1.1 Management report

1.1.1 REPORT ON OPERATIONS AND RESULTS

1.1.1.1 KEY FIGURES (ADJUSTED)

(in millions of euros except income and dividends per share)	2015	2014	Total change	Organic change
Order intake	18,880	14,363	+31%	+28%
Order book at end of period	32,292	27,285	+18%	+17%
Sales	14,063	12,974	+8.4%	+4.5%
EBIT[a]	1,216	985	+23%	+18%
in % of sales	*8.6%*	*7.6%*	*+1pt*	*+1pt*
Adjusted net income, Group share[a]	809	562	+44%	
Adjusted net income, Group share, per share[a]	3.89	2.75	+42%	
Consolidated net income, Group share	765	714	+7%	
Dividend per share[b]	1.36	1.12	+21%	
Free operating cash flow[a]	1,110	501	+122%	
Net cash at year-end	1,978	1,006	+97%	

(a) Non-GAAP measures, see definitions in section 1.1.1.2, and computations page 9.
(b) Proposed to the Shareholders' Meeting on 18 May 2016.

In 2015, Thales achieved a record level of orders. Sales experienced solid growth after remaining virtually stable for several years. Profitability grew in line with medium-term targets.

The Group exceeded all financial targets set for 2015, which were to achieve a low-single digit sales growth and an EBIT of between €1,130 million and €1,150 million.

1.1.1.2 PRESENTATION OF FINANCIAL INFORMATION

Accounting policies

The consolidated financial statements of the Thales group are prepared in accordance with IFRS (International Financial Reporting Standards) as approved by the European Union at 31 December 2015.

These principles, described in note 14 of the consolidated financial statements (pages 73 to 77), are consistent with those applied for the year ended 31 December 2014, with the exception of the first time adoption of the new IFRIC 21 interpretation on public levies, and the amendment to IAS1 (presentation of financial statements).

Definitions of non-GAAP financial indicators

In order to facilitate better monitoring and benchmarking of its financial and operating performance, the Group presents three key non-GAAP indicators, which allow it to exclude non-operating and non-recurring items. They are determined as follows:

- **EBIT,** an adjusted operating metric, corresponds to income from operations plus the share of the net income (loss) of equity-accounted companies, before the impact of entries relating to the amortisation of intangible assets acquired (purchase price allocation, "PPA") recorded as part of significant business combinations;
- **adjusted net income** corresponds to the net income, excluding the following items, net of the corresponding tax effects:
  - amortisation of acquired intangible assets,
  - results of disposals of assets, change in scope of consolidation and others,
  - change in fair value of derivative foreign exchange instruments (recorded in "other financial results" in the consolidated accounts),
  - actuarial gains (losses) on long-term benefits (accounted within the "finance cost on pensions and other long-term benefits" in the consolidated accounts);
- **free operating cash-flow** corresponds to the net cash flow from operating activities before contributions to reduce the pension deficit in the United Kingdom, and after deducting net operating investments.

It is reminded that only the consolidated financial statements at 31 December were audited by the statutory auditors. The consolidated financial statements include the EBIT, the calculation of which is outlined in note 2 "segment information" to the consolidated financial statements, page 40. Adjusted financial information other than that provided in note 2 "segment information" is subject to the verification procedures applicable to all information included in this report.

The impact of these adjustment entries on the income statements for 2014 and 2015 is reflected in the tables on pages 9 and 10. Calculation of free operating cash-flow is outlined on page 11.

In this management report, the amounts expressed in millions of euros are rounded to the nearest million. As a result, the sums of the rounded amounts may differ very slightly from the reported totals. All ratios and variances are calculated based on underlying amounts, which feature in the consolidated financial statements.

IMPACT OF ADJUSTMENT ENTRIES IN THE INCOME STATEMENT – 2015

		Adjustments				
(€ million)	2015 consolidated P&L	Amort. of intangible assets (PPA)	Income (loss) from disposals and others	Change in fair value of FX derivatives	Actuarial differences long-term benefits	2015 adjusted P&L
Sales	**14,063**					**14,063**
Cost of sales	(10,688)					(10,688)
R&D expenses	(692)					(692)
Marketing and selling expenses	(981)					(981)
General and administrative expenses	(532)					(532)
Restructuring costs	(94)					(94)
Amortisation of acquired intangible assets (PPA)	(112)	112				0
Income from operations	**965**					**N/A**
Impairment of non-current operating assets[(a)]	0					–
Disposal of assets, changes in scope and others	53		(53)			0
Share of net income (loss) in equity affiliates	113	27				140
Income from operations after income from equity affiliates	**1,131**					**–**
EBIT	**N/A**					**1,216**
Impairment of non-current operating assets[(a)]	–					0
Cost of net financial debt	4					4
Other financial income (expenses)	(42)			32		(10)
Financial cost on pensions and other long-term benefits	(60)				(12)	(73)
Income tax	(220)	(38)	(1)	(11)	4	(266)
Net income (loss)	**813**	**100**	**(55)**	**21**	**(8)**	**871**
Non-controlling interests	(48)	(13)		(2)		(62)
NET INCOME, GROUP SHARE	**765**	**88**	**(55)**	**19**	**(8)**	**809**
Average number of shares (thousands)	*208,112*					*208,112*
NET INCOME, GROUP SHARE, PER SHARE *(in euros)*	**3.68**					**3.89**

(a) Included in "Income from operations after income from equity-accounted companies" in the consolidated income statement and in "Net income (loss)" in the adjusted income statement.

IMPACT OF ADJUSTMENT ENTRIES IN THE INCOME STATEMENT – 2014

		Adjustments				
(€ million)	**2014 consolidated P&L**	**Amort. of intangible assets (PPA)**	**Income (loss) from disposals and others**	**Change in fair value of FX derivatives**	**Actuarial differences long-term benefits**	**2014 adjusted P&L**
Sales	**12,974**					**12,974**
Cost of sales	(9,792)					(9,792)
R&D expenses	(641)					(641)
Marketing and selling expenses	(914)					(914)
General and administrative expenses	(519)					(519)
Restructuring costs	(114)					(114)
Amortisation of acquired intangible assets (PPA)	(104)	104				0
Income from operations	**889**					**N/A**
Impairment of non-current operating assets[(a)]	0					–
Income from disposals, changes in scope and others	249		(249)			0
Share of income (loss) in equity affiliate companies	(34)	27				(7)
Income from operations after income from equity affiliates	**1,104**					**–**
EBIT	**N/A**					**985**
Impairment of non-current operating assets[(a)]	-					0
Cost of net financial debt	2					2
Other financial income (expenses)	(40)			12		(27)
Financial cost on pensions and other long-term benefits	(90)				13	(77)
Income tax	(214)	(35)	(1)	(4)	(4)	(258)
Net income (loss)	**762**	**95**	**(249)**	**8**	**9**	**625**
Non-controlling interests	(48)	(15)				(62)
NET INCOME, GROUP SHARE	**714**	**80**	**(249)**	**8**	**9**	**562**
Average number of shares (thousands)	*204,774*					*204,774*
NET INCOME, GROUP SHARE, PER SHARE *(in euros)*	**3.49**					**2.75**

(a) Included in "Income from operations after income from equity-accounted companies" in the consolidated income statement and in "Net income (loss)" in the adjusted income statement.

> DETERMINING FREE OPERATING CASH-FLOW

(€ million)	2015	2014
Operating cash-flow before interest and tax	**1,643**	**1,466**
Change in working capital requirements and in reserves for contingencies	143	(287)
Payment of pension benefits, excluding contributions related to the reduction of the UK pension deficit	(124)	(122)
Net financial interest paid	9	(14)
Income tax paid	(102)	(98)
Net cash-flow from operating activities, excluding contributions related to the reduction of the UK pension deficit	**1,569**	**944**
Net operating investments	(458)	(443)
FREE OPERATING CASH-FLOW	**1,110**	**501**
Net (acquisitions)/disposals	37	(374)
Contributions related to the reduction of the UK pension deficit	(101)	(69)
Dividends	(234)	(243)
Exchange rate and others	159	114
CHANGE IN NET CASH	**971**	**(71)**

1.1.1.3 ORDER INTAKE

The **new orders** booked in 2015 amounted to **€18,880 million, an increase of 31%** compared to 2014 (+28% at constant scope and exchange rates[1]). The **book-to-bill ratio** was **1.34** for the 2015 financial year.

(€ million)	2015	2014	Total change	Organic change
Aerospace	6,279	5,024	+25%	+20%
Transport	2,826	1,651	+71%	+66%
Defence & Security	9,704	7,608	+28%	+24%
Total – operating segments	18,809	14,284	+32%	+28%
Others	71	79		
TOTAL	**18,880**	**14,363**	**+31%**	**+28%**

Thales also benefited from a particularly high number of **large orders (with a unit value over €100 million):** 24 large orders in all Group segments, following on from 19 in 2013 and 2014:

- 12 large orders in the Aerospace segment, including the installation of a new generation of individual screens across the entire A320 fleet of US airline JetBlue, the supply of two military satellite systems for the French Army (Ceres and ComSat NG), two telecommunications satellites (Bangladesh, Eutelsat), the construction of 8 additional satellites for the O3B constellation, a new phase of the Cosmo-SkyMed contract (Italy), a contract as part of the Galileo global navigation system and 4 contracts for the European Space Agency in observation and exploration (Sentinel 1C/1D, Sentinel 3C/3D, additional tranches of the Euclid and Exomars programs);
- 3 large orders in the Transport segment, for the supervision and signalling in the subway systems of London, Doha (Qatar) and Hong Kong;
- 9 large orders in the Defence & Security segment, including the upgrade of the French army's air defence system (Aster B1NT), optronics systems for "Scout" armoured vehicles in the UK, "Hawkei" light protected vehicles for the Australian Defense Force, contracts for the Rafale fighter aircraft in Egypt and Qatar, airport security in Oman, an air defence system in Malaysia as well as the sale of military equipment to two customers in the Middle East.

In 2015, the Group signed **5 "jumbo" contracts** with a unit value over €500 million: the signalling for 4 lines of the London Underground network, orders relating to the acquisition of the Rafale fighter aircraft by Egypt and Qatar, the order for over 1,000 vehicles by the Australian Defense Force ("Hawkei"), and a military satellite communications system for France (ComSat NG).

The positive dynamic order trend was not restricted to large contracts: **orders with a unit value under €10 million** were up 6% compared to 2014.

From a geographical perspective, orders were up sharply both in mature markets (€12,701 million, +26%, including France: +14%, United Kingdom: +68%, Australia/New Zealand: +58%) and in emerging markets (€6,179 million, +45%, including Asia: +17% and the Middle East: +93%).

Order intake for the **Aerospace** segment rose sharply to **€6,279 million**, compared to €5,024 million in 2014 (+25%). Avionics orders increased, boosted by continued growth in commercial and military avionics, both original equipment and support. In the in-flight entertainment (IFE) business, the Group signed several large contracts, including with JetBlue, Singapore Airlines, Saudi Arabian Airlines and Japan Airlines. There was a strong commercial momentum in the Space business, in the institutional segment for observation, navigation and exploration satellites as well as in the telecommunications segment, with the signing of the previously mentioned large contracts.

(1) Given a positive exchange rate effect of €399 million and a net positive scope effect of €47 million, mainly related to the consolidation of Live TV on 1st July 2014 (Aerospace segment).

In the **Transport** segment, orders were up 71% on 2014, at **€2,826 million**, thanks in particular to the "jumbo" contract awarded by London Underground for the renovation of the signalling for four major lines on its network.

Order intake in the **Defence & Security** segment totaled **€9,704 million** compared to €7,608 million in 2014 (+28%). As previously explained, this segment enjoyed numerous commercial successes in Land & Air Systems (provision of "Hawkei" light protected vehicles to the Australian Defense Force, the French army's air defence system upgrade, optronics for "Scout" armoured vehicles in the UK, etc.) and in Defence Mission Systems (equipments for the Egyptian and Qatari Rafales, submarine systems…). Orders in the Secure Communications and Information Systems business line fell slightly, but remained above sales.

1.1.1.4 SALES

(€ million)	2015	2014	Total change	Organic change
Aerospace	5,381	5,014	+7.3%	+1.7%
Transport	1,519	1,402	+8.4%	+4.1%
Defence & Security	7,084	6,480	+9.3%	+6.8%
Total – operating segments	**13,985**	**12,895**	**+8.5%**	**+4.5%**
Others	78	79		
TOTAL	**14,063**	**12,974**	**+8.4%**	**+4.5%**

Sales for 2015 amounted to **€14,063 million**, compared to €12,974 million in 2014, up 8.4% on a reported basis[(1)], and up 4.5% at constant scope and exchange rates ("organic" change), while in 2014, they fell organically by 1.1% compared to 2013.

Geographically speaking, this performance can be explained both by the return of organic growth in mature markets (+0.5%) and by continued solid growth in emerging markets (+16%, following on from +12% in 2014).

In the **Aerospace** segment, sales amounted to **€5,381 million**, up 7.3% compared to 2014 (+1.7% at constant scope and exchange rates). The Avionics business continued to benefit from a favourable currency impact and the acquisition of Live TV, as well as the increased sales of commercial avionics and in-flight entertainment systems. However, sales of helicopter avionics, tubes and imaging systems were down. Revenues in the Space business increased slightly, with the momentum in observation, exploration and navigation activities offsetting the fall in revenues seen from telecommunication satellites.

In the **Transport** segment, sales amounted to **€1,519 million**, up 8.4% compared to 2014 (+4.1% at constant scope and exchange rates). Despite execution difficulties on a number of contracts, this segment returned to growth after two years of organic decline in sales, thanks to main line rail signalling, supervision, and especially urban rail signalling projects, which are growing once again.

Sales in the **Defence & Security** segment reached **€7,084 million**, up 9.3% compared to 2014 (+6.8% at constant scope and exchange rates). All activities contributed to this positive trend. The Land & Air Systems business saw strong growth, specifically in missile systems, "Bushmaster" and "Hawkei" armoured vehicles, and civil and military radars. The Defence Mission Systems business benefited from the ramp-up of the SSOP (Sensors Support Optimisation Project) contract in the United Kingdom, and the start of the Rafale contract in Egypt. In addition to the good performance seen in cyber-security activities, the Secure Communications and Information Systems business did well in terms of radio-communications and started to book revenues on the Oman airports project.

(1) Given a positive exchange rate effect of €413 million and a net positive scope effect of €78 million, mainly related to the consolidation of Live TV on 1st July 2014 (Aerospace segment).

1.1.1.5 ADJUSTED RESULTS

➢ EBIT

For 2015, the Group reported an **EBIT**[1] of **€1,216 million,** which represents **8.6%** of sales, compared to €985 million (7.6% of sales) in 2014.

(€ million)	2015	2014	Total change	Organic change
Aerospace	**518**	**505**	**+2%**	**-3%**
in % of sales	*9.6%*	*10.1%*		
Transport	**(37)**	**32**	**NM**	**NM**
in % of sales	*(2.4%)*	*2.3%*		
Defence & Security	**760**	**620**	**+23%**	**+18%**
in % of sales	*10.7%*	*9.6%*		
Total – operating segments	**1,241**	**1,158**	**+7%**	**+3%**
in % of sales	*8.9%*	*9.0%*		
Others – excluding DCNS	(47)	(56)		
Total – excluding DCNS	**1,194**	**1,102**	**+8%**	**+4%**
in % of sales	*8.5%*	*8.5%*		
DCNS (share at 35%)	22	(117)		
TOTAL	**1,216**	**985**	**+23%**	**+18%**
in % of sales	*8.6%*	*7.6%*		

The EBIT for the **Aerospace** segment increased again to **€518 million** (**9.6%** of sales) compared to €505 million (10.1% of sales) in 2014. The EBIT margin, which reached a high level in 2014, was down slightly, due primarily to the effect of higher R&D spending.

The **Transport** segment reported an EBIT of **-€37 million** (**-2.4%** of sales) compared to €32 million (2.3% of sales) in 2014. As part of the in-depth review of the contract portfolio carried out during the first half of 2015, additional charges were booked, which had a major impact on the profitability of this segment. In line with the recovery plan implemented by the new management team, this segment achieved break-even in the second half of 2015 (+€2 million).

After 2016, which should see break-even achieved, the current recovery plan should allow this business to gradually return to profitability in the coming years.

The EBIT for the **Defence & Security** segment increased significantly, totaling **€760 million** (**10.7%** of sales) compared to €620 million in 2014 (9.6% of sales). In addition to the very satisfactory level of contract execution, the rise in margins was driven by the healthy commercial dynamics, particularly in the Land & Air Systems and Secure Communications and Information Systems businesses.

The contribution made by **DCNS** to EBIT stood at **€22 million** in 2015, compared with –€117 million in 2014. DCNS is implementing its recovery plan as expected. DCNS results in 2015 were a little higher than expected, mainly due to non-recurring items.

Adjusted financial results

The amount of **net financial interest** remained low, at €4 million in 2015 compared to €2 million in 2014, while **other adjusted financial results**[2] were improving (–€10 million in 2015 compared to –€27 million in 2014). **Adjusted financial income on pensions and other employee benefits**[2] fared slightly better than in 2014 (**-€73 million** compared to -€77 million), since the discount rates at the end of 2014, which were used to determine the 2015 financial cost, were lower than the 2013 rates.

Adjusted net income

The **adjusted net income, Group share**[2] stood at **€809 million,** compared to €562 million in 2014, after an adjusted tax charge[2] of €266 million compared to €258 million in 2014. The effective tax rate is 27%, compared to 29% in 2014.

The **adjusted net income, Group share, per share**[2] amounted to **€3.89,** up sharply on 2014 (€2.75).

1.1.1.6 CONSOLIDATED RESULTS

Income from operations

Income from operations amounted to **€965 million** against €889 million in 2014, up 9%. This increase reflects the improvement in gross profitability and tighter control of indirect costs, up only 5%.

Income from operations after income from equity-accounted companies

Income from operations after income from equity-accounted companies came to **€1,131 million**, compared to €1,104 million in 2014. The limited increase, in spite of the increase in income from operations, reflected two items:

- gain on disposal amounted to €53 million, significantly lower compared to the level recorded in 2014 (€249 million), which was driven by a significant fair value adjustment on Thales Raytheon Systems SAS and Trixell SAS, after an amendment to the shareholders'

(1) *Non-GAAP measures, see definitions in section 1.1.1.2, page 8 and computation, page 10.*

(2) *Non-GAAP measures, see definitions in section 1.1.1.2, page 8, and computation pages 9 and 10.*

agreements of these joint ventures led to Thales taking sole control, but with no change in the percentage ownership of the joint shareholders of these companies;

- the share of income of equity-accounted companies amounted to €113 million, after a loss in 2014 related to the substantial net loss posted by DCNS for that year.

Net income

Consolidated net income, Group share, totaled **€765 million** compared with €714 million in 2014, after tax of €220 million versus €214 million in 2014, and including an improvement in the financial costs on pensions and other long-term benefits (€60 million versus €90 million in 2014).

1.1.1.7 FINANCIAL POSITION AT 31 DECEMBER 2015

Free operating cash flow, the calculation for which is given in Section 1.1.1.2, amounted to **€1,110 million**. It increased sharply compared to 2014 (€501 million), despite an increase in net operating investments (€458 million compared to €443 million in 2014) as part of the optimisation of the Group's industrial base. Above and beyond the improvement in EBIT, it benefited from advance payments received on orders recorded during the year.

At 31 December 2015, **net cash** amounted to **€1,978 million** compared to €1,006 million at the end of December 2014. The acquisition of Vormetric, announced in October 2015, is expected to be completed in the first half of 2016.

Equity, Group share, stood at **€4,646 million** compared to €3,782 million at the end of December 2014, due primarily to consolidated net income, Group share, of €765 million.

1.1.1.8 PROPOSED DIVIDEND

At the Annual General Meeting on 18 May 2016, the Board of Directors will propose the distribution of a **dividend** of **€1.36** per share to the shareholders, an increase of 21% on 2014.

If approved, the ex-dividend date will be 30 May 2016 and the payment date will be 1st June 2016. The dividend will be paid fully in cash and will amount to €1.01 per share, after deducting the interim dividend of €0.35 per share already paid in December 2015.

1.1.1.9 OUTLOOK

After the record level seen in 2015, new orders are expected to remain high in 2016, close to the level observed in 2013-2014[1]. Sales should see a mid-single digit organic growth compared to 2015.

This positive trend, combined with continuing efforts to improve competitiveness, should result in Thales posting an EBIT between €1,300 and €1,330 million (based on exchange rates in February 2016), which will represent an increase between 7% and 9% compared to 2015.

In this context, Thales is upgrading its medium-term sales growth target. The Group is now aiming for mid-single digit organic growth in 2017 and 2018. It also confirms its EBIT margin target of 9.5 to 10% in the same time frame.

1.1.2 RISK FACTORS

Thales is exposed to a number of risks and uncertainties which could materially affect its business, reputation, financial position, results or ability to achieve its objectives. The risks described below are not the only ones that Thales faces. Other risks, unknown to Thales on this date, or which presently appear to be non-significant, could also have an unfavourable impact on the business, profitability and financial position of the Group or its ability to achieve its objectives.

Generally, Thales may be faced with a number of operational, strategic, legal and financial risks.

1.1.2.1 OPERATIONAL AND STRATEGIC RISKS

1.1.2.1.1 Competitive environment

Thales operates in highly competitive markets, both in terms of international groups and in terms of local or niche companies in certain market segments. This competitive pressure could negatively impact Thales's commercial position, sales and profits.

It could also intensify in an unfavourable economic environment and there is no guarantee that Thales will be able to position itself successfully against its current or future competitors.

In order to limit the impact of this risk, Thales continues its research and development efforts in order to provide more competitive and differentiating elements, and it also works to upgrade its product offer in order to meet the needs of its customers in both the defence and civil markets.

1.1.2.1.2 Cyclical nature of the civil aviation market

Demand for air travel appears closely linked to general economic trends, but is also affected by specific factors, such as the characteristics of aircraft fleets in service, regulatory changes (new environmental standards, deregulation, etc.) and the ability of airlines to access financing. Moreover, trends in oil prices have a direct impact on the profitability, and therefore, the investment decisions of airlines. In addition, the civil aviation market is also susceptible to the effects of intensification (real or perceived) of terrorist activity, as well as conflicts and epidemics or disasters, which can have an important, if temporary, impact on air traffic and thus affect the entire civil aviation market.

In order to remain profitable in a difficult market, airlines could cancel or postpone orders and aircraft manufacturers might have to reduce production rates. This environment could also lead the airlines to reduce or delay their maintenance expenditure or their investments in in-flight entertainment systems. Similarly, air navigation service providers could reduce or delay investments in air traffic control equipment and systems. Were they to materialise, these factors could have a negative impact on Thales's profitability and financial position.

(1) Average 2013-14 order intake: €13.6 billion.

To limit the impact of this risk, Thales is pursuing action on two fronts: (i) ongoing improvements to its competitive performance and industrial flexibility in order to better manage trading fluctuations during the cycle and (ii) a comprehensive strategy seeking a balance within its business portfolio (with exposure to the civil aviation market limited to around 15% of Group sales).

1.1.2.1.3 Dependence on public procurement

Thales generates most of its business from governments, particularly in the defence markets in France and the UK, and, to a lesser extent, in the rest of Europe, North America and Australia. In these markets, public spending is dependent on political and economic factors and is therefore likely to fluctuate from one year to the next. A significant reduction in defence budgets, particularly in Europe as part of a more restrictive budget policy, could affect the Group's business and profitability. In fact, a reduction in the budget resources of government customers could generate delays in order booking, contract execution, payments or a decrease in funding for research and development programmes.

Thales has based its strategy on a balanced portfolio of defence operations and civil operations, each accounting for approximately 50% of sales. The overall solidity of the portfolio is underpinned by a diversified base of orders with a unit value of less than €100 million. Finally, the broad geographic spread of Thales's business, particularly through its international operations, ensures further diversification of its customer base.

1.1.2.1.4 Political risks

A significant proportion of Thales's sales is subject to the risk of economic and/or political instability in the countries in which the Group operates. The materialisation of these risks may affect the Group's financial position and profitability.

In particular, a change in government, major political event, armed conflict, act of terrorism, sharp deterioration in the balance of payments, industrial action, strike or protest could lead to various types of risks. These include:

- more restrictive currency control, with limitations or exclusions on withdrawing currency from a customer country, preventing it from honouring its financial commitments to Thales;
- impairment of assets because of devaluations of the local currency or other measures taken by public authorities that significantly affect the value of operations;
- expropriation (by confiscation, nationalisation, requisition, etc.) or the forced sale of Thales's interest in a local company, or, more broadly, discriminatory measures that compromise Thales's operations in a country;
- a security situation entailing a risk of bodily harm for its employees and/or security breaches at its facilities, which severely limit or prevent Thales from assuming its performance obligations under a contract, or reduce or prohibit the use of its local industrial assets;
- an unexpected breach of a contract or commitment;
- an unfair call of a bond or a guarantee;
- the non-certification of documents eligible for payment, or non-payment on the due dates stipulated in a contract, which prevent the anticipated progress of that contract.

To limit the financial impact of these risks, Thales seeks to protect its interests as far as possible through contractual provisions. In addition, the Group may use government and/or private sector insurers when necessary to provide appropriate cover. If applicable, it may also transfer receivables without recourse to financial institutions.

Lastly, the Group has implemented a global procedure for employee security, crisis detection and response, protection and monitoring (see paragraph 1.1.2.1.10 on Security breaches in respect of sites and staff).

1.1.2.1.5 Control of bids and programmes

Many of Thales's products and systems are highly complex due to their advanced technology content, the rigorous operational constraints and harsh environments in which they operate (which require them to be extremely reliable) and the contractual arrangements surrounding their sale (comprehensive prime contractorships for large-scale systems, public-private partnerships or equivalent, local shares, compensation commitments, etc.).

The actual cost of design, development and manufacture may therefore exceed initial cost estimates, which in turn may adversely impact Thales's results and financial position, especially considering that the associated contracts are generally based on a fixed, all-inclusive price. In addition, many contracts include stringent performance levels and/or tight delivery schedules for the products or systems sold, particularly given the increased competition. If Thales is unable to deliver these products or systems in line with the required level of performance and/or delivery schedule, customers may demand penalty payments or even decide to terminate the contract.

Bid and project management is therefore subject to a detailed risk management and assessment process. Thales ranks the various levels of criticality. Critical bids and projects are specifically monitored at the management level of the operating entities (Business Lines and Global Business Units) and, as needed, by Group management.

Contractual risk assessment is an integral part of the tendering process. Depending on the complexity of the bid, this procedure involves a number of steps which progressively sharpen the estimated level of profitability and the associated risks to be assessed. Particular attention is paid to long-term sales contracts that include fixed prices valid for the entire duration of the agreement.

For certain contracts that run for several years and involve products and services with a high degree of complexity, regular reviews are organised in order to monitor the technical and financial progress.

The Group continues to pay particular attention to analyses and action plans for the management efficiency of bids and projects by measuring and monitoring financial variance on the projects and the implementation of corrective actions.

In the context of the Ambition Boost performance programme, the Group has also implemented action plans to improve the management of bids and projects, engineering and the supply chain. These actions aim in particular to:

- improve the product policy, in order to streamline new developments and thus reduce risks;
- improve the management of commitments made, with widespread use of independent peer reviews, closer involvement of Engineering, Purchasing, Production, Legal and Quality Control and the introduction of Product and Project Design Authorities responsible for developing the technical project solution (during the bid or product/project execution phase);
- improve the supply chain, by increasing its global dimension and enhance the growing maturity of emerging countries in project implementation;

- improve methods, practices and tools, to make them more relevant to international products/projects. In particular for emerging countries, this involves the implementation of a project management tool, SAP by Design, adapted to these countries;
- introduce advanced training for project managers to obtain International Project Management Association (IPMA) certification. At the end of 2015, nearly 1,000 project managers within the Group had gained IPMA certification, with approximately 210 certified during the year.

1.1.2.1.6 Supplier risk

Purchases constitute a very significant proportion of Thales's business, representing nearly half its sales for manufacturing, services, equipment and sub-systems. Thales is thus exposed to the risk of industrial, technical or financial failure of any of its suppliers, which in turn could affect the Company's profitability and performance.

There are two major types of supplier risk:

- legal or regulatory non-compliance (ethics, export control, intellectual property, etc.); these risks are handled by the departments concerned using the Group Risk Management system with the support of the Purchasing Department;
- structural and operational risks that could disrupt supply, which are dealt with by the Purchasing Department using the Group Risk Management system. The Purchasing Department has identified two key triggers: supplier default and economic dependence.

Risk of supplier default

Supplier default could be caused by a major incident at one of its sites, by its external environment (shortage of raw materials or components, major political instability, natural disaster, etc.) or through mismanagement. The supplier's management performance is monitored both in operating terms (poor procurement planning, failure to manage tier 2 suppliers, loss of control over industrial processes, plant obsolescence, etc.) and in cross-disciplinary and financial terms (poor skills management, loss of know-how, fall in sales, mismanagement of working capital requirement, cash flow problems, administration or bankruptcy protection, etc.). A combination of problems could lead to the disappearance of a company or its takeover by investors with different interests from those of Thales.

Consequently, faced with this risk of a supply shortage, Thales implements a dual sourcing (or alternative-source) policy as frequently as possible for each technology family, regularly updated and accompanied by buffer stocks that cover its requirements until customer contracts have been fulfilled.

In addition, taking into account the increased risk of fragility of certain suppliers in the current economic climate, Thales has introduced a special approach. Based on close cooperation between buyers and financial teams, it is aimed at identifying, from among its critical suppliers, those that would be particularly susceptible financially and implementing an appropriate action plan to ensure continuity of supply. Apart from individual monitoring, analysis is carried out by technology field in conjunction with the professional bodies concerned, to identify appropriate solutions.

Alongside these financial supervision measures, Purchasing and Quality Control have stepped up their appraisal, accreditation and management of supplier performance to better identify structural risks. Supplier performance audits are broad-based (covering quality control, industrial maturity, flow optimisation, compliance with environmental regulations, expertise in technical and technological processes, financial strength, etc.) and therefore allow a complete risk analysis to be carried out. When executing a purchasing contract, Thales closely monitors the implementation by the supplier of measures aimed at tackling the risks identified during the selection process.

Risk of economic dependence

The economic dependence of small and medium-sized enterprises (SMEs) on Thales is considered a separate risk in its own right. It is particularly significant now that the economic crisis has disrupted the sales portfolios of a number of them, jeopardising the operating cycle with Thales and potentially leading to a supply shortage.

In order to mitigate this risk, the commitment rate (orders placed by Thales as a percentage of the supplier's total annual sales) is monitored for each panel of suppliers by market segment (vertical approach) and for the main countries where the Group is established (France, the UK, the Netherlands, etc.). If the commitment rate exceeds 50% for more than two consecutive years, an action plan coordinated with internal specifiers and internal users is drawn up and implemented in order to return to a commitment rate of 25%.

The purchasing policy, supplier selection and performance monitoring processes and supervisory and risk mitigation measures are also all designed to reduce these risks, during both the bidding phase and the project implementation phase.

1.1.2.1.7 Raw materials risk

Given the nature of its business, Thales uses few raw materials. The Group's exposure to raw materials risk is therefore negligible.

1.1.2.1.8 Human resources risk

a) Workplace health and safety

Ensuring a healthy and safe working environment for its employees pursuant to the laws in force, monitoring procedures, preventing health and professional risks and employee training are key priorities for Thales.

These principles are reflected in a structure designed to prevent risks related to health and safety in the workplace, whether on Thales sites or external sites, and to manage major health crises that could occur internationally.

Regular monitoring of the risks to which the Group's employees may be exposed is performed each year.

Practical measures are also implemented by the Group's Human Resources Department and Health, Safety and Environment Department in relation to employee health and safety in the workplace. Thales is also committed to increase the quality of life in the workplace. In France, for example, a three-year Group agreement on "Quality of life at work" was signed on 4 February 2014. Continuing the approach adopted in the agreement signed in 2009 on the same subject, the agreement defines a general framework for prevention and aims to place particular focus on psycho-social risks by implementing individual and collective preventive actions.

Proof of the Group's continuing commitment to certification, 95 Thales entities (representing 76% of the workforce) had obtained OHSAS 18001 certification by the end of 2015.

b) Talent development

If Thales is not attractive enough to recruit the qualified staff it needs in a timely manner and to retain and motivate its employees to develop and run its business, sales and operating profitability could be negatively affected. Thales's success and performance effectively depend on its capacity to recruit employees in the different employment markets, in France and abroad, the quality of the key skills and the commitment of its employees, and its capacity for global management of the talents required for the development of its activity worldwide.

Thales therefore attaches great importance to its attractiveness and positioning as a top employer, ensuring a good external image which will boost recruitment and an internal situation that will contribute to retain employees.

As an attractive and recognised employer in France, Thales is also building up its image in all the countries where the Group is already present or plans to develop, with the "Attractiveness" programme. Currently in the implementation stage, this programme aims to expand recognition of the Thales employer brand using communication campaigns and partnerships with leading universities. In addition, a global recruitment function, attached to the HR general management has been created to help the Group develop in these geographical zones.

The global process of identifying and managing talent within the Group has also been reinforced, by encouraging interaction between management teams in different parts of the organisation.

Thales is also continuing its dynamic skills management policy for the Group's main professional families. A Steering Committee per family, composed of operational and HR managers, conducts a yearly analysis of changes in jobs, expertise, and the needs of the Company, and establishes action plans (for training, anticipated management of internal mobility, external recruitment, etc.). To complement this tool, each year the Group's internal University updates the key programmes in response to changing needs. Significant work has been carried out to identify employees' soft skills, namely for those employees attached to the R&D Systems, R&D Hardware and R&D Software job families. This work helps to more precisely identify training and recruitment requirements. This approach is now being extended to other job families such as Purchasing and Project Management.

Lastly, in 2013, the Group signed agreements in support of the following, with the unanimous agreement of the trade union organisations in France: taking on young people, either on work-study training schemes or post-qualification, and transferring knowledge to them (the Generation Contract); and developing diversity in the organisation (the Gender Equality Agreement) or taking a forward-looking approach to jobs and skills.

In the months and years to come, these agreements will allow the Group to better manage the integration of young graduates in France, improve the development of its critical skills, promote diversity and better anticipate changes within the Group.

1.1.2.1.9 Environmental risks

For many years, Thales has conducted regular analysis and update of environmental risks in accordance with its business activities, scientific and technical developments and the emerging environmental challenges.

This analysis aims at:

- ensuring that employees and surrounding residents are not exposed to health and environmental risks (pollution, asbestos, etc.) through their activities or work environment, whether on Thales or external sites;
- ensuring the compliance of activities and products (substances, waste, etc.);
- analysing the impact of new regulations, including on product design;
- analysing the impact of the environment on activities (water stress, climatic events, etc.);
- specifying an appropriate organisational structure and associated action plans, either at Group level or locally, based on the results of this analysis.

To support this analysis, an Environmental Management System has been rolled out at all sites in order to ensure that the environmental impacts of products and operations are controlled and limited. Part of the Group reporting arrangement, this management system encompasses the different functions, such as engineering, manufacturing, supply chain, purchasing, contract management, auditing and risk management, etc. Special training, communication tools and the sharing of experience are used to support the approach.

At the end of 2015, 117 entities had been certified to ISO 14001, representing 88% of the Group's workforce.

At 31 December 2015, the amount of reserves for environmental contingencies stood at €8.0 million.

1.1.2.1.10 Security breaches in respect of sites and employees

Thales is exposed to attempts to breach the security of its sites (attempts by unauthorised persons to access confidential information, threats to the physical security of sites and facilities, etc.). The occurrence of such events could affect the rollout of the Group's activities and its reputation and, consequently, its results and financial situation.

In order to minimise this risk, the Group Security Department has drafted a policy for regulating access to and movement around all Group sites. This policy is applied by the Group's network of security officers. In its defence businesses, the Group is subject to different national regulations requiring it to implement measures to protect its employees and industrial assets.

The Group is therefore subject to a large number of audits and inspections by the national supervisory authorities.

In addition, the Group has implemented a global procedure for employee security, crisis detection and response, protection and monitoring to ensure they have an appropriate level of security in the countries in which they perform their work. In certain countries, this global procedure runs alongside a local intervention system, which ensures a quick response to incidents.

1.1.2.1.11 Risk of IT system failure

The Group operates – directly or through service providers – complex IT systems and infrastructures that are essential to the smooth running of its commercial, industrial and financial processes. The malfunction or failure of these systems may have external causes (viruses or hacking, power cuts or network failures, natural disasters, etc.) or internal causes (malicious acts, breaches of data confidentiality, human error or obsolescence). Any such malfunction or failure could have an impact on the Group's operations and its financial results.

To guard against these risks, the Group has implemented multi-year plans to deal with part of the IT systems being temporarily or permanently unavailable, as well as any cyber-security threats to these systems.

The disaster recovery plan for each country in case of failure of part of the IT systems sets out arrangements for the implementation of disaster recovery solutions appropriate to the degree of risk and its operational impact.

Furthermore, a plan to protect against risks related to cyber-security has been defined and implemented in countries where the Group currently operates, using "CyberSecurity Operation Centres". As well as continuing to adapt the means of protection already in place, the plan includes the implementation of new measures to strengthen the protection of sensitive information, and the development of systems for early identification and prompt correction of any non-compliances.

The plan is completed by ongoing efforts to raise employees' awareness of these threats.

Lastly, the Thales IT system security and anti-cyber crime strategy has been approved by Group management, in close cooperation with the national and governmental authorities of the countries concerned.

1.1.2.1.12 Risk related to failure of equipment or technology

Thales systems and equipment are highly complex and technical and are likely to be integrated within high-value civil or military platforms. A malfunction of any such systems, equipment or technologies could result in client claims or third-party litigation. Thales could thus be held liable in the event of damage to property or personal injury. Were they to occur, such events would be liable to impact Thales's results and financial position, as well as its reputation.

In order to limit the impact, Thales has put Group-wide standards in place (Design Authority, quality, documentation, contractual arrangements and risk management). In addition, Thales follows a policy of maintaining appropriate insurance coverage (see Section 1.1.2.4 on Insurance).

1.1.2.1.13 Risk of lower impact of performance improvement measures

In 2014, to support its medium-term financial targets, Thales launched the "Ambition Boost" performance plan to increase the entire Group's performance.

This global performance plan provides a common framework within which the units can implement plans and initiatives adapted to their own issues in terms of performance improvements.

The earnings and financial position of Thales could be negatively impacted if the initiatives planned under the Ambition Boost framework could not be fully implemented or if they failed to generate the expected results according to the original timetable. Moreover, the cost of implementing these initiatives could end up being higher than expected, which is why Thales has introduced specific monitoring for performance improvement initiatives. The Group's corporate management regularly reviews the progress of the main initiatives.

1.1.2.1.14 Risks relating to strategic acquisitions and investments

Thales regularly looks to acquire new companies (as well as making strategic investments and combining business activities through joint ventures, etc.) in order to round out its technological portfolio and strengthen its presence in certain markets. Integrating these businesses into Thales could prove more difficult and take longer than envisaged, requiring more significant involvement by senior managers and the teams concerned and, in turn, negatively impacting the Group's results and financial position.

In addition, there are no guarantees that the newly acquired companies will perform as well as expected in accordance with the initial business plans, which form the basis of the investment decision. This type of variance could lead to the recognition of impairment losses on goodwill and other intangible assets, thereby negatively impacting Thales's results and financial position.

Before any planned acquisitions, Thales conducts audits and due diligence with the assistance of external consultants where necessary, in order to analyse the fundamentals of the target company. A review is also conducted at each key stage in the acquisition process to confirm Thales's interest and specify the necessary conditions and parameters to ensure a successful outcome. The newly acquired company is then integrated into Thales's financial reporting system so that its performance can be monitored.

1.1.2.1.15 Risks related to minority investments

Thales generates part of its sales from companies in which control is shared with, or exercised by, other partners; in accordance with the accounting principles in force on 1 January 2015, these companies are consolidated using the equity method [1].

Moreover, the share in net income of equity affiliates is included in Thales's EBIT [2] and adjusted net income [2]. A deterioration in the performance of these companies may therefore impact on the Group's income and financial position.

Since Thales's influence over these minority investments varies, decisions that are detrimental to the interests of Thales may be taken, without Thales necessarily having the means to oppose them.

In addition, the risk of disagreement or blockage, inherent in any jointly-controlled entity, exists, particularly in those where important decisions require the unanimity of members or where there are limited exit rights.

Furthermore, the application of management rules and principles in these entities may differ from those adopted by Thales for entities over which it exerts exclusive control. This also means that the ability to carry out analysis and give instructions regarding financial or operational data, or even to access this data, may be more limited than in the entities over which Thales exerts exclusive control.

As a result, the Group aims to define appropriate governance methods by seeking to be represented on the Board of Directors (or a similar decision-making body), and more generally, to negotiate contractual provisions that are in Thales's best interests.

1.1.2.2 LEGAL AND COMPLIANCE RISKS

1.1.2.2.1 Compliance with laws and regulations

The Group operates its business in a strict and evolving complex legal and regulatory environment, both nationally and internationally.

The legal and regulatory framework in which Thales operates covers a broad range of areas, relating in particular to company law, financial market regulation, fiscal legislation, labour law, export control and measures to combat corruption and money laundering.

(1) *See the list of companies consolidated using the equity method on pages 78 and 79.*

(2) *Non-GAAP measures, see definition and computation in Section 1.1.1.2, pages 8 to 10.*

Thales is able to monitor developments within this legal and regulatory framework through its international network. The Company is not always able to foresee them, however, and in this respect its business could be affected.

Despite the steps taken by Thales as a Company to comply with all applicable legislation, risks still exist due to their inherent nature, the interpretative powers of regulatory agents, the extraterritorial reach of certain regulations, and changes in legal/judicial precedent and sanctioning powers.

In most cases, regulators in conjunction with the judicial authorities have the right to initiate legal proceedings, which could expose the Group or its employees to civil, administrative or criminal rulings. Such rulings could, if applicable, involve a temporary ban on trading, which would in turn have an adverse impact on the Group's profitability and financial position.

Using a risk map validated by the Risk Management Committee, the Audit, Risks & Internal Control Department carries out assessments and audits of the implementation and improvement of compliance plans within the Group's Units. Compliance measures rely for these needs on networks of compliance officers who may be specialists (in export control), on risk advisors responsible for the prevention of each of the major risks identified and monitored by the Risk Assessment Committee, or on a dedicated organisation as regards international trade (see below).

The Audit, Risks & Internal Control Department takes into account these compliance areas when preparing its audit plan.

a) Business ethics

Thales's business encompasses a variety of sectors in more than 50 countries. Infringement of applicable laws and regulations may have severe legal and financial consequences and seriously harm the Group's reputation.

A strict corruption and integrity risk prevention programme, introduced to all Group entities over 15 years ago, is regularly amended to reflect changes in the legislative and regulatory framework and increasing societal expectations. The Code of Ethics provides the foundation for Thales's culture of integrity. With a preface by the Chairman & Chief Executive Officer, it reaffirms in particular the principle of zero tolerance for any act of corruption. In 2015, a new edition of the Code of Ethics was personally addressed to all Group employees. The corruption risk prevention programme, which is assessed regularly and amended to reflect changes in legislation and in external and internal risks, was certified by Mazars and by ADIT in July 2014. The ADIT/Mazars benchmark is compliant with national and international laws and regulations concerning the fight against corruption (French law, the United Kingdom Bribery Act, the United States Foreign Corrupt Practices Act (FCPA), the OECD Anti-Bribery Convention on Bribery of Foreign Public Officials in International Business Transactions), the tenth principle of the United Nations Global Compact and best practices in terms of anti-corruption procedures. Furthermore, this benchmark is focused on five main areas (control environment, risk assessment, control, monitoring, information and communication) set out in over 200 control points. It was validated by an International Advisory Board and by the Central Anti-Corruption Service (Service Central de Prévention de la Corruption - SCPC) of the French Ministry of Justice.

An international, dedicated network, independent of the operational commercial structures, conducts the verifications required during the vetting and selection phases for agents, consultants and local industrial partners for Thales. These verifications are backed up by external studies and diagnostics performed by companies that specialise in business intelligence.

The risk factors inherent in business are handled by the various processes that govern the management of bids and projects in the Thales reporting system (Chorus 2.0). From the preliminary phase of a project, these operating processes envisage action plans to mitigate business risks, focusing particularly on the prevention of corruption.

Thales strictly governs the use of agents and consultants by means of a highly detailed procedure, which requires in-depth preliminary verifications (due diligence), reinforced by the analysis of red flags or risk factors, as well as appropriate representations and commitments from these consultants. Designed by the Group's Ethics & Corporate Responsibility Department, this procedure is regularly revised in conjunction with the Group's Legal Department and the Sales Department.

To strengthen its role on the international stage and to gain a strong foothold in target countries, Thales chooses and qualifies its key industrial partners. The selection and qualification process is designed to secure sustainable partnerships with domestic industrial players meeting a set of criteria relating to integrity and business ethics, competence and expertise. This system is part of a process of applying appropriate and reasonable measures for prior verification (due diligence) with regard to third parties.

The players in the supply chain are also stakeholders in the integrity policy: at the end of 2015, 7,660 suppliers and subcontractors in the portfolio pledged to adhere to the terms of the Thales Company Purchasing and Corporate Responsibility Charter.

Thales is particularly keen to make its employees aware of ethical business conduct as soon as they join the Group. Adherence and accountability are key to the awareness and training model designed by the Ethics and Corporate Responsibility Department. A wide range of guides (reference guide and ethical business conduct guides) and training (both face-to-face and via e-learning) is available to employees throughout their careers. Special focus is given to employees involved in the sales processes, bid management, project management, and purchasing. The training plan for "Business Ethics and Preventing Corruption", which is worldwide in scope, is a priority intended for this group of employees. More than 7,000 employees have been trained since 2008.

In addition to its rigorous internal control procedures, the Audit, Risks & Internal Control Department conducts regular compliance and integrity audits on the various components of the model.

In 2015, the Thales corruption risk prevention and integrity programme earned recognition from several renowned institutions, resulting in Thales's inclusion in the Europe and World Dow Jones Sustainability Indices. In addition, the Group is now one of the four leading European companies in Transparency International's "Corruption Perceptions Index" for 2015 covering companies in the defence sector. Moreover, the Group has renewed its support for the principles of the United Nations Global Compact. It is one of 400 companies around the world that have submitted their Communication on Progress to the UN with "Global Compact Advanced" status.

The overall system is completed by Thales's active participation in various initiatives in the fight against corruption. Thales also actively participates in national professional organisations (MEDEF, GIFAS, ADS [1], etc.) and international organisations (Business Ethics Committee of ASD [2], ICC [3], B20 [4], IFBEC [5], etc.) dealing with business ethics, and has an active presence within the working groups of intergovernmental organisations (OECD, United Nations, ISO [6], etc.).

(1) Association of UK aerospace, defence security & space industries.

(2) The AeroSpace and Defence Industries Association of Europe.

(3) International Chamber of Commerce.

(4) International business community bringing together 22 employer organisations.

(5) International Forum on Business Ethical Conduct.

(6) International Organization for Standardization.

b) Export control

Exports account for a significant proportion of Thales's business. Many of the Group's products and systems are designed for military or dual use applications. Consequently, the export of these products or systems to customers located outside Thales's domestic markets where they are manufactured, particularly in the defence sector, may be subject to limitations, export licences or specific export controls (imposed by the countries in which Thales operates, as well as by other countries where the suppliers of component products or technologies are based, most notably the United States).

There are no guarantees that (i) the export controls to which Thales is subject will not be tightened; (ii) new-generation products or systems developed by Thales will not be subject to similar or tighter controls; and (iii) geopolitical factors will not make it impossible for Thales or its suppliers to obtain export licences for certain customers or make it more difficult for Thales to execute previously signed contracts. Further limitations on access to military markets would thus have a negative impact on Thales's business, profitability and financial position.

Thales has introduced systems and formal procedures to ensure compliance with applicable regulations and controls, and reinforces these measures through awareness-raising programmes with dedicated e-learning modules and alerts on legislative and regulatory changes relating to export control that are relevant to Thales's business. Operating units have access to a network of specialists within the Group, who are responsible for monitoring the application within operating units of compliance rules decided at Group level as well as monitoring the necessary authorisations and the conformity of their implementation.

c) Competition law

Thales's business activities are subject to a wide range of national and international regulations mainly aimed at combating anti-competitive practices.

Infringement of these rules could lead to severe sanctions, such as fines, payment of damages, and legal bans, and could also have a serious impact on the Group's reputation.

To avoid any such infringements, Thales has initiated a programme to raise awareness of these rules, in particular through dedicated training programmes.

d) Intellectual property

Thales is exposed to two main types of intellectual property risk: dependence on third-party technology and third-party actions against the Company for perceived infringement of their intellectual property rights.

To reduce the risk of reliance on critical third-party technology, Thales has implemented a process to identify and manage each situation with a precise, strategic "Make/Team/Buy" (MTB) plan.

Given the nature of its activities and the specific features of its products, Thales conducts most of its research and development work in-house and controls the technology which is critical to the business. Thales's extensive intellectual property portfolio (over 16,500 patents, as well as software and know-how) and its presence throughout the value chain (equipment, systems and systems of systems) reduce its reliance on third-party technology. As a result, Thales's dependence on such technology can be considered very low.

To reduce the risk of third-party actions for alleged infringement of their intellectual property rights by Thales entities, the Group identifies and analyses this risk in the context of its own patent filing procedures and/or when embarking on technical research or product development.

In the event of a third-party infringement claim against a Thales company, the legal and technical analysis of the allegedly infringing products and intellectual property rights are handled centrally by Thales experts, with the assistance of specialist external consultants where needed.

The Group's intellectual heritage is a significant asset. Thales may face the risk of third party infringement of its intellectual property rights. To limit this risk, Thales contractually protects its rights in its contracts and agreements, has an active policy of filing and maintaining patents, carries out technological monitoring of equipment and systems marketed by third parties in order to ensure that its own intellectual property rights are not infringed, and, where appropriate, takes all necessary steps to enforce its rights.

1.1.2.2.2 Litigation

Due to the nature of its business activities, Thales is exposed to the risk of technical and commercial litigation.

To prevent disputes or limit their impact, Thales' policy is to systematically seek alternative dispute resolution mechanisms. This policy is reviewed on a regular basis to take into account changes in the Company's core areas of business and is backed by employee training programmes.

In addition, Thales implemented a procedure several years ago to centralise all civil commercial and criminal litigation and claims. These are handled by the Corporate Legal Affairs Department, with the support of the Group companies concerned.

At the end of 2002, a group of French manufacturers, including Thales and one of its subsidiaries, collectively received a request for arbitration from a common customer claiming an amount which allegedly should not be below the $260 million figure and for which the group of French manufacturers might be jointly liable towards the claimant. This request for arbitration is related to the execution of old contracts by the group of French manufacturers. Pursuant to an agreement signed by all the parties in 2003, the claimant withdrew its request for arbitration.

In November 2012, the claimant filed a new request for arbitration for a revised amount of €226 million of which Thales' share would be around 28% of the amount claimed. The manufacturers are strongly disputing this demand and at this date it is not possible to evaluate any potential financial risk. Consequently, Thales has not recognised any provision. This process is still pending.

There are no other government, judicial or arbitration claims, of which the Group is aware, which are pending or threatened, which could have, or which had, in the course of the last 12 months, any significant effect on the financial position or the profitability of the Company and/or the Group.

1.1.2.3 FINANCIAL RISKS

1.1.2.3.1 Liquidity

The Group's liquidity risk is the risk of it being unable to meet its cash needs out of its financial resources. In particular, it relates to Thales's level of exposure to changes in the main market indicators that could lead to an increase in the cost of credit, or even to a temporary limitation of access to external sources of financing.

The Group manages this risk by trying to anticipate its cash needs and ensures that these are covered by the Group's short-term and long-term financial resources, as follows:

- shareholders' equity, listed by heading in Note 8 to the consolidated financial statements;
- gross debt, listed by maturity in Note 6 to the consolidated financial statements;
- committed, undrawn credit facilities granted by banks as backup to the commercial paper programme and acting as a financial reserve. These are described in more detail in Note 6 to the consolidated financial statements.

The principle of centralising the entities' short-term assets and liabilities (cash pooling) is applied to the combination of entities in the same currency zone (euro zone, sterling zone, dollar zone and Australian dollar zone, etc.) and, in some cases, in the same country.

By consolidating and centralising the cash requirements and surpluses of its units, the Group is in a position to:

- simplify cash management and match the cash positions of units to produce a single consolidated position that is easier to manage; and
- gain prime access to financial markets through the parent company's financing programmes, rated by Standard & Poor's and Moody's (see below).

At 31 December 2015, cash recorded under consolidated assets amounted to €3,450.2 million (compared with €2,481.4 million at end-2014), including:

- €2,949.8 million held by the parent company and available for immediate use (€2,051.4 million in 2014);
- €500.4 million in the bank credit balances of subsidiaries (€430 million in 2014), most of them outside of France. This figure includes, inter alia, payments received in the last few days of the financial year and subsequently transferred to the corporate treasury account.

Cash at bank and equivalents at year-end is invested solely in bank deposits, in very short-term bank certificates of deposit with first-tier banks or in money market funds. At the date of publication, Thales's credit risk ratings were as follows:

	Moody's	Standard & Poor's
Medium and long-term loans	A2	BBB+
Outlook	Stable	Stable
Commercial paper & short-term loans	Prime-1	A2

A decrease in Thales's credit risk rating would not place at risk financial covenants included in financing contracts. The coming into effect of the unique clause providing for accelerated repayment would only apply in the event that the State no longer held its golden share and, simultaneously, the ratio of consolidated net financial debt to EBITDA (earnings before interest, taxes, depreciation and amortisation) were to exceed 3.

A lower rating would result in an increase (capped) in the margins applicable to the committed credit facility of €1.5 billion (described in Note 6 to the consolidated financial statements); at the same time, these margins would be improved (with a minimum threshold) in the event of a rating upgrade.

1.1.2.3.2 Interest rates

Thales is exposed to interest rate volatility and in particular its impact on the conditions associated with variable-rate financing. To limit this risk, Thales operates an active policy of interest rate hedging.

The Corporate Financing and Treasury Department consolidates data on Thales's exposure to interest rate risk and uses appropriate financial instruments to hedge those risks.

Thales policy is to control interest rate and counterpart risks and to optimise its funding and banking operations.

The breakdown of Thales's debt by type of interest rate is described in Note 6 to the consolidated financial statements page 54. The table below summarises the Group's exposure to interest rate risk before and after hedging. Based on the average net cash (taking into account hedging instruments), a 1% rise in interest rates would increase financial interest, net by €11.4 million in 2015 (€8.4 million in 2014).

	< 1 year		> 1 year		Total	
(€ million)	Interest rates fixed	Variable rate	Interest rates fixed	Variable rate	Interest rates fixed	Variable rate
Financial liabilities	(612.1)	(77.5)	(792.2)	(18.3)	(1,404.3)	(95.8)
Financial assets	–	3,477.7	–	–	–	3,477.7
Net exposure before taking account of derivatives	**(612.1)**	**3,400.2**	**(792.2)**	**(18.3)**	**(1,404.3)**	**3,381.9**
Derivatives	395.5	(395.5)	585.3	(585.3)	980.8	(980.8)
Net exposure after accounting for derivatives	**(216.6)**	**3,004.7**	**(206.9)**	**(603.6)**	**(423.5)**	**2,401.1**

1.1.2.3.3 Foreign exchange

Due to the international nature of its business, Thales is exposed to the risk of exchange rate fluctuations.

a) Business-related currency risk

Business-related currency risk occurs when some of the business is billed in a currency other than that of the related costs.

a. As a general rule, Thales is structurally immune to exchange rate fluctuations for a significant part of its business activity. Around 40% of Thales's sales are generated in the euro zone, which is also where most of its industrial operations are located. More generally, the reinforcement of the Group's international industrial footprint allows the Company to manufacture and invoice in local currency, which helps to reduce exchange rate risk on local sales.

b. The accounts of Thales subsidiaries located in countries where the official currency is not the euro are translated into euros in the Group's consolidated financial statements. A fall in these currencies against the euro is likely to have a negative impact on the accounts. Its impact on profitability is limited, however, since the cost base of these subsidiaries is essentially in the same currency as their sales. The main currencies are the Pound sterling, the US dollar, the Canadian dollar and the Australian Dollar.

c. For certain Group businesses (civil avionics and tubes, civil space, etc.), the US dollar ("$") is the reference transaction currency. For business activities outside the dollar zone (the in-flight entertainment and connectivity business is based essentially in the United States and is therefore naturally immune to this risk), a specific currency risk hedging policy is implemented:

- for equipment transactions (avionics and tubes), this policy is defined on the basis of sales forecasts in $, after accounting for corresponding purchases in $. For these transactions, net exposure to dollar risk represents around 3.5% of the Group's total sales for 2015;
- for longer-term programmes in markets traditionally denominated in $ (primarily in civil space), each bid is examined for profitability in the light of the effect of currency fluctuations, after accounting for corresponding purchases in $, and, if necessary, is specifically hedged through market transactions (forward exchange-rate contracts and options).

  Where necessary, a similar approach is adopted for other Thales activities if a customer specifically requires a contract denominated in $ on an ad hoc basis.

  Overall, net exposure amounted to around 3.5% of the Group's total sales for 2015;
- as well as this direct dollar risk, which thus concerned around 7% in total of consolidated sales at end-2015, the Group is also exposed to an "indirect" dollar risk on contracts denominated in currencies other than the dollar. This occurs when it is bidding against companies that benefit from a cost base in dollars. Approximately one quarter of total sales may be exposed to this "indirect" dollar risk.

The "dollar risk" is thus the main currency risk that Thales needs to hedge. The figures corresponding to the hedging of business-related dollar risk are as follows:

- $3,309 million, the amount of financial instruments hedging net firm commitments ($ risk against the euro, Canadian dollar and pound sterling) at 31 December 2015 compared with $ 3,191 million at 31 December 2014;
- $124 million, the amount of financial instruments hedging bids in $ against the euro, Canadian dollar and pound sterling at 31 December 2015 compared to $ 198 million at 31 December 2014.

Operating receivables and payables denominated in foreign currency are exchange-rate hedged and therefore not exposed to currency risk.

The change in value of financial instruments (forward transactions) used as cash flow hedges is recognised in shareholders' equity. A decrease (increase) of 5% in the US dollar compared to the euro, pound sterling and Canadian dollar, would have increased (decreased) shareholders' equity by approximately €153 million at 31 December 2015, compared with €132 million at 31 December 2014. The premium/discount component is not eligible to cash flow hedge accounting and is recognised through profit and loss. In 2015, the change in market value of the premium/discount was €-15 million.

The change in value of financial instruments matched with portfolios of sales offers which are not eligible for hedge accounting is recognised in profit and loss. A decrease (increase) of 5% in the US dollar compared to the euro, pound sterling and Canadian dollar, would have increased (decreased) income by approximately €1 million at 31 December 2015, compared with €2 million at 31 December 2014.

Foreign currency-denominated financial debt does not generate any exposure in profit and loss, as it is either denominated in the functional currency of the entity in which it is recognised, or is used as a net foreign investment hedge.

b) Management of risks relating to foreign currency-denominated assets

The Group may hedge a portion of its foreign currency-denominated assets, mainly those likely to be disposed of at a future date. The main criteria for determining whether or not a given foreign currency-denominated asset should be hedged are as follows:

- the nature of the business operations involved;
- the structure of Thales's commitment with respect to jointly held companies, in particular the specific features of the shareholders' agreement in each joint venture.

The actual application of this policy also depends on:

- the objective of optimising hedges in the light of market conditions (availability of foreign currency, interest rates, hedging rate, etc.);
- the risks inherent in the future value of the assets being hedged and the nature of the business of the corresponding subsidiaries.

SUMMARY OF ASSET RISKS AT 31 DECEMBER 2015 FOR THE MAIN CURRENCIES

(€ million)	GBP	$	AUD
Assets	2,119.5	1,372.2	852.3
Liabilities	2,008.5	938.5	455.0
Net position before management	**111.0**	**433.7**	**397.3**
Off-balance-sheet position	–	–	–
NET POSITION AFTER MANAGEMENT	**111.0**	**433.7**	**397.3**

1.1.2.3.4 Shares

Thales was not exposed to any significant equity risk at end-2015, excluding the risk on treasury shares.

At 31 December 2015, Thales held 839,254 treasury shares, representing 0.40% of the share capital.

1.1.2.3.5 Off-balance-sheet commitments

a) Pension commitments

Defined-benefit pension plans are in place for certain Group employees, mainly in the United Kingdom, and are externally funded by the Company under the provisions of the applicable national legislation. As such, at 31 December 2015, Thales's commitments in the United Kingdom to current employees (access to these plans has been closed to new employees), former employees and retired employees amounted to €4,294.5 million, hedged by €3,274.6 million in investments, representing an underlying shortfall of €1,019.9 million.

In addition, certain employees, particularly in France and Germany, have other long-term benefits (retirement award, long-service awards, etc.) which are also of a defined-benefit nature but for which external funding is not systematically put in place.

At 31 December 2015, the total of all defined-benefit commitments was €5,891.7 million, covered by €3,572.8 million in invested assets, to the extent of:

- 31% in equities;
- 36% in fixed-rate bonds;
- 11% in inflation-linked bonds;
- 9% in alternative liquid investments;
- 12% in alternative long-term investments (real estate, infrastructure, etc.);
- 1% in cash.

Changing market parameters could affect the amount of the shortfall and the annual costs of defined-benefit plans. At 31 December 2015, the main risk variables were as follows, listed in order of importance:

- a reduction or increase in the discount rate applied to liabilities, which could increase or reduce the underlying shortfall; this variable is partly offset by changes in the value of fixed-rate hedging bonds held as plan assets and interest rate swaps;
- changes in the total return on investments in equities and other assets;
- changes in the forecast inflation rate;
- a substantial change in mortality tables;
- exchange rate fluctuations (mainly sterling against the euro).

Thales has introduced quarterly reporting on its pension plan positions and makes regular projections measuring the sensitivity of unfunded status to possible changes in market parameters taking into account correlation factors. In the UK, Thales is committed to defined-benefit pension schemes, but plan assets are managed by trustees in accordance with the applicable regulations and in consultation with the Group. Plan assets are allocated with regard to the long-term maturity of the commitments they cover.

b) Parent company guarantees

Thales, as the parent company, issues guarantees on commitments undertaken by its subsidiaries on commercial contracts. These guarantees are centralised by the Group Corporate Financing & Treasury Department.

Guarantees are issued out of an envelope of €3 billion regularly delegated to the Chairman & Chief Executive Officer by the Board of Directors. Prior to each renewal of the authority granted to the Chairman & Chief Executive Officer, the Group's Corporate Financing & Treasury Department reports to the Board on the level of use of this envelope, based on the monitoring carried out by the Department.

At 31 December 2015, outstanding guarantees issued by the parent company in support of its subsidiaries stood at €15,127 million. This figure includes all commitments given in relation to Thales Alenia Space (matched by a counter-guarantee from Finmeccanica in proportion to its 33% interest in Thales Alenia Space).

Thales manages risks connected to these parent company guarantees and optimises the financial conditions of the transactions guaranteed. The main objectives of this risk management policy are as follows:

- to limit risks to those corresponding to normal commitments on commercial contracts, particularly in terms of volume and duration;
- to limit the issue of guarantees to commitments made by wholly owned subsidiaries, with guarantees on commitments by consortia or joint ventures only in proportion to the Group's equity interest or counter-guaranteed by the other shareholder in proportion to its interest;
- to enable its subsidiaries to benefit, when appropriate, from the credit rating of the parent company by controlling the financial conditions of the transactions guaranteed.

1.1.2.3.6 Customer credit

Credit risk relates to the risk that a party to a contract will default on its commitments or fail to pay what it owes.

a) Risk relating to failure of a private sector customer

Non-governmental customers (aircraft manufacturers, airlines, private infrastructure operators and industry) account for approximately 25% of Thales's revenues. These customers may encounter major and/or prolonged financial difficulties that could lead to payment defaults or order cancellations. Such occurrences could have a negative impact on Thales's sales, profitability and financial position.

To mitigate these risks, Thales conducts regular analysis of the ability of customers to meet their obligations. When necessary, Thales may request bank guarantees or corporate guarantees, or may use credit insurers.

b) Credit risk relating to public sector customers

Public, Government and institutional customers account for around 75% of Thales's sales. Thales works with a large number of countries. Some of these could present a significant credit risk which could, for example, lead them to suspend an order in production, or make them be unable to pay on delivery, as agreed under the terms of the contract. To limit its exposure to these risks, Thales takes out insurance with export credit agencies (such as Coface in France) or private insurers.

At 31 December 2015, only two customers accounted for annual sales for Thales in excess of €500 million: the French State (around €2.5 billion) and the UK government (approx. €1 billion). At 31 December 2015, these two countries still had first-class or high-quality ratings (France was rated AA by S&P and Aa2 by Moody's; the UK was rated AAA by S&P and Aa1 by Moody's).

1.1.2.4 INSURANCE

Thales's Insurance and Risk Management Department, based at head office and reporting to the SEVP Finance & Information Systems, is responsible for the Group's insurance activities and insurable risk management. It is in charge of Group operations and oversees policy implementation by Group companies.

The Group covers the financial consequences of the risk of accidental damage suffered or caused by property or people using appropriate insurance policies with leading international insurance and reinsurance companies.

The insurance policies arranged by the Group to cover these major risks relate to areas such as:

- damage to property and consequent operating losses;
- transport;
- assembling and testing;
- aviation liability, including liability for aeronautical products and hull/ test flight insurance;
- civil liability for space products;
- risks of damage to or by naval vessels by subsidiaries, as naval equipment suppliers;
- general third-party liability;
- environmental liability;
- liability of executive officers and directors;
- individual accident – repatriation assistance for employees on assignment.

Whilst certain harmful events were notified to insurers, the Group had no major loss in 2015.

Thales's policy is to arrange cover on the insurance market based on the rates and limits that it considers reasonable, in view of the conditions offered by the market. Limits are applicable to insurance for major risks, while general exclusions for the entire market (e.g. asbestos) also apply to Thales.

In 2015, the maximum coverage limit for insurance against damage to property and consequent operating losses was €1.3 billion. This limit takes into account the estimated maximum possible loss caused to an industrial site which the Group could incur in this regard.

Levels of liability cover depend on the quantification of a reasonable claim expectancy for Thales, as identified by the risk map of the main business activities and at Group level, and on cover capacity available on the insurance market. The insurance coverage for aviation liability commitments, which is covered by a specific programme, amounts to $ 2 billion.

The insurance industry depends on the financial markets. There are also no guarantees that Thales will be able to maintain current levels of insurance under similar financial conditions in the future.

In order to reduce its exposure to insurance market volatility, Thales insures major risks on a two-tier basis:

- the Group's contribution, through captive insurance and reinsurance companies, towards the settlement of claims, to a maximum net retention of €12 million per year, for damage to property and consequent operating losses, transport, general third-party liability, assembling and testing, development and space risks;
- transfer to insurers of payment for catastrophic losses.

In parallel, an active Prevention and Protection policy for industrial sites is designed to reduce the magnitude and frequency of the accidental risks of fire or explosion and to detect other exposures, such as environmental or natural disasters and the vulnerability of critical industrial facilities. In 2015, more than 80% of the assets insured were the subject of a "multi peril" audit by the insurers during their visits to the principal operating sites and infrared thermography inspections by an outside organisation specialised in the prevention of electrical damage.

In accordance with Group processes, measures were taken to minimise business interruption and the consequences of any unforeseen events. An organisational structure and crisis management tools are in place to deal as efficiently as possible with the immediate consequences of a catastrophic event and to take the necessary emergency measures.

Furthermore, Thales continues to roll out an insurance policy for its staff to cover them in the context of their professional activity. Lastly, specific and/ or local cover has been arranged to comply with the regulations in force and to satisfy the specific requirements of certain business activities or projects, particularly public-private partnerships.

1.1.3 HUMAN RESOURCES, ENVIRONMENTAL AND SOCIAL INFORMATION

TABLE OF RECONCILIATION DECREE NO. 2012-557 OF 24 APRIL 2012

In accordance with decree no. 2012-557 of 24 April 2012 and with Article R.225-105-1 of the French Commercial Code on transparency obligations for companies on human resources and environmental matters, in its management report, Thales provides information on the Group's human resources, environmental and social issues. This information is set out in full in Chapter 5 of this registration document, entitled "corporate responsibility", pages 195 to 233. An independent verifier issued a declaration of inclusion and a limited assurance report on consolidated social, environmental and societal information, which can be found on pages 229 *et seq.*

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Organisation of working hours	205	5.1.5.5	Working time
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Health and safety conditions at work	204	5.1.5	A safe and healthy working environment: workplace health and safety
Summary of health and safety agreements entered into with trade union organisations or employee representatives with regard to health and safety at work			
Frequency and severity of work-related accidents and sick leave and occupational influences	205	5.1.5.3	Information on accidents at work and absenteeism
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Anti-discrimination policy	205 206	5.1.6 5.1.6.2	Gender equality and diversity Promoting cultural diversity
g) Promotion of and compliance with the International Labour Organisation's fundamental conventions:			
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2) ENVIRONMENTAL INFORMATION	**209**	**5.2**	**ENVIRONMENTAL INFORMATION**
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e) Protection of biodiversity	**217**	**5.2.5**	**Protection of biodiversity**
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	229	**5.4**	**Statutory auditors' independent third-party report on consolidated human resources, environmental and social information published in the management report**

1.1.4 EVENTS SINCE YEAR-END

No significant events after reporting period.

1.1.5 SUMMARY STATEMENT OF SHARE TRANSACTIONS CARRIED OUT IN 2015 BY DIRECTORS, NON-VOTING DIRECTORS AND RELATED PERSONS

In accordance with Article 223-26 of the General Regulations of the French Financial Markets Authority (AMF).

In accordance with Article L. 621-18-2 a) of the French Monetary and Financial Code, the members of the Board of Directors are subject to this disclosure requirement.

Pursuant to Article L. 621-18-2 b) of the French Monetary and Financial Code, the Company has declared to the AMF that all members of the Executive Committee come under the category of non-voting directors in respect of obligations to disclose share transactions.

Related persons in the sense of Article L. 621-18-2 c) of the French Monetary and Financial Code are people who have, under the conditions defined by decree in the Council of State, close personal relations with the people indicated in Article L. 621-18-2 a) and b) above.

Details of the corresponding operations can be found in Section 4.3.3.7 of this document, pages 182 and 183.