BAE SYSTEMS
INSPIRED WORK

Half-yearly Report
2016

BAE Systems plc
Half-yearly Report 2016

Results in brief

	Six months ended 30 June 2016	Six months ended 30 June 2015	Year ended 31 December 2015
Sales[1]	**£8,714m**	£8,472m	£17,904m
Revenue	**£8,278m**	£8,001m	£16,787m
Underlying EBITA[2]	**£849m**	£800m	£1,683m
Operating profit	**£776m**	£700m	£1,502m
Underlying earnings[3] per share	**17.4p**	17.1p	40.2p
Basic earnings per share[4]	**12.9p**	12.3p	29.0p
Order backlog[1,5]	**£36.3bn**	£37.3bn	£36.8bn
Dividend per share	**8.6p**[6]	8.4p	20.9p
Operating business cash flow[7]	**£(20)m**	£(349)m	£681m
Net debt (as defined by the Group)[8]	**£(2,036)m**	£(1,939)m	£(1,422)m

Ian King, Chief Executive, said "In the first half of 2016, BAE Systems performed well. Despite economic and political uncertainties, governments in our major markets continue to prioritise national security, with strong demand for our capabilities. In the US, we are seeing encouraging signs of a return to growth in defence budgets and improved prospects for our core franchises. In the UK, the result of the EU referendum will lead to a period of uncertainty, but we do not anticipate any material near-term trading impact on our business.

Our business benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia. We are well placed to maximise opportunities, deal with the challenges and continue to generate attractive shareholder returns."

Financial key points

- Sales[1] increased by £0.2bn to £8.7bn mainly due to exchange translation
- Underlying EBITA[2] increased by 6% to £849m, or 3% on a constant currency basis
- Underlying earnings[3] per share increased by 2% to 17.4p
- Large order backlog[1,5] of £36.3bn
- Interim dividend increased by 2% to 8.6p per share
- Net debt[8] of £2.0bn on utilisation of customer advances
- Group's share of the pre-tax accounting net pension deficit[9] increased by £1.6bn to £6.1bn

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 8).
3. Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 4).
4. Basic earnings per share in accordance with International Accounting Standard (IAS) 33, Earnings per Share.
5. Comprises funded and unfunded unexecuted customer orders, and is stated after the elimination of intra-group orders.
6. Interim dividend declared (see note 6).
7. Net cash (outflow)/inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
8. Comprises cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments) and cash received on customers' account (see page 10).
9. Net IAS 19 deficit excluding amounts allocated to equity accounted investments and other participating employers.

Key business highlights

- In April, Eurofighter partner, Leonardo, signed a contract to supply 28 Typhoon aircraft to Kuwait, which is expected to result in airframe manufacture, capability upgrade and Electronically Scanned (E-Scan) radar integration work valued at approximately £1bn for BAE Systems
- In July, BAE Systems welcomed a ten-year partnership arrangement with the UK Ministry of Defence, expected to be worth £2.1bn, to support the UK Typhoon fleet
- Three contracts announced with a total value of approximately £300m to support the UK Ministry of Defence's fleet of Hawk fast jet trainer aircraft until 2020
- Awarded a £118m contract to build engineering and training facilities in the UK for F-35 Lightning II aircraft
- UK and French governments announced a new €2bn (£1.7bn) project to build an unmanned combat air system demonstrator
- £472m UK Ministry of Defence contract extension to the Type 26 frigate demonstration phase
- $245m (£183m) contract to provide three gun systems and a trainer for the Royal Navy's Type 26 frigate
- $149m (£111m) contract for the production of new Assault Amphibious Vehicles for the Japanese Ministry of Defence
- $182m (£136m) contract to refurbish 262 Swedish Army CV90 combat vehicles
- The MBDA joint venture, in which BAE Systems has a 37.5% interest, continued to win new orders, BAE Systems' share of which was £462m in the first half of 2016

Guidance for 2016

Group

With some anticipated trading bias to the second half of the year, the Group continues to expect underlying earnings[2] per share for 2016 to be approximately 5% to 10% higher than the adjusted underlying earnings[2] per share of 36.6p* in 2015.

* *Reported underlying earnings[2] per share of 40.2p excluding tax provision releases of 4.3p per share and adjusting for a 0.7p per share benefit to an assumed US$1.45 to sterling translation rate. A ten cent movement in the US$/£ exchange rate translates to approximately 0.8p in underlying earnings[2] per share.*

Segmental

Electronic Systems:

- Low single-digit sales[1] growth is expected in 2016 with margins around the middle of an increased 13% to 15% range.

Cyber & Intelligence comprising the US Intelligence & Security sector and UK-headquartered Applied Intelligence business:

- Low single-digit sales[1] growth is expected in 2016 with stable sales in Intelligence & Security and good double-digit growth in Applied Intelligence.
- Margins are expected to improve to within a 7% to 9% range principally as anticipated second half sales growth in Applied Intelligence outpaces the continued high investment in product development and marketing costs.

Platforms & Services (US):

- Sales[1] are expected to be some 10% lower, including a reduction in naval ship repair activity as the pivot of the fleet to the West Coast continues.
- Margins are expected to increase, to a range of 7% to 8%, including charges taken in commercial shipbuilding in the first half.

Platforms & Services (UK):

- Sales[1] are expected to be slightly lower in line with planned lower Typhoon deliveries. Increased submarine programme activity is expected to offset reducing aircraft carrier sales.
- Margins are expected to be at the lower end of a 10% to 12% range.

Platforms & Services (International):

- Sales[1] are expected to grow around 5% in 2016 with increased Typhoon aircraft support.
- Margins are expected to be at the lower end of a 10% to 12% range.

HQ costs are expected to be similar to those in 2015. Underlying finance costs are expected to increase by £35m in 2016. The effective tax rate remains dependent on the geographical mix of profits, but is expected to increase slightly to around 22%.

1. Including share of equity accounted investments.
2. Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 4).

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Analyst and investor webcast/call

The first half results will be presented via a webcast for analysts and investors today (28 July 2016) at 10.30am. 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 later in the day.

About BAE Systems

At BAE Systems, we provide some of the world's most advanced technology defence, aerospace and security solutions. We employ a skilled workforce of 83,000 people[1] in over 40 countries. Working with customers and local partners, our products and services deliver military capability, protect people and national security, and keep critical information and infrastructure secure.

Interim management report

In the first half of 2016, BAE Systems performed well. Despite economic and political uncertainties, governments in the Group's major markets continue to prioritise national security, with strong demand for its capabilities.

The business benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia, and the Group is well placed to maximise opportunities, deal with the challenges and continue to generate attractive shareholder returns.

US

Following the two-year Bipartisan Budget Act signed last year, the defence market outlook in the US is improving with encouraging signs of a return to growth in defence budgets and the ramp up of production on a number of the Group's long-term programmes. A possible Continuing Resolution may result in the federal government running at fiscal year 2016 spending levels from 1 October 2016. The Group does not expect any material disruption if a short-term Continuing Resolution takes effect.

BAE Systems' US electronics business continued to perform well, with strong programme execution and good order intake enhancing its positions in the high-technology areas of electronic warfare, electro-optics and Intelligence, Surveillance and Reconnaissance. Growth continues in commercial electronics through flight and engine controls and in the HybriDrive® business.

While market conditions remain highly competitive and continue to evolve, BAE Systems' US-based Intelligence & Security business performed solidly in the period. The momentum from improved performance and strong order intake in 2015 has been maintained.

BAE Systems is a leading supplier of ship repair services to the US Navy and continues to adjust its workforce to meet evolving demand. Additional contracts received in the first half of 2016 have largely mitigated anticipated workforce reductions in the Norfolk, Virginia, shipyard. In future years, the Group's San Diego operations are expected to benefit from enhanced Pacific deployment over the mid-term, mitigating the anticipated reduction in activity in the East Coast facilities. Additional dry dock capacity for the San Diego operations is on track for completion by early 2017.

The US business's commercial shipbuilding contracts remain challenging with further charges of $49m (£34m) taken in the period. Charges totalling $16m (£11m) and $57m (£37m) were taken on commercial shipbuilding contracts in the first and second half of 2015, respectively. Of the eight ships, only three now remain for delivery and customer acceptance. The US business has not contracted for any more commercial shipbuild.

The US land business delivered good order intake in the period on the back of contract awards on amphibious vehicles to Japan, BvS10 military vehicles to Austria and CV90 combat vehicle upgrades for Sweden and, in July, the weapon systems business was awarded a contract for gun systems for the Royal Navy's Type 26 frigate.

The Group's US-based combat vehicles business is underpinned by the Armored Multi-Purpose Vehicle and M109A7 self-propelled howitzer contracts. The business is also experiencing US and international demand on amphibious programmes. These long-term contracts, opportunities in international markets and the strong franchise in tracked vehicles make the business well placed for a return to growth in the medium term in the land domain.

UK

BAE Systems' UK-based businesses continued to perform well, benefiting from good programme execution and stability in customer requirements following the UK Strategic

Defence and Security Review last year. The result of the EU referendum will lead to a period of uncertainty, but the Group does not anticipate any material near-term trading impact on its business.

In the air domain, the contract signed and led by Leonardo to supply 28 Typhoon aircraft for the Kuwaiti Air Force is consistent with the medium-term production planning assumptions announced last year.

Typhoon aircraft deliveries to the Royal Air Force and Royal Saudi Air Force continued alongside airframe sub-assembly deliveries to European partner nations.

Export activity continues to be supported by the UK government and, although there can be no certainty as to the timing of orders, discussions with current and prospective operators of the Typhoon aircraft continue to support the Group's expectations for additional Typhoon contract awards.

Typhoon's capabilities continue to expand with the Captor E-Scan radar and with the Meteor, Storm Shadow and Brimstone 2 weapons integration contracts moving into flight tests during 2016.

BAE Systems supports its UK and European customers' Typhoon and Tornado aircraft and their operational commitments. A ten-year partnership arrangement with the Ministry of Defence to support the UK Typhoon fleet, expected to be worth £2.1bn, is expected to be signed shortly.

The first five Hawk aircraft for Saudi Arabia under the contract signed in 2012 were delivered in the period. The Group continues to support the Indian Hawk programme with the supply of assemblies. Long-term Hawk support contracts in the UK were announced in the period.

UK-based production of rear fuselage assemblies for the F-35 aircraft is increasing at the Group's advanced manufacturing facility, with much of the production investment already in place to achieve the higher production volumes.

The unmanned air systems activity benefited from the announcement by the UK and French governments of a new €2bn (£1.7bn) project to build an unmanned combat air system demonstrator following a successful joint feasibility study.

In the maritime domain, the Queen Elizabeth Class aircraft carrier programme progresses well with assembly of the second ship well underway. Preparations for sea trials in 2017 on the first of class vessel are progressing to plan and activity to support entry into service is expanding.

A £472m extension to the Type 26 frigate demonstration phase was received and work to define the overall build programme continues with the UK Ministry of Defence. Build of Offshore Patrol Vessels for the Royal Navy is progressing well.

The first three Astute Class submarines are now in operational service with the Royal Navy and the remaining four boats are in build. Activity is increasing on the Successor submarine programme and major redevelopment of the Barrow site is underway. The UK government's commitment to the Successor programme has recently been endorsed by parliament.

International

Four Typhoon aircraft were delivered to the Kingdom of Saudi Arabia. The Royal Saudi Air Force has achieved high utilisation and aircraft availability across its Typhoon and Tornado fleets, operating under demanding conditions.

In the fiftieth year of its presence in Saudi Arabia, BAE Systems is progressing current and potential new requirements as part of the long-standing agreements between the UK government and the Kingdom. The current five-year Saudi British Defence Co-operation Programme contract is due to complete at the end of 2016. Discussions between BAE Systems, the UK government and the Saudi Arabian customer are underway to define the terms of the next five-year contract.

In Australia, the business is stable. The rationalisation of the Williamstown shipbuilding facility and cost reduction actions taken across the wider business in 2015 are largely complete and support the streamlined business model.

As the MBDA joint venture wins significant order intake on air, land and naval platforms, building on its already large order book, good growth is expected over the medium term.

Cyber security

Applied Intelligence saw strong order intake and sales growth in the period. Investment continued in engineering capabilities and product development along with a new 'Business Defence' marketing campaign to increase brand awareness. Sales growth is expected to continue as cyber security becomes an increasingly important part of government security and a core element of stewardship for commercial enterprises.

Balance sheet and capital allocation

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

Pension schemes

The Group's share of the pre-tax accounting net pension deficit has increased by £1.6bn from 31 December 2015 to £6.1bn mainly reflecting an increase in liabilities due to a 0.5 percentage point reduction in the real discount rate to 0.2% in the UK and a 0.8 percentage point reduction in the nominal discount rate to 3.7% in the US.

The cash contributions in 2016 to fund the deficit recovery plans of the relevant pension schemes are expected to remain consistent with the prior year at approximately £0.3bn.

The next UK triennial funding review is planned to commence in April 2017 and, in conjunction with the trustees of the schemes, the Group will be looking at various options with a focus on the longer-term view.

Research and development

BAE Systems has developed some of the world's most innovative technologies and invests in research and development to generate future products and capabilities. Company-funded research and development often leads to customer-funded development activity as requirements mature.

Company-funded research and development investment is more relevant in some areas of the Group's activities and is, therefore, disproportionately focused in areas such as defence and commercial aerospace electronics, military aircraft and cyber security. Customer and company-funded research and development activities represent approximately 13% of sales in these areas.

Summary

BAE Systems closed 2015 with good momentum across the Group. With further good performance in the first half of 2016, underpinned by a large order backlog, a well-balanced portfolio and the expected recovery in defence budgets in a number of its markets, the Group is well placed to continue to generate attractive returns for shareholders.

Directors

Elizabeth Corley was appointed to the Board as a non-executive director on 1 February.

On 9 May, Charles Woodburn joined the Board and Executive Committee in the newly-created role of Chief Operating Officer.

Led by the Senior Independent Director, Nick Rose, the Board has agreed to extend Sir Roger Carr's term of appointment as Chairman until February 2020.

Dividend

The Board has declared a 2% increase in the interim dividend to 8.6p for the half year to 30 June 2016.

Income statement

Summarised income statement

	Six months ended 30 June 2016 £m	Six months ended 30 June 2015 £m
Sales[1]	**8,714**	8,472
Less: share of sales of equity accounted investments	**(436)**	(471)
Revenue	**8,278**	8,001
Underlying EBITA[2]	**849**	800
Return on sales	***9.7%***	*9.4%*
Non-recurring items	**–**	(24)
EBITA	**849**	776
Amortisation of intangible assets[1]	**(43)**	(62)
Impairment of intangible assets	**–**	(3)
Finance costs[1]	**(263)**	(201)
Taxation expense[1]	**(125)**	(112)
Profit for the period	**418**	398
Underlying earnings[3] per share	**17.4p**	17.1p
Basic earnings per share[4]	**12.9p**	12.3p
Dividend per share	**8.6p[6]**	8.4p

Exchange rates

Average	Six months ended 30 June 2016	Six months ended 30 June 2015
£/$	**1.433**	1.523
£/€	**1.283**	1.366
£/A$	**1.954**	1.949
Period end	**30 June 2016**	30 June 2015
£/$	**1.337**	1.571
£/€	**1.205**	1.410
£/A$	**1.796**	2.043
Year end		31 December 2015
£/$		1.474
£/€		1.357
£/A$		2.027

Sensitivity analysis	**£m**
Estimated impact on annual sales[1] of a ten cent movement in the average exchange rate	
$	**450**
€	**60**
A$	**30**

Segmental analysis

	Sales[1]		Underlying EBITA[2]	
	Six months ended 30 June 2016 £m	Six months ended 30 June 2015[5] £m	**Six months ended 30 June 2016 £m**	Six months ended 30 June 2015[5] £m
Electronic Systems	**1,443**	1,387	**209**	212
Cyber & Intelligence	**833**	746	**18**	27
Platforms & Services (US)	**1,287**	1,328	**86**	92
Platforms & Services (UK)	**3,664**	3,544	**414**	355
Platforms & Services (International)	**1,739**	1,621	**158**	155
HQ	**104**	128	**(36)**	(41)
Intra-group	**(356)**	(282)	**–**	–
	8,714	8,472	**849**	800

Sales[1] in the first half increased by £0.2bn to £8.7bn mainly due to exchange translation. Some second half bias in sales is expected this year, in particular for the scheduling of aircraft and related equipment deliveries into the Kingdom of Saudi Arabia.

Underlying EBITA[2] was £849m (2015 £800m), 6% up on last year, or 3% on a constant currency basis.

Non-recurring items in 2015 of £24m represented a loss on the disposal of the Group's 75% shareholding in the Land Systems South Africa business.

Amortisation of intangible assets[1] reduced to £43m (2015 £62m) due to acquired intangibles fully amortising.

Finance costs[1] were £263m (2015 £201m). The underlying interest charge, excluding pension accounting, and fair value and foreign exchange adjustments on financial instruments and investments, was higher at £120m (2015 £107m) primarily reflecting the higher level of gross debt following the bonds issued in December 2015.

Taxation expense[1] reflects the Group's effective tax rate for the period of 23% (2015 21%). The effective tax rate for the full year is expected to be around 22% with some dependency on the geographical mix of profits.

Underlying earnings[3] per share for the period was 17.4p (2015 17.1p).

Basic earnings per share[4] for the period was 12.9p (2015 12.3p).

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 4).
4. Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.
5. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.
6. Interim dividend declared (see note 6).

Cash flow

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

	Six months ended 30 June 2016 £m	Six months ended 30 June 2015 £m
Cash inflow/(outflow) from operating activities	**143**	(257)
Net capital expenditure and financial investment	**(186)**	(129)
Dividends received from equity accounted investments	**23**	37
Operating business cash flow	**(20)**	(349)
Interest	**(103)**	(94)
Taxation	**(66)**	(60)
Free cash flow	**(189)**	(503)
Acquisitions and disposals	**–**	16
Net sale of own shares	**1**	3
Equity dividends paid	**(397)**	(389)
Dividends paid to non-controlling interests	**(6)**	(21)
Cash flow from matured derivative financial instruments	**240**	(49)
Cash flow from movement in cash collateral	**25**	3
Net decrease in cash and cash equivalents	**(326)**	(940)
Foreign exchange translation	**(339)**	25
Other non-cash movements	**51**	8
Increase in net debt (as defined by the Group)	**(614)**	(907)
Opening net debt (as defined by the Group)	**(1,422)**	(1,032)
Net debt (as defined by the Group)	**(2,036)**	(1,939)
Comprising:		
Cash and cash equivalents	**2,240**	1,383
Debt-related derivative financial instrument assets	**114**	13
Loans – non-current	**(4,128)**	(2,850)
Loans and overdrafts – current	**(262)**	(485)
Net debt (as defined by the Group)	**(2,036)**	(1,939)

Operating business cash flow

	Six months ended 30 June 2016 £m	Six months ended 30 June 2015[5] £m
Electronic Systems	**105**	169
Cyber & Intelligence	**33**	12
Platforms & Services (US)	**(33)**	(20)
Platforms & Services (UK)	**(154)**	(296)
Platforms & Services (International)	**178**	(49)
HQ	**(149)**	(165)
Operating business cash flow	**(20)**	(349)

5. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

Operating business cash flow

Cash inflow from operating activities was £143m (2015 outflow £257m), which includes cash contributions in respect of pension deficit funding, over and above service costs, for the UK and US schemes totalling £148m (2015 £186m). As anticipated, advances continue to be consumed on the Omani Typhoon and Hawk programme, the European Typhoon contract and the Saudi training aircraft contract. Costs are being incurred against provisions created in previous years, including the US commercial shipbuilding programmes.

Net capital expenditure and financial investment was £186m (2015 £129m).

Dividends received from equity accounted investments, mainly comprising MBDA and FNSS, amounted to £23m (2015 £37m).

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

Net debt (as defined by the Group)

The Group's **net debt** at 30 June 2016 was £2,036m, a reported net increase of £614m from the net debt position of £1,422m at the start of the period.

Cash and cash equivalents of £2.2bn are held primarily for repayment of debt securities, pension deficit funding, payment of the 2016 interim dividend and management of working capital.

Going concern

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

Principal risks

The principal risks facing the Group for the remainder of the year are unchanged from those reported in the Annual Report 2015, although the result of the EU referendum will lead to a period of uncertainty. BAE Systems benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia, and the Group does not anticipate any material near-term trading impact on its business arising from the UK vote.

The Group's principal risks are detailed on pages 54 to 57 of the Annual Report 2015, and relate to the following areas: defence spending; government customers; international market; competition in international markets; laws and regulations; contract risk and execution; contract cash profiles; pension funding; information technology security; and people.

There has been volatility in currency exchange rates and UK and US bond yields in the period since the announcement of the result of the EU referendum.

The international market risk includes the exposure of the Group to volatility arising from movements in currency exchange rates, particularly in respect of the US dollar, Euro, Saudi Riyal and Australian dollar. Mitigation against currency risk is the Group's policy to hedge all material firm transactional exposures. More detail on currency risk is provided in note 10.

The pension funding risk is that there is an actuarial deficit between the value of the projected liabilities of the Group's defined benefit pension schemes and the assets they hold, and that the deficit may be adversely affected by changes in a number of factors, including long-term interest rate and price inflation expectations. The next UK triennial funding review is planned to commence in April 2017 and, in conjunction with the trustees of the schemes, the Group will be looking at various options with a focus on the longer-term view.

Reporting Segments: Electronic Systems

Electronic Systems, with 13,900 employees[1], comprises the US and UK-based electronics activities, including electronic warfare systems, electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

Financial performance

	Six months ended 30 June 2016	Six months ended 30 June 2015[5]	Year ended 31 December 2015[5]
Sales[1]	**£1,443m**	£1,387m	£2,922m
Underlying EBITA[2]	**£209m**	£212m	£437m
Return on sales	**14.5%**	15.3%	15.0%
Cash inflow[3]	**£105m**	£169m	£370m
Order intake[1]	**£1,470m**	£1,248m	£2,799m
Order backlog[1,4]	**£4.7bn**	£4.0bn	£4.4bn

The business recorded sales[1] of \$2.1bn (£1.4bn), 2% down (in US dollars) on last year due to some second-half weighting of deliveries under contracts for Common Missile Warning and Electronic Warfare systems. Sales in the commercial areas of the business now stand at 26%, having seen growth in the first half of 15% primarily in HybriDrive® systems.

The return on sales achieved of 14.5% (2015 15.3%) was in line with expectations.

Cash[3] conversion of underlying EBITA[2] in the first half year reflects a build-up of inventory ahead of stronger second half sales.

Order backlog[1,4] stands at \$6.3bn (£4.7bn), broadly unchanged (in US dollars) since the start of the year on a like-for-like basis.

Operational performance

Electronic Combat

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

Low-Rate Initial Production hardware deliveries on the F-35 Lightning II programme continue with Lot 9 and 10 deliveries. The business has received initial funding for Lot 11 and expects deliveries to commence in 2018.

The business is under contracts, from Boeing and Warner Robins Air Logistics Complex, totalling over \$1.0bn (£0.7bn) to install the Digital Electronic Warfare System on 84 new F-15 aircraft, upgrade 70 existing F-15 aircraft and provide spare units and modules for an international customer. The programme remains on schedule.

In 2015, BAE Systems was selected by Boeing to develop and manufacture the next-generation digital electronic warfare system for the US Air Force's Eagle Passive Active Warning Survivability System programme to upgrade up to 400 F-15 aircraft. The programme, which could be worth over \$1.0bn (£0.7bn) over its life, is currently in the technology maturation and risk reduction phase.

The business is executing an initial 12-month, \$20m (£15m) contract on the first phase of a programme to develop a new electronic warfare system for the US Air Force Special Operations Command's fleet of C-130J aircraft. The lifecycle value of the programme could exceed \$400m (£299m).

Due to the sensitive nature of electronic combat systems and technology, many of the business's programmes are classified. As a world leader in electronic warfare systems, the business continues to experience growth in this increasingly important area.

Survivability, Targeting & Sensing

The Advanced Precision Kill Weapon System (APKWS™) laser-guided rocket is experiencing growing demand, with deliveries expected to exceed 7,000 units in 2016. In addition to expanding its use in the US military, the product is generating strong international attention, with 16 nations expressing interest. A three-year Indefinite Delivery, Indefinite Quantity contract is being negotiated with the US Navy that may increase production to 10,000 units per year.

The business continues to export the latest configuration of the Common Missile Warning System and pursue multiple international orders.

The business is performing well on the Terminal High-Altitude Area Defence programme and expects to achieve a production rate of eight seekers per month following the $80m (£60m) contract received for Lots 7 and 8 during the first half of the year.

The Enhanced Night Vision Goggle III and Family of Weapon Sights – Individual programme is undergoing a series of tests in preparation for expected production orders in the second half of the year.

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

Intelligence, Surveillance & Reconnaissance

In January, Cyber & Intelligence's Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance (GEOINT-ISR) business transferred to Electronic Systems and was merged with the existing Intelligence, Surveillance & Reconnaissance business.

The business provides the US Air Force and US Army with airborne surveillance capability based on two wide-area, high-resolution imaging sensor systems: the Airborne Wide Area Persistent Surveillance System, which has exceeded 30,000 hours in operational use; and the Autonomous Real-time Ground Ubiquitous Surveillance – Imaging System.

Electronic Systems provides signals intelligence capability for the US Army and other US Department of Defense customers, and has received incremental funding for additional production and a technical refresh of Tactical Signals Intelligence Payloads for the US Army's Gray Eagle unmanned aircraft, bringing the total contract value of this production effort to over $100m (£75m).

Electronic Systems provides state-of-the-art processing capabilities for the US Navy's P-8A Poseidon maritime surveillance aircraft programme, which is in Full-Rate Production, and delivered eight mission computer and display systems during the period to 30 June.

Since winning the Geospatial Data Services Foundational GEOINT Content Management programme in 2014, the business has been awarded orders valued at $149m (£111m) and is performing well on two contracts awarded in 2015 to assist new US intelligence community customers with the development of advanced geospatial intelligence data collection and processing solutions.

Controls & Avionics

On the F-35 Lightning II programme, the business completed Low-Rate Initial Production Lot 8 deliveries of vehicle management computer and active inceptor system equipment to Lockheed Martin. Both systems are now in production for Lot 9 and under contract for Lot 10.

BAE Systems is a major supplier to Boeing of flight controls, and cabin and flight deck systems. Development of the integrated flight control electronics and remote electronic units for Boeing's next-generation 777X aircraft is on track with Critical Design Reviews for all system components to be completed by the end of 2016. On the Boeing 737 MAX, qualification testing of spoiler controls, flight deck systems and utilities was completed, and the aircraft had a successful first flight in January.

FADEC Alliance, a joint venture between FADEC International (the Group's joint venture with Safran Electronics & Defense, formerly Sagem) and GE Aviation, was awarded contracts to provide the full authority digital engine controls (FADEC) for the GE9X, the Boeing 777X engine, and the GE93, an advanced turboprop engine. Certification of the FADEC on the Leap-1B engine for the Boeing 737 MAX was also completed in the period. Deliveries of the Leap-1A FADEC, equipping the Airbus A320neo, continue following certification in 2015.

Qualification of an active control side-stick under development for the Gulfstream G500 and Embraer KC-390 aircraft is expected to be completed by the end of the year. The product will be the first civil-certified active control side-stick with application across both commercial and military markets.

HybriDrive® Solutions

In the first half of the year, the business delivered more than 1,000 hybrid-electric propulsion systems to transit agencies around the world and, in April, achieved the milestone of having approximately 6,000 HybriDrive® systems in service.

Cities around the world continue to pursue zero-emission transportation solutions and to look for practical ways to incorporate electric technology into their bus fleets. Cities including London, Paris, Boston and Seattle are now using BAE Systems' engine-off technology to save fuel, reduce noise and improve local air quality.

Looking forward

In the US, defence spending remains aligned with last year's Bipartisan Budget Act that allows for government spending above the Budget Control Act caps through 2017. A possible Continuing Resolution may result in the federal government running at fiscal year 2016 spending levels from 1 October 2016.

Electronic Systems remains well positioned to address changing US Department of Defense priorities. The business expects to benefit from its franchise positions, particularly on the F-35 Lightning II and F-15 programmes. Its focus remains on maintaining a diverse portfolio of defence and commercial products and capabilities for US and international customers, while sustaining its emphasis on cost efficiency and research and development.

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Net cash inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
4. Comprises funded and unfunded unexecuted customer orders.
5. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

Reporting Segments: Cyber & Intelligence

Cyber & Intelligence, with 11,800 employees[1], comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber security, secure government, and commercial and financial security activities.

Financial performance

	Six months ended 30 June 2016	Six months ended 30 June 2015[5]	Year ended 31 December 2015[5]
Sales[1]	**£833m**	£746m	£1,564m
Underlying EBITA[2]	**£18m**	£27m	£104m
Return on sales	**2.2%**	3.6%	6.6%
Cash inflow[3]	**£33m**	£12m	£46m
Order intake[1]	**£874m**	£861m	£1,753m
Order backlog[1,4]	**£2.2bn**	£1.7bn	£2.2bn

In aggregate, sales[1] were up 5% (in US dollars) at $1.2bn (£833m). Sales in the US business were up 4%, whilst growth in the Applied Intelligence business was 16%, benefiting from increases in all three divisions.

Margins of 2.2% (2015 3.6%) reflect the accelerated engineering, product development costs and sales team build up, in Applied Intelligence, as well as the recent 'Business Defence' marketing campaign in support of future growth expectations. These costs are expensed through the income statement. A significant second half bias in margin performance is expected in Applied Intelligence.

Cash[3] conversion improved on reduced working capital requirements in the Applied Intelligence business.

Order backlog[1,4] reduced from $3.2bn (£2.2bn) at 31 December 2015 to $3.0bn (£2.2bn). The Applied Intelligence business backlog grew by 13% for longer-term contract awards in the UK division. In the US Intelligence & Security business, order backlog reduced on trading out of certain longer-term contracts.

Operational performance

Intelligence & Security

Intelligence & Security delivers a broad range of services to the US military and government.

Global Analysis & Operations

Global Analysis & Operations provides innovative, mission-enabling analytic solutions and support to the US government, including geospatial intelligence data analysis support services.

The business has more than 500 analysts sustaining mission-critical activities on full-motion video and Intelligence, Surveillance and Reconnaissance analysis programmes globally. Several of these programmes, with a combined value over $400m (£299m), are currently being re-competed, with anticipated awards in the second half of the year.

The business is executing the second year of a five-year contract worth up to $143m (£107m) to provide counter-terrorism analysis services to the US government.

In June, the business was awarded a five-year contract with an estimated ceiling value of $75m (£56m) to provide the US Army with enhanced geospatial intelligence technical and analytical support.

Integrated Electronics & Warfare Systems

Integrated Electronics & Warfare Systems provides systems engineering, integration and through-life support services for US defence and coalition partner customers.

The business continues to perform under a five-year, $278m (£208m) contract awarded in 2015 to provide logistics and sustainment engineering services for US Department of Defense radar, optical and telemetry systems.

The business is executing the first year of a five-year contract, potentially worth $76m (£57m), to test Command, Control, Communications, Computers and Intelligence (C4i) systems for tactical vehicles.

Several US Navy contracts have been secured, including a two-year, $73m (£55m) contract from the Naval Air Warfare Center Aircraft Division to provide life-cycle support services for communications and electronics equipment and subsystems.

The business has been awarded more than $76m (£57m) in additional engineering scope change proposals on the US Air Force's Intercontinental Ballistic Missile Integration Support Contractor programme.

IT Solutions

IT Solutions delivers secure solutions that enable US national security customers to perform operations and to protect their data and networks.

The business is executing the first of several task orders to provide IT services to high-priority US government agencies under a ten-year, single-award Indefinite Delivery, Indefinite Quantity (IDIQ) contract with a potential value of over $1.0bn (£0.7bn).

During the first half of the year, the business pursued task orders on strategic re-competes for the Information Technology Enterprise Solutions – Services contract vehicle for the US Army. Under the Enhanced Solutions for the Information Technology Enterprise IDIQ contract for the Defense Intelligence Agency, over $500m (£374m) of task order proposals have been submitted.

Applied Intelligence

The business has continued to invest in engineering capabilities and commercial cyber and financial crime product development, sales and marketing. A 'Business Defence' marketing campaign, launched initially in the US, is generating new leads in the commercial business.

Commercial Solutions

Commercial Solutions focuses on the provision of cyber security, counter-fraud and compliance software and solutions to commercial organisations.

Sales of multi-year, subscription-based managed service offerings continue to increase, with awards in the period including a five-year contract to provide a customised NetReveal™ counter-fraud analytics solution for HM Revenue & Customs in the UK. The business has seen growth in its managed security services through partnerships with regional communications service providers in North America.

Whilst moving towards more subscription-based, cloud-delivered products, the business continues to leverage its investment in technology through the sale of software licences. Awards in the period include the CyberReveal™ threat analytics solution, which defends large enterprises against sophisticated cyber-attacks, under a pilot with a major UK financial institution.

UK Services

UK Services is a provider of cyber security, data analytics and digital transformation consulting and systems integration services to government, national security and large enterprises in the UK.

The business has maintained its position as a key supplier to national security agencies in the UK, with contract wins in the first half including follow-on phases of work for existing customers on secure IT infrastructure programmes.

Demand for cyber security services from large enterprises has continued, with a two-year cyber security support contract in the transport sector and the extension of a team delivering cyber security advisory services for a UK telecommunications operator.

The digital and data transformation business continues to grow, with new contracts including the extension of a team delivering aspects of IT transformational change in HM Revenue & Customs through 2017.

International Services & Solutions

International Services & Solutions focuses on cyber and communications intelligence services and solutions for international governments and communications service providers.

The business is seeing demand in Asia-Pacific, Europe and the Middle East in support of protection against national threats. It successfully implemented an advanced cyber threat analytics and investigation solution on a national telecommunications network in Asia and has seen growth in business with top-tier telecommunications providers in Australia.

The latest release of the IntelligenceReveal™ all-source analysis solution, which enables customers to view a single, unified intelligence picture, has supported the implementation of a large programme for a strategic law enforcement customer. The business has also won a contract to build a technology demonstrator in the UK that allows users to move information between security domains without compromising confidentiality, integrity or availability.

Looking forward

Intelligence & Security

In the US, defence spending remains aligned with last year's Bipartisan Budget Act that allows for government spending above the Budget Control Act caps through 2017. A possible Continuing Resolution may result in the federal government running at fiscal year 2016 spending levels from 1 October 2016.

Intelligence & Security continues to strategically organise its business areas to address the priorities of its customers and to pursue growth opportunities in critical, mission-focused areas. The business is recruiting technical staff and IT subject matter experts to progress its position as a premier service provider for next-generation IT and intelligence analysis across US government and defence markets.

Applied Intelligence

In support of future growth, Applied Intelligence is investing in engineering and product development and the sales team to grow its order backlog and opportunities from both commercial and government customers in North America, Europe, Asia-Pacific and the Middle East.

1. Including share of equity accounted investments.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Net cash inflow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments.
4. Comprises funded and unfunded unexecuted customer orders.
5. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

Reporting Segments: Platforms & Services (US)

Platforms & Services (US), with 11,400 employees[1] and operations in the US, UK and Sweden, produces combat vehicles, weapons and munitions, and delivers US-based services and sustainment activities, including ship repair and the management of government-owned munitions facilities.

Financial performance

	Six months ended 30 June 2016	Six months ended 30 June 2015	Year ended 31 December 2015
Sales[1]	**£1,287m**	£1,328m	£2,779m
Underlying EBITA[2]	**£86m**	£92m	£177m
Return on sales	**6.7%**	6.9%	6.4%
Cash (outflow)/inflow[3]	**£(33)m**	£(20)m	£100m
Order intake[1]	**£1,604m**	£1,119m	£2,737m
Order backlog[1,4]	**£4.4bn**	£3.9bn	£3.9bn

Sales[1] of $1.8bn (£1.3bn) in the first half year were lower by 9% (in US dollars) from the expected reductions in the naval ship repair business as the US fleet continues its pivot to the Pacific, partially offset by increased deliveries on the CV90 Norway programme.

Margin performance for the first half year at 6.7% (2015 6.9%) is stated after further charges of $49m (£34m) on the commercial shipbuilding contracts. A charge of $16m (£11m) was taken in the first half of 2015. Five of the eight ships have now been delivered off contract. Of the remaining three ships, one is expected to complete this year and two in 2017.

Cash flow[3] was impacted by the utilisation of the provisions created against the US commercial shipbuilding programmes and of customer advances on the CV90 Norway contract, along with investment in the new floating dry dock to be located in San Diego.

Order backlog[1,4] has increased marginally from $5.8bn (£3.9bn) at 31 December 2015 to $5.9bn (£4.4bn) primarily on the international awards for amphibious vehicles to Japan, BvS10 to Austria and CV90 upgrades for Sweden.

Operational performance

US Combat Vehicles

BAE Systems is producing 29 vehicles under the engineering and manufacturing development phase of the US Army's Armored Multi-Purpose Vehicle (AMPV) programme awarded in December 2014. The potential contract value for the initial phase of the programme is $1.2bn (£0.9bn), including options for 289 vehicles in Low-Rate Initial Production. Anticipated Full-Rate Production is expected to approach 3,000 vehicles.

The business continues to execute the M109A7 Paladin self-propelled howitzer programme and is delivering 66 vehicle sets, plus an additional turret, under the $666m (£498m) Low-Rate Initial Production phase. The US Army's total acquisition objective is for 581 vehicle sets.

In April, BAE Systems received a contract valued at $110m (£82m) from the US Army to convert 36 M88A1 recovery vehicles to the M88A2 Heavy Equipment Recovery Combat Utility Lift Evacuation Systems (HERCULES) configuration. Deliveries are expected to begin in November 2017 and continue to August 2018.

Along with industry partner IVECO Defence, BAE Systems is producing 16 Amphibious Combat Vehicle prototypes under a $104m (£78m) contract for the engineering and manufacturing development phase of the programme. The first vehicles are on schedule for delivery in early 2017. The award was one of two for this phase and the Marine Corps customer is expected to make a down-selection to a single manufacturer in 2018.

In the period, BAE Systems was awarded contracts totalling $160m (£120m) for the production of 30 new Assault Amphibious Vehicles (AAV) and the upgrade of two AAV for the Japanese Ministry of Defence.

In April, BAE Systems agreed a contract valued at $50m (£37m) to deliver 236 M113 upgrade kits and technical support for the Brazilian Army. Work is to be performed by Brazilian Army personnel in Curitiba, Brazil, and contract deliveries are scheduled to complete in 2018.

Weapon Systems and Munition Operations

BAE Systems is working with the US and Indian governments to progress the Foreign Military Sale of M777 155mm lightweight howitzers to contract agreement. In February, BAE Systems announced the down-selection of Mahindra as its supplier to establish an assembly, integration and test facility in India in support of the Indian Prime Minister's 'Make in India' initiative. In June, the Indian Defence Acquisition Council agreed to progress the programme.

Deliveries to the Swedish government of the re-baselined Archer artillery system continue on schedule.

On 1 July, the business received a $245m (£183m) contract to provide three gun systems and a trainer for the Royal Navy's Type 26 frigate.

In April, the business received a $72m (£54m) contract from the US Navy to produce and deliver propulsor systems for Block IV Virginia Class submarines. The value of the contract could eventually amount to $163m (£122m) if all options are exercised.

BAE Systems continues to manage the US Army's Radford and Holston munitions plant facilities. In the period, the business was awarded $53m (£40m) of contract modifications at Holston for waste water management.

The business received a $38m (£28m) contract modification from the US Navy to provide additional missile canisters for the Mk 41 Vertical Launching System.

BAE Systems continues to partner with the US Navy on the development of the Hyper Velocity Projectile and the Electromagnetic Railgun.

US Ship Repair and Modernisation

Delivery of the new dry dock is on schedule and is expected to be operational in the first quarter of 2017 at the San Diego, California, shipyard to support the US Navy's re-balance to the Asia-Pacific region.

The business is well positioned to compete on a ship-by-ship basis for an estimated $3.9bn (£2.9bn) of US Navy ship repair work over the next five years and has secured a number of firm orders from the US Navy across its US shipyards totalling $619m (£463m) in the first half of 2016.

The business continues to adjust its workforce to meet evolving demand for US Navy ship repair. Contracts received in the first half of 2016 have largely mitigated previously anticipated workforce reductions.

The commercial shipbuilding business continued to experience challenges in the period, taking a $49m (£34m) charge against ongoing contracts. Charges totalling $16m (£11m) and $57m (£37m) were taken on commercial shipbuilding contracts in the first and second half of 2015, respectively. Of the eight ships, five have now been accepted by the customers, with one ship expected to complete later this year and two in 2017.

BAE Systems Hägglunds

Series production continues on the $865m (£647m) contract, awarded in 2012, for the supply of CV90 Infantry Fighting Vehicles to Norway.

In March, the Swedish government awarded the business a contract, valued at $182m (£136m), to refurbish 262 CV90 vehicles for the Swedish Army.

In June, BAE Systems was awarded a contract to produce 32 BvS10 military vehicles for Austria, the fifth nation to acquire the all-terrain vehicle.

FNSS

FNSS, the land systems joint venture, has continued production under the $524m (£392m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army.

Production is on schedule under a contract to upgrade M113 tracked armoured personnel carriers for the Royal Saudi Land Forces. The business has received a contract to integrate mortar systems.

In June, the business received a contract for the development of 260 tracked and wheeled vehicles, and the integration of anti-tank guided missile system turrets.

Two competitive proposals have been submitted for combat vehicle programmes, with award decisions expected in 2016 and 2017.

Looking forward

In the US, defence spending remains aligned with last year's Bipartisan Budget Act that allows for government spending above the Budget Control Act caps through 2017. A possible Continuing Resolution may result in the federal government running at fiscal year 2016 spending levels from 1 October 2016.

The business is maintaining its strong positions on key franchise programmes across the land and maritime domains. In land, these include the US Army's AMPV, Bradley and Paladin programmes and the CV90 for Norway. In maritime, the Group has a strong position on naval gun programmes and US Navy ship repair, as evidenced by the awards secured in the first half of 2016. Capital investment to support the anticipated expansion of ship repair operations in San Diego is on track to complete in early 2017.

Core programmes are successfully transitioning through engineering and manufacturing development phases into production, and underpin near-term growth. Leveraging its strong franchise positions, the business is pursuing a range of domestic and international opportunities in combat vehicles, weapon systems and maritime support services.

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

Reporting Segments: Platforms & Services (UK)

Platforms & Services (UK), with 29,600 employees[1], comprises the Group's UK-based air, maritime, combat vehicle, munitions and shared services activities.

Financial performance

	Six months ended 30 June 2016	Six months ended 30 June 2015	Year ended 31 December 2015
Sales[1]	**£3,664m**	£3,544m	£7,405m
Underlying EBITA[2]	**£414m**	£355m	£721m
Return on sales	**11.3%**	10.0%	9.7%
Cash (outflow)/inflow[3]	**£(154)m**	£(296)m	£220m
Order intake[1]	**£2,207m**	£2,151m	£4,944m
Order backlog[1]	**£16.3bn**	£18.7bn	£17.8bn

Sales[1] were at £3,664m, up 3% compared with the first half of 2015. This year, on the Saudi programme, there were four Typhoon aircraft deliveries in the first half and seven are scheduled for the second half.

Return on sales increased to 11.3% (2015 10.0%). In the first half of 2015, there was a dilutive impact from trading of the radar and Defensive Aids Sub-System equipment of around 0.5 percentage points. In the first half of 2016, there has been a benefit on the Astute programme from the pricing of Batch 1 and profit recognition on the later boats.

As expected, the £154m of cash outflow[3] in the period reflects the consumption of customer advances on the Omani Typhoon and Hawk programme, the European Typhoon contract and the Saudi training aircraft contract.

Order backlog[1] reduced to £16.3bn (31 December 2015 £17.8bn) primarily on the trading of Typhoon aircraft, the aircraft carriers and Astute.

Operational performance

Military Air & Information

In the six months to 30 June, six Typhoon aircraft were delivered from the UK final assembly facility, of which four were delivered to Saudi Arabia. Three further aircraft were delivered to Saudi Arabia in July.

In April, Italian Eurofighter partner, Leonardo, signed a contract for the supply of 28 Typhoon aircraft to Kuwait. The contract is expected to result in airframe manufacture, capability upgrade and Electronically Scanned (E-Scan) radar integration work valued at approximately £1bn for BAE Systems. Initial orders for £229m were received in the first six months of 2016, and orders and funding for the Group's workshare are expected to be finalised in the second half.

The Oman Typhoon and Hawk aircraft programme continues to meet all contractual milestones, with aircraft production schedules on track for commencement of deliveries in 2017.

Typhoon's capabilities continue to expand with the Captor E-Scan radar and with the Meteor, Storm Shadow and Brimstone 2 weapons integration contracts moving into flight tests during 2016.

BAE Systems supports its UK and European customers' Typhoon and Tornado aircraft and their operational commitments. A ten-year partnership arrangement with the Ministry of Defence to support the UK Typhoon fleet, expected to be worth £2.1bn, is expected to be signed shortly.

On the F-35 Lightning II programme, BAE Systems completed 23 aft fuselage assembly deliveries for the Lot 9 and 10 Low-Rate Initial Production contracts in the first half of 2016.

Negotiations for Lot 11 commenced in July. BAE Systems has been awarded a £118m contract to build engineering and training facilities at RAF Marham in Norfolk, UK. The work is scheduled to be completed in 2018 in readiness for the arrival of the UK's first F-35 Lightning II aircraft.

Support continues to be provided to users of Hawk trainer aircraft around the world. The Indian Air Force and Navy have received a further six and three Hawk aircraft, respectively, from Hindustan Aeronautics Limited, built under the Batch 2 licence for 57 aircraft. Discussions continue on the proposal for up to a further 32 Hawk aircraft for the Indian Air Force.

In March, the Ministry of Defence announced the award of three contracts with a total value of approximately £300m to support the UK's fleet of Hawk fast jet trainer aircraft until 2020.

In March, the Group welcomed the announcement by the UK and French governments of a new €2bn (£1.7bn) project to build an unmanned combat air system demonstrator. This will secure highly-skilled engineering jobs and is anticipated to be contracted in 2017.

Maritime

A £472m extension to the Type 26 frigate demonstration phase contract was secured in March, covering detailed design activities and enabling BAE Systems to subcontract for key equipment with companies throughout the supply chain. The programme currently employs over 1,000 staff.

On the aircraft carrier programme, good progress has been made on commissioning HMS Queen Elizabeth's key systems. Activity will continue throughout 2016 to support sea trials due to commence in the first quarter of 2017. On HMS Prince of Wales, all of the blocks are now assembled with large volume installation activities underway.

Progress has been maintained on the River Class Offshore Patrol Vessels, Forth, Medway and Trent. The Offshore Patrol Vessel programme supports shipbuilding skills and provides a bridge for the business between the aircraft carrier programme and the start of manufacture for the Type 26 frigate. A contract for a further two River Class ships is expected to be secured in the second half of the year.

Under the Maritime Support Delivery Framework contract, in place until March 2019, BAE Systems provides services at HM Naval Base Portsmouth and support to half of the Royal Navy's surface fleet. Cost savings remain on target.

BAE Systems manages the support, maintenance and upgrade of the Royal Navy's fleet of Type 45 destroyers. The business has met its contractual deliverables and is now supporting the Ministry of Defence through its decision on the power improvement project.

Progress continues on the £270m Spearfish torpedo upgrade programme, with the demonstration phase expected to complete in 2019 prior to commencement of full manufacture.

The first three of seven Astute Class submarines are in operational service with the Royal Navy, with the reactor core load on boat four planned for the second half of the year. Further funding of £87m for the sixth and seventh boats was received in the period. Negotiations for full pricing of the sixth and seventh boats have commenced.

Functional and spatial design continues to advance on Successor, the replacement programme for the Royal Navy's Vanguard Class submarine fleet. The programme is approaching the production stage with the Ministry of Defence's initial build commitment anticipated later this year. Limit of liability funding of £91m was received in the period. Preparations for the manufacture of Successor include a major programme of building works at the Barrow site, with contracts in place totalling over £300m. The UK government's commitment to the Successor programme has recently been endorsed by parliament.

Land (UK)

The business provides ongoing support to previously-supplied armoured vehicles and bridging systems, with orders of £34m received in the period. In the overseas market, the business secured a multi-year contract for support and maintenance to the Latvian fleet of Combat Vehicle Reconnaissance (Tracked) vehicles purchased from the UK Ministry of Defence.

The first of 515 40mm cased-telescopic cannons was delivered to the Ministry of Defence by CTA International, a 50% joint venture between BAE Systems and Nexter. CTA International is pursuing opportunities in domestic and overseas markets, and has signed a further production order with the French Army for £20m.

The business is in pricing negotiations for the last five years of its 15-year Munitions Acquisition Supply Solution partnering agreement with the Ministry of Defence.

Looking forward

Although the result of the EU referendum will lead to a period of uncertainty, Platforms & Services (UK) has a strong order backlog of long-term committed programmes and an enduring support business.

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

In Maritime, sales are underpinned by the manufacture of the Queen Elizabeth Class aircraft carriers, River Class Offshore Patrol Vessels and Astute Class submarines, and the design and subsequent manufacture of the Type 26 frigates and Successor submarines. The through-life support of surface ship platforms, together with their associated command and combat systems, provides a sustainable business in technical services and mid-life upgrades.

The Land (UK) business continues to deliver support to armoured vehicle and bridging systems in UK and international markets, munitions under the 15-year Acquisition Supply Solution agreement secured in 2008, and 40mm cased-telescopic cannons for the UK and French armies. The business has also launched a bid, in conjunction with a number of industry partners, for the assessment phase of the Challenger 2 life extension programme which is expected to be awarded to the successful bidder in 2016.

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

Reporting Segments: Platforms & Services (International)

Platforms & Services (International), with 13,800 employees[1], comprises the Group's businesses in Saudi Arabia, Australia and Oman, together with its 37.5% interest in the pan-European MBDA joint venture.

Financial performance

	Six months ended 30 June 2016	Six months ended 30 June 2015	Year ended 31 December 2015
Sales[1]	**£1,739m**	£1,621m	£3,742m
Underlying EBITA[2]	**£158m**	£155m	£335m
Return on sales	**9.1%**	9.6%	9.0%
Cash inflow/(outflow)[3]	**£178m**	£(49)m	£164m
Order intake[1]	**£995m**	£1,112m	£3,046m
Order backlog[1]	**£10.1bn**	£10.7bn	£10.2bn

Sales[1] for the first six months of £1,739m (2015 £1,621m) were 7% higher than in 2015 on higher levels of support in the Kingdom of Saudi Arabia.

Underlying EBITA[2] was £158m (2015 £155m), with higher-margin weapon system deliveries from the MBDA joint venture weighted to the second half year.

There was an operating cash inflow[3] of £178m (2015 outflow £49m) consistent with the profit generation in the period.

Order backlog[1] is at £10.1bn (31 December 2015 £10.2bn) pending the anticipated renewal of the five-year Saudi support contract.

Operational performance

Saudi Arabia

On the Salam Typhoon programme, four aircraft were delivered to the half year. As at 30 June, 61 aircraft had been delivered to the Royal Saudi Air Force. Three further aircraft were delivered in July. Typhoon capability expansion is progressing to schedule.

The Typhoon support contracts are operating well, meeting all contractual metrics.

Through the Saudi British Defence Co-operation Programme (SBDCP), the business continues to support the operational capabilities of the Royal Saudi Air Force and Royal Saudi Naval Forces. The contract for Hawk aircraft signed in 2012 continues on schedule, with 17 aircraft in advanced stages of production and five aircraft delivered and accepted by the Royal Saudi Air Force at 30 June. The contract to supply a further 22 Hawk aircraft, associated ground equipment and training aids is progressing to plan. Training and support under existing five-year contracts is ongoing.

Under the Royal Saudi Naval Forces' Minehunter mid-life update programme, acceptance of the second ship is now expected during the second half of 2016. Work on the third and final ship has commenced and is progressing to plan.

The current five-year SBDCP contract is due to complete at the end of 2016. Discussions between BAE Systems, the UK government and the Saudi Arabian customer are underway to define the terms of the next five-year contract.

Under the planned re-organisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia, Riyadh Wings Aviation Academy LLC has contracted to acquire a 49% shareholding in a Group subsidiary, Overhaul and Maintenance Company. The re-organisation supports BAE Systems' strategy to expand the customer base of its In-Kingdom Industrial Participation programme, promoting training, development and employment opportunities in line with Vision 2030.

Under the In-Kingdom Industrial Participation programme, a number of young Saudi engineers have been integrated into UK engineering teams working on Typhoon capability enhancement programmes, furthering knowledge transfer on the Typhoon platform. BAE Systems is planning to undertake a significant proportion of the work on the new Hawk contract in Saudi Arabia. These industrialisation activities are consistent with the Group's long-standing commitment to the development and growth of the Saudi Arabian aerospace industry. Almost two-thirds of the Group's workforce in the country now comprises Saudi nationals undertaking skilled technical jobs or senior management positions.

Australia

The consolidation of operating divisions announced in 2015, from three to two, was completed during the period.

BAE Systems continues to provide in-service support to the Australian Navy's two Landing Helicopter Dock ships under a four-year support contract.

The fifth of the seven Anzac Class frigates to be modernised under the current Anti-Ship Missile Defence programme has departed the Henderson shipyard on schedule to undertake final trials, prior to her acceptance later in 2016. In April, the Australian government signed an agreement valued at approximately A$2bn (£1.1bn) for the sustainment and upgrade of the Anzac Class frigates under the Warship Asset Management Alliance. BAE Systems is a significant participant in the alliance and the agreement underpins the Group's engineering and complex project management capabilities. Contracts totalling A$180m (£100m) were awarded to BAE Systems in the period and the Group expects its through-life workshare to be approximately one-third.

In April, the Australian government announced that BAE Systems' Type 26 Global Combat Ship had been shortlisted as one of three designs for its SEA 5000 Future Frigate programme.

In 2015, BAE Systems was selected as the South Pacific regional prime contractor to undertake airframe maintenance, repair and overhaul for the F-35 Lightning II programme. The business continues to work with the Australian government to prepare for the arrival of the first aircraft in 2018.

During May, the Royal Australian Air Force celebrated its Hawk aircraft fleet achieving the significant milestone of over 100,000 flying hours. The fleet is supported by BAE Systems under a long-term availability partnering arrangement.

In September 2015, the business submitted a proposal for the multi-billion Australian dollar Land 400 Phase 2 Combat Reconnaissance Vehicle programme to the Australian government. In April, the government announced a pause in its evaluation to assess the industrial implications. Down-selection is expected in the second half of the year.

Discussions with the Australian government regarding the forward delivery schedule for the delayed JP 2008 Phase 3F programme for enhanced satellite communications services to the Australian Defence Force are expected to be completed during 2016.

Oman

Information on the operational performance of the Oman Typhoon and Hawk aircraft programme, being undertaken by Platforms & Services (UK), is provided on page 21.

The business is fulfilling its industrial participation obligations in Oman through delivery of an agreed training and knowledge transfer programme. An expansion of this programme has been contracted and, when delivered, will satisfy all outstanding industrial participation obligations.

MBDA

In 2015, the German government announced its intention to acquire the Medium Extended Air Defence System missile defence system being developed by MBDA in partnership with Lockheed Martin. Contract signature is expected in 2017, subject to German political approval.

Following the signature of a treaty between the UK and French governments in 2015, both nations have confirmed their commitment to supporting the development of a next-generation Future Cruise/Anti-Ship Weapon System. This commitment represents the next major joint UK/French missile development programme and cements the bilateral relationship in the complex weapons sector.

The £339m Selective Precision Effects At Range 3 programme has been contracted with the UK government to provide an air-to-ground, long-range precision attack capability against mobile targets.

MBDA continues to pursue weapons package orders as part of export contracts for Typhoon and Rafale aircraft.

Looking forward

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

In Australia, the 2016 Defence White Paper was accompanied by a ten-year Integrated Investment Programme outlining a significant number of acquisition and sustainment programmes. The business is underpinned by ongoing sustainment activities and a number of key strategic campaigns.

In Oman, the business continues to provide support to its products in service to position for future requirements. The Typhoon and Hawk aircraft programme is on track for commencement of deliveries in 2017.

MBDA builds on the effective partnerships it has established with its domestic customers, securing export opportunities that underpin future growth.

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

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

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

- The condensed set of financial statements has been prepared in accordance with IAS 34, Interim Financial Reporting, as adopted by the European Union.
- The interim management report on pages 1 to 26 includes a fair review of the information required by:
  (a) DTR 4.2.7R of the Disclosure and Transparency Rules (DTR), being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
  (b) DTR 4.2.8R of the DTR, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or the performance of the Company during that period; and any changes in the related party transactions described in the last annual report that could do so.

For and on behalf of the directors:

Sir Roger Carr

Chairman

27 July 2016

Directors

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

Independent review report to BAE Systems plc

Introduction
We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2016 which comprises the Condensed consolidated income statement, the Condensed consolidated statement of comprehensive income, the Condensed consolidated statement of changes in equity, the Condensed consolidated balance sheet, the Condensed consolidated cash flow statement, and the related explanatory notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

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

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

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

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

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

Conclusion
Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2016 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FCA.

Ian Starkey

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

27 July 2016

Condensed consolidated income statement

	Notes	Six months ended 30 June 2016 £m	Six months ended 30 June 2016 £m	Six months ended 30 June 2015 £m	Six months ended 30 June 2015 £m
Continuing operations					
Combined sales of Group and share of equity accounted investments	2		**8,714**		8,472
Less: share of sales of equity accounted investments	2		**(436)**		(471)
Revenue	2		**8,278**		8,001
Operating costs			**(7,563)**		(7,368)
Other income			**51**		39
Group operating profit			**766**		672
Share of results of equity accounted investments			**10**		28
Underlying EBITA[1]		**849**		800	
Non-recurring items[2]		**–**		(24)	
EBITA		**849**		776	
Amortisation of intangible assets		**(43)**		(62)	
Impairment of intangible assets		**–**		(3)	
Financial expense of equity accounted investments		**(15)**		(9)	
Taxation expense of equity accounted investments		**(15)**		(2)	
Operating profit	2		**776**		700
Financial income		**460**		161	
Financial expense		**(708)**		(353)	
Finance costs	3		**(248)**		(192)
Profit before taxation			**528**		508
Taxation expense			**(110)**		(110)
Profit for the period			**418**		398
Attributable to:					
Equity shareholders			**408**		390
Non-controlling interests			**10**		8
			418		398
Earnings per share	4				
Basic earnings per share			**12.9p**		12.3p
Diluted earnings per share			**12.8p**		12.3p

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

Condensed consolidated statement of comprehensive income

	Six months ended 30 June 2016			Six months ended 30 June 2015		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Profit for the period	**–**	**418**	**418**	–	398	398
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on retirement benefit schemes	**–**	**(1,504)**	**(1,504)**	–	537	537
Tax on items that will not be reclassified to the income statement	**–**	**305**	**305**	–	(134)	(134)
Equity accounted investments (net of tax)	**–**	**(39)**	**(39)**	–	5	5
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	**687**	**–**	**687**	(105)	–	(105)
Reclassification of cumulative currency translation reserve on disposal	**–**	**–**	**–**	20	–	20
Amounts credited/(charged) to hedging reserve	**82**	**–**	**82**	(59)	–	(59)
Tax on items that may be reclassified to the income statement	**(15)**	**–**	**(15)**	14	–	14
Equity accounted investments (net of tax)	**17**	**–**	**17**	(19)	–	(19)
Total other comprehensive income for the period (net of tax)	**771**	**(1,238)**	**(467)**	(149)	408	259
Total comprehensive income for the period	**771**	**(820)**	**(49)**	(149)	806	657
Attributable to:						
Equity shareholders	**769**	**(830)**	**(61)**	(148)	798	650
Non-controlling interests	**2**	**10**	**12**	(1)	8	7
	771	**(820)**	**(49)**	(149)	806	657

Condensed consolidated statement of changes in equity

	Attributable to equity holders of the parent						
	Issued share capital £m	Share premium £m	Other reserves[1] £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 January 2016	87	1,249	5,277	(3,624)	2,989	13	3,002
Profit for the period	–	–	–	408	408	10	418
Total other comprehensive income for the period	–	–	769	(1,238)	(469)	2	(467)
Share-based payments	–	–	–	26	26	–	26
Net sale of own shares	–	–	–	1	1	–	1
Ordinary share dividends	–	–	–	(397)	(397)	(6)	(403)
At 30 June 2016	**87**	**1,249**	**6,046**	**(4,824)**	**2,558**	**19**	**2,577**
At 1 January 2015	87	1,249	5,061	(4,555)	1,842	35	1,877
Profit for the period	–	–	–	390	390	8	398
Total other comprehensive income for the period	–	–	(148)	408	260	(1)	259
Share-based payments	–	–	–	22	22	–	22
Net sale of own shares	–	–	–	3	3	–	3
Ordinary share dividends	–	–	–	(389)	(389)	(21)	(410)
Disposal of non-controlling interest	–	–	–	–	–	(6)	(6)
At 30 June 2015	87	1,249	4,913	(4,121)	2,128	15	2,143

1. The net increase comprises translation reserve increase £706m (2015 decrease £103m) and hedging reserve increase £63m (2015 decrease £45m).

Condensed consolidated balance sheet

	Notes	30 June 2016 £m	31 December 2015 £m
Non-current assets			
Intangible assets		**10,704**	10,117
Property, plant and equipment		**1,872**	1,698
Investment property		**121**	120
Equity accounted investments		**218**	250
Other investments		**6**	6
Other receivables		**310**	275
Retirement benefit surpluses	5	**215**	193
Other financial assets		**322**	107
Deferred tax assets		**1,280**	985
		15,048	13,751
Current assets			
Inventories		**766**	726
Trade and other receivables including amounts due from customers for contract work		**3,286**	2,940
Current tax		**7**	4
Other financial assets		**236**	105
Cash and cash equivalents		**2,240**	2,537
Assets held for sale		**–**	20
		6,535	6,332
Total assets		**21,583**	20,083
Non-current liabilities			
Loans		**(4,128)**	(3,775)
Other payables		**(1,151)**	(1,020)
Retirement benefit obligations	5	**(6,281)**	(4,694)
Other financial liabilities		**(134)**	(72)
Deferred tax liabilities		**(12)**	(13)
Provisions		**(385)**	(354)
		(12,091)	(9,928)
Current liabilities			
Loans and overdrafts		**(262)**	(237)
Trade and other payables		**(5,926)**	(6,162)
Other financial liabilities		**(178)**	(130)
Current tax		**(325)**	(315)
Provisions		**(224)**	(301)
Liabilities held for sale		**–**	(8)
		(6,915)	(7,153)
Total liabilities		**(19,006)**	(17,081)
Net assets		**2,577**	3,002
Capital and reserves			
Issued share capital		**87**	87
Share premium		**1,249**	1,249
Other reserves		**6,046**	5,277
Retained earnings – deficit		**(4,824)**	(3,624)
Total equity attributable to equity holders of the parent		**2,558**	2,989
Non-controlling interests		**19**	13
Total equity		**2,577**	3,002

Condensed consolidated cash flow statement

	Notes	Six months ended 30 June 2016 £m	Six months ended 30 June 2015 £m
Profit for the period		**418**	398
Taxation expense		**110**	110
Research and development expenditure credits		**(6)**	–
Share of results of equity accounted investments		**(10)**	(28)
Finance costs		**248**	192
Depreciation, amortisation and impairment		**159**	184
Profit on disposal of property, plant and equipment, and investment property		**(6)**	(5)
Profit on disposal of non-current other investments		**–**	(1)
Loss on disposal of businesses		**–**	24
Cost of equity-settled employee share schemes		**26**	22
Movements in provisions		**(84)**	(125)
Decrease in liabilities for retirement benefit obligations		**(116)**	(145)
Decrease/(increase) in working capital:			
Inventories		**29**	(36)
Trade and other receivables		**(155)**	(248)
Trade and other payables		**(470)**	(599)
Cash inflow/(outflow) from operating activities	7	**143**	(257)
Interest paid		**(107)**	(98)
Taxation paid		**(66)**	(60)
Net cash outflow from operating activities		**(30)**	(415)
Dividends received from equity accounted investments		**23**	37
Interest received		**4**	4
Purchases of property, plant and equipment, and investment property		**(166)**	(134)
Purchases of intangible assets		**(27)**	(21)
Proceeds from sale of property, plant and equipment, and investment property		**10**	27
Proceeds from sale of non-current other investments		**–**	1
Purchase of subsidiary undertakings (net of cash acquired)		**–**	(6)
Equity accounted investment funding		**(3)**	(2)
Proceeds from sale of subsidiary undertakings (net of cash disposed)		**–**	22
Net cash outflow from investing activities		**(159)**	(72)
Net sale of own shares		**1**	3
Equity dividends paid	6	**(397)**	(389)
Dividends paid to non-controlling interests		**(6)**	(21)
Cash flow from matured derivative financial instruments		**240**	(49)
Cash flow from cash collateral		**25**	3
Net cash outflow from financing activities		**(137)**	(453)
Net decrease in cash and cash equivalents		**(326)**	(940)
Cash and cash equivalents at 1 January		**2,537**	2,313
Effect of foreign exchange rate changes on cash and cash equivalents		**29**	2
Cash and cash equivalents at end of period		**2,240**	1,375
Comprising:			
Cash and cash equivalents		**2,240**	1,383
Overdrafts		**–**	(8)
Cash and cash equivalents at end of period		**2,240**	1,375

Notes to the condensed half-yearly financial statements

1. Preparation

Basis of preparation and statement of compliance
These condensed consolidated half-yearly financial statements of BAE Systems plc (the Group) have been prepared in accordance with International Accounting Standard (IAS) 34, Interim Financial Reporting. The annual consolidated financial statements of the Group are prepared in accordance with EU-endorsed International Financial Reporting Standards (IFRSs). These condensed consolidated half-yearly financial statements do not comprise statutory accounts within the meaning of Section 435 of the Companies Act 2006 and should be read in conjunction with the Annual Report 2015. The comparative figures for the year ended 31 December 2015 are not the Group's statutory accounts for that financial year. Those accounts have been reported upon by the Group's auditors and delivered to the registrar of companies. The report of the auditors was unqualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and did not contain statements under Section 498 (2) or (3) of the Companies Act 2006.

The accounting policies adopted in the preparation of these condensed consolidated half-yearly financial statements to 30 June 2016 are consistent with the accounting policies applied by the Group in its consolidated financial statements as at, and for the year ended, 31 December 2015 as required by the Disclosure and Transparency Rules of the UK's Financial Conduct Authority.

2. Segmental analysis

Sales and revenue by reporting segment

	Combined sales of Group and share of equity accounted investments (Sales)		Less: share of sales of equity accounted investments		Add: sales to equity accounted investments		Revenue	
	Six months ended 30 June 2016 £m	Six months ended 30 June 2015[1] £m	**Six months ended 30 June 2016 £m**	Six months ended 30 June 2015 £m	**Six months ended 30 June 2016 £m**	Six months ended 30 June 2015 £m	**Six months ended 30 June 2016 £m**	Six months ended 30 June 2015[1] £m
Electronic Systems	**1,443**	1,387	**(38)**	(36)	**38**	36	**1,443**	1,387
Cyber & Intelligence	**833**	746	**–**	–	**–**	–	**833**	746
Platforms & Services (US)	**1,287**	1,328	**(43)**	(53)	**–**	–	**1,244**	1,275
Platforms & Services (UK)	**3,664**	3,544	**(521)**	(885)	**478**	850	**3,621**	3,509
Platforms & Services (International)	**1,739**	1,621	**(290)**	(297)	**–**	–	**1,449**	1,324
HQ	**104**	128	**(104)**	(128)	**–**	–	**–**	–
	9,070	8,754	**(996)**	(1,399)	**516**	886	**8,590**	8,241
Intra-group sales/revenue	**(356)**	(282)	**–**	–	**44**	42	**(312)**	(240)
	8,714	8,472	**(996)**	(1,399)	**560**	928	**8,278**	8,001

Sales represents the amounts derived from the provision of goods and services, and includes the Group's share of sales of its equity accounted investments. Sales is used by the Group for internal performance analysis.

Reporting segment result

	Underlying EBITA[2]		Non-recurring items[3]		Amortisation of intangible assets		Impairment of intangible assets		Reporting segment result	
	Six months ended 30 June 2016 £m	Six months ended 30 June 2015[1] £m	**Six months ended 30 June 2016 £m**	Six months ended 30 June 2015 £m	**Six months ended 30 June 2016 £m**	Six months ended 30 June 2015 £m	**Six months ended 30 June 2016 £m**	Six months ended 30 June 2015 £m	**Six months ended 30 June 2016 £m**	Six months ended 30 June 2015[1] £m
Electronic Systems	**209**	212	**–**	–	**(9)**	(10)	**–**	–	**200**	202
Cyber & Intelligence	**18**	27	**–**	–	**(18)**	(35)	**–**	(3)	**–**	(11)
Platforms & Services (US)	**86**	92	**–**	(24)	**(7)**	(7)	**–**	–	**79**	61
Platforms & Services (UK)	**414**	355	**–**	–	**(6)**	(5)	**–**	–	**408**	350
Platforms & Services (International)	**158**	155	**–**	–	**(3)**	(5)	**–**	–	**155**	150
HQ	**(36)**	(41)	**–**	–	**–**	–	**–**	–	**(36)**	(41)
	849	800	**–**	(24)	**(43)**	(62)	**–**	(3)	**806**	711
Financial expense of equity accounted investments									**(15)**	(9)
Taxation expense of equity accounted investments									**(15)**	(2)
Operating profit									**776**	700
Finance costs									**(248)**	(192)
Profit before taxation									**528**	508
Taxation expense									**(110)**	(110)
Profit for the period									**418**	398

1. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.
2. Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3. Non-recurring items represents loss on disposal of businesses.

Underlying EBITA excludes amortisation and impairment of intangible assets, finance costs and taxation expense, and non-recurring items (defined as items that are relevant to an understanding of the Group's performance with reference to their materiality and nature). Underlying EBITA is used by the Group for internal performance analysis as a measure of operating profitability that is comparable over time.

3. Finance costs

	Six months ended 30 June 2016 £m	Six months ended 30 June 2015 £m
Finance costs:		
Group	**(248)**	(192)
Share of equity accounted investments	**(15)**	(9)
	(263)	(201)
Analysed as:		
Underlying interest expense:		
Group	**(114)**	(106)
Share of equity accounted investments	**(6)**	(1)
	(120)	(107)
Other:		
Group:		
Net interest expense on retirement benefit obligations	**(86)**	(95)
Fair value and foreign exchange adjustments on financial instruments and investments[1]	**(48)**	9
Share of equity accounted investments:		
Net interest expense on retirement benefit obligations	**(3)**	(3)
Fair value and foreign exchange adjustments on financial instruments and investments	**(6)**	(5)
	(263)	(201)

1. Includes gains of £452m (2015 £147m) and losses of £500m (2015 £138m). The increase in the gains and losses primarily reflects movements in foreign currency exchange rates.

4. Earnings per share

	Six months ended 30 June 2016			Six months ended 30 June 2015		
	£m	**Basic pence per share**	**Diluted pence per share**	£m	Basic pence per share	Diluted pence per share
Profit for the period attributable to equity shareholders	**408**	**12.9**	**12.8**	390	12.3	12.3
Add back/(deduct):						
Loss on disposal of businesses	**–**			24		
Net interest expense on retirement benefit obligations, post tax	**69**			77		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	**41**			(3)		
Amortisation and impairment of intangible assets, post tax	**33**			51		
Underlying earnings, post tax	**551**	**17.4**	**17.3**	539	17.1	17.0

	Millions	**Millions**	Millions	Millions
Weighted average number of shares used in calculating basic earnings per share	**3,168**	**3,168**	3,158	3,158
Incremental shares in respect of employee share schemes		**8**		9
Weighted average number of shares used in calculating diluted earnings per share		**3,176**		3,167

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

5. Retirement benefit obligations

	UK £m	US and other £m	Total £m
Total IAS 19 deficit before allocation to equity accounted investments and other participating employers at 1 January 2016	(4,824)	(730)	(5,554)
Impact of the sectionalisation of the BAE Systems Pension Scheme (Main Scheme)[1]	667	–	667
	(4,157)	(730)	(4,887)
Actual return on assets excluding amounts included in net interest expense	974	227	1,201
Increase in liabilities due to changes in financial assumptions	(2,443)	(429)	(2,872)
Experience gains	45	9	54
Additional contributions in excess of service cost	126	–	126
Recurring contributions in excess of/(below) service cost	30	(8)	22
Past service cost – plan amendments	(5)	–	(5)
Net interest expense	(76)	(18)	(94)
Foreign exchange adjustments	–	(91)	(91)
Movement in US healthcare schemes	–	(10)	(10)
Total IAS 19 deficit before allocation to equity accounted investments and other participating employers at 30 June 2016	**(5,506)**	**(1,050)**	**(6,556)**
Allocated to equity accounted investments and other participating employers	490	–	490
Group's share of IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments and other participating employers at 30 June 2016	**(5,016)**	**(1,050)**	**(6,066)**
Represented by:			
Retirement benefit surpluses	143	72	215
Retirement benefit obligations	(5,159)	(1,122)	(6,281)
	(5,016)	**(1,050)**	**(6,066)**

1. The Main Scheme deficit allocated to Airbus at 31 December 2015 of £683m as adjusted for a £16m contribution into the scheme by Airbus in the first quarter of 2016.

The increase in liabilities due to changes in financial assumptions reflects, in the UK, a 0.5 percentage point reduction in the real discount rate to 0.2% and, in the US, a 0.8 percentage point reduction in the nominal discount rate to 3.7%.

A deferred tax asset in respect of the Group's share of the IAS 19 deficit excluding the Group's share of amounts allocated to equity accounted investments and other participating employers of £1,213m (31 December 2015 £908m) is included in total net deferred tax assets of £1,268m (31 December 2015 £972m).

Deficit allocation

The Group operates a number of multi-employer defined benefit pension schemes and allocates a share of the surpluses and deficits in those schemes to the equity accounted investments and other employers that participate in them.

On 1 April 2016, a separate Airbus section of the Main Scheme was created, reducing the total IAS 19 deficit, with a corresponding reduction in the allocation to equity accounted investments and other participating employers.

The deficit allocation methodology for the remaining employers of the Main Scheme and for all other schemes is based on the relative payroll contributions of active members, which is consistent with prior years and is intended to reflect a reasonable approximation of the share of the deficit.

In the event that an employer who participates in the Group's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Group considers the likelihood of this event arising as remote. Following the creation of the Airbus section of the Main Scheme, the Group's obligation in respect of Airbus has been removed.

Principal actuarial assumptions

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

	UK		US	
	30 June 2016	31 December 2015	**30 June 2016**	31 December 2015
Financial assumptions				
Discount rate (%)	**3.1**	3.9	**3.7**	4.5
Inflation (%)	**2.9**	3.2	**n/a**	n/a
Rate of increase in salaries (%)	**2.9**	3.2	**n/a**	n/a
Rate of increase in deferred pensions (%)	**2.0/2.9**	2.3/3.2	**n/a**	n/a
Rate of increase in pensions in payment (%)	**1.7 – 3.5**	1.8 – 3.6	**n/a**	n/a
Demographic assumptions				
Life expectancy of a male currently aged 65 (years)	**87 – 89**	87 – 89	**87**	87
Life expectancy of a female currently aged 65 (years)	**89 – 90**	89 – 90	**89**	89
Life expectancy of a male currently aged 45 (years)	**89 – 91**	89 – 91	**87**	87
Life expectancy of a female currently aged 45 (years)	**91 – 92**	91 – 92	**89**	89

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 30 June 2016 and keeping all other assumptions the same.

Financial assumptions

Changes in the following financial assumptions would have the following effect on the gross defined benefit pension liabilities, excluding scheme assets, before allocation to equity accounted investments and other participating employers:

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

The sensitivity analysis does not allow for the impact of the Group's risk management activities in respect of interest rate and inflation risk on the valuation of the assets. Across all of its pension schemes, the Group is hedged against approximately 35% and 40% of interest rate and inflation risk, respectively, measured relative to the funding liabilities. The Group's US schemes are not indexed with inflation.

The 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 gross defined benefit pension liabilities, excluding scheme assets, before allocation to equity accounted investments and other participating employers resulting from larger changes in the inflation assumption would be as follows:

	(Increase)/ decrease £bn
Inflation:	
0.5 percentage point increase	(1.6)
0.5 percentage point decrease	1.6
1.0 percentage point increase	(3.4)
1.0 percentage point decrease	3.0

Demographic assumptions

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

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

6. Equity dividends

	Six months ended 30 June 2016 £m	Six months ended 30 June 2015 £m
Prior year final 12.5p dividend per ordinary share paid in the period (2015 12.3p)	**397**	389

The directors have declared an interim dividend of 8.6p per ordinary share (2015 8.4p), totalling £273m (2015 £266m). The dividend will be paid on 30 November 2016 to shareholders registered on 21 October 2016. The ex-dividend date is 20 October 2016.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 9 November 2016.

7. Operating business cash flow

	Six months ended 30 June 2016 £m	Six months ended 30 June 2015 £m
Cash inflow/(outflow) from operating activities	**143**	(257)
Purchases of property, plant and equipment, and investment property	**(166)**	(134)
Purchases of intangible assets	**(27)**	(21)
Proceeds from sale of property, plant and equipment, and investment property	**10**	27
Proceeds from sale of non-current other investments	**–**	1
Equity accounted investment funding	**(3)**	(2)
Dividends received from equity accounted investments	**23**	37
Operating business cash flow	**(20)**	(349)

Operating business cash flow represents net cash flow from operating activities after capital expenditure (net), financial investment and dividends from equity accounted investments. Operating business cash flow is the measure used to assess the operating cash generation of the Group.

8. Net debt (as defined by the Group)

	30 June 2016 £m	31 December 2015 £m
Cash and cash equivalents	**2,240**	2,537
Debt-related derivative financial instrument assets	**114**	53
Loans – non-current	**(4,128)**	(3,775)
Loans and overdrafts – current	**(262)**	(237)
Net debt (as defined by the Group)	**(2,036)**	(1,422)

Net debt comprises cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments) and cash received on customer's account. Net debt is the measure used to assess the net cash generation of the Group.

9. Fair value measurement

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

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

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

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

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

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

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

Carrying amounts and fair values of certain financial instruments

	Carrying amounts	
	30 June 2016 £m	31 December 2015 £m
Financial instruments measured at fair value:		
Non-current		
Available-for-sale financial assets	**–**	6
Other receivables[1]	**267**	234
Other financial assets	**322**	107
Other financial liabilities	**(134)**	(72)
Loans	**(389)**	(346)
Other payables[1]	**(295)**	(264)
Current		
Other financial assets	**236**	105
Other financial liabilities	**(178)**	(130)
Financial instruments not measured at fair value:		
Non-current		
Loans	**(3,739)**	(3,429)
Current		
Cash and cash equivalents	**2,240**	2,537
Loans and overdrafts	**(262)**	(237)

1. Represents US deferred compensation plan assets and liabilities.

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

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

The fair value of total loans and overdrafts estimated using market prices at 30 June 2016 is £4,903m (31 December 2015 £4,291m).

10. Financial risk management

Currency risk

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

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

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

11. Related party transactions

Transactions with related parties are shown on page 160 of the Annual Report 2015.

	Six months ended 30 June 2016 £m	Six months ended 30 June 2015 £m
Sales to equity accounted investments	**560**	928
Purchases from equity accounted investments	**205**	297

	30 June 2016 £m	31 December 2015 £m
Amounts owed by equity accounted investments	**102**	75
Amounts owed to equity accounted investments[1]	**1,020**	446

1. Includes cash loaned to the Group in proportion to its equity interest.

12. Annual General Meeting

The Annual General Meeting of BAE Systems plc will be held on 10 May 2017.

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 Section 90A of the Financial Services and Markets Act 2000. It should be noted that Section 90A contains limits on the liability of the directors of BAE Systems plc so that their liability is solely to BAE Systems plc.