HALF-YEARLY REPORT 2015

BAE SYSTEMS PLC
HALF-YEARLY REPORT 2015

RESULTS IN BRIEF

	Six months ended 30 June 2015	Six months ended 30 June 2014	Year ended 31 December 2014
Sales[1]	**£8,472m**	£7,611m	£16,637m
Underlying EBITA[2]	**£800m**	£802m	£1,702m
Operating profit	**£700m**	£689m	£1,300m
Underlying earnings[3] per share	**17.1p**	17.7p	38.0p
Basic earnings per share[4]	**12.3p**	13.5p	23.4p
Order backlog[1,5]	**£37.3bn**	£39.7bn	£40.5bn
Dividend per share	**8.4p**	8.2p	20.5p
Operating business cash flow[6]	**£(349)m**	£287m	£1,191m
Net debt (as defined by the Group)[7]	**£(1,939)m**	£(1,182)m	£(1,032)m

Ian King, Chief Executive, said
"Overall, the business performed well during the first half of 2015 during which we have leveraged our capabilities in adjacent growth markets and maintained disciplined cost control. We have also continued to invest in developing skills and new technologies for the future. These actions have provided resilience through an extended period of reduced defence spending in some key markets and ensured that BAE Systems is well positioned to benefit from a generally improving market environment."

FINANCIAL KEY POINTS

– Sales[1] increased by £0.9bn including incremental equipment sales of £0.3bn on European Typhoon Tranche 3 aircraft and favourable exchange translation of approximately £0.2bn
– Underlying EBITA[2] of £800m after favourable exchange translation of £21m
– Underlying earnings[3] per share of 17.1p reflecting a higher finance charge
– Large order backlog[1,5] of £37.3bn providing good visibility of future sales
– Interim dividend increased by 2% to 8.4p per share

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, non-recurring items (see note 5) and, in the year ended 31 December 2014, a credit in respect of the re-assessment of existing tax provisions.
4. Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.
5. Comprises funded and unfunded unexecuted customer orders, and is stated after the elimination of intra-group orders.
6. Net cash (outflow)/inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
7. See definition on page 9.

OPERATIONAL AND STRATEGIC HIGHLIGHTS

- £859m demonstration phase contract agreed for the UK Royal Navy's Type 26 frigate programme
- Good momentum continues in progressively expanding the Typhoon aircraft's capabilities, including the integration of the Captor E-Scan radar and the integration of additional weapons
- The F-35 Lightning II programme is ramping up, including our UK-based production of rear fuselage assemblies and deliveries of the electronic warfare suite from our US business
- The award of a contract to supply remote electronic units for the Boeing 777X aircraft means BAE Systems will provide the complete suite of flight control electronics for the aircraft's fly-by-wire system
- Selected to provide information technology services to the US government in a single-award Indefinite Delivery, Indefinite Quantity contract
- US Army's Enhanced Night Vision Goggle III programme now proceeding, with framework contract value of up to $435m (£277m)
- $110m (£70m) contract from the US Army to upgrade 36 M88A1 recovery vehicles
- BAE Systems' 37.5% share of recent contracts signed in Egypt and Qatar by the MBDA guided weapons joint venture expected to total €1.2bn (£0.9bn)
- A total of £1.3bn of international orders are being finalised at the half year
- Acquisition of Eclipse Electronic Systems, Inc., a provider of highly-advanced Intelligence, Surveillance and Reconnaissance products and services, completed in June
- Strategic assessment of manpower and services businesses within the US-managed Intelligence & Security sector underway
- Options to address an anticipated workload reduction in Australian shipbuilding business under review, with initial headcount reductions in the first half
- Land Systems South Africa business disposal completed

GUIDANCE

Group

With an anticipated trading bias to the second half of the year, the Group remains on track to deliver sales[1] growth and continues to expect underlying earnings[3] per share for 2015 to be marginally higher than in 2014, despite the lack of earnings accretion from share repurchases. This earnings guidance remains conditional upon anticipated aircraft orders and a review of options for the Melbourne shipyard facility, and assumes an average exchange rate of $1.55/£.

Reporting segments

Electronic Systems: Sales[1] in US dollars are expected to be similar to 2014, with good growth from commercial business and defence sales largely unchanged. Margins are expected to be at the high end of a 12% to 14% guidance range.

Cyber & Intelligence: Cyber & Intelligence comprises the US Intelligence & Security sector and UK-headquartered Applied Intelligence. The Intelligence & Security sector includes the Integrated Electronics & Warfare Systems activities, transferred from the Platforms & Services (US) segment at the end of 2014. Guidance is unchanged.

Mid-single digit sales[1] growth expected in 2015 with strong sales growth planned of around 30% in Applied Intelligence offsetting marginally lower sales in Intelligence & Security.

Margins are expected to be at the lower end of an 8% to 10% range, after integration costs of SilverSky and continued investment in the Applied Intelligence business.

Platforms & Services (US): Sales[1] are expected to reduce by around 10%, in line with previous guidance. Margins are expected to be in a 6% to 8% range, reflecting continued margin dilution from sales trading on the Radford and commercial shipbuilding contracts.

Platforms & Services (UK): Sales[1] are expected to increase by close to 10%, with higher sales from Salam Typhoon deliveries and Typhoon Tranche 3 equipment deliveries. The Astute and Successor submarine programmes more than offset reducing trading on the Queen Elizabeth Class carrier programme. Margins are expected to be at the lower end of a 10% to 12% range, reflecting the impact of increased UK pension service costs due to the lower discount rate and the margin dilution on Tranche 3 equipment trading.

Platforms & Services (International): Sales[1] in 2015 are expected to be approximately 10% higher than in 2014 from higher volumes of weapon systems. Margins are expected to be at the lower end of a 10% to 12% range.

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

1. Including share of equity accounted investments.
3. Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, non-recurring items (see note 5) and, in the year ended 31 December 2014, a credit in respect of the re-assessment of existing tax provisions.

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Analyst and investor webcast/call

The first half results will be presented via a webcast for analysts and investors today (30 July 2015) at 10:30am. Details can be found on **www.baesystems.com/investors**, together with presentation slides and a pdf copy of this report. A recording of the webcast will be available later in the day.

About BAE Systems

At BAE Systems, we provide some of the world's most advanced, technology-led defence, aerospace and security solutions. We employ a skilled workforce of 83,100 people[1] in 40 countries. Working with customers and local partners, we develop, engineer, manufacture and support products and systems to deliver military capability, protect national security and people, and keep critical information and infrastructure secure.

INTERIM MANAGEMENT REPORT

Overall, the business performed well during the first half of 2015 during which the Group has leveraged its capabilities in adjacent growth markets and maintained disciplined cost control. The Group has also continued to invest in developing skills and new technologies for the future. These actions have provided resilience through an extended period of reduced defence spending in some key markets and ensured that BAE Systems is well positioned to benefit from a generally improving market environment.

US

The defence market outlook in the US is improving, with recent indications of a return to growth in defence budgets. The current 2015 fiscal year appropriations legislation included stable Department of Defense funding and support for major programmes, including F-35 Lightning II aircraft. There are signs of potential improvement as fiscal year 2016 defence budget proposals continue to seek funding above previously imposed spending caps.

The Group's US defence electronics business is performing well across the advanced technology areas of electronic warfare, electro-optics and Intelligence, Surveillance and Reconnaissance.

BAE Systems' commercial aerospace electronics business continues to grow. The business has been selected to provide the remote electronic units for the new Boeing 777X airliner. With this award, in addition to previous equipment awards on the aircraft, BAE Systems will provide the complete suite of flight control electronics for the aircraft's fly-by-wire system. In April, the Group secured its first customer for its IntelliCabin™ wireless in-flight entertainment systems.

The Intelligence & Security sector performed well in the period, notwithstanding market headwinds. In April, a strategic review commenced to examine whether greater value would result from disposal of one or more of the Group's manpower and services businesses within Intelligence & Security. This review does not include the technology/product-focused geospatial intelligence division.

The Group's strategy to deliver performance in the fast-growing cyber security and intelligence market will continue to be addressed through the UK-headquartered Applied Intelligence business.

As anticipated, the Group's US-based combat vehicles business is stabilising after several years of contraction following the reductions in US land forces' operations overseas, with its strong franchise of combat vehicle programmes and the award, at the end of last year, of the Armored Multi-Purpose Vehicle contract.

UK

The Group's UK business is stable, with much of the business subject to long-term contracts. The recent budget announcements are supportive of defence and the announcement in June of a £500m reduction in the current year defence budget is not expected to materially impact programmes on which the Group is engaged. A Strategic Defence and Security Review is anticipated later this year; the current expectation is for stability across the Group's large platform and support programme activities.

In the air domain, BAE Systems' UK-based production of rear fuselage assemblies for the F-35 Lightning II aircraft is set to increase significantly over coming years driven by demand from the US armed forces and international customers. Typhoon aircraft deliveries to the Royal Air Force and the Royal Saudi Air Force continued alongside airframe major unit and equipment deliveries to European partner nations. BAE Systems continues to provide extensive support and upgrade capability for aircraft in service with the Royal Air Force.

In the naval domain, BAE Systems has a large order backlog and good long-term visibility benefiting from work over recent years to develop, with the UK government, a coherent industrial strategy for the UK naval sector.

The Queen Elizabeth Class aircraft carrier programme progresses with assembly of the second ship well underway, alongside key systems integration and commissioning on the first of class. Following the renewal of the multi-year agreement to manage Portsmouth Naval Base in 2014, BAE Systems is progressing plans with the Royal Navy for the basing and support of the two new carriers at their intended home port in Portsmouth, later this decade.

Consistent with the UK government's strategy for naval shipbuilding capability, BAE Systems is progressing the construction of three Offshore Patrol Vessels for the Royal Navy. This work will preserve shipbuilding skills and contribute to the de-risking of the follow-on build of the Royal Navy's new Type 26 multi-role frigates, for which UK government commitment was received in February.

Infrastructure investment required in support of the proposed Successor submarine programme, expected to replace the Royal Navy's Vanguard Class boats, has been agreed and work has commenced at BAE Systems' Barrow facility. The third boat of seven Astute Class submarines will exit Barrow later this year, a major milestone for the programme.

International

In Saudi Arabia, the Group continues to support the Royal Saudi Air Force during a period of military operations. The equipment supplied by the Group is achieving high levels of availability. Relationships between all parties undertaking the government-to-government programme remain mature and effective to support significant operational requirements.

As indicated earlier this year, the Group is facing a challenging outlook in its naval shipbuilding business in Australia. Following the run-off from a high volume of activity on the Landing Helicopter Dock programme, the business is seeing an increasing gap in workload at the Williamstown shipyard in Melbourne. The Group is reviewing options for the facility and its operations.

BAE Systems holds a 37.5% interest in MBDA, the world's second largest missile company. The Group has seen a high level of order intake for equipment to support Tornado and Typhoon aircraft in service in Saudi Arabia. In addition, MBDA has been a major beneficiary of recent French aircraft sales in Egypt and Qatar. BAE Systems' share of MBDA order intake from those two contracts is expected to total €1.2bn (£0.9bn), of which €0.3bn (£0.2bn) has been booked in the first half of the year.

In total, £1.3bn of international orders are being finalised at the half year.

Applied Intelligence

Applied Intelligence's strategy to grow its commercial cyber security business and to develop UK and international government-facing activities is accelerating. The SilverSky business acquired in the fourth quarter of 2014 has been successfully integrated. Investment in product development and resourcing to support growth plans has also materially ramped up. An active pipeline of new business supports the Group's expectation for growth in the second half of the year.

Balance sheet and capital allocation

BAE Systems' balance sheet continues to be managed conservatively in line with the policy to retain an investment grade credit rating and to ensure operating flexibility. The Group remains committed to allocating capital to maximise long-term shareholder value, prioritising its pension obligations, organic investment opportunities and dividend payments in line with its policy of maintaining 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. The same criteria for returns on capital invested will continue to be applied when considering accelerated returns of capital to shareholders through share repurchases, when the balance sheet allows.

Following last year's triennial funding valuations and funding agreements on all of the Group's UK pension schemes, the cash contributions in 2015 to fund the pension deficit recovery plans will be consistent with the prior year at approximately £0.4bn.

Summary

BAE Systems continues to perform well with a large order backlog. With its broad international market footprint, it is well positioned to benefit as economies recover in domestic markets and as the defence and security requirements of its customers continue to evolve.

The Group has demonstrated resilience driven by efficiencies and focused investment to protect its core franchise through the challenging business cycle. BAE Systems expects to continue to perform well as those market environments stabilise.

Directors

In June, Carl Symon, a non-executive director, retired from the Board of BAE Systems plc. Paula Rosput Reynolds, a non-executive director, has succeeded him as chairman of the Remuneration Committee.

Dividend

The Board has declared a 2% increase in the interim dividend to 8.4p for the first half year to 30 June 2015.

Summarised income statement

	Six months ended 30 June 2015 £m	Six months ended 30 June 2014 £m
Sales[1]	**8,472**	7,611
Underlying EBITA[2]	**800**	802
Loss on disposal of businesses	**(24)**	–
EBITA	**776**	802
Amortisation of intangible assets	**(62)**	(88)
Impairment of intangible assets	**(3)**	–
Finance costs[1]	**(201)**	(169)
Taxation expense[1]	**(112)**	(111)
Profit for the period	**398**	434
Underlying earnings[3] per share	**17.1p**	17.7p
Basic earnings per share[4]	**12.3p**	13.5p
Dividend per share	**8.4p**	8.2p

Exchange rates – average	Six months ended 30 June 2015	Six months ended 30 June 2014
£/$	**1.523**	1.669
£/€	**1.366**	1.218
£/A$	**1.949**	1.825

Exchange rates – period end	30 June 2015	30 June 2014
£/$	**1.571**	1.711
£/€	**1.410**	1.249
£/A$	**2.043**	1.812

Exchange rates – year end	31 December 2014
£/$	1.559
£/€	1.287
£/A$	1.908

Segmental analysis

	Sales[1]		Underlying EBITA[2]	
	Six months ended 30 June 2015 £m	Six months ended 30 June 2014[5] £m	Six months ended 30 June 2015 £m	Six months ended 30 June 2014[5] £m
Electronic Systems	**1,246**	1,108	**187**	143
Cyber & Intelligence	**887**	814	**52**	60
Platforms & Services (US)	**1,328**	1,375	**92**	92
Platforms & Services (UK)	**3,544**	2,844	**355**	393
Platforms & Services (International)	**1,621**	1,576	**155**	157
HQ[6]	**128**	127	**(41)**	(43)
Intra-group	**(282)**	(233)	**–**	–
	8,472	7,611	**800**	802

Income statement

Sales[1] in the first half increased by £0.9bn to £8.5bn, which includes incremental equipment sales of some £0.3bn on European Typhoon Tranche 3 aircraft. Approximately £0.2bn of the increase in sales was due to exchange translation. There is some second half bias in sales due to the contracted schedules for deliveries into Saudi Arabia this year.

Underlying EBITA[2] was £800m (2014 £802m), almost unchanged from 2014. Favourable exchange translation was £21m.

Amortisation of intangible assets reduced to £62m (2014 £88m) due to acquired intangible assets fully amortising in 2014.

Finance costs[1] were £201m (2014 £169m). The underlying interest charge, excluding pension accounting, and fair value and foreign exchange adjustments on financial instruments and investments, was higher at £107m (2014 £89m) reflecting the additional cost of carry of debt issued in October 2014 to pre-finance debt maturing in 2015 and 2016 and foreign exchange translation of interest payments on US dollar-denominated borrowing.

Taxation expense[1] reflects the Group's effective tax rate for the period of 21.0% (2014 20.4%). The effective tax rate for the full year is expected to be around 20% with some dependency on the geographical mix of profits.

Underlying earnings[3] **per share** for the period was 17.1p (2014 17.7p).

Basic earnings per share[4] for the period was 12.3p (2014 13.5p).

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 5).
4. Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.
5. Re-presented for the reallocation of the Integrated Electronics & Warfare Systems activities from Platforms & Services (US) to Cyber & Intelligence.
6. In 2014, the HQ reporting segment included, in underlying EBITA, a £30m benefit from re-assessment of a long-term liability and a £17m charge in respect of a US contract pricing dispute.

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

	Six months ended 30 June 2015 £m	Six months ended 30 June 2014 £m
Cash outflow from operating activities	**(257)**	(30)
Capital (expenditure)/proceeds (net) and financial investment	**(129)**	304
Dividends received from equity accounted investments	**37**	13
Operating business cash flow	**(349)**	287
Interest	**(94)**	(76)
Taxation	**(60)**	(65)
Free cash flow	**(503)**	146
Acquisitions and disposals	**16**	–
Share repurchase programme	**(4)**	(235)
Other net sale/(purchase) of own shares	**7**	(2)
Equity dividends paid	**(389)**	(383)
Dividends paid to non-controlling interests	**(21)**	(2)
Cash flow from matured derivative financial instruments	**(49)**	(57)
Movement in cash collateral	**3**	(7)
Foreign exchange translation	**25**	63
Other non-cash movements	**8**	(6)
Increase in net debt (as defined by the Group)	**(907)**	(483)
Opening net debt (as defined by the Group)	**(1,032)**	(699)
Closing net debt (as defined by the Group)	**(1,939)**	(1,182)
Comprising:		
Debt-related derivative financial instrument assets	**13**	3
Cash and cash equivalents	**1,383**	1,374
Cash (as defined by the Group)	**1,396**	1,377
Loans – non-current	**(2,850)**	(2,459)
Loans and overdrafts – current	**(485)**	(100)
Debt (as defined by the Group)	**(3,335)**	(2,559)
Net debt (as defined by the Group)	**(1,939)**	(1,182)

Operating business cash flow

	Six months ended 30 June 2015 £m	Six months ended 30 June 2014[5] £m
Electronic Systems	**139**	86
Cyber & Intelligence	**42**	54
Platforms & Services (US)	**(20)**	79
Platforms & Services (UK)	**(296)**	(201)
Platforms & Services (International)	**(49)**	541
HQ	**(165)**	(272)
Operating business cash flow	**(349)**	287

5. Re-presented for the reallocation of the Integrated Electronics & Warfare Systems activities from Platforms & Services (US) to Cyber & Intelligence.

Cash flows

Cash outflow from operating activities was £257m (2014 £30m), which includes contributions in excess of service costs for the UK and US pension schemes totalling £186m (2014 £163m).

As anticipated, advances continue to be consumed on the Omani Typhoon and Hawk programme, the European Typhoon contract and the Saudi training aircraft contract. The second and final payment under the Salam Variation of Price settlement has been received. Costs are being incurred against a number of provisions created in previous years, including the US commercial shipbuild programmes and UK rationalisation.

In 2014, there was a net cash inflow from **capital expenditure and financial investment** of £304m, which included the receipt of £418m in respect of the sale and leaseback of two properties in Saudi Arabia.

Dividends received from equity accounted investments, mainly comprising MBDA and Advanced Electronics Company, amounted to £37m (2014 £13m).

The net cash inflow from **acquisitions and disposals** in 2015 includes £22m received in respect of the sale of the Group's Land Systems South Africa business and £6m paid in respect of the acquisition of Eclipse Electronic Systems, Inc.

During the first half of 2015, there was a cash outflow of £4m (2014 £235m) under the **share repurchase programme** representing shares purchased and cancelled under the programme announced in February 2013. The return on investment from buying back the Group's own shares reduces as the share price rises and, as a result, activity on the programme has been minimal in the year to date.

Foreign exchange translation during the period, primarily in respect of the Group's US dollar-denominated borrowing, reduced reported net debt by £25m.

Net debt (as defined by the Group)

The Group's net debt at 30 June 2015 was £1,939m, a net increase of £907m from the net debt position of £1,032m at the start of the period.

Cash and cash equivalents of £1.4bn are held primarily for repayment of £0.5bn of debt securities maturing in August 2015, the share repurchase programme, pension deficit funding, payment of the 2015 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 the foreseeable future and therefore continue to adopt the going concern basis in preparing the accounts.

Principal risks

The principal risks facing the Group for the remainder of the year are unchanged from those reported in the Annual Report 2014.

These risks, together with the Group's risk management process, are detailed on pages 48 to 53 of the Annual Report 2014, and relate to the following areas: defence spending; government customers; international market; competition in international markets; laws and regulations; contract risk and execution; contract cash profiles; pension funding; information technology security; and people.

REPORTING SEGMENTS: ELECTRONIC SYSTEMS

Electronic Systems, with 12,800 employees[1], comprises the US and UK-based electronics activities, including electronic warfare systems and electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

	Six months ended 30 June 2015	Six months ended 30 June 2014	Year ended 31 December 2014
Sales[1]	**£1,246m**	£1,108m	£2,415m
Underlying EBITA[2]	**£187m**	£143m	£373m
Return on sales	**15.0%**	12.9%	15.4%
Cash inflow[3]	**£139m**	£86m	£246m
Order intake[1]	**£1,106m**	£1,160m	£2,341m
Order backlog[1,4]	**£3.7bn**	£3.6bn	£3.9bn

Financial performance

Sales[1] were $1.9bn (£1.2bn), 3% ahead of last year. Sales in the commercial areas of the business now stand at 23%, with growth in the first half of 12%. Sales on the defence side were stable, with growth on the F-35 Lightning II programme offsetting contracts completing in 2014.

The return on sales achieved of 15.0% was well above the first half of 2014 (12.9%), benefiting from strong programme execution across most business lines.

Cash[3] conversion of underlying EBITA[2] in the first half year was better than last year and an improved conversion level is expected for the full year.

Order backlog[1,4] stands at $5.8bn (£3.7bn), slightly down since the start of the year, pending a number of expected second half awards.

Operational performance

Electronic Combat

Electronic Systems has sustained its leadership position in the US electronic warfare market and production is ramping up across a number of programmes. Low-Rate Initial Production Lot 8 deliveries of the F-35 Lightning II electronic warfare suite continue.

The business is under contract from Boeing and the US Air Force to install the Digital Electronic Warfare System on new and existing F-15 aircraft for the Royal Saudi Air Force. System verification and flight testing continues on schedule.

The US Air Force has defined its requirements for the next-generation electronic warfare system, Eagle Passive Active Warning Survivability System, for more than 400 existing F-15 aircraft. The award is expected in the second half of the year.

Survivability & Targeting

Risk reduction funding from the US Army totalling $11m (£7m) was received during the period for the Common Infrared Countermeasures programme following the completion of the technology development phase in 2014. The selection of the winning bid for the engineering and manufacturing development phase is expected to be announced in the second half of the year.

The US Army continues the fielding of the third-generation upgrade to its Common Missile Warning Systems and has placed its first Foreign Military Sales orders for third-generation systems with Turkey, Qatar, South Korea and Indonesia.

Electronic Systems continues to deliver on Advanced Precision Kill Weapon System Full-Rate Production Lots 3 and 4, now worth a total of $87m (£55m) with the US Navy, with more than 950 systems shipped during the period to 30 June. The first international order of 110 systems for Jordan was received in May.

The business continues to perform on the Terminal High-Altitude Area Defense Full-Rate Production contract, valued at $340m (£216m), for 307 infrared missile seekers supporting both the US government and Foreign Military Sales.

The US Government Accountability Office denied the second protest of the five-year, Indefinite Delivery, Indefinite Quantity contract awarded to BAE Systems to support the US Army's Enhanced Night Vision Goggle III and Family of Weapon Sight-Individual programme, enabling work to re-start. The contract has a potential value of approximately $435m (£277m).

Communications & Control
Electronic Systems' Data Link Solutions joint venture with Rockwell Collins is working with the US Navy to design and develop advanced capabilities for the Multi-functional Information Distribution System (MIDS) Low Volume Terminal and advanced networking capabilities of the MIDS Joint Tactical Radio System.

The next-generation Striker® II helmet-mounted display has completed flight trials, successfully demonstrating the performance of the integrated digital night vision camera.

Intelligence, Surveillance & Reconnaissance
Electronic Systems continues to provide Airborne Surveillance capability for the US Air Force and US Army based on two wide-area, high-resolution imaging sensor systems – the Airborne Wide Area Persistent Surveillance System, which has been operational for more than 26,000 hours in theatre, and the Autonomous Real-time Ground Ubiquitous Surveillance - Imaging System.

The business provides processing capabilities for the US Navy's P-8A Poseidon programme and delivered seven mission computer and display systems during the period to 30 June.

In June, BAE Systems completed the acquisition of Eclipse Electronic Systems, Inc. from Esterline Corporation for a cash consideration of approximately $10m (£6m). The Texas-based business provides highly-advanced Intelligence, Surveillance and Reconnaissance products and services to the US defence and intelligence community.

Commercial Aircraft Solutions
BAE Systems remains well positioned in the commercial avionics domain with strong positions on most major commercial platforms, including the leading Boeing and Airbus commercial fleets. As a major supplier to Boeing for flight controls, and cabin and flight deck systems, in February, the Group was selected to provide the remote electronic units on its next-generation 777X aircraft programme. BAE Systems will now provide the entire flight controls for 777X, which is projected to be worth approximately $1.5bn (£1.0bn) over the life of the aircraft.

Development of subsystems for the 737 MAX aircraft, including the fly-by-wire spoiler units, is on track to support aircraft integration planned for later in the year.

The business completed certification of the flight control system for the Embraer Legacy 500 aircraft and its flight control electronics enabled first flights of the Gulfstream G500 and Embraer KC-390 aircraft.

FADEC Alliance, a joint venture between FADEC International (the Group's joint venture with Sagem) and GE Aviation, completed certification of the full authority digital engine controls on the Leap engine for the Airbus A320neo aircraft.

Vistara, an Indian airline, has become the launch customer for BAE Systems' IntelliCabin™ wireless in-flight entertainment systems.

HybriDrive® Solutions
In the commercial market, BAE Systems' new anti-idling technology and zero-emission drive modes are important for European and North American transit operators and metropolitan cities concerned with greenhouse gas emissions and clean air regulations.

BAE Systems expects to deliver its 5,000th propulsion system into transit buses this year with deliveries into cities including Quebec, Paris, Boston and Seattle. In the first half of 2015, BAE Systems secured orders from Iveco to support its provision of hybrid buses into Paris and from Nova Bus for buses for the province of Quebec.

Other

In response to the South Korean government's claim for approximately $43m (£27m) under a bid guarantee on the terminated F-16 upgrade programme, the Group has asked a US federal court to rule that it does not owe any monies to Korea. In July, the South Korean government's Defence Acquisition Programme Administration reportedly filed a counter suit against BAE Systems and Raytheon in a Korean court.

Looking forward

The current 2015 fiscal year appropriations legislation included stable Department of Defense funding and support for major programmes, including F-35 Lightning II aircraft. There are signs of potential improvement as fiscal year 2016 defence budget proposals continue to seek funding above previously imposed spending caps.

Whilst the longer-term outlook remains uncertain, Electronic Systems remains well positioned to address changing US Department of Defense priorities. Its focus remains on maintaining a diverse portfolio of defence and commercial products and capabilities, with both US and international customers, and sustained emphasis on cost reduction and research and development.

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

Effective 6 July, the Communications & Control business has been realigned across the three remaining defence business areas of Electronic Systems to promote continued operational efficiency and innovation.

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

REPORTING SEGMENTS: CYBER & INTELLIGENCE

Cyber & Intelligence, with 12,800 employees[1], comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber, secure government, and commercial and financial security activities.

	Six months ended 30 June 2015	Six months ended 30 June 2014[2]	Year ended 31 December 2014[2]
Sales[1]	**£887m**	£814m	£1,658m
Underlying EBITA[3]	**£52m**	£60m	£153m
Return on sales	**5.9%**	7.4%	9.2%
Cash inflow[4]	**£42m**	£54m	£125m
Order intake[1]	**£1,003m**	£893m	£1,784m
Order backlog[1,5]	**£2.0bn**	£1.8bn	£2.0bn

Financial performance

In aggregate, sales[1] were almost unchanged at $1.4bn (£887m). Sales in the US business decreased by 2% in line with expected further reductions in IT services. Sales growth in the Applied Intelligence business was 16%, benefiting from the acquisition of SilverSky at the end of last year. The business has seen some delays in short-cycle order awards as the pipeline is developed and this has constrained sales in the first half year.

Margins of 5.9% (2014 7.4%) reflect the expensing of the integration costs of SilverSky, accelerated product development costs and sales team build up in Applied Intelligence in support of expectations for growth in the full year.

Order backlog[1,5] increased to $3.2bn (£2.0bn). Despite the first half top-line pressures, order backlog in the US business grew marginally on securing a large classified programme award. In the Applied Intelligence business, after adjusting for exchange translation, order backlog increased by 6%.

Operational performance

Intelligence & Security

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

Intelligence & Security continues to mature its capabilities in activity-based intelligence to help the intelligence and defence communities transform data into actionable intelligence.

The business is building on its history of providing support to the National Geospatial-Intelligence Agency (NGA), with an $18m (£11m) contract on the Consolidated Library programme for a Flexible Content Management System and orders valued at over $75m (£48m) on the Geospatial Data Services Foundational GEOINT Content Management programme.

In addition to its NGA support, the business was awarded two contracts with new US intelligence community customers to assist with the development of advanced data processing and next-generation geospatial intelligence data collection solutions.

Signal Innovations Group, acquired in September 2014, has been integrated into the Geospatial eXploitation Products business to leverage geospatial imagery and analytics software technologies, creating new opportunities within the US intelligence and defence communities.

Global Analysis & Operations

In Full Motion Video and Intelligence, Surveillance and Reconnaissance analysis, the business has more than 500 analysts sustaining mission critical activities globally and is executing on programmes worth over $400m (£255m).

Integrated Electronics & Warfare Systems

On the US Air Force's Intercontinental Ballistic Missile Integration Support Contractor programme, the business has been awarded $87m (£55m) for additional scope in the first half of 2015.

The business secured a re-compete award in June, winning the five-year US Marine Corps' Air Traffic Control and Landing Systems contract, with an estimated total value of $77m (£49m).

Global IT Solutions

The business continues to support the US High Performance Computing Infrastructure Group, providing high-speed data centre access to more than 3,000 users.

The business has achieved two Indefinite Delivery, Indefinite Quantity contract wins that will expand its IT services footprint with the US Air Force, with positions to pursue task orders on the Network Operations and Infrastructure Full and Open multiple-award contract and the Joint Worldwide Intelligence Communications System contract.

Intelligence & Security has been selected to provide information technology services to the US government in a single-award Indefinite Delivery, Indefinite Quantity contract with a potential ceiling value of more than $1.0bn (£0.6bn) over a ten-year period.

Applied Intelligence

Applied Intelligence operates in highly competitive markets with fast-moving customer requirements in the areas of cyber security, financial crime, communications intelligence and digital transformation. Following the acquisition of SilverSky in 2014, the business has now been organised into three divisions, Commercial Solutions, UK Services and International Services & Solutions, reflecting the distinct needs of commercial and government customers in the UK and international markets.

The strategy for the business is focused on creating market-leading positions in the commercial cyber security market and increasing the scale of system integration and service contracts in the UK and for government customers overseas. Investment in the first half of the year has focused on bringing new cyber security products to market and bidding for larger service integration contracts for UK and overseas governments. Bids have been, and are being, tendered for large service integration government contracts in the Far East and for Service Integration and Applications Management contracts in the UK. A growing commercial pipeline is expected to support cyber security and anti-fraud licence sales in the second half. A strong second half bias to both sales and profitability is anticipated.

Commercial Solutions

Commercial Solutions focuses on the provision of financial crime and cyber security products and solutions.

NetReveal® continues to be recognised as an industry-leading product-based solution and has been named as a category leader in the Chartis Financial Crime Risk Management Systems Report.

NetReveal® was selected by Metro Bank to provide a range of anti-money laundering services. The business continues to grow existing accounts, including the provision of managed analytics services to the Canadian National Insurance Crime Services (CANATICS) and the procurement of a trade finance fraud solution by a large banking and financial services organisation to detect collusion between counterparties and their suppliers.

The business is experiencing increased demand for managed services, particularly in cyber security for commercial customers, including a three-year contract awarded to provide advanced threat detection services to an international law firm and a contract for e-mail protection services to a leading international airline. In June, it launched its cloud-based security products in Europe and Canada.

CyberReveal™ continues to receive interest from major financial institutions in Europe and North America, with orders from both new and existing customers. Recent trials with customers in the financial services and pharmaceuticals industries have again demonstrated the product's ability to detect significant threats that were otherwise going undetected.

Applied Intelligence is the first company in the world to gain CBEST approval, a scheme backed by the Bank of England, HM Treasury and the Financial Conduct Authority, for delivery of both threat intelligence and penetration testing services. It has also partnered with the Chartered Institute of Public Finance and Accountancy's Counter Fraud Centre to help public services in the fight against fraud and cyber-attack.

UK Services

UK Services is a provider of systems integration and consulting services to UK customers in national security and critical national infrastructure, with a particular focus on digital, data analytics and cyber security.

The business has secured approximately £100m of Service Integration and Applications Management (SIAM) contracts over the last two years and is pursuing other SIAM opportunities.

UK Services has recently been awarded a three-year framework contract for the business intelligence IT portfolio at Network Rail, positioning it as Network Rail's partner for business intelligence IT systems integration work and building on its ongoing programme of cyber consulting. A second half bias in sales is expected due to the timing of these large SIAM orders and some UK government budget discontinuity connected with the UK election.

International Services & Solutions

International Services & Solutions focuses on cyber, communications and intelligence services and solutions for international governments and communications service providers. It also acts as a channel to pull through any relevant commercial product-based solutions to meet the demands of international governments.

The business continues to see demand in Asia-Pacific and the Middle East in support of protection against national threats. In Europe, the business has been awarded a contract to provide a long-term government partner with a solution to investigate new concepts for situational awareness using the IntelligenceReveal™ all-source analysis product.

Decisions on a number of service integration contracts for governments in the Far East are expected in the second half.

Looking forward

In the US, the current 2015 fiscal year appropriations legislation included stable Department of Defense funding. There are signs of potential improvement as fiscal year 2016 defence budget proposals continue to seek funding above previously imposed spending caps.

In April, BAE Systems announced that it had engaged advisers to support a strategic assessment of three of the four divisions of the US Intelligence & Security sector: Global Analysis & Operations, Integrated Electronics & Warfare Systems and Global IT Solutions. This review could potentially lead to the divestiture of one or more of these divisions.

BAE Systems Applied Intelligence has a growing order backlog and pipeline of opportunities underpinning expected growth from commercial and government customers in North America, Europe, Asia-Pacific and the Middle East.

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

REPORTING SEGMENTS: PLATFORMS & SERVICES (US)

Platforms & Services (US), with 12,100 employees[1] and operations in the US, UK and Sweden, produces combat vehicles, weapons and munitions, and delivers US-based services and sustainment activities, including ship repair and the management of government-owned munitions facilities.

	Six months ended 30 June 2015	Six months ended 30 June 2014[2]	Year ended 31 December 2014[2]
Sales[1]	**£1,328m**	£1,375m	£2,689m
Underlying EBITA[3]	**£92m**	£92m	£117m
Return on sales	**6.9%**	6.7%	4.4%
Cash (outflow)/inflow[4]	**£(20)m**	£79m	£147m
Order intake[1]	**£1,119m**	£1,061m	£2,565m
Order backlog[1,5]	**£3.9bn**	£4.4bn	£4.7bn

Financial performance

Sales[1] in the first half year reduced by 12% to $2.0bn (£1.3bn) following last year's completion of the Ground Combat Vehicle development activity. Excluding the impact of the disposal of the South African land business and exchange translation, the sales reduction was 9%.

Return on sales of 6.9% (2014 6.7%) was broadly in line with the prior year.

There was a cash outflow[4] of £20m (2014 inflow £79m) mainly reflecting the utilisation of the provisions created in previous periods against the US commercial shipbuilding programmes and customer advances on the CV90 Norway contract, along with investment to construct a new floating dry dock in San Diego.

Order backlog[1,5] reduced to $6.2bn (£3.9bn) in line with the sales traded on the long-term Multi-Ship, Multi-Option contracts in the naval ship repair business.

Operational performance

As the US defence market stabilises, the business retains its focus on sustaining its franchise of combat vehicle programmes and building a strong domestic and international pipeline, whilst shaping and scaling operational resources to optimise competitiveness.

US Combat Vehicles

In March, the business delivered the first vehicles to the US Army under the current $335m (£213m) Low-Rate Initial Production contract for M109A7 self-propelled howitzers (Paladin).

Work has commenced on the US Army's Armored Multi-Purpose Vehicle programme and a preliminary design review was completed in June. BAE Systems is producing 29 vehicles under the engineering and manufacturing development phase. Including options to produce 289 vehicles under Low-Rate Initial Production, the total potential value of the contract for these initial phases of the programme is $1.2bn (£0.8bn).

In May, the US Army awarded BAE Systems a contract worth $110m (£70m) to convert 36 M88A1 recovery vehicles to the M88A2 Heavy Equipment Recovery Combat Utility Lift Evacuation System (HERCULES) configuration. The M88 plays an important role in the Group's efforts to maintain the combat vehicle industrial base. The first vehicle delivery is scheduled for 2017.

In May, the business submitted its proposal to the US Marine Corps for the engineering and manufacturing development phase of the Amphibious Combat Vehicle 1.1 programme. The business has teamed with Iveco Defense to develop a fully amphibious solution.

The business was also awarded a $29m (£18m) follow-on contract for trade studies and analysis related to the future infantry fighting vehicle. Under the contract, BAE Systems will develop concepts that span from modernising the Bradley vehicle to a new design, including capitalising on technology created under the Ground Combat Vehicle programme.

As a subcontractor to Lockheed Martin on the Joint Light Tactical Vehicle programme, BAE Systems continues to pursue award of the Low-Rate Initial Production contract.

Weapon Systems and Munition Operations
In May, BAE Systems was awarded a contract for five Bofors 40 Mk4 naval guns for the Brazilian Navy's 500T Macae Class patrol vessels. Series production of the guns has commenced, with a portion of the manufacturing, final assembly and test to take place in Brazil. Deliveries are scheduled to begin in 2016.

BAE Systems has been contracted by an additional end-user to provide two 57 Mk3 naval gun systems. With this contract, BAE Systems will have ongoing production for six international users of the 57mm system.

BAE Systems continues to work with the governments of India and the US to formalise an agreement for the purchase of 145 M777 155mm lightweight howitzers. BAE Systems has proposed the establishment of an assembly integration and test facility in partnership with an Indian company, which supports the Indian prime minister's 'Make in India' initiative.

The business continues to execute the re-baselined Archer artillery system programme for its Swedish government customer, with delivery of the first system expected in the second half of the year.

BAE Systems is continuing its partnership with the US Navy on the development of an Electromagnetic Railgun, with plans to conduct the first test of the system at sea during 2016.

The US Navy awarded BAE Systems a $53m (£34m) contract in April to provide canisters for the Vertical Launch System as part of a procurement that began in 2013 and is expected to run to 2017.

The business continues to execute its contracts to manage operations at the Holston and Radford Army ammunition plants, and received a $30m (£19m) contract to modernise the insensitive munitions ingredient facility at Holston.

US Ship Repair, Modernisation and Shipbuilding
Construction of the new $100m (£64m) dry dock in the San Diego shipyard begins in the third quarter and other infrastructure improvements are underway.

In the commercial shipbuilding business, process improvement initiatives are being implemented and the business continues to make progress under the current experienced leadership team. Three of the eight vessels have now been accepted by their customers.

BAE Systems Hägglunds
The business is pursuing opportunities with potential customers for the CV90 vehicle. In May, it was announced that the business was unsuccessful in its bid for Denmark's Armoured Personnel Carrier. In June, BAE Systems announced that it was starting consultations with trade unions and employee representatives on a proposed reduction of up to 130 employees.

The business continues to execute contracts for the BvS10 for Sweden and the CV90 Infantry Fighting Vehicle for Norway. In June, the business delivered the first production vehicles of the last two of five CV90 variants to the Norwegian Army customer: the command vehicle and the reconnaissance vehicle.

FNSS
FNSS, the Turkish land systems joint venture, has continued production under the $559m (£356m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army.

Production is also underway on a contract to upgrade M113 tracked armoured personnel carriers for the Royal Saudi Land Forces. The business is pursuing other armoured vehicle prospects elsewhere in the Middle East region.

Three competitive proposals have been submitted for combat vehicle programmes in Turkey and the Middle East. Award decisions are expected in late 2015 and 2016.

Business disposal
In April, the Group completed the sale of its shareholding in Land Systems South Africa.

Looking forward

The current 2015 fiscal year appropriations legislation included stable Department of Defense funding and support for major programmes. There are signs of potential improvement as fiscal year 2016 defence budget proposals continue to seek funding above previously imposed spending caps.

The business is underpinned by strong positions on key franchise programmes – on the US Army's Armored Multi-Purpose Vehicle and Paladin programmes – as well as US Navy ship repair and modernisation activities. The business continues to pursue a range of potential domestic and international opportunities in combat vehicles, weapon systems and maritime support services.

1. Including share of equity accounted investments.
2. Re-presented for the reallocation of the Integrated Electronics & Warfare Systems activities from Platforms & Services (US) to Cyber & Intelligence.
3. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
4. Net cash (outflow)/inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
5. Comprises funded and unfunded unexecuted customer orders.

REPORTING SEGMENTS: PLATFORMS & SERVICES (UK)

Platforms & Services (UK), with 28,900 employees[1], comprises the Group's UK-based air, maritime, combat vehicle, munitions and shared services activities.

	Six months ended 30 June 2015	Six months ended 30 June 2014	Year ended 31 December 2014
Sales[1]	**£3,544m**	£2,844m	£6,623m
Underlying EBITA[2]	**£355m**	£393m	£772m
Return on sales	**10.0%**	13.8%	11.7%
Cash (outflow)/inflow[3]	**£(296)m**	£(201)m	£173m
Order intake[1]	**£2,151m**	£1,612m	£5,386m
Order backlog[1]	**£18.7bn**	£20.4bn	£20.1bn

Financial performance

Sales[1] were £3.5bn, an increase of 25% compared with the first half of 2014 (£2.8bn). This year, whilst European Typhoon deliveries have a much more balanced profile over the year than in 2014, on the Saudi programme, there were four aircraft deliveries in the first half, with nine scheduled for the second half.

The business has contracted to supply the radar and Defensive Aids Sub-System (DASS) equipment for all 88 European Tranche 3 aircraft, which was not the case for Tranche 2. This has added incremental sales of some £300m, albeit the Group takes only a small handling fee on this minimal risk element of the contract.

Return on sales was 10.0% (2014 13.8%). The first half of 2014 benefited from strong programme execution and risk reduction on the European Typhoon Tranche 2 production contract as deliveries moved towards completion. The business is now delivering against the Tranche 3 contract. The dilutive impact on return on sales from trading of the radar and DASS equipment is around 60 basis points.

The cash outflow[3] of £296m (2014 £201m) in the period reflects the consumption of customer advances on the Omani Typhoon and Hawk programme, the European Typhoon contract and the Saudi training aircraft contract, as well as rationalisation costs against provisions created in prior periods.

Order backlog[1] reduced to £18.7bn (31 December 2014 £20.1bn) primarily reflecting sales trading on the Typhoon aircraft, aircraft carrier and Astute Class submarine programmes.

Operational performance

Military Air & Information

In the six months to 30 June, six Typhoon aircraft were delivered from the UK final assembly facility, of which four were delivered to Saudi Arabia. In addition, 14 front fuselage sub-assemblies were delivered in the first half of the year, comprising eight for aircraft production in the UK and six for the Group's European partners. The 2014 issues delaying acceptance of Typhoon Tranche 3 aircraft from the Group's partners in Germany, Italy and Spain have been resolved.

The Oman Typhoon and Hawk aircraft programme continues to meet all contractual milestones, with aircraft production schedules on track for commencement of deliveries in 2017. Steady progress is being made on the construction programme at the Omani air base.

Good momentum continues in progressively expanding Typhoon's capabilities, including the integration of the Captor E-Scan radar under a contract secured during 2014, the integration of additional weapons, including Brimstone 2, and the initial work on the development of a common weapon launcher.

The business continues to perform well in supporting its UK and European customers' Typhoon and Tornado aircraft and their operational commitments. The business supports its UK customer through availability-based service contracts.

On the F-35 Lightning II programme, the business completed 22 aft fuselage assembly deliveries to 30 June for the Lot 8 Low-Rate Initial Production (LRIP) contract. Production of aft fuselage assemblies for the Lot 9 LRIP contract has commenced. A total of 25 aft fuselage deliveries are planned for the second half of the year.

Support continues to be provided to users of Hawk trainer aircraft around the world. The Indian Air Force and Navy have received a further nine and one Hawk aircraft, respectively, from Hindustan Aeronautics Limited, built under the Batch 2 licence for 57 aircraft. Commercial discussions continue on the proposal for an additional 20 Hawk aircraft for the Indian Air Force.

A £25m order has been received from the UK Ministry of Defence for continued support to the Advanced Jet Trainer facility in North Wales.

Working jointly with Dassault Aviation, progress continues in maturing and demonstrating critical technology and operational aspects for an Unmanned Combat Air System.

Maritime

Following the award of contracts during 2014 from the UK Ministry of Defence covering both the revised target cost arrangements for the delivery of the two Queen Elizabeth Class aircraft carriers and the construction of three River Class Offshore Patrol Vessels, work continues towards the start of manufacture for the anticipated Type 26 frigate programme which will sustain shipbuilding capability in Glasgow through the next decade.

On the aircraft carrier programme, key systems commissioning has commenced on HMS Queen Elizabeth and will continue into the second half of 2016. On the Prince of Wales, the forward island has been lifted and positioned onto the ship and the final bow unit attached, completing the major assembly work on the forward part of the ship's hull.

On the River Class Offshore Patrol Vessel contract for the Royal Navy, construction of the first of class vessel, HMS Forth, continues and construction of the second ship, HMS Medway, commenced in June. The first ship is due to be delivered in 2017.

An £859m demonstration phase contract for the Type 26 frigate was secured in March following conclusion of the assessment phase. The contract covers detailed design activities and enables BAE Systems to award subcontracts to approximately 30 companies throughout the supply chain covering procurement of key equipment for the full manufacture contract anticipated in 2016.

Final acceptance of the third and final Khareef Class corvette for the Royal Navy of Oman is planned for completion in the third quarter of the year.

The UK Ministry of Defence and its French counterpart have committed to the design of a new Maritime Mine Counter Measures demonstrator programme, which may form the basis of a future Royal Navy unmanned system to combat the threat of underwater sea mines.
BAE Systems and Thales are collaborating on the first phase of the project covering programme definition and design.

The five-year Maritime Support Delivery Framework contract secured in 2014 for the delivery of services at Portsmouth Naval Base and support to half of the Royal Navy's surface fleet continues to progress well, with the first year of cost saving targets delivered.

BAE Systems manages the support, maintenance and upgrade of the Royal Navy's fleet of Type 45 destroyers. The ships are currently meeting their operational requirements.

The upgrade of the Spearfish torpedo is continuing to schedule with all key milestones to date achieved.

HMS Artful, the third of class attack submarine for the Royal Navy, will exit Barrow later this year, a major milestone for the programme. Construction of HMS Audacious, the fourth of class, is progressing.

On the Successor submarine, the replacement for the Vanguard Class fleet, functional and spatial design and development continues to mature as the programme approaches the production stage. Build phase preparations continue in support of the UK Ministry of Defence's Main Gate approval, anticipated in 2016, including the commencement of building works as part of a major programme to redevelop the Barrow manufacturing site. At 30 June, BAE Systems had over 5,800 employees based in Barrow.

Combat Vehicles (UK)
The business has continued to provide support to previously supplied armoured and bridging vehicles. The last four Terrier vehicles, of a total of 60 to be completed to the final accepted build standard, will be completed by the year end.

A €188m (£133m) contract for 515 cased telescopic canons for the Ministry of Defence was secured in March by CTA International, a 50% joint venture between BAE Systems and Nexter.

Munitions
The business continues pricing negotiations for the last five years of its 15-year Munitions Acquisition Supply Solution partnering agreement with the UK Ministry of Defence, which are expected to conclude in the second half of 2015. Orders totalling £77m were received in the first half of the year.

Looking forward

Platforms & Services (UK) has a strong order backlog of long-term committed programmes and an enduring support business. Stability across these activities is expected following the Strategic Defence and Security Review anticipated later this year.

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

In Maritime, sales are underpinned by the manufacture of the Queen Elizabeth Class aircraft carriers and Astute Class submarines, and the design and subsequent manufacture of the Type 26 frigate and Successor submarine.

The through-life support of surface ship platforms, together with their associated command and combat systems, provides a sustainable business in technical services and mid-life upgrades.

Combat Vehicles (UK) continues to deliver on support programmes in the UK and international markets. The business is pursuing obsolescence and upgrade programmes on the Challenger 2 main battle tank and bridging platforms.

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

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

REPORTING SEGMENTS: PLATFORMS & SERVICES (INTERNATIONAL)

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

	Six months ended 30 June 2015	Six months ended 30 June 2014	Year ended 31 December 2014
Sales[1]	**£1,621m**	£1,576m	£3,572m
Underlying EBITA[2]	**£155m**	£157m	£366m
Return on sales	**9.6%**	10.0%	10.2%
Cash (outflow)/inflow[3]	**£(49)m**	£541m	£881m
Order intake[1]	**£1,112m**	£761m	£3,398m
Order backlog[1]	**£10.7bn**	£11.4bn	£11.6bn

Financial performance

Sales[1] for the first six months of £1,621m are 6% higher than in 2014 (£1,576m) on a like-for-like basis. The delivery of equipment to the Royal Saudi Air Force and milestones on the Australian Landing Helicopter Dock programme are weighted to the second half year.

Underlying EBITA[2] was £155m (2014 £157m), giving a broadly consistent return on sales of 9.6% (2014 10.0%), after taking a small charge of £5m for some 200 redundancies announced at the Williamstown shipyard during the first half.

There was an operating cash outflow[3] of £49m (2014 inflow £541m), which includes the second payment under the Salam Variation of Price agreement. Some £200m of receivables were collected in December 2014, ahead of the contracted due dates.

Order backlog[1] reduced to £10.7bn (31 December 2014 £11.6bn) on the trading of the five-year Saudi support contracts.

Operational performance

Saudi Arabia

On the Salam Typhoon programme, as at 30 June, 49 aircraft have been delivered to the customer. Work on enhancing Typhoon's capability is progressing to schedule.

The Typhoon support contract is operating well with all Key Performance Indicators meeting contractual levels. Several aircraft have completed scheduled maintenance and upgrade activities.

Through the Saudi British Defence Co-operation Programme, the business continues to support the operational capabilities of the Royal Saudi Air Force (RSAF) and Royal Saudi Naval Forces (RSNF). The modernisation of the RSAF's training aircraft fleet continues on schedule, with all 22 Hawk aircraft in advanced stages of production and the first aircraft scheduled to fly in September. At 30 June, a total of 32 of the 55 Pilatus PC-21 aircraft have been delivered. Training delivery and support under five-year contracts continues.

The upgrade of Tornado aircraft and equipment procurement are proceeding to plan.

Under the minehunter mid-life update programme, acceptance of the second ship back into the RSNF fleet is scheduled for the second half, having originally been scheduled for the first half of the year. It is anticipated that there will be a subsequent delay in delivery of the third ship in the programme.

The planned re-organisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia continues. Riyadh Wings Aviation Academy LLC has contracted to acquire a 49% shareholding in a Group subsidiary, Overhaul and Maintenance Company. The re-organisation supports BAE Systems' strategy to expand the customer base of its In-Kingdom

Industrial Participation programme, promoting training, development and employment opportunities in line with the Saudi National Objective. As part of the re-organisation, and subject to gaining the necessary regulatory and stakeholder approvals, the business plans to commence the transfer of a material proportion of its Saudi-based workforce to one of the local Saudi industrial companies in the second half of 2015.

The Salam In-Kingdom Industrial Participation programme progresses, with the Al Salam Aircraft Company being accredited as a repair agent for Typhoon windscreens and transparencies following Advanced Electronics Company's accreditation as a repair agent for Typhoon avionics equipment in 2014.

Australia

The first Landing Helicopter Dock warship, HMAS Canberra, was commissioned in to the operational naval fleet in November 2014 and BAE Systems has commenced in-service support activities under a four-year contract. The second ship has commenced sea trials, and is progressing towards delivery and initial acceptance in the second half of the year.

Construction of ship blocks for the Air Warfare Destroyer (AWD) programme at the Williamstown shipyard continues, with 13 of the 21 contracted delivered at 30 June. Production continues through to the first half of 2016.

After delivery of the second Landing Helicopter Dock ship and AWD blocks, there is no contracted shipbuilding programme for the Williamstown shipyard. BAE Systems continues to engage with the Australian government on its shipbuilding capability. In the meantime, workforce reductions commenced in the first half of the year and will continue progressively if no new shipbuilding work is secured.

The fourth of eight Anzac Class frigates to be modernised under the Anti-Ship Missile Defence programme is progressing towards sea trials and acceptance in the second half of the year. The fifth and sixth ships are undergoing their re-fits at the Henderson shipyard, with scheduled acceptance dates in 2016.

BAE Systems has been selected as the Asia-Pacific regional prime contractor to undertake airframe maintenance, repair and overhaul for the F-35 Lightning II programme. This represents a significant growth opportunity and is expected to underpin the Group's aerospace sustainment activities in Australia over the next decade and beyond.

Negotiations continue with the Commonwealth to agree a revised schedule for the delayed delivery of the JP 2008 Phase 3F programme for enhanced satellite communications services to the Australian Defence Force. The negotiations are expected to be concluded in the second half year.

Oman

The two major contracts in Oman, the Khareef Class corvettes and the Typhoon and Hawk aircraft programme, are being undertaken by Platforms & Services (UK). See pages 20 and 21 for further information on the operational performance of these contracts.

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

The business continues to fulfil its industrial participation obligations in Oman through delivery of an agreed training and knowledge transfer programme. An expansion of this programme has been agreed and, when delivered, will satisfy all of the Group's industrial participation obligations.

MBDA

Following completion of the Meteor development programme at the end of 2014, deliveries of production-standard missiles ordered by the six partner nation customers continue to plan.

The German government has announced its intention to buy the Medium Extended Air Defence Systems (MEADS) missile defence system being developed by MBDA in partnership with Lockheed Martin. Contract signature is expected in 2016, with development expected to be complete within five years. This decision provides an opportunity for MEADS to compete for significant export opportunities worldwide.

MBDA has been awarded a substantial weapons order as part of an agreed export contract for Rafale aircraft in Egypt and a further agreement has been signed with Qatar. In total, the orders are expected to deliver €1.2bn (£0.9bn) to BAE Systems, with €0.3bn (£0.2bn) of order intake in the first half.

A significant number of ground-based air defence export campaigns continue to be pursued in central Europe and the Gulf region.

Looking forward

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

In Australia, the 2015 Federal Budget statement confirmed the government's commitment to increasing annual defence expenditure to 2% of Gross Domestic Product within a decade of the budget. Following delivery of the second Landing Helicopter Dock in 2015, the Williamstown shipyard needs a follow-on shipbuilding programme to sustain capability. In the meantime, the Group is reviewing options for the facility and its operations.

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

MBDA continues to build on the effective partnerships it has established with its domestic customers and has secured export opportunities that underpin future growth.

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

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 25 includes a fair review of the information required by:
  (a) DTR 4.2.7R of the Disclosure 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 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 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

29 July 2015

Directors

Sir Roger Carr	Chairman
Ian King	Chief Executive
Jerry DeMuro	President and Chief Executive Officer of BAE Systems, Inc.
Peter Lynas	Group Finance 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

Introduction

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 2015 which comprises the Condensed Consolidated Income Statement, the Condensed Consolidated Statement of Comprehensive Income, the Condensed Consolidated Cash Flow Statement, the Condensed Consolidated Balance Sheet, the Condensed Consolidated Statement of Changes in Equity and the related explanatory notes. 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 the terms of our engagement to assist the Company in meeting the requirements of the Disclosure and Transparency Rules (the DTR) of the UK's Financial Conduct Authority (the UK FCA). Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

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

The annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union (EU). The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with IAS 34, Interim Financial Reporting, as adopted by the EU.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the 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 Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2015 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FCA.

Ian Starkey

For and on behalf of
KPMG LLP
Chartered Accountants
15 Canada Square
London E14 5GL

29 July 2015

CONDENSED CONSOLIDATED INCOME STATEMENT

	Notes	**Six months ended 30 June 2015** £m	**Six months ended 30 June 2015** £m	Six months ended 30 June 2014 £m	Six months ended 30 June 2014 £m
Continuing operations					
Combined sales of Group and share of equity accounted investments	2		**8,472**		7,611
Less: share of sales of equity accounted investments	2		**(471)**		(489)
Revenue	2		**8,001**		7,122
Operating costs			**(7,368)**		(6,493)
Other income			**39**		46
Group operating profit			**672**		675
Share of results of equity accounted investments			**28**		14
Underlying EBITA[1]		**800**		802	
Non-recurring items[2]		**(24)**		–	
EBITA		**776**		802	
Amortisation of intangible assets		**(62)**		(88)	
Impairment of intangible assets		**(3)**		–	
Financial expense of equity accounted investments		**(9)**		(21)	
Taxation expense of equity accounted investments		**(2)**		(4)	
Operating profit	2		**700**		689
Financial income		**161**		165	
Financial expense		**(353)**		(313)	
Finance costs	3		**(192)**		(148)
Profit before taxation			**508**		541
Taxation expense			**(110)**		(107)
Profit for the period			**398**		434
Attributable to:					
Equity shareholders			**390**		429
Non-controlling interests			**8**		5
			398		434
Earnings per share	5				
Basic earnings per share			**12.3p**		13.5p
Diluted earnings per share			**12.3p**		13.5p

1. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
2. Non-recurring items represents loss on disposal of businesses (see note 4).

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Six months ended 30 June 2015			Six months ended 30 June 2014		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Profit for the period	**–**	**398**	**398**	–	434	434
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Remeasurements on defined benefit pension schemes:						
Subsidiaries	**–**	**537**	**537**	–	(308)	(308)
Equity accounted investments	**–**	**6**	**6**	–	(19)	(19)
Tax on items that will not be reclassified to the income statement	**–**	**(135)**	**(135)**	–	69	69
Items that may be reclassified to the income statement:						
Currency translation on foreign currency net investments:						
Subsidiaries	**(105)**	**–**	**(105)**	(161)	–	(161)
Equity accounted investments	**(19)**	**–**	**(19)**	(22)	–	(22)
Reclassification of cumulative currency translation reserve on disposal	**20**	**–**	**20**	–	–	–
Amounts charged to hedging reserve	**(59)**	**–**	**(59)**	(45)	–	(45)
Tax on items that may be reclassified to the income statement	**14**	**–**	**14**	10	–	10
Total other comprehensive income for the period (net of tax)	**(149)**	**408**	**259**	(218)	(258)	(476)
Total comprehensive income for the period	**(149)**	**806**	**657**	(218)	176	(42)
Attributable to:						
Equity shareholders	**(148)**	**798**	**650**	(217)	171	(46)
Non-controlling interests	**(1)**	**8**	**7**	(1)	5	4
	(149)	**806**	**657**	(218)	176	(42)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity holders of the parent						
	Issued share capital £m	Share premium £m	Other reserves[1] £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 January 2015	87	1,249	5,061	(4,555)	1,842	35	1,877
Profit for the period	–	–	–	390	390	8	398
Total other comprehensive income for the period	–	–	(148)	408	260	(1)	259
Share-based payments	–	–	–	22	22	–	22
Net sale of own shares	–	–	–	3	3	–	3
Ordinary share dividends	–	–	–	(389)	(389)	(21)	(410)
Disposal of non-controlling interest	–	–	–	–	–	(6)	(6)
At 30 June 2015	**87**	**1,249**	**4,913**	**(4,121)**	**2,128**	**15**	**2,143**
At 1 January 2014	89	1,249	4,868	(2,825)	3,381	37	3,418
Profit for the period	–	–	–	429	429	5	434
Total other comprehensive income for the period	–	–	(217)	(258)	(475)	(1)	(476)
Share-based payments	–	–	–	22	22	–	22
Net purchase of own shares	(1)	–	1	(237)	(237)	–	(237)
Ordinary share dividends	–	–	–	(383)	(383)	(2)	(385)
At 30 June 2014	88	1,249	4,652	(3,252)	2,737	39	2,776

1. The net decrease comprises translation reserve decrease £103m (2014 £182m), hedging reserve decrease £45m (2014 £35m) and capital redemption reserve increase £nil (2014 £1m).

CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	30 June 2015 £m	31 December 2014 £m
Non-current assets			
Intangible assets		**9,870**	9,983
Property, plant and equipment		**1,551**	1,589
Investment property		**131**	129
Equity accounted investments		**208**	229
Other investments		**7**	7
Other receivables		**336**	347
Retirement benefit surpluses	6	**178**	162
Other financial assets		**51**	38
Deferred tax assets		**1,154**	1,327
		13,486	13,811
Current assets			
Inventories		**723**	690
Trade and other receivables including amounts due from customers for contract work		**3,076**	2,850
Current tax		**8**	7
Other financial assets		**52**	46
Cash and cash equivalents		**1,383**	2,308
Assets held for sale		**20**	76
		5,262	5,977
Total assets		**18,748**	19,788
Non-current liabilities			
Loans		**(2,850)**	(2,868)
Other payables		**(678)**	(932)
Retirement benefit obligations	6	**(4,952)**	(5,530)
Other financial liabilities		**(103)**	(79)
Deferred tax liabilities		**(16)**	(21)
Provisions		**(402)**	(436)
		(9,001)	(9,866)
Current liabilities			
Loans and overdrafts		**(485)**	(482)
Trade and other payables		**(6,258)**	(6,670)
Other financial liabilities		**(167)**	(107)
Current tax		**(456)**	(448)
Provisions		**(230)**	(315)
Liabilities held for sale		**(8)**	(23)
		(7,604)	(8,045)
Total liabilities		**(16,605)**	(17,911)
Net assets		**2,143**	1,877
Capital and reserves			
Issued share capital		**87**	87
Share premium		**1,249**	1,249
Other reserves		**4,913**	5,061
Retained earnings – deficit		**(4,121)**	(4,555)
Total equity attributable to equity holders of the parent		**2,128**	1,842
Non-controlling interests		**15**	35
Total equity		**2,143**	1,877

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Notes	**Six months ended 30 June 2015 £m**	Six months ended 30 June 2014 £m
Profit for the period		**398**	434
Taxation expense		**110**	107
Share of results of equity accounted investments		**(28)**	(14)
Finance costs		**192**	148
Depreciation, amortisation and impairment		**184**	226
Profit on disposal of property, plant and equipment		**(5)**	(4)
Profit on disposal of investment property		**–**	(3)
Profit on disposal of non-current other investments		**(1)**	–
Loss on disposal of businesses	4	**24**	–
Cost of equity-settled employee share schemes		**22**	22
Movements in provisions		**(125)**	(124)
Decrease in liabilities for retirement benefit obligations		**(145)**	(143)
Increase in working capital:			
Inventories		**(36)**	(28)
Trade and other receivables		**(248)**	(125)
Trade and other payables		**(599)**	(526)
Cash outflow from operating activities[1]		**(257)**	(30)
Interest paid		**(98)**	(81)
Taxation paid		**(60)**	(65)
Net cash outflow from operating activities		**(415)**	(176)
Dividends received from equity accounted investments		**37**	13
Interest received		**4**	5
Purchases of property, plant and equipment, and investment property		**(134)**	(100)
Purchases of intangible assets		**(21)**	(28)
Proceeds from sale of property, plant and equipment, and investment property		**27**	433
Proceeds from sale of non-current other investments		**1**	–
Purchase of subsidiary undertakings (net of cash acquired)		**(6)**	–
Equity accounted investment funding		**(2)**	(1)
Proceeds from sale of subsidiary undertakings (net of cash disposed)	4	**22**	–
Net cash (outflow)/inflow from investing activities		**(72)**	322
Net sale/(purchase) of own shares		**3**	(237)
Equity dividends paid	7	**(389)**	(383)
Dividends paid to non-controlling interests		**(21)**	(2)
Cash outflow from matured derivative financial instruments		**(49)**	(57)
Cash inflow/(outflow) from cash collateral		**3**	(7)
Cash outflow from repayment of loans		**–**	(298)
Net cash outflow from financing activities		**(453)**	(984)
Net decrease in cash and cash equivalents		**(940)**	(838)
Cash and cash equivalents at 1 January		**2,313**	2,222
Effect of foreign exchange rate changes on cash and cash equivalents		**2**	(10)
Cash and cash equivalents at end of period		**1,375**	1,374
Comprising:			
Cash and cash equivalents		**1,383**	1,374
Overdrafts		**(8)**	–
Cash and cash equivalents at end of period		**1,375**	1,374

1. See reconciliation to operating business cash flow on page 9.

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 2014. The comparative figures for the year ended 31 December 2014 are not the Group's statutory accounts for that financial year. Those accounts have been reported upon by the Group's auditors and delivered to the registrar of companies. The report of the auditors was unqualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and did not contain statements under Section 498 (2) or (3) of the Companies Act 2006.

The accounting policies adopted in the preparation of these condensed consolidated half-yearly financial statements to 30 June 2015 are consistent with the accounting policies applied by the Group in its consolidated financial statements as at, and for the year ended, 31 December 2014 as required by the Disclosure and Transparency Rules of the UK's Financial Conduct Authority.

Changes in accounting policies

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

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

2. Segmental analysis

Sales and revenue by reporting segment

	Combined sales of Group and share of equity accounted investments		Less: sales by equity accounted investments		Add: sales to equity accounted investments		Revenue	
	Six months ended 30 June 2015 £m	Six months ended 30 June 2014[1] £m	**Six months ended 30 June 2015 £m**	Six months ended 30 June 2014 £m	**Six months ended 30 June 2015 £m**	Six months ended 30 June 2014 £m	**Six months ended 30 June 2015 £m**	Six months ended 30 June 2014[1] £m
Electronic Systems	**1,246**	1,108	**(36)**	(36)	**36**	36	**1,246**	1,108
Cyber & Intelligence	**887**	814	**–**	–	**–**	–	**887**	814
Platforms & Services (US)	**1,328**	1,375	**(53)**	(36)	**–**	–	**1,275**	1,339
Platforms & Services (UK)	**3,544**	2,844	**(885)**	(428)	**850**	382	**3,509**	2,798
Platforms & Services (International)	**1,621**	1,576	**(297)**	(297)	**–**	–	**1,324**	1,279
HQ	**128**	127	**(128)**	(127)	**–**	–	**–**	–
	8,754	7,844	**(1,399)**	(924)	**886**	418	**8,241**	7,338
Intra-group sales/revenue	**(282)**	(233)	**–**	–	**42**	17	**(240)**	(216)
	8,472	7,611	**(1,399)**	(924)	**928**	435	**8,001**	7,122

Reporting segment result

	Underlying EBITA[2]		Non-recurring items[3]		Amortisation of intangible assets		Impairment of intangible assets		Reporting segment result	
	Six months ended 30 June 2015 £m	Six months ended 30 June 2014[1] £m	**Six months ended 30 June 2015 £m**	Six months ended 30 June 2014 £m	**Six months ended 30 June 2015 £m**	Six months ended 30 June 2014[1] £m	**Six months ended 30 June 2015 £m**	Six months ended 30 June 2014 £m	**Six months ended 30 June 2015 £m**	Six months ended 30 June 2014[1] £m
Electronic Systems	**187**	143	**–**	–	**(10)**	(7)	**–**	–	**177**	136
Cyber & Intelligence	**52**	60	**–**	–	**(35)**	(30)	**(3)**	–	**14**	30
Platforms & Services (US)	**92**	92	**(24)**	–	**(7)**	(7)	**–**	–	**61**	85
Platforms & Services (UK)	**355**	393	**–**	–	**(5)**	(42)	**–**	–	**350**	351
Platforms & Services (International)	**155**	157	**–**	–	**(5)**	(2)	**–**	–	**150**	155
HQ[4]	**(41)**	(43)	**–**	–	**–**	–	**–**	–	**(41)**	(43)
	800	802	**(24)**	–	**(62)**	(88)	**(3)**	–	**711**	714
Financial expense of equity accounted investments									**(9)**	(21)
Taxation expense of equity accounted investments									**(2)**	(4)
Operating profit									**700**	689
Finance costs									**(192)**	(148)
Profit before taxation									**508**	541
Taxation expense									**(110)**	(107)
Profit for the period									**398**	434

1. Re-presented for the reallocation of the Integrated Electronics & Warfare Systems activities from Platforms & Services (US) to Cyber & Intelligence.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Non-recurring items represents loss on disposal of businesses (see note 4).
4. In 2014, the HQ reporting segment included a £30m benefit from re-assessment of a long-term liability and a £17m charge in respect of a US contract pricing dispute.

3. Finance costs

	Six months ended 30 June 2015 £m	Six months ended 30 June 2014 £m
Finance costs:		
Group	**(192)**	(148)
Share of equity accounted investments	**(9)**	(21)
	(201)	(169)
Analysed as:		
Underlying interest expense:		
Group	**(106)**	(88)
Share of equity accounted investments	**(1)**	(1)
	(107)	(89)
Other:		
Group:		
Net interest expense on retirement benefit obligations	**(95)**	(76)
Fair value and foreign exchange adjustments on financial instruments and investments	**9**	16
Share of equity accounted investments:		
Net interest expense on retirement benefit obligations	**(3)**	(4)
Fair value and foreign exchange adjustments on financial instruments and investments	**(5)**	(16)
	(201)	(169)

4. Disposal of subsidiaries

In April, the Group completed the sale of its 75% holding in BAE Systems Land Systems South Africa (Pty) Limited for cash consideration of 655 million Rand (£36m).

	£m	£m
Cash consideration		36
Transaction costs paid		(1)
Cash proceeds		**35**
Transaction costs accrued		(1)
Net proceeds		**34**
Intangible assets	(19)	
Property, plant and equipment	(9)	
Inventories	(7)	
Trade and other receivables	(9)	
Deferred tax assets	(3)	
Cash and cash equivalents	(13)	
Trade and other payables	8	
Deferred tax liabilities	2	
Provisions	6	
Net assets disposed		**(44)**
Non-controlling interest disposed		6
Cumulative currency translation loss		(20)
Loss on disposal of businesses		**(24)**

5. Earnings per share

	Six months ended 30 June 2015			Six months ended 30 June 2014		
	£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	**390**	**12.3**	**12.3**	429	13.5	13.5
Add back/(deduct):						
Loss on disposal of businesses	**24**			–		
Net interest expense on retirement benefit obligations, post tax	**77**			64		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	**(3)**			–		
Amortisation and impairment of intangible assets, post tax	**51**			70		
Underlying earnings, post tax	**539**	**17.1**	**17.0**	563	17.7	17.7

	Millions	**Millions**	Millions	Millions
Weighted average number of shares used in calculating basic earnings per share	**3,158**	**3,158**	3,175	3,175
Incremental shares in respect of employee share schemes		**9**		9
Weighted average number of shares used in calculating diluted earnings per share		**3,167**		3,184

Underlying earnings per share is presented in addition to that required by IAS 33, Earnings per Share, to align the adjusted earnings measure with the performance measure reviewed by the directors. The directors consider that this gives a more appropriate indication of underlying performance.

6. Retirement benefit obligations

	UK £m	US and other £m	Total £m
Total IAS 19 deficit at 1 January 2015	(6,066)	(746)	(6,812)
Actual return on assets, less amounts included in net interest expense	(127)	(85)	(212)
Decrease in liabilities due to changes in financial assumptions and experience	575	197	772
Additional contributions in excess of service cost	160	–	160
Recurring contributions in excess of service cost	34	(8)	26
Past service cost – plan amendments	(6)	–	(6)
Net interest expense	(104)	(16)	(120)
Foreign exchange adjustments	–	9	9
Movement in US healthcare schemes	–	3	3
Total IAS 19 deficit at 30 June 2015	**(5,534)**	**(646)**	**(6,180)**
Allocated to equity accounted investments and other participating employers	1,406	–	1,406
Group's share of IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments and other participating employers at 30 June 2015	**(4,128)**	**(646)**	**(4,774)**
Represented by:			
Retirement benefit surpluses	105	73	178
Retirement benefit obligations	(4,233)	(719)	(4,952)
	(4,128)	**(646)**	**(4,774)**

The net decrease in liabilities due to changes in financial assumptions and experience reflects, in the UK, a 0.1 percentage point increase in the real discount rate to 0.5% and, in the US, a 0.4 percentage point increase in the nominal discount rate to 4.5%.

Deficit allocation

Certain of the Group's equity accounted investments participate in the Group's defined benefit schemes as well as Airbus SAS, the Group's share of which was disposed of in 2006. As these schemes are multi-employer schemes, the Group has allocated a share of the IAS 19 pension deficit to its equity accounted investments and other participating employers using a consistent allocation method intended to reflect a reasonable approximation of their share of the deficit. The deficit allocation method for all schemes is based on the BAE Systems Pension Scheme's (Main Scheme) schedule of contributions agreed with the sponsoring employers and trustees as part of the triennial funding valuations performed in 2014. Following completion of the triennial funding valuations, discussions have commenced between the participating employers on the allocation of the deficit. The outcome of those discussions will be reflected in the allocation of the IAS 19 deficit should agreement in principle be reached by the employers and the Trustees. In the event that an agreement is reached, any change to the amounts allocated would be dependent upon market conditions, in particular discount rates. The impact, if measured at 30 June 2015, would have been an increase of approximately 4% of the Group's share of the reported IAS 19 deficit. The Group's share of the IAS 19 pension deficit allocated to the equity accounted investments is included in the balance sheet within equity accounted investments. In the event that an employer who participates in the Group's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Group considers the likelihood of this event arising as remote.

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 2015 £m	31 December 2014 £m	**30 June 2015 £m**	31 December 2014 £m
Financial assumptions				
Discount rate (%)	**3.8**	3.6	**4.5**	4.1
Inflation (%)	**3.3**	3.2	**n/a**	n/a
Rate of increase in salaries (%)	**3.3**	3.2	**n/a**	n/a
Rate of increase in pensions in payment (%)	**1.9 – 3.7**	1.8 – 3.6	**n/a**	n/a
Rate of increase in deferred pensions (%)	**2.4/3.3**	2.3/3.2	**n/a**	n/a
Demographic assumptions				
Life expectancy of a male currently aged 65 (years)	**87 – 89**	87 – 89	**87**	87
Life expectancy of a female currently aged 65 (years)	**89 – 90**	89 – 90	**89**	89
Life expectancy of a male currently aged 45 (years)	**89 – 91**	89 – 91	**87**	87
Life expectancy of a female currently aged 45 (years)	**91 – 92**	91 – 92	**89**	89

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 30 June 2015 and keeping all other assumptions the same.

Financial assumptions

Changes in the following financial assumptions would have the following effect on the defined benefit pension obligation:

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

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

	(Increase)/ decrease £bn
Inflation:	
0.5 percentage point increase	(1.7)
0.5 percentage point decrease	1.6
1.0 percentage point increase	(3.4)
1.0 percentage point decrease	3.1

Demographic assumptions

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

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

7. Equity dividends

	Six months ended 30 June 2015 £m	Six months ended 30 June 2014 £m
Prior year final 12.3p dividend per ordinary share paid in the period (2014 12.1p)	**389**	383

The directors have declared an interim dividend of 8.4p per ordinary share (2014 8.2p), totalling £266m (2014 £259m). The dividend will be paid on 30 November 2015 to shareholders registered on 23 October 2015. The ex-dividend date is 22 October 2015.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 9 November 2015.

8. Fair value measurement

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

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

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

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

– the fair values of both interest rate and cross-currency swaps are calculated by discounting expected future principal and interest cash flows and translating at the appropriate balance sheet rates; and

– the fair values of loans and overdrafts have been estimated by discounting the future cash flows to net present values using appropriate market-based interest rates prevailing at 30 June.

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

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

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

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

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

Carrying amounts and fair values of certain financial instruments

	Carrying amounts	
	30 June 2015 £m	31 December 2014 £m
Financial instruments measured at fair value:		
Non-current		
Available-for-sale financial assets	**7**	7
Other receivables[1]	**241**	238
Other financial assets	**51**	38
Other financial liabilities	**(103)**	(79)
Loans	**(324)**	(325)
Other payables[1]	**(261)**	(262)
Current		
Other financial assets	**52**	46
Other financial liabilities	**(167)**	(107)
Financial instruments not measured at fair value:		
Non-current		
Loans	**(2,526)**	(2,543)
Current		
Cash and cash equivalents	**1,383**	2,308
Loans and overdrafts	**(485)**	(482)

1. Represents US deferred compensation plan assets and liabilities.

Financial assets and liabilities in the Group's Consolidated Balance Sheet are either held at fair value or their carrying value approximates to fair value, with the exception of loans, most of which are held at amortised cost.

The fair value of total loans and overdrafts estimated using market prices at 30 June 2015 is £3,661m (31 December 2014 £3,719m).

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.

9. Related party transactions

Transactions with related parties are shown on page 154 of the Annual Report 2014. The more significant transactions in the period are disclosed below:

	Six months ended 30 June 2015 £m	Six months ended 30 June 2014 £m
Sales to equity accounted investments	**928**	435
Purchases from equity accounted investments	**297**	57

	30 June 2015 £m	31 December 2014 £m
Amounts owed by equity accounted investments	**94**	92
Amounts owed to equity accounted investments	**578**	494