BAE SYSTEMS

INSPIRED WORK

Preliminary Announcement 2016

BAE Systems plc
Preliminary Announcement 2016

Results in brief

Financial performance measures as defined by the Group[1]

	2016	2015
Sales	**£19,020m**	£17,904m
Underlying EBITA	**£1,905m**	£1,683m
Underlying earnings per share	**40.3p**	40.2p
Operating business cash flow	**£1,004m**	£681m
Net debt	**£(1,542)m**	£(1,422)m
Order intake[3]	**£22,443m**	£14,921m
Order backlog[3]	**£42.0bn**	£36.8bn

Other financial highlights

	2016	2015
Group's share of the net pension deficit	**£(6.1)bn**	£(4.5)bn
Dividend per share	**21.3p**	20.9p

Financial performance measures defined in IFRS[2]

	2016	2015
Revenue	**£17,790m**	£16,787m
Operating profit	**£1,742m**	£1,502m
Basic earnings per share	**28.8p**	29.0p
Net cash flow from operating activities	**£1,229m**	£808m[4]

Ian King, Chief Executive, said: "*2016 was a good year for BAE Systems. Our strategy is well defined; we have a large order backlog, long-term programme positions, strong programme execution and a well-balanced portfolio. With an improved outlook for defence budgets in a number of our markets, we are well placed to continue to generate attractive returns for shareholders.*"

Financial highlights

Financial performance measures as defined by the Group[1]

– Sales increased by £1.1bn to £19.0bn, almost all of which was due to exchange translation.

– Underlying EBITA increased to £1,905m, or 7% on a constant currency basis.

– Underlying earnings per share of 40.3p, 7% higher than adjusted 2015 underlying earnings per share of 37.8p[5], in line with guidance.

– Operating business cash flow increased by £323m to £1,004m.

– Net debt of £1.5bn.

– Order intake[3] increased by £7.5bn to £22.4bn.

– Order backlog[3] increased by £5.2bn to £42.0bn.

Financial performance measures defined in IFRS[2]

– Revenue increased by £1.0bn to £17.8bn, almost all of which was due to exchange translation.

– Operating profit increased to £1,742m, or 10% on a constant currency basis.

– Basic earnings per share of 28.8p.

– Net cash flow from operating activities increased by £421m to £1,229m.

Other financial highlights

– Group's share of the pre-tax accounting net pension deficit increased by £1.6bn compared with 31 December 2015 to £6.1bn, largely unchanged from 30 June 2016.

– Final dividend of 12.7p per share making a total of 21.3p per share for the year, an increase of 2% over 2015.

1. We monitor the underlying financial performance of the Group using alternative performance measures. These measures are not defined in International Financial Reporting Standards (IFRS) and, therefore, are considered to be non-GAAP (Generally Accepted Accounting Principles) measures. Accordingly, the relevant IFRS measures are also presented where appropriate. For alternative performance measure definitions see glossary on page 8.
2. International Financial Reporting Standards.
3. Including share of equity accounted investments.
4. Re-presented to reclassify interest paid from operating to investing activities.
5. 2015 underlying earnings per share (40.2p) excluding tax provision releases (-4.3p) and adjusted to 2016 exchange rates (+1.9p).

Operational and strategic review

– Awarded a $146m (£118m) engineering and manufacturing development contract for the US Air Force's Eagle Passive Active Warning Survivability System as a follow-on to the technology maturation and risk reduction phase.

– On the F-35 combat aircraft programme, delivered the 250th electronic warfare suite in the US, received orders for additional Low-Rate Initial Production in the US and UK, and selected to provide maintenance, repair, overhaul and upgrade services to support a range of aircraft system components in the UK and Australia for the Europe and Pacific regions, respectively.

– On Typhoon, partnership arrangement for support to the UK fleet expected to be worth at least £2.1bn over a ten-year period and £1.0bn of orders for BAE Systems' workshare on 28 aircraft for Kuwait.

– Continued provision of support agreed under the Saudi British Defence Co-operation Programme to the Royal Saudi Air Force and Royal Saudi Naval Forces through to 2021.

– To support the US Navy's re-balance to the Asia-Pacific region, a new dry dock arrived in our San Diego shipyard in December.

– In maritime in the UK, £472m extension to the Type 26 frigate demonstration phase contract, £287m contract for two additional Offshore Patrol Vessels, including support services for the five-ship programme, and £1.3bn of funding for the Dreadnought Class submarine programme, including design, initial manufacture, materials and facilities investment.

– Roll-out of the first prototype Armored Multi-Purpose Vehicle for the US Army and delivery of the first prototype Amphibious Combat Vehicles for the US Marine Corps.

– Secured a $542m (£439m) contract to provide 145 M777 lightweight howitzers to India in January 2017.

– Continued growth in commercial cyber security and counter-fraud from investment in product development, and sales and marketing.

– Judicial Review proceedings into the process followed by the UK government in granting defence export licences to the Kingdom of Saudi Arabia are under way with a judgment expected in the near future.

Guidance for 2017

Group guidance

For the year ending 31 December 2017, we expect the Group's underlying earnings per share to be 5% to 10% higher than full-year underlying earnings per share in 2016 of 40.3p.*

The guidance is based on the measures used to monitor the underlying financial performance of the Group. Reconciliations from these measures to the financial performance measures defined in International Financial Reporting Standards for 2016 are provided on pages 9 to 12.

Segmental guidance

Electronic Systems:

– Mid-single-digit sales growth is expected in 2017 driven by a number of electronic warfare contracts, with 75% of projected sales in the 2016 closing order backlog.

– Margins[1] are expected to be at the top end of a 13% to 15% range.

Cyber & Intelligence comprising the US Intelligence & Security sector (71% of Cyber & Intelligence sales in 2016) and Applied Intelligence:

– Low single-digit sales growth is expected in 2017, with stable sales in Intelligence & Security and double-digit growth in Applied Intelligence across each of its three divisions.

– Margins[1] are expected to improve to within a 6% to 8% range, following the high level of product development investment in the Applied Intelligence business over the last two years.

Platforms & Services (US):

- Sales are expected to be stable, with the completion of CV90 deliveries to Norway being offset by the increasing volumes from the US vehicles and munition businesses. Of this sales guidance, 75% is within the 2016 closing order backlog.
- Another year of margin[1] improvement, to a range of 8% to 9%, is expected in 2017, absent further charges on the commercial shipbuilding contracts.

Platforms & Services (UK):

- Sales are expected to be 5% lower. On Typhoon, European and Saudi deliveries are largely complete and this is only partly offset by trading on the contracts to Oman and Kuwait, along with the increased F-35 volumes. Almost 95% of this sales guidance is within the 2016 closing order backlog.
- Margins[1] are expected to be at the lower end of a 10% to 12% range, having absorbed the impact of increased pension service costs.

Platforms & Services (International):

- Sales growth of around 5% is expected in 2017, with increased levels of support to the Salam Typhoon aircraft and higher delivery volumes from MBDA. Close to 90% of the sales guidance is within the 2016 closing order backlog.
- Margins[1] are expected to be at a similar level to those in 2016.

HQ:

- HQ costs are expected to be similar to those in 2016.
- Underlying finance costs are expected to be slightly lower, absent the incremental net present value charges seen in 2016.
- The underlying effective tax rate for 2017 is expected to increase slightly from 21% to around 22%, with the final rate dependent on the geographical mix of profits.

* Assuming a US$1.25 to sterling exchange rate.

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Analyst and investor presentation

A presentation, for analysts and investors, of the Group's Results for 2016 will be available via webcast at 9.00am today (23 February 2017).

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

About BAE Systems

At BAE Systems, our advanced defence technology protects people and national security, and keeps critical information and infrastructure secure. We search for new ways to provide our customers with a competitive edge across the air, maritime, land and cyber domains. We employ a skilled workforce of 83,100 people[2] in over 40 countries, and work closely with local partners to support economic development by transferring knowledge, skills and technology.

1. Underlying EBITA as a percentage of sales.
2. Including share of equity accounted investments.

Preliminary results statement

2016 was a good year for BAE Systems. The Company has performed well despite economic and political uncertainties, delivering sales and order backlog growth. Governments in our major markets continue to prioritise defence and security with strong demand for our capabilities.

2016 performance

US

Following the two-year Bipartisan Budget Act signed in 2015, the defence market outlook in the US is improving with encouraging signs of a return to growth in defence budgets. We are also seeing the ramp up of production on a number of the Group's long-term programmes.

Our US electronics business continued to perform well, with strong programme execution and good order intake enhancing positions in the high-technology areas of electronic warfare, electro-optics and Intelligence, Surveillance and Reconnaissance. As a major supplier on the F-35 Lightning II combat aircraft programme, including the electronic warfare system, we are well positioned on the progressive increases in production output planned over the coming years to meet the requirements of US and international customers.

The Eagle Passive Active Warning Survivability System electronic warfare upgrade for US Air Force F-15 aircraft is progressing to its engineering and manufacturing development phase. The Advanced Precision Kill Weapon System (APKWS™) laser-guided rocket is experiencing growing demand and, in October, the US Navy awarded a three-year Indefinite Delivery, Indefinite Quantity contract for Full-Rate Production.

Performance in the commercial electronics business continued to be good and our all-electric and hybrid power and propulsion business delivered growth.

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.

The US land business delivered good export order intake in the period on the back of contract awards on Assault Amphibious Vehicles to Japan, BvS10 military vehicles to Austria, CV90 combat vehicle upgrades for Sweden, and M109 and M113 upgrades to Brazil, and our weapon systems business was awarded contracts for gun systems for the Royal Navy Type 26 frigate. The contract for M777 howitzers to India under a US Foreign Military Sale was signed in January 2017.

FNSS, the Turkish land systems business in which BAE Systems holds a 49% interest, secured further domestic and international orders in the year, and the business holds an order book of $1.1bn (£0.9bn).

These long-term contracts, which offer opportunities in international markets, and our strong franchise in tracked vehicles make the land business well placed for a return to growth in the medium term.

BAE Systems is a leading supplier of ship repair services to the US Navy and continues to adjust its workforce and facilities to meet evolving demand. Our San Diego operations are expected to benefit from enhanced Asia-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 became operational in February 2017.

Our US business's commercial shipbuilding contracts have been challenging in the year, with further charges taken. Six ships have now been accepted and production of the remaining two is maturing well with delivery and customer acceptance expected in 2017. The US business has not contracted for any more commercial ship-build.

Whilst market conditions remain highly competitive and continue to evolve, our US-based Intelligence & Security business has performed well, securing good 2016 order intake including a number of new multi-year service contracts.

UK

Our UK-based business continued to perform well, benefiting from good programme execution and stability in customer requirements following the UK Strategic Defence and Security Review in 2015.

Whilst the result of the 2016 EU referendum in the UK continues to create economic uncertainty, good progress has been achieved in implementing the Strategic Defence and Security Review through long-term contract awards and commitments.

In the air domain, Typhoon aircraft deliveries for the Royal Air Force and Royal Saudi Air Force continued alongside airframe sub-assembly deliveries to European partner nations. The Oman Typhoon programme is on track to commence deliveries in 2017. The contract to supply 28 Typhoon aircraft sets for the Kuwaiti Air Force is consistent with the medium-term production planning assumptions announced last year. We have received £1bn of order intake on this programme.

Export activity continues to be well 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 ongoing integration of the Captor E-Scan radar, Storm Shadow, Meteor and Brimstone 2 missiles, and development towards the Royal Air Force Centurion standard. A Typhoon support partnership arrangement, expected to be worth at least £2.1bn over a ten-year period, was signed in July.

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

In November, the F-35 Joint Programme Office announced that it had chosen the UK and Australia as significant repair hubs for the maintenance, repair, overhaul and upgrade of F-35 Lightning II avionics and components. These repair hub assignments will support the growing global fleet until 2025 after which the UK and Australia will undertake repairs for the European and Pacific fleets, respectively. BAE Systems plays a leading role in both the UK and Australia as we bring our strong track record of working alongside our international customers and industry partners to deliver innovative and cost-effective sustainment solutions.

A long-term Hawk support contract in the UK was announced in the year and support was maintained to the Indian Hawk programme with the supply of materiel and engineering services.

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

In Turkey, following a pre-contract study phase between BAE Systems and Turkish Aerospace Industries, we have signed a heads of agreement to collaborate on the first design and development phase of an indigenous fifth-generation fighter jet for the Turkish Air Force. When on contract, this will have a value in excess of £100m.

In the maritime domain, submarine activity is increasing with the Astute and Dreadnought Class submarines now both in production. The first three Astute Class submarines are in operational service with the Royal Navy and the remaining four boats in build.

The UK government's commitment to the Dreadnought programme was endorsed by Parliament during the year. Funding was received for the continued design, initial manufacture of the first boat, material commitment and facilities investment for the major redevelopment of the Barrow site.

The Ministry of Defence, BAE Systems and Rolls-Royce have signed a heads of terms to set up a Dreadnought Build Alliance documenting the UK government and industry's commitment to the delivery of the Dreadnought Class submarine programme, the replacement for the Royal Navy's Vanguard Class submarine fleet, and setting out an organisational and managerial structure and series of commercial principles necessary to deliver it.

The Queen Elizabeth Class aircraft carrier programme progresses with assembly of the second ship well under way. Preparations for sea trials on the first of class vessel in 2017 are maturing and activity to support entry into service is expanding.

In preparation for the manufacturing phase, an extension to the Type 26 frigate demonstration phase contract was secured in March and, under a heads of terms signed in November, BAE Systems and the Ministry of Defence reached agreement on the intention to build eight Type 26 ships on the Clyde, with a cut-steel date in summer 2017. Two additional River Class Offshore Patrol Vessels were also contracted for in December. Build of the first three Offshore Patrol Vessels is progressing well, with sea trials for the first ship planned in the second quarter of 2017.

International
In the 50th year of its presence in Saudi Arabia, BAE Systems continues to address current and potential new requirements as part of the long-standing agreements between the UK government and the Kingdom. Our In-Kingdom Industrial Participation programme also continues apace.

An agreement has been reached with the Saudi Arabian government for BAE Systems to continue to provide support services to the Royal Saudi Air Force and Royal Saudi Naval Forces under the Saudi British Defence Co-operation Programme for a further five years.

On the Salam Typhoon programme, the remaining four of the contracted 72 aircraft will be delivered in 2017. Deliveries have commenced under the Hawk aircraft contract signed in 2012. The Royal Saudi Air Force has achieved high utilisation and aircraft availability across its Typhoon, Tornado and training aircraft fleets.

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 complete. Long-term sustainment and upgrade contracts were received for the Anzac Class frigates and F-35 Lightning II aircraft.

In India, BAE Systems has a long-standing relationship with Hindustan Aeronautics Limited (HAL). Delivery of the second batch of HAL-built Hawk aircraft was completed in the year and an order for a further batch from the Indian Air Force is being negotiated.

In November, the US and Indian governments signed a Letter of Agreement for the Foreign Military Sale of 145 M777 lightweight howitzers and, in January 2017, we received the $542m (£439m) contract from the US government to supply these howitzers to the Indian Army. As previously announced, Mahindra & Mahindra will be our supplier to establish an assembly, integration and test facility in India as further support for the 'Make in India' initiative.

The MBDA joint venture won significant order intake on air, maritime and land platforms in the year, including a number of contracts supporting the UK's complex weapons requirements and significant export awards. Building on its already large order book, good growth in MBDA is expected over the medium term.

Cyber security
Applied Intelligence achieved double-digit order intake and sales growth. Ongoing investment in engineering capabilities, product development and marketing costs, all expensed, continues to support the future growth profile for the business.

Cyber security is becoming an 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 and where they deliver on the Group's strategy.

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 1.2 percentage point reduction in the real discount rate to –0.5% in the UK, partly offset by returns on scheme assets.

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

Summary

Our business benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia. Our clear and well-defined strategy has guided us through a period of difficult market conditions. As the overall business environment in our major markets improves and through execution of our strategy, we are well placed to maximise opportunities, deal with the challenges and continue to generate attractive shareholder returns.

Directors

On 22 February 2017, the Group announced the appointment of Charles Woodburn to succeed Ian King as Chief Executive with effect from 1 July 2017. Ian King retires from the Company at the end of June having served over 40 years, including leading BAE Systems as Chief Executive for the past eight years. Charles Woodburn is currently Chief Operating Officer and has been a director of the Company since May 2016.

Elizabeth Corley was appointed to the Board as a non-executive director on 1 February 2016.

Dividend

The Board has recommended a final dividend of 12.7p per share making a total of 21.3p per share for the year, an increase of 2% compared to 2015.

Glossary

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

	Definition	Purpose
Financial performance measures as defined by the Group		
Sales	Revenue including the Group's share of revenue of equity accounted investments.	Allows management to monitor the sales performance of subsidiaries and equity accounted investments.
Underlying EBITA	Profit for the year before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items*.	Provides a measure of operating profitability that is comparable over time.
Underlying earnings per share	Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items*.	Provides a measure of underlying performance that is comparable over time.
Operating business cash flow	Net cash flow from operating activities excluding taxation after net capital expenditure, financial investment and dividends from equity accounted investments.	Allows management to monitor the operating cash generation of the Group.
Net debt	Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments).	Allows management to monitor the net cash generation of the Group.
Order intake	Funded orders received from customers including the Group's share of order intake of equity accounted investments.	Allows management to monitor the order intake of subsidiaries and equity accounted investments.
Order backlog	Funded and unfunded unexecuted customer orders including the Group's share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.	Supports future years' sales performance of subsidiaries and equity accounted investments.
Financial performance measures defined in IFRS		
Revenue	Income derived from the provision of goods and services by the Company and its subsidiary undertakings.	N/a
Operating profit	Profit for the year before finance costs and taxation expense. This measure includes finance costs and taxation expense of equity accounted investments.	N/a
Basic earnings per share	Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.	N/a
Net cash flow from operating activities	Net cash flow from operating activities in accordance with International Accounting Standard 7, Statement of Cash Flows.	N/a
Other financial measures		
Net pension deficit	Net International Accounting Standard 19, Employee Benefits, deficit excluding amounts allocated to equity accounted investments.	N/a
Dividend per share	Interim dividend paid and final dividend proposed per share.	N/a

* Items that are relevant to an understanding of the Group's performance with reference to their materiality and nature (see page 11).

Income statement

	2016 £m	2015 £m
Financial performance measures as defined by the Group[1]		
Sales	**19,020**	17,904
Underlying EBITA	**1,905**	1,683
Return on sales	**10.0%**	9.4%
Financial performance measures defined in IFRS[2]		
Revenue	**17,790**	16,787
Operating profit	**1,742**	1,502
Return on revenue	**9.8%**	8.9%
Reconciliation of sales to revenue	**£m**	£m
Sales	**19,020**	17,904
Deduct Share of sales by equity accounted investments	**(2,427)**	(2,719)
Add Sales to equity accounted investments	**1,197**	1,602
Revenue	**17,790**	16,787
Reconciliation of underlying EBITA to operating profit	**£m**	£m
Underlying EBITA	**1,905**	1,683
Non-recurring items	**(12)**	26
Amortisation of intangible assets	**(87)**	(108)
Impairment of intangible assets	**–**	(78)
Financial (expense)/income of equity accounted investments	**(28)**	3
Taxation expense of equity accounted investments	**(36)**	(24)
Operating profit	**1,742**	1,502
Net finance costs	**(591)**	(412)
Taxation expense	**(213)**	(147)
Profit for the year	**938**	943

Segmental analysis

Financial performance measures as defined by the Group[1]

	Sales		Underlying EBITA	
	2016 £m	2015[3] £m	**2016 £m**	2015[3] £m
Electronic Systems	**3,282**	2,922	**494**	437
Cyber & Intelligence	**1,778**	1,564	**90**	104
Platforms & Services (US)	**2,874**	2,779	**211**	177
Platforms & Services (UK)	**7,806**	7,405	**810**	721
Platforms & Services (International)	**3,943**	3,742	**400**	335
HQ	**233**	237	**(100)**	(91)
Deduct Intra-group	**(896)**	(745)		
	19,020	17,904	**1,905**	1,683

Financial performance measures defined in IFRS[2]

	Revenue		Operating profit/(loss)	
	2016 £m	2015[3] £m	**2016 £m**	2015[3] £m
Electronic Systems	**3,282**	2,922	**474**	419
Cyber & Intelligence	**1,778**	1,564	**59**	(31)
Platforms & Services (US)	**2,783**	2,678	**182**	142
Platforms & Services (UK)	**7,699**	7,319	**780**	756
Platforms & Services (International)	**3,037**	2,957	**365**	299
HQ	**–**	–	**(118)**	(83)
Deduct Intra-group	**(789)**	(653)		
	17,790	16,787	**1,742**	1,502

Exchange rates

	2016	2015
Average		
£/$	**1.354**	1.528
£/€	**1.223**	1.377
£/A$	**1.823**	2.036
Year end		
£/$	**1.236**	1.474
£/€	**1.172**	1.357
£/A$	**1.707**	2.027

Sensitivity analysis	**£m**
Estimated impact on sales of a ten cent movement in the average exchange rate:	
$	**500**
€	**60**
A$	**30**

Sales increased by £1.1bn to £19.0bn (2015 £17.9bn), almost all of which was due to exchange translation.

Underlying EBITA increased by £222m to £1,905m (2015 £1,683m), giving a return on sales of 10.0% (2015 9.4%). There was an exchange translation benefit of £96m. Growth on a constant currency basis was at 7%.

Revenue increased by £1.0bn to £17.8bn (2015 £16.8bn).

Operating profit increased by £240m to £1,742m (2015 £1,502m), giving a return on revenue of 9.8% (2015 8.9%). There was an exchange translation benefit of £86m.

Non-recurring items represents an impairment in respect of the BAE Systems San Francisco Ship Repair business sold in January 2017. Non-recurring items in 2015 of £26m included research and development expenditure credits relating to 2013 and 2014 (£50m), partly offset by a loss on the disposal of the Group's 75% shareholding in the Land Systems South Africa business (£24m).

Amortisation of intangible assets reduced to £87m (2015 £108m) due to previously acquired intangible assets now fully amortised.

Impairment of intangible assets in 2015 mainly comprised the impairment of goodwill in the US Intelligence & Security business reflecting lower business growth assumptions.

Financial expense of equity accounted investments is £28m (2015 income £3m). There was a large gain in 2015 on the translation of foreign currency assets in Air Astana.

Net finance costs were £591m (2015 £412m). The underlying interest charge, excluding pension accounting, and fair value and foreign exchange adjustments on financial instruments and investments, increased to £245m (2015 £191m) primarily reflecting interest on the bonds issued in December 2015, incremental charges relating to net present value adjustments on the discounting of long-term liability provisions and adverse exchange translation of interest charges on US dollar-denominated borrowings. Net interest expense on the Group's pension deficit was lower at £169m (2015 £192m) mainly reflecting the lower 2015 closing deficit. Fair value and foreign exchange adjustments increased to £177m (2015 £29m) on adverse exchange translation of US dollar-denominated bonds.

Taxation expense, including equity accounted investments, of £249m (2015 £171m) reflects the Group's underlying effective tax rate for the year of 21%. The underlying effective tax rate for 2017 is expected to increase slightly from 21% to around 22%, with the final rate dependent on the geographical mix of profits.

Looking beyond 2017, the effective tax rate will depend principally on whether there are any changes in tax legislation in the Group's most significant countries of operation, the geographical mix of profits and the resolution of open issues. With the political change in the US, proposals to significantly reform the corporate tax system are being considered. The Group will actively monitor any developments and evaluate their potential impact. The Group does not expect the future rate to be materially impacted by the changes to the international tax landscape resulting from the package of measures developed under the OECD/G20 Base Erosion and Profit Shifting project and the investigations and proposals of the European Commission. However, the Group will keep these under review.

1. For alternative performance measure definitions see glossary on page 8.
2. International Financial Reporting Standards.
3. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

Earnings per share

	2016	2015
Financial performance measures as defined by the Group[1]		
Underlying earnings	**£1,277m**	£1,270m
Underlying earnings per share	**40.3p**	40.2p
Financial performance measures defined in IFRS[2]		
Profit for the year attributable to equity shareholders	**£913m**	£918m
Basic earnings per share	**28.8p**	29.0p

Reconciliation of underlying earnings to profit for the year attributable to equity shareholders	**£m**	£m
Underlying earnings	**1,277**	1,270
Non-recurring items, post tax	**(9)**	(19)
Amortisation and impairment of intangible assets, post tax	**(69)**	(88)
Impairment of goodwill	**–**	(75)
Net interest expense on retirement benefit obligations, post tax	**(140)**	(158)
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	**(146)**	(12)
Profit for the year attributable to equity shareholders	**913**	918
Non-controlling interests	**25**	25
Profit for the year	**938**	943

Underlying earnings per share for the year was 40.3p (2015 40.2p). The prior year included a 4.3p per share benefit from tax provision releases.

Basic earnings per share was 28.8p (2015 29.0p).

1. For alternative performance measure definitions see glossary on page 8.
2. International Financial Reporting Standards.

Cash flow

	2016 £m	2015[1] £m
Financial performance measures as defined by the Group[2]		
Operating business cash flow	**1,004**	681
Financial performance measures defined in IFRS[3]		
Net cash flow from operating activities	**1,229**	808

Reconciliation from operating business cash flow to net cash flow from operating activities	**£m**	£m
Operating business cash flow	**1,004**	681
Add back Net capital expenditure and financial investment	**450**	284
Deduct Dividends received from equity accounted investments	**(38)**	(41)
Deduct Taxation	**(187)**	(116)
Net cash flow from operating activities	**1,229**	808
Net capital expenditure and financial investment	**(450)**	(284)
Dividends received from equity accounted investments	**38**	41
Net interest paid	**(200)**	(173)
Acquisitions and disposals	**6**	16
Net cash flow from investing activities	**(606)**	(400)
Net sale of own shares	**3**	1
Equity dividends paid	**(670)**	(655)
Dividends paid to non-controlling interests	**(24)**	(40)
Cash flow from matured derivative financial instruments	**480**	12
Movement in cash collateral	**32**	3
Net cash flow from loans	**(286)**	490
Net cash flow from financing activities	**(465)**	(189)
Net increase in cash and cash equivalents	**158**	219
Add back/(deduct) Net cash flow from loans	**286**	(490)
Deduct Cash classified as held for sale	**(2)**	–
Foreign exchange translation	**(621)**	(165)
Other non-cash movements	**59**	46
Increase in net debt	**(120)**	(390)
Opening net debt	**(1,422)**	(1,032)
Net debt	**(1,542)**	(1,422)

Segmental analysis

	2016 £m	2015[4] £m
Financial performance measures as defined by the Group[2]		
Electronic Systems	**469**	370
Cyber & Intelligence	**83**	46
Platforms & Services (US)	**58**	100
Platforms & Services (UK)	**199**	220
Platforms & Services (International)	**435**	164
HQ	**(240)**	(219)
Operating business cash flow	**1,004**	681
Financial performance measures defined in IFRS[3]		
Electronic Systems	**568**	445
Cyber & Intelligence	**106**	70
Platforms & Services (US)	**129**	144
Platforms & Services (UK)	**385**	289
Platforms & Services (International)	**473**	193
HQ	**(245)**	(217)
Deduct Taxation[5]	**(187)**	(116)
Net cash flow from operating activities	**1,229**	808

Operating business cash flow was £1,004m (2015 £681m), which includes cash contributions in respect of pension deficit funding, over and above service costs, for the UK and US schemes totalling £253m (2015 £274m).

Receipts aggregating to approximately £250m, expected in 2017 on the Omani Typhoon programme, Saudi support and MBDA's Qatar contract, were received in 2016.

Major advances received in 2012 on the Omani Typhoon and Hawk order, and the Saudi training aircraft contract, were consumed. Advances were also utilised in the year on European Typhoon production. Costs are being incurred against provisions created in previous years, primarily on the US commercial shipbuilding programmes.

Net cash flow from operating activities was £1,229m (2015 £808m).

Taxation payments increased to £187m (2015 £116m) primarily reflecting higher payments in the US due to higher US taxable profits and timing differences.

Net capital expenditure and financial investment was £450m (2015 £284m) largely reflecting lower proceeds from sale of property, plant and equipment, and investment property of £45m (2015 £136m). Purchases of property, plant and equipment, and investment property were £49m higher primarily reflecting investment in manufacturing facilities at Electronic Systems.

Dividends received from equity accounted investments of £38m (2015 £41m) is primarily receipts from MBDA and FNSS.

Net interest paid was £27m higher at £200m (2015 £173m) primarily for interest on the bonds issued in December 2015 and adverse exchange translation of interest on US dollar-denominated borrowings.

The cash inflow in respect of **acquisitions and disposals** in 2016 of £6m reflects the sale of a 4.1% shareholding in a subsidiary company in Saudi Arabia. In 2015, the net cash inflow of £16m included £21m received from the sale of the Group's 75% shareholding in the Land Systems South Africa business, less £5m paid for the acquisition of Eclipse Electronic Systems, Inc.

Equity dividends paid in 2016 represents the 2015 final (£397m) and 2016 interim (£273m) dividends.

Dividends paid to non-controlling interests reduced to £24m (2015 £40m). An increased dividend was paid in 2015 by the Group's 75%-owned South African business prior to disposal.

As a consequence of movements in US dollar and euro exchange rates, there was a **cash inflow from matured derivative financial instruments** of £480m (2015 £12m) from rolling hedges on balances with the Group's subsidiaries and equity accounted investments. The inflow as a result of hedging cash loaned internally, from the US to the UK business, partially offsets the foreign exchange translation on the Group's external US dollar-denominated borrowing (see below).

Net cash flow from loans represents repayment of a $350m (£286m) 3.5% bond at maturity in October. In 2015, BAE Systems issued $1.5bn (£971m) of bonds in the US capital market and repaid a $750m (£481m) 5.2% bond at maturity.

Foreign exchange translation, which primarily arises in respect of the Group's US dollar-denominated borrowing, is partially offset by the cash inflow from matured derivative financial instruments (see above).

1. Re-presented to re-classify interest paid from operating to investing activities.
2. For alternative performance measure definitions see glossary on page 8.
3. International Financial Reporting Standards.
4. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.
5. Taxation is managed on a Group basis.

Net debt

	2016 £m	2015 £m
Components of net debt		
Cash and cash equivalents	**2,769**	2,537
Debt-related derivative financial instrument assets	**114**	53
Loans – non-current	**(4,425)**	(3,775)
Loans and overdrafts – current	**–**	(237)
Net debt	**(1,542)**	(1,422)

The Group's **net debt** at 31 December 2016 is £1,542m, a net increase of £120m from the net debt position of £1,422m at the start of the year. A $350m (£286m) 3.5% bond was repaid at maturity in October. There are no further material debt maturities before 2019.

Cash and cash equivalents of £2,769m (2015 £2,537m) are held primarily for the repayment of debt securities, pension deficit funding, payment of the 2016 final dividend and management of working capital.

Segmental performance: Electronic Systems

Electronic Systems, with 13,800 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.

Operational and strategic highlights

- Delivered the 250th electronic warfare suite for the F-35 Lightning II combat aircraft programme
- Initiated our 'Ramp 2 Rate' capital investment strategy to support growth in defence electronics production
- Awarded a $146m (£118m) engineering and manufacturing development contract for the US Air Force's Eagle Passive Active Warning Survivability System
- Signed a three-year Indefinite Delivery, Indefinite Quantity contract for Advanced Precision Kill Weapon System (APKWS™) Full-Rate Production Lots 5 to 7, worth up to $600m (£486m)
- Awarded a $249m (£201m) contract modification on the Common Missile Warning System programme
- Awarded a contract on the US Army's Family of Weapon Sights – Crew Served programme worth up to $384m (£311m)
- Integration of the GEOINT-ISR business transferred from Cyber & Intelligence completed

Financial performance

Financial performance measures as defined by the Group[2]

	2016	2015[4]
Sales	**£3,282m**	£2,922m
Underlying EBITA	**£494m**	£437m
Return on sales	**15.1%**	15.0%
Operating business cash flow	**£469m**	£370m
Order intake[1]	**£3,322m**	£2,799m
Order backlog[1]	**£5.2bn**	£4.4bn

Financial performance measures defined in IFRS[3]

	2016	2015[4]
Revenue	**£3,282m**	£2,922m
Operating profit	**£474m**	£419m
Return on revenue	**14.4%**	14.3%
Cash flow from operating activities	**£568m**	£445m

- Sales compared with 2015 were almost unchanged at $4.4bn (£3.3bn). The commercial areas of the business now amount to 24%, having seen sales growth in the year of 11% primarily in HybriDrive® systems. On the defence side, sales were slightly down on timing of production deliveries on the Digital Electronic Warfare System and other electronic warfare programmes.
- The return on sales achieved of 15.1% (2015 15.0%) was largely from continued strong programme execution and risk retirement.
- Cash conversion of underlying EBITA for the year was at 97%, excluding pension deficit funding.
- Order backlog[1] was sustained at $6.5bn (£5.2bn) benefiting from awards for F-35 Lightning II electronic warfare systems, the F-15 Eagle Passive Active Warning Survivability System programme and APKWS™.

Operational performance

Electronic Combat

BAE Systems has sustained its leadership position in the US electronic warfare and communications and navigation markets. 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. We have received initial funding for Lot 11 with deliveries expected to commence in 2018.

The business is under contracts, from Boeing and Warner Robins Air Logistics Complex, totalling more than $1.0bn (£0.8bn) to install the Digital Electronic Warfare System 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, we were 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. In 2016, we received the engineering and manufacturing development contract, worth $146m (£118m), as a follow-on to the technology maturation and risk reduction phase. The programme could be worth more than $1.0bn (£0.8bn) over its life.

In January 2017, BAE Systems was awarded a $67m (£54m) modification to exercise the option on a previously awarded contract for an electronic warfare system for the US Air Force Special Operations Command's fleet of C-130J aircraft. The award is currently under protest with the Government Accountability Office.

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

Survivability, Targeting & Sensing

Our Advanced Precision Kill Weapon System (APKWS™) laser-guided rocket is experiencing growing demand, with deliveries exceeding 8,000 units through 2016. In addition to expanding its use in the US military, the system is generating strong international attention, with 16 nations expressing interest. In October, the US Navy awarded us a three-year Indefinite Delivery, Indefinite Quantity contract for Full-Rate Production Lots 5 to 7 worth up to $600m (£486m) that could increase production to 10,000 units per year.

We continue to perform well on the Terminal High-Altitude Area Defence programme, delivering over 90 seekers in 2016 following the $80m (£65m) contract received for Lots 7 and 8 during the year.

On the Common Missile Warning System programme, the business was awarded a $249m (£201m) Indefinite Delivery, Indefinite Quantity contract modification to fulfil increased demand from our customers, the US Army and allied nations, extending the current five-year contract by two years.

On the Enhanced Night Vision Goggle III and Family of Weapon Sights – Individual programme, we completed the first round of qualification and reliability testing in September under a five-year, $434m (£351m) Indefinite Delivery, Indefinite Quantity contract.

On the US Army's Family of Weapon Sights – Crew Served programme, we were awarded a seven-year contract with a potential value of up to $384m (£311m) in September. The sight is designed to allow soldiers to acquire and engage targets at extended range.

We continue to leverage our technology and engineering capabilities, and the LiteHUD® head-up display has been selected by critical launch customers for integration on multiple platforms.

The next-generation Striker® II helmet-mounted display has completed the second phase of flight trials to integrate the system's technology with the Typhoon combat aircraft.

Intelligence, Surveillance & Reconnaissance

In 2016, Cyber & Intelligence's Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance (GEOINT-ISR) business transferred to Electronic Systems and was merged with the sector's existing Intelligence, Surveillance & Reconnaissance business.

Since winning the Geospatial Data Services Foundational GEOINT Content Management programme in 2014, we have been awarded orders valued at $170m (£138m) and the business is meeting all delivery orders to date. The programme assists US intelligence community customers with the development of advanced geospatial intelligence data collection and processing solutions.

We provide signals intelligence capability for the US Army and other US Department of Defense customers and have 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 to approximately $116m (£94m).

The business is in Full-Rate Production on the US Navy's P-8A Poseidon maritime surveillance aircraft programme, providing state-of-the-art processing capabilities. We delivered 18 mission computer and display systems in 2016, and received a $60m (£49m) contract for Full-Rate Production Lot 4 in December.

Controls & Avionics
BAE Systems is a major supplier to Boeing for 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 schedule, with the Critical Design Reviews for all system components complete and systems integration testing in progress. On the Boeing 737 MAX aircraft, flight testing of our spoiler controls, flight deck systems and utilities is progressing well, with the first production hardware delivered in November. The Bombardier CSeries aircraft entered service equipped with BAE Systems' flight control electronics.

FADEC Alliance, a joint venture between FADEC International (the Group's joint venture with Safran Electronics & Defense) and GE Aviation, is now on contract to provide the full authority digital engine controls (FADEC) for: the Leap engine on the Airbus A320neo, Boeing 737 MAX and Comac C919; the Passport 20 engine on the Bombardier Global 7000/8000; the GE9x engine on the Boeing 777X; and a new generation of advanced turboprop engines.

We completed qualification of an active control side-stick for the Gulfstream G500/G600 aircraft, with testing nearing completion for the Embraer KC-390. The product will be the first civil-certified active control side-stick with application across both commercial and military markets.

On the F-35 Lightning II programme, the business completed Low-Rate Initial Production Lot 9 deliveries of 57 production shipsets, plus spares, of the vehicle management computer and active inceptor system equipment. Both systems are now in production for Lot 10 and we expect to be under contract for Lot 11 in 2017.

Power & Propulsion Solutions
In 2016, the business delivered more than 1,000 hybrid-electric propulsion systems to transit agencies around the world and, in November, achieved the milestone of having 7,000 hybrid-electric propulsion systems in service.

Cities including London, Paris, Seattle and Boston are using our hybrid and electric drive systems to save fuel and prevent CO_2 emissions.

We continued to increase our global presence with Solaris Bus & Coach in Poland offering our hybrid-electric system on its buses from September.

Looking forward

In the US, following the two-year Bipartisan Budget Act signed in 2015, there are signs of a return to growth in defence budgets, with the new administration expected to further increase defence and security spending.

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

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

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 8.
3. International Financial Reporting Standards.
4. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

Segmental performance: 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.

Operational and strategic highlights

Intelligence & Security

- Established prime positions under a five-year imagery analysis, training and support contract worth an estimated $350m (£283m)
- Awarded a five-year contract valued at up to $368m (£298m) to integrate weapon systems aboard US and UK submarines
- Awarded task orders totalling more than $240m (£194m) to provide information technology services to the US government

Applied Intelligence

- Second year of expanded investment in product development, and sales and marketing driving continued growth in commercial cyber security and counter-fraud
- 'Business Defence' marketing campaign is generating new leads in the commercial business
- Continued shift towards multi-year managed services and subscription-based, cloud-delivered products in the commercial sector
- Good execution of cyber defence and intelligence programmes for UK and international government customers

Financial performance

Financial performance measures as defined by the Group[2]

	2016	2015[4]
Sales	**£1,778m**	£1,564m
Underlying EBITA	**£90m**	£104m
Return on sales	**5.1%**	6.6%
Operating business cash flow	**£83m**	£46m
Order intake[1]	**£1,885m**	£1,753m
Order backlog[1]	**£2.4bn**	£2.2bn

Financial performance measures defined in IFRS[3]

	2016	2015[4]
Revenue	**£1,778m**	£1,564m
Operating profit/(loss)	**£59m**	£(31)m
Return on revenue	**3.3%**	(2.0)%
Cash flow from operating activities	**£106m**	£70m

- In aggregate, sales were marginally higher at $2.4bn (£1.8bn). The Intelligence & Security business saw a 2% increase largely in the area of provision of managed services to the intelligence community. Growth in the Applied Intelligence business was at 11%, benefiting from increases in the Commercial Solutions and UK Services divisions.
- The return on sales achieved was 5.1% (2015 6.6%). Higher levels of costs expensed in the Applied Intelligence business, together with delays in securing software licence sales, meant that there was a loss recorded in the business of £19m. In the year, the total cost base of the business (labour and overheads) amounted to more than £480m, all of which was expensed through the income statement.
- There was an operating loss in the prior year due to the impairment of goodwill in the Intelligence & Security business reflecting lower business growth assumptions.
- Cash conversion of underlying EBITA for the year was in excess of 100%, excluding pension deficit funding.
- In aggregate, order backlog[1] reduced to $3.0bn (£2.4bn). Order backlog in the Intelligence & Security business was 5% lower on trading out of certain longer-term contracts. In the Applied Intelligence business, order backlog increased by 9% over the year driven mainly by UK government services and commercial awards.

Operational performance

Intelligence & Security

Global Analysis & Operations

In Full-Motion Video and Intelligence, Surveillance and Reconnaissance analysis, we have more than 500 analysts sustaining mission-critical activities globally. These security-cleared analysts are currently executing on programmes with a combined value of more than $400m (£324m). Re-compete awards for many of these programmes are being awarded under a new Indefinite Delivery, Indefinite Quantity contract. We have established a prime position on two of the three functional areas under this contract, worth an estimated $350m (£283m) over five years, which could enable us to expand our work in motion-imagery analysis, analytic training, multi-media support and research. Award of a third functional area under this contract is expected in 2017.

We are currently performing under the first year of a five-year contract with an estimated ceiling value of $75m (£61m) to provide the US Army with geospatial intelligence data analysis support services and the business is fulfilling the third year of a five-year contract worth up to $143m (£116m) to provide counter-terrorism analysis services to the US government.

Integrated Electronics & Warfare Systems

We have been awarded a five-year, sole-source contract worth up to $368m (£298m) by the US Navy to assist with system integration and provide test engineering services and special test equipment for weapons systems on board US Ohio and UK Vanguard Class submarines.

Other US Navy awards in the year include: a five-year contract worth up to $86m (£70m) to provide management, engineering, maintenance and IT support services for critical mission equipment and combat services used by Naval Sea Systems Command; a two-year, $73m (£59m) contract from the Naval Air Warfare Center Aircraft Division to provide lifecycle support services for communications and electronics equipment and subsystems; and a five-year, $52m (£42m) contract to provide essential maintenance and testing support for various air traffic control and landing systems.

We continued to support the US Navy's Space and Naval Warfare Systems Center Atlantic, to integrate new C4I (Command, Control, Communications, Computers and Intelligence) equipment on approximately 6,000 Mine Resistant Ambush Protected vehicles over a five-year period, with more than 2,000 vehicles serviced in 2016.

We were awarded a two-year, $16m (£13m) task order by the US Army's Space and Missile Defense Command/Army Strategic Command to continue the development of specialised cyber vulnerability assessment tools to harden and protect space assets. We also secured a two-year, $13m (£11m) task order to build a Cyber Warrior Training Capability in support of the Missile Defense Agency.

Under the US Air Force's Intercontinental Ballistic Missile Integration Support Contractor programme, we were awarded more than $190m (£154m) in additional engineering scope change proposals in 2016, which has resulted in the total contract lifecycle value reaching nearly $900m (£728m) since we began managing the programme in 2013.

IT Solutions

We are 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 contract awarded in 2015 with a potential value of more than $1.0bn (£0.8bn), under which task orders totalling approximately $240m (£194m) have been awarded to date.

Under the Enhanced Solutions for the Information Technology Enterprise (e-SITE) Indefinite Delivery, Indefinite Quantity contract for the Defense Intelligence Agency, we were awarded a five-year, $58m (£47m) re-compete task order to continue designing, developing, engineering, installing and sustaining information technology resources.

The US Air Force Research Laboratory awarded the business a five-year contract worth up to $49m (£40m) to develop, deploy and maintain cross-domain solutions for safeguarding the sharing of sensitive information between government networks.

Applied Intelligence

The business has continued to invest in commercial cyber security and counter-fraud product development, and sales and marketing to drive revenue growth. A 'Business Defence' marketing campaign, launched initially in the US, is generating new leads in the commercial business. We have continued to build our cyber skills and engineering capabilities internationally. During the year, we opened a 'Nerve Centre' in Malaysia, a state-of-the-art facility that supports our global cyber security, anti-financial crime and threat intelligence capabilities.

Commercial Solutions

The business continues to shift towards more multi-year managed services and subscription-based, cloud-delivered products. During the year, an enhanced Managed Security Services offering to enterprise-class customers was launched in the US, building on the success of our existing mid-market offering. We have seen growth in managed security services through partnerships with regional communications service providers in the UK and North America.

The business continues to sell licensed 'on premise' software products, with awards in the year including a pilot with a major UK financial institution for the CyberReveal™ threat analytics solution, which defends large enterprises against sophisticated cyber-attacks.

We have continued to extend our position in counter-fraud and financial compliance with further sales of multi-year service offerings, including a five-year contract to provide a customised NetReveal™ counter-fraud analytics solution for HM Revenue & Customs in the UK and the extension of the managed fraud detection service for the Insurance Fraud Bureau in the UK to 2020. The business was appointed by SWIFT, the world's leading provider of secure financial messaging services, to join its new Customer Security Intelligence team and has announced an Incident Response partnership with Allianz Global Corporate & Specialty.

UK Services

The business has maintained its position as a key supplier to national security agencies in the UK, with a number of new framework agreements and contract wins, including follow-on work for existing customer 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 data and digital transformation business continues to grow, with new contracts covering a team delivering aspects of IT transformational change in HM Revenue & Customs to the final quarter of 2017 and collaboration in the Digital Railway programme helping to develop an industry architecture and capability development framework for the UK rail industry. We have won a number of service integration and management advisory contracts in central government departments.

International Services & Solutions

We have seen continued demand in Asia-Pacific, Europe and the Middle East for protection against national threats. A pilot advanced cyber threat analytics and investigation solution on a national telecommunications network in Asia was successfully implemented during the year and there has been 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. We have 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

Following a period of market contraction in the US government services sector, the Group believes the outlook is now stable with market conditions remaining highly competitive.

The Intelligence & Security business has continued to reduce costs to address government budget pressures, whilst pursuing growth opportunities, particularly in critical, mission-focused areas.

Applied Intelligence

Investment continues in product development, sales and marketing, and building cyber and engineering capabilities in the UK and international markets.

The business continues to migrate towards a multi-year managed service and subscription-based model, providing enhanced predictability of revenues, and growing further the order backlog and pipeline of opportunities from commercial and government customers in North America, Europe, Asia-Pacific and the Middle East.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 8.
3. International Financial Reporting Standards.
4. Re-presented for the transfer of the GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) business from Cyber & Intelligence to Electronic Systems.

Segmental performance: Platforms & Services (US)

Platforms & Services (US), with 11,300 employees[1], has operations in the US, UK and Sweden. It produces combat vehicles, weapons and munitions, and delivers services and sustainment activities, including ship repair and the management of government-owned munitions facilities.

Operational and strategic highlights

- Roll-out of the first prototype Armored Multi-Purpose Vehicle for the US Army and delivery of the first prototype Amphibious Combat Vehicles for the US Marine Corps
- 34 vehicle sets delivered to the US Army under the M109A7 Paladin self-propelled howitzer programme
- Commenced production of 30 Assault Amphibious Vehicles for Japan under a $160m (£129m) contract
- £183m contract received in July for the gun system on the UK Type 26 frigate
- Secured a $542m (£439m) contract to provide 145 M777 lightweight howitzers to India in January 2017
- Received a $182m (£147m) contract to refurbish and upgrade 262 CV90 Infantry Fighting Vehicles for Sweden
- FNSS awarded a contract to supply 260 Anti-Tank Vehicles to the Turkish Land Forces worth more than €278m (£237m)
- The arrival of a new dry dock at the San Diego shipyard to expand capabilities for servicing US Navy ships

Financial performance

Financial performance measures as defined by the Group[2]

	2016	2015
Sales	**£2,874m**	£2,779m
Underlying EBITA	**£211m**	£177m
Return on sales	**7.3%**	6.4%
Operating business cash flow	**£58m**	£100m
Order intake[1]	**£3,308m**	£2,737m
Order backlog[1]	**£4.6bn**	£3.9bn

Financial performance measures defined in IFRS[3]

	2016	2015
Revenue	**£2,783m**	£2,678m
Operating profit	**£182m**	£142m
Return on revenue	**6.5%**	5.3%
Cash flow from operating activities	**£129m**	£144m

- Sales in the year declined by 8% to $3.9bn (£2.9bn). The sales reduction in the naval ship repair business was less than expected, with stronger volumes through our Norfolk yard.
- The business has delivered an improved return on sales of 7.3% (2015 6.4%). Whilst further charges had to be taken in the year on the commercial shipbuilding programmes, these were partly offset by provision releases, primarily on the Radford munitions contract. The net impact of these charges and releases was 1.3 percentage points on return on sales.
- Cash conversion of underlying EBITA was impacted by the use of provisions on the commercial shipbuilding programmes and of customer advances on the CV90 Norway contract, along with the investment, now completed, on the new floating dry dock facilities in San Diego.
- Order backlog[1] was almost unchanged at $5.7bn (£4.6bn). The trading out of the five-year Multi-Ship, Multi-Option contracts in the ship repair business and on the CV90 Norway programme were largely offset by multiple domestic and international land vehicle awards along with the gun contract for the UK's Type 26 frigate. The Indian M777 lightweight howitzer award for $542m (£439m) was not contracted until January 2017.

Operational performance

US Combat Vehicles

The business continues to hold a number of key franchise programmes, including the long-standing Bradley Infantry Fighting Vehicle, the M109 family of vehicles, the M88 Heavy Recovery Vehicle, the Assault Amphibious Vehicle and the more recent Armored Multi-Purpose Vehicle, with future prospects including the Amphibious Combat Vehicle 1.1 programme.

We have rolled out the first of 29 vehicles under the engineering and manufacturing development phase of the US Army's Armored Multi-Purpose Vehicle programme. The potential contract value for the initial phase of the programme is $1.2bn (£1.0bn), including options for 289 vehicles in Low-Rate Initial Production. Anticipated Full-Rate Production is expected to approach 3,000 vehicles.

We continue to execute on the $670m (£542m) Low-Rate Initial Production phase of the M109A7 Paladin self-propelled howitzer programme to deliver 66 vehicle sets and an additional howitzer. At 31 December, 34 vehicle sets, together with the additional howitzer, had been delivered. The US Army's total acquisition objective through all programme phases is for 581 vehicle sets.

The business is executing a $286m (£231m) Engineering Change Proposal to address the space, weight, power and cooling limitations of the Bradley family of vehicles as well as preparing the vehicle for communication network upgrades. In 2017, the customer's production decision is expected regarding the upgrade of approximately 500 vehicles over a three-year period from 2019.

In April, we received a contract valued at $110m (£89m) 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 scheduled to begin in November 2017.

Along with industry partner Iveco Defence, BAE Systems has begun deliveries of the first of 16 Amphibious Combat Vehicle 1.1 prototypes under a $104m (£84m) contract for the engineering and manufacturing development phase of the programme. Testing by the US Marine Corps will start in the first half of 2017 and final down-selection to a single manufacturer is expected in 2018.

Leveraging our expertise in amphibious capabilities, we were awarded contracts totalling $160m (£129m) for the production of 30 new Assault Amphibious Vehicles (AAV) and the upgrade of two AAV for the Japanese Ministry of Defence.

In April, we received a contract valued at $50m (£40m) to deliver 236 M113 upgrade kits and technical support for the Brazilian Army, with contract deliveries scheduled to complete in 2018. In September, the Brazilian government awarded the business a $54m (£44m) contract to provide 32 upgraded M109A5+ self-propelled howitzers.

Weapon Systems and Munition Operations

BAE Systems remains a leading provider of gun systems and precision strike capabilities, and continues work with the US Navy on the development of the Hyper Velocity Projectile and the Electromagnetic Railgun.

In April, we received multiple awards from the US Navy, including a $38m (£31m) contract modification to provide additional missile canisters for the Mk 41 Vertical Launching System and a $72m (£58m) contract to produce and deliver propulsor systems for Block IV Virginia Class submarines.

In August, the US Navy exercised a $50m (£40m) contract option to upgrade four additional Mk 45 gun systems, bringing the total value of the contract to $130m (£105m) for ten systems.

In July, we received a £183m contract from the UK Ministry of Defence to provide the gun system known as the Maritime Indirect Fire System for the Royal Navy's Type 26 frigate.

Deliveries to the Swedish government of the 24 Archer artillery systems were completed in December. In September, the Swedish government announced its intent to purchase the additional 24 Archer systems originally contracted for Norway.

In February 2017, we completed the acquisition of IAP Research, an engineering company focused on the development and production of electromagnetic launchers, power electronics and advanced materials.

In the complex infrastructure operations business, we manage the US Army's Radford and Holston munitions facilities. In the year, we were awarded $85m (£69m) in contract modifications at Holston for waste water management, followed by a $146m (£118m) contract in October to construct a nitric acid recovery facility to increase capacity for producing insensitive munitions. In September, we received a $69m (£56m) contract for continued production of MK 90 propellant grain.

In November, the US and Indian governments signed a Letter of Agreement for the Foreign Military Sale of 145 M777 lightweight howitzers and, in January 2017, we received the $542m (£439m) contract from the US government to supply these howitzers to the Indian Army. We have selected Mahindra &

Mahindra as our supplier to establish an assembly, integration and test facility in India in support of the Indian Prime Minister's 'Make in India' initiative.

US Ship Repair and Modernisation

We are a leading provider of ship repair and modernisation services. In 2016, we secured firm orders across our US shipyards totalling approximately $1.1bn (£0.9bn) and the business remains well positioned to compete for future contracts in the maritime domain.

We continue to adjust our workforce and facilities to meet the evolving demand for US Navy ship repair. To support the US Navy's re-balance to the Asia-Pacific region, a new dry dock arrived in our San Diego shipyard in December and became operational in February 2017. The USS New Orleans, an amphibious dock landing ship, will be the first vessel to be serviced in the dry dock under a $37m (£30m) contract received in November.

In commercial shipbuilding, we continued to experience challenges in the year, taking a $73m (£54m) charge against ongoing contracts. Workforce adjustments continue as these contracts near completion. Six ships have now been accepted by customers, with the remaining two ships expected to complete in 2017.

In January 2017, we completed the sale of our BAE Systems San Francisco Ship Repair business enabling us to focus on our larger, retained shipyards providing strong capabilities and support to our key maritime customers, including the US Navy.

BAE Systems Hägglunds

Series production continues on the $865m (£700m) contract awarded in 2012 for the supply of CV90 Infantry Fighting Vehicles to Norway.

In addition to production of CV90 vehicles, we have been awarded contracts for refurbishment and upgrade. In March, we were awarded a contract valued at $182m (£147m) to refurbish 262 CV90 vehicles for the Swedish Army and, in September and October, two contracts from the Danish government for sustainment and upgrade of its CV90 fleet. In December, the Swedish government awarded us a $68m (£55m) contract for the integration of Mjölner mortar systems on 40 CV90s, and we received a contract from the Dutch government for testing and verification of Active Protection Systems on CV90s.

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

FNSS

FNSS, our land systems joint venture based in Turkey, has continued to perform under its $524m (£424m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army.

Production remains on schedule under a contract to upgrade M113 tracked armoured personnel carriers for the Royal Saudi Land Forces and, in 2016, the business received a contract to integrate mortar systems.

In support of a customer contract awarded in 2015 to supply the PARS Wheeled Armoured Vehicle, work has begun to deliver 8x8 and 6x6 vehicles in a number of configurations.

In June, FNSS was awarded a contract worth more than €278m (£237m) to supply 260 Anti-Tank Vehicles to the Turkish Land Forces. The scope of the project includes both tracked and wheeled vehicles equipped with anti-tank guided missile system turrets.

In December, FNSS signed an €84m (£72m) contract with ASELSAN, a Turkish defence electronics company, for amphibious tracked armoured vehicles for the Turkish Land Forces.

Looking forward

In the US, following the two-year Bipartisan Budget Act signed in 2015, there are signs of a return to growth in defence budgets, with the new administration expected to further increase defence and security spending.

The business is underpinned by strong positions on key franchise programmes. In the land domain, this includes the US Army's Armored Multi-Purpose Vehicle, Bradley and Paladin programmes and the CV90 and BvS10 export programmes from our BAE Systems Hägglunds business.

FNSS has grown its order book with both domestic and international orders secured during 2016.

These long-term contracts, our strong franchise in tracked vehicles and opportunities in international markets, position the land business for a return to growth in the medium term.

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

The business continues to pursue a range of domestic and international opportunities in combat and amphibious vehicles, weapons systems and maritime support services.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 8.
3. International Financial Reporting Standards.

Segmental performance: Platforms & Services (UK)

Platforms & Services (UK), with 30,100 employees[1], comprises the Group's UK-based air, maritime, land and shared services activities.

Operational and strategic highlights

- £1.0bn of orders for our workshare on 28 Typhoon aircraft for Kuwait
- Partnership arrangement for support to the UK Typhoon fleet expected to be worth at least £2.1bn over a ten-year period
- F-35 Lightning II orders worth £637m, including Lot 10 production and construction of engineering and training facilities in the UK, and the UK selected as European regional avionics and component repair hub
- £472m extension to the Type 26 frigate demonstration phase contract and UK government commitment to manufacture eight ships
- £287m contract awarded for two additional Offshore Patrol Vessels, including support services for the five-ship programme
- Reactor core successfully loaded on the fourth Astute Class submarine
- £1.3bn of funding received for Dreadnought Class submarine design, initial manufacture, materials and facilities investment
- Down-selected as one of two contenders for the Challenger 2 Life Extension programme
- £445m order on the Munitions Acquisition Supply Solution partnering agreement for five years of supply

Financial performance

Financial performance measures as defined by the Group[2]

	2016	2015
Sales	**£7,806m**	£7,405m
Underlying EBITA	**£810m**	£721m
Return on sales	**10.4%**	9.7%
Operating business cash flow	**£199m**	£220m
Order intake[1]	**£8,024m**	£4,944m
Order backlog[1]	**£17.8bn**	£17.8bn

Financial performance measures defined in IFRS[3]

	2016	2015
Revenue	**£7,699m**	£7,319m
Operating profit	**£780m**	£756m
Return on revenue	**10.1%**	10.3%
Cash flow from operating activities	**£385m**	£289m

- The year's sales of £7.8bn were 5% higher than 2015. The increase came from the expected ramp up on F-35 Lightning II deliveries and Saudi trainer aircraft. Activity and milestone performance on the submarine programmes was ahead of plan. There was also a higher level of intercompany activity under the Saudi support contracts which is eliminated at the Group level.
- The return on sales was 10.4% (2015 9.7%).
- Cash performance was better than expected, with an operating business cash inflow of £199m (2015 £220m). Consumption of customer advances occurred on the Omani, Saudi and European Typhoon contracts, albeit some early receipts on the Omani contract mitigated that to a limited extent.
- Order backlog[1] was stable at £17.8bn (2015 £17.8bn). Sales trading on the Typhoon aircraft and aircraft carrier programmes was replaced by the ten-year UK Typhoon support award and Kuwait Typhoon subcontract.

Operational performance

Military Air & Information

In the year, 16 Typhoon aircraft were delivered from the UK final assembly facility, of which 11 were delivered to Saudi Arabia. Cumulative aircraft deliveries to the UK, Germany, Italy and Spain total 232 of the contracted 236 Tranche 2 aircraft and 33 of the contracted 88 Tranche 3 aircraft.

The Oman Typhoon and Hawk aircraft programme is on track for commencement of deliveries in 2017.

Orders totalling £1.0bn have been received via Eurofighter from our Italian Eurofighter partner, Leonardo, for BAE Systems' share of work on the 28 Typhoon aircraft for Kuwait covering airframe manufacture, support, capability upgrade and Electronically Scanned (E-Scan) radar integration work.

Typhoon's capabilities continue to be enhanced with the ongoing integration of the Captor E-Scan radar and the Storm Shadow, Meteor and Brimstone 2 missiles as part of European capability delivery programmes. Development towards the Royal Air Force Centurion standard continues, which will enable transition of capability from Tornado to Typhoon.

We have continued to support our 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 at least £2.1bn, was signed in July.

On the F-35 Lightning II programme, we completed delivery of 55 aft fuselage assemblies for the Low-Rate Initial Production Lot 9 and 10 contracts. Additional orders were received for Lot 10 during the year, worth £168m, with full contract award expected in 2017 following agreement of the front-end contract between Lockheed Martin and the US government. The proposal for Lot 11 has been submitted to Lockheed Martin in advance of negotiations expected to complete in 2017. A £118m contract to build engineering and training facilities at RAF Marham in Norfolk, UK, has been secured, with work scheduled to be completed in 2018 in readiness for the arrival of the UK's first F-35 Lightning II aircraft. In November, the F-35 Joint Programme Office announced that it had chosen the UK as a major repair hub for the maintenance, repair, overhaul and upgrade of F-35 Lightning II avionics and components, during the period 2021 to 2025 on a global basis and from 2025 onwards for the Europe region.

Support continues to be provided to users of Hawk trainer aircraft around the world. A long-term support contract for the Royal Air Force's UK fleet of Hawk fast jet trainer aircraft was announced in the year and we continue to deliver against all contractual milestones.

In 2016, the Indian Navy and Air Force received three and ten Hawk aircraft, respectively, completing the delivery of all 57 aircraft built under licence by Hindustan Aeronautics Limited (HAL). Negotiations continue with HAL for the supply of 32 aircraft kit sets which will result in aircraft built under licence by HAL for the Indian Air Force and Indian Navy.

In March, we welcomed the announcement by the UK and French governments of a €2bn (£1.7bn) programme to build operationally representative unmanned combat air system demonstrators. This will secure highly-skilled engineering jobs and the first phase is anticipated to commence in 2018.

The UK technology programme for the air sector continues to progress with a successful set of demonstrations in 2016 and further order intake has been received to develop critical systems and capabilities for future unmanned systems and other aircraft.

In Turkey, following a pre-contract study phase between BAE Systems and Turkish Aerospace Industries, we have signed a heads of agreement to collaborate on the first design and development phase of an indigenous fifth-generation fighter jet for the Turkish Air Force. When on contract, this will have a value in excess of £100m.

Maritime

On the aircraft carrier programme, good progress has been made on commissioning HMS Queen Elizabeth's key systems and the business is working with the Ministry of Defence to prepare the support solution in advance of her expected arrival at HM Naval Base, Portsmouth, in 2017. On HMS Prince of Wales, all of the blocks are now assembled, with large volume installation activities under way. Sea trials on the aircraft carriers are expected to complete in 2017 and 2019, respectively.

In preparation for the manufacturing contract for the Type 26 frigate, a £472m extension to the demonstration phase contract was secured in March, covering detailed design activities and enabling us to subcontract for key equipment with companies throughout the supply chain. The engineering design programme continues to progress to enable commencement of manufacture of the first ship in 2017. The programme currently employs more than 1,000 staff.

Under a heads of terms signed in November, BAE Systems and the Ministry of Defence reached agreement in principle on the award of a contract reflecting the government's intention to build eight Type 26 frigates on the Clyde and a further two River Class Offshore Patrol Vessels. The Offshore Patrol Vessels were contracted in December for £287m, including support services for the five-ship programme.

Progress has been maintained on the manufacture of the first three Offshore Patrol Vessels, FORTH, MEDWAY and TRENT. The programme supports shipbuilding skills and provides a bridge for the business between the aircraft carrier programme and manufacture of the Type 26 frigate.

Under the Maritime Support Delivery Framework contract, in place until March 2019, we provide services at HM Naval Base, Portsmouth, and support to half of the Royal Navy's surface fleet. Achievement of target cost remains on track.

BAE Systems manages the support, maintenance and upgrade of the Royal Navy's fleet of Type 45 destroyers.

Progress continues on the £270m Spearfish torpedo upgrade demonstration and manufacture phases, with the demonstration phase currently forecast to complete in 2019.

The first three of seven Astute Class submarines are in operational service with the Royal Navy, with the reactor core load on boat four completed in the second half of the year. Further funding of £228m for the sixth and seventh boats was received in the year. Negotiations for full pricing of the sixth and seventh boats have commenced.

The Ministry of Defence, BAE Systems and Rolls-Royce have signed a heads of terms to set up a Dreadnought Build Alliance documenting the UK government and industry's commitment to the delivery of the Dreadnought Class submarine programme, the replacement for the Royal Navy's Vanguard Class submarine fleet, and setting out an organisational and managerial structure and series of commercial principles necessary to deliver it.

Functional and spatial design continues to advance on the Dreadnought Class submarine. During 2016, £1.3bn of funding was received for continued design, initial manufacture of the first boat, material commitment and facilities investment. Preparations for the manufacture of Dreadnought include a major programme of building works at the Barrow site, with contracts in place totalling more than £300m. The UK government's commitment to the Dreadnought programme was endorsed by Parliament during the year.

Land (UK)

The business provides ongoing support to previously-supplied armoured vehicles and bridging systems, with orders of £56m received in the year. In the UK, the business has been down-selected as one of two contenders to deliver the first stage of the Challenger 2 Life Extension Programme and, 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 29 of 515 40mm cased-telescopic cannons were delivered to the Ministry of Defence by CTA International, a 50% joint venture between BAE Systems and Nexter.

The business continues to provide UK and international customers with a full range of light and heavy munitions. We have concluded pricing negotiations on our 15-year Munitions Acquisition Supply Solution partnering agreement with the Ministry of Defence, worth £445m.

Looking forward

Platforms & Services (UK) has an order backlog of long-term committed programmes and an enduring support business. The Strategic Defence and Security Review announced in November 2015 provided clarity, continuity and stability for the UK contracted business and has been consistently implemented through long-term contract awards and commitments.

In Military Air & Information, sales are underpinned by Typhoon and F-35 Lightning II aircraft production and in-service support. There are opportunities to secure further Typhoon export sales building on the purchase of 28 aircraft by Kuwait.

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

The Land (UK) business is underpinned by the 15-year Munitions Acquisition Supply Solution partnering agreement with the Ministry of Defence secured in 2008 and continues to pursue upgrade programmes with a focus on the Challenger 2 main battle tank.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 8.
3. International Financial Reporting Standards.

Segmental performance: Platforms & Services (International)

Platforms & Services (International), with 13,700 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.

Operational and strategic highlights

- BAE Systems celebrated 50 years in Saudi Arabia
- 11 Typhoon aircraft delivered on the Salam programme in the year
- Continued provision of support agreed under the Saudi British Defence Co-operation Programme to the Royal Saudi Air Force and Royal Saudi Naval Forces through to 2021, against which we have booked initial order intake in 2016
- BAE Systems Australia selected to provide maintenance, repair, overhaul and upgrade to support a range of F-35 Lightning II system components
- Awarded a contract for the Risk Mitigation Activity phase of the Land 400 vehicle competition in Australia
- Contracts totalling A$430m (£252m) awarded for sustainment and upgrade of Anzac Class frigates under the Warship Asset Management Alliance
- UK Ministry of Defence awarded MBDA a contract for additional Common Anti-air Modular Missiles
- MBDA signed two significant contracts in Qatar for naval air defence and coastal battery defence systems
- MBDA secured weapons package orders with India as part of agreed export contracts for Rafale aircraft

Financial performance

Financial performance measures as defined by the Group[2]

	2016	2015
Sales	**£3,943m**	£3,742m
Underlying EBITA	**£400m**	£335m
Return on sales	**10.1%**	9.0%
Operating business cash flow	**£435m**	£164m
Order intake[1]	**£6,175m**	£3,046m
Order backlog[1]	**£13.1bn**	£10.2bn

Financial performance measures defined in IFRS[3]

	2016	2015
Revenue	**£3,037m**	£2,957m
Operating profit	**£365m**	£299m
Return on revenue	**12.0%**	10.1%
Cash flow from operating activities	**£473m**	£193m

- Sales of £3.9bn were 5% up over 2015. The trading increase comes from the higher levels of support to the Salam Typhoon aircraft now in service and weapon volumes from MBDA.
- Underlying EBITA of £400m (2015 £335m) has moved the return on sales back above 10% (2015 9.0%). The 2015 result included charges totalling £53m in respect of the impairment and rationalisation taken in the Australian business.
- Operating business cash flow was strong at £435m (2015 £164m), although accelerated receipts from 2017 on Saudi support and the MBDA Qatar programme were major factors.
- Order backlog[1] increased to £13.1bn (2015 £10.2bn) as initial order intake was booked for the renewal of the five-year support contract in Saudi Arabia.

Operational performance

Saudi Arabia

On the Salam Typhoon programme, 68 of the contracted 72 aircraft had been delivered at 31 December. 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, 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 14 aircraft delivered and accepted at 31 December. Manufacturing for the second batch of 22 aircraft, awarded in 2015, is progressing to schedule. Under this contract, we will undertake the final assembly of these aircraft in Saudi Arabia.

Under the Royal Saudi Naval Forces' Minehunter mid-life update programme, acceptance of the second ship was completed in the second half of the year. Work on the third and final ship is progressing to plan, with acceptance expected in the second half of 2017.

Agreement has been reached with the Saudi Arabian government for BAE Systems to continue to provide support services to the Royal Saudi Air Force and Royal Saudi Naval Forces under the Saudi British Defence Co-operation Programme for a further five years, against which we have booked initial order intake in 2016. Discussions with the UK government and the Saudi Arabian customer are under way to define the details of this follow-on contract.

Under the planned reorganisation of our portfolio of interests in a number of industrial companies in Saudi Arabia, Riyadh Wings Aviation Academy LLC has acquired a 4.1% shareholding in a Group subsidiary, Overhaul and Maintenance Company, and is expected to acquire a further interest up to a maximum of 49%. The reorganisation supports our strategy to expand the customer base of our In-Kingdom Industrial Participation programme, promoting training, development and employment opportunities in line with Vision 2030.

The Saudi Arabian In-Kingdom Industrial Participation programme continues to make progress. During 2016, there has been further capability and knowledge transfer on the Typhoon platform and planning is well advanced for the transfer of other capabilities and work into our In-Kingdom partner companies. All of these activities are aligned with our long-term industrialisation strategy, as well as the Saudi Arabian government's National Transformation Plan and Vision 2030.

Australia

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

We have continued to provide in-service support to the Navy's two Landing Helicopter Docks under a four-year support contract awarded in 2014. Final acceptance of these vessels is scheduled in 2017.

The fifth Anzac Class frigate to be modernised under the current Anti-Ship Missile Defence programme, HMAS Parramatta, has completed final sea trials and has been accepted into service by the Commonwealth. Completion of the upgrade programme is expected in 2017.

In April, the Australian government signed an agreement for the sustainment and upgrade of the Anzac Class frigates under the Warship Asset Management Alliance. We are a significant participant and the agreement underpins our engineering and complex project management capabilities. We were awarded contracts totalling A$430m (£252m) in the year.

In April, the Australian government announced that our Type 26 Global Combat Ship had been shortlisted as one of three designs for its SEA 5000 Future Frigate programme and, in August, a contract was signed with the Commonwealth to further refine the design as part of a competitive evaluation process.

In November, BAE Systems was chosen to provide maintenance, repair, overhaul and upgrade services to support a range of system components on the F-35 Lightning II aircraft. Our scope of work involves global sustainment services for life support components and sustainment services for the South Pacific region across avionics and digital mission systems and electrical systems components. This award follows our selection, in 2015, as the Pacific regional prime contractor to undertake airframe maintenance, repair, overhaul and upgrade.

In May, the Royal Australian Air Force celebrated its Hawk aircraft fleet achieving the significant milestone of more than 100,000 flying hours. We support the fleet as the systems integrator, including logistics, maintenance, repair, overhaul and upgrade. From July, our scope of work was expanded to include operational maintenance, a reflection of this successful long-term partnering arrangement.

In 2016, the government announced that we were one of two tenderers successfully down-selected on the Land 400 Phase 2 Combat Reconnaissance Vehicle programme.

We are engaged in 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.

Oman
The Oman Typhoon and Hawk aircraft programme, being undertaken by Platforms & Services (UK), is on track for commencement of aircraft deliveries in 2017. Separately, we continue to fulfil our legacy industrial participation obligations in Oman through delivery of an agreed training and knowledge transfer programme.

MBDA
In 2015, the German government announced its intention to acquire a ground-based air defence system based upon the Medium Extended Air Defence System missile defence system being developed by MBDA in partnership with Lockheed Martin. MBDA has now submitted its proposal for the development of this system.

In a significant development for the Aster surface-to-air missile family, France and Italy have jointly launched development of the Aster 30 Block 1 NT (New Technologies) missile which will provide enhanced capabilities against the ballistic missile threat.

MBDA is responsible for the delivery of the majority of the UK's complex weapons requirements. During the year, a number of contracts have been awarded to MBDA, including a contract to supply Advanced Short-Range Air-to-Air Missiles (ASRAAM) for F-35 Lightning II aircraft, a development phase contract for SPEAR 3 (a multi-purpose stand-off strike weapon for the F-35 Lightning II aircraft), and a demonstration and manufacture contract for the supply of the Sea Ceptor air defence weapon system for the Type 26 frigate.

The UK Ministry of Defence awarded MBDA a contract for additional Common Anti-air Modular Missiles to support its land requirements.

The Meteor Beyond Visual Range Air-to-Air Missile achieved its most significant milestone to date during the Farnborough International Airshow in 2016 when it was officially declared in operational service on Swedish Air Force Gripen JAS 39 combat jets.

Two significant contracts were signed with Qatar, including the supply of Aster/VL Mica air defence systems and the Exocet MM40 Block 3 anti-ship missile for the Naval surface fleet, as well as a Missile Coastal Defence System.

MBDA has secured an aircraft weapons package contract from India and continues to pursue weapons package orders as part of export contracts for Typhoon and other aircraft platforms.

Looking forward

In the Kingdom of Saudi Arabia, following agreement of the budget for the next five years of the Saudi British Defence Co-operation Programme, we expect to sustain our long-term presence through delivering current programmes, further industrialisation and developing new business in support of the Saudi military forces. We are focused on our ongoing commitment to support the national objectives of local skills and technology, increasing employment and developing an indigenous defence industry, and will structure our business and portfolio of interests in Saudi Arabia to meet this long-term strategy.

In Australia, the business is now structured around long-term sustainment and upgrade activities and we are progressing further opportunities with the Australian government to provide leading defence build and support capabilities.

MBDA has a strong order book that underpins future growth built on the effective partnerships it has established with its domestic customers and recent export success. The business will look to further this domestic and export strategy in the air, maritime and land domains.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see glossary on page 8.
3. International Financial Reporting Standards.

Consolidated income statement
for the year ended 31 December

	Notes	2016 £m	2016 Total £m	2015 £m	2015 Total £m
Continuing operations					
Sales	2	**19,020**		17,904	
Deduct Share of sales by equity accounted investments		**(2,427)**		(2,719)	
Add Sales to equity accounted investments		**1,197**		1,602	
Revenue	2		**17,790**		16,787
Operating costs			**(16,274)**		(15,622)
Other income			**136**		227
Group operating profit			**1,652**		1,392
Share of results of equity accounted investments			**90**		110
Underlying EBITA	2	**1,905**		1,683	
Non-recurring items		**(12)**		26	
EBITA		**1,893**		1,709	
Amortisation of intangible assets		**(87)**		(108)	
Impairment of intangible assets		**–**		(78)	
Financial (expense)/income of equity accounted investments		**(28)**		3	
Taxation expense of equity accounted investments		**(36)**		(24)	
Operating profit	2		**1,742**		1,502
Financial income		**713**		241	
Financial expense		**(1,304)**		(653)	
Net finance costs	3		**(591)**		(412)
Profit before taxation			**1,151**		1,090
Taxation expense	4		**(213)**		(147)
Profit for the year			**938**		943
Attributable to:					
Equity shareholders			**913**		918
Non-controlling interests			**25**		25
			938		943
Earnings per share	5				
Basic earnings per share			**28.8p**		29.0p
Diluted earnings per share			**28.7p**		28.9p

Consolidated statement of comprehensive income

for the year ended 31 December

	2016			2015[1]		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Profit for the year	**–**	**938**	**938**	–	943	943
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on retirement benefit schemes	**–**	**(1,468)**	**(1,468)**	–	864	864
Tax on items that will not be reclassified to the income statement	**–**	**260**	**260**	–	(258)	(258)
Equity accounted investments (net of tax)	**–**	**(53)**	**(53)**	–	18	18
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	**1,287**	**–**	**1,287**	260	–	260
Reclassification of cumulative currency translation reserve on disposal	**–**	**–**	**–**	20	–	20
Fair value loss on available-for-sale financial assets	**–**	**–**	**–**	–	(1)	(1)
Amounts credited to hedging reserve	**96**	**–**	**96**	11	–	11
Tax on items that may be reclassified to the income statement	**(17)**	**–**	**(17)**	(2)	–	(2)
Equity accounted investments (net of tax)	**45**	**–**	**45**	(74)	–	(74)
Total other comprehensive income for the year (net of tax)	**1,411**	**(1,261)**	**150**	215	623	838
Total comprehensive income for the year	**1,411**	**(323)**	**1,088**	215	1,566	1,781
Attributable to:						
Equity shareholders	**1,408**	**(348)**	**1,060**	216	1,541	1,757
Non-controlling interests	**3**	**25**	**28**	(1)	25	24
	1,411	**(323)**	**1,088**	215	1,566	1,781

1. Re-presented in accordance with Amendments to IAS 1: Disclosure Initiative.

Consolidated statement of changes in equity

for the year ended 31 December

	Attributable to equity holders of the parent						
	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 January 2016	**87**	**1,249**	**5,277**	**(3,624)**	**2,989**	**13**	**3,002**
Profit for the year	**–**	**–**	**–**	**913**	**913**	**25**	**938**
Total other comprehensive income for the year	**–**	**–**	**1,408**	**(1,261)**	**147**	**3**	**150**
Share-based payments (inclusive of tax)	**–**	**–**	**–**	**59**	**59**	**–**	**59**
Net sale of own shares	**–**	**–**	**–**	**3**	**3**	**–**	**3**
Ordinary share dividends	**–**	**–**	**–**	**(670)**	**(670)**	**(24)**	**(694)**
Partial disposal of shareholding in subsidiary undertaking	**–**	**–**	**–**	**(3)**	**(3)**	**9**	**6**
At 31 December 2016	**87**	**1,249**	**6,685**	**(4,583)**	**3,438**	**26**	**3,464**
At 1 January 2015	87	1,249	5,061	(4,555)	1,842	35	1,877
Profit for the year	–	–	–	918	918	25	943
Total other comprehensive income for the year	–	–	216	623	839	(1)	838
Share-based payments	–	–	–	44	44	–	44
Net sale of own shares	–	–	–	1	1	–	1
Ordinary share dividends	–	–	–	(655)	(655)	(40)	(695)
Disposal of non-controlling interest	–	–	–	–	–	(6)	(6)
At 31 December 2015	87	1,249	5,277	(3,624)	2,989	13	3,002

Consolidated balance sheet

as at 31 December

	Notes	2016 £m	2015 £m
Non-current assets			
Intangible assets		**11,264**	10,117
Property, plant and equipment		**2,098**	1,698
Investment property		**110**	120
Equity accounted investments		**299**	250
Other investments		**6**	6
Other receivables		**351**	275
Retirement benefit surpluses	6	**223**	193
Other financial assets		**345**	107
Deferred tax assets		**1,251**	985
		15,947	13,751
Current assets			
Inventories		**744**	726
Trade and other receivables including amounts due from customers for contract work		**3,305**	2,940
Current tax		**5**	4
Other financial assets		**204**	105
Cash and cash equivalents		**2,769**	2,537
Assets held for sale		**2**	20
		7,029	6,332
Total assets		**22,976**	20,083
Non-current liabilities			
Loans		**(4,425)**	(3,775)
Other payables		**(1,027)**	(1,020)
Retirement benefit obligations	6	**(6,277)**	(4,694)
Other financial liabilities		**(102)**	(72)
Deferred tax liabilities		**(10)**	(13)
Provisions		**(372)**	(354)
		(12,213)	(9,928)
Current liabilities			
Loans and overdrafts		**–**	(237)
Trade and other payables		**(6,540)**	(6,162)
Other financial liabilities		**(212)**	(130)
Current tax		**(311)**	(315)
Provisions		**(234)**	(301)
Liabilities held for sale		**(2)**	(8)
		(7,299)	(7,153)
Total liabilities		**(19,512)**	(17,081)
Net assets		**3,464**	3,002
Capital and reserves			
Issued share capital		**87**	87
Share premium		**1,249**	1,249
Other reserves		**6,685**	5,277
Retained earnings – deficit		**(4,583)**	(3,624)
Total equity attributable to equity holders of the parent		**3,438**	2,989
Non-controlling interests		**26**	13
Total equity		**3,464**	3,002

Approved by the Board on 22 February 2017 and signed on its behalf by:

I G King
Chief Executive

P J Lynas
Group Finance Director

Consolidated cash flow statement

for the year ended 31 December

	Notes	2016 £m	2015[1] £m
Profit for the year		**938**	943
Taxation expense		**213**	147
Research and development expenditure credits		**(22)**	(65)
Share of results of equity accounted investments		**(90)**	(110)
Net finance costs		**591**	412
Depreciation, amortisation and impairment		**345**	460
Profit on disposal of property, plant and equipment		**(5)**	(28)
Profit on disposal of investment property		**(12)**	(41)
Profit on disposal of non-current other investments		**–**	(1)
Loss on disposal of businesses		**–**	24
Cost of equity-settled employee share schemes		**55**	44
Movements in provisions		**(122)**	(139)
Decrease in liabilities for retirement benefit obligations		**(214)**	(234)
Decrease/(increase) in working capital:			
Inventories		**95**	(6)
Trade and other receivables		**(93)**	60
Trade and other payables		**(263)**	(542)
Taxation paid		**(187)**	(116)
Net cash flow from operating activities		**1,229**	808
Dividends received from equity accounted investments		**38**	41
Net interest paid		**(200)**	(173)
Purchase of property, plant and equipment, and investment property		**(408)**	(359)
Purchase of intangible assets		**(82)**	(54)
Proceeds from sale of property, plant and equipment, and investment property		**45**	136
Proceeds from sale of non-current other investments		**–**	1
Purchase of subsidiary undertakings		**–**	(5)
Equity accounted investment funding		**(5)**	(8)
Proceeds from sale of subsidiary undertakings		**6**	34
Cash and cash equivalents disposed of with subsidiary undertakings		**–**	(13)
Net cash flow from investing activities		**(606)**	(400)
Net sale of own shares		**3**	1
Equity dividends paid	7	**(670)**	(655)
Dividends paid to non-controlling interests		**(24)**	(40)
Cash inflow from matured derivative financial instruments		**480**	12
Cash inflow from movement in cash collateral		**32**	3
Cash inflow from loans		**–**	1,625
Cash outflow from repayment of loans		**(286)**	(1,135)
Net cash flow from financing activities		**(465)**	(189)
Net increase in cash and cash equivalents		**158**	219
Cash and cash equivalents at 1 January		**2,537**	2,313
Effect of foreign exchange rate changes on cash and cash equivalents		**76**	5
Cash and cash equivalents at 31 December		**2,771**	2,537
Comprising:			
Cash and cash equivalents		**2,769**	2,537
Cash classified as held for sale		**2**	–
Cash and cash equivalents at 31 December		**2,771**	2,537

1. Re-presented to reclassify interest paid from operating to investing activities.

Notes to the accounts

1. Preparation

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

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

2. Segmental analysis

Sales and revenue by reporting segment

	Sales		Deduct: Share of sales by equity accounted investments		Add: Sales to equity accounted investments		Revenue	
	2016 £m	2015[1] £m	**2016 £m**	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015[1] £m
Electronic Systems	**3,282**	2,922	**(79)**	(72)	**79**	72	**3,282**	2,922
Cyber & Intelligence	**1,778**	1,564	**–**	–	**–**	–	**1,778**	1,564
Platforms & Services (US)	**2,874**	2,779	**(91)**	(101)	**–**	–	**2,783**	2,678
Platforms & Services (UK)	**7,806**	7,405	**(1,118)**	(1,524)	**1,011**	1,438	**7,699**	7,319
Platforms & Services (International)	**3,943**	3,742	**(906)**	(785)	**–**	–	**3,037**	2,957
HQ	**233**	237	**(233)**	(237)	**–**	–	**–**	–
	19,916	18,649	**(2,427)**	(2,719)	**1,090**	1,510	**18,579**	17,440
Intra-group sales/revenue	**(896)**	(745)	**–**	–	**107**	92	**(789)**	(653)
	19,020	17,904	**(2,427)**	(2,719)	**1,197**	1,602	**17,790**	16,787

Operating profit/(loss) by reporting segment

	Underlying EBITA		Non-recurring items		Amortisation and impairment of intangible assets		Financial and taxation (expense)/income of equity accounted investments		Operating profit/(loss)	
	2016 £m	2015[1] £m	**2016 £m**	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015 £m	**2016 £m**	2015[1] £m
Electronic Systems	**494**	437	**–**	–	**(20)**	(18)	**–**	–	**474**	419
Cyber & Intelligence	**90**	104	**–**	–	**(31)**	(135)	**–**	–	**59**	(31)
Platforms & Services (US)	**211**	177	**(12)**	(24)	**(15)**	(13)	**(2)**	2	**182**	142
Platforms & Services (UK)	**810**	721	**–**	50	**(15)**	(11)	**(15)**	(4)	**780**	756
Platforms & Services (International)	**400**	335	**–**	–	**(6)**	(9)	**(29)**	(27)	**365**	299
HQ	**(100)**	(91)	**–**	–	**–**	–	**(18)**	8	**(118)**	(83)
	1,905	1,683	**(12)**	26	**(87)**	(186)	**(64)**	(21)	**1,742**	1,502
Net finance costs									**(591)**	(412)
Profit before taxation									**1,151**	1,090
Taxation expense									**(213)**	(147)
Profit for the year									**938**	943

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

3. Net finance costs

	2016 £m	2015 £m
Interest income	**10**	17
Gain on remeasurement of financial instruments at fair value through profit or loss[1,2]	**665**	167
Foreign exchange gains	**38**	57
Financial income	**713**	241
Interest expense on bonds and other financial instruments	**(208)**	(175)
Facility fees	**(4)**	(4)
Net present value adjustments	**(43)**	(29)
Net interest expense on retirement benefit obligations	**(169)**	(192)
Loss on remeasurement of financial instruments at fair value through profit or loss[1]	**(55)**	(72)
Foreign exchange losses[3]	**(825)**	(181)
Financial expense	**(1,304)**	(653)
Net finance costs	**(591)**	(412)

1. Comprises gains and losses on derivative financial instruments, including derivative instruments to manage the Group's exposure to interest rate fluctuations on external borrowings and exchange rate fluctuations on balances with the Group's subsidiaries and equity accounted investments.
2. The increase in the gain on remeasurement of financial instruments primarily reflects exchange rate movements on hedges relating to US dollar-denominated borrowings (2016 £446m; 2015 £98m). Loss on remeasurement of financial instruments includes £23m (2015 £nil) in respect of these exchange rate movements.
3. The increase in foreign exchange losses primarily reflects exchange rate movements on US dollar-denominated borrowings (2016 £592m; 2015 £144m).

Additional analysis

	2016 £m	2015 £m
Net finance costs:		
Group	**(591)**	(412)
Share of equity accounted investments	**(28)**	3
	(619)	(409)
Analysed as:		
Underlying net interest expense:		
Group	**(245)**	(191)
Share of equity accounted investments	**(12)**	(3)
	(257)	(194)
Other:		
Group:		
Net interest expense on retirement benefit obligations	**(169)**	(192)
Fair value and foreign exchange adjustments on financial instruments and investments[1]	**(177)**	(29)
Share of equity accounted investments:		
Net interest expense on retirement benefit obligations	**(8)**	(8)
Fair value and foreign exchange adjustments on financial instruments and investments	**(8)**	14
	(619)	(409)

1. The net cost primarily reflects foreign exchange translational losses on US dollar-denominated bonds held by BAE Systems plc.

4. Taxation expense

Reconciliation of taxation expense

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

	2016 £m	2015 £m
Profit before taxation	**1,151**	1,090
UK corporation tax rate	**20.0%**	20.25%
Expected income tax expense	**(230)**	(221)
Effect of tax rates in foreign jurisdictions, including US state taxes	**(81)**	(69)
Effect of intra-group financing	**15**	13
Expenses not tax effected	**(15)**	(13)
Income not subject to tax	**37**	41
Research and development tax credits and patent box benefits	**12**	7
Non-deductible goodwill impairment	**–**	(15)
Chargeable gains and non-taxable gains/non-deductible losses on disposal of businesses	**(3)**	(7)
Utilisation of previously unrecognised tax losses	**3**	4
Adjustments in respect of prior years[1]	**41**	115
Adjustments in respect of equity accounted investments	**18**	22
Tax rate adjustment	**(2)**	(5)
Other	**(8)**	(19)
Taxation expense	**(213)**	(147)

Calculation of the underlying effective tax rate

	2016 £m	2015 £m
Profit before taxation	**1,151**	1,090
Add back:		
Taxation expense of equity accounted investments	**36**	24
Loss on disposal of businesses	**–**	24
Goodwill impairment	**–**	75
Adjusted profit before taxation	**1,187**	1,213
Taxation expense	**(213)**	(147)
Taxation expense of equity accounted investments	**(36)**	(24)
Taxation expense (including equity accounted investments)	**(249)**	(171)
Adjusted profit before taxation (above)		1,213
Exclude: Research and development expenditure credits[2]		(77)
		1,136
Taxation expense (including equity accounted investments) (above)		(171)
Exclude: Adjustments relating to research and development expenditure credits[2]		68
Exclude: Adjustment of tax provisions[1]		(134)
		(237)
Underlying effective tax rate	**21%**	21%

1. 2016 comprises a number of separate items, individually less than £20m, in relation to which either resolution was reached in the year or new information enabled the Group to re-assess the related tax provisions. 2015 included credits totalling £134m in respect of the adjustment of certain UK and overseas tax provisions in the light of clarification and rulings received.
2. In 2013, UK legislation changed so that UK government credits for research and development spend are now accounted for as part of operating profit rather than as part of taxation expense. This treatment was optional for the first three years. During 2015, the Group exercised that option, effective from 2013, and reflected the change in the 2015 accounts. The adjustment reversed this treatment to show an underlying effective tax rate that was comparable with the prior year. The £77m excluded from profit before taxation comprised £50m included in non-recurring items relating to 2013 and 2014 and £27m included in underlying EBITA relating to 2015, of which £12m related to the Group's share of equity accounted investments. The £68m adjustment included £45m relating to the £50m included in non-recurring items.

5. Earnings per share

	2016 £m	2016 Basic pence per share	2016 Diluted pence per share	2015 £m	2015 Basic pence per share	2015 Diluted pence per share
Profit for the year attributable to equity shareholders	**913**	**28.8**	**28.7**	918	29.0	28.9
Add back:						
Non-recurring items, post tax[1]	**9**			19		
Amortisation and impairment of intangible assets, post tax[1]	**69**			88		
Impairment of goodwill	**–**			75		
Net interest expense on retirement benefit obligations, post tax[1]	**140**			158		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax[1]	**146**			12		
Underlying earnings, post tax	**1,277**	**40.3**	**40.1**	1,270	40.2	40.1

	2016 Basic Millions	2016 Diluted Millions	2015 Basic Millions	2015 Diluted Millions
Weighted average number of shares used in calculating basic earnings per share	**3,171**	**3,171**	3,161	3,161
Incremental shares in respect of employee share schemes		**14**		10
Weighted average number of shares used in calculating diluted earnings per share		**3,185**		3,171

1. The tax impact is calculated using the underlying effective tax rate of 21% (2015 21%).

6. Retirement benefits

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2016	(4,824)	(730)	(5,554)
Impact of 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	2,649	180	2,829
Increase in liabilities due to changes in financial assumptions	(4,815)	(170)	(4,985)
Decrease in liabilities due to changes in demographic assumptions	250	40	290
Experience gains	242	10	252
Additional contributions in excess of service cost	164	–	164
Recurring contributions in excess of service cost	46	43	89
Past service cost – plan amendments	(7)	(4)	(11)
Net interest expense	(150)	(34)	(184)
Foreign exchange adjustments	–	(135)	(135)
Movement in US healthcare schemes	–	8	8
Total net IAS 19 deficit at 31 December 2016	**(5,778)**	**(792)**	**(6,570)**
Allocated to equity accounted investments	516	–	516
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 31 December 2016	**(5,262)**	**(792)**	**(6,054)**
Represented by:			
Retirement benefit surpluses	132	91	223
Retirement benefit obligations	(5,394)	(883)	(6,277)
	(5,262)	**(792)**	**(6,054)**

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 in the UK schemes reflects a 1.2 percentage point decrease in the real discount rate to –0.5%.

Deficit allocation

Certain of the Group's equity accounted investments participate in the Group's defined benefit schemes and, as these are multi-employer schemes, the Group has allocated a share of the IAS 19 pension surpluses and deficits to its equity accounted investments.

On 1 April 2016, a separate Airbus section of the BAE Systems Pension Scheme (Main Scheme) was created, reducing the total net IAS 19 deficit, with a corresponding reduction in the allocation to equity accounted investments. There was no settlement gain or loss upon sectionalisation of the Main Scheme.

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. Whilst this methodology is intended to reflect a reasonable estimate of the share of the deficit, it may not accurately reflect the obligations of the participating employers.

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

Funding

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

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

The separate actuarial valuations for funding purposes include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown below. The latest valuations of the Main Scheme and BAE Systems 2000 Pension Plan were performed as at 31 March 2014 and showed a funding deficit of £2.6bn.

The total net funding deficit in respect of all of the UK schemes was £2.7bn. Deficit recovery plans agreed with the trustees of the relevant schemes run until 2026.

The next UK triennial funding valuations, as at 31 March 2017, will commence in April 2017 and, in conjunction with the trustees of the schemes and other stakeholders, the Group will be looking at various options with a focus on the longer-term view. The results of future triennial valuations and associated funding requirements will be impacted by the future performance of investment markets, and interest and inflation rates.

The total Group contributions made to the defined benefit schemes in the year ended 31 December 2016 were £411m (2015 £438m) excluding those amounts allocated to equity accounted investments of £50m (2015 £98m). Equity accounted investments make regular contributions to the schemes in which they participate in line with the schedule of contributions and are allocated a share of deficit funding contributions.

In 2017, the Group expects to make contributions at a similar level to the recurring contributions and deficit funding as made in 2016.

The Group incurred a charge of £163m (2015 £140m) in relation to defined contribution schemes for employees.

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	
	2016	2015	**2016**	2015
Financial assumptions				
Discount rate (%)	**2.7**	3.9	**4.2**	4.5
Inflation (%)	**3.2**	3.2	**n/a**	n/a
Rate of increase in salaries (%)	**3.2**	3.2	**n/a**	n/a
Rate of increase in deferred pensions (%)	**2.2/3.2**	2.3/3.2	**n/a**	n/a
Rate of increase in pensions in payment (%)	**1.7 – 3.7**	1.8 – 3.6	**n/a**	n/a
Demographic assumptions				
Life expectancy of a male currently aged 65 (years)	**86 – 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)	**88 – 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 31 December 2016 and keeping all other assumptions the same.

Financial assumptions
Changes in the following financial assumptions would have the following effect on the defined benefit pension obligation before allocation to equity accounted investments:

	(Increase)/ decrease in pension obligation £bn
Discount rate:	
0.1 percentage point increase	0.6
0.1 percentage point decrease	(0.6)
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 scheme 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 table below shows the estimated impact of changes in the following financial assumptions allowing for the impact of the Group's risk management activities in respect of interest rate and inflation risk swaps, together with the impact on the matched asset portfolio. It does not reflect any natural matching that occurs in the wider asset portfolio:

	(Increase)/ decrease in pension obligation £bn	(Increase)/ decrease in scheme assets £bn
Discount rate:		
0.1 percentage point increase	0.6	(0.2)
0.1 percentage point decrease	(0.6)	0.2
Inflation:		
0.1 percentage point increase	(0.5)	0.2
0.1 percentage point decrease	0.5	(0.2)

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

	(Increase)/ decrease in pension obligation £bn
Inflation:	
0.5 percentage point increase	(1.8)
0.5 percentage point decrease	1.6
1.0 percentage point increase	(3.5)
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 net IAS 19 deficit:

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

7. Equity dividends

	2016 £m	2015 £m
Prior year final 12.5p dividend per ordinary share paid in the year (2015 12.3p)	**397**	389
Interim 8.6p dividend per ordinary share paid in the year (2015 8.4p)	**273**	266
	670	655

After the balance sheet date, the directors proposed a final dividend of 12.7p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 1 June 2017 to shareholders registered on 21 April 2017. The ex-dividend date is 20 April 2017.

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 10 May 2017.

8. Fair value measurement

Fair value of financial instruments

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

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

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

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

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

– the fair values of loans and overdrafts have been estimated by discounting the future cash flows to net present values using appropriate market-based interest rates prevailing at 31 December.

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

Fair value hierarchy

The fair value measurement hierarchy is as follows:

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

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

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

Carrying amounts and fair values of certain financial instruments

	2016		2015	
	Carrying amount £m	**Fair value £m**	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:				
Non-current				
Available-for-sale financial assets	**6**	**6**	6	6
Other receivables[1]	**296**	**296**	234	234
Other financial assets	**345**	**345**	107	107
Other financial liabilities	**(102)**	**(102)**	(72)	(72)
Other payables[1]	**(326)**	**(326)**	(264)	(264)
Current				
Other financial assets	**204**	**204**	105	105
Other financial liabilities	**(212)**	**(212)**	(130)	(130)
Financial instruments not measured at fair value:				
Non-current				
Loans[2]	**(4,425)**	**(4,805)**	(3,775)	(4,050)
Current				
Cash and cash equivalents	**2,769**	**2,769**	2,537	2,537
Loans and overdrafts	**–**	**–**	(237)	(241)

1. Represents US deferred compensation plan assets and liabilities.
2. US$500m of the US$800m 3.8% bond, repayable 2024, has been converted to a floating rate bond by utilising interest rate swaps. These derivatives have been designated as fair value hedges. Changes in the fair value of the interest rate risk on the bond, and gains and losses on the derivatives are recognised in the income statement. The bond has been included in financial instruments not measured at fair value because its carrying value has only been adjusted for the fair value of the interest rate risk on a portion of the bond.

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

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

9. Financial risk management

Currency risk

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

The Group is exposed to movements in foreign currency exchange rates in respect of foreign currency denominated transactions. All material firm transactional exposures are hedged 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.

The estimated impact on foreign exchange gains and losses in net finance costs of a ten cent movement in the closing US dollar exchange rate on the retranslation of US dollar-denominated bonds held by BAE Systems plc is approximately £59m (2015 £58m).

10. Related party transactions

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

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Sales to related parties	**1,197**	1,602
Purchases from related parties	**376**	379

	31 December 2016 £m	31 December 2015 £m
Amounts owed by related parties	**69**	75
Amounts owed to related parties[1]	**750**	446

1. Excludes £285m (2015 £217m) included within amounts due to long-term contract customers.

11. Annual General Meeting

This year's Annual General Meeting will be held on 10 May 2017. Details of the resolutions to be proposed at that meeting will be included in the notice of Annual General Meeting that will be sent to shareholders at the end of March 2017.

12. Other information

The financial information for the year ended 31 December 2016 contained in this preliminary announcement was approved by the Board on 22 February 2017. This announcement does not constitute statutory accounts of the Company within the meaning of Section 435 of the Companies Act 2006, but is derived from those accounts.

Statutory accounts for the year ended 31 December 2015 have been delivered to the Registrar of Companies. Statutory accounts for the year ended 31 December 2016 will be delivered to the Registrar of Companies following the Company's Annual General Meeting.

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

Cautionary statement:

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