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BAE Systems Update
Pensions, Sectors & IFRS 15

30 November 2017

Agenda

- Introduction – Martin Cooper
- Pension Update – Peter Lynas
- Reporting Sectors Update – Peter Lynas
- IFRS 15 Revenue from Contracts with Customers – Peter Earl
- Q&A
- Closing remarks

Pension Funding Update – Agreement Reached

- Agreement reached with the Trustees and UK Pensions Regulator on the UK defined benefit schemes
- Funding increased by £15m pa from c£205m to c£220m from 2018
- Deficit broadly similar – asset led discount approach, prudent return assumptions
- Contingency plans in place
- Cash profile of Main Scheme remains positive until 2028
- Repayment plans
  - Main Scheme - remains 9 years
  - 2000 Plan (second largest) – 4 years
  - 7 others have accelerated funding profiles / fully funded
- Next triennial funding valuation 2020
- US schemes not part of this review but expect funding to remain at c$80m pa to 2022
- Accounting methodology unchanged

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Reporting Sectors Update

- 3 operational reporting sectors remain unchanged
  - Electronic Systems
  - Platforms & Services (US)
  - Cyber & Intelligence
- UK and International P&S sectors replaced by:
  - Maritime – UK maritime programmes. Reporting directly to CEO and focusing on operational excellence
    - Submarine build – Astute /Dreadnought
    - Shipbuild – Carrier, OPVs, Type 26
    - Support and combat systems
    - For external reporting Land (UK) will be in this sector - c£300m revenues – operationally separate
  - Air – strengthened and streamlined sector to focus on delivery and international opportunities
    - UK Air business – build and support – F-35 (fuselage), Typhoon, Hawk, Tornado
    - KSA operations
    - International collaborations and programmes
    - Australian business
    - MBDA
- 2017 reporting in old structure and restated for new sectors - 2018 guidance in new structure

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External Sectors

Current Structure		New Structure
• **Electronic Systems**	No change	• **Electronic Systems**
• **Cyber & Intelligence** - Intelligence & Security - Applied Intelligence	No change	• **Cyber & Intelligence** - Intelligence & Security - Applied Intelligence
• **P&S (US)**	No change	• **P&S (US)**
• **P&S (International)** - KSA - Australia - MBDA	To Air	• **Air** - European and International Programmes - UK-based US programmes - KSA - Australia - MBDA
• **P&S (UK)** - MA&I	To Air	
- Submarines - Naval Ships - Maritime Services - Land (UK)	To Maritime	• **Maritime** - Submarines - Naval Ships - Maritime Services - Land (UK)
- UK Shared Services	To HQ	
• **HQ** - HQ - Air Astana		• **HQ** - HQ incl CTO - Air Astana - UK Shared Services

IFRS 15

Key points

- IFRS 15 effective from 1 January 2018
    - No impact on lifetime revenue and profitability of contracts
    - No impact on the Group's cash flow
    - No impact on approach to managing contracts
    - Impact of restating 2017 full year results expected to be a reduction of approximately 1p on Earnings per Share
    - Earnings impact on 2018 and beyond not expected to be material

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IFRS 15 Revenue From Contracts With Customers

- IFRS 15 replaces IAS 11 *Construction Contracts* and IAS 18 *Revenue*
    - ➢ Impacts contract accounting and accounting for certain software licences
    - ➢ Full retrospective application

- 2017 Full Year will report under existing accounting standards
    - ➢ Preliminary results announcement on 22 February 2018 will include a re-presentation of the 2017 income statement under IFRS 15
    - ➢ 2018 earnings guidance will be under IFRS 15

IFRS 15 impacts

- Accounting implications for the Group
- On long-term contracts:
  - sales recognised earlier based on cumulative costs incurred plus attributable margin
  - margin will continue to be recognised progressively as risks have been mitigated or retired
  - margin recognised earlier on shorter-term contracts in the Group's US businesses
  - margin recognition deferred on a few development & production contracts within the MBDA joint venture
  - Work-in-Progress to be replaced with Contract Receivables
- Some licence sales in Applied Intelligence will be deferred over the licence term

“Over Time” sales recognition

- IFRS 15 requires sales recognition either “Over Time” or “Point in Time”
- Sales recognition on a contract is “Over Time” if:
  - the customer simultaneously receives & consumes the benefits provided the Group; or
  - the Group creates or enhances an asset controlled by the customer; or
  - the goods being manufactured have no alternative use by the Group without significant modification;
- Majority of the Group’s long-term contracts are “Over Time”:
  - products are bespoke to customer requirements
  - limited ability to re-direct to other customers
- Sales recognised “Over Time” means:
  - sales depends on costs incurred
  - no Work-in-Progress in the balance sheet; replaced by unbilled receivables

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Cumulative impact of "Over Time" sales recognition

- **Cumulative** impact to 31 December 2016

£m	**Sales**	**EBITA**
Electronic Systems	729	118
Cyber & Intelligence	19	2
Platforms & Services (US)	435	62
Platforms & Services (UK)	2,361	69
Platforms & Services (Int'l)	662	15
HQ	-	-
Eliminations	(427)	-
	3,779	266

- Electronic Systems, Platforms & Services (US)
  - contracts typically shorter-term
  - margin traded on WIP at close to outturn margin
- Platforms & Services (UK), Platforms & Services (Int'l)
  - contracts higher risk & long-term in nature
  - sales traded reflects cost incurred to date
  - margin traded is lower relative to sales traded as risk mitigation/retirement points are not affected

* Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense excluding non-recurring items

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Development & Production Contracts - MBDA

- A few contracts in MBDA joint venture are combined development & production contracts
  - under existing accounting:
    - sales recognised in line with milestones achieved; and
    - margin is recognised as risks are mitigated or retired on the overall contract
  - IFRS 15 requires the transaction price to be allocated to the separate design & production elements
    - recognises lower margin in the development phase and higher margin in the production phase
- Cumulative impact to 31 December 2016:
  - no sales impact on transition
  - profits of £79m (our share) previously traded on combined development & production contracts are de-traded and will be traded over the production phases of the contracts

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Licence Revenue – Applied Intelligence

- Existing standard (IAS 18) requires software licence sales to be recognised either:
  - upfront on delivery (perpetual licence), or
  - spread over the licence term or related customer relationship (term licence)
- Recognition of software licence sales under IFRS 15 is determined by either:
  - a right to use the Intellectual Property (IP) as it exists when the licence is granted, or
  - a right to access the IP as it exists throughout the licence period, and expectation that the Group will provide significant updates to the IP over the contract term
- Cumulative impact at 31 December 2016;
  - £39m of licence sales previously traded to be deferred over the licence term

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Transition adjustment – cumulative to 31 December 2016

£m	"Over Time" Sales	"Over Time" EBITA	Development & Production Progs – MBDA Sales	Development & Production Progs – MBDA EBITA	Licence Sales – Applied Intelligence Sales	Licence Sales – Applied Intelligence EBITA	Cumulative Transition Adjustment Sales	Cumulative Transition Adjustment Profit
Electronic Systems	729	118	-	-	-	-	729	118
Cyber & Intelligence	19	2	-	-	(39)	(39)	(20)	(37)
Platforms & Services (US)	435	62	-	-	-	-	435	62
Platforms & Services (UK)	2,361	69	-	-	-	-	2,361	69
Platforms & Services (Int'l)	662	15	-	(79)	-	-	662	(64)
HQ	-	-	-	-	-	-	-	-
Eliminations	(427)	-	-		-		(427)	-
	3,779	266	-	(79)	(39)	(39)	**3,740**	**148**
Taxation expense								(56)
Profit after tax								**92**
31/12/16 Net Assets – reported								3,564
31/12/16 Net Assets – IFRS 15								**3,656**

Impact of IFRS 15 on earnings in 2017 (in-year) expected to be a reduction of approximately 1p on EPS
Impact of IFRS 15 on earnings in 2018 (in year) and beyond not expected to be material

Summary

- No impact on lifetime revenue and profitability of contracts
- No impact on the Group's cash flow
- No impact on approach to managing contracts
- Impact of restating 2017 full year results expected to be a reduction of less than 1p on Earnings per Share
- Earnings impact on 2018 and beyond not expected to be material
- Restated 2017 results will be baseline for 2018 guidance

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Q&A

Appendix

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External Sectors – 2016 Restatement

£m	2016 Reported			Transfers *		2016 Restated			
	Sales	EBITA	RoS	Sales	EBITA	Sales	EBITA	RoS	
ES	3,282	494	15.1%			3,282	494	15.1%	ES
C&I	1,778	90	5.1%			1,778	90	5.1%	C&I
P&S (US)	2,874	211	7.3%			2,874	211	7.3%	P&S (US)
P&S (Int'l)	3,943	400	10.1%	4,152	557	8,095	957	11.8%	Air
P&S (UK)	7,806	810	10.4%	(4,753)	(559)	3,053	251	8.2%	Maritime
HQ	233	(100)		48	2	281	(98)		HQ
Elims	(896)			553		(343)			
TOTAL	**19,020**	**1,905**	**10.0%**			**19,020**	**1,905**	**10.0%**	**TOTAL**

* Military Air & Information to Air; Maritime includes Land (UK); UK Shared Services to HQ

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External Sectors – HY17 Restatement

£m	HY17 Reported			Transfers *		HY17 Restated			
	Sales	EBITA	RoS	Sales	EBITA	Sales	EBITA	RoS	
ES	1,726	257	14.9%			1,726	257	14.9%	ES
C&I	923	35	3.8%			923	35	3.8%	C&I
P&S (US)	1,433	109	7.6%			1,433	109	7.6%	P&S (US)
P&S (Int'l)	1,771	176	9.9%	1,996	290	3,767	466	12.4%	Air
P&S (UK)	3,913	416	10.6%	(2,214)	(293)	1,699	123	7.2%	Maritime
HQ	128	(48)		24	3	152	(45)		HQ
Elims	(329)			194		(135)			
TOTAL	**9,565**	**945**	**9.9%**			**9,565**	**945**	**9.9%**	**TOTAL**

* Military Air & Information to Air; Maritime includes Land (UK); UK Shared Services to HQ