial assets and hedge accounting. The adoption of IFRS 9 Financial Instruments from 1 January 2018 resulted in changes in accounting policies however no adjustments were required to the amounts recognised in the financial statements in previous periods. The new accounting policies are set out below.

Classification and measurement

On 1 January 2018, the Group has classified its financial instruments in the appropriate IFRS 9 categories.

The derivative financial instruments designated as cash flow hedges and fair values hedges under IAS 39 at 31 December 2017 continue to qualify for hedge accounting under IFRS 9 at 1 January 2018 and are therefore treated as continuing hedges.

Derivative financial instruments that did not qualify for hedge accounting under IAS 39 were classified in the "fair value through profit or loss" category and gains and losses were recognised in the income statement in the period. There is no change to the classification of these financial instruments under IFRS 9 as they fail the contractual cash flow characteristics test in IFRS 9 (4.1.2(b)) and (4.1.2A(b)).

Financial assets previously classified in the "loans and receivables" category and measured at amortised cost under IAS 39 (being trade and other receivables and amounts owed by equity accounted investments) continue to be classified in the "amortised cost" category under IFRS 9.

Impairment of financial assets

The Group has three types of financial assets that are subject to IFRS 9's new expected credit loss model:

– trade and other receivables;
– contract receivables; and
– amounts owed by equity accounted investments.

Trade and other receivables, and contract receivables, do not contain a significant financing element and therefore expected credit losses are measured using the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from the initial recognition of the receivables.

The Group has assessed credit risk in relation to defence-related sales to government customers or sub-contractors to governments and believes it be extremely low, therefore no expected credit loss provision is required for these trade and other receivables, or contract receivables. The Group considers expected credit losses for non-government commercial customers, however this risk is not expected to be material to the financial statements.

Amounts due from equity accounted investments primarily relate to trading balances with no significant financing element, in accordance with IFRS 15. The simplified approach is therefore used for these balances.

While cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial.

There was no IFRS 9 impact on retained earnings at 1 January 2018.

IFRS 9 Financial Instruments – accounting policies applied since 1 January 2018

Investments and other financial assets

Classification
From 1 January 2018, the Group classifies its financial assets in the following measurement categories:

– those to be measured subsequently at fair value (either through other comprehensive income, or through profit or loss); and
– those to be measured at amortised cost.

Measurement
At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not measured at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset.

The Group subsequently measures derivative financial instruments at fair value. Gains and losses on derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement for the period. Where a derivative financial instrument is designated as a cash flow hedge, the effective portion of any change in the fair value of the instrument is recognised in other comprehensive income and presented in the hedging reserve in equity. Amounts recognised in equity are reclassified from reserves into the cost of the underlying transaction and recognised in the income statement when the underlying transaction affects profit or loss. The ineffective portion of any change in the fair value of the instrument is recognised in profit or loss immediately. Where a derivative financial instrument is designated as a fair value hedge, changes in the fair value of the underlying asset or liability attributable to the hedge risk, and gains and losses on the derivative financial instrument, are recognised in the income statement for the period.

The Group subsequently measures trade and other receivables, contract receivables and amounts due from equity accounted investments at amortised cost.

The Group subsequently measures all equity investments at fair value and has elected to present fair value gains and losses on equity investments in other comprehensive income. There is therefore no subsequent reclassification of fair value gains and losses to profit or loss following a disposal of the investment.

Impairment
For trade and other receivables, contract receivables and amounts due from equity accounted investments, the Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

Derivatives and hedging

Fair value through profit or loss
Gains and losses on derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement for the period.

Cash flow hedges
Where a derivative financial instrument is designated as a hedge of cash flows relating to a highly probable forecast transaction (income or expense), the effective portion of any change in the fair value of the instrument is recognised in other comprehensive income and presented in the hedging reserve in equity. The ineffective portion of any change in the fair value of the instrument is recognised in the income statement immediately.

Fair value hedges
Where a derivative financial instrument is designated as a fair value hedge, changes in the fair value of the underlying asset or liability attributable to the hedged risk, and gains and losses on the derivative instrument, are recognised in the income statement for the period.

Financial liabilities

There are no changes to the accounting policies in respect of loans, overdrafts, and trade and other payables, which continue to be measured at amortised cost, except where fair value hedge accounting is applied.

IFRS 15 Revenue from Contracts with Customers – impact of adoption

As a result of the adoption of IFRS 15 Revenue from Contracts with Customers from 1 January 2018, the following adjustments were made to restate the amounts recognised in the balance sheet at 31 December 2017:

	As reported 31 December 2017 £m	Reclassification £m	Remeasurement £m	IFRS 15 restated 31 December 2017 £m
Equity accounted investments	384	–	(60)	324
Deferred tax assets	724	–	(40)	684
Inventories	723	10	–	733
Trade and other receivables including amounts due from customers for contract work	3,586	(3,586)	–	–
Trade, other and contract receivables	–	4,055	189	4,244
Non-current other payables	(1,722)	22	(23)	(1,723)
Current trade and other payables	(6,322)	(424)	(9)	(6,755)
Non-current provisions	(413)	(22)	–	(435)
Current provisions	(345)	(55)	–	(400)

At 30 June 2018, trade, other and contract receivables includes contract receivables of £2,137m (31 December 2017 £1,420m).

At 30 June 2018, trade and other payables includes contract liabilities of £3,068m (31 December 2017 £3,551m).

The impact of adoption on the Group's retained earnings at 31 December 2017 and 31 December 2016 is as follows:

	31 December 2017 £m	31 December 2016 £m
Retained earnings – as previously reported	**(2,693)**	**(4,583)**
Recognition of revenue for over time contracts based on costs incurred and including attributable margin	201	259
Equity accounted investments – separation of development and production margin, net of tax	(59)	(48)
Licence revenue – deferral of revenue over the licence term	(32)	(39)
Deferred tax	(45)	(80)
Adjustment to retained earnings from adoption of IFRS 15	65	92
Retained earnings – IFRS 15 (restated)	**(2,628)**	**(4,491)**

IFRS 15 Revenue from Contracts with Customers – accounting policies applied since 1 January 2018

The Group has adopted IFRS 15 fully retrospectively in accordance with paragraph C3(a). Comparatives for the half year ended 30 June 2017 and the year ended 31 December 2017 have been restated. The following expedients have been or will be used in accordance with paragraph C5:

- revenue in respect of completed contracts that begin and end in the same accounting period has not been restated;
- revenue in respect of completed contracts with variable consideration reflects the transaction price at the date the contracts were completed; and
- in the financial statements for the year ending 31 December 2018, the comparative information for the year ending 31 December 2017 will not disclose the amount of the transaction price allocated to the remaining performance obligations or an explanation of when the Group expects to recognise that amount as revenue.

Following the adoption of IFRS 15, the Group's accounting policy in respect of revenue is as follows:

Revenue represents income derived from contracts for the provision of goods and services by the Company and its subsidiary undertakings to customers in exchange for consideration in the ordinary course of the Group's activities.

Performance obligations
Upon approval by the parties to a contract, the contract is assessed to identify each promise to transfer either a distinct good or service or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Goods and services are distinct and accounted for as separate performance obligations in the contract if the customer can benefit from them either on their own or together with other resources that are readily available to the customer and they are separately identifiable in the contract.

Transaction price
At the start of the contract, the total transaction price is estimated as the amount of consideration to which the Group expects to be entitled in exchange for transferring the promised goods and services to the customer, excluding sales taxes. Variable consideration, such as price escalation, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Group's products and services, which are designed and/or manufactured under contract to the customer's individual specifications, there are typically no observable stand-alone selling prices. Instead, stand-alone selling prices are typically estimated based on expected costs plus contract margin consistent with the Group's pricing principles.

Revenue and profit recognition
Revenue is recognised as performance obligations are satisfied as control of the goods and services is transferred to the customer.

For each performance obligation within a contract, the Group determines whether it is satisfied over time or at a point in time. Performance obligations are satisfied over time if one of the following criteria is satisfied:

- the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs;
- the Group's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date.

The Group has determined that most of its contracts satisfy the over time criteria, either because the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs (typically services or support contracts) or the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date (typically development or production contracts).

For each performance obligation to be recognised over time, the Group recognises revenue using an input method, based on costs incurred in the period. Revenue and attributable margin are calculated by reference to reliable estimates of transaction price and total expected costs, after making suitable allowances for technical and other risks. Revenue and associated margin are therefore recognised progressively as costs are incurred, and as risks have been mitigated or retired. The Group has determined that this method faithfully depicts the Group's performance in transferring control of the goods and services to the customer.

If the over time criteria for revenue recognition are not met, revenue is recognised at the point in time that control is transferred to the customer, which is usually when legal title passes to the customer and the business has the right to payment, for example, on delivery.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

Software licences
The Group sells software licences either separately or together with other goods and services, including computer hardware and implementation, hosting and support. Revenue recognition in respect of software licences sold as part of a bundle of goods and services is considered separately when the licence is determined to be a separate performance obligation. Software licences either represent a right to access the Group's intellectual property as it exists throughout the licence period or a right to use the Group's intellectual property as it exists at the point in time at which the licence is granted. Revenue in respect of right to access licences is recognised over the licence term or, in relation to perpetual licences, over the related customer relationship and revenue in respect of right to

use licences is recognised upfront on delivery to the customer. A software licence is considered to be a right to access the Group's intellectual property as it exists throughout the licence period if all of the following criteria are satisfied:

– the contract requires, or the customer reasonably expects, that the Group will undertake activities that significantly affect the intellectual property; and
– the licence directly exposes the customer to the effects of those activities; and
– those activities do not result in the transfer of a good or service to the customer.

Contract modifications
The Group's contracts are often amended for changes in customers' requirements and specifications. A contract modification exists when the parties to the contract approve a modification that either changes existing or creates new enforceable rights and obligations. The effect of a contract modification on the transaction price and the Group's measure of progress towards the satisfaction of the performance obligation to which it relates is recognised in one of the following ways:

1. Prospectively as an additional, separate contract;
2. Prospectively as a termination of the existing contract and creation of a new contract; or
3. As part of the original contract using a cumulative catch up.

The majority of the Group's contract modifications are treated under either 1 (for example, the requirement for additional distinct goods or services) or 3 (for example, a change in the specification of the distinct goods or services for a partially completed contract), although the facts and circumstances of any contract modification are considered individually as the types of modifications will vary contract-by-contract and may result in different accounting outcomes.

Costs to obtain a contract
The Group expenses pre-contract bidding costs which are incurred regardless of whether a contract is awarded. The Group does not typically incur costs to obtain contracts that it would not have incurred had the contracts not been awarded, such as sales commission.

Costs to fulfil a contract
Contract fulfilment costs in respect of over time contracts are expensed as incurred. Contract fulfilment costs in respect of point in time contracts are accounted for under IAS 2 Inventories.

Inventories
Inventories includes raw materials, work-in-progress and finished goods recognised in accordance with IAS 2 in respect of contracts with customers which have been determined to fulfil the criteria for point in time revenue recognition under IFRS 15. It also includes inventories in relation to which the Group does not have a contract. This is often because fulfilment costs have been incurred in expectation of a contract award. The Group does not typically build inventory to stock. Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value.

Contract receivable
The contract receivable represents amounts for which the Group has an unconditional right to consideration in respect of unbilled revenue recognised at the balance sheet date and comprises costs incurred plus attributable margin.

Contract liability
The contract liability represents the obligation to transfer goods or services to a customer for which consideration has been received, or consideration is due, from the customer.

11. Shareholder information

The Annual General Meeting of BAE Systems plc will be held on 9 May 2019.

Registered office

BAE Systems plc
6 Carlton Gardens
London
SW1Y 5AD
United Kingdom

Registered in England and Wales, No 1470151

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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.