

BAE Systems plc

Preliminary Announcement 2019

Results in brief

Financial performance measures as defined by the Group ¹			Financial performance measures defined in IFRS ²		
	2019	2018		2019	2018
Sales	£20,109m	£18,407m	Revenue	£18,305m	£16,821m
Underlying EBITA ³	£2,117m	£1,928m	Operating profit ³	£1,899m	£1,605m
Underlying earnings per share ³			Basic earnings per share ³	46.4p	31.3p
excluding one-off tax benefit	45.8p	42.9p			
including one-off tax benefit	50.8p	42.9p			
Operating business cash flow ³	£1,307m	£993m	Net cash flow from operating activities ³	£1,597m	£1,200m
Net debt	£(743)m	£(904)m			
Order intake ⁴	£18,447m	£28,280m			
Order backlog ⁴	£45.4bn	£48.4bn			
Post-employment benefits and dividend					
	2019	2018			
Group's share of the net post-employment benefits deficit ⁵	£(4.5)bn	£(4.0)bn			
Dividend per share	23.2p	22.2p			

Charles Woodburn, Chief Executive, said: "2019 has been a year of significant progress for BAE Systems. We delivered a good set of financial results in line with guidance, growing sales and earnings, with improved operational performance and increased investment in the business to underpin our growth outlook. Strategically we took a number of actions to strengthen the portfolio and the pensions agreement announced today is good for all stakeholders. These will help to accelerate our strategy and further our growth outlook. We have a large order backlog and remain focused on strong programme performance to deliver a sustainable business model with enhanced financial performance."

Financial highlights

Financial performance measures as defined by the Group¹

- Sales increased by £1.7bn, a 7% increase, excluding the impact of currency translation⁶.
- Underlying EBITA increased to £2,117m, a 5% increase on a constant currency basis⁶ and excluding the impact of IFRS 16³.
- Underlying earnings per share³ increased by 7% to 45.8p (excluding the one-off tax benefit).
- Operating business cash flow³ increased by £314m to £1,307m.
- Net debt decreased to £743m.
- Order intake⁴ of £18.4bn.
- Order backlog⁴ of £45.4bn.

Financial performance measures defined in IFRS²

- Revenue increased by £1.5bn, a 7% increase, excluding the impact of currency translation⁶.
- Operating profit³ increased by £294m to £1,899m, including £27m of non-recurring charges (2018 £154m).
- Basic earnings per share³ increased by 48% to 46.4p.
- Net cash flow from operating activities³ increased by £397m to £1,597m. Under IFRS 16 net lease cash outflows of £273m are now classified under financing and investing activities.

Post-employment benefits and dividend

- Group's share of the pre-tax accounting net post-employment benefits deficit increased by £0.5bn to £4.5bn compared with 31 December 2018⁵.

- After consultation with the The Pensions Regulator in the UK, the Group has reached agreement with the Trustee Board of the combined pension scheme on the accelerated funding valuation and a revised deficit recovery plan.
- At the 31 October 2019 funding valuation date, the deficit was £1.9bn. The current deficit recovery plan which runs to 2026 will be replaced by a new deficit recovery plan, under which a one-off payment of £1bn is to be made in the coming months, with approximately £240m of funding payable in the scheme year ending 31 March 2020 and approximately £250m by 31 March 2021.
- Final dividend of 13.8p making a total of 23.2p per share for the year, an increase of 4.5% over 2018.

One-off tax benefit

- A one-off tax benefit of £161m was recognised in the year, arising from agreements reached in respect of overseas tax matters, net of a provision taken in respect of the estimated exposure arising from the EU's decision regarding the UK's Controlled Foreign Company regime.

1. We monitor the underlying financial performance of the Group using alternative performance measures. These measures are not defined in International Financial Reporting Standards (IFRS) and, therefore, are considered to be non-GAAP (Generally Accepted Accounting Principles) measures. Accordingly, the relevant IFRS measures are also presented where appropriate. For alternative performance measure definitions see glossary on page 12.
2. International Financial Reporting Standards.
3. The financial impact of the adoption of IFRS 16 Leases is described on page 15, 16, 18, 19 and 53.
4. Including share of equity accounted investments.
5. The Saudi Arabia end of service benefit obligation of £97m at 31 December 2018 has been reclassified from trade and other payables to post-employment benefit obligations.
6. Current year compared with prior year translated at current year exchange rates.

Operational and strategic key points

Air

- Qatar Typhoon and Hawk aircraft programme met its contractual milestones in the year. Contract amendment agreed to accelerate Typhoon deliveries
- F-35 programme Lots 12 to 14 price negotiations concluded. 142 rear fuselage assemblies delivered in the year in line with ramp-up to full rate production in 2020
- Tempest technology maturation programme contracted between industry and UK government. Italy and Sweden governments committed to working with UK to develop next-generation combat air capability
- The first four Hawk aircraft assembled in Saudi Arabia were accepted and entered service in-Kingdom
- UK Tornado fleet successfully retired from service on schedule following RAF declaration that Typhoon had met Centurion standard with embodiment across the Typhoon fleet
- The design and production readiness phase of the Hunter Class programme for the Royal Australian Navy continues to make good progress

Maritime

- HMS Prince of Wales vessel acceptance achieved in December
- Four River Class Offshore Patrol Vessels have now been accepted, with the programme on target for completion in 2020
- Construction commenced on second of the three contracted Type 26 frigates in August
- Construction of the first Dreadnought Class submarine continues to advance, with £1.4bn of funding received in the year
- Sea trials for the fourth Astute Class submarine are due to take place in 2020
- A £230m seven-year Torpedo Repair and Maintenance contract was awarded
- The UK combat vehicles joint venture between Rheinmetall and BAE Systems Land UK was launched on 1 July
- Design requirements for the Canadian Surface Combatant are progressing towards finalisation with partners and the Royal Canadian Navy

Electronic Systems

- Growing demand for Advanced Precision Kill Weapon System (APKWS®) laser-guided rockets, with production awards totalling over \$400m (£302m) received in the year
- Over 500 electronic warfare systems delivered for the F-35 Lightning II programme, and awarded production and Block 4 modernisation contracts worth more than \$750m (£566m)
- Acquired Riptide Autonomous Solutions to advance capabilities in maritime mission requirements
- Continuing growth in space resilience domain
- Establishing new facilities in Huntsville, Alabama and Manchester, New Hampshire to meet the record order backlog
- Active interceptors certified for Gulfstream G500 and G600 jets and in production
- Battery electric and fuel cell electric transit systems recorded five million zero emission miles

Platforms & Services (US)

- Deliveries of the M109A7 self-propelled howitzer and ammunition carrier vehicle sets are progressing and the decision to proceed to full-rate production was made in Q1 2020
- First deliveries achieved of the Amphibious Combat Vehicle to the US Marine Corps
- Contract modification award of \$575m (£434m) received for LRIP vehicles on the Armored Multi-Purpose Vehicle programme
- Work underway to upgrade 332 vehicles to the Bradley A4 configuration
- Awarded contracts worth \$466m (£352m) to upgrade configuration on various M88 vehicles
- First tandem docking of two large warships in San Diego dry-dock for contracts worth more than \$170m (£128m)

- Deliveries continue of the M777 ultra-lightweight howitzer to the Indian Army, with subsequent systems to be assembled at the Mahindra Defence Systems facility

Cyber & Intelligence

- Received orders exceeding \$100m (£76m) to provide logistics sustainment support to US Air Force Space Command
- Awarded \$437m (£330m) task order to provide open source support to US Army and Army Intelligence & Security Command approved partners
- Technology offerings further developed and the business achieved four Amazon Web Services designations, recognising our technical proficiency and operational excellence
- Divestment of the Silversky business and exit from the UK-based Managed Security Services business in progress at year-end. Restructuring charge of £20m recognised in the year
- Strong order intake and revenue growth in the Government business unit

Guidance for 2020

Whilst the Group is subject to geopolitical uncertainties, the following guidance is provided on current expected operational performance.

Impacts from the proposed acquisitions announced in January of the Collins Aerospace Military Global Positioning business and Raytheon's Airborne Tactical Radios business are not included in the following guidance.

Group guidance

For the year ending 31 December 2020, the Group's underlying earnings per share is expected to grow by mid-single digit percentage compared to the full-year underlying earnings per share in 2019 of 45.8p, assuming a \$1.30 to sterling exchange rate.

The guidance is based on the measures used to monitor the underlying financial performance of the Group. Reconciliations from these measures to the financial performance measures defined in International Financial Reporting Standards for 2019 are provided on pages 14 to 16.

Segmental guidance

Electronic Systems:

- Sales, in US dollar terms, are expected to show mid-single digit percentage growth driven by a number of electronic warfare contracts including F-35. Some 70% of projected sales are in the 2019 closing order backlog, similar to last year.
- Margin¹ is expected to be at the higher end of our 14% to 16% range.

Cyber & Intelligence:

- In aggregate, we expect sales to be in line with 2019.
- The US business, which represented some 70% of this segment in 2019, is expected to show low-single digit percentage growth.
- In the Applied Intelligence business we expect good top line expansion in the Government and Financial Services areas. However, the proposed disposal of the Silversky business is expected to reduce sales by approximately \$100m.
- Margin¹ in 2020 is expected to improve into the 7% to 8% range. The US business is again expected to contribute around the 8% to 9% mark. In Applied Intelligence we expect the business to move back into profitability absent the restructuring charge and following the exit of the two proposed business disposals.

Platforms & Services (US):

- Sales, in US dollar terms, are expected to show high-single digit percentage growth, with increasing volumes from the US Combat Vehicles backlog and in ship repair. More than 80% of guidance is within the closing order backlog, similar to last year.
- Margin¹ is expected to remain at the low end of the 8% to 9% range. The ramp-up of vehicle deliveries primarily on the Armored Multi-Purpose Vehicle together with trading of the Mobile Protected Firepower development programme will continue to be at initial low margin levels.

Air:

- Sales are expected to show mid-single digit percentage growth, for increased activity on the Qatar Typhoon and Hawk programme and on F-35 as full rate production levels are achieved. Close to 90% of sales guidance is within the closing order backlog.
- Margin¹ is expected to be lower than 2019, towards the bottom end of our 11% to 13% range. There is a headwind from higher pension service costs, as well as the further increase in self-funded research and development expenditure on the Tempest programme. Partly offsetting these is an expected step up in Qatar margin recognition.

Maritime:

- Sales are expected to be stable overall. Activity on the Carrier and Offshore Patrol Vessel programmes is almost complete. These are offset by increases in the Dreadnought submarine and Type 26 programmes. Around 80% of guidance is already covered by the order backlog.
- Margin¹ levels are expected to be at the top end of our 8% to 9% range.

HQ:

- HQ costs are expected to be slightly lower than in 2019.
- Underlying finance costs are expected to be around 10% less. There will be a full-year of benefit following the repayment of the high coupon \$1bn bond in June 2019. Net present value charges will also be lower. These will be partly offset by the cost of the term debt to support the planned £1bn of accelerated pension deficit funding.
- The underlying effective tax rate is expected to increase from 19% to around 20%, with the final rate dependent on the geographical mix of profits.
- Minority interest is expected to increase to around £75m as we complete further sell downs in our Saudi partner companies.
- The Group is targeting free cash flow of £3.5bn to £3.8bn in the three-year period 2020 to 2022, with close to £1bn expected in 2020.

1. Underlying EBITA as a percentage of sales.

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Analyst and investor presentation

A presentation, for analysts and investors, of the Group's Results for 2019 will be available via webcast at 9.00am today (20 February 2020).

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

About BAE Systems

At BAE Systems, we provide some of the world's most advanced, technology-led defence, aerospace and security solutions.

We employ a skilled workforce of 87,800 people¹ in more than 40 countries. We help our customers to stay a step ahead when protecting people and national security, critical infrastructure and vital information. We also work closely with local partners to support economic development through the transfer of knowledge, skills and technology.

1. Including share of equity accounted investments.

Preliminary results statement

Introduction

In 2019, BAE Systems delivered a good set of financial results underpinned by improving operational performance. Governments in key markets continue to prioritise defence and security and there is a strong demand for the Group's capabilities, products and services.

BAE Systems is a resilient company with long-term strength from its programmes, technologies, customer relationships and sustainability agenda. The Group maintained its strong balance between production and aftermarket services in terms of both revenue and margin, and the geographic mix of the business continued to evolve as the US and International business continued to grow and UK and Kingdom of Saudi Arabia revenues remained stable. Following the significant international wins in recent years, as these programmes ramp-up they will become the second-largest revenue drivers for the Group behind its US-based businesses.

The Group strategy remains focused, consistent and is delivering results. Execution on the key strategic objectives of operational excellence, competitiveness and technological innovation is vital for the successful delivery of the order backlog, to deliver future growth and a high-performing sustainable business. Good progress in all areas was made in 2019.

Operationally, programme performance improvement is now being delivered. The business will continue to drive programme performance to ensure successful delivery of its order backlog and the expected improvements in long-term cash generation. However, safety performance in the year fell below the Group's high expectations. The safety and wellbeing of employees is paramount. To that end, the Group has sought external expertise to review a number of its sites and strengthened the team with new heads of safety in the UK and US to refocus and sharpen thinking in this critical area.

Investment in self-funded research and development increased in the year and the Group's portfolio was further bolstered by two technology-focused acquisitions. The business aims to further increase technology funding in the coming years especially in Air and Electronic Systems as it looks to maintain and enhance its long-term strategic positions.

2019 performance

US

The Group's US-based portfolio remains well aligned with customer priorities and the key focus areas outlined in the US National Defense Strategy.

The passage and signing of the fiscal year 2020 Defense Appropriations bill ended the Continuing Resolution and maintained funding support for many key BAE Systems programmes, including combat vehicles, F-35, electronic warfare programmes, and current and future precision weapons systems.

The fiscal year 2020 measure includes a top line budget of \$738bn for defence, a 3% increase over 2019, and lawmakers have already agreed to a bipartisan deal setting the defence spending caps for fiscal year 2021 at \$740.5bn. Whilst the Group remains cautiously optimistic about the budget process, numerous ongoing political issues may continue to detract from the timely passage of appropriations legislation.

The US electronics business delivered another standout operational performance in 2019, especially in its core franchise positions in the high-technology areas of electronic warfare, precision-guided munitions, Intelligence, Surveillance and Reconnaissance, and electro-optics. The business closed with a record order backlog and the outlook for all its defence-focused divisions is positive with the portfolio well positioned to address key growth areas. These capabilities are also being leveraged on international as well as domestic programmes. The Controls and Avionics and Power and Propulsion Solutions businesses are leveraging capabilities from the Group's defence base to provide adjacencies into the commercial markets, giving exposure to the expanding civil aerospace market through the engine and flight control franchises.

The business remains focused on investment in emerging technologies and leveraging customer funding to maintain, develop and grow its strong market positions. Aligned with this strategy, Electronic

Systems acquired the Riptide Autonomous Solutions business, a developer of unmanned underwater vehicles, in June 2019.

In January 2020, the Group announced two asset purchase agreements worth a total estimated \$2.2bn for the proposed acquisitions of Collins Aerospace's Military Global Positioning System business and Raytheon's Airborne Tactical Radios business, both of which would be integrated into the Electronic Systems portfolio. These proposed acquisitions are conditional upon the successful closing of the pending Raytheon and United Technologies Corporation merger, as well as other customary closing conditions and required US regulatory approvals.

Platforms & Services (US) made steady progress in addressing its operational challenges. The US-based combat vehicles business is implementing a number of process and automation improvements to meet increased production volumes across multiple programmes with lessons learned being applied across the portfolio. The M109A7 met its delivery targets in the second half of the year and initial deliveries were made on the Amphibious Combat Vehicle programme. Further contract awards were received for the M88A3 modernisation and Bradley A4 programmes, strengthening the order backlog. Looking into 2020 the business will have three upgrade and three new-build programmes ramping up through its facilities.

The sector continued to shape its market-leading US naval ship repair business, maintaining a strong bid pipeline for repair and modernisation services, and working with the US Navy to improve utilisation levels. To this end, it was a strategic step forward in October when the first destroyer tandem docking in the Group's San Diego facility was achieved. The ship repair and naval guns franchises are well supported by the growth outlook in the US Navy budget and projected fleet size. With the delivery of the final constructed ship in March and the sale of the Mobile shipyard, the business exited commercial shipbuilding.

The US-based Intelligence & Security business is maintaining a high level of bid activity and a strong pipeline despite a highly competitive and evolving market. The business is delivering on contracts with good programme and financial performance in the year.

UK

The UK is Europe's largest defence market. The UK government recently stated its commitment to uphold the NATO commitment to spend at least 2% of Gross Domestic Product on defence, and to increase the defence budget by at least 0.5% above inflation, in every year of the current parliament. The government is also expected to launch an Integrated Foreign Policy, Defence and Security Review during the course of 2020.

The work under the Team Tempest contract to develop next-generation combat air technologies, skills and expertise, in collaboration with UK government and industry partners, continues at pace. In the second half of the year the commitment of both Sweden and Italy to work with the UK on creating next-generation combat air capability was a welcome development.

During 2019, the Group remained focused on the execution of its long-term contracted positions in Air and Maritime.

In Air, the production ramp-up of rear fuselage assemblies for the F-35 Lightning II aircraft progressed well with 142 sets delivered. Full-rate production levels of approximately 160 sets are targeted in 2020. As the UK and global fleets grow, securing a long-term support position on the F-35 Lightning II remains a key focus.

With imminent completion of the current partner nation deliveries, Typhoon production is now focused on the sub-assembly build on the Kuwait and Qatar programmes, which sustain production into the mid-2020s. The potential pipeline for Typhoon additional orders remains positive, with opportunities both with partner nations and through exports with existing and new customers. Securing additional orders would extend production revenue levels.

Typhoon support delivered the expected operational performance levels and, with the Centurion standard having been declared, the UK Tornado fleet successfully retired from service on schedule.

In Maritime, the aircraft carrier build programme was completed with HMS Prince of Wales being accepted by the customer. The Offshore Patrol Vessels programme stabilised in the year delivering the second and third ships. The fourth ship was accepted by the customer in February 2020, and the final ship is expected to complete this year. Manufacturing work on the Type 26 programme in the UK continues to increase following cut steel on the second ship in August. Activity on the Dreadnought programme ramped up throughout the year with revenues now exceeding those on the Astute programme. The associated major programme of building works continued to progress.

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

The Group has relatively limited UK-EU trading and the majority of persons employed in the UK are UK nationals, with only limited movement of EU nationals into and out of the Group's UK businesses. Accordingly, the resulting Brexit near-term impacts across the business are likely to be limited.

International

BAE Systems' defence and security capabilities remain highly relevant in an uncertain global environment with complex threats. During 2019, the Group further widened its international reach through the export win in Canada and a number of Foreign Military Sales through the Electronic Systems business. There are good prospects in existing and new international markets for the Group's products and services in air, maritime, land and cyber security. Defence and security remains high on national agendas with the need in many cases to recapitalise or upgrade ageing equipment.

In Saudi Arabia, BAE Systems continues to work closely with industry partners and UK government to ensure that the export licences required to enable the Group to fulfil its contractual obligations in the Kingdom are in place. On the Hawk programme, the first in-Kingdom final assembled aircraft were completed and entered into service.

BAE Systems continues to address current and potential new requirements as part of long-standing agreements between the UK government and the Saudi Arabian government as the Group continues to work on the localisation of defence capabilities in Saudi Arabia, in support of the Saudi Arabian government's National Transformation Plan and Vision 2030. Over many years, the Group has developed and taken shareholdings in local Saudi businesses. The Group is restructuring its portfolio of interests in these businesses and in the year, it disposed of its shareholding in Aircraft Accessories and Components Company. Following the Group's subsidiary, Overhaul and Maintenance Company, entering into a heads of terms for the sale of its 50% shareholding in Advanced Electronics Company to Saudi Arabian Military Industries, negotiations are continuing and the transaction is expected to take place in 2020.

In Qatar the contract between BAE Systems and the Government of the State of Qatar for the supply of 24 Typhoon and nine Hawk aircraft to the Qatar Amiri Air Force, along with a bespoke support and training package, is meeting its contractual milestones with Typhoon aircraft delivery now aligned to an accelerated schedule which was agreed in the year.

In Australia, the initial four-year design and productionisation phase on the Hunter Class programme commenced and the first formal integrated baseline review is scheduled to commence in Q1 2020. Production of the first ship is expected to commence in South Australia in the early 2020s. This Hunter Class programme will, over time, double the size of the Group's current Australian business.

Following contract signing in February 2019, BAE Systems is providing the design, based on the Type 26, for the Canadian Surface Combatant programme. Mobilisation activities are progressing on the programme.

Whilst operating under a difficult geopolitical backdrop, the MBDA joint venture has continued to win orders in both domestic and international markets. The business continues to invest in new products and is well placed to benefit from defence spend increases in a number of European countries and international opportunities.

Cyber security

In the Group's Applied Intelligence business, the UK Government Services division performed well. Following a strategic review, the Group commenced a process for the disposal of the Applied Intelligence US-based software-as-a-service business and decided to exit the UK-based Managed Security Services business. Cyber security is an increasingly important part of government security and a core element of stewardship for companies in a sophisticated and persistent threat environment. The services and products the Group offers in the remaining core business, including the Financial Services division, are expected to drive growth and improved returns as the market continues to develop.

Balance sheet and capital allocation

The Group's balance sheet is managed conservatively, in line with its policy, to retain its investment grade credit rating and to ensure operating flexibility.

Consistent with this approach, the Group expects to continue to meet its pension obligations, invest in research and technology and pursue other organic investment opportunities, and plans to pay dividends in line with its policy of long-term sustainable cover of around two times underlying earnings.

Investment in value-enhancing acquisitions and returns to shareholders through a share buyback will be considered in line with the Group's clear and consistent strategy and capital allocation policy.

A \$1bn 6.375% bond, of which \$500m had been converted to a floating rate bond by utilising interest rate swaps, matured and was repaid in June 2019.

Post-employment benefits schemes

The Group's share of the pre-tax accounting net post-employment benefits deficit increased to £4.5bn (2018 £4.0bn). The impact of lower discount rates increasing liabilities was in some part offset by good asset returns and changes in mortality assumptions.

In October 2019, six of the Group's nine UK pension schemes (including the two largest schemes) were consolidated into a single scheme. Following that consolidation, the Company agreed with the new Trustee Board to bring forward the funding valuation of the combined scheme to 31 October 2019 from the previously scheduled date of 31 March 2020.

After consultation with the The Pensions Regulator in the UK, the Group has reached agreement with the Trustee Board of the combined scheme on the accelerated funding valuation and revised deficit recovery plan.

At the 31 October 2019 funding valuation date, the deficit was £1.9bn. The current deficit recovery plan which runs to 2026 will be replaced by a new deficit recovery plan, under which a one-off payment of £1bn is to be made in the coming months, with approximately £240m of funding payable in the scheme year ending 31 March 2020 and approximately £250m by 31 March 2021.

Board and Executive Committee changes

Nicole Piasecki and Stephen Pearce were appointed to the Board as non-executive directors on 1 June 2019. Harriet Green retired from the Board on 7 November 2019, having served as a non-executive director for nine years. As previously announced, Peter Lynas and Jerry DeMuro will retire from the Board on 31 March 2020. With effect from 1 April 2020, they will be succeeded by Brad Greve and Tom Arseneault, respectively. On joining the Board, Mr Greve will be appointed Group Finance Director, and Mr Arseneault will be appointed President & Chief Executive Officer of BAE Systems, Inc.. Nick Rose, a non-executive director, will retire from the Board on 31 March 2020.

At the start of 2019 David Armstrong was appointed as Group Business Development Director following Alan Garwood's retirement. In June, Mark Phillips was appointed Group Communications Director and in May, Andrew Wolstenholme left the Company and was replaced by Glynn Phillips as Group Managing Director Maritime. Brad Greve joined the Executive Committee in September following his appointment as Group Finance Director designate. At the start of 2020 Ben Hudson was appointed as Chief Technology Officer, replacing Nigel Whitehead who announced his intention to retire.

Summary

The business benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia. The Group's strategy is clear and well defined with

governments in its key markets continuing to prioritise defence and security, with strong demand for the Group's capabilities. Through execution of its strategy, BAE Systems is well placed to maximise opportunities, deal with the challenges and deliver a business focused on sustainability and generating shareholder value.

Dividends

The Board has recommended a final dividend of 13.8p for a total of 23.2p for the full year. Subject to shareholder approval at the May 2020 Annual General Meeting, the dividend will be paid on 1 June 2020 to holders of ordinary shares registered on 17 April 2020.

Glossary

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

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

* Non-recurring items are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying business performance. The Group's definition of non-recurring items includes profit or loss on business transactions, and costs incurred which are one-off in nature, for example non-routine costs or income relating to post-retirement benefit schemes, and other exceptional items which management has determined as not being relevant to an understanding of the Group's underlying business performance.

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

Income statement

	2019 £m	2018 £m
Financial performance measures as defined by the Group¹		
Sales	20,109	18,407
Underlying EBITA	2,117	1,928
Return on sales	10.5%	10.5%
Financial performance measures defined in IFRS²		
	£m	£m
Revenue	18,305	16,821
Operating profit	1,899	1,605
Return on revenue	10.4%	9.5%
Reconciliation of sales to revenue		
	£m	£m
Sales	20,109	18,407
<i>Deduct</i> Share of sales by equity accounted investments	(2,878)	(2,812)
<i>Add</i> Sales to equity accounted investments	1,074	1,226
Revenue	18,305	16,821
Reconciliation of underlying EBITA to operating profit		
	£m	£m
Underlying EBITA	2,117	1,928
Non-recurring items	(27)	(154)
Amortisation of intangible assets	(109)	(85)
Impairment of intangible assets	(6)	(33)
Financial expense of equity accounted investments	(23)	(13)
Taxation expense of equity accounted investments	(53)	(38)
Operating profit	1,899	1,605
Net finance costs	(273)	(381)
Taxation expense	(94)	(191)
Profit for the year	1,532	1,033
Underlying net interest expense ³	(257)	(215)
Net interest expense on post-employment benefit obligations	(117)	(106)
Fair value and foreign exchange adjustments on financial instruments and investments	78	(73)
Net finance costs (including equity accounted investments)	(296)	(394)
Exchange rates		
	2019	2018
Average		
£/\$	1.277	1.335
£/€	1.141	1.130
£/A\$	1.836	1.786
Year end		
£/\$	1.324	1.274
£/€	1.180	1.114
£/A\$	1.884	1.809
Sensitivity analysis		
	£m	
Estimated impact on sales of a ten cent movement in the average exchange rate:		
\$	675	
€	100	
A\$	40	

1. For alternative performance measure definitions see glossary on page 12.

2. International Financial Reporting Standards.

3. Underlying net interest expense is defined as finance costs for the Group and its share of equity accounted investments, excluding net interest expense on post-employment benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.

Sales increased by £1.7bn to £20.1bn (2018 £18.4bn), a 7% increase on a constant currency basis.

Underlying EBITA increased to £2,117m (2018 £1,928m), giving a return on sales of 10.5% (2018 10.5%). Excluding the impacts of IFRS 16 and exchange translation, growth was 5%.

Revenue increased by £1.5bn to £18.3bn (2018 £16.8bn), a 7% increase on a constant currency basis.

Operating profit increased by £294m to £1,899m (2018 £1,605m). There was a favourable exchange translation impact of £36m.

Non-recurring items in 2019 of £27m comprises a £36m charge relating to the derecognition of Enterprise Resource Planning software intangible assets in the Air sector, charges of £13m relating to legal disputes arising from historical disposals, a gain of £14m on the sale of the Group's 55% shareholding in BAE Systems Global Combat Systems Limited upon formation of the Rheinmetall BAE Systems Land joint venture, and a gain of £8m relating to the disposal of the Aircraft Accessories and Components Company. Non-recurring items in 2018 of £154m represented a Guaranteed Minimum Pension equalisation charge of £114m, and a loss on disposal of the Mobile, Alabama, shipyard of £40m.

Amortisation of intangible assets is £109m (2018 £85m), the increase mainly a result of new IT systems becoming operational.

Impairment of intangible assets in 2019 is £6m. In 2018 the charge represented the impairment of Silversky customer-related intangibles in the Applied Intelligence business.

Net finance costs, including equity accounted investments, were £296m (2018 £394m). The underlying interest charge, excluding pension accounting, and fair value and foreign exchange adjustments on financial instruments and investments increased to £257m (2018 £215m). Net interest expense on the Group's pension deficit was £117m (2018 £106m). There was a credit in respect of fair value and foreign exchange adjustments of £78m (2018 £73m charge) on exchange translation of US dollar-denominated bonds.

IFRS 16 Leases has been applied for the first time in 2019, and as a result underlying EBITA and operating profit are both approximately £50m higher than the prior year as a depreciation charge on leased assets is reported, rather than the operating lease expense previously recognised. Net finance costs have also increased under IFRS 16 by approximately £50m owing to the recognition of the interest charge element of the lease liabilities.

Taxation expense, including equity accounted investments, of £147m (2018 £229m) reflects the Group's underlying effective tax rate for the year of 19%, less a £161m credit in respect of two items. Following agreements reached in respect of overseas tax matters, a one-off benefit has been recognised; and, following review of the April 2019 EU Commission decision that concluded that the UK's Controlled Foreign Company regime partially represents State Aid, a provision has been recognised for the estimated exposure. The underlying effective rate increased to 19% from 18% in 2018.

The underlying effective tax rate for 2020 is expected to increase from 19% to around 20%, with the final rate dependent on the geographical mix of profits.

Earnings per share

	2019	2018
Financial performance measures as defined by the Group¹		
Underlying earnings (excluding the one-off tax benefit)	£1,457m	£1,370m
Underlying earnings per share (excluding the one-off tax benefit)	45.8p	42.9p
Underlying earnings (including the one-off tax benefit)	£1,618m	£1,370m
Underlying earnings per share (including the one-off tax benefit)	50.8p	42.9p
Financial performance measures defined in IFRS²		
Profit for the year attributable to equity shareholders	£1,476m	£1,000m
Basic earnings per share	46.4p	31.3p
Reconciliation of underlying EBITA to underlying earnings		
	£m	£m
Underlying EBITA	2,117	1,928
Underlying net interest expense (including equity accounted investments) ³	(257)	(215)
	1,860	1,713
Taxation expense (at the underlying effective tax rate, excluding the one-off tax benefit)	(347)	(310)
Non-controlling interests	(56)	(33)
Underlying earnings (excluding the one-off tax benefit)	1,457	1,370
One-off tax benefit	161	–
Underlying earnings (including the one-off tax benefit)	1,618	1,370
Reconciliation of underlying earnings to profit for the year attributable to equity shareholders		
	£m	£m
Underlying earnings (excluding the one-off tax benefit)	1,457	1,370
Non-recurring items, post tax	(18)	(126)
Amortisation and impairment of intangible assets, post tax	(93)	(97)
Net interest expense on post-employment benefit obligations, post tax	(95)	(87)
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	64	(60)
One-off tax benefit	161	–
Profit for the year attributable to equity shareholders	1,476	1,000
Non-controlling interests	56	33
Profit for the year	1,532	1,033

Underlying earnings per share excluding the one-off tax benefit for the year increased by 7% to 45.8p (2018 42.9p). Underlying earnings per share including the one-off tax benefit for the year was 50.8p.

Basic earnings per share was 46.4p (2018 31.3p).

The application of IFRS 16 Leases for the first time in 2019 has had no material impact on earnings per share.

1. For alternative performance measure definitions see glossary on page 12.

2. International Financial Reporting Standards.

3. Underlying net interest expense is defined as finance costs for the Group and its share of equity accounted investments, excluding net interest expense on post-employment benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.

Cash flow

	2019 £m	2018 £m
Financial performance measures as defined by the Group¹		
Operating business cash flow	1,307	993
Financial performance measures defined in IFRS²		
Net cash flow from operating activities	1,597	1,200
Reconciliation from operating business cash flow to net cash flow from operating activities		
	£m	£m
Operating business cash flow	1,307	993
Add back Net capital expenditure and financial investment	454	464
Add back Principal element of lease payments and receipts	230	–
Deduct Dividends received from equity accounted investments	(142)	(57)
Deduct Taxation	(252)	(200)
Net cash flow from operating activities	1,597	1,200
Net capital expenditure and financial investment	(454)	(464)
Principal element of finance lease receipts	9	–
Dividends received from equity accounted investments	142	57
Interest received	28	25
Acquisitions and disposals ³	43	24
Net cash flow from investing activities	(232)	(358)
Interest paid	(233)	(203)
Net sale of own shares	–	1
Equity dividends paid	(724)	(703)
Partial disposal of shareholding in subsidiary undertaking ³	31	17
Dividends paid to non-controlling interests	(56)	(28)
Principal element of finance lease payments	(239)	–
Cash flow from matured derivative financial instruments (excluding cash flow hedges)	40	6
Movement in cash collateral	1	2
Net cash flow from loans	(782)	(7)
Net cash flow from financing activities	(1,962)	(915)
Net decrease in cash and cash equivalents	(597)	(73)
Add back Net cash flow from loans	782	7
Foreign exchange translation	72	(188)
Other non-cash movements	(96)	102
Decrease/(increase) in net debt	161	(152)
Opening net debt	(904)	(752)
Net debt	(743)	(904)
	£m	£m
Operating business cash flow	1,307	993
Interest paid, net of interest received	(205)	(178)
Taxation	(252)	(200)
Free cash flow (as defined by the Group)⁴	850	615

1. For alternative performance measure definitions see glossary on page 12.

2. International Financial Reporting Standards.

3. 2018 comparatives have been reclassified to present a cash inflow of £17m in respect of a partial disposal of the Group's shareholding in a subsidiary undertaking within financing activities. This cash flow was previously presented within investing activities.

4. Free cash flow is defined as operating business cash flow less interest paid (net) and taxation.

Operating business cash inflow was £1,307m (2018 £993m), which includes cash contributions in respect of pension deficit funding, over and above service costs, for the UK and US schemes totalling £231m on a funding basis.

Net cash inflow from operating activities was £1,597m (2018 £1,200m). Under IFRS 16 net lease cash outflows of £273m are now classified under financing and investing activities.

Taxation payments increased to £252m (2018 £200m) partly reflecting payments in Australia following the end of utilisation of prior year losses.

Net capital expenditure and financial investment was £454m (2018 £464m).

Dividends received from equity accounted investments of £142m (2018 £57m) were primarily receipts from MBDA (£73m), Advanced Electronics Company (£38m) and FNSS (£17m).

Interest received was £28m (2018 £25m).

The cash inflows in respect of **acquisitions, disposals, held for sale assets** and the **partial disposal of shareholdings in subsidiary undertakings** represent the disposal of Aircraft Accessories and Components Company (£26m), the disposal of the UK-based land vehicles business into the RBSL joint venture (£29m), the reduction in the Group's shareholding in Overhaul and Maintenance Company (£31m) (2018 £17m), less the investment in Riptide Autonomous Solutions (£9m) and the Prismatic acquisition (£3m). The cash inflow in 2018 of £24m included cash acquired as part of the ASC Shipbuilding acquisition (£14m) and cash received on the sale of the Mobile, Alabama, shipyard (£12m).

Interest paid was £233m (2018 £203m).

Equity dividends paid in 2019 represents the 2018 final (£423m) and 2019 interim (£301m) dividends.

Dividends paid to non-controlling interests increased to £56m (2018 £28m), reflecting a higher payment by Saudi Maintenance & Supply Chain Management Company, in which the Group has a 51% shareholding.

There was a **cash inflow from matured derivative financial instruments** of £40m (2018 £6m), arising from rolling hedges relating to balances within the Group's subsidiaries and equity accounted investments.

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

Net debt

	2019 £m	2018 £m
Components of net debt		
Cash and cash equivalents	2,587	3,232
Debt-related derivative financial instruments (net)	67	163
Loans – non-current	(3,020)	(3,514)
Loans and overdrafts – current	(377)	(785)
Net debt	(743)	(904)

The Group's **net debt** at 31 December 2019 is £743m, a net decrease of £161m from the position at the start of the year. The \$1bn 6.375% bond, of which \$500m had been converted into a floating rate bond by utilising interest rate swaps, matured and was repaid in June 2019.

Cash and cash equivalents of £2,587m (2018 £3,232m) are held primarily for the repayment of debt securities, pension deficit funding, payment of the 2019 final dividend and management of working capital.

Accounting policies

Changes in accounting policies

With effect from 1 January 2019, the Group adopted IFRS 16 Leases. This results in almost all leases being recognised on the balance sheet by lessees. The Group has applied the modified retrospective transition approach and therefore has not restated comparative amounts for the year ended 31 December 2018.

Underlying EBITA and operating profit are both approximately £50m higher than the prior year as a depreciation charge on leased assets is reported, rather than the operating lease expense previously recognised. Net finance costs have also increased under IFRS 16 by approximately £50m owing to the recognition of the interest charge element of the lease liabilities.

There are no accounting policy changes which are expected to have a significant impact on the Group with effect from 1 January 2020.

Segmental review

The Group reports its performance through five principal reporting segments.

	Year ended 31 December 2019									
	As defined by the Group					Defined in IFRS ¹				
	Sales £m	Underlying EBITA £m	Return on sales %	Operating business cash flow £m	Order intake ² £m	Order backlog ² £bn	Revenue £m	Operating profit/ (loss) £m	Return on revenue %	Net cash flow from operating activities £m
Electronic Systems	4,439	687	15.5	672	5,023	6.0	4,439	672	15.1	833
Cyber & Intelligence	1,732	91	5.3	68	1,846	1.8	1,732	80	4.6	99
Platforms & Services (US)	3,337	267	8.0	241	4,020	5.8	3,185	239	7.5	305
Air	7,457	887	11.9	408	4,594	23.9	6,153	777	12.6	497
Maritime	3,116	268	8.6	150	2,875	8.6	3,071	253	8.2	289
HQ ³	387	(83)		(232)	386	–	43	(122)		(174)
Deduct Intra-group	(359)				(297)	(0.7)	(318)			
Deduct Taxation ⁴										(252)
Total	20,109	2,117	10.5	1,307	18,447	45.4	18,305	1,899	10.4	1,597

	Year ended 31 December 2018									
	As defined by the Group					Defined in IFRS ¹				
	Sales £m	Underlying EBITA £m	Return on sales %	Operating business cash flow £m	Order intake ² £m	Order backlog ² £bn	Revenue £m	Operating profit/ (loss) £m	Return on revenue %	Net cash flow from operating activities £m
Electronic Systems	3,965	606	15.3	431	4,624	5.4	3,965	590	14.9	575
Cyber & Intelligence	1,678	111	6.6	85	1,802	1.9	1,678	59	3.5	96
Platforms & Services (US)	3,005	210	7.0	(30)	3,693	5.4	2,864	161	5.6	31
Air	6,712	859	12.8	666	14,845	27.4	5,579	810	14.5	719
Maritime	2,975	209	7.0	67	3,513	9.0	2,940	191	6.5	190
HQ ³	350	(67)		(226)	358	0.1	41	(206)		(211)
Deduct Intra-group	(278)				(555)	(0.8)	(246)			
Deduct Taxation ⁴										(200)
Total	18,407	1,928	10.5	993	28,280	48.4	16,821	1,605	9.5	1,200

1. International Financial Reporting Standards.

2. Including share of equity accounted investments.

3. HQ comprises the Group's head office activities, together with a 49% interest in Air Astana.

4. Taxation is managed on a Group-wide basis.

Segmental performance: Electronic Systems

Electronic Systems, with 16,600 employees¹, comprises the US- and UK-based electronics activities, including electronic warfare systems, electro-optical sensors, military and commercial digital engine and flight controls, precision guidance and seeker solutions, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

Operational and strategic key points

- Growing demand for Advanced Precision Kill Weapon System (APKWS[®]) laser-guided rockets, with production awards totalling over \$400m (£302m) received in the year
- Over 500 electronic warfare systems delivered for the F-35 Lightning II programme, and awarded production and Block 4 modernisation contracts worth more than \$750m (£566m)
- Acquired Riptide Autonomous Solutions to advance capabilities in maritime mission requirements
- Continuing growth in space resilience domain
- Establishing new facilities in Huntsville, Alabama and Manchester, New Hampshire to meet the record order backlog
- Active interceptors certified for Gulfstream G500 and G600 jets and in production
- Battery electric and fuel cell electric transit systems recorded five million zero emission miles

Financial performance

	Financial performance measures as defined by the Group ²		Financial performance measures defined in IFRS ³	
	2019	2018	2019	2018
Sales	£4,439m	£3,965m	Revenue	£4,439m £3,965m
Underlying EBITA	£687m	£606m	Operating profit	£672m £590m
Return on sales	15.5%	15.3%	Return on revenue	15.1% 14.9%
Operating business cash flow	£672m	£431m	Cash flow from operating activities	£833m £575m
Order intake ¹	£5,023m	£4,624m		
Order backlog ¹	£6.0bn	£5.4bn		

- Sales compared to 2018 were up 7% at \$5.7bn (£4.4bn). Growth in the defence business was at 9% driven by the F-35 programme, APKWS[®] volumes and increased classified activity. Commercial sales of engine and flight controls and hybrid-electric drive systems also grew and at \$1.2bn (£0.9bn) now amount to 21% of the sector.
- Underlying EBITA was up to \$877m (£687m), delivering a return on sales of 15.5%, at the higher end of our guidance range.
- As expected, cash conversion of EBITA was very strong in the second half of the year, and close to 100% for the full year.
- Order backlog was another record high, at \$7.9bn (£6.0bn), with significant awards on F-35 for LRIP 14 and Block 4 development, APKWS[®] volumes and the Radar Warning Receiver upgrade.

Operational performance

Electronic Combat Solutions

Staying at the forefront of emerging threats and delivering next-generation electronic warfare (EW) capabilities are important discriminators for success. As a leader in EW, we continue to see growth across our portfolio for both US and international customers.

The F-35 Lightning II programme completed deliveries for Lot 11 and achieved the milestone of delivering over 500 EW systems. In addition, the programme was awarded a Block 4 modernisation and further F-35 system production contracts from Lockheed Martin totalling over £750m (£566m). We continue to operate under a five-year Performance Based Logistics contract to provide material availability and support for the F-35 sustainment programme.

Executing on our current contract from Boeing, we continue to deliver to the United States Air Force our Eagle Passive Active Warning Survivability System, which provides advanced aircraft protection and has completed successful F-15 aircraft flight tests despite experiencing cost and schedule overruns. We

were also awarded a \$495m (£374m) contract to digitally upgrade our ALR-56 Radar Warning Receiver system, enhancing the capability of our technology on F-15 jets.

Providing advanced EW capability for international F-15 aircraft, we continue to deliver on our contract from Boeing and Warner Robins Air Logistics Complex, totalling more than \$1bn (£0.8bn) for the installation of the Digital Electronic Warfare System (DEWS) on new and existing F-15 aircraft. We are also executing a contract worth in excess of \$300m (£227m) to provide DEWS to support the sale of new F-15 aircraft to another international customer.

As a provider of the long-range sensor and targeting technology for the Long Range Anti-Ship Missile (LRASM), we have completed Lot 1 production for our prime contractor Lockheed Martin. In addition, we received a contract modification to a previous Lot 2 production award, increasing this contract award to \$78m (£59m).

The Compass Call programme continues its long history of sustaining and upgrading the prime mission equipment in support of the existing EC-130H fleet. Cross-decking the mission system onto the newly-designated Gulfstream G550 jet, the programme is currently executing contracts with a total value of nearly \$500m (£378m).

Due to the sensitive nature of electronic combat systems and technology, approximately one quarter of our revenues in this business area are driven by our work on classified programmes.

Survivability, Targeting & Sensing Solutions

Our APKWS[®] laser-guided rocket is experiencing growing demand, with over 36,000 units delivered to date. The programme received a five-year Indefinite Delivery, Indefinite Quantity contract worth up to \$2.7bn (£2.0bn). Further production awards totalling over \$400m (£302m) were received this year. In addition to expanding US military use, the system is generating strong international interest.

We are developing a next-generation missile warning system for the US Army under the Limited Interim Missile Warning System programme. We are completing qualification and continue to support government testing. We also received additional funding to enable fielding on other US Army aircraft variants.

Both fixed- and rotary-wing demonstrations of our Striker[®] II helmet-mounted display are ongoing and full development awaits customer funding.

C4ISR Systems

Consistent with our strategy to obtain and incubate small business innovations that can yield disruptive technology breakthroughs, our Electronic Systems FAST Labs[™] organisation acquired the key assets of Riptide Autonomous Solutions to advance our capabilities to address expanding maritime mission requirements for integrated, flexible, modular, unmanned underwater vehicle solutions.

In the space resilience domain, we are a leading provider of space-qualified subsystems and components. We continue to experience growth in the areas of integrated on-board processors, reconfigurable processing payloads and secure communications. In May, our radiation-hardened electronic products achieved 10,000 cumulative years in orbit.

We have been awarded funding from the Defense Advanced Research Projects Agency to integrate machine-learning into platforms that exploit radio frequency signals in increasingly crowded electromagnetic spectrum environments. Our flexible, reconfigurable hardware solutions will provide commercial and military users with greater, automated situational awareness of their operating environment.

Controls & Avionics Solutions

We continue to develop the integrated flight control electronics and remote electronic units for Boeing's next-generation 777X aircraft. A successful first flight of the aircraft was undertaken in January 2020 and the business is continuing software updates and systems verification testing in support of the aircraft certification efforts. During the year, our 737 MAX production rates were scaled back in line with Boeing's reduced demand.

Our active inceptors received certification for the Gulfstream G500 and G600 and are now in production. A derivative, LinkEdge™ (Active Parallel Actuation Subsystem), is being developed for the Chinook CH-47.

Our engine control product line continues to see strong performance from FADEC Alliance, a joint venture between GE Aviation and FADEC International (our joint venture with Safran Electronics & Defense). We have successfully completed component certification testing of the engine control for the Boeing 777X aircraft.

Under the recently-awarded Improved Turbine Engine Program, we will provide the Electronic Engine Controls to modernise the US Army's Black Hawk and Apache fleets.

Development of the F-35 vehicle management computer technology refresh is proceeding to plan and we are actively engaged with Lockheed Martin Aeronautics in moving towards a sustainment contract for the active inceptor systems.

Power & Propulsion Solutions

With 12,000 electric-hybrid propulsion transit buses in operation globally, we have launched the next-generation battery electric system to a market moving to zero emission technology. This year, our battery electric and fuel cell electric systems recorded five million zero emission miles. As cities work to reach low emission targets, this number is expected to grow significantly.

The demand for low and zero emission technology is growing in both commercial and military applications, with a number of European cities employing fully electric vehicles powered by our technology. Our first and largest transit customer, New York City Transit (Metropolitan Transportation Authority) announced its decision to purchase up to a further 435 electric-hybrid power and propulsion systems from BAE Systems. In addition, the maritime domain is now adopting green technology and our electric-hybrid systems are powering both passenger and cargo vessels.

Looking forward

Forward-looking information for the Electronic Systems reporting segment is provided on page 37.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 12.
3. International Financial Reporting Standards.

Segmental performance: Cyber & Intelligence

Cyber & Intelligence, with 10,100 employees¹, comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber security, secure government and commercial financial security activities.

Operational and strategic key points

Intelligence & Security

- Received orders exceeding \$100m (£76m) to provide logistics sustainment support to US Air Force Space Command
- Awarded \$437m (£330m) task order to provide open source support to US Army and Army Intelligence & Security Command approved partners
- Technology offerings further developed and the business achieved four Amazon Web Services designations, recognising our technical proficiency and operational excellence

Applied Intelligence

- Divestment of the Silversky business and exit from the UK-based Managed Security Services business in progress at year-end. Restructuring charge of £20m recognised in the year
- Strong order intake and revenue growth in the Government business unit

Financial performance

Financial performance measures as defined by the Group ²	Financial performance measures defined in IFRS ³	
	2019	2018
Sales	£1,732m	£1,678m
Underlying EBITA	£91m	£111m
Return on sales	5.3%	6.6%
Operating business cash flow	£68m	£85m
Order intake ¹	£1,846m	£1,802m
Order backlog ¹	£1.8bn	£1.9bn

- In aggregate, sales were broadly unchanged on a constant currency basis at \$2.2bn (£1.7bn). Sales in the US business were 2% lower owing to customer awards made but subsequently protested. In the Applied Intelligence business, sales were up 4%, all arising in the Government business line.
- Return on sales in the US business was in line with the prior year at 9.1%. Within Applied Intelligence, the business recorded a loss of £20m following the restructuring charge taken in the first half of the year.
- Disposal of the Silversky business and exit from the UK-based Managed Security Service are expected in the near future, both of which will improve profitability in future years.
- As expected, order backlog was stable at \$2.3bn (£1.8bn), after adjusting for the expected Applied Intelligence disposals.

Operational performance

Intelligence & Security

Air Force Solutions

We received orders exceeding \$100m (£76m) to provide logistics sustainment support to US Air Force Space Command for instrumentation tracking (radar, telemetry and optics) systems, which includes 26 agencies across the US Department of Defense, Department of Energy, National Aeronautics and Space Administration, plus six foreign governments.

On the US Air Force Intercontinental Ballistic Missile Integration Support Contractor Program, we were awarded a sole-source modification to increase the contract ceiling by \$93m (£70m) to \$1.1bn (£0.8bn). The period of performance remains through to January 2022, and our work includes programme management, systems engineering, integration and testing, sustainment and cyber defence.

Integrated Defense Solutions

We are executing the fourth year of a five-year, \$368m (£278m) sole-source contract to support weapons systems on board US Ohio and UK Vanguard Class submarines, as well as future US Columbia Class and UK Dreadnought Class submarines.

The US Navy has awarded the business a five-year Indefinite Delivery, Indefinite Quantity (IDIQ) contract with an expected lifecycle value of \$280m (£211m) to modernise and maintain command, control, communications, computers, cyber, intelligence, surveillance and reconnaissance systems aboard new construction aircraft carriers and large deck amphibious ships.

We secured a \$126m (£95m) contract for the US Marshals Service (USMS), a component of the US Department of Justice. The business will provide mission-critical IT infrastructure support, sustainment operations and engineering services to the USMS Information Technology Division.

The business has been awarded a \$300m (£227m) contract to provide enterprise and mission-critical IT support to the Federal Emergency Management Agency's Operations and Maintenance Division. The programme will provide IT infrastructure modernisation, system sustainment and telecommunications, network and helpdesk services.

We were awarded a \$212m (£160m) US Navy follow-on contract for the design, acquisition, integration and test of radio communication suites for Guided Missile Destroyers and other US Navy and Coast Guard ships. This win continues our near 50-year legacy as an integrator of mission-critical shipboard systems.

The business was awarded a five-year, \$200m (£151m) contract to provide systems engineering, security management, modelling and simulation, and training services to help in the US government defence cyber mission.

Intelligence Solutions

The team is executing on a number of task order contracts valued at approximately \$320m (£242m) to provide motion-imagery analysis, training, and research support services to the US intelligence community, and provide technical, functional, and general support to enhance the situational awareness and training of US Army troops deployed around the world.

A \$70m (£53m) engineering change proposal was secured, extending the period of performance on a contract originally awarded in 2013 to provide high-performance computing and infrastructure support to the US intelligence community.

The business was awarded a significant follow-on contract and a new award with a combined value of over \$490m (£370m) to provide critical intelligence support to the US government.

We were awarded a new \$437m (£330m) task order to provide open source support for the Army and Army Intelligence & Security Command approved partners, to provide training, policy and governance recommendations, assessments and implementation of emerging capabilities, and to establish and manage a secure cloud hosting environment for these efforts.

The business was awarded a prime position on Solutions for Intelligence Analysis 3, a ten-year multiple award IDIQ contract. The company will provide worldwide coverage, support and assistance to the Defense Intelligence Agency delivering timely, objective and cogent military intelligence to defence planners and policy makers.

We are delivering our first Federated Secure Cloud implementation, supporting multiple independent levels of security, and leveraging this capability into adjacent customers. In addition, the business has established multiple commercial cloud partnerships to drive additional services revenue across defence and intelligence customers.

Among a number of strategic developments in 2019, the business furthered its technology offerings and attained Amazon DevOps, Government and Disaster Response and Public Safety Competencies, as well as being named an Amazon Web Services Premier Consulting Partner.

Applied Intelligence

As at the 2019 year-end, negotiations relating to the disposal of the US-based software-as-a-service business were ongoing.

Government

The Government business delivered good growth in orders. Performance was particularly strong in UK National Security which benefited from the signing of a number of transformational multi-year deals. Revenue growth followed the higher order intake, with increased headcount and continuing investment in talent in a competitive labour market for highly-skilled software engineers with enhanced security clearances. Profitability continued to benefit from cost control and greater efficiency in sales and management activity in the International business in particular.

Financial Services

The Financial Services business has seen a significant increase in business development investment in the year. The higher spend on product engineering culminated in the launch of a new version of NetReveal[®], v8.0, in the first half of the year. Response to the product has been positive and has led to a number of pipeline opportunities for upgrades to existing customers and deployment to new customers. The conversion of these opportunities drove order intake growth in the second half of the year and positions the business for higher levels of growth in the future.

Looking forward

Forward-looking information for the Cyber & Intelligence reporting segment is provided on page 37.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 12.
3. International Financial Reporting Standards.

Segmental performance: Platforms & Services (US)

Platforms & Services (US), with 12,500 employees¹, has operations in the US, UK and Sweden. It manufactures combat vehicles, weapons and munitions, and delivers services and sustainment activities, including naval ship repair and the management and operation of government-owned munitions facilities.

Operational and strategic key points

- Deliveries of the M109A7 self-propelled howitzer and ammunition carrier vehicle sets are progressing and the decision to proceed to full-rate production was made in Q1 2020
- First deliveries achieved of the Amphibious Combat Vehicle to the US Marine Corps
- Contract modification award of \$575m (£434m) received for LRIP vehicles on the Armored Multi-Purpose Vehicle programme
- Work underway to upgrade 332 vehicles to the Bradley A4 configuration
- Awarded contracts worth \$466m (£352m) to upgrade configuration on various M88 vehicles
- First tandem docking of two large warships in San Diego dry-dock for contracts worth more than \$170m (£128m)
- Deliveries continue of the M777 ultra-lightweight howitzer to the Indian Army, with subsequent systems to be assembled at the Mahindra Defence Systems facility

Financial performance

Financial performance measures as defined by the Group ²	2019		Financial performance measures defined in IFRS ³	2018	
	2019	2018		2019	2018
Sales	£3,337m	£3,005m	Revenue	£3,185m	£2,864m
Underlying EBITA	£267m	£210m	Operating profit	£239m	£161m
Return on sales	8.0%	7.0%	Return on revenue	7.5%	5.6%
Operating business cash flow	£241m	£(30)m	Cash flow from operating activities	£305m	£31m
Order intake ¹	£4,020m	£3,693m			
Order backlog ¹	£5.8bn	£5.4bn			

- Sales in the year were up 6% to \$4.3bn (£3.3bn), within guidance. In the US Combat Vehicles business, the second half challenge to deliver the ramp up in M109A7 deliveries was met.
- Return on sales performance for the year improved to 8.0% with no material charges taken in the year. As regards the ramp in Combat Vehicles sales, we are trading profit on the Armored Multi-Purpose Vehicle and Amphibious Combat Vehicle programmes at an initial low level.
- Cash flow performance was very strong in the second half of the year as vehicle production deliveries increased and working capital was liquidated.
- Order backlog was further increased to \$7.7bn (£5.8bn), with total in-year funded Combat Vehicle orders received of \$2.5bn (£1.9bn).

Operational performance

US Combat Vehicles

The business continues to make progress towards achieving consistent production throughput across multiple programmes with the implementation of ongoing improvements and investments in modernising facilities and manufacturing technologies, including automation and robotic welding.

We are leveraging the lessons learned on the M109A7 programme and continue to integrate innovative manufacturing capabilities during the early stages of the production of new combat vehicles. While schedule adjustments have been necessary, addressing these challenges will facilitate consistency of quality and delivery for our customers, and bring long-term benefits across our vehicle programmes.

Initial Amphibious Combat Vehicles (ACVs) were delivered to the US Marine Corps under Low-Rate Initial Production (LRIP), with a third LRIP contract received in October bringing the total value to \$458m (£346m) for 90 vehicles. Under a \$67m (£51m) contract awarded in June, we have begun design and development activities on two new mission variants of the ACV family of vehicles.

As one of two competitors, we continue to work on the US Army's Mobile Protected Firepower programme under a \$376m (£284m) contract for the engineering and manufacturing development phase for rapid prototyping efforts.

On the US Army's Armored Multi-Purpose Vehicle programme, we were awarded a \$575m (£434m) contract modification, bringing the cumulative award value to \$873m (£659m). Initial LRIP vehicles are scheduled to begin delivery in 2020.

We continue to progress the LRIP phase of the M109A7 programme, with contracts in 2018 and 2019 totalling approximately \$750m (£566m) for 108 vehicle sets. These cumulative LRIP awards include the recent December contract modification and long-lead material funding. The decision to proceed to full-rate production was subsequently made in the first quarter of 2020. In July, we received a \$45m (£34m) contract to support the integration of the Extended Range Cannon Artillery on the M109A7 to double the range of the gun system, which is among the Army's top priorities.

Work has begun under contracts for 332 vehicles, valued at \$578m (£437m) to upgrade to the Bradley A4 configuration.

We continue to work on US Army contracts for production and sustainment of M88 recovery vehicles, to include upgrades from the M88A1 to the M88A2 HERCULES configuration. In September we received a \$148m (£112m) contract to upgrade an additional 43 vehicles, and were competitively selected for a \$318m (£240m) contract to upgrade to the next-generation M88A3 configuration to restore single-vehicle recovery.

Internationally, the delivery of an additional 11 Assault Amphibious Vehicles for Japan was completed in the second half of the year and work continues on 36 vehicles for Taiwan. The delivery of 32 M109A5+ self-propelled howitzers to the Brazilian Army was completed in the second half of the year.

Weapon Systems

Deliveries of M777 ultra-lightweight howitzers continue to the Indian Army under a \$542m (£409m) Foreign Military Sale contract for 145 M777s. The initial guns are being built in our facilities, with at least 120 subsequent systems to be assembled in India at Mahindra Defence Systems' new facility.

We received two orders totalling \$85m (£64m) from the US Navy to deliver six Mk45 Mod 4 gun systems, providing a solid US Navy order book of 20 Mk45 systems. We are also delivering 57mm Mk110 gun systems to the US Navy and Coast Guard, with nearly 60 systems now delivered to US maritime forces.

We continue to execute on contracts for 155mm BONUS ammunition to the Swedish Army and the US Army. Under a 2016 contract modification, we are providing 24 additional ARCHER artillery systems to the Swedish government, and we are under multiple export contracts to deliver 40 Mk4 and 57 Mk3 naval gun systems.

We continue to perform on a \$183m (£138m) contract to provide the Maritime Indirect Fire System for the UK Royal Navy's Type 26 frigate, which includes Mk45 Mod 4 gun systems, automated ammunition handling systems and gun fire control systems.

Under the latest contract awarded in March, we are to produce 28 more Virginia Payload Module tubes for the US Navy's Block V Virginia-class submarines.

Ordnance Systems

We manage, operate and modernise the US Army's Radford and Holston munitions facilities.

At Holston, production operations impacted by a fire in January 2019 resulted in a £10m charge recognised in the HQ segment under the Group insurance arrangement. Modernisation activities continue under multiple contracts to construct a natural gas-fired steam facility, a waste water management facility that is nearing completion, as well as the design, construction and commissioning of new production facilities to improve efficiency and modernise energetics manufacturing.

At Radford, in addition to ongoing operations, work continues on the construction of a modernised nitrocellulose facility, and we are actively managing ongoing subcontractor performance issues, cost and schedule overruns, and related disputes.

US Ship Repair

Our US maintenance and modernisation shipyards remain in strong demand. In 2019, we secured orders across our US shipyards totalling approximately \$1bn (£0.8bn), including awards to service the USS The Sullivans in Jacksonville and the USS Vicksburg in Norfolk.

In September, we received two contracts totalling more than \$170m (£128m) for the repair and maintenance of the guided-missile destroyers USS Stethem and USS Decatur in San Diego, resulting in the first tandem docking of two large warships in our San Diego dry-dock.

Following a thorough analysis of the new Multiple Award Contract structure being implemented in Pearl Harbor, Hawaii, we informed the Navy we will not bid for future work in Hawaii, and will focus on completing existing contracts.

BAE Systems Hägglunds

With an installed base of nearly 1,300 CV90 vehicles in Sweden and across six other international markets, the business continues to pursue contractual opportunities, including the Czech Republic's competition to replace its fleet of BMP2 Infantry Combat Vehicles.

Work is progressing to refurbish Swedish CV90s, and initial deliveries have begun on the integration of 40 Mjölner mortar systems under a separate contract. We were selected by the Dutch Army to integrate the Elbit Systems' Iron Fist Active Protection System on its fleet of CV90s.

32 BvS10 all-terrain vehicles under contract for Austria were delivered for final acceptance.

FNSS

FNSS, our land systems joint venture based in Turkey, continues to perform under its \$524m (£396m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army. Deliveries continue under a contract with Oman for PARS wheeled armoured vehicles in 8x8 and 6x6 configurations.

Work progresses under multiple contracts for the Turkish Armed Forces, including a €278m (£236m) contract for 260 anti-tank vehicles, an €84m (£71m) contract for air defence vehicles, a €155m (£131m) contract for 27 assault amphibious vehicles, and a contract worth €154m (£131m) for 100 special purpose 8x8 and 6x6 vehicles.

Looking forward

Forward-looking information for the Platforms & Services (US) reporting segment is provided on page 37.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 12.
3. International Financial Reporting Standards.

Segmental performance: Air

Air, with 28,300 employees¹, comprises the Group's UK-based air activities for European and International Markets, and US Programmes, and its businesses in Saudi Arabia and Australia, together with its 37.5% interest in the European MBDA joint venture.

Operational and strategic key points

- Qatar Typhoon and Hawk aircraft programme met its contractual milestones in the year. Contract amendment agreed to accelerate Typhoon deliveries
- F-35 programme Lots 12 to 14 price negotiations concluded. 142 rear fuselage assemblies delivered in the year in line with ramp-up to full rate production in 2020
- Tempest technology maturation programme contracted between industry and UK government. Italy and Sweden governments committed to working with UK to develop next-generation combat air capability
- The first four Hawk aircraft assembled in Saudi Arabia were accepted and entered service in-Kingdom
- UK Tornado fleet successfully retired from service on schedule following RAF declaration that Typhoon had met Centurion standard with embodiment across the Typhoon fleet
- The design and production readiness phase of the Hunter Class programme for the Royal Australian Navy continues to make good progress

Financial performance

Financial performance measures as defined by the Group ²	2019		2018		
	2019	2018	2019	2018	
Sales	£7,457m	£6,712m	Revenue	£6,153m	£5,579m
Underlying EBITA	£887m	£859m	Operating profit	£777m	£810m
Return on sales	11.9%	12.8%	Return on revenue	12.6%	14.5%
Operating business cash flow	£408m	£666m	Cash flow from operating activities	£497m	£719m
Order intake ¹	£4,594m	£14,845m			
Order backlog ¹	£23.9bn	£27.4bn			

- Sales were up 11% at £7.5bn. As expected there was higher production activity on the new Typhoon and Hawk programme for Qatar, and the F-35 programme continues to ramp up towards full rate next year. In addition sales from MBDA grew on deliveries to Egypt and Qatar.
- The return on sales of 11.9% was ahead of expectations on strong programme execution. It reflects low initial profit recognition on the early stages of the Qatar programme, and increased self-funded research and development on the Tempest future combat air development. Last year's return on sales benefited by 70bps from the completing Oman Typhoon contract.
- Cash flow largely reflects the utilisation of provisions, timing on receivables, and the difference between joint venture profits and cash dividends received. There was also some usage of prior year Qatar funding.
- Order backlog reduced to £23.9bn, primarily for the trading on multi-year orders, received in prior years, for the Saudi Arabian support and Qatar programmes.

Operational performance

European & International Markets

Mobilisation activity on the 24 Typhoon and nine Hawk aircraft and associated support and training contract for the Government of the State of Qatar has progressed to plan with all initial milestones achieved. A contract amendment was agreed during the year accelerating Typhoon deliveries and contract milestones.

The first eight of 28 major units on the Kuwait Typhoon contract, secured by Italian Eurofighter partner Leonardo, have been delivered. The remaining major units are planned for delivery by 2022.

In the year, the Royal Air Force accepted the final three Typhoon aircraft from the UK final assembly facility. The German, Italian and Spanish Air Forces accepted a total of 11 aircraft in 2019, leaving one of the 88 Tranche 3 aircraft to be delivered.

Following the declaration by the Royal Air Force that Typhoon had met Centurion standard in December 2018, enabling the transition of capabilities from Tornado to Typhoon, the UK Tornado fleet successfully retired from service on schedule. Centurion standard has now been embodied across the Typhoon fleet.

In the UK, under a ten-year partnership arrangement, and in Oman, under a five-year availability service contract, we continue to support Typhoon fleets to achieve customer target flying hours. BAE Systems continues to support the European Partner Nations' own support arrangements.

Support to the Royal Air Force's UK fleet of Hawk fast jet trainer aircraft continues through the long-term availability contract. We are in discussions with the UK on future Hawk support arrangements and we continue to support users of Hawk trainer aircraft around the world.

The next phase of the Tempest technology maturation programme was contracted between industry and the UK government. This was followed by the signing of a Memorandum of Understanding between the UK and Sweden in July, and a Statement of Intent between the UK and Italy in September, committing the respective governments to working with the UK government to develop next-generation combat air capability.

Progress continues on the collaboration for the design and development phase of an indigenous fifth-generation fighter jet for the Turkish Air Force.

US Programmes

On the F-35 programme, price negotiations on Lots 12 to 14 concluded in the second half of 2019 and the business is ramping up to full-rate production by the end of 2020. In the period, 142 rear fuselage assemblies were delivered under the Low-Rate Initial Production contracts for Lots 11 to 13, bringing total deliveries on the programme to over 600.

At RAF Marham in the UK, following the declaration of Initial Operational Capability in 2018, we continue to support the customer in integrating the F-35 into its operational fleet and forward deployments.

BAE Systems continues to play a growing role on the F-35 sustainment programme including the supply of spares and technical support, software products, upgrades and specialist manpower services.

Saudi Arabia

The Group is reliant on the continued approval of export licences by a number of governments in order to continue supplies to the Kingdom of Saudi Arabia. Following extensions being granted by the German government to a number of export licences on joint collaborative programmes, we are working closely with industry partners and the UK government to continue to fulfil the contractual support arrangements in Saudi Arabia on the key European collaboration programmes.

In June 2019, the Court of Appeal of England and Wales directed the Secretary of State for International Trade to revisit the decision-making process for granting export licences for the sale of military equipment to the Kingdom of Saudi Arabia for possible use in the conflict in Yemen and to retake its decisions regarding such licences on that basis. The Company will assess the result of the retaking by the Secretary of State of such decisions, once they have been made. Pursuant to the Order of the Court, the Secretary of State undertook not to grant new licences for the export of arms or military equipment to Saudi Arabia for possible use in the conflict in Yemen until such decisions have been retaken. Both the Secretary of State and the other party to the proceedings have sought and obtained permission to appeal the Court's ruling to the Supreme Court.

In March 2018, the UK and the Kingdom of Saudi Arabia signed a Memorandum of Intent for the supply of a further 48 Typhoon aircraft, support and transfer of technology and capability. This would enable BAE Systems to continue with the localisation of defence capabilities in Saudi Arabia. Final assembly of all 48 Typhoon aircraft would be in-Kingdom.

The business continues to perform against the contract secured in 2018 to provide Typhoon support services to the Royal Saudi Air Force through to 2022.

The Saudi British Defence Co-operation Programme five-year funding agreement through to 2021 comprises a number of contracts, including support to the Tornado fleet and provision of Officer and Aircrew Training for the Royal Saudi Air Force, as well as engineering and logistics services for the Royal Saudi Naval Forces. These services continue to progress well. Previous issues relating to the availability of the Hawk trainer aircraft have been addressed and the aircraft availability is now consistent with the contractual requirements.

Four Hawk aircraft assembled in-Kingdom have been accepted and entered service with the Royal Saudi Air Force in the year. The company has delivered all of the 22 major units to meet this final assembly programme.

Work continues to reorganise our portfolio of interests in a number of industrial companies in Saudi Arabia. Riyadh Wings Aviation Academy LLC increased its ownership in 2019 to 23.5% in the Group's Overhaul and Maintenance Company (OMC) subsidiary. Additionally during the year OMC disposed of its 85.7% shareholding in Aircraft Accessories and Components Company. Following OMC entering into a heads of terms for the sale of its 50% shareholding in Advanced Electronics Company to Saudi Arabian Military Industries (SAMI), negotiations are continuing and the transaction is expected to take place in the first half of 2020.

Through the restructuring of the Group's portfolio of interests in its Kingdom of Saudi Arabia industrial companies, along with transformation activities to transfer local capability into these companies, we are working in partnership with SAMI to explore how we can collaborate to deliver further In-Kingdom Industrial Participation, in line with the Kingdom's Vision 2030.

Australia

The initial design and production readiness phase of the Hunter Class programme for the Royal Australian Navy continues to make progress, and the integration of ASC Shipbuilding into our Australian operations is progressing well. The first Integrated Baseline Review on the programme is expected to be completed in Q2 2020.

Progress continues on the Jindalee Operational Radar Network upgrade contract secured in 2018 from the Commonwealth of Australia, with the System Requirements Review completed and the first tranche programme baseline under review. On the sustainment contract, support to the three radar sites continues to see all operational milestones being achieved to plan.

Final acceptance of the Royal Australian Navy's two Landing Helicopter Docks is expected to be in 2020. Responsibility for future support has now been fully transitioned to Naval Ship Management.

Progress on the sustainment and upgrade of the Anzac fleet under the Warship Asset Management Alliance continues with the first of class, HMAS Arunta, now deployed back to operations. The second vessel, HMAS Anzac, has now undocked.

The Hawk Mk127 Lead-In Fighter project did not meet all aircraft availability requirements for the year. The pilot training programme however, was for the most part not impacted. The upgrade of the Hawk fleet to meet the F-35 training requirements has been completed.

Sustainment activity continues for the regional F-35 fleet at our Williamstown facility, with 13 aircraft now on base.

We were notified in September that we had been unsuccessful in our bid for the Land 400 Phase 3 Combat Vehicle programme.

MBDA

During 2019, MBDA secured development contracts for Enhanced Modular Air Defence Solutions in Italy and for Enforcer missile systems in Germany. Further contracts for Meteor were secured for additional tranches in France and Germany, as well as an integration contract for the South Korean KF-X fighter aircraft. Other contract awards include ASRAAM for Typhoon in Oman and in Qatar (the latter having

already ordered Meteor and Brimstone) and a number of key support contracts for both European domestic and international customers.

In June, the MBDA/Lockheed Martin joint venture submitted to the German customer the updated TLVS (Ground-Based Air Defence System) proposal.

Good progress has been made on a number of development programmes including: the next-generation MICA missile; Spear Capability 3; and Aster Block 1 New Technology. In addition the Future Cruise/Anti-Ship Weapon (the Anglo/French co-operation programme to replace Storm Shadow/Harpoon in the UK and SCALP/Exocet in France) has successfully achieved its concept review, an important step in the decision to launch the following phases of the programme. Progress has also continued on production programmes, notably MICA missile deliveries for a number of international customers.

Looking forward

Forward-looking information for the Air reporting segment is provided on page 38.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 12.
3. International Financial Reporting Standards.

Segmental performance: Maritime

Maritime, with 16,300 employees¹, comprises the Group's UK-based maritime and land activities.

Operational and strategic key points

- HMS Prince of Wales vessel acceptance achieved in December
- Four River Class Offshore Patrol Vessels have now been accepted, with the programme on target for completion in 2020
- Construction commenced on second of the three contracted Type 26 frigates in August
- Construction of the first Dreadnought Class submarine continues to advance, with £1.4bn of funding received in the year
- Sea trials for the fourth Astute Class submarine are due to take place in 2020
- A £230m seven-year Torpedo Repair and Maintenance contract was awarded
- The UK combat vehicles joint venture between Rheinmetall and BAE Systems Land UK was launched on 1 July
- Design requirements for the Canadian Surface Combatant are progressing towards finalisation with partners and the Royal Canadian Navy

Financial performance

Financial performance measures as defined by the Group ²	2019		2018		
	2019	2018	2019	2018	
Sales	£3,116m	£2,975m	Revenue	£3,071m	£2,940m
Underlying EBITA	£268m	£209m	Operating profit	£253m	£191m
Return on sales	8.6%	7.0%	Return on revenue	8.2%	6.5%
Operating business cash flow	£150m	£67m	Cash flow from operating activities	£289m	£190m
Order intake ¹	£2,875m	£3,513m			
Order backlog ¹	£8.6bn	£9.0bn			

- Sales in the Maritime businesses were up 5%, ahead of guidance, at £3.1bn. Whilst the Dreadnought submarine and Type 26 programmes continue to ramp up, the Carrier and Offshore Patrol Vessel programmes are close to completion. Activity levels in Portsmouth Naval Base support remained strong through the year.
- Return on sales was at 8.6%, within our guidance range.
- The operating cash inflow of £150m reflects utilisation of the Naval Ships provision created last year and the completion of the Carrier programme.
- Order backlog has reduced slightly to £8.6bn, with further awards for funding on the Dreadnought programme outweighed by trading on the Astute, Carrier and Type 26 programmes.

Operational performance

Naval Ships

The second Queen Elizabeth Class aircraft carrier, HMS Prince of Wales, departed Rosyth in September to undertake comprehensive sea trials before entering Portsmouth for the first time in November and being accepted in December. The first Queen Elizabeth Class aircraft carrier, HMS Queen Elizabeth, celebrated a significant milestone in October with the first UK F-35s landing on board for operational trials, with HMS Dragon, the BAE Systems-designed and manufactured Type 45 destroyer, escorting.

Four of the five River Class Offshore Patrol Vessels have now been accepted by the Ministry of Defence and we are working to a schedule which would see programme completion in 2020.

The first three City Class Type 26 frigates are on contract with construction underway on the first two ships. The programme currently employs over 2,000 people and approximately one half of the First of Class, HMS Glasgow, is under construction and she remains on track to enter service in the mid-2020s. Work continues on the second ship, HMS Cardiff, following the formal start of full-scale manufacture in August. Investment in site infrastructure in our Glasgow shipyards continues with dock readiness works progressing well and new office space to be completed in early 2020.

Following the success of the Global Combat Ship design in Australia and Canada both programmes are gaining momentum as teams are mobilised. Work continues to transfer product and process knowledge, share experiences of complex operations and help to prepare the organisation in Australia for the transition of delivery responsibility. We are working closely with our partners and the Royal Canadian Navy to finalise the design requirements for the Canadian Surface Combatant.

Submarines

BAE Systems is a member of the Dreadnought Alliance, working alongside the Submarine Delivery Agency and Rolls-Royce to deliver a replacement for the Royal Navy's Vanguard class, which carries the UK's independent nuclear deterrent. The value of the programme to the Company to date is £5.2bn, with contract funding of £1.4bn received in 2019. Four Dreadnought Class submarines will be built in Barrow, with the first of these due to be in operational service in the early 2030s. Construction of the first submarine continues to advance with many of the major pressure hull units now manufactured. The major programme of investment to redevelop the Barrow site to support the delivery of Dreadnought is well underway, with several of the new facilities now complete and in operation.

The first three Astute Class submarines are in operational service with the Royal Navy. The remaining four boats are at an advanced stage of construction. The fourth boat, Audacious, is in the final stages of testing and commissioning ahead of sea trials.

Maritime Services

Our Maritime Services business is responsible for management and maintenance of HM Naval Base Portsmouth and supports more than half of the Royal Navy's surface fleet, including the Type 45 destroyers, through the Maritime Support Delivery Framework (MSDF) contract which runs to March 2020. An 18-month extension to MSDF is due to be finalised in March 2020. In November, HMS Prince of Wales arrived at HM Naval Base Portsmouth, her home port.

The company was awarded the Torpedo Repair and Maintenance contract. This seven-year contract is worth £230m and secured over 100 highly skilled jobs at the Broad Oak site in Portsmouth.

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

The company was awarded four contracts to support the repair and maintenance of over 600 small boats operated by the Royal Navy, the Royal Marines, the Royal Fleet Auxiliary, the Army and the Ministry of Defence Police over a period of six and a half years.

Land UK

The munitions business continues to provide UK and international customers with a wide range of light and heavy munitions, as well as offering complementary support services for development, testing and evaluation. We continue to work with the UK Ministry of Defence to agree a replacement to the existing Munitions Acquisition Supply Solution partnering agreement.

In July 2019, following receipt of regulatory approvals, the business formed a joint venture with Rheinmetall, Rheinmetall BAE Systems Land (RBSL), to create a joint UK-based land vehicle design, manufacturing and support business. Rheinmetall purchased a 55% stake in the existing BAE Systems UK-based combat vehicles business for £31.5m with BAE Systems retaining 45%. This transaction did not include the Land UK munitions business or its holding in the CTA International joint venture with Nexter.

The UK Ministry of Defence has now awarded the £2.3bn contract to provide the British Army with over 500 8x8 armoured vehicles. The contract was awarded to Artec GmbH, comprising Rheinmetall and Krauss-Maffei Wegmann. Rheinmetall will subcontract approximately half the production to RBSL which will undertake vehicle structure fabrication, assembly, integration, and test of the vehicles at its Telford facility.

During the year, 95 40mm cased-telescopic cannons were delivered to the Ministry of Defence by CTA International, bringing cumulative deliveries to 370. This entirely new cannon design – currently being integrated in the British Army's new Ajax and upgraded Warrior vehicles – has also been selected by the Belgian Army for its Jaguar vehicles.

Looking forward

Forward-looking information for the Maritime reporting segment is provided on page 38.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 12.
3. International Financial Reporting Standards.

Segmental looking forward

Electronic Systems

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

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

The business expects to benefit from its ability to apply innovative technology solutions that meet defence customers' changing requirements. As a result, the business is well positioned for the medium term with strong significant roles on F-35 Lightning II, F-15 upgrade and classified programmes, as well as with specific products such as APKWS[®]. Over the longer term, the business is poised to leverage its technology strength in emerging areas of demand such as precision weaponry, space resilience, hyper-velocity and autonomous vehicles. In the commercial aviation market, Electronic Systems' technology innovations are enabling the business to maintain its long-standing customer positions and to compete for, and win, new business and with our electric hybrid propulsion capability we are well placed to continue to address the need for low- and zero-emission technology.

Cyber & Intelligence

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

Intelligence & Security

The outlook for the US government services sector is stable, although market conditions remain highly competitive and continue to evolve. The US business remains well positioned and will continue to leverage its established market positions and reputation for reliable and adaptable performance to meet customer demands for innovative, cost-effective and cyber-hardened solutions to pursue both re-competed contracts and new business across its portfolio of sustainment, integration and modernisation solutions for military and intelligence customers.

Applied Intelligence

The services and products we offer under our Government and Financial Services divisions are well placed to deliver growth and increased profitability, as cyber security becomes an increasingly important part of a nation's security and a core element of stewardship for companies in a sophisticated and persistent threat environment.

Platforms & Services (US)

Platforms & Services (US), with operations in the US, UK and Sweden, manufactures combat vehicles, weapons and munitions, and delivers services and sustainment activities, including naval ship repair and the management and operation of government-owned munitions facilities.

Combat Vehicles is underpinned by a growing order backlog and incumbencies on key franchise programmes. These include the US Army's Armored Multi-Purpose Vehicle, M109A7 self-propelled howitzer, Bradley upgrade programmes, Amphibious Combat Vehicle, M88, as well as the CV90 and BvS10 export programmes from BAE Systems Hägglunds. FNSS continues to execute on its order book of both Turkish and international orders. These long-term contracts and franchise positions make the combat vehicles business well placed for growth in the medium term. The team is working on, and is closely following, the US Army's acquisition plans for its next generation of combat vehicles, in particular the mobile protected firepower and robotic combat vehicle programmes.

In the maritime domain, the sector has a strong position on naval gun programmes and US Navy ship repair activities where the business has invested in facilities in key homeports. This capitalised infrastructure represents a high barrier to entry, and the business remains well aligned to the US Navy's operational strategy. The Group remains a leading provider of gun systems and precision strike capabilities and, in the complex ordnance manufacturing business, continues to manage and operate the US Army's Radford and Holston munitions facilities under previously awarded contracts.

Air

Air comprises the Group's UK-based air activities for European and International Markets, and US Programmes, and its businesses in Saudi Arabia and Australia, together with its 37.5% interest in the European MBDA joint venture.

Future Typhoon production and support sales are underpinned by existing contracts. Discussions continue in relation to potential further contract awards for Typhoon which would extend current production revenues. Production of rear fuselage assemblies for the F-35 will increase in 2020 to reach its expected peak rate for the decade. The business plays a significant role in the F-35 sustainment programme, and revenues are set to grow as the number of aircraft deployed increases over the coming years. Defence and security remain priorities for the UK government. The UK Combat Air Strategy provides the base to enable long-term planning and investment in a key strategic part of the business.

In Saudi Arabia, the In-Kingdom Industrial Participation programme continues to make good progress consistent with our long-term strategy, as well as the Saudi Arabian government's National Transformation Plan and Vision 2030. In order to provide ongoing capability to international customers, the Group is reliant on the continued approval of export licences by a number of governments. The withholding of such export licences may have an adverse effect on the Group's provision of capability to the Kingdom of Saudi Arabia and the Group will seek to work closely with the UK government to manage the impact of any such occurrence.

The Australian business has long-term sustainment and upgrade activities in maritime, air, wide-area surveillance, missile defence and electronic systems. The Hunter Class frigate programme is expected to drive growth in the coming years.

MBDA has a strong order book, which is driving increased production and sales. Development programmes continue to improve the long-term capabilities of the business, and as European nations embark on new combat air systems development, MBDA will be well placed to provide the technologies and system solutions required to deliver efficient and competitive armaments to these platforms.

Maritime

Maritime comprises the Group's UK-based maritime and land activities.

Maritime

Overall the outlook is stable based on long-term contracted positions. Within Submarines, the business is executing the Astute Class programme, with four boats still in build. On the Dreadnought programme manufacturing activities continue on the first of class boat. Investment continues in the Barrow facilities in order to provide the capabilities to deliver these long-term programmes through the next decade and beyond. In shipbuilding, following the completion of the two aircraft carriers, sales are underpinned by the manufacture of Type 26 frigates. The through-life support of surface ship platforms provides a sustainable business in technical services and mid-life upgrades.

Land UK

Future work will be underpinned by existing support contracts and the expected workshare on the Mechanised Infantry Vehicle programme.

Munitions supply continues under the Munitions Acquisition Supply Solution partnering agreement secured in 2008.

Consolidated income statement

for the year ended 31 December

	Notes	2019		2018	
		£m	Total £m	£m	Total £m
Continuing operations					
Sales	2	20,109		18,407	
<i>Deduct</i> Share of sales by equity accounted investments	2	(2,878)		(2,812)	
<i>Add</i> Sales to equity accounted investments	2	1,074		1,226	
Revenue	2		18,305		16,821
Operating costs			(16,724)		(15,514)
Other income			150		158
Group operating profit			1,731		1,465
Share of results of equity accounted investments			168		140
<i>Underlying EBITA</i>	2	2,117		1,928	
<i>Non-recurring items</i>		(27)		(154)	
<i>EBITA</i>		2,090		1,774	
<i>Amortisation of intangible assets</i>		(109)		(85)	
<i>Impairment of intangible assets</i>		(6)		(33)	
<i>Financial expense of equity accounted investments</i>		(23)		(13)	
<i>Taxation expense of equity accounted investments</i>		(53)		(38)	
Operating profit	2		1,899		1,605
<i>Financial income¹</i>		27		26	
<i>Financial expense¹</i>		(300)		(407)	
Net finance costs	3		(273)		(381)
Profit before taxation			1,626		1,224
Taxation expense	4		(94)		(191)
Profit for the year			1,532		1,033
Attributable to:					
Equity shareholders			1,476		1,000
Non-controlling interests			56		33
			1,532		1,033
Earnings per share					
Basic earnings per share	5		46.4p		31.3p
Diluted earnings per share			46.1p		31.2p

1. Gains on remeasurement of financial instruments at fair value through profit or loss and foreign exchange gains for the year ended 31 December 2018 have been reclassified to remove them from financial income and present all movements within financial expense. See note 3 for details.

Consolidated statement of comprehensive income

for the year ended 31 December

	2019			2018		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings £m	Total £m
Profit for the year	–	1,532	1,532	–	1,033	1,033
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on post-employment benefit schemes	–	(556)	(556)	–	74	74
Tax on items that will not be reclassified to the income statement	–	57	57	–	5	5
Equity accounted investments (net of tax)	–	(38)	(38)	–	6	6
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	(327)	–	(327)	400	–	400
Reclassification of cumulative currency translation reserve on disposal	(8)	–	(8)	–	–	–
Fair value gain arising on hedging instruments during the period	11	–	11	14	–	14
Cumulative fair value gain on hedging instruments reclassified to the income statement	(7)	–	(7)	(39)	–	(39)
Tax on items that may be reclassified to the income statement	–	–	–	5	–	5
Equity accounted investments (net of tax)	6	–	6	15	–	15
Total other comprehensive income for the year (net of tax)	(325)	(537)	(862)	395	85	480
Total comprehensive income for the year	(325)	995	670	395	1,118	1,513
Attributable to:						
Equity shareholders	(320)	940	620	391	1,085	1,476
Non-controlling interests	(5)	55	50	4	33	37
	(325)	995	670	395	1,118	1,513

Consolidated statement of changes in equity

for the year ended 31 December

	Attributable to equity holders of BAE Systems plc						
	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non- controlling interests £m	Total equity £m
Balance at 1 January 2019 as originally presented	87	1,249	6,481	(2,271)	5,546	72	5,618
Transition adjustment upon adoption of IFRS 16 Leases	–	–	–	(92)	(92)	–	(92)
Balance at 1 January 2019	87	1,249	6,481	(2,363)	5,454	72	5,526
<i>Profit for the year</i>	–	–	–	1,476	1,476	56	1,532
<i>Total other comprehensive income for the year</i>	–	–	(320)	(536)	(856)	(6)	(862)
Total comprehensive income for the year	–	–	(320)	940	620	50	670
Share-based payments (inclusive of tax)	–	–	–	75	75	–	75
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)	–	–	(5)	–	(5)	–	(5)
Ordinary share dividends	–	–	–	(724)	(724)	(56)	(780)
Partial disposal of shareholding in subsidiary undertaking	–	–	–	(13)	(13)	38	25
At 31 December 2019	87	1,249	6,156	(2,085)	5,407	104	5,511
Balance at 1 January 2018	87	1,249	6,090	(2,714)	4,712	43	4,755
<i>Profit for the year</i>	–	–	–	1,000	1,000	33	1,033
<i>Total other comprehensive income for the year</i>	–	–	391	85	476	4	480
Total comprehensive income for the year	–	–	391	1,085	1,476	37	1,513
Share-based payments (inclusive of tax)	–	–	–	63	63	–	63
Net sale of own shares	–	–	–	1	1	–	1
Ordinary share dividends	–	–	–	(703)	(703)	(28)	(731)
Partial disposal of shareholding in subsidiary undertaking	–	–	–	(3)	(3)	20	17
At 31 December 2018	87	1,249	6,481	(2,271)	5,546	72	5,618

Consolidated balance sheet

as at 31 December

	2019 £m	2018 ¹ £m
Non-current assets		
Intangible assets	10,371	10,658
Property, plant and equipment	2,437	2,365
Right-of-use assets	1,138	–
Investment property	137	98
Equity accounted investments	428	429
Other investments	13	13
Other receivables	484	352
Post-employment benefit surpluses	6 302	308
Other financial assets	350	245
Deferred tax assets	726	702
	16,386	15,170
Current assets		
Inventories	835	774
Trade, other and contract receivables	5,458	5,177
Current tax	19	81
Other financial assets	210	166
Cash and cash equivalents	2,587	3,232
Assets held for sale	135	146
	9,244	9,576
Total assets	25,630	24,746
Non-current liabilities		
Loans	(3,020)	(3,514)
Lease liabilities	(1,116)	–
Other payables	(1,481)	(1,461)
Post-employment benefit obligations	6 (4,757)	(4,337)
Other financial liabilities	(227)	(104)
Provisions	(385)	(427)
	(10,986)	(9,843)
Current liabilities		
Loans and overdrafts	(377)	(785)
Lease liabilities	(238)	–
Trade and other payables	(7,926)	(7,718)
Other financial liabilities	(232)	(74)
Current tax	(55)	(334)
Provisions	(300)	(334)
Liabilities held for sale	(5)	(40)
	(9,133)	(9,285)
Total liabilities	(20,119)	(19,128)
Net assets	5,511	5,618
Capital and reserves		
Issued share capital	87	87
Share premium	1,249	1,249
Other reserves	6,156	6,481
Retained earnings – deficit	(2,085)	(2,271)
Total equity attributable to equity holders of BAE Systems plc	5,407	5,546
Non-controlling interests	104	72
Total equity	5,511	5,618

1. The Saudi Arabia end of service benefit obligation of £97m at 31 December 2018 has been reclassified from trade and other payables to post-employment benefit obligations (see note 6).

Approved by the Board of BAE Systems plc on 19 February 2020 and signed on its behalf by:

C N Woodburn
Chief Executive

P J Lynas
Group Finance Director

Consolidated cash flow statement

for the year ended 31 December

	Notes	2019 £m	2018 ¹ £m
Profit for the year		1,532	1,033
Taxation expense	4	94	191
Research and development expenditure credits		(12)	(27)
Share of results of equity accounted investments		(168)	(140)
Net finance costs		273	381
Depreciation, amortisation, impairment and derecognition		660	411
Gain on investment revaluation		–	(7)
Profit on disposal of property, plant and equipment, and investment property		(9)	(18)
(Gain)/loss in respect of held for sale assets and business disposals		(9)	9
Cost of equity-settled employee share schemes		74	64
Movements in provisions		(73)	(101)
Decrease in liabilities for post-employment benefit obligations		(214)	(153)
(Increase)/decrease in working capital:			
Inventories		(76)	(16)
Trade, other and contract receivables		(481)	(757)
Trade and other payables		258	530
Taxation paid		(252)	(200)
Net cash flow from operating activities		1,597	1,200
Dividends received from equity accounted investments		142	57
Interest received		28	25
Principal element of finance lease receipts		9	–
Purchase of property, plant and equipment, and investment property		(360)	(358)
Purchase of intangible assets		(110)	(139)
Proceeds from sale of property, plant and equipment, and investment property		21	34
Proceeds from the sale of intangible assets		1	–
Purchase of equity accounted investment		–	(2)
Equity accounted investment funding		(6)	(1)
Purchase of subsidiary undertakings, net of cash and cash equivalents acquired		(12)	14
Cash flow in respect of held for sale assets and business disposals, net of cash and cash equivalents disposed		55	12
Net cash flow from investing activities		(232)	(358)
Interest paid		(233)	(203)
Net sale of own shares		–	1
Equity dividends paid	7	(724)	(703)
Dividends paid to non-controlling interests		(56)	(28)
Partial disposal of shareholding in subsidiary undertaking		31	17
Principal element of lease payments		(239)	–
Cash flow from matured derivative financial instruments (excluding cash flow hedges)		40	6
Cash flow from movement in cash collateral		1	2
Cash outflow from repayment of loans		(782)	(7)
Net cash flow from financing activities		(1,962)	(915)
Net decrease in cash and cash equivalents		(597)	(73)
Cash and cash equivalents at 1 January		3,232	3,264
Effect of foreign exchange rate changes on cash and cash equivalents		(48)	41
Cash and cash equivalents at 31 December		2,587	3,232

1. 2018 comparatives have been reclassified to present a cash inflow of £17m in respect of a partial disposal of the Group's shareholding in a subsidiary undertaking within financing activities. This cash flow was previously presented within investing activities.

Notes to the accounts

1. Preparation

Basis of preparation and statement of compliance

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

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

Changes in accounting policies

IFRS 16 Leases became effective from 1 January 2019. The impact of adoption is set out in note 12.

2. Segmental analysis

Sales and revenue by reporting segment

	Sales		Deduct Share of sales by equity accounted investments		Add Sales to equity accounted investments		Revenue	
	2019 £m	2018 £m	2019 £m	2018 £m	2019 £m	2018 £m	2019 £m	2018 £m
Electronic Systems	4,439	3,965	(114)	(101)	114	101	4,439	3,965
Cyber & Intelligence	1,732	1,678	–	–	–	–	1,732	1,678
Platforms & Services (US)	3,337	3,005	(153)	(141)	1	–	3,185	2,864
Air	7,457	6,712	(2,221)	(2,224)	917	1,091	6,153	5,579
Maritime	3,116	2,975	(50)	(37)	5	2	3,071	2,940
HQ	387	350	(344)	(309)	–	–	43	41
	20,468	18,685	(2,882)	(2,812)	1,037	1,194	18,623	17,067
Intra-group sales/revenue	(359)	(278)	4	–	37	32	(318)	(246)
	20,109	18,407	(2,878)	(2,812)	1,074	1,226	18,305	16,821

Operating profit/(loss) by reporting segment

	Underlying EBITA		Non-recurring items ¹		Amortisation and impairment of intangible assets		Financial and taxation expense of equity accounted investments		Operating profit/(loss)	
	2019 £m	2018 £m	2019 £m	2018 £m	2019 £m	2018 £m	2019 £m	2018 £m	2019 £m	2018 £m
Electronic Systems	687	606	–	–	(15)	(16)	–	–	672	590
Cyber & Intelligence	91	111	–	–	(11)	(52)	–	–	80	59
Platforms & Services (US)	267	210	(13)	(40)	(11)	(8)	(4)	(1)	239	161
Air	887	859	(28)	–	(32)	(12)	(50)	(37)	777	810
Maritime	268	209	14	–	(25)	(16)	(4)	(2)	253	191
HQ	(83)	(67)	–	(114)	(21)	(14)	(18)	(11)	(122)	(206)
	2,117	1,928	(27)	(154)	(115)	(118)	(76)	(51)	1,899	1,605
Net finance costs									(273)	(381)
Profit before taxation									1,626	1,224
Taxation expense									(94)	(191)
Profit for the year									1,532	1,033

1. Non-recurring items in 2019 of £27m comprises a £36m charge relating to the derecognition of Enterprise Resource Planning software intangible assets in the Air sector, charges of £13m relating to legal disputes arising from historical disposals, a gain of £14m on the sale of the Group's 55% shareholding in BAE Systems Global Combat Systems Limited upon formation of the Rheinmetall BAE Systems Land joint venture, and a gain of £8m relating to the disposal of the Aircraft Accessories and Components Company. Non-recurring items in 2018 of £154m represented a Guaranteed Minimum Pension equalisation charge of £114m, and a loss on disposal of the Mobile, Alabama, shipyard of £40m.

3. Net finance costs

	2019 £m	2018 £m
Interest income on cash and other financial instruments	26	26
Interest income on finance lease receivables	1	–
Financial income ¹	27	26
Interest expense on bonds and other financial instruments	(187)	(204)
Facility fees	(4)	(4)
Interest expense on lease liabilities	(48)	–
Net present value adjustments on provisions and other payables	(28)	(31)
Net interest expense on post-employment benefit obligations	(114)	(103)
(Loss)/gain on remeasurement of financial instruments at fair value through profit or loss ²	(73)	146
Foreign exchange gains/(losses) ³	154	(211)
Financial expense ¹	(300)	(407)
Net finance costs	(273)	(381)

1. Gains on remeasurement of financial instruments at fair value through profit or loss of £186m and foreign exchange gains of £16m were previously presented within financial income in 2018. The Group believes it is more representative to present these items within financial expense, since the gains and losses relate to the same underlying transactions. Accordingly, amounts previously included within financial income in 2018 have been reclassified to financial expense.
2. Comprises gains and losses on derivative financial instruments, including derivative instruments to manage the Group's exposure to interest rate fluctuations on external borrowings and exchange rate fluctuations on balances with the Group's subsidiaries and equity accounted investments.
3. The foreign exchange gains and losses primarily reflect exchange rate movements on US dollar-denominated borrowings.

Additional analysis

	2019 £m	2018 £m
Net finance costs:		
Group	(273)	(381)
Share of equity accounted investments	(23)	(13)
	(296)	(394)
Analysed as:		
Underlying net interest expense ¹ :		
Group	(240)	(213)
Share of equity accounted investments	(17)	(2)
	(257)	(215)
Other:		
Group:		
Net interest expense on post-employment benefit obligations	(114)	(103)
Fair value and foreign exchange adjustments on financial instruments and investments ²	81	(65)
Share of equity accounted investments:		
Net interest expense on post-employment benefit obligations	(3)	(3)
Fair value and foreign exchange adjustments on financial instruments and investments	(3)	(8)
	(296)	(394)

1. Underlying net interest expense is defined as finance costs for the Group and its share of equity accounted investments, excluding net interest expense on post-employment benefit obligations, and fair value and foreign exchange adjustments on financial instruments and investments.
2. The net gain (2018 loss) primarily reflects foreign exchange translational gains (2018 losses) on US dollar-denominated bonds held by BAE Systems plc.

4. Taxation expense

Reconciliation of taxation expense

The following table reconciles the theoretical income tax expense, using the UK corporation tax rate, to the reported tax expense. The reconciling items represent, besides the impact of tax rate differentials and changes, non-taxable benefits or non-deductible expenses arising from differences between the local tax base and the reported financial statements.

	2019 £m	2018 £m
Profit before taxation	1,626	1,224
UK corporation tax rate	19%	19%
Expected income tax expense	(309)	(233)
Effect of tax rates in foreign jurisdictions, including US state taxes	(52)	(43)
Effect of intra-group financing	–	14
Expenses not tax effected	(14)	(14)
Income not subject to tax	61	18
Research and development tax credits and patent box benefits	10	14
Non-taxable non-recurring items	4	–
Chargeable gains	(3)	(1)
Utilisation of previously unrecognised tax losses	3	1
Current year losses not tax effected	(3)	–
Adjustments in respect of prior years	192	37
Adjustments in respect of equity accounted investments	32	27
Tax rate adjustment	(1)	5
Other	(14)	(16)
Taxation expense	(94)	(191)

Calculation of the underlying effective tax rate

	2019 £m	2018 £m
Profit before taxation	1,626	1,224
Add back: Taxation expense of equity accounted investments	53	38
Deduct: Non-taxable non-recurring items	(22)	–
Adjusted profit before taxation	1,657	1,262
Taxation expense	(94)	(191)
Taxation expense of equity accounted investments	(53)	(38)
Exclude: One-off tax benefit	(161)	–
Adjusted taxation expense (including equity accounted investments)	(308)	(229)
Underlying effective tax rate	19%	18%

The one-off tax benefit relates to two items. Firstly, following agreements reached in respect of overseas tax matters, a benefit has been recognised. Secondly, following review of the April 2019 EU Commission decision that concluded that the UK's Controlled Foreign Company regime partially represents State Aid, a provision has been recognised for the estimated exposure. There remains uncertainty surrounding HMRC's likely approach to the assessment of the deemed State Aid and recovery of amounts which they consider to be due, and, accordingly, developments will continue to be monitored and assessed.

5. Earnings per share

	2019			2018		
	£m	Basic pence per share	Diluted pence per share	£m	Basic pence per share	Diluted pence per share
Profit for the year attributable to equity shareholders	1,476	46.4	46.1	1,000	31.3	31.2
Add back/(deduct):						
Amortisation and impairment of intangible assets, post tax ¹	93			97		
Net interest expense on post-employment benefit obligations, post tax ¹	95			87		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax ¹	(64)			60		
Non-recurring items, post tax ¹	18			126		
Underlying earnings, post tax	1,618	50.8	50.5	1,370	42.9	42.8
One-off tax benefit	(161)			–		
Underlying earnings, excluding one-off tax benefit	1,457	45.8	45.5	1,370	42.9	42.8
		Millions	Millions		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		3,183	3,183		3,192	3,192
Incremental shares in respect of employee share schemes			18			9
Weighted average number of shares used in calculating diluted earnings per share			3,201			3,201

1. The tax impact is calculated using the underlying effective tax rate of 19% (2018 18%). The calculation of the underlying effective tax rate is shown in note 4.

6. Post-employment benefits

Funding

Introduction

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

For funding valuation purposes, pension scheme assets are included at market value at the valuation date, whilst the liabilities are measured on an actuarial funding basis using the projected unit credit method and discounted to their present value based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The funding valuations are performed by professionally qualified independent actuaries and include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 49. The purpose of the funding valuations is to design funding plans which ensure that the schemes have sufficient funds available to meet future benefit payments.

UK valuations

Funding valuations of the Group's UK defined benefit pension schemes are performed every three years. Following the merger of several of the Group's UK pension schemes in October 2019, the Company and trustees agreed to carry out an early triennial funding valuation for the BAE Systems Pension Scheme (Main Scheme) as at 31 October 2019. The next funding valuations for the other UK schemes will have an effective date of no later than 31 March 2020.

The results of the most recent triennial valuations are shown below. These valuations and, where necessary, deficit recovery plans were agreed with the trustees and certified by the scheme actuaries after consultation with The Pensions Regulator in the UK.

	Main Scheme as at 31 October 2019 £bn	Other schemes as at 31 March 2017 £bn
Market value of assets	20.6	2.2
Present value of liabilities	(22.5)	(2.0)
Funding (deficit)/surplus	(1.9)	0.2
Percentage of accrued benefits covered by the assets at the valuation date	92%	110%

The valuations in 2017 and 2019 were determined using the following mortality assumptions:

Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	87 – 90
Life expectancy of a male currently aged 45 (years)	88 – 92
Life expectancy of a female currently aged 45 (years)	90 – 93

The discount rate assumptions used in the 2017 and 2019 valuations were directly based on prudent levels of expected returns for the assets held by the schemes, reflecting the planned investment strategies and maturity profiles of each scheme. The discount rates are curves which provide a different rate for each year into the future.

The inflation assumptions were derived using data from the Bank of England which is based on the difference between the yields on index-linked and fixed interest long-term government bonds. The inflation assumption is a curve which provides a different rate for each year into the future.

The funding valuations resulted in a significantly lower deficit than under IAS 19, largely due to lower liabilities reflecting the higher discount rate assumption. Under IAS 19, the discount rate for accounting purposes is based on third-party AA corporate bond yields whereas, for funding valuation purposes, the discount rate is based on a prudent level of expected returns from the broader and mixed types of investments reflected in the schemes' investment strategies, which are expected overall to yield higher returns than bonds.

The 2019 funding agreement is underpinned by a contingency plan, which includes a commitment by the Group to a further £50m of deficit funding in each of 2021 and 2022 into the Main Scheme prior to the next triennial valuation in the event that the scheme funding level were to fall below pre-determined parameters. In addition, the Group would be required to pay £187m in respect of the Main Scheme if the funding level were to fall significantly and were to remain at or below those levels for nine months.

There have been no changes to the contributions or benefits, as set out in the rules of the schemes, for pension scheme members as a result of the new funding valuations.

The results of future triennial valuations and associated funding requirements will be impacted by a number of factors, including the future performance of investment markets and anticipated members' longevity.

US valuations

The Group's US pension schemes are valued annually, with the latest valuations performed as at 1 January 2019.

Contributions

Under the terms of the trust deeds of the UK schemes, the Group is required to have a funding plan determined at the conclusion of the triennial funding valuations.

Equity accounted investments make regular contributions to the schemes in which they participate in line with the schedule of contributions and are allocated a share of deficit funding contributions.

In 2019, total employer contributions to the Group's pension schemes were £461m (2018 £554m), including amounts funded by equity accounted investments of £40m (2018 £38m), and included approximately £231m (2018 £211m) of deficit recovery payments in respect of the UK schemes and £nil (2018 £119m) in respect of the US schemes.

Deficit contributions will further increase in line with any percentage growth in dividend payments made by the Group. As part of the 31 October 2019 valuation agreement, the Company has agreed to pay £1bn into the Main Scheme in the coming months representing an advancement of £1bn in deficit contributions that were due, under

the 2017 valuation deficit recovery plan, between 2022 and 2026. The annual payments are expected to end in 2021 and the deficit is expected to be cleared in 2026.

In 2020, Group contributions to the US pension schemes are expected to increase by approximately £60m.

IAS 19 accounting

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		
	2019	2018	2017	2019	2018	2017
Financial assumptions						
Discount rate – past service (%)	2.1	2.9	2.6	3.1	4.2	3.7
Discount rate – future service (%)	2.2	3.0	2.7	3.1	4.2	3.7
Retail Prices Index (RPI) inflation (%)	2.8	3.1	3.1	n/a	n/a	n/a
Rate of increase in salaries (%)	2.8	3.1	3.1	n/a	n/a	n/a
Rate of increase in deferred pensions (%)	2.0/2.8	2.1/3.1	2.1/3.1	n/a	n/a	n/a
Rate of increase in pensions in payment (%)	1.5 – 3.6	1.6 – 3.7	1.6 – 3.7	n/a	n/a	n/a
Demographic assumptions						
Life expectancy of a male currently aged 65 (years)	87 – 88	86 – 88	86 – 88	87	87	87
Life expectancy of a female currently aged 65 (years)	88 – 90	88 – 90	88 – 90	89	89	89
Life expectancy of a male currently aged 45 (years)	88 – 89	88 – 90	88 – 90	87	87	87
Life expectancy of a female currently aged 45 (years)	89 – 91	90 – 91	90 – 92	89	89	89

Summary of movements in post-employment benefit obligations

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2019 ¹	(3,554)	(779)	(4,333)
Actual return on assets excluding amounts included in net interest expense	1,491	766	2,257
Increase in liabilities due to changes in financial assumptions	(2,547)	(638)	(3,185)
Decrease in liabilities due to changes in demographic assumptions	448	19	467
Experience losses	(96)	(28)	(124)
Contributions in excess of/(below) service cost	243	(22)	221
Past service cost – plan amendments	(4)	–	(4)
Net interest expense	(92)	(28)	(120)
Foreign exchange adjustments	–	28	28
Movement in other schemes	–	14	14
Total net IAS 19 deficit at 31 December 2019	(4,111)	(668)	(4,779)
Allocated to equity accounted investments	324	–	324
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 31 December 2019	(3,787)	(668)	(4,455)

1. At 31 December 2018 the Saudi Arabia end of service benefit of £97m was presented within trade and other payables. The comparative balance sheet has been reclassified to include this balance within post-employment benefits as the Group considers this to be a more appropriate presentation.

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2019 and keeping all other assumptions as set out above.

Financial assumptions

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

	(Increase)/decrease in pension obligation ¹ £bn	Increase/(decrease) in scheme assets ¹ £bn
Discount rate:		
0.1 percentage point increase	0.5	(0.3)
0.1 percentage point decrease	(0.5)	0.3
Inflation:		
0.1 percentage point increase	(0.4)	0.2
0.1 percentage point decrease	0.3	(0.2)

1. Before allocation to equity accounted investments.

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

	(Increase)/decrease in pension obligation ¹ £bn
Inflation:	
0.5 percentage point increase	(1.5)
0.5 percentage point decrease	1.4
1.0 percentage point increase	(3.0)
1.0 percentage point decrease	2.8

1. Before allocation to equity accounted investments.

Demographic assumptions

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

	(Increase)/decrease in net deficit ¹ £bn
Life expectancy:	
One-year increase	(1.3)
One-year decrease	1.3

1. Before allocation to equity accounted investments.

7. Equity dividends

	2019 £m	2018 £m
Prior year final 13.2p dividend per ordinary share paid in the year (2018 13.0p)	423	415
Interim 9.4p dividend per ordinary share paid in the year (2018 9.0p)	301	288
	724	703

After the balance sheet date, the directors proposed a final dividend of 13.8p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 1 June 2020 to shareholders registered on 17 April 2020. The ex-dividend date is 16 April 2020.

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 7 May 2020.

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 money market funds are calculated by multiplying the net asset value per share by the investment held at the balance sheet date.

Due to the variability of the valuation factors, the fair values presented at 31 December may not be indicative of the amounts the Group would expect to realise in the current market environment.

Fair value hierarchy

The fair value measurement hierarchy is as follows:

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

Carrying amounts and fair values of certain financial instruments

	2019		2018	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:				
Non-current				
Equity investments at fair value through profit and loss	13	13	13	13
Other financial assets	350	350	245	245
Other financial liabilities	(227)	(227)	(104)	(104)
Current				
Other financial assets	210	210	166	166
Money market funds	680	680	908	908
Other financial liabilities	(232)	(232)	(74)	(74)
Financial instruments not measured at fair value:				
Non-current				
Loans	(3,020)	(3,315)	(3,514)	(3,597)
Current				
Cash and cash equivalents (excluding money market funds)	1,907	1,907	2,324	2,324
Loans and overdrafts	(377)	(380)	(785)	(794)

All of the financial assets and liabilities measured at fair value are classified as level 2 using the fair value hierarchy, except for money market funds, which are classed as level 1. There were no transfers between levels during the year.

Financial assets and liabilities in the Group's Consolidated balance sheet are either held at fair value or their carrying value approximates to fair value, with the exception of loans, which are held at amortised cost. The fair value of loans presented in the table above is derived from market prices, classified as level 1 using the fair value hierarchy.

9. Financial risk management

Currency risk

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

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

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

The estimated impact on foreign exchange gains and losses in net finance costs of a ten cent movement in the closing sterling to US dollar exchange rate on the retranslation of US dollar-denominated bonds held by BAE Systems plc is approximately £52m (2018 £56m).

10. Related party transactions

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

	Year ended 31 December 2019 £m	Year ended 31 December ¹ 2018 £m
Sales to related parties	1,074	1,226
Purchases from related parties	664	723
	31 December 2019 £m	31 December 2018 £m
Amounts owed by related parties	53	71
Amounts owed to related parties ²	1,359	965

1. 2018 purchases from related parties have been restated to include £313m of purchases from Eurofighter Jagdflugzeug GmbH.

2. At 31 December 2019, £862m (2018 £869m) was owed by BAE Systems plc and £497m (2018 £96m) by other Group subsidiaries. Amounts owed to related parties at 31 December 2019 include £225m in respect of lease liabilities measured under IFRS 16 payable to BAE Systems Pension Funds Trustees Limited. The undiscounted minimum lease commitments to this related party at 31 December 2018 were £297m, which is not included in amounts owed to related parties in the table above.

11. Events after the reporting period

In January 2020, the Group announced that it has entered into a definitive Asset Purchase Agreement to acquire Collins Aerospace's Military Global Positioning System business for \$1.9bn in cash, subject to customary closing adjustments. The Group has also entered into a definitive Asset Purchase Agreement to acquire Raytheon's Airborne Tactical Radios business for \$275m in cash, subject to customary closing adjustments. Completion of both acquisitions is subject to successful closure of the Raytheon-United Technologies Corporation merger, as well as customary regulatory approvals and conditions.

In October 2019, six of the Group's nine UK pension schemes (including the two largest schemes) were consolidated into a single scheme. Following that consolidation, the Company agreed with the new Trustee Board to bring forward the funding valuation of the combined scheme to 31 October 2019 from the previously scheduled date of 31 March 2020.

After consultation with the The Pensions Regulator in the UK, the Group has reached agreement with the Trustee Board of the combined scheme on the accelerated funding valuation and revised deficit recovery plan.

At the 31 October 2019 funding valuation date, the deficit was £1.9bn. The current deficit recovery plan which runs to 2026 will be replaced by a new deficit recovery plan, under which a one-off payment of £1bn is to be made in the coming months, with approximately £240m of funding payable in the scheme year ending 31 March 2020 and approximately £250m by 31 March 2021.

12. Adoption of IFRS 16 Leases

IFRS 16 became effective from 1 January 2019 and has replaced IAS 17 Leases and related interpretations. It has resulted in almost all leases being recognised on the balance sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, a right-of-use asset and a financial liability for future lease payments are recognised. The only exceptions are short-term leases, low-value leases and leases of intangible assets.

The Group has applied the modified retrospective transition approach and has not restated comparative amounts for the year ended 31 December 2018. In the majority of cases the Group has elected to measure right-of-use assets at the amount of the lease liability on adoption (adjusted for any lease prepayments or accrued lease expenses, onerous lease provisions and leased assets which have subsequently been subleased). For a number of property leases the Group has elected to measure the right-of-use asset as if IFRS 16 had been applied since the start of the lease, but using the incremental borrowing rate at 1 January 2019, with the difference between the right-of-use asset and the lease liability taken to retained earnings.

The Group has elected to adopt the following practical expedients on transition:

- not to capitalise a right-of-use lease asset or related lease liability where the lease expires before 31 December 2019;
- not to reassess contracts to determine if the contract contains a lease and not to separate lease and non-lease elements;
- where an onerous lease provision is in existence, to utilise this provision to reduce the right-of-use asset value rather than undertaking an impairment review;
- to use hindsight in determining the lease term;
- to exclude initial direct costs from the measurement of the right-of-use asset; and
- to apply the portfolio approach where a group of leases has similar characteristics.

Impact of adoption of IFRS 16 Leases

Balance sheet

Upon transition on 1 January 2019, the Group recognised a right-of-use lease asset of £1,298m (after adjustments for onerous lease provisions, lease prepayments and accrued lease expenses at 31 December 2018), and lease liabilities of £1,486m (non-current £1,270m; current £216m), along with a deferred tax asset of £2m. A sublease finance receivable of £72m was also recognised. A transition adjustment of £92m was recognised as a debit to retained earnings. The Group did not capitalise low-value leases on transition, or those which expire before 31 December 2019, and has opted not to apply IFRS 16 to leases relating to intangible assets. The right-of-use lease asset principally consists of property.

Income statement

Under IFRS 16 the Group sees a different pattern of expense within the income statement, as the IAS 17 operating lease expense is replaced by depreciation and interest charges. In 2019, the Group's EBITA metric has improved by approximately £50m under IFRS 16 as the new depreciation expense is lower than the IAS 17 operating lease charge; however the new finance costs have broadly offset this, such that net profit after tax and the underlying earnings metrics are not materially different compared to the previous IAS 17 reporting basis.

Cash flow statement

The change in presentation as a result of the adoption of IFRS 16 has seen an improvement in 2019 of approximately £46m in operating business cash flow, offset by a corresponding decline in cash flow from financing activities. There is no overall cash flow impact from the adoption of the new Standard.

Lessor accounting under IFRS 16 is largely unchanged from IAS 17.

Impact on Consolidated balance sheet at 1 January 2019 (extract)

The following table shows the effect of adopting IFRS 16 on the Consolidated balance sheet at 1 January 2019.

	£m
Non-current assets	
Right-of-use assets	1,255
Investment property	43
Equity accounted investments	(11)
Finance lease receivable	62
Deferred tax assets	2
	1,351
Current assets	
Finance lease receivable	10
Trade, other and contract receivables	(26)
	(16)
Total assets	1,335
Non-current liabilities	
Lease liabilities	(1,270)
Provisions	24
	(1,246)
Current liabilities	
Lease liabilities	(216)
Trade and other payables	28
Provisions	7
	(181)
Total liabilities	(1,427)
Net assets	(92)
Capital and reserves	
Retained earnings	(92)
Total equity attributable to equity holders of BAE Systems plc	(92)
Non-controlling interests	–
Total equity	(92)

The weighted average incremental borrowing rate applied to lease liabilities was 3.4%.

Reconciliation between operating lease commitments and lease liability

The following table explains the difference between the operating lease commitments disclosed applying IAS 17 at 31 December 2018 and the lease liability recognised on adoption of IFRS 16 at 1 January 2019.

	£m
Total minimum lease payments reported at 31 December 2018 under IAS 17	1,706
Change in assessment of lease term under IFRS 16	107
Leases outside the scope of IFRS 16	(81)
Impact of discounting lease liability under IFRS 16	(246)
Lease liability recognised on transition to IFRS 16 at 1 January 2019	1,486

13. Annual General Meeting

This year's Annual General Meeting will be held on 7 May 2020. Details of the resolutions to be proposed at that meeting will be included in the notice of Annual General Meeting that will be sent to shareholders at the end of March 2020.

14. Other information

The financial information for the year ended 31 December 2019 contained in this preliminary announcement was approved by the Board on 19 February 2020. This announcement does not constitute statutory accounts of the Company within the meaning of Section 435 of the Companies Act 2006, but is derived from those accounts.

Statutory accounts for the year ended 31 December 2018 have been delivered to the Registrar of Companies. Statutory accounts for the year ended 31 December 2019 will be delivered to the Registrar of Companies following the Company's Annual General Meeting.

The auditors have reported on those accounts. Their reports were not qualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and did not contain a statement under Section 498(2) or (3) of the Companies Act 2006.

Cautionary statement:

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