



PRELIMINARY ANNOUNCEMENT AND PRESENTATION 2013



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Results in brief, key points and outlook

Results in brief

	2013	2012
Sales ³	£18,180m	£17,905m ¹
Underlying EBITA ⁴	£1,925m	£1,862m ^{1,2}
Operating profit	£806m	£1,605m ^{1,2}
Underlying earnings ⁵ per share	42.0p	38.7p ^{1,2}
Basic earnings per share ⁶	5.2p	29.3p ^{1,2}
Order backlog ^{3,7}	£42.7bn	£42.5bn ¹
Dividend per share	20.1p	19.5p
Operating business cash flow ⁸	£147m	£2,692m
Net (debt)/cash (as defined by the Group) ⁹	£(699)m	£387m

Key points

- Sales³ increased by 2% to £18.2bn
- Underlying EBITA⁴ increased by 3% to £1.9bn and underlying earnings⁵ per share increased by 9% to 42.0p
- Equitable conclusion reached on price escalation negotiations with the Kingdom of Saudi Arabia
- Order backlog^{3,7} of £42.7bn maintained at 2012 levels with non-UK/US order intake³ of £9.3bn
- Robust, investment grade balance sheet, with net debt⁹ of £699m at year end
- Non-cash goodwill impairment of £865m in US businesses, due to increased weighted average cost of capital and taking into account lower US defence spending
- Full year dividend increased by 3% to 20.1p per share
- £850m returned to shareholders in 2013, including £212m on the share repurchase programme

Ian King, BAE Systems plc Chief Executive, said: “Overall, the Group delivered a solid performance in 2013, against the background of reduced government spending and challenging market conditions. A proactive focus on costs and enhanced competitiveness protected our margins across the majority of the business and we secured further contract wins in the US, Saudi Arabia and internationally. We have started 2014 with good momentum with a settlement on Salam pricing, US budgets in place and a well-defined UK Maritime sector plan. Budget pressures in some of the Group's larger markets are expected to prevail but BAE Systems has a broad-based portfolio. Our strong order backlog and robust balance sheet provide a solid basis for growth over the medium term.”

Outlook

Following last year's non-recurring benefit from the Salam price escalation settlement, together with continuing US budget pressures, the Group's reported earnings⁵ per share is expected to reduce by approximately 5% to 10% compared to 2013.

Reporting segments

Electronic Systems: Sales³, in US dollars, in 2014 are expected to be similar to those in 2013 with margins at the high end of a 12% to 14% range.

Cyber & Intelligence: Sales³ in 2014 are expected to be broadly in line with those in 2013 with margins in an improved 8% to 10% range.

Platforms & Services (US): In 2014, sales³ in the Land & Armaments business (adjusted for the transfer out of the UK Munitions business into Platforms & Services (UK)) are expected to be some 20% to 25% lower with margins of around 9%. Sales³ in the Support Solutions business are expected to be a little lower in 2014 with mid-single digit margins.

Platforms & Services (UK): Following the trading in 2013 of the price escalation on the Salam Typhoon contract, and excluding the transfer of the UK Munitions business, sales³ are expected to reduce by around 5% with margins expected to return to a 10% to 12% range.

Platforms & Services (International): Sales³ are expected to be similar to 2013 with margins expected to be in a 10% to 12% range.

1 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.

2 Restated on adoption of the revised International Accounting Standard 19, Employee Benefits.

3 Including share of equity accounted investments.

4 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 4).

5 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 4).

6 Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.

7 Order backlog comprises funded and unfunded unexecuted customer orders, and is stated after the elimination of intra-group orders.

8 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

9 See page 5.

Preliminary results statement

Overview

Overall, the Group delivered a solid performance in 2013, against the background of reduced government spending and tough market conditions. A proactive focus on costs and enhanced competitiveness allowed us to protect our margins across the majority of the business and we secured further contract wins in the US, Saudi Arabia and internationally. Our results also benefited from the satisfactory conclusion of price escalation negotiations with the Kingdom of Saudi Arabia, relating to an existing contract to supply Typhoon aircraft. We have continued to invest in research and technology and to develop business in international markets, and our strong order backlog and robust balance sheet as we enter 2014 are testament to our business health.

US

In the US, budget uncertainties continued to impact government spending and procurement decisions throughout 2013. Sequestration measures resulting from the 2011 Budget Control Act either reduced or delayed many US activities. The Sequestration measures were targeting savings of approximately \$450bn (£272bn) from US defence budgets over a ten-year period, equivalent to an approximately 10% overall reduction. As certain areas of spending were protected from these reductions, such as military personnel accounts, the budgets funding much of the US defence industrial base are likely to be disproportionately impacted.

In addition to the Sequestration measures, in October, the political disagreements over the terms of a Continuing Resolution to cover the remainder of the 2013 fiscal year resulted in a partial US government shutdown. Following the brief shutdown, a Continuing Resolution was passed to fund the government until 15 January 2014. Whilst some disruption resulted from the shutdown, the impact to the Group's overall financial performance was not material.

In December, a bipartisan budget proposal for a two-year federal budget agreement was approved by Congress and signed into law. The resulting spending bill was approved in January 2014, far earlier in the fiscal cycle than in previous years, and whilst this legislation does not eliminate the Sequester completely, it does ease the significant and indiscriminate cuts that were expected in 2014 and 2015.

Given this environment, we based our planning assumptions on a progressive reduction in our US defence and security businesses of approximately 15% for 2013 and 2014. The recent budget developments return some clarity to near-term US government spending, although pressures to reduce spending and address the US deficit are expected to continue.

Nonetheless, there does seem to be clear support for some key programmes, including the F-35 Lightning II in which BAE Systems has a significant participation.

Some of the Group's US activities are not directly exposed to US government budgets. Our commercial electronics business continues to grow and we anticipate a rising contribution from US Foreign Military Sales. In December, the Republic of Korea finalised an agreement with the US government for BAE Systems to perform upgrades and systems integration for its fleet of more than 130 F-16 aircraft. This business opportunity, potentially worth approximately \$1.3bn (£0.8bn), is not yet included in our order backlog.

The Group also continues to be successful in winning competitive new business. In March, BAE Systems was awarded a five-year contract for the operation and management of the Holston Army Ammunition Plant in the US. In August, the Group was awarded an eight-year contract to maintain the readiness of Minuteman III intercontinental ballistic missiles in the US. In October, the Group received a US Army contract for Low-Rate Initial Production on the Paladin Integrated Management programme, a tracked artillery system. In December, the US Navy awarded BAE Systems a three-year, \$171m (£103m) contract to continue providing

engineering and integration support to Trident II D-5 submarine-launched ballistic missiles.

In Land & Armaments, we have refocused the business on core markets and our capabilities in combat vehicles, amphibious vehicles, artillery systems and naval surface fires. We have also rationalised the land facilities more broadly, reducing 51 sites to 15 centres. Against a background of substantially reduced demand, we are working to protect key industrial capabilities and margins.

Performance issues recently emerged in the multi-year Radford Army Ammunition Plant support contract. Customer volume reductions require this contract to be restructured and we aim to renegotiate an agreement on this key military capability.

UK

Notwithstanding the continued pressure on many areas of government spend in the UK, our business is in good shape and the outlook remains stable. Much of the Group's UK business is concentrated on a small number of large programmes where multi-year contracts provide good visibility, as evidenced by the large UK order backlog.

In the air sector, the first Tranche 3 Typhoon has flown and we have recently been able to reveal previously classified footage of the successful flight trials of the Taranis unmanned aerial vehicle. Deliveries of Typhoon continued to European partner nations.

In the maritime sector, in November, BAE Systems reached agreement with the UK government on measures to enable the implementation of a restructuring of its UK naval ships business. The measures included a restructuring of the Queen Elizabeth Class aircraft carrier contract to accommodate changes to the programme and to reflect its increased maturity. In addition, a programme to build three Offshore Patrol Vessels for the Royal Navy was announced. Consultation with trade union and employee representatives commenced regarding the rationalisation of the naval ships business to address anticipated reduced workload levels beyond the current high volume of activity on the aircraft carrier programme. Contracts to enact this overall agreement are forecast to be finalised in 2014.

Good progress has been made in defining the Type 26 frigate programme to replace Type 23 vessels, with over 600 employees now working on the contract.

Submarines activity continues to progress on the Astute Class programme and workload is increasing on the Successor programme in preparation for a possible replacement of the Vanguard Class boats.

Our Applied Intelligence business (formerly BAE Systems Detica), which is well-positioned in the fast-growing commercial cyber security sector, has substantially increased its order backlog.

In February 2013, Applied Intelligence and Vodafone agreed the formation of a five-year partnership to provide businesses with a range of advanced mobile communications security products and services, initially focused on smartphones and tablets.

Applied Intelligence signed, in September, a framework contract with the Foreign & Commonwealth Office (FCO) to deliver service management integration services across the FCO's global IT estate.

International

Building on the strong international order intake performance in 2012, a further £9.3bn of non-UK/US order intake¹ was achieved in the year.

While the opportunity was not included in our business plans, we were disappointed that the government of the United Arab Emirates (UAE) elected not to proceed with proposals regarding a range of defence and security capabilities including the potential supply of Typhoon aircraft. Nonetheless, the aircraft fully met the customer's

exacting requirements and BAE Systems stands ready to work with the UAE to address any future requirements.

We continue to pursue a number of opportunities in international markets. Building on the successful sale of Typhoon and Hawk aircraft in Saudi Arabia and Oman, a number of military aircraft-related opportunities have been identified.

Aircraft deliveries on the Salam Typhoon programme to Saudi Arabia re-commenced in April.

In February 2014, the governments of the UK and Kingdom of Saudi Arabia agreed price escalation terms relating to the Typhoon aircraft under the Salam programme and these have been reflected in contractual arrangements between the UK government and BAE Systems. The terms of the agreement are broadly consistent with the Group's prior trading outlook for 2013. Cash settlement is expected to follow this pricing agreement, commencing in the early part of 2014. The Group believes this to be an equitable outcome for all parties and is pleased to conclude this negotiation which builds on the long-standing relationship with this much-valued customer.

The significant flow of new contract awards with the Kingdom of Saudi Arabia continued through 2013. Contracts valued at approximately £6.4bn have been signed in the year, including a five-year, £1.8bn follow-on support contract on the Salam Typhoon programme and a further £1.5bn contract for Tornado aircraft upgrades and weapons under the Saudi British Defence Co-operation Programme.

In December, the Swedish government exercised its option to buy 102 more BvS10 all-terrain vehicles in an order worth approximately \$120m (£72m). In December, FNSS, BAE Systems' Turkish joint venture, received a \$360m (£217m) contract from the land forces of a Middle Eastern country for the upgrade of M113 tracked armoured personnel carriers.

The Group was disappointed that the Canadian government decided to cancel its Close Combat Vehicle programme. However, we continue to pursue opportunities for combat vehicles with the Swedish CV90 tracked infantry fighting vehicle forming the basis for a current bid in Denmark. In addition, BAE Systems is working with Polish Defence Holdings to address substantial replacement vehicle requirements expected to emerge later this decade in Poland.

BAE Systems continues to develop opportunities for Bradley fighting vehicles in Saudi Arabia and, more recently, another emerging requirement in the region.

The success in South Korea on the F-16 upgrade programme is a significant competitive win.

Balance sheet and capital allocation

The Group's balance sheet continues to be managed conservatively in line with our policy to retain an investment grade credit rating and to ensure operating flexibility.

Consistent with this approach, the Group expects to continue to meet its pension obligations, pursue organic investment opportunities, 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.

In February 2013, the Group initiated a share repurchase programme of up to £1bn over three years. Implementation of the programme has been influenced by the timing of a satisfactory resolution of the Salam Typhoon price escalation negotiations. As at 19 February 2014, BAE Systems had purchased 65 million shares for approximately £271m under the programme.

Consistent with previous share buybacks, the Group has agreed with the trustees of its UK pension schemes to pay £340m of cash contributions into the schemes over the three-year period of a full implementation of the share repurchase programme.

Directors and management

Sir Peter Mason, a non-executive director, retired from the Board of BAE Systems plc on 8 May. Ian Tyler joined the Board as a non-executive director of the Company on that date.

In June, Chris Grigg was appointed a non-executive director of the Company with effect from 1 July.

Lee McIntire, a non-executive director, resigned from the Board of BAE Systems plc on 20 August.

Sir Roger Carr joined the Board as a non-executive director of BAE Systems plc and Chairman designate on 1 October and succeeded Sir Richard Olver as Chairman on 1 February 2014. Sir Richard stepped down from the Board on that date.

On 1 February 2014, Linda Hudson retired as President and Chief Executive Officer of BAE Systems, Inc. and as an executive director of BAE Systems plc. On the same date, Jerry DeMuro was appointed as President and Chief Executive Officer of BAE Systems, Inc. and as an executive director of BAE Systems plc. He will also serve on BAE Systems' Executive Committee.

On 5 February 2014, Tom Arseneault, formerly Executive Vice President, Product Sectors, was appointed as Chief Operating Officer for BAE Systems, Inc. and Dave Herr, formerly Executive Vice President, Service Sectors, for BAE Systems, Inc. and Executive Committee member, will retire from the Group on 31 March 2014.

In January 2014, Claire Diver joined the Group from Xstrata plc as Group Communications Director and a member of the Executive Committee. She replaced Charlotte Lambkin who left the Group in September.

Dividend

The Board has recommended a final dividend of 12.1p per share making a total of 20.1p per share for the year, an increase of 3% over 2012. At this level, the annual dividend is covered 2.1 times by underlying earnings (2012 2.0 times).

1 Including share of equity accounted investments.

Preliminary results statement *continued*

Income statement

	2013 £m	Restated ¹ 2012 ² £m
Sales³	18,180	17,905
Underlying EBITA⁴	1,925	1,862
Return on sales	10.6%	10.4%
Profit on disposal of businesses	6	103
EBITA	1,931	1,965
Amortisation of intangible assets	(189)	(226)
Impairment of intangible assets	(887)	(86)
Finance costs ³	(392)	(410)
Taxation expense ³	(287)	(284)
Profit for the year	176	959
Exchange rates – average	2013	2012
£/\$	1.564	1.585
£/€	1.178	1.233
£/A\$	1.623	1.531

Segmental analysis

	Sales ³		Underlying EBITA ⁴	
	2013 £m	2012 ² £m	2013 £m	Restated ¹ 2012 ² £m
Electronic Systems	2,466	2,507	346	356
Cyber & Intelligence	1,243	1,402	115	124
Platforms & Services (US)	4,196	4,539	265	394
Platforms & Services (UK)	6,890	5,717	879	695
Platforms & Services (International)	4,063	4,071	429	417
HQ	306	267	(109)	(124)
Intra-group	(984)	(598)		
	18,180	17,905	1,925	1,862

Accounting change

With effect from 1 January 2013, the Group has adopted the revised International Accounting Standard 19, Employee Benefits. This replaces interest cost on gross pension liabilities and expected return on gross pension assets with a finance cost on the net pension deficit calculated using the rate currently used to discount defined benefit pension liabilities and requires certain administrative costs to be included within underlying EBITA⁴. Comparative financial information has been restated accordingly.

Sales³ increased by 2% to £18,180m (2012 £17,905m). Volume reductions in the US businesses and, in particular, at Land & Armaments were more than offset by the resumption of Typhoon aircraft deliveries and trading of the price escalation on the Salam programme.

Underlying EBITA⁴ increased by 3%, to £1,925m (2012 £1,862m), giving a return on sales of 10.6% (2012 10.4%).

Profit on disposal of businesses of £6m includes the disposal of the Commercial Armored Vehicles business, which was part of Land & Armaments. The profit of £103m in 2012 included the disposals of Safety Products and Safariland, and assets comprising the Tensylon business, which were also Land & Armaments businesses.

Amortisation of intangible assets is £37m lower at £189m mainly reflecting intangible assets on programmes in the Land & Armaments business becoming fully amortised in 2012.

Impairment of intangible assets of £887m includes goodwill impairment of £865m relating to the US Intelligence & Security and Land & Armaments businesses as a result of an increase in the Group's post-tax weighted average cost of capital and an estimate of reductions in US defence spending. The £86m charge in 2012 mainly related to the Safariland and Tensylon businesses sold in 2012, and the Commercial Armored Vehicles business sold in 2013.

Finance costs³ were £392m (2012 £410m). The underlying interest charge, which excludes pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements, is £25m lower at £179m. A full year of interest on the £400m of debt issued in June 2012 is more than offset by the lower level of net present value charges on long-term liabilities in 2013.

Taxation expense³ reflects an effective tax rate of 22% (2012 24%). The underlying tax rate for 2014 is expected to be between 21% and 23%, with the final number dependent on the geographical mix of profits.

Earnings per share

Underlying earnings⁵ per share was 42.0p, an increase of 9% on 2012.

Basic earnings per share, in accordance with International Accounting Standard 33, Earnings per Share, was 5.2p (2012 29.3p). The reduction on 2012 mainly reflects the £887m of impairment charges taken in 2013 (2012 £86m) which are excluded from underlying earnings⁵ per share.

1 On adoption of the revised International Accounting Standard 19, Employee Benefits.

2 Re-presented on classification of the Regional Aircraft line of business as a continuing operation within Platforms & Services (UK).

3 Including share of equity accounted investments.

4 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

5 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 4).

6 2012 excludes the £428m contribution from Trust to the UK pension schemes and the £29.5m charitable contribution for the benefit of the people of Tanzania in connection with the global settlement with the UK's Serious Fraud Office in 2010, both made in 2012, as the amounts had been deducted from the Group's net (debt)/cash.

7 Cash received on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance. It is included within trade and other payables in the consolidated balance sheet.

Cash flow

Reconciliation of cash flow from operating activities⁶ to net (debt)/cash (as defined by the Group)

	2013 £m	2012 £m
Cash flow from operating activities⁶	205	2,916
Capital expenditure (net) and financial investment	(153)	(293)
Dividends received from equity accounted investments	95	94
Assets contributed to Trust	–	(25)
Operating business cash flow	147	2,692
Interest	(166)	(147)
Taxation	(138)	(115)
Free cash flow	(157)	2,430
Acquisitions and disposals	4	96
Net purchase of own shares	(212)	(16)
Equity dividends paid	(638)	(620)
Dividends paid to non-controlling interests	(11)	(11)
Cash outflow from matured derivative financial instruments	(47)	(119)
Movement in cash collateral	(10)	(2)
Movement in cash received on customers' account ⁷	1	1
Foreign exchange translation	3	92
Other non-cash movements	(19)	(25)
Total cash (outflow)/inflow	(1,086)	1,826
Opening net cash/(debt) (as defined by the Group)	387	(1,439)
Closing net (debt)/cash (as defined by the Group)	(699)	387

Components of net (debt)/cash (as defined by the Group)

	2013 £m	2012 £m
Debt-related derivative financial instrument assets	6	22
Cash and cash equivalents	2,222	3,355
Loans – non-current	(2,524)	(2,967)
Loans and overdrafts – current	(402)	(21)
Less: Cash received on customers' account ⁷	(1)	(2)
Net (debt)/cash (as defined by the Group)	(699)	387

Operating business cash flow

	2013 £m	2012 ² £m
Electronic Systems	235	256
Cyber & Intelligence	118	113
Platforms & Services (US)	192	314
Platforms & Services (UK)	59	1,717
Platforms & Services (International)	(189)	506
HQ	(268)	(214)
Operating business cash flow	147	2,692

Cash inflow from operating activities⁶ was £205m (2012 £2,916m). As anticipated, advances received in 2012 on the Omani Typhoon and Hawk, Saudi training aircraft and Saudi Tornado upgrade programmes are being utilised. Advances were also consumed in the year on the European Typhoon Tranche 2 programme. Provisions created in previous years were utilised on the Oman Offshore Patrol Vessel contract and on rationalisation. The £131m Trinidad and Tobago termination settlement was paid during the year.

Cash contributions in respect of deficit funding, over and above service costs to the UK and US pension schemes, were £389m (2012 £507m).

There was an outflow from net capital expenditure and financial investment of £153m (2012 £293m).

Dividends received from equity accounted investments, primarily Gripen and MBDA, totalled £95m (2012 £94m).

Interest payments were £19m higher at £166m reflecting a full year of interest on the £400m of debt issued in June 2012.

Taxation payments were £23m higher primarily reflecting tax refunds in 2012 following the 2011 UK Research & Development tax settlement, partly offset by lower US taxable profits and timing differences on US tax payments.

Net cash inflow in respect of acquisitions and disposals of £96m in 2012 mainly comprised the disposals of Safety Products and Safariland, and assets comprising the Tensylon business.

The net purchase of own shares of £212m represents 51.6 million shares purchased under the buyback programme (including transaction costs).

As a consequence of movements in US dollar and Euro exchange rates during the year, there has been a cash outflow from matured derivative financial instruments of £47m (2012 £119m) from rolling hedges on balances with the Group's subsidiaries and equity accounted investments.

Net debt (as defined by the Group) is £699m, a net outflow from the net cash position of £387m at the start of the year. Cash and cash equivalents of £2,222m (2012 £3,355m) are held primarily for the share repurchase programme, pension deficit funding, payment of the 2013 final dividend, repayment of £0.4bn of debt securities maturing in 2014 and management of working capital.

Reporting segments: Electronic Systems

Electronic Systems, with 12,500 employees¹, comprises the US and UK-based electronics activities, including electronic warfare systems and electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

	2013	2012	2011
Funded order intake ¹	£2,697m	£2,540m	£2,620m
Order backlog ^{1,4}	£3.7bn	£3.6bn	£3.6bn
Sales ¹	£2,466m	£2,507m	£2,645m
Underlying EBITA ²	£346m	£356m	£386m
Return on sales	14.0%	14.2%	14.6%
Cash inflow ³	£235m	£256m	£268m

Financial key points

- 6% like-for-like increase in order backlog^{1,4}
- Sales¹ reduced by 2%, with growth in the commercial business mitigating the defence decline
- Return on sales maintained at around 14%

Operational key points

- Maintained a leadership position in the electronic warfare market, with strong performance on the Group's components for F-35 Lightning II
- Won a development contract on the US Army's Joint Effects Targeting System programme
- Strengthened position in the Identification Friend or Foe market
- Strengthened position in the high growth commercial aircraft electronics market
- Not selected on the US Army's next-generation Mid-tier Networking Vehicular Radio programme
- £0.2bn of research and development expenditure⁵ in 2013

Financial performance

Despite US budget pressures, order backlog^{1,4} of £3.7bn was up from the start of the year, benefiting from production awards on the Terminal High-Altitude Area Defence programme.

Sales¹ compared with 2012 decreased by 2% to £2,466m (2012 £2,507m). The commercial areas of the business amount to 21%, having seen sales growth in the year of 8%. This helped to offset some of the pressures on the defence side, which reduced by 5% in the year.

The return on sales achieved was 14.0% (2012 14.2%).

Programme execution remained strong, with good risk retirement and in-year benefit from continued cost reduction actions.

Cash flow³ conversion of underlying EBITA² for the year was 68%, but excluding pension deficit funding, that conversion rate was 89%.

Operational performance

Electronic Combat

Electronic Systems maintains its leadership position in the US electronic warfare market. Under the flight test programme for the electronic warfare suite on the F-35 Lightning II programme, initial design verification testing of the system was completed. Low-Rate Initial Production (LRIP) Lot 6 deliveries continued throughout the year and initial Lot 7 deliveries commenced. The business was awarded a not to exceed contract of \$143m (£86m) for LRIP Lot 8.

Under contracts totalling over \$0.9bn (£0.5bn), the Digital Electronic Warfare System (DEWS) will be installed on 84 new F-15 aircraft with upgrades to 70 existing F-15 aircraft for the Royal Saudi Air Force. Initial flight testing began in November. The business continues to pursue other export opportunities for the DEWS suite.

The business was successful in demonstrating the Long-Range Anti-Ship Missile (LRASM) prototype in a direct-hit live missile shot test under a joint programme of the Defense Advanced Research Projects Agency and the Office of Naval Research. Offering capabilities not available in current cruise missile systems, LRASM is a next-generation, anti-ship missile for which the business provides a radio frequency sensor used for targeting. LRASM is being developed as an advanced prototype for rapid transition to the US Navy's Offensive Anti-Surface Weapon programme.

BAE Systems was not awarded the technology development contract for the Next-Generation Jammer.

Survivability & Targeting

Electronic Systems continues to execute its \$38m (£23m) technology development contract in a competition to provide the Common Infrared Countermeasures capability for the US Army, meeting or exceeding every programme milestone. The programme is now in a government-led test phase.

The Advanced Precision Kill Weapon System™ continues to demonstrate its versatility, completing qualification and successful testing on almost a dozen fixed and rotary wing platforms for the US armed forces. The business continues to execute its \$69m (£42m) Full-Rate Production contract. More than 2,000 systems have been delivered, with continued positive feedback from performance in theatre.

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 4).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

4 Comprises funded and unfunded unexecuted customer orders.

5 Includes both Group-funded and customer-funded expenditure.

The Terminal High-Altitude Area Defence programme provides a transportable, rapidly deployable, ground-based capability to intercept and destroy ballistic missiles inside or outside the atmosphere during their final phase of flight. BAE Systems has received orders of \$340m (£205m) in combined US government and Foreign Military Sales to the United Arab Emirates.

BAE Systems was awarded a \$15m (£9m) contract to support the US Army's Joint Effects Targeting System programme in March with its HAMMER™ precision targeting system, which has been designed to enhance soldiers' ability to rapidly identify, precisely locate and accurately mark targets for Global Positioning System-guided and laser-guided munitions in all weather and lighting conditions. The contract initiates a three-year engineering and manufacturing development phase, and is a key win that advances BAE Systems' market leadership in precision targeting systems.

Communications & Control

The F-35 Lightning II programme continues to be a key platform for the Group's avionics products with deliveries on plan for the active inceptor and vehicle management systems. The US Air Force has discontinued second sourcing efforts for the advanced helmet system that was being provided by BAE Systems.

BAE Systems was not selected on the US Army's next-generation Mid-tier Networking Vehicular Radio competition.

Intelligence, Surveillance & Reconnaissance (ISR)

The business continues to provide Airborne Surveillance capability for the US Air Force and US Army. These key programmes are based on two wide-area, high-resolution imaging sensor systems, the Airborne Wide Area Persistent Surveillance System, which has been operational for more than 16,000 hours in theatre, and the Autonomous Real-time Ground Ubiquitous Surveillance – Imaging System.

The business is providing state-of-the-art processing capabilities to Boeing for the US Navy's P-8A Poseidon programme, which has entered Full-Rate Production. Sixteen production mission computer and display systems have been delivered to the US Navy. Eight systems have been delivered to the Indian Navy, the first international customer.

In the Identification Friend or Foe market, BAE Systems has been awarded a \$34m (£21m) contract to provide its enhanced Combined Interrogator Transponder system to the US Air Force and participating European air force partners. Deliveries of the Reduced Size Transponder have been completed for the US Navy's Triton System Design and Development programme and BAE Systems is now under contract for Low-Rate Initial Production.

In 2013, BAE Systems achieved a cumulative equivalent of 7,000 years in space across its three generations of space computers. The third-generation RAD750® computer has now been launched on more than 35 satellites supporting civil, national and commercial missions. The business is continuing to innovate in the space processing market with the development of its next-generation space computer.

The business continues to provide Signal Intelligence (SIGINT) capability for the US Army and Special Operations Command. These programmes are based on the Group's S-3000 family of SIGINT systems and have successfully deployed with multiple customers.

Commercial Aircraft electronics

The business continues to expand its market opportunities for Full Authority Digital Engine Controls (FADEC). FADEC Alliance, a joint venture between FADEC International, the Group's joint venture with Sagem, and GE Aviation, delivered the Leap FADEC and successfully completed testing on GE's Passport 20 engine. Entry into service of the Passport engine, which will power Bombardier's Global 7000 and 8000 jets, is scheduled for 2016. The Leap FADEC will be used on the Boeing 737 MAX and Airbus A320neo.

Following successful first flights of Embraer's mid-size business jet, Legacy, and Bombardier's CSeries regional aircraft, enabled by several flight control subsystems provided by BAE Systems, efforts are now focused on both aircraft entering full revenue service.

BAE Systems is a supplier on the Boeing 737 MAX, notably with the fly-by-wire spoiler controls. Contracts awarded to the Group have a total potential value of \$1bn (£0.6bn) over the life of the aircraft programme.

The business has opened a new office in Shanghai which will enable it to expand its commercial aftermarket presence in China, whilst strengthening existing and developing new partnerships with in-country suppliers and airframe manufacturers.

HybriDrive® propulsion

Dijon, France, a new customer for the business, has taken delivery of 102 buses from Iveco powered by HybriDrive® propulsion systems, making it the largest hybrid fleet in mainland Europe. King County Metro, Seattle, Washington, purchased 120 New Flyer buses powered by HybriDrive® Series-E systems, the county's latest hybrid product, to add to its existing HybriDrive®-powered fleet.

Looking forward

Efforts to reduce the US government's budget deficit are expected to continue to impact government spend. A bipartisan budget proposal was approved in December 2013 that mitigates the full impact of the Sequester for 2014 and 2015. The Group expects lower defence spending than previously programmed, but the cuts are not expected to be as significant or indiscriminate as they would have been under Sequestration.

Whilst further funding reductions and the resultant slow down or cancellation of ongoing and new programmes could impact the business, Electronic Systems continues to be well-positioned to address the changing US Department of Defense priorities with its balanced portfolio of programmes and customers, and its sustained emphasis on cost reduction and research and development.

The business expects to benefit from its incumbent positions and ability to provide capability upgrades on platforms. The business anticipates increased activity on international defence programmes and continued growth in the commercial aviation market.

Reporting segments: Cyber & Intelligence

Cyber & Intelligence, with 7,700 employees¹, comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence (formerly BAE Systems Detica) business, and covers the Group's cyber, secure government, and commercial and financial security activities.

	2013	2012	2011
Funded order intake ¹	£1,247m	£1,454m	£1,443m
Order backlog ^{1,4}	£0.7bn	£1.0bn	£1.1bn
Sales ¹	£1,243m	£1,402m	£1,399m
Underlying EBITA ²	£115m	£124m	£136m
Return on sales	9.3%	8.8%	9.7%
Cash inflow ³	£118m	£113m	£123m

Financial key points

- Order backlog^{1,4} reduced by 24% reflecting delayed awards in the US business. Order backlog^{1,4} in Applied Intelligence increased by 60%
- Sales¹ reduced by 11% reflecting an 18% decrease in Intelligence & Security and a 9% increase in Applied Intelligence
- Return on sales of 9.3% includes continued high levels of spend to support organic growth in Applied Intelligence

Operational key points

Intelligence & Security

- Awarded a three-year follow-on contract to the Counter-Improvised Explosive Device programme
- Maintained a leadership position in activity-based intelligence
- Continued to invest in differentiating technologies to support a bid pipeline of \$2.4bn (£1.4bn) at the end of 2013
- US business significantly impacted by US budget pressures and partial government shutdown

Applied Intelligence

- Named as cyber security partner to Vodafone for provision of secure mobile services
- Achieved launch of new product for detection of sophisticated cyber threats, CyberReveal™, adopted by one major investment bank
- A number of important customer wins for NetReveal® OnDemand services
- Awarded framework contracts for IT services to the Foreign & Commonwealth Office and Network Rail
- Awarded integrated cyber security services contracts to three Middle Eastern countries

Financial performance

Order backlog^{1,4} reduced to £0.7bn (2012 £1.0bn). The US business continued to be impacted by budget-induced delays to award decisions of competitive bids. At 31 December 2013, there were some \$2.4bn (£1.4bn) of competitive bids of which more than half were overdue against decision timescales. In addition, some \$320m (£193m) of backlog has been removed following customer de-scoping across a large number of programmes. By contrast, order backlog¹ in the Applied Intelligence business grew by 60%.

Sales¹ in the year reduced by 11% to £1,243m (2012 £1,402m). The US business saw an 18% decrease, including the reduction from the Counter-Improvised Explosive Device programme, and the impacts from budget reductions were experienced more quickly than expected, with competitive award decisions continuing to be delayed. Growth in the Applied Intelligence business was at 9%.

The return on sales achieved of 9.3% (2012 8.8%) includes the continued organic investment in the Applied Intelligence business in support of targeted future growth in commercial and international markets.

Cash flow³ conversion of underlying EBITA² for the year was at 103%.

Operational performance

Intelligence & Security

The US-based Intelligence & Security business delivers a broad range of solutions and services, including systems development, IT, cyber operations and intelligence analysis to enable the US military and government to recognise, manage and defeat threats. The business is structured into three key business areas that provide specific domain expertise, whilst working closely together to provide enterprise-wide support to a range of customers and key agencies in the intelligence, defence, homeland security and civilian markets.

The business has been impacted by uncertainty in future programme budget levels, driven first by Sequestration and then by the partial US government shutdown in October, which had greater impacts on services and support programmes. Some customers have chosen to reduce contractor volumes significantly on existing programmes, delay award activity on pending programmes or simply cancel others. The level of impact has been much higher than anticipated.

Global Analysis and Operations provides mission-enabled analytic solutions and support to operations across the US homeland security, law enforcement, defence, intelligence and counter-intelligence communities.

The business won all task orders competed in the market for Full Motion Video Analysis during the year and continues to execute awarded contracts, which are worth over \$400m (£242m), with over 300 analysts supporting mission critical activities.

In August, the \$450m (£272m) Counter-Improvised Explosive Device programme ended and the follow-on programme, Combat Intelligence Augmentation Teams, began. Orders on the new programme totalling approximately \$150m (£91m) are expected over the next three years. The business continues to provide almost 300 security-cleared intelligence analysts working alongside forward deployed US defence personnel in Afghanistan.

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 4).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

4 Comprises funded and unfunded unexecuted customer orders.

GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) develops and supports software systems and mission applications for geospatial tasking, including data collection, processing, exploitation and dissemination, as well as mission planning, Intelligence, Surveillance and Reconnaissance (ISR), precision targeting, and command and control for the US defence and intelligence communities.

In October, the business received authorisation to proceed on a \$16m (£10m) M151 Engineering Change Proposal (ECP) that continues its leadership in activity-based intelligence. The scope of the ECP includes analytics automation for complex mission problems across the intelligence community.

In September, the business was awarded the first ECP on the Mobility Air Force Automated Flight Planning Service programme to develop and sustain a new air vehicle flight planning and route optimisation capability for the US Air Force's Tanker Airlift Control Center under the \$62m (£37m) contract awarded in April. The ECP focuses on the Aero Advisory Notification Tool capability in support of the Air Force's transition to a consolidated mission planning architecture.

IT Solutions develops, deploys and maintains mission applications focused on information sharing, knowledge management and enhanced enterprise mission IT solutions for the US federal, civilian and defence intelligence communities. The business also provides analytics, cyber analysis and real-time network forensics.

Work increased on the \$70m (£42m) Next-Generation Desktop Environment programme for the US Defense Intelligence Agency by providing global networking solutions in US Korea Command and US Africa Command, based on virtual desktop infrastructure and multiple-security-level access.

On the Solutions for the Information Technology Enterprise Indefinite Delivery, Indefinite Quantity contract, with task orders worth \$344m (£208m), the business has transitioned the customer from a costly regional support model to an efficient enterprise support model. Through the implementation of the Global Enterprise Operation Center, the business has enabled the US Defense Intelligence Agency to provide reliable, cost-effective and highly secure IT services to over 50,000 Department of Defense personnel worldwide with no impact to mission.

Under the \$0.5bn (£0.3bn) Centralized Operations, Maintenance and Management Information Technology Indefinite Delivery, Indefinite Quantity contract, the business won a task order to provide 24/7 monitoring support for the Federal Emergency Management Agency Security Operations Center. The award brings total task orders under the contract to over \$110m (£66m) and maintains BAE Systems' position as the largest provider of IT services on the contract.

In January 2013, the business was awarded a \$127m (£77m) contract to support the US National Security Agency's High Performance Computing Infrastructure Group with architecture, installation and administration for a complex networking environment supporting multiple network enclaves and high-speed data centre access. Under the contract, both server and desktop computer support will be provided to more than 3,000 end users.

Applied Intelligence (formerly BAE Systems Detica)

The business continues to grow through selling its portfolio of products and services to domestic and international governments, financial institutions, communications service providers, energy and utility operators and other commercial enterprises.

The business is demonstrating its ability to win large, multi-year contracts. It has extended its portfolio of products and services, and is responding to demand for solutions which combine capabilities from across its portfolio, where client requirements are converging. Market awareness and recognition continue to grow, evidenced through a number of industry analyst and association awards during the year. The business has opened a Global Delivery Centre in Malaysia to augment capability alongside existing centres in the UK and Poland.

Cyber Security

New additions to the product portfolio in 2013 have included: CyberReveal™, an advanced cyber threat monitoring solution, already sold to a major global financial institution; MobileProtect™, a cloud-based service for securing smart mobile devices, launched alongside a five-year strategic partnership with Vodafone; and IndustrialProtect™, a military-grade solution to protect organisations' industrial control systems. MobileProtect™ subscribers are expected to exceed 100,000 during 2014.

Managed security services continue to gain traction, with the business named as official cyber security partner to McLaren in April. In December, the business won new cyber security and services contracts totalling £48m in the Middle East.

Financial Crime

The business continues to provide enterprise risk, fraud and compliance solutions internationally.

NetReveal® has been selected by CANATICS (Canadian National Insurance Crime Services) to provide a five-year managed analytics service to detect auto insurance claims fraud. It has been selected as preferred vendor by an Eastern European government to detect tax fraud and non-compliance, and has been selected by HMRC to extend its risk and fraud system to cover VAT repayment transactional fraud. The business has also broadened its offering to tackle emerging risks, such as unauthorised trading, including a significant sale to the investment banking division of a major global banking group. Other customer wins during the year include Commerzbank and Home Trust, contributing to a total order intake of £102m.

Communications Solutions

The business is a provider of end-to-end communications intelligence solutions internationally. It is addressing changes in market conditions which presented operational challenges in 2013. However, in 2014, it is pursuing opportunities in the Middle East and Asia Pacific regions and, in late 2013, won strategically important deals with both governments and communications service providers in Europe and North America.

UK Services

The consulting, systems integration and managed services business had a successful year. It signed a framework contract with the Foreign & Commonwealth Office (FCO) to deliver service management integration services across the FCO's global IT estate, worth around £40m over a five-year period. The business also signed a framework agreement with Network Rail to provide IT solutions and systems integration over a four-year period.

The business continues to expand its relationships with communications service providers, including Vodafone and EE, providing solutions from across its portfolio.

Reporting segments: Cyber & Intelligence *continued*

Looking forward

Efforts to reduce the US government's budget deficit are expected to continue to impact government spend. A bipartisan budget proposal was approved in December 2013 that mitigates the full impact of the Sequester for 2014 and 2015. The Group expects lower defence spending than previously programmed, but the cuts are not expected to be as significant or indiscriminate as they would have been under Sequestration.

The US market continues to experience delays in procurement awards. Customers will continue to look for opportunities to achieve efficiencies in IT services through consolidation and cloud computing, areas in which the US business has deep domain expertise and experience. Big data continues to pose a challenge for the US government and commercial businesses, which also provides an opportunity for growth.

Intelligence & Security is well-positioned to pursue opportunities in cyber, special operations and Intelligence, Surveillance and Reconnaissance, which remain priority activities in the US. Other avenues for growth exist across the intelligence analysis spectrum. The US business is also exploring international opportunities where its IT, cyber and analysis capabilities can be implemented by governments or in commercial markets.

Applied Intelligence expects continued growth both in the UK and internationally, with increasing demand from government and commercial sector customers for products and services which protect and enhance operations in the areas of cyber security, financial crime, communications intelligence and digital transformation.

Reporting segments: Platforms & Services (US)

Platforms & Services (US), with 19,200 employees¹, comprises the US-headquartered Land & Armaments business, with operations in the US, UK, Sweden and South Africa, and the US-based services and sustainment activities, including ship repair and munitions services.

	2013	2012	2011
Funded order intake ¹	£3,421m	£5,010m	£5,077m
Order backlog ^{1,4}	£7.4bn	£8.4bn	£8.7bn
Sales ¹	£4,196m	£4,539m	£5,305m
Underlying EBITA ²	£265m	£394m	£478m
Return on sales	6.3%	8.7%	9.0%
Cash inflow ³	£192m	£314m	£410m

Financial key points

- Sales¹ reduced by 17% in Land & Armaments and increased by 2% in Support Solutions
- Return on sales increased to 9.3% in Land & Armaments and reduced to 3.0% in Support Solutions

Operational key points

Land & Armaments

- Strong operational performance
- Continued focus on cost reduction actions
- Contract for Low-Rate Initial Production received on the Paladin Integrated Management programme
- Integration work ceased on Caiman Multi-Terrain Vehicles and Sealy, Texas, facility to close in 2014

Support Solutions

- Performance impacted by charges taken on the Radford Army Ammunition Plant contract, commercial shipbuilding activity and not being awarded follow-on options on the US Navy aircraft maintenance contract
- Follow-on awards on US munitions facilities management contracts
- Significant multi-year contracts to support ballistic missiles in the US
- Letter of Agreement finalised for upgrades and systems integration for South Korean F-16 aircraft

Financial performance

Order backlog^{1,4} was £7.4bn (2012 £8.4bn). At Land & Armaments, order backlog^{1,4} reduced to £4.3bn (2012 £5.1bn) reflecting trading on M777 and long-term UK munitions contracts. Disappointingly, the CV90 prospect in Canada was cancelled by the customer and no procurement decision has yet been taken by the Indian authorities with regard to the M777 lightweight howitzer acquisition. At Support Solutions, order backlog^{1,4} reduced to £3.1bn (2012 £3.3bn) as the five-year ship repair Multi-Ship, Multi-Option contracts are traded through.

In aggregate, sales¹ were £4.2bn (2012 £4.5bn), representing a like-for-like reduction of 5%. At Land & Armaments, sales¹ declined by 10% on a like-for-like basis, taking into account exchange translation, the impact of last year's business disposals and the transfer of the Combat Vehicles (UK) business to Platforms & Services (UK). The sales¹ reduction was largely from completion of contracts for Mine Resistant Ambush Protected vehicle upgrades and lower Bradley reset work. In the Support Solutions business, sales¹ were 2% higher than in 2012. The business benefited from higher volumes in the ship repair and munitions facilities management businesses.

Underlying EBITA² was £265m (2012 £394m). Return on sales reduced to 6.3% (2012 8.7%). Return on sales at Land & Armaments of 9.3% (2012 8.6%) benefited from ongoing cost reduction actions and good programme execution, and includes the charge taken for the closure of the wheeled vehicle facility at Sealy. Return on sales at Support Solutions of 3.0% (2012 8.8%) includes a charge of \$46m (£29m) taken against overhead under-absorption relating to 2013 and future years as the business seeks to restructure the Radford Army Ammunition Plant contract. In addition, a charge of \$30m (£19m) has been taken against cost overruns on commercial shipbuild activity.

Operating cash flow³ reduced to £192m (2012 £314m). Cash flow³ conversion of underlying EBITA², excluding pension deficit funding, was 86% and 68% at Land & Armaments and Support Solutions, respectively. Operating cash flow³ in Support Solutions was impacted by short-term US government payment delays.

Operational performance

Land & Armaments

US Combat Vehicles

Despite significant down-sizing and ongoing uncertainties in the US market, the business has continued to maintain key industrial base capabilities based on the US Army's stated requirements at the Bradley production line in York, Pennsylvania. In addition to domestic Bradley reset and conversion programmes, the business continues to make progress in securing international business, primarily in the Middle East. In November, Land & Armaments signed a joint venture agreement to pursue Bradley opportunities in Saudi Arabia.

Although uncertainty remains with respect to the future of the US Army's Ground Combat Vehicle programme, the business continues to support the US Army and execute its technology maturation and risk reduction contract. The Hybrid Electric Drive system successfully completed 2,000 miles of testing four months ahead of schedule.

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 4).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

4 Comprises funded and unfunded unexecuted customer orders.

Reporting segments: Platforms & Services (US) *continued*

In October, the Paladin Integrated Management (PIM) programme received a \$195m (£118m) contract to begin Low-Rate Initial Production. During this phase, BAE Systems will produce 18.5 vehicle sets, comprising 19 PIM howitzers and 18 PIM Carrier Ammunition, Tracked vehicles. Through future options, the US Army intends to purchase a total of 66.5 vehicle sets, plus spares, kits and technical documentation for a total contract value of \$688m (£416m).

During 2013, Land & Armaments continued to streamline its US business. The sale of the Commercial Armored Vehicles business completed in February and the Fayette, Pennsylvania, facility closed in December.

Whilst Land & Armaments remains a committed member of the Lockheed Martin Joint Light Tactical Vehicle (JLTV) programme, in August, the business received a notice of termination for convenience from the US government, ceasing all integration work on Caiman Multi-Terrain Vehicles. Following this notice, the business announced closure of the Sealy, Texas, facility by the end of June 2014. Work under the JLTV programme is in the process of transitioning to the York, Pennsylvania, facility.

Weapon Systems

The business was awarded a \$40m (£24m) contract to produce vertical launching system canisters for the US Navy. If all options under the contract are exercised, the total value could exceed \$400m (£242m).

The business secured a \$57m (£34m) contract with the Royal Malaysian Navy for six naval guns that will equip the country's second generation patrol vessels, Littoral Combat Ships.

The first five pre-serial Archer artillery systems were delivered to the Swedish Defence Materiel Administration (FMV). In December, Norway announced its intent to end its co-operation with Sweden on the Archer system. BAE Systems remains committed to the programme and continues to work with its customer, the FMV, to deliver the system to the Swedish armed forces.

BAE Systems Hägglunds

The business continues to have success with its CV90 programme. Work on the \$750m (£453m) contract for the Norwegian Army remains on schedule, with delivery of pre-series vehicles in February 2013 and series manufacture starting in September. A CV90 vehicle was delivered to the Danish Army to participate in a competitive evaluation to meet the requirement for future armoured personnel vehicles. The business signed a teaming agreement in May with Polish Defence Holdings to offer a new family of armoured vehicles based on CV90 technology.

In December, the business was notified of the Canadian government's decision to cancel its proposed Close Combat Vehicle programme.

In December, the Swedish government exercised its option to buy 102 more BvS10 all-terrain vehicles in an order worth approximately \$120m (£72m). This order follows its January 2012 purchase of 48 BvS10 vehicles that are under delivery to the Swedish Army.

FNSS

FNSS, BAE Systems' Turkish joint venture, continues to produce and upgrade tracked and wheeled military vehicles for international customers.

Production has commenced under the \$559m (£338m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army and the first vehicles were delivered in 2013.

In December, FNSS received a \$360m (£217m) contract from the land forces of a Middle Eastern country for the upgrade of M113 tracked armoured personnel carriers. The business is pursuing other armoured vehicle prospects elsewhere in the region.

Munitions

A pricing proposal for the next five years (2018 to 2022) of the Munitions Acquisition Supply Solution partnering agreement was submitted to the UK Ministry of Defence in September. Orders totalling £105m were received from the UK Ministry of Defence, US Navy, Kingdom of Saudi Arabia government and the French Ministry of Defence in the year.

The Munitions business will be reported in the financial results of the Platforms & Services (UK) reporting segment from 1 January 2014.

Support Solutions

Whilst strategic contracts were won during the period, the US-based services businesses were impacted materially by budget uncertainties and operational challenges. There were operational challenges in commercial shipbuilding and on start-up activity on the Radford Army Ammunition Plant contract. In addition, the business was not awarded follow-on options under the US Navy training aircraft maintenance and logistics support contract, under which work continued until 1 December.

The conditional Worker Adjustment and Retraining Notification (WARN) Act notices issued in February to nearly 3,600 ship repair employees were largely mitigated by the funding legislation passed in March.

The US-based ship repair business achieved its commitments under Multi-Ship, Multi-Option contract vehicles with the US Navy, receiving orders totalling \$1.2bn (£0.7bn) for the repair, maintenance and modernisation of various vessels during the year.

BAE Systems continues to co-operate with ongoing government investigations regarding the employee fatality at the Mobile, Alabama, shipyard that occurred on 4 April when the Carnival Triumph cruise ship came free from its moorings during unexpected severe weather.

The business continues to manage the operations of the Holston Army Ammunition Plant in the US. In March, the US Army awarded an Indefinite Delivery, Indefinite Quantity contract valued at up to \$780m (£471m) over five years to operate and manage the Holston Army Ammunition Plant, as well as purchase explosives from the plant.

South Korea down-selected BAE Systems to upgrade avionics and electronic systems, as well as perform systems integration for its fleet of more than 130 F-16 aircraft. The US Congressional Notification process was completed with the Letter of Acceptance put in place in December.

In August, BAE Systems was awarded an eight-year, \$534m (£323m) contract from the US Air Force to maintain the readiness of Minuteman III intercontinental ballistic missiles in the US. The Group will provide systems engineering, integration, testing, logistics and other services to support the missile, ground and launch systems for 450 deployed missiles. In December, the US Navy awarded BAE Systems a three-year, \$171m (£103m) contract to continue providing engineering and integration support to Trident II D-5 submarine-launched ballistic missiles.

The US Army awarded Support Systems Associates, Inc., with BAE Systems as a subcontractor, the Logistics Support Facilities Management Activity contract to provide flexible, timely and cost-effective facilities, personnel and expertise to support aircraft modifications and other support services.

In protection systems, BAE Systems produced its one millionth combat helmet since the 1980s. A \$28m (£17m) order from the US Marine Corps for the production of lightweight combat helmets was received in February 2013.

In October, the business was awarded a \$60m (£36m) order from the US Defense Logistics Agency to produce additional tactical vests equipped with body armour and incorporating a number of

benefits for the soldier, including a 10% weight reduction in the armour system.

In the maritime defence solutions business, BAE Systems was awarded an \$80m (£48m) contract to continue providing systems engineering and other technical services to support the operational readiness of US Navy submarine torpedoes and other weapons systems.

Under the Concepts and Operations for Space and Missile Defence Integration Capabilities contract, the business was awarded an \$85m (£51m), two-year extension to continue its support of the US Army in providing services for developing and understanding missile defence methods and technologies.

Looking forward

Efforts to reduce the US government's budget deficit are expected to continue to impact government spend. A bipartisan budget proposal was approved in December 2013 that mitigates the full impact of the Sequester for 2014 and 2015. The Group expects lower defence spending than previously programmed, but the cuts are not expected to be as significant or indiscriminate as they would have been under Sequestration.

Whilst potential cancellations and delays in new programmes could affect the business, Support Solutions may be able to offset the impact through additional opportunities to sustain and modernise existing platforms.

In the near term, Land & Armaments continues to operate in a challenging environment. To remain viable in the future, the business is investing to protect franchise programmes, including Bradley modernisation and the CV90 family, and establish new franchise programmes, such as Paladin Integrated Management. In addition, the business continues to offer export products to international markets and invest in new technology fast lanes, such as directed energy weapons and hybrid electric drives for combat vehicles. The business continues to drive rationalisation efforts to maximise efficiency and remain competitive.

Reporting segments: Platforms & Services (UK)

Platforms & Services (UK), with 28,300 employees¹, comprises the Group's UK-based air, maritime, combat vehicle, munitions and certain shared services activities.

	2013	2012 ⁴	2011
Funded order intake ¹	£5,979m	£8,160m	£4,355m
Order backlog ¹	£20.3bn	£21.3bn	£18.7bn
Sales ¹	£6,890m	£5,717m	£6,258m
Underlying EBITA ²	£879m	£695m	£658m
Return on sales	12.8%	12.2%	10.5%
Cash inflow ³	£59m	£1,717m	£69m

Financial key points

- Sales¹ increased by 21% on resumption of Salam Typhoon aircraft deliveries and trading of price escalation
- Return on sales of 12.8% benefited from the trading of price escalation and strong programme execution
- Operating cash flow³ reflects the utilisation of advances and provisions

Operational key points

- 34 Typhoon Tranche 2 and the first Tranche 3 aircraft delivered to the European partner nations
- First Hawk jets delivered to the Indian Navy
- Naval sector restructuring agreement reached with the UK Ministry of Defence
- Two Khareef Class corvettes for the Royal Navy of Oman achieved interim acceptance
- Sixth and final Type 45 destroyer accepted off-contract
- Third and final Offshore Patrol Vessel delivered to the Brazilian Navy
- £0.1bn of funding for ongoing design and development of the Royal Navy's Successor submarine
- Increased funding for the fifth, sixth and seventh Astute Class submarines

Financial performance

Order backlog¹ reduced to £20.3bn (2012 £21.3bn) on trading of aircraft deliveries under the contracts for European and Saudi Typhoon aircraft and the Indian Hawk contract.

The year's sales¹ of £6.9bn (2012 £5.7bn) were 21% higher than 2012, benefiting from the ten aircraft deliveries made on the Salam Typhoon programme and trading of the price escalation. There were no Salam aircraft deliveries made in 2012.

The return on sales of 12.8% (2012 12.2%) was strong, benefiting from not only the trading of the Salam Typhoon price escalation, but also another year of strong programme execution and risk reduction across the business.

There was a cash inflow³ of £59m (2012 £1,717m) in the year reflecting the consumption of customer advances on the Omani Typhoon and Hawk programme, the European Typhoon contract and the Saudi training aircraft contract. In addition, provisions were utilised against costs incurred on rationalisation, on the Oman Offshore Patrol Vessel programme and for the Trinidad and Tobago termination settlement payment.

Operational performance

Military Air & Information

In the year, deliveries of Typhoon Tranche 2 aircraft to the four partner nations totalled 34, bringing the total number of Tranche 2 aircraft delivered to 203 of the contracted 236. Sixteen Tranche 3 front fuselage sub-assemblies were manufactured in the year and the first Tranche 3 aircraft was delivered to the Royal Air Force (RAF).

Initial mobilisation under the Omani Typhoon and Hawk aircraft contract, awarded in December 2012, has commenced with the first aircraft deliveries scheduled for 2017.

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

On the F-35 Lightning II programme, the business has continued to deliver aircraft fuselages for the sixth Low-Rate Initial Production (LRIP) contract, delivering 26 aircraft sets to Lockheed Martin in 2013. Production for the seventh LRIP contract has commenced. A bid proposal for LRIP 8 has been submitted and negotiations have commenced.

Support continues to be provided to users of Hawk trainer aircraft around the world. The Indian Navy has received its first five Hawk aircraft from Hindustan Aeronautics Limited, built under the Batch 2 licence for 57 aircraft. Commercial discussions continue on the proposal for an additional 20 Hawk aircraft.

A response to the competitive proposal to supply eight Hawk trainer aircraft, support and training to Poland was submitted in November. Following evaluation by the Polish Ministry of Defence, the Group has been informed that it will not be down-selected for the next phase of this competition.

Working with UK industry partners and the Ministry of Defence, BAE Systems has designed and built a stealthy unmanned combat air vehicle demonstrator named Taranis. The aircraft made its maiden flight in August 2013 and has undertaken a number of successful trial flights.

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 4).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

4 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.

Progress continued, to plan, on the joint BAE Systems and Dassault Aviation Future Combat Air System demonstration programme preparation contract to mature and demonstrate critical technology and operational aspects for an Unmanned Combat Air System.

In January 2014, it was announced that there would be further joint UK/French Future Combat Air System technology development under a two-year feasibility study worth £120m.

In the defence information domain, final deliveries of the Falcon secure deployable communication system for the British Army and RAF were completed in 2013, and the business continues to provide support for the system.

In the Regional Aircraft business, engineering revenues have remained under pressure reflecting the current trading conditions. This has been offset by a good performance within the support business.

Maritime

Following detailed discussions about how best to sustain the long-term capability to deliver complex warships, BAE Systems has proposed and agreed with the UK Ministry of Defence that Glasgow would be the most effective location for the manufacture of the future Type 26 frigates. Subject to consultation with trade union and employee representatives, the Group announced in November that it proposes to consolidate its shipbuilding operations in Glasgow and that shipbuilding operations at Portsmouth will cease in the second half of 2014. Consultation has commenced on a total employee reduction of up to 1,775, including up to 940 in Portsmouth in 2014 and up to 835 across Filton, Glasgow and Rosyth, progressively through to 2016. The relevant cost of the restructuring will be borne by the Ministry of Defence.

A significant reduction in workload will follow the peak of activity on the aircraft carrier programme, the six Type 45 destroyers and two export contracts. The anticipated Type 26 programme will, in future years, address some of that workload reduction. In the interim period, a proposed contract for the manufacture of three Offshore Patrol Vessels was announced in November, which, as well as providing interim shipbuilding workload, will provide additional capability for the Royal Navy and sustain key shipbuilding skills.

Cumulative savings of £457m have been reported to the Ministry of Defence against commitments made under the Terms of Business Agreement (ToBA), which remains ahead of target. The agreements announced in November, together with the anticipated contract for the design and manufacture of the Type 26, will progressively replace the ToBA.

Progress continues on assembly of the first aircraft carrier, HMS Queen Elizabeth, whilst block build for the second ship, HMS Prince of Wales, is underway. BAE Systems, with the other participants in the Aircraft Carrier Alliance, announced in November that it had agreed changes to the contract to accommodate both programme changes and activities previously excluded. Under the new target cost arrangements, the industrial participants' fee includes a 50:50 risk share arrangement providing greater cost performance incentives.

HMS Duncan, the sixth and final Type 45 destroyer, was accepted by the Ministry of Defence in March. The Type 45 support contract met all ship deployment dates in the year.

The assessment phase contract for the Type 26 is proceeding and there are now over 600 employees working on the contract, which will complete in 2014.

Following the agreement in December 2011 for the sale of Offshore Patrol Vessels to the Brazilian Navy, the third and final vessel was delivered on schedule in June.

Progress continues on the Khareef Class corvettes for Oman, with the first two ships achieving interim acceptance in 2013 and the final ship scheduled for interim acceptance in 2014.

The Warship Support Modernisation Initiative contract, for delivery of services at Portsmouth Naval Base, was extended for one year in April, while discussions continue on the new Maritime Support Delivery Framework.

The Advanced Radar Target Indication Situational Awareness Navigation (ARTISAN) 3D radar programme continues towards full qualification, with the first of class now fitted to HMS Iron Duke, a Type 23 frigate, and further installations underway in line with the production plan.

The Maritime Composite Training System, a shore-based warfare operator training solution for the Royal Navy, has now achieved full operating capability. Training has been delivered to over 2,000 personnel and to warfare teams from every major warship.

HMS Astute and HMS Ambush, the first and second of class attack submarines for the Royal Navy, achieved operational handover in 2013. Artful, the third of class, is planned to launch in 2014, and a further £441m of orders have been secured for Boats 5, 6 and 7.

Progress continues on the design and development phase of the Successor submarine programme, the replacement to the Vanguard Class fleet. Over 1,300 people are now employed on this programme.

Combat Vehicles (UK)

The Terrier® combat engineer vehicle was declared 'in service' by the Ministry of Defence in April, with 43 of the 60 contracted vehicles delivered in 2013. Final vehicle deliveries are expected during the first half of 2014.

The Newcastle facility will close in the second half of 2014 following completion of final vehicle deliveries.

Munitions

The Munitions business will be reported in the financial results of the Platforms & Services (UK) reporting segment from 1 January 2014. The business is reported in Platforms & Services (US) in 2013.

Looking forward

Platforms & Services (UK) has a strong order backlog of long-term committed programmes and an enduring support business.

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

In Maritime, sales are underpinned by the Queen Elizabeth Class aircraft carrier and Astute Class submarine manufacturing programmes, the Warship Support Modernisation Initiative contract, and the design and future manufacture of the Successor submarine and Type 26 frigate. Support of these platforms and Type 45, together with their associated command and combat systems, is expected to provide sustainable business in technical services and mid-life upgrades.

In Combat Vehicles (UK), following completion of deliveries on the Terrier® programme, sales are expected to be derived from through-life support of legacy platforms.

The Munitions business is underpinned by the 15-year Munitions Acquisition Supply Solution partnering agreement with the UK Ministry of Defence, together with a number of international contracts and potential opportunities.

Reporting segments: Platforms & Services (International)

Platforms & Services (International), with 14,600 employees¹, comprises the Group's businesses in Saudi Arabia, Australia, India and Oman, together with its 37.5% interest in the pan-European MBDA joint venture.

	2013	2012	2011
Funded order intake ¹	£7,221m	£5,266m	£3,319m
Order backlog ¹	£12.3bn	£9.3bn	£8.3bn
Sales ¹	£4,063m	£4,071m	£3,794m
Underlying EBITA ²	£429m	£417m	£449m
Return on sales	10.6%	10.2%	11.8%
Cash (outflow)/inflow ³	£(189)m	£506m	£80m

Financial key points

- Order backlog¹ increased by 32% on multi-year support awards and weapons procurement in Saudi Arabia
- Operating cash outflow³ of £189m on utilisation of customer advances and pending receipt of Salam settlement proceeds

Operational key points

- Salam Typhoon price escalation negotiations concluded
- Resumption of Typhoon aircraft deliveries to Saudi Arabia under the Salam programme
- Five-year, £1.8bn output-based Salam Typhoon support contract received
- £1.5bn of orders received for Tornado aircraft upgrades and weapons procurement under the Saudi British Defence Co-operation Programme
- Integration and trials of the first Landing Helicopter Dock (LHD) in Australia ongoing
- Second LHD hull arrived in Australia for consolidation to commence in the first quarter of 2014
- Five-year, A\$342m (£185m) support contract for Royal Australian Air Force Hawk training aircraft received
- MBDA secured significant contracts with its UK and French government customers

Financial performance

Order backlog¹ has increased to £12.3bn (2012 £9.3bn) following awards in Saudi Arabia for five years of support on Typhoon and further weapons packages on Tornado, together with renewal of the Australian Hawk support programme.

Sales¹ of £4.1bn were almost unchanged from 2012. The deferred trading arising from the Salam price escalation and increased levels of support for Typhoon aircraft now in service were offset by reductions in the Australian business as the Landing Helicopter Dock build programme ramps down.

Underlying EBITA² of £429m (2012 £417m) generated a return on sales of 10.6% (2012 10.2%).

The operating cash outflow³ reflects the utilisation of advances received in 2012 on the Saudi Tornado upgrade programme.

Operational performance

Saudi Arabia

Through the entry into service of Typhoon and the continued development of the in-country industrial base, the Group remains committed to developing a greater indigenous capability in Saudi Arabia.

On the Salam Typhoon programme, UK final assembly of 72 Typhoon aircraft continues. Aircraft deliveries re-commenced in April. At 31 December 2013, 34 aircraft had been delivered to the customer. Work is progressing to schedule on the provision of a multi-role capability for the aircraft.

A five-year, £1.8bn output-based contract was received to support the Royal Saudi Air Force (RSAF) Typhoon aircraft as they progressively enter into service. In addition, a four-year contract to deliver scheduled maintenance and upgrade to 30 Typhoon aircraft by the end of 2017 was received.

Discussions on Typhoon price escalation reached agreement with the Saudi Arabian government.

Under the Saudi British Defence Co-operation Programme (SBDPCP), the business continues to support the operational capability of both the RSAF and Royal Saudi Naval Forces (RSNF). Under a £1.6bn contract awarded in 2012 to upgrade the RSAF's aircrew training aircraft, the production of Hawk and Pilatus PC-21 training aircraft continues to programme. Under contracts totalling £3.4bn awarded in 2012 for support to the RSAF to the end of 2016, the first graduation ceremony of cadets from the King Faisal Air Academy took place in May.

Weapon deliveries were completed and orders worth £1.5bn for the upgrade of Tornado aircraft and additional weapons procurement were received.

Work was completed on the first ship re-fit on the RSNF minehunter mid-life update programme. The ship was accepted back into the RSNF fleet during the second half of 2013 and the second ship has entered the update programme.

Australia

Consolidation of the first of two Landing Helicopter Docks (LHD) was completed at the Williamstown shipyard following the arrival of the hull from subcontractor Navantia in Spain. Integration and test of the ship's systems and the initial stages of ship acceptance trials are progressing. Consolidation of the second LHD hull will begin in Melbourne in the first quarter of 2014. In April, the business opened a new simulation and training facility in Sydney for training future LHD crew.

¹ Including share of equity accounted investments.

² Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 4).

³ Net cash (outflow)/inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

Under the Air Warfare Destroyer programme, all 11 hull blocks have been accepted by the customer and nine delivered. Seven additional blocks have now been contracted for A\$69m (£37m) and are under construction.

Under the initial ANZAC frigate anti-ship missile defence system contract awarded in 2004, the operational trials process was concluded on HMAS Perth. Under the follow-on contract awarded in 2012, the second frigate, HMAS Arunta, is continuing its refurbishment and construction to fit the new masts and systems, and the third frigate, HMAS ANZAC, is progressing through its own refurbishment and upgrade programme.

The business was awarded a five-year, A\$342m (£185m) contract, with options to extend through to 2026, to continue to support the Royal Australian Air Force Hawk Lead-In Fighter aircraft fleet.

The first upgraded AP-3C Orion maritime surveillance aircraft to be fitted with a new Electronic Support Measures system was delivered in November, marking a significant milestone in the delivery of the project to the Royal Australian Air Force.

Tigerair Australia awarded BAE Systems a five-year contract to provide base maintenance services for its fleet of Airbus A320 aircraft. The business continues to examine opportunities to expand further its commercial aviation maintenance footprint in Australia.

The business incurred operating losses on the JP 2008 Phase 3F programme which provides strategic and tactical satellite communications capabilities to support Australian Defence Force operations.

The business was not down-selected for the Defence Logistics Transformation Programme.

India

The business sold its 26% shareholding in Defence Land Systems India to Mahindra & Mahindra, the holder of the other 74% of the shares in the joint venture.

In March, the US government issued a Letter of Acceptance to the Indian government under the US Foreign Military Sales (FMS) process for the supply of 145 M777 howitzers to the Indian Army. The Indian government has yet to progress the M777 FMS case through all levels of its procurement process. As a result of this and with no other new orders for M777, in October, the business took the decision to suspend M777 manufacture in Barrow-in-Furness, UK.

A fixed-price proposal has been submitted to Hindustan Aeronautics Limited (HAL) for a third batch of Hawk trainer aircraft for the Indian Air Force and discussions with HAL continue.

Whilst the Indian government deemed Dassault to be the lowest priced compliant bidder in the Medium Multi-Role Combat Aircraft

competition, contract negotiations that began in early 2012 have not been concluded. The Group continues to monitor the competition and stands ready to support the Indian government's procurement process.

Oman

Following the signature of the contract to supply 12 Typhoon and eight Hawk aircraft in 2012, initial mobilisation has commenced. The business continues to focus on strengthening its close relationship with the Royal Oman Air Force, Navy and Army, and to address their future requirements.

MBDA

Following publication of the 2013 Livre Blanc in France, a €433m (£360m) contract was secured from the French customer for the development and production of the Missile Milieu de Trame system. In January 2014, the UK and French governments signed an agreement worth €500m (£416m) for the joint development and production of the MBDA Future Anti-Ship Guided Weapon – Anti-Navire Léger (FASGW-ANL) missile for their armed forces.

In export markets, significant orders have been awarded in the Middle East and Far East.

MBDA continues to support the various aircraft procurement campaigns around the world and is well placed to respond to any associated weapon requirements.

Looking forward

In the Kingdom of Saudi Arabia, the Group expects to sustain its long-term presence through delivering current programmes and industrialisation, and developing new business in support of the Saudi military and paramilitary forces.

In Australia, the change of government following a federal election in September is not anticipated to affect materially the future outlook for defence spending. The new administration has committed to the release of a revised white paper and to make, within 18 months of the election, the decisions necessary to ensure that Australia has no submarine capability gap. The Group is continuing to explore and secure opportunities in adjacent markets, particularly in the oil and gas industry in Western Australia.

In India, aircraft and artillery opportunities continue to be pursued.

In Oman, following signature of the Typhoon and Hawk contract in 2012, the Group will work with the customer to strengthen further its close ties and to address their future requirements.

MBDA continues to build on the effective partnerships it has established with its domestic customers and is actively pursuing a significant number of export opportunities.

Consolidated income statement

for the year ended 31 December

	Notes	2013		Restated ¹ 2012 ²	
		£m	Total £m	£m	Total £m
Continuing operations					
Combined sales of Group and share of equity accounted investments	2		18,180		17,905
Less: share of sales of equity accounted investments	2		(1,316)		(1,214)
Revenue	2		16,864		16,691
Operating costs			(16,297)		(15,459)
Other income			128		282
Group operating profit			695		1,514
Share of results of equity accounted investments			111		91
<i>Underlying EBITA</i> ³			1,925		1,862
<i>Non-recurring items</i> ⁴			6		103
<i>EBITA</i>			1,931		1,965
<i>Amortisation</i>			(189)		(226)
<i>Impairment</i>			(887)		(86)
<i>Financial expense of equity accounted investments</i>			(8)		(7)
<i>Taxation expense of equity accounted investments</i>			(41)		(41)
Operating profit	2		806		1,605
<i>Financial income</i>			216		452
<i>Financial expense</i>			(600)		(855)
Finance costs	3		(384)		(403)
Profit before taxation			422		1,202
Taxation expense			(246)		(243)
Profit for the year			176		959
Attributable to:					
Equity shareholders			168		948
Non-controlling interests			8		11
			176		959
Earnings per share					
Basic earnings per share	4		5.2p		29.3p
Diluted earnings per share			5.2p		29.1p

1 On adoption of the revised IAS 19, Employee Benefits.

2 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.

3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

4 Comprises profit on disposal of businesses of £6m (2012 £103m).

Consolidated statement of comprehensive income

for the year ended 31 December

	2013			Restated ¹ 2012		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings £m	Total £m
Profit for the year	–	176	176	–	959	959
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Remeasurements on defined benefit pension schemes:						
Subsidiaries	–	918	918	–	(625)	(625)
Equity accounted investments	–	8	8	–	(81)	(81)
Tax on items that will not be reclassified to the income statement	–	(421)	(421)	–	119	119
Items that may be reclassified to the income statement:						
Currency translation on foreign currency net investments:						
Subsidiaries	(246)	–	(246)	(164)	–	(164)
Equity accounted investments	(3)	–	(3)	(25)	–	(25)
Reclassification of cumulative currency translation reserve on disposal	(8)	–	(8)	(97)	–	(97)
Amounts credited/(charged) to hedging reserve	53	–	53	(21)	–	(21)
Tax on items that may be reclassified to the income statement	(14)	–	(14)	5	–	5
Total other comprehensive income for the year (net of tax)	(218)	505	287	(302)	(587)	(889)
Total comprehensive income for the year	(218)	681	463	(302)	372	70
Attributable to:						
Equity shareholders	(212)	673	461	(302)	361	59
Non-controlling interests	(6)	8	2	–	11	11
	(218)	681	463	(302)	372	70

1 On adoption of the revised IAS 19, Employee Benefits.

Notes to the accounts

1. Preparation

The consolidated financial statements of BAE Systems plc have been prepared 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).

Changes in accounting policies

With effect from 1 January 2013, the Group has adopted the following amendment to an existing standard and new standard:

- **International Accounting Standard (IAS) 19 (revised 2011), Employee Benefits**, replaces interest cost on gross pension liabilities and expected return on gross pension assets with a finance cost on the net pension deficit calculated using the rate currently used to discount defined benefit pension liabilities. The discount rate is lower than the expected return on plan assets, increasing finance costs recognised in the income statement and correspondingly reducing remeasurements recognised in other comprehensive income. In addition, certain costs associated with the administration of the Group's pension schemes are now reported within operating costs rather than finance costs. The net pension deficit is not affected by these changes.

These changes have been applied retrospectively to the comparative financial information for 2012 and have had the following impact on the financial statements compared with the previous version of IAS 19:

	2013 £m	2012 £m
Operating costs	(34)	(39)
Share of results of equity accounted investments	(2)	(2)
Operating profit	(36)	(41)
Finance costs	(166)	(132)
Profit before taxation	(202)	(173)
Taxation expense	61	53
Net decrease in profit for the year	(141)	(120)
Remeasurements on defined benefit pension schemes	203	174
Tax on items that will not be reclassified to the income statement	(62)	(54)
Total comprehensive income for the year	–	–

Earnings per share

Basic earnings per share	(4.4)p	(3.7)p
Diluted earnings per share	(4.3)p	(3.7)p
Underlying earnings¹ per share		
Underlying earnings ¹ per share	(0.2)p	(0.4)p

The reduction in underlying earnings¹ per share mainly reflects the reclassification of certain costs associated with the administration of the Group's pension schemes from finance movements on pensions, which are excluded from underlying earnings¹, to underlying EBITA². In addition, during 2013, longevity swap arrangements were entered into by the trustees of certain UK schemes. Under the revised IAS 19, these swaps are required to be valued in accordance with IFRS 13, Fair Value Measurement. The valuation under the previous version of IAS 19 would have reduced total comprehensive income for the year by £177m.

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

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 4).

- **IFRS 13** aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement disclosure requirements for use across other standards within IFRSs. IFRS 13 does not extend the use of fair value accounting and has not impacted the fair value measurements carried out by the Group other than in relation to longevity swaps as above. IFRS 13 requires specific disclosures on fair values, which are provided in the relevant notes to the Group accounts.

A number of new EU-endorsed standards and amendments to existing standards, which are listed below, are effective for periods beginning on or after 1 January 2014 and have not been applied in preparing these consolidated financial statements. With the exception of new disclosure requirements, none of these are expected to have an impact on the consolidated financial statements of the Group and as such they have not been early adopted.

New standards and amendments to existing standards	Effective for periods beginning on or after
IFRS 10, Consolidated Financial Statements	1 January 2014
IFRS 11, Joint Arrangements	1 January 2014
IFRS 12, Disclosure of Interests in Other Entities	1 January 2014
IAS 27, Separate Financial Statements (revised 2011)	1 January 2014
IAS 28, Investments in Associates and Joint Ventures (revised 2011)	1 January 2014

There are no other IFRSs or IFRIC interpretations that are not yet effective that are expected to have a material impact on the Group.

Notes to the accounts – income statement

2. Segmental analysis

Sales and revenue by reporting segment

	Combined sales of Group and share of equity accounted investments		Less: sales by equity accounted investments		Add: sales to equity accounted investments		Revenue	
	2013 £m	2012 ² £m	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 ² £m
Electronic Systems	2,466	2,507	(61)	(52)	61	52	2,466	2,507
Cyber & Intelligence	1,243	1,402	–	–	–	–	1,243	1,402
Platforms & Services (US)	4,196	4,539	(75)	(70)	1	1	4,122	4,470
Platforms & Services (UK)	6,890	5,717	(1,169)	(1,430)	1,077	1,346	6,798	5,633
Platforms & Services (International)	4,063	4,071	(873)	(830)	–	–	3,190	3,241
HQ	306	267	(306)	(267)	–	–	–	–
	19,164	18,503	(2,484)	(2,649)	1,139	1,399	17,819	17,253
Intra-group sales/revenue	(984)	(598)	–	2	29	34	(955)	(562)
	18,180	17,905	(2,484)	(2,647)	1,168	1,433	16,864	16,691

Reporting segment result

	Underlying EBITA ³		Non-recurring items ⁴		Amortisation of intangible assets		Impairment of intangible assets		Reporting segment result	
	2013 £m	Restated ¹ 2012 ² £m	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	Restated ¹ 2012 ² £m
Electronic Systems	346	356	–	–	(15)	(22)	(4)	(2)	327	332
Cyber & Intelligence	115	124	–	–	(63)	(76)	(425)	–	(373)	48
Platforms & Services (US)	265	394	7	103	(21)	(92)	(458)	(84)	(207)	321
Platforms & Services (UK)	879	695	–	–	(84)	(28)	–	–	795	667
Platforms & Services (International)	429	417	(1)	–	(6)	(8)	–	–	422	409
HQ	(109)	(124)	–	–	–	–	–	–	(109)	(124)
	1,925	1,862	6	103	(189)	(226)	(887)	(86)	855	1,653
Financial expense of equity accounted investments									(8)	(7)
Taxation expense of equity accounted investments									(41)	(41)
Operating profit									806	1,605
Finance costs									(384)	(403)
Profit before taxation									422	1,202
Taxation expense									(246)	(243)
Profit for the year									176	959

1 On adoption of the revised IAS 19, Employee Benefits.

2 Re-presented on classification of the Regional Aircraft line of business as a continuing operation within Platforms & Services (UK).

3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

4 Comprises profit on disposal of businesses of £6m (2012 £103m).

Notes to the accounts – income statement *continued*

3. Finance costs

	2013 £m	Restated ¹ 2012 £m
Interest income	48	39
Gain on remeasurement of financial instruments at fair value through profit or loss	51	280
Foreign exchange gains	117	133
Financial income	216	452
Interest expense on bonds and other financial instruments	(197)	(187)
Facility fees	(11)	(7)
Net present value adjustments	(20)	(56)
Net interest expense on retirement benefit obligations	(186)	(187)
Loss on remeasurement of financial instruments at fair value through profit or loss	(146)	(250)
Foreign exchange losses	(40)	(168)
Financial expense	(600)	(855)
Finance costs	(384)	(403)

Additional analysis

	2013 £m	Restated ¹ 2012 £m
Finance costs:		
Group	(384)	(403)
Share of equity accounted investments	(8)	(7)
	(392)	(410)
Analysed as:		
Underlying interest (expense)/income:		
Group	(180)	(211)
Share of equity accounted investments	1	7
	(179)	(204)
Other:		
Group:		
Net interest expense on retirement benefit obligations	(186)	(187)
Fair value and foreign exchange adjustments on financial instruments and investments	(18)	(5)
Share of equity accounted investments	(9)	(14)
	(392)	(410)

1 On adoption of the revised IAS 19, Employee Benefits.

4. Earnings per share

	2013			Restated ¹ 2012		
	£m	Basic pence per share	Diluted pence per share	£m	Basic pence per share	Diluted pence per share
Profit for the year attributable to equity shareholders	168	5.2	5.2	948	29.3	29.1
(Deduct)/add back:						
Profit on disposal of businesses	(6)			(103)		
Net interest expense on retirement benefit obligations, post tax	153			153		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	14			4		
Amortisation and impairment of intangible assets, post tax	165			194		
Impairment of goodwill	865			57		
Underlying earnings, post tax	1,359	42.0	41.8	1,253	38.7	38.5
		Millions	Millions		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		3,234	3,234		3,244	3,244
Incremental shares in respect of employee share schemes			14			14
Weighted average number of shares used in calculating diluted earnings per share			3,248			3,258

1 On adoption of the revised IAS 19, Employee Benefits.

Consolidated cash flow statement

for the year ended 31 December

	Notes	2013 £m	Restated ¹ 2012 £m
Profit for the year		176	959
Taxation expense		246	243
Share of results of equity accounted investments		(111)	(91)
Finance costs		384	403
Depreciation, amortisation and impairment		1,397	669
Profit on disposal of property, plant and equipment		(6)	(7)
Profit on disposal of investment property		(13)	(12)
Profit on disposal of businesses		(6)	(103)
Cost of equity-settled employee share schemes		49	57
Movements in provisions		63	(224)
Decrease in liabilities for retirement benefit obligations		(337)	(820)
(Increase)/decrease in working capital:			
Inventories		(35)	6
Trade and other receivables		(275)	447
Trade and other payables		(1,327)	931
Cash inflow from operating activities		205	2,458
Interest paid		(177)	(170)
Taxation paid		(138)	(115)
Net cash (outflow)/inflow from operating activities		(110)	2,173
Dividends received from equity accounted investments		95	94
Interest received		11	23
Purchase of property, plant and equipment, and investment property		(236)	(359)
Purchase of intangible assets		(33)	(43)
Proceeds from sale of property, plant and equipment, and investment property		93	115
Proceeds from sale of intangible assets		28	–
Purchase of subsidiary undertakings (net of cash acquired)		(1)	(5)
Equity accounted investment funding		(5)	(6)
Proceeds from sale of subsidiary undertakings (net of cash disposed)		5	101
Net cash outflow from investing activities		(43)	(80)
Net purchase of own shares		(212)	(16)
Equity dividends paid	6	(638)	(620)
Dividends paid to non-controlling interests		(11)	(11)
Cash outflow from matured derivative financial instruments		(47)	(119)
Cash outflow from movement in cash collateral		(10)	(2)
Cash inflow from loans		–	1,863
Cash outflow from repayment of loans		–	(1,975)
Net cash outflow from financing activities		(918)	(880)
Net (decrease)/increase in cash and cash equivalents		(1,071)	1,213
Cash and cash equivalents at 1 January		3,334	2,136
Effect of foreign exchange rate changes on cash and cash equivalents		(41)	(15)
Cash and cash equivalents at 31 December		2,222	3,334
Comprising:			
Cash and cash equivalents		2,222	3,355
Overdrafts		–	(21)
Cash and cash equivalents at 31 December		2,222	3,334

1 On adoption of the revised IAS 19, Employee Benefits.

Consolidated balance sheet

as at 31 December

	Notes	2013 £m	2012 £m
Non-current assets			
Intangible assets		9,735	10,928
Property, plant and equipment		1,936	2,285
Investment property		135	122
Equity accounted investments		283	265
Other investments		3	5
Other receivables		477	254
Other financial assets		42	62
Deferred tax assets		901	1,375
		13,512	15,296
Current assets			
Inventories		680	655
Trade and other receivables including amounts due from customers for contract work		3,038	2,873
Current tax		8	11
Other financial assets		81	64
Cash and cash equivalents		2,222	3,355
Assets held for sale		140	20
		6,169	6,978
Total assets		19,681	22,274
Non-current liabilities			
Loans		(2,524)	(2,967)
Trade and other payables		(1,160)	(1,481)
Retirement benefit obligations	5	(3,665)	(4,607)
Other financial liabilities		(59)	(66)
Deferred tax liabilities		(7)	(13)
Provisions		(403)	(449)
		(7,818)	(9,583)
Current liabilities			
Loans and overdrafts		(402)	(21)
Trade and other payables		(7,074)	(8,067)
Other financial liabilities		(81)	(88)
Current tax		(497)	(422)
Provisions		(391)	(297)
Liabilities held for sale		-	(22)
		(8,445)	(8,917)
Total liabilities		(16,263)	(18,500)
Net assets		3,418	3,774
Capital and reserves			
Issued share capital		89	90
Share premium		1,249	1,249
Other reserves		4,868	5,079
Retained earnings – deficit		(2,825)	(2,698)
Total equity attributable to equity holders of the parent		3,381	3,720
Non-controlling interests		37	54
Total equity		3,418	3,774

Approved by the Board on 19 February 2014 and signed on its behalf by:

I G King
Chief Executive

P J Lynas
Group Finance Director

Consolidated statement of changes in equity

for the year ended 31 December

	Attributable to equity holders of the parent					Non-controlling interests £m	Total equity £m
	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m		
At 1 January 2013	90	1,249	5,079	(2,698)	3,720	54	3,774
Profit for the year	–	–	–	168	168	8	176
Total other comprehensive income for the year	–	–	(212)	505	293	(6)	287
Share-based payments	–	–	–	49	49	–	49
Net purchase of own shares	(1)	–	1	(212)	(212)	–	(212)
Ordinary share dividends	–	–	–	(638)	(638)	(11)	(649)
Disposal of non-controlling interest	–	–	–	1	1	(8)	(7)
At 31 December 2013	89	1,249	4,868	(2,825)	3,381	37	3,418
At 1 January 2012	90	1,249	5,381	(2,480)	4,240	59	4,299
Profit for the year ¹	–	–	–	948	948	11	959
Total other comprehensive income for the year ¹	–	–	(302)	(587)	(889)	–	(889)
Share-based payments	–	–	–	57	57	–	57
Net purchase of own shares	–	–	–	(16)	(16)	–	(16)
Ordinary share dividends	–	–	–	(620)	(620)	(11)	(631)
Other	–	–	–	–	–	(5)	(5)
At 31 December 2012	90	1,249	5,079	(2,698)	3,720	54	3,774

1 Restated on adoption of the revised IAS 19, Employee Benefits.

Notes to the accounts – balance sheet

5. Retirement benefit obligations

	UK £m	US and other £m	Total £m
Total IAS 19 deficit at 1 January 2013	(4,795)	(913)	(5,708)
Actual return on assets excluding amounts included in interest expense	1,190	214	1,404
(Increase)/decrease in liabilities due to changes in assumptions and experience	(750)	351	(399)
Additional contributions in excess of service cost	232	–	232
Recurring contributions in excess of service cost	62	95	157
Past service cost – plan amendments	(11)	–	(11)
Net interest expense	(200)	(29)	(229)
Foreign exchange adjustments	–	(20)	(20)
Movement in US healthcare schemes	–	36	36
Total IAS 19 deficit at 31 December 2013	(4,272)	(266)	(4,538)
Allocated to equity accounted investments and other participating employers	1,029	–	1,029
Group's share of IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments and other participating employers at 31 December 2013	(3,243)	(266)	(3,509)
Represented by:			
Pension prepayments (within other receivables)	79	77	156
Retirement benefit obligations	(3,322)	(343)	(3,665)
	(3,243)	(266)	(3,509)

The net increase in UK liabilities due to changes in assumptions and experience reflects a 0.5 percentage point reduction in the real discount rate to 1.1%, partially offset by the rate of increase in salaries being held at RPI inflation of 3.4% (2012 0.5% above RPI inflation of 2.9%).

Certain of the Group's equity accounted investments participate in the Group's defined benefit schemes as well as Airbus SAS, the Group's share of which was disposed of in 2006. As these schemes are multi-employer schemes, the Group has allocated a share of the IAS 19 pension deficit to its equity accounted investments and other participating employers using a consistent allocation method intended to reflect a reasonable approximation of their share of the deficit. The allocation method for all schemes is based on the Main Scheme's schedule of contributions agreed with the sponsoring employers and trustees as part of the triennial funding valuations performed in 2011. The next funding valuations will be performed in 2014 and, accordingly, the schedule of contributions and resultant allocation method will be agreed at that time. The Group's share of the IAS 19 pension deficit allocated to the equity accounted investments is included in the balance sheet within equity accounted investments. In the event that an employer who participates in the Group's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Group considers the likelihood of this event arising as remote.

The Group's share of the IAS 19 deficit excluding the Group's share of amounts allocated to equity accounted investments and other participating employers is £2.8bn (31 December 2012 £3.4bn) after tax.

Life expectancy

In February 2013, with the agreement of the Company, the trustees of the BAE Systems 2000 Pension Plan entered into an arrangement with Legal & General to insure against longevity risk for the current pensioner population, covering £2.7bn of pension scheme liabilities. In December 2013, similar arrangements were entered into, with Legal & General, by the trustees of the Royal Ordnance Pension Scheme and Shipbuilding Industries Pension Scheme, covering £0.9bn and £0.8bn of pension scheme liabilities, respectively. These arrangements will reduce the funding volatility relating to increasing life expectancy.

Contributions

The total Group contributions made to the defined benefit schemes in the year ended 31 December 2013 were £560m (2012 £1,029m) excluding those amounts allocated to equity accounted investments and participating employers of £86m (2012 £128m). This includes additional contributions of £44m into the UK schemes relating to the share buyback programme (2012 £nil).

In 2014, the Group expects to make regular contributions at a similar level to the recurring contributions made in 2013 and additional contributions, such that total deficit funding, in excess of service cost, is expected to be approximately £0.4bn.

The Group incurred a charge in respect of cash contributions of £130m (2012 £129m) paid to defined contribution schemes for employees.

Notes to the accounts – other information

6. Equity dividends

	2013 £m	2012 £m
Prior year final 11.7p dividend per ordinary share paid in the year (2012 11.3p)	380	367
Interim 8.0p dividend per ordinary share paid in the year (2012 7.8p)	258	253
	638	620

After the balance sheet date, the directors proposed a final dividend of 12.1p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 2 June 2014 to shareholders registered on 22 April 2014. The ex-dividend date is 16 April 2014.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 9 May 2014.

7. 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 2013 £m	Year ended 31 December 2012 £m
Sales to related parties	1,168	1,433
Purchases from related parties	263	250

	31 December 2013 £m	31 December 2012 £m
Amounts owed by related parties	56	163
Amounts owed to related parties	563	708

8. Contingent liability

Since 2009, BAE Systems, Inc. has been in dispute with a customer, AM General LLC. On 2 April 2013, the Superior Court in Gary, Indiana, USA, issued a ruling in favour of AM General's claim, denying a counterclaim from BAE Systems, Inc. and entering judgement against BAE Systems, Inc. which, including pre-judgement and estimated post-judgement interest amounts to \$290m (£175m). BAE Systems disagrees with the trial court's ruling and is currently appealing that decision. The process is expected to run into 2015 or later.

9. Events after the balance sheet date

In February 2014, the governments of the UK and Kingdom of Saudi Arabia agreed price escalation terms relating to the Typhoon aircraft under the Salam programme and these have been reflected in contractual arrangements between the UK government and BAE Systems. Accordingly, an adjustment has been made to sales and profit in 2013, reflecting the goods and services provided to the customer in both the current and prior years.

10. Annual General Meeting

This year's Annual General Meeting will be held on 7 May 2014. 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 2014.

11. Other information

The financial information for the year ended 31 December 2013 contained in this preliminary announcement was approved by the Board on 19 February 2014. 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 2012 have been delivered to the Registrar of Companies. Statutory accounts for the year ended 31 December 2013 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.



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