1.1 2017 MANAGEMENT REPORT

1.1.1 Report on operations and results

1.1.1.1 Key figures (adjusted)

(in € millions, except earnings per share and dividend in €)	2017	2016	Total change	Organic change
Order intake	14,920	16,514	−10%	−9%
Order book at end of period	31,914	33,530	−5%	−3%
Sales	15,795	14,885	+6.1%	+7.2%
EBIT[(a)] *In % of sales*	1,543 *9.8%*	1,354 *9.1%*	+14% *+0.7 pt*	+16% *+0.8 pt*
Adjusted net income, Group share[(a)]	982	897	+9%	
Consolidated net income, Group share	822	946	−13%	
Adjusted net income, Group share, per share[(b)]	4.64	4.25	+9%	
Dividend per share[(b)]	1.75	1.60	+9%	
Free operating cash flow[(b)]	1,365	954	+43%	
Net cash at end of period	2,971	2,366	+26%	

(a) Non-GAAP measures, see definitions in the appendices, pages 8 and 9.
(b) Proposed to the Shareholders' Meeting on 23 May 2018.

New orders in 2017 amounted to €14,920 million, down 10% compared to the high level recorded in 2016, which was boosted by the Q3 2016 booking of the 36 Rafale fighter aircraft contract ordered by the Indian government. The Group has therefore exceeded the €14 billion order intake target set at the start of 2017. The strong order momentum in Transport and Defence & Security enabled the Group to offset the slowdown of orders in Space. At 31 December 2017, the Group's order book stood at €31,914 million, which represents almost 2 years' worth of sales.

Sales came in at €15,795 million, up 6.1% on a reported basis, and up 7.2% at constant scope and currency ("organic" change). Sales benefitted from both a high rate of growth in emerging markets[(1)] organic growth of +10.3%, running at more than 10% for the fourth consecutive year) and a marked upturn in organic growth in mature markets[(1)] (+5.8%, after +3.9% in 2016 and +0.5% in 2015).

In 2017, consolidated EBIT was €1,543 million (9.8% of sales) compared to €1,354 million (9.1% of sales) in 2016, up 14%. All operating segments contributed to this increase and improved their EBIT margin.

As such, the Group noticeably exceeded all the financial objectives it had set for 2017: an order intake of around €14 billion, a mid-single digit organic sales growth, and an EBIT of between €1,480 million and €1,500 million, up 9% to 11% on 2016, based on February 2017 scope and exchange rates.

At €982 million, adjusted net income, Group share rose 9%. Its increase was held back by one-off items relating to tax reforms in France and the United States.

Consolidated net income, Group share was €822 million. It posted a fall of 13%, affected by the sharp fall in capital gains on disposal of assets.

At €1,365 million compared to €954 million in 2016, free operating cash flow reached a record level, benefiting from the rise in adjusted net income, from a slight reduction in operating investments (€431 million compared to €472 million in 2016) and from a combination of items that improved the change in working capital requirement. At 31 December 2017, net cash was €2,971 million, up more than €600 million compared to 31 December 2016.

1.1.1.2 Presentation of financial information

Accounting policies

The Thales group's consolidated financial statements are prepared in accordance with IFRS (International Financial Reporting Standards) as approved by the European Union at 31 December 2017.

These principles, described in Note 13, are consistent with those applied for the year ended 31 December 2016. In particular, the new mandatory standards applicable as from 1 January 2017 (amendments to IAS 12 – Income Tax and annual improvements 2013-2016), have no impact on the Group's financial statements.

Non-GAAP financial indicators

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

- **EBIT**, an adjusted operating indicator, corresponds to income from operations plus the share in the net income 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 business combinations. From 1 January 2016, it also excludes the other expenses recorded in income from operations that are directly related to business combinations, which are unusual by nature.

(1) "Mature markets" include Europe, North America, Australia and New Zealand; "emerging markets" include all other countries.

This definition drives the definition of other operating indicator on the adjusted P&L:

- **adjusted gross margin** corresponds to the difference between sales and the cost of sales, less expenses recorded in cost of sales that are directly related to business combinations, which are unusual by nature,
- **adjusted indirect costs** correspond to the indirect costs on the consolidated profit and loss account (research and development expenses, marketing and selling expenses, general and administrative expenses), less expenses recorded as part of these expenses and that are directly related to business combinations, which are unusual by nature;

- **adjusted net income** corresponds to net income, excluding the following items and net of the corresponding tax effects:
  - amortisation of acquired intangible assets (PPA) recorded as part of business combinations,
  - expenses recognised in income from operations, that are directly related to business combinations, which are unusual by nature,
  - gains and losses on disposals of assets, changes in scope of consolidation and other,
  - changes in the fair value of derivative foreign exchange instruments (recognised under "Other financial income and expenses" in the consolidated financial statements),
  - actuarial gains (losses) on long-term benefits (recognised under "Finance costs on pensions and other long-term employee benefits" in the consolidated financial statements);
- **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.

Readers are reminded that only the consolidated financial statements at 31 December were audited by the statutory auditors, including the calculation of EBIT, which is described in Note 2 "Segment Information" to the consolidated financial statements, and free operating cash flow, which is described and computed in Note 6.4. Adjusted financial information other than that provided in the notes to the consolidated financial statements is subject to the verification procedures applicable to all information included in this press release.

In this management report, 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 changes are calculated based on underlying amounts, which feature in the consolidated financial statements.

"Organic change" measures the movement in monetary indicators excluding the effects of changes in exchange rates and scope of consolidation. It is defined as the difference between (i) the indicator for the prior period, recomputed at the exchange rates applicable for the current period to entities whose reporting currency is not the euro, less the contribution of entities divested during the current period, and (ii) the value of the indicator for the current period less the contribution of entities acquired during the current period.

The impact of these adjustment entries on the income statements at 31 December 2017 and 31 December 2016 is shown in the tables on pages 4 and 5. Calculation of free operating cash flow is outlined on page 6.

> CALCULATION OF EBIT AND ADJUSTED NET INCOME – 2017

(in € millions)	2017 consolidated profit and loss account	Adjustments: Amortisation of intangible assets (PPA), related charges [(a)]	Adjustments: Gains (losses) on disposals and other	Adjustments: Change in fair value of foreign exchange derivatives	Adjustments: Actuarial differences on long-term employee benefits	2017 adjusted P&L
Sales	**15,795**					**15,795**
Cost of sales	(11,951)	1				(11,951)
Research and development expenses	(802)	5				(797)
Marketing and selling expenses	(1,041)	5				(1,036)
General and administrative expenses	(550)	7				(542)
Restructuring costs	(81)					(81)
Amortisation of acquisition-related intangible assets (PPA)	(113)	113				0
Income from operations	**1,258**					**N/A**
Impairment of non-current assets [(b)]	0					0
Disposal of assets, changes in scope and other	(82)		82			0
Share in net income of equity affiliates	135	19				154
EBIT	**N/A**					**1,543**
Impairment of non-current assets [(b)]	0					0
Cost of net debt	5					5
Other financial income and expenses	(99)			70		(29)
Finance costs on pensions and other long-term employee benefits	(66)				3	(63)
Income tax	(264)	(85)	(29)	(24)	(1)	(403)
Net income	887	65	53	46	2	1,052
Non-controlling interests	(65)	(5)		(1)		(71)
NET INCOME, GROUP SHARE	**822**	**60**	**53**	**46**	**2**	**982**
Average number of shares (thousands)	211,661					211,661
NET INCOME, GROUP SHARE, PER SHARE (in €)	**3.88**					**4.64**

(a) Including expenses related to acquisitions recorded in income from operations. See definitions of EBIT and adjusted net income on pages 8 and 9.
(b) Included in "Share in net income of equity-accounted companies" in the consolidated income statement and in "Net income" in the adjusted income statement.

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> CALCULATION OF EBIT AND ADJUSTED NET INCOME – 2016

		Adjustments				
(in € millions)	**2016 consolidated profit and loss account**	**Amortisation of intangible assets (PPA), related charges [a]**	**Gains (losses) on disposals and other**	**Change in fair value of foreign exchange derivatives**	**Actuarial differences on long-term employee benefits**	**2016 adjusted P&L**
Sales	**14,885**					**14,885**
Cost of sales	(11,277)	1				(11,276)
Research and development expenses	(736)	6				(731)
Marketing and selling expenses	(1,023)	6				(1,017)
General and administrative expenses	(544)	7				(537)
Restructuring costs	(101)					(101)
Amortisation of acquisition-related intangible assets (PPA)	(107)	107				0
Income from operations	**1,097**					**N/A**
Impairment of non-current assets [b]	0					0
Disposal of assets, changes in scope and other	205		(205)			0
Share in net income of equity affiliates	120	11				131
EBIT	**N/A**					**1,354**
Impairment of non-current assets [b]	0					0
Cost of net debt	6					6
Other financial income and expenses	(81)			70		(10)
Finance costs on pensions and other long-term employee benefits	(78)				12	(66)
Income tax	(256)	(58)	28	(24)	(4)	(314)
Net income	1,015	79	(177)	46	8	970
Non-controlling interests	(68)	(4)		(1)		(74)
NET INCOME, GROUP SHARE	**946**	**75**	**(177)**	**45**	**8**	**897**
Average number of shares (thousands)	210,872					210,872
NET INCOME, GROUP SHARE, PER SHARE (in €)	**4.49**					**4.25**

(a) Including expenses related to acquisitions recorded in income from operations. See definitions of EBIT and adjusted net income on pages 8 and 9.
(b) Included in "Share in net income of equity-accounted companies" in the consolidated income statement and in "Net income" in the adjusted income statement.

(1) Compte tenu d'un effet change négatif de 316 M€ et d'un effet de périmètre net positif de 81 M€, principalement lié à la consolidation de la société Vormetric à compter de mars 2017 (secteur Défense & Sécurité).

CALCULATION OF FREE OPERATING CASH FLOW

(in € millions)	2017	2016	Change
Operating cash flow before interest and tax	**1,776**	**1,698**	**+78**
Change in working capital and reserves for contingencies	223	(63)	+286
Pension expense, excluding contributions related to the reduction of the UK pension deficit	(121)	(102)	–19
Net interest (paid)/received	8	(8)	+16
Income tax paid	(91)	(99)	+9
Net cash flow from operating activities, excluding contributions related to the reduction of the UK pension deficit	**1,796**	**1,426**	**+369**
Net operating investments	(431)	(472)	+41
FREE OPERATING CASH FLOW	**1,365**	**954**	**+411**
Net (acquisitions)/disposals	(80)	(94)	+15
Contributions related to the reduction of the UK pension deficit	(82)	(88)	+6
Dividends paid	(349)	(297)	–52
Changes in exchange rates and other	(248)	(87)	–162
CHANGE IN NET CASH	**606**	**388**	**+218**

1.1.1.3 Order intake

2017 **order intake** amounted to **€14,920 million, down 10%** on 2016 (-9% at constant scope and currency[1]). The **book-to-bill** ratio was **0.94** for the year, compared to **1.11** in 2016 and **1.34** in 2015, both years marked by an exceptional intake of large contracts, notably with the booking of 6 major orders[2].

(in € millions)	2017	2016	Total change	Organic change
Aerospace	5,200	5,872	–11%	–11%
Transport	1,780	1,504	+18%	+20%
Defence & Security	7,883	9,063	–13%	–12%
Total – operating segments	**14,863**	**16,439**	**–10%**	**–9%**
Other	57	75		
TOTAL	**14,920**	**16,514**	**–10%**	**–9%**
Of which mature markets[a]	10,824	10,138	+7%	+7%
Of which emerging markets[a]	4,095	6,376	–36%	–35%

(a) Mature markets: Europe, North America, Australia, New Zealand. Emerging markets: all other countries.

The consolidated **order book** remained at a high level: **€31.91 billion** at 31 December 2017, an increase of €7.4 billion (30%) since the launch of Ambition 10 (€24.47 billion at 31 December 2013).

Thales received **19 large orders with a unit value of over €100 million**, representing a total amount of €2,915 million:

- one contract booked in Q1 2017, for the provision of a telecommunications satellite to the Russian operator Gazprom Space System;
- seven large orders booked in Q2 2017:
  - the supply of in-flight entertainment (IFE) systems to a major carrier,
  - the construction for Inmarsat of a very high throughput satellite (V-HTS),
  - the operation and maintenance of critical security, information and communication systems at the French Ministry of Defence's new headquarters,
  - a contract in the framework of the development and construction of five intermediate-sized frigates (FTIs) for the French Navy,
  - Thales's stake in the manufacturing of the first armoured vehicles for the Scorpion programme, for the French Ministry of Defence,
  - the supply of AREOS reconnaissance pods to a military customer,
  - the delivery of several systems and sensors to an emerging-market Navy;

(1) Taking into account a negative exchange rate effect of €142 million and a net positive scope effect of €5 million, mainly linked to the consolidation of RUAG's opto-electronic business as at 1 January 2017 (Aerospace segment), Vormetric as at 16 March 2016 and Guavus as at 12 September 2017 (Defence & Security segment), off-set by the disposal of the identity management business, effective as at 9 May 2017 (Defence & Security segment).
(2) With a unit value of more than €500 million.

- three large orders booked in Q3 2017:
  - an additional contract in the framework of the development and construction of the intermediate-sized frigates (FTIs) for the French Navy,
  - the notification of an additional contract in the framework of the CONTACT tactical digital communications programme for the French Ministry of Defence,
  - The sale of an integrated air defence system to an Asian country;
- eight large orders booked in Q4 2017:
  - a new tranche of the construction programme for 6 meteorological observation satellites "Meteosat Third Generation", for ESA and EUMETSAT,
  - the modernisation of the signalling and telecommunication systems for one of the main railways in Egypt,
  - the extension of a signalling project for one of the world's largest undergrounds,
  - a further contract related to the 36 Rafale fighter aircraft ordered by the Indian government,
  - an operational support contract for the European air defence systems on behalf of OCCAR, to be delivered through the Eurosam joint venture,
  - the support of the "Voyager" air-tanker programme for the United Kingdom's air force,
  - the second part of the SSOP sensor support contract for the United Kingdom's Royal Navy,
  - the first tranche of the Aerospace consumables logistics programme for the French armed forces (LORCA programme).

Orders with a unit value of less than €100 million grew by 1% compared to 2016.

From a geographical point of view, order intake was logically down in emerging markets (€4,095 million, -36%), Asia having benefited in 2016 from the order related to Indian Rafale fighter aircraft and the Middle East, of 2 large orders[1]. Order intake in mature markets recorded growth (€10,824 million, +7%), driven especially by France (+28%) and the United Kingdom (+15%).

At **€5,200 million** compared to €5,872 million in 2016, order intake in the **Aerospace** segment was down 11%. Avionics, both civil and military, was particularly robust. In-flight entertainment (IFE) maintained a solid commercial performance, in both the fields of traditional multimedia systems and in connectivity. Space order intake was however significantly down, affected by the wait-and-see attitude of telecommunications satellite operators and by a high basis of comparison in the institutional area (observation, exploration, navigation).

Order intake in the **Transport** segment totalled **€1,780 million**, up 18% on 2016, driven by robust growth in both urban and mainline signalling.

At **€7,883 million**, order intake in the **Defence & Security** segment posted a **13%** fall which can be explained by India's 2016 booking for Rafale fighter aircraft. Excluding this "one-off" item, order intake in this segment was up, benefiting from robust bookings across almost all businesses.

1.1.1.4 Sales

(in € millions)	2017	2016	Total change	Organic change
Aerospace	5,985	5,812	+3.0%	+3.6%
Transport	1,761	1,603	+9.9%	+11.2%
Defence & Security	7,983	7,390	+8.0%	+9.4%
Total – operating segments	**15,729**	**14,805**	**+6.2%**	**+7.3%**
Other	66	80		
TOTAL	**15,795**	**14,885**	**+6.1%**	**+7.2%**
Of which mature markets[a]	10,913	10,395	+5.0%	+5.8%
Of which emerging markets[a]	4,882	4,490	+8.7%	+10.3%

(a) Mature markets: Europe, North America, Australia, New Zealand. Emerging markets: all other countries.

Sales for 2017 stood at **€15,795 million**, compared to €14,885 million for 2016, up 6.1% on a reported basis, and up **7.2% at constant scope and exchange rates**[2] ("organic" change), driven by very good momentum across virtually all segments.

As expected, sales saw a marked acceleration in the fourth quarter (+12.5% on reported basis, +14.8% in organic terms), driven by a weak basis of comparison and by phasing effects between Q3 and Q4 2017.

From a geographical perspective, this good performance reflects both continued strong growth in emerging markets, running at more than 10% for the fourth consecutive year (+10.3%), and increased organic growth in mature markets (+5.8%, after +3.9% in 2016 and +0.5% in 2015). Emerging markets accounted for 31% of Group sales, up from 30% in 2016 and 23% in 2013, the year prior to the launch of Ambition 10.

Sales in the **Aerospace** segment came in at **€5,985 million**, up 3.0% compared to 2016 (up +3.6% at constant scope and currency). The commercial avionics business remained robust, driven in particular by the growth in deliveries of avionic systems to Airbus. In-Flight Entertainment was affected by a high basis of comparison and posted a slight drop in sales as a result. Space sales experienced strong growth, lifted by the ramp-up of contracts signed in 2014 and 2015 in both observation and telecommunications activities. Sales in other segment businesses fell, as the growth in the training and simulation business was insufficient to offset the declining sales of microwave tubes, affected by the slowdown of the global satellite market.

(1) In-flight entertainment systems for Emirates' future Boeing 777X as well as the signalling systems for the Dubai metro extension.
(2) Taking into account a negative exchange rate effect of €145 million and a net positive scope effect of €2 million, mainly linked to the consolidation of RUAG's opto-electronic business as at 1 January 2017 (Aerospace segment), Vormetric as at 16 March 2016 and Guavus as at 12 September 2017 (Defence & Security segment), off-set by the disposal of the identity management business, effective as at 9 May 2017 (Defence & Security segment).

In the **Transport** segment, sales totalled **€1,761 million**, up 9.9% compared to 2016 (up +11.2% at constant scope and currency). This growth reflected the progress on the major urban signalling projects won in 2015 and 2016 (Doha, Dubai, Hong Kong, London). The strong rise in sales in the fourth quarter is not representative of the trend in this business activity; it reflects a low basis of comparison and phasing effects between quarters.

Sales in the **Defence & Security** segment were **€7,983 million**, up 8.0% compared to 2016 (up +9.4% at constant scope and currency). Almost all businesses contributed to this momentum. The Land and Air Systems business recorded particularly acute growth in optronics, missile electronics, Air Traffic Management and protected vehicles, with the ramping-up of the Hawkei vehicle supply contract for the Australian Defence Force. The Defence Mission Systems business posted strong growth for combat aircraft systems, driven by the 3 major Rafale contracts in Egypt, Qatar and India. Despite favourable dynamics in cybersecurity and military network and infrastructure systems, the Secure Information Systems and Communication business posted a more modest growth, especially as several major critical infrastructure protection contracts came to an end.

As expected, sales in the Defence & Security segment recorded strong growth in the fourth quarter (+19.4% based on reported figures, +22.1% on an organic basis), owing to contract phasing effects and a favourable prior-year basis of comparison.

1.1.1.5 Adjusted results

EBIT

In 2017, consolidated **EBIT**[1] was **€1,543 million**, or **9.8%** of sales, compared to €1,354 million (9.1% of revenues) for the same period in 2016. EBIT advanced by 14% based on reported figures, and by 16% on an organic basis. Compared to 2013, the year before the launch of Ambition 10, it is up 53% (+50% on an organic basis).

(in € millions)	2017	2016	Total change	Organic change
Aerospace	**601**	**571**	**+5%**	**+7%**
In % of sales	*10.0%*	*9.8%*	*+0.2 pt*	*+0.3 pt*
Transport	**72**	**11**	**x6.3**	**x6.3**
In % of sales	*4.1%*	*0.7%*	*+3.4 pt*	*+3.3 pt*
Defence & Security	**869**	**787**	**+10%**	**+13%**
In % of sales	*10.9%*	*10.7%*	*+0.2 pt*	*+0.3 pt*
Total – operating segments	**1,542**	**1,370**	**+13%**	**+15%**
In % of sales	*9.8%*	*9.3%*	*+0.5 pt*	*+0.6 pt*
Other – excluding Naval Group	(47)	(49)		
Total – excluding Naval Group	**1,495**	**1,321**	**+13%**	**+15%**
In % of sales	*9.5%*	*8.9%*	*+0.6 pt*	*+0.7 pt*
Naval Group (35% share)	48	34		
TOTAL	**1,543**	**1,354**	**+14%**	**+16%**
In % of sales	*9.8%*	*9.1%*	*+0.7 pt*	*+0.8 pt*

The **Aerospace** segment posted EBIT of **€601 million** (**10.0%** of sales), versus €571 million (9.8% of sales) in 2016. The EBIT margin rose in particular in the Space and cockpit avionics businesses, even as the Group implemented a sharp upturn in R&D investments. Profitability remained however under pressure within the microwave and imaging systems activities, affected by the slowdown in the global satellite construction market.

EBIT for the **Transport** segment continued to grow sharply, at **€72 million** (**4.1%** of sales), compared to €11 million (0.7% of sales) in 2016. This improvement is fully in line with the recovery plan that has been implemented since mid-2015, but low or zero margin contracts continued to weigh down on profitability. Ongoing transformation efforts and the gradual phasing-out of low-margin contracts should help this business regain its past profitability levels by 2018/2019.

EBIT for the **Defence & Security** segment was **€869 million** (**10.9%** of sales), compared to €787 million (10.7% of sales) in 2016. Just as in 2016, the EBIT margin for this segment improved organically by 0.3 points, driven by sales growth, good cost control and a drop in restructuring costs.

Naval Group's contribution to EBIT totalled **€48 million** in 2017, compared to €34 million in 2016, buoyed by the improved operating profitability in naval defence (which nevertheless included a few one-time items), partially offset by the depreciation of some assets in renewable marine energies..

Naval Group's contribution to EBIT totalled **€48 million** in 2017, compared to €34 million in 2016, the improved operating profitability being partially offset by the depreciation of some assets in renewable marine energies.

Adjusted financial result

At **€5 million** in 2017 compared to €6 million in 2016, the amount of **net financial interest** remained low. **Other adjusted financial results (expense)** amounted to a net expense of **-€29 million**, compared to a net expense of -€10 million in 2016, primarily due to a less favourable foreign exchange performance. **Adjusted finance costs on pensions and other employee benefits** remained stable (**-€63 million**, versus -€66 million in 2016), with the rise in pension obligations between 1 January 2016 and 1 January 2017 offset by a decline in discount rates.

(1) Non-GAAP measures, see definitions on pages 8 and 9.

Adjusted tax expense

Adjusted tax expense amounted to a net of -€403 million in 2017 compared to -€314 million in 2016, representing 31.0% of adjusted net income before tax and Thales's share in the net income of equity affiliates. This rise in the effective tax rate can be explained by 3 one-off non-cash items representing a negative amount of €66 million:

- the benefit from the cancellation by France of the 3% tax payable on dividends, which was offset in 2017 by the one-off tax contribution implemented by the government;
- the estimated impact of the French parliament approving a gradual reduction of corporate income tax, which will drop from 34.43% in 2018 to 25.83% in 2022; and
- the estimated impact of the drop in the United States federal tax rate, which moves from 35% to 21% as of 1 January 2018, following the approval of the "Tax Cuts and Jobs Act".

Excluding these 3 one-off items, the effective tax rate would have been 26%, the same rate as in 2016.

Adjusted net income

Adjusted net income, Group share[1] totalled **€982 million**, compared to €897 million in 2016, up **9%**.

Adjusted net income, Group share, per share[1] came out at **€4.64**, also up **9%** on 2016 (€4.25). Without the 3 one-off tax items mentioned above, the adjusted net income, Group share, would have come out at **€4.96**, up **14%** compared to 2016.

1.1.1.6 Consolidated results

Income from operations

Income from operations amounted to **€1,258 million** versus €1,097 million in 2016, up around 15%. This increase reflects the improvement in gross margin and great discipline over indirect costs, which were up just 4%. General and administrative expenses increased by 1% from 2016 to 2017

Income from operations after share in net income of equity-accounted companies

Income from operations after share in net income of equity-accounted companies amounted to **€1,311 million** versus €1,422 million in 2016, down 8%, affected by changes to the "disposal of assets, changes in scope of consolidation and other" line, which had benefited in 2016 from capital gains on the disposal of shareholdings, in Hanwha Thales and Thales-Raytheon Systems LLC. Share in net income of equity affiliates amounted to €135 million, up 12%.

Net income

Consolidated net income, Group share, came out at **€822 million** versus €946 million, down **13%**.

1.1.1.7 Financial position at 31 December 2017

At **€1,365 million** versus €954 million in 2016, **free operating cash flow**[1] reached a record level, benefiting from the rise in adjusted net income, from a good control of operating investments (€431 million compared to €472 million in 2016) and from a combination of items that improved the change in working capital requirement The cash conversion rate from adjusted net income into free operating cash flow reached 139%.

The net balance of acquisitions and disposals amounted to -€80 million. It primarily included the net cash outflow of €91 million incurred when finalising the acquisition of Guavus, one of the pioneers in real-time "big data" analytics, and the proceeds from the disposal of the identity management business finalised in May 2017.

At 31 December 2017, **net cash** totalled **€2,971 million** compared to €2,366 million at 31 December 2016, after the distribution of €349 million in dividends (€297 million in 2016).

At **€5,326 million** versus €4,640 million at 31 December 2016, **equity, Group share** was up, driven by the consolidated net income, Group share, a fall in net pension provisions, and a higher valuation of the currency derivatives portfolio.

1.1.1.8 Proposed dividend

At the Annual General Meeting on 23 May 2018, the Board of Directors will propose the distribution of a **dividend** of **€1.75** per share, an increase of 9% on 2016.

If approved, the ex-dividend date will be 30 May 2018 and the payment date will be 1 June 2018. The dividend will be paid fully in cash and will amount to € 1.30 per share, after deducting the interim dividend of € 0.45 per share paid in December 2017.

1.1.1.9 IFRS 15 implementation

In 2017, the Group continued to work on the implementation of the IFRS 15 standard "Revenue from contracts with customers". This standard, the application of which has been mandatory since 1 January 2018, provides for:

- new criteria to demonstrate the continuous transfer of control of goods to the customer and enable the recognition of revenue over time;
- the unbundling of multiple performance obligations within a single contract;
- measurement of progress towards completion of a contract (or performance obligation for unbundled contracts) based on costs incurred.

With regard to **sales** and **adjusted gross margin**, the differences are primarily due to the change in the percentage-of-completion method for long-term contracts. Currently, contract sales and margins are recognised as and when technical milestones are reached, which attest to the effective stage of completion of a portion of the work or the performance of services provided for in the contract. Under IFRS 15, the percentage-of-completion method used is the cost-to-cost method, whereby revenue is recognised based on costs incurred at a given date divided by total costs expected at completion. For each contract, depending on the stage of completion and the type of milestones reached and costs incurred during the period, this change of method may lead to the recognition of revenue and margins being deferred from one period to another.

To a lesser degree, these differences are due to certain contracts being unbundled into performance obligations with differentiated margins (particularly for contracts combining construction and operation, or the construction and launch of a satellite), which may also lead to the deferral of the recognition of revenue and margins.

Finally, the impact of the requalification of contracts no longer fulfilling over time recognition criteria is very limited. A detailed analysis of the contract portfolio found that this requalification, which could have generated very significant deferrals in the recognition of revenue and margins if it had applied to a large number of contracts, only concerns a small number, the total revenue of which represents less than 1% of the order book at 31 December 2016.

(1) Non-GAAP measures, see definitions pages 8 and 9.

Had this standard been applicable as of 1st January 2017, these impacts taken together would have led to a negative restatement of €568 million on **2017 sales**, and of €133 million on 2017 **adjusted gross margin**, which would in turn amount to 24.4% of sales (+0.0 points). As the new standard affects neither the total revenue nor the overall profitability of each contract, this restatement corresponds solely to timing differences.

The impact of the standard on **2017 adjusted indirect costs** would have amounted to −€29 million, corresponding solely to the derecognition of bid costs from costs at completion and their subsequent recognition under indirect costs for the period.

The impact on the 2017 **share in net income of equity affiliates** would have been negative by €15 million, exclusively linked to Naval Group.

As a result, **restated 2017 EBIT** would have been €1,365 million, €177 million lower than the EBIT reported for the same period. The fall in **EBIT margin** (9.0% under IFRS 15 versus 9.8% under current standards) corresponds primarily to the negative operating leverage due to lower sales, with the gross margin remaining stable in percentage, and indirect costs virtually unchanged by the standard.

These amounts reflect the impact on the aggregate sales and margin of several thousand contracts; they are not representative of the standard's impact on the financial statements of future periods.

After restatement, the **adjusted net income, Group share** would have amounted to €840 million, €142 million lower than the reported amount, reflecting the shifts in the timing of sales recognition resulting from the new standard.

The application of the standard would have had a similar negative impact, €142 million, on the **consolidated net income, Group share**.

> RESTATED KEY 2017 FIGURES

2017 (in € millions, except earnings per share (in €))	Restated for IFRS 15	Reported	Difference €m	Difference %
Order intake	14,931	14,920	+12	+0%
Order book at end of period	32,064	31,914	+150	+0%
Sales	15,228	15,795	(568)	−4%
Adjusted gross margin [(a)] *In % of sales*	3,711 *24.4%*	3,845 *24.3%*	(133)	−3% *+0.0 pt*
Adjusted indirect costs [(a)]	(2,404)	(2,375)	(29)	+1%
Restructuring costs	(81)	(81)	–	+0%
Share in net income of equity affiliates	139	154	(15)	−10%
EBIT [(a)] *In % of sales*	1,365 *9.0%*	1,543 *9.8%*	(177)	−11% *−0.8 pt*
Adjusted net income, Group share [(a)]	840	982	(142)	−14%
Adjusted net income, Group share, per share [(a)]	3.97	4.64	(0.67)	−14%
Consolidated net income, Group share	680	822	(142)	−17%
Free operating cash flow [(a)]	1,365	1,365	0	+0%

(a) Non-GAAP measures, see definitions on pages 8 and 9.

> RESTATED 2017 SALES AND EBIT BY OPERATING SEGMENT

2017	Restated for IFRS 15			Reported			Difference		
(in € millions)	Sales	EBIT	EBIT margin	Sales	EBIT	EBIT margin	Sales	EBIT	EBIT margin
Aerospace	5,747	567	9.9%	5,985	602	10.0%	−4%	−6%	−0.1 pt
Transport	1,723	57	3.3%	1,761	72	4.1%	−2%	−21%	−0.8 pt
Defence & Security	7,690	757	9.8%	7,983	869	10.9%	−4%	−13%	−1.1 pt
Total – operating segments	**15,160**	**1,380**	**9.1%**	**15,729**	**1,542**	**9.8%**	**−4%**	**−10%**	**−0.7 pt**
Other	67	−15		66	1				–
TOTAL	**15,228**	**1,365**	**9.0%**	**15,795**	**1,543**	**9.8%**	**−4%**	**−11%**	**−0.8 PT**

1.1.1.10 Update on the projected Gemalto acquisition

On 17 December 2017, Thales and Gemalto (Euronext Amsterdam and Paris: GTO) announced the signing of a merger agreement including an all-cash offer for all issued and outstanding ordinary shares of Gemalto, for a price of €51 per share cum dividend[1]. This offer was unanimously recommended by Gemalto's Board of Directors.

Preparations for this offer are proceeding as planned. The draft offer document is under review by the Dutch Financial Markets Authority (AFM). The process of obtaining the necessary regulatory authorisations is also underway. The transaction is expected to close shortly after all of the usual regulatory approvals have been secured, which is expected in the second half of 2018.

All charges directly related to this transaction will be excluded from the 2018 EBIT and adjusted net income.

1.1.1.11 2018 Outlook

As of 1 January 2018, the Group applies the IFRS 15 standard "Revenue from contracts with customers". To provide a basis for understanding the 2018 financial targets, the 2017 results restated for the application of this standard are presented on page 16.

In 2018, Thales should continue to benefit from positive trends in the majority of its markets. The acceleration of the commercial momentum in the defence businesses should offset the slowdown of the telecom satellite market. In this context, 2018 order intake is expected to be around €15.5 billion.

In spite of a more moderate growth in the Aerospace segment, sales should see an organic growth of between 4 and 5% compared to 2017 sales restated for the application of the IFRS 15 standard (€15,228 million).

The Group will continue to significantly increase its R&D investments, particularly in digital technologies. The self-funded R&D expenses should therefore increase by around 10% compared to 2017.

The growth in sales, combined with the impact of the Ambition 10 strategy on product competitiveness and differentiation, should result in Thales delivering an EBIT of between €1,620 and €1,660 million in 2018 (based on February 2018 scope and exchange rates), representing an increase of 19% to 22% compared to 2017 EBIT restated for the application of the IFRS 15 standard (€1,365 million).

Therefore, the Group expects to exceed its two mid-term objectives: the average organic sales growth in the 2016-2018 period should be over 5%, and the 2018 EBIT margin should be above the top end of the range set in April 2014 (9.5% to 10% in 2017/2018).

This outlook does not take into account the projected acquisition of Gemalto. The Group may need to update its outlook depending on the effective conclusion date of this transaction.

The Group will provide a detailed update on its strategy and set medium-term financial targets at a Capital Markets Day to be held on 6th June 2018, at its Gennevilliers site, in the Paris area.

1.1.2 Risk factors

Thales is exposed to numerous 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, currently unknown to Thales, 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 and strategic risks (Section 1.1.2.1), legal and compliance risks (Section 1.1.2.2) and financial risks (Section 1.1.2.3).

See also Section 1.1.3 "Internal control and risk management".

1.1.2.1 Operational and strategic risks

1.1.2.1.1 Control of bids and projects

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 their equivalent, local shares, compensation commitments (see Section 1.1.2.1.10), etc.).

The actual cost of 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 strong 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 assessment and management 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.

Numerous Thales contracts, particularly those that involve the most complex products and services, run for several years. Their economic contribution to the Group's result over a given period is therefore assessed, in accordance with applicable accounting standards, based on an estimate of their cost to completion.

These assessments can result in uncertainties that require subsequent correction despite the careful attention that is paid to estimates for each project through regular reviews to measure the technical, contractual and financial progress made.

(1) Valuing the equity capital of Gemalto at approximately €4.8 billion.

The Group pays special attention to analyses and action plans for efficiently managing bids and projects by measuring and monitoring financial variance on the projects as well as appropriately applying corrective actions.

As part of the Ambition Boost performance programme (see also Section 1.1.2.1.8 "Risk of lower impact of performance improvement measures"), 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 product policy and ensure it is better adapted to customer needs in order to streamline new developments and thus reduce risks;
- improve the management of commitments in both the bidding phase and the project phase, with the 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 solutions for products and projects (during the bid or project implementation phase);
- Improve the supply chain, by increasing its global dimension and enhance the increasing maturity of emerging countries in project implementation;
- improve methods, practices and tools to make them more relevant to international products/projects, in particular, through the implementation of a project management tool adapted to emerging countries, SAP by Design;
- introduce advanced training for project managers to obtain certification issued jointly with the International Project Management Association (IPMA). At the end of 2017, nearly 1,353 bid and project managers and project management officers (PMO) within the Group had gained IPMA certification, with approximately 187 certified during the year. The role of these project managers will be further increased within the PMO organizations and teams.

1.1.2.1.2 Supplier risk

Purchases constitute a very significant proportion of Thales's business, representing nearly half its sales with purchases ranging from industrials to services, equipment and sub-systems. Thales is therefore exposed to the risk of the industrial, technical or financial default of any of its suppliers, which could affect tits performance and, hence, profitability.

There are two major types of supplier risk:

- legal or regulatory non-compliance (ethics, export control, intellectual property, etc.); each of these risks is 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 in 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 disasters, 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.

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 inventories that cover its requirements until customer contracts have been fulfilled.

In addition, given 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, this is aimed at identifying, from among its critical suppliers, those that would be particularly susceptible financially and implementing appropriate action plans to ensure continuity of supply. Apart from individual monitoring, an analysis is also carried out by technology field in conjunction with the professional bodies concerned, to identify the most 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 performing a purchasing contract, Thales closely monitors the implementation by the supplier of measures aimed at addressing the risks identified during the selection process.

Risk of economic dependence

The economic dependence of small and medium-sized enterprises (SMEs) towards Thales is considered a risk in its own right.

In order to mitigate this risk, the commitment rate (orders placed by Thales as a percentage of the supplier's annual sales) is measured 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 created in order to return to a commitment rate of 25%.

The purchasing policy, supplier selection and performance monitoring processes, and the supplier monitoring systems are designed to reduce these risks, during both the bidding phase and the project implementation phase.

1.1.2.1.3 Human resources risk

a) Workplace health and safety

One of the Group's key priorities is to provide a safe and healthy work environment for all employees, in compliance with applicable law, by monitoring procedures, preventing health and occupational risks and training employees.

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.

Tangible measures are also implemented in relation to the prevention of risks related to the health and safety of employees in the workplace by the Group's Human Resources and Health, Safety and Environment Departments. For many years, Thales has also been committed to improving the quality of life in the workplace. In France, a third Group agreement on "quality of life in the workplace" is under negotiation to increase the Group's commitments and actions relating specifically to protecting the health of employees, improving well-being at work, preventing psychosocial risk situations and the right to disconnect to ensure a good work-life balance.

Proof of the Group's continuing commitment to certification, 107 Thales entities (representing 82% of the workforce) had obtained OHSAS 18001 certification by the end of 2017.

b) Talent development

If Thales is not attractive enough compared to its competitors to recruit the qualified staff it needs in a timely manner and to retain and motivate its employees, 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 to globally manage the talent required for the development of its activity worldwide.

Thales therefore attaches great importance to its attractiveness and positioning as a top employer, ensuring a positive external image which will boost recruitment and an internal work environment that will contribute to retaining 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 and in the countries in which Thales plans to expand, notably through communication campaigns and partnerships with leading universities. In addition, a global recruitment role, reporting to the corporate HR department has been created to help the Group expand in these geographical zones.

Thales works constantly to support its employer brand. The Group recently updated its brochures, booths, posters, web visuals and all other communication materials used at the various recruitment events worldwide and on Thales's social media pages. The Group currently has more than 230,000 followers on LinkedIn.

Thales has also developed innovative initiatives to attract rare skills in fields such as in electronics and cyber-security, by organising challenges for students and young engineers such as cyber-security week and the Arduino project, a university competition held in 10 countries. This project gives more than 100 teams of young engineers the opportunity to develop innovative projects on subjects defined by the Group. These events give young engineers from across the world an insight into the Group and its business activities.

In recent years, Thales has also contributed to the integration of young people into business through the signature of close to 1,500 work-study contracts each year. Thales maintains active relations with schools and universities in all the countries where it intends to increase its presence. Many partnerships have been signed with these schools, which employees sometimes visit to provide training. Thales also has a presence on campuses through young employees who are alumni of these schools, and form a network of contacts. In France, Thales is regularly recognised as one of the top three companies by students of engineering schools.

The global process of identifying and developing 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 proactive 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 creates action plans (for training, anticipated management of internal mobility, external recruitment, etc.). To complement this tool, each year the Group's internal university updates key training programmes in response to changing needs. Significant work was carried out from 2014 to 2016 to pinpoint employee soft skills, namely for those employees reporting to the R&D Systems, R&D Hardware, R&D Software, Purchasing and Project Management job families. This work helps to more precisely identify training and recruitment requirements. In July 2017, Thales University, renamed Learning Hub, was completely overhauled to adapt its training tools to the digital era and to better integrate the training into employees' professional life.

Lastly, in 2013, the Group signed a series of agreements with the unanimous support of the trade union organisations in France that encourage the integration of young people, either on work-study training schemes or post-qualification, and the transfer of knowledge (the Intergenerational Agreement); that develop diversity (the Gender Equality Agreement); and that take a forward-looking approach to jobs and skills. In 2017, the number of young people on work-study contracts in Thales's workforce in France represented close to 5%, in line with the agreement signed in 2013.

1.1.2.1.4 Environmental risks

For many years, Thales has conducted a regular analysis and update of environmental risks in accordance with its business activities, scientific and technical developments as well as with current regulatory change.

This analysis is aimed at:

- regularly ensuring that employees and neighbouring residents are not exposed to health and environmental risks (hazardous substances, pollution, asbestos, etc.) through their activities or work environment, whether on Thales or external sites;
- ensuring the compliance of activities and products used and/or marketed (substances, waste, etc.);
- analysing the impact of new regulations (e.g. REACh in Europe) on the supply chain and on product design;
- analysing the impact of the environment on activities (water stress, climatic events, etc.);
- identifying an appropriate organisational structure and associated action plans, either at Group level or locally, based on the results of this analysis to reduce and manage the associated risks.

To support this analysis, an environmental management system designed to ensure control and limitation of the environmental impacts of activities and products is implemented on all sites. This management system, which forms an integral part of the Group's framework, encompasses the different functions of the Group (engineering, manufacturing, supply chain, etc.) and is based on frameworks, special training, communication tools and sharing experience.

At the end of 2017, 124 entities had been ISO 14001 certified, representing 89% of the Group's workforce, 33 had been ISO 50001 certified, representing 26% of the Group's workforce and 107 had been OHSAS 18001 certified, representing 82% of the Group's workforce.

Thales also regularly assesses the risks linked to climate change in order to evaluate their impact on activity and costs. The main risks identified are:

- regulatory change (reporting, carbon taxes, etc.) which has a very limited impact for Thales (not affected by the EU Emissions Trading Scheme). Nevertheless, Thales closely monitors current and future laws and regulations in order to analyse and anticipate their impact and set in place the requisite measures;

- changes in the regulations on substances and products (REACh in Europe and elsewhere in the world) in order to anticipate obsolescence issues to secure its supplies, reduce and control the impacts on the products and services it delivers through the required avoidance and replacement measures; but also to control the risks related to the handling of hazardous substances, for both people and the natural environment;
- financial risks related to the effects of climate change (floods, hurricanes, fires, water stress, etc.) that can result in damages and a continuous disruption in activity at Thales sites as well as the sites of its subcontractors and partners.

  To manage this risk and reduce its vulnerability, Thales has carried out regular assessments of the exposure of its different sites to natural disasters and their consequences for several years now. Action plans linked to these assessments have been defined in order to attenuate this risk (see Section 5.2.4), and the Group's insurance policy (see Section 1.1.2.4 "Insurance") is also based on these assessments;
- risks related to water shortages. The majority of Group sites in vulnerable areas are offices that have very limited risk exposure given their low water consumption.

  An analysis of "natural disaster" and "water stress" risks is now included in the regular prevention visits at Thales' sites and those of our critical subcontractors and suppliers;
- image risk: any failure by Thales to implement adequate measures in the fight against climate change could have a specific negative impact on its corporate image. Thales publishes information on the measures it has put in place to combat climate change and the results it obtains (see also Section 5.2.4) for its stakeholders (customers, investors, civil society, etc.). In 2017, it was awarded a rating of A- for "climate change" in the CDP (Carbon Disclosure Project), placing it in the top 20% of best-performing companies listed. In keeping with the commitments made in 2015, in December 2017 Thales signed the Paris "French Business Pledge"[1].

At 31 December 2017, provisions for environmental risks amounted to €5.7 million.

1.1.2.1.5 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, cyber-attacks, threats to the physical security of facilities and persons, etc. The occurrence of such events could affect the Group's intellectual, economic or human capital, the rollout of the Group's activities and its reputation and, consequently, its results and financial position.

In order to minimise these risk, the Group Security department has put in place a policy for regulating access to and movement around all sites. This policy, applied by the Group's network of security officers, is in keeping with the Group's defence businesses and the different national regulations requiring it to implement measures to protect its employees and industrial assets. The Group is therefore required to undergo a large number of audits and inspections by the national supervisory authorities.

It has also implemented a global procedure for employee safety and protection in all of 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.

Faced with the current heightened terrorist threat, the Group has increased the level of security and protection for its most sensitive sites.

Finally, in close collaboration with the other major functions concerned, the Group Security department is working to improve crisis management processes, put in place rules and define a policy to raise awareness on information protection.

1.1.2.1.6 Risk of IT system failure

The Group operates – whether directly or through service providers – complex IT systems and infrastructures that are essential to the smooth running of its commercial, industrial and financial processes. These information systems include management, development and engineering systems as well as platforms operated on behalf of our customers and must be protected against any malfunctions, natural disasters, malicious acts or human error at all costs. The malfunction or failure of these systems may have external causes (viruses or hacking, network failures, natural disasters, etc.) or internal causes (malicious acts, breaches of data confidentiality, human error or obsolescence). Any such malfunction or failure can 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 develop its protection measures in order to deal with part of its IT systems being temporarily or permanently unavailable, as well as any cyber-security threats to these systems.

Business continuity

A Disaster Recovery Plan is adapted to the different countries to deal with failures of part of Thales's IT systems; a methodology to prevent the risk of a failure of the Group's IT systems is applied to ensure disaster recovery solutions are adapted to the degree of the risk and its operational impact. The plan is based on an analysis of the criticality of the different services given their impact on the Group's operations and undergoes regular test runs.

Cybersecurity

A plan to protect against risks related to cyber-security has been defined and implemented in countries where the Group currently operates. As well as adapting the means of protection already in place, the plan includes the introduction of new measures to heighten protection against cyber sabotage attacks (e.g. Wannacry) to identify and correct any non-compliance. It is adapted to new regulations (military programming law in France, general regulations on data protection) and to technological developments (e.g. cloud computing).

This plan also includes the implementation of "CyberSecurity Operation Centres" coordinated at global level, so that anomalies and incidents that could affect the security of systems are identified as early as possible and the appropriate solutions put in place. These measures for monitoring and sharing information in relation to vectors of attack were further developed throughout 2017.

A number of "Key rules" on the security of Thales's information systems ensure the convergence and coherence of cyber-security and defence measures throughout the Group. Their effective application is regularly monitored and reporting submitted to the Group Information Systems Security department.

Awareness and know-how

The plan is completed by ongoing efforts to raise employee awareness of these threats: communication campaigns and training are rolled out to help users ensure the security of their IT systems and remind them of the best practices when using them. Regular forums for discussion attended by all employees are also held on site. Since 2017 new employees have also been made aware of cyber security issues.

(1) French Business Pledge: on the eve of the One Planet Summit on 12 December 2017, 91 French companies of all sizes and from all sectors announced the signature of a shared commitment to climate. Each of these companies put forward its actions as a committed player in the fight against global warming.

1.1.2.1.7 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 commercial or military platforms. A malfunction of any such systems, equipment or technologies could result in client claims or third-party litigation. Thales could therefore be held liable, notably in the event of damage to property or personal injury, or in the event that they result in a disruption in the business and activities of its customers. 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 "Insurance").

1.1.2.1.8 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. Five new cross-disciplinary initiatives are also now in place to complete and strengthen the performance plans: Going Global, Digital Transformation, Competitiveness, Diversity & Inclusion and Leadership & Governance.

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.

Thales has introduced specific monitoring for performance improvement initiatives and the Group's corporate management regularly reviews the progress of the main initiatives.

1.1.2.1.9 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 a less favourable 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 investments in order to provide more competitive and differentiating elements, and it also works to structure and upgrade its product offer in order to always best meet the needs of its customers in both the defence and commercial markets.

The Group's success and performance in relation to its competitors also depends on its capacity to recruit and retain quality employees with the requisite skills and commitment. Thales therefore attaches great importance to its attractiveness and positioning as a top employer, ensuring a positive external image which will boost recruitment and an internal work environment that will help retain employees (see Section 1.1.2.1.3-b) "Talent development").

1.1.2.1.10 Offsets

In some countries, the awarding of major contracts, particularly defence contracts, may be dependent on a legal or regulatory requirement to fulfil a direct, semi-direct or indirect offset requirement. The Group's ability to factor this into a proposal can be a major source of differentiation and, as such, have a decisive impact on its commercial success or failure.

The non-fulfilment of contractual offset obligations within the requisite deadlines can result in penalties, the payment of which does not always release the obligor from its obligations. It can also compromise the Group's capacity to expand its activities in a given country.

Thales's order intake in recent years (particularly the order for the Rafale fighter aircraft placed by the Indian authorities in the third quarter of 2016) has led to a substantial increase in its offset obligations.

Faced with these risks, Thales has set in place a dedicated structure, both at a central level and for its exporting units and destination countries, which is responsible for integrating and overseeing these obligations as early as the bid phase. The Group also has a specific unit that is entirely devoted to the management of indirect offsets, Thales International Offsets (TIO).

1.1.2.1.11 Market trends

The markets on which Thales operates are broadly correlated to the current economic backdrop, but can also be impacted by specific factors: technological breakthroughs, the impact of digitalisation, drastic changes in Business Models, deregulation, new standards, real or perceived increase in the threat of terrorism, changes in oil prices, conflicts or major political change, epidemics and disasters that could have an impact, however temporary, on these markets. This is particularly true of the civil aviation market.

As part of the development of its activities related to in-flight broadband, Thales entered into a strategic agreement with SES in 2016 to secure bandwidth over the Americas. Under this agreement, Thales committed to an annual bandwidth purchasing programme over the 2016 to 2028 period and the payment to SES of a set minimum fee. The profitability of this business could therefore be affected if the sale of the broadband services was lower than forecast for several consecutive years.

The main risk mitigation factors are Thales' efforts to bolster and promote the offer to airlines and the flexibility built into the agreement.

In the space sector, the telecommunications satellite market is affected by constant technological developments resulting in a decrease in the Megabyte transmission cost. Some operators face complex technological challenges which force them to postpone their investments. In particular, uncertainties remain in the articulation between new constellation models and the more traditional satellites in high orbit which are becoming increasingly technologically advanced, allowing for the development of higher capacity solutions. Thales is developing its offer and investing in breakthrough technologies to embrace these developments.

More generally, to limit the impact of market risk, Thales constantly seeks (i) to adapt its product lines to foreseeable changes in demand and to improve their competitive performance and industrial flexibility in line with fluctuations in activity, and (ii) a comprehensive strategy to balance its business portfolio.

1.1.2.1.12 Dependence on public procurement

Thales generates a significant share of its business from governments, particularly in the defence markets in many countries. 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 reduction in the budget resources of government customers could, for example, generate delays in order booking, contract execution and payments, or mean a cut 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 order base 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.

1.1.2.1.13 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' 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, that prevent the anticipated progress of that contract.

To limit the financial impact of the risks listed above, Thales has put in place a methodology to identify and analyse the risks, determine measures to reduce them and define roles and responsibilities, within Thales, for the teams involved in the financial engineering of contracts. This enables Thales to use public or private insurers to cover the risk of contract interruption, credit risk or the risk of unfair calling of sureties. It can also make use of financial instruments such as notified or confirmed letters of credit, receivables discounting without recourse or export credit facilities.

In June 2016, by referendum, the United Kingdom, which represents approximately 9% of Group sales and 6,400 employees, voted to leave the European Union. This decision could have a number of consequences on the activities and financial performance of Thales. It could notably lead to a higher degree of volatility between the pound sterling and the euro, in interest rates and in the value of plan assets covering the Group's pension commitments in the United Kingdom. The management of these financial risks is part of the procedures set in place by the Group and described in Section 1.1.2.3 "Financial risks". The risk of an increase in tariff barriers is automatically reduced by Thales's predominant use of local country production resources a strategy which also tends to reduce the effects of greater volatility in the pound since sales and production costs are essentially denominated in the same currency.

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 assumptions which form the basis of their valuation and the investment decision. Significant variance could lead to the amortisation of goodwill and other intangible assets, thereby negatively impacting Thales's results and financial position.

In addition, the integration of a newly acquired company into the Group may prove difficult or fail to generate all the expected synergies and other benefits. Such events could have a negative impact on the Group's results.

The significance of these risks and their impact varies depending on the target company's size.

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. This due diligence is more limited when the target company is listed, due to the applicable regulations.

A review is also conducted at each key stage in the acquisition process to confirm Thales's interest and set 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.

An internal audit is carried out for all major acquisitions within 18 months of the finalisation of the acquisition. These audits assess the strength of the business plans that led to the decision, the integration of the newly acquired company into the Group, the implementation of synergies and the level of performance in relation to the assumptions made. The audit reports are sent to the Group's corporate management and are summarised for the Audit and Accounts Committee.

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 2017, these companies are consolidated using the equity method[1].

(1) See the list of companies accounted for under the equity method on pages 79 and 80.

By definition, the share in net income of equity-accounted companies is included in Thales's EBIT[1] and adjusted net income[1]. A deterioration in the performance of these companies may therefore impact on the Group's income, financial position and achievement of EBIT objectives.

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 deadlock, 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.

Lastly, 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 analyses 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, both nationally and internationally, in a strict and evolving complex legal and regulatory environment. This environment encompasses various fields such as company law, stock exchange law, tax law, employment law, intellectual property, personal data protection, export control, economic sanction measures, anti-corruption, influence peddling and money laundering.

Despite the steps taken by Thales in the form of organisation and internal procedures 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 approved 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 Trade Compliance, international trade, etc.) and on risk advisors responsible for the prevention of each of the major risks identified and monitored by the Risk Assessment Committee.

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.

An integrity programme linked to corruption risk prevention has been in place in all Group entities for more than 15 years. It is based on a Code of Ethics for all Group employees that is regularly updated in line with external and internal reference systems and is posted on the Group intranet. With a preface by the Chairman and CEO, it reaffirms in particular the principle of zero tolerance for any act of corruption. Thales's integrity programme was certified by independent third parties Mazars and ADIT in 2014.

In 2017, the Group reviewed its integrity programme to bring it in line with French Law 2016-1691 of 9 December 2016 on transparency, the fight against corruption and the modernisation of the economy (known as the "Sapin II Law").

The various components of the integrity programme form an integral part of Thales's reference system (Chorus 2.0), particularly the processes which govern the management of bids and projects, purchases and subcontracting, and the use of agents and consultants. In addition to its internal control procedures, the Audit, Risks & Internal Control Department conducts regular compliance and integrity audits on the various components of the model.

The anti-corruption policy is outlined in Section 5.3.2.1 "Anti-corruption".

b) Export control and economic sanctions

The export of many products, technologies and systems for military and dual use by Thales is subject to obtaining licences issued by the French and foreign authorities in advance.

In addition, the French, European and foreign regulations including the extraterritorial regulation issued by the Office of Foreign Assets Control (OFAC), establish a framework of embargoes and economic and criminal sanctions on any natural person or legal entity, or any state in breach of these provisions.

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; (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 or will not give rise to economic sanctions (embargoes) which could prevent Thales from conducting or continuing to conduct business with certain countries or certain customers. Further limitations on access to certain international military markets could thus have a negative impact on Thales's business, financial position and profitability.

The Group has put in place an ISO 9100 certification process to ensure compliance with the regulations and controls applicable in terms of export and the economic sanctions in force. This process includes procedures, specific IT tools, employee awareness programmes, with, in particular, e-learning modules, an annual internal audit plan and a system to monitor changes in the legislation, regulations and restrictions following economic sanctions relevant to Thales's business activities.

Operating units have access to a network of specialists within the Group, who are responsible for monitoring the correct application of compliance rules decided at Group level as well as tracking requests for the required authorisations and the conformity of their implementation.

(1) Non-GAAP measures, see definition and computation in Section 1.1.1.2.

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, concerning suppliers, customers, partners and the competitors themselves.

Infringement of these rules could lead to severe sanctions, such as fines, payment of damages and interest, and statutory prohibitions and criminal penalties. Such sanctions could also have a serious impact on the Group's reputation.

To prevent these risks, a dedicated team of experts carries out competitive assessment on sensitive agreements and projects, notifying the competent regulatory authorities in Europe or abroad as required. In addition, the Group has initiated a programme to raise awareness of these rules, in particular through the drafting of directives, the implementation of online training tools and dedicated training programmes for the most exposed employees.

d) Intellectual property

Thales is exposed to two main types of intellectual property risk: dependence on third-party technology and the infringement of 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 focuses on controlling the key technology which is critical to the business. The size of Thales's internal 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 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.

Thales may be exposed to the risk of infringement of its intellectual property rights by a third party. To limit this risk, Thales contractually protects its rights in its contracts and agreements, engages in an active policy for filing and maintaining its patents, carries out technological monitoring on the equipment and systems sold by third parties to ensure that its own intellectual property rights are not infringed and, where applicable, takes all necessary measures to ensure these rights are respected.

e) Personal data protection

In the context of the application, effective 25 May 2018, of Regulation 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, Thales has committed to bringing its policies into line with this European regulation.

A Data Protection Officer has been appointed to coordinate compliance with this new European regulation within the Thales group. The Data Protection Officer relies on a network of contacts in the different functions and entities both in France and the other countries where the group operates.

Initiatives are already under way within the Group to launch this compliance process, including insertion into contractual clauses on personal data protection, the drafting of factsheets, the acquisition of a tool to record Thales's processing of personal data.

1.1.2.2.2 Litigation

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

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

In addition, for several years now Thales has implemented a procedure 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.

In October 2017, Thales was notified of an arbitration award in a commercial dispute between the Republic of China and a group of three French manufacturers, including Thales Systèmes Aéroportés, a Thales subsidiary. As a result of this arbitration award, which pertains to a contract signed in 1992, the manufacturers were ordered to pay a total sum of €227 million including interest, of which €64.2 million was payable by Thales Systèmes Aéroportés. The corresponding charge was recognised under "Disposal of assets, changes in scope of consolidation and other" in the financial statements as at 31 December 2017 (see Note 3.2 of the consolidated financial statements).

There are no other government, judicial or arbitration claims, of which the Group is aware, which are pending or threatened, which had, in the course of the last 12 months, or which could have a material impact 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 caption in Note 8 to the consolidated financial statements;
- gross debt, listed by maturity in Note 6 to the consolidated financial statements;
- committed, undrawn bank credit facilities used as backup to the commercial paper programme and as a financial reserve. These are described in more detail in Note 6 to the consolidated financial statements. At 31 December 2017, the Group also had an undrawn bridge loan to finance its proposed offer for the acquisition of Gemalto.

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 (eurozone, 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;
- gain prime access to financial markets through the parent company's financing programmes, rated by S&P Global Ratings and Moody's (see below).

At 31 December 2017, cash recorded under consolidated assets amounted to €4,282.7 million (compared with €3,616.9 million at end-2016), including:

- €3,450.5 million held by the parent company and available for immediate use (€3,183.1 million in 2016);
- €832.2 million in the credit balances of subsidiaries (€433.8 million in 2016), most of them outside France. This figure includes payments received in the last days of the financial year and subsequently transferred to the cash pooling account.

Cash at bank and equivalents at year-end is invested solely in sight and term bank deposits or in money market funds. At the date of publication, Thales's risk ratings were as follows:

	Moody's	S&P Global Ratings
Medium & long-term loans	A2	A-
Outlook	Negative	Negative watch
Commercial paper & short-term loans	Prime-1	A2

Moody's and S&P Global ratings downgraded their outlook (from "stable" to "negative" and "negative watch" respectively) following the announcement on 17 December 2017 of the planned cash tender offer for Gemalto. If this acquisition, partly financed from the Group's own cash flow and partly through borrowings, goes ahead, it would in all likelihood cause Thales's rating to be lowered, due mainly to the change in the Group's financing structure.

The decrease of Thales's credit risk rating would not trigger the financial covenants included in its financing contracts. The coming into effect of the unique clause providing for accelerated repayment of bank credit facilities would only apply in the event that the French government 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 interest rate hedging policy.

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. 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 impact net financial interest by €27.4 million in 2017 (€21.6 million in 2016).

(31/12/2017, in € millions)	< 1 year		> 1 year		Total	
	Fixed rate	Variable rate	Fixed rate	Variable rate	Fixed rate	Variable rate
Financial liabilities	(512.1)	(192.1)	(891.8)	(47.3)	(1,403.9)	(239.4)
Financial assets	–	4,614.7	–	–	–	4,614.7
Net exposure before impact of derivative instruments	**(512.1)**	**4,422.6**	**(891.8)**	**(47.3)**	**(1,403.9)**	**4,375.3**
Derivatives	296.2	(296.2)	695.4	(695.4)	991.6	(991.6)
Net exposure after impact of derivative instruments	**(215.9)**	**4,126.4**	**(196.4)**	**(742.7)**	**(412.3)**	**3,383.7**

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 eurozone, where a significant portion of its industrial operations are located. More generally, the reinforcement of the Group's international industrial footprint allows it to produce and invoice in local currency, which helps to reduce exchange rate risk on local sales.

b. The accounts of Thales's subsidiaries located in countries where the functional 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 concerned are the pound sterling, the US dollar, the Canadian dollar and the Australian dollar.

c. For certain Group businesses (commercial avionics and microwave systems, commercial space, etc.), the US dollar ("$" or "USD") 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 microwave systems), this policy is defined on the basis of sales forecasts in USD, after accounting for corresponding purchases in USD. For these transactions, net exposure to dollar risk represents around 3.5% of the Group's total sales for 2017,

- for longer-term programmes in markets traditionally denominated in USD (primarily commercial space activities), each bid is examined for profitability in light of the effect of currency fluctuations, after accounting for corresponding purchases in USD, 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 USD on an ad hoc basis.

  Overall, net exposure amounted to around 2% of the Group's total sales for 2017;
- as well as this direct dollar risk, which concerned around 5.5% in total of consolidated sales at end-2017, 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. At least 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 manage. The figures corresponding to the management of business-related dollar risk are as follows:

- $2,496 million, the amount of financial instruments hedging net firm commitments (US dollar risk against the euro, Canadian dollar and pound sterling) at 31 December 2017 compared with $2,985 million at 31 December 2016;
- financial instruments (forward transactions) used to hedge bids in US dollars against the euro, Canadian dollar and pound sterling amounted to zero at 31 December 2017 versus $310 million at 31 December 2016.

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

The change in the value of financial instruments (forward transactions) used to hedge cash flows is recognised in equity for the spot rate component. A decrease (increase) of 5% in the dollar against the main currencies (EUR, GBP and CAD), would have increased (decreased) shareholders' equity by approximately €104 million at 31 December 2017 (€153 million at 31 December 2016). The premium/discount component is not eligible for hedge accounting and is recognised through profit and loss. In 2017, the change in market value of the premium/discount was -€65.3 million (compared to -€54.0 million in 2016).

The change in value of financial instruments used to hedge commercial bids which are not eligible for hedge accounting is recognised in profit and loss. A decrease (increase) of 5% in the dollar against the main currencies (EUR, GBP and CAD) would have had no impact on profit or loss at 31 December 2017 or 31 December 2016.

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. 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 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 2017 FOR THE MAIN CURRENCIES

(in € millions)	GBP zone	USD zone	AUD zone	Other currencies & eliminations	Total
Assets	1,989.6	1,652.5	963.9	17,037.5	21,643.5
Liabilities	2,093.1	1,424.3	489.5	12,081.1	16,088.0
Net position before hedging	**(103.5)**	**228.2**	**474.4**	**4,956.4**	**5,555.5**
Hedge	–	–	–	–	–
NET POSITION AFTER HEDGING	**(103.5)**	**228.2**	**474.4**	**4,956.4**	**5,555.5**

1.1.2.3.4 Shares

Thales was not exposed to any material equity risk at end-2017, excluding the risk on treasury shares.

At 31 December 2017, Thales held 568,739 treasury shares, representing 0.27% of the share capital.

1.1.2.3.5 Pension commitments

Defined-benefit pension plans are in place for certain Group employees, mainly in the UK, which are financed by the Group under the provisions of the applicable domestic legislation. As such, at 31 December 2017, Thales's pension commitments in the United Kingdom amounted to €4,431.8 million, hedged by €3,248.7 million in investments, representing an underlying shortfall of €1,183.1 million.

Changing market parameters can lead to a substantial increase or decrease in the amount of the shortfall and the annual costs of defined-benefit plans. At 31 December 2017, the main sensitivity factors were as follows:

- a decrease 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 six-monthly reporting on its pension plan commitments and makes regular projections measuring the sensitivity of underlying shortfalls to possible market changes taking into account their correlations. In the UK, Thales 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.

Additional information on the amount of commitments and the annual costs linked to pension and other employee benefits, as well as the valuation and allocation of plan assets and the sensitivity of net commitments to different actuarial assumptions is given in Note 9.3 of the consolidated financial statements at 31 December 2017.

1.1.2.3.6 Sureties, endorsements and guarantees granted by Thales (parent company)

Thales (parent company) issues sureties, endorsements and guarantees, primarily in support of commitments undertaken by its subsidiaries through commercial contracts. The Group's Corporate Financing and Treasury Department centralises the issuance of these sureties, endorsements and guarantees.

They are issued out of an envelope of €4 billion, which is regularly delegated by the Board of Directors to the Chairman and CEO. Before each time the Chairman's authorisation is renewed, the extent of use of this envelope, which is monitored by the Corporate Financing and Treasury Department, is notified to the Board.

As of 31 December 2017, outstanding sureties, endorsements and guarantees granted by Thales (parent company) to its subsidiaries amounted to €12,760.4 million. These guarantees include all commitments given in relation to Thales Alenia Space, which are backed by a counter guarantee from Leonardo in proportion to its interest in the capital of Thales Alenia Space (33%).

Thales has initiated a programme to control risks related to these sureties, endorsements and guarantees through the parent company and to optimise the financial terms of transactions guaranteed using these instruments with the following main objectives:

- to limit the risks to those corresponding to normal commitments in commercial contracts, particularly in terms of volume and duration;
- to limit their issuance to commitments made by wholly owned subsidiaries, with guarantees commitments involving business combinations or joint ventures only being issued in proportion to the Group's interest or counter-guaranteed by the other shareholder in proportion to its interest;
- to allow its subsidiaries to benefit, where appropriate, from the credit quality of Thales (parent company), by controlling the financial terms of guaranteed transactions.

1.1.2.3.7 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 of default by private sector customers

Non-governmental customers (aircraft manufacturers, airlines, private infrastructure operators and industry) account for approximately 25% of Thales's sales. 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 the Group's sales, profitability and financial position.

To mitigate these risks, Thales conducts regular analyses 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 them could present a significant credit risk which could, for example, lead them to suspend an order in production, or render them 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 BPIFrance) or private insurers.

At 31 December 2017, only three customers accounted for annual sales in excess of €500 million: the French government (around €2.8 billion), the UK government (around €1 billion) and the Australian government (around €0.7 billion). At 31 December 2017, these three countries had first-class or high-quality ratings (France was rated AA by S&P and Aa2 by Moody's, the United Kingdom was rated AA by S&P and Aa2 by Moody's, and Australia was rated AAA by S&P and Aaa 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 insurance activities and insurable risk management. It is in charge of Group operations and oversees policy implementation by Group companies.

The Group is covered against 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;
- 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;
- cyber liability.

The Group had no major loss in 2017.

The Group's policy is to arrange cover on the insurance market based on the rates and within the limits that it considers reasonable, in view of the conditions offered by the market. Insurance policies covering the major risks may be limited in terms of guarantee (application of limits), while general exclusions for the entire market (e.g. asbestos) also apply to Thales.

In 2017, 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. In 2017, the Group renewed a specific cover against cyber incidents (IT data attack) and damages that could compromise its internal IT systems.

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, is capped at $2 billion.

The insurance industry depends on the financial markets. There are therefore 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 or high intensity 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 2017, more than 70% 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.

A risk prevention policy for critical supplier sites was also pursued to reduce the risk of operating losses for Thales in the event of an accidental disaster at one of their sites.

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 Internal control and risk management

This section was submitted to the Audit and Accounts Committee at its meeting of 15 February 2018, attended by the statutory auditors. It was prepared on the basis of the main conclusions from the internal audit, internal control and risk management work carried out by the Group in 2017. The results of this work were reviewed at the various meetings of the Risk Assessment Committee and the Risk Management Committee (see Section 1.1.3.5) during the year, and also at meetings of the Audit and Accounts Committee held in 2017.

This section is based on the AMF reference framework on risk management and internal control systems, updated on 22 July 2010.

It covers all the suggested items, albeit sometimes in a different order.

1.1.3.1 Objectives and definitions

a) Objectives of risk management

Thales adheres to the risk management objectives formalised by the AMF in its reference framework. Risk management is a management tool that Thales uses to:

- **Create and preserve the value, assets and reputation of the Group**

Risk management identifies and analyses the main threats and potential opportunities to which the Group is exposed. By anticipating the potential impact of these risks, it is intended to more effectively preserve the value, assets and reputation of the Group.

- **Secure the Group's decision-making and processes to help it achieve its objectives**

Risk analysis is designed to identify the principal events and situations which could significantly impact the achievement of the Group's objectives. Controlling such risks helps to achieve those objectives.

Risk management is integral to the Group's decision-making and operational processes. It is one of the tools for steering and assisting in decision-making.

Risk management gives executives an objective and comprehensive vision of potential threats and opportunities to which the Group is exposed, enabling them to take measured and considered risks and guiding them in their decisions on the allocation of human and financial resources.

- **Promote the consistency of action with the values of the Group**

The Group's approach to risk management is consistent with its values, particularly with regard to the strict compliance of its business activities with national and international rules and legislation.

- **Involve the Group's employees in a shared vision of the main risks and make them aware of the risks inherent in their work**

b) Definition of internal control at Thales

The Group uses as a reference the international standards of COSO 2013 (Committee of Sponsoring Organizations of the Treadway Commission) and IFACI.

According to the definition used by Thales, internal control is a process that the organisation implements with the intention of providing reasonable assurance as to the achievement of the Group's objectives, through:

- the effectiveness and efficiency of internal processes;
- accounting and financial internal control aimed at:
  - ensuring the reliability of the information used internally for management and monitoring purposes as well as for the preparation of the published accounting and financial information,
  - preventing the risk of fraud;
- legal compliance, which is intended to ensure compliance with regulatory requirements.

c) Scope of application and limits

Thales implements its corporate risk management and internal control approach in the companies it controls.

These internal control and risk management processes contribute to the achievement of the Group's objectives without providing an absolute guarantee because of the limitations inherent in any system, such as the need to take into account the cost/benefit ratio leading to acceptance of a certain level of risk, and due to external uncertainties beyond the Group's control.

1.1.3.2 Control environment

For most of its operations, the Group is subject to a control environment imposed by its customers and regulatory authorities (Ministries of Defence and Industry, Authorities in its customers' countries, Commercial Aviation Authorities, etc.), which require strict certification and controls.

These specific constraints are in addition to its statutory obligations and are an integral part of the Group's control environment.

a) The main parties in risk management and internal control

Thales is organised according to a two-dimensional matrix structure comprising Global Business Units and countries.

- The Global Business Units are organised into business lines, which cover a coherent range of products, solutions and services.

  For the products, solutions and services entrusted to them, the business lines have worldwide responsibility for strategy, product policy and marketing, competitiveness, customer access, contractual commitments, engineering, development, production, integration, quality and services, industrial organisations, optimisation of resources, and economic performance (contribution to EBIT and cash flow).
- In the region assigned to them, country managers are responsible for the successful implementation of every aspect of Group policy and handle relations with customers and local partners.

The main countries in which the Group operates (Australia, Canada, France, Germany, the Netherlands, the United Kingdom and the United States) share responsibility with the Global Business Units for local bids and projects. Country managers are involved in all decisions taken by the Global Business Units with regard to organisation and appointments, or relating to bids, projects and centres of excellence of any kind in their territories. They are responsible for HR development and the optimisation of industrial resources. They are also responsible for Thales's institutional relations as well as for communication.

The country manager of each of the six major industrial countries (excluding France) in which the Group operates (see list above) reports to a Non-Executive Chairman, appointed from among the Group's senior executives. The Non-Executive Chairman acts an interface between the country and head office and liaises between the Country Manager and Executive Committee.

For the other countries in Europe (apart from those with a Non-Executive Chairman, see above), the country or regional Manager reports to the Europe and International Operations department, which in turn reports to the Senior Executive Vice President, Operations & Performance.

In all other regions (Africa, Latin America, Asia and the Middle East), the country or regional manager reports to the Senior Executive Vice President, International Development.

The Group defines common processes and internal rules on delegation setting out the way in which responsibility is shared, provides entities with the corresponding tools and sets up umbrella departments.

The delegations are implemented in legal entities coordinated at national level.

The Group's managing bodies

These consist of Global Business Units, countries and functional departments and are ultimately responsible for the Group's entire internal control system, relying in particular on internal processes and the work of the Risk Management Committee and the Risk Assessment Committee.

The Group's governance is founded on the key principle of the responsibility of the directors of operational entities, who are responsible for establishing and maintaining the risk management and internal control system within their operational entities.

The corporate risk assessment function

Since 2007, the Audit, Risks & Internal Control Department has included a corporate risk analysis function. This is the responsibility of a dedicated team, separate from the audit team, which provides support to all operating and functional managers to help them identify and assess the risks to which their activities are exposed and to institute the means to manage or reduce these risks. It is also responsible for developing and updating internal control assessment tools, such as the yearly attestation letter and the internal control questionnaire, and collating and analysing the responses given by the operational entities in these annual questionnaires.

The internal audits conducted by the Audit, Risks & Internal Control Department are primarily chosen and planned based on this risk analysis.

Finance function

The Group's Finance Department oversees the Company's accounting and financial operations. Its central organisation comprises:

- an accounting and consolidation function, responsible for preparing and presenting the Group's consolidated financial statements;
- a management and budget control function, which analyses the Group's financial data and produces monthly reports comparing actual results with the budget and comparable prior-year periods. On this occasion, financial forecasts for the current half-year and financial year are reviewed and discussed so as to steer the business in order to achieve the objectives set;
- a tax function, which provides support to the operational entities on legislation and during tax audits. It also monitors tax consolidation within the Group and ensures their overall coherence;
- a risk and prevention insurance function, which manages all insurance policies taken out by the Group to guarantee all of its companies, optimises the costs of these policies, verifies that the companies are properly covered against insurable risks that they incur and issues recommendations to prevent them. It also monitors any significant claims;
- a treasury and financing function, which optimises financial resources and manages the Group's financial risks (foreign exchange, interest rates, pensions, etc.);
- a financial engineering function, in support of commercial contracts to offer customers suitable financing, secure payments to be received and hedge against the financial consequences of contract interruption which could arise in particular in the event of political risk or risk of customer default.

The Group's Finance department is represented in each Global Business Unit, each operational entity and each of the main countries by a Finance Director who functionally reports to it. The implementation of the accounting and financial internal control is carried out by these Finance Directors, who have local teams within their scope of responsibility to ensure that the financial information is prepared in compliance with the rules on internal control.

At the time of the annual and half-year financial statements, the Chief Executive Officers and the Finance Directors issue a letter of representation to the Group's Finance department, certifying the fair presentation and completeness of the financial data submitted for consolidation.

Legal function

The Group's Legal & Contracts Department, as well as the legal counsel in the various countries and Global Business Units, provide support to the operational entities with regard to local and international laws, in order to manage any potential legal risks that may be incurred in the various fields of the law.

The Group's Human Resources department also has a network of legal advisors who specialise in employment law and who provide support to the Group's entities. The Legal & Contracts Department and the Human Resources Department call upon outside law firms, where necessary.

Operations and performance function

The Operations and Performance department is responsible for the operational resources necessary to carry out projects and ensure customer satisfaction and quality, thus contributing to risk management. It approves the most sensitive bids according to specific criteria and holds quarterly reviews of projects deemed critical. It manages skills development plans as well as bid and project manager certification plans. It rolls out and upgrades bid costing and project management tools and provides *ad hoc* support to any Global Business Units and countries requesting it. In each entity, the Director of Operations coordinates, in close collaboration with the Legal Director and the Finance Director, the management of all of the Company's risks.

The Operations and Performance department includes the Quality Assurance and Customer Satisfaction Department, which defines the quality assurance policy and objectives and drives improvements in customer satisfaction. It steers the process management framework (Chorus 2.0) applicable to all Group entities. Each process is entrusted to a manager who is responsible for defining rules and setting targets, as well as for implementing them and making sure that they are effective. This translates into process targets being achieved while reducing risk. Quality assurance procedures for offers, projects and products are carried out by the operational entities, in order to effectively meet customer demands and ensure customer satisfaction and secure the execution of operations.

In addition, the Quality Assurance and Customer Satisfaction function manages the policy in place for assessing the maturity of operational entities (see description in Section 1.1.3.4-a).

b) The Group's operating principles and procedures

Thales's operating principles and procedures underpin the Group's internal control. This set of organisational rules, policies and procedures, which includes rules on ethical conduct and corporate responsibility, is available on the Group intranet and is provided to all new employees in their welcome pack.

Reference system

Thales has created a process-based reference system called Chorus 2.0, which defines the organisation, rules, practices and methods to be implemented at each Group entity.

Thanks to its modular design, it can be adapted to the business context and can be augmented within each entity or country, by local rules and practices detailed in a technical reference system.

Chorus 2.0 is accessible via the intranet, making it easy to locate the policies, procedures, instructions, templates and forms which need to be used. Chorus 2.0 covers nine headline processes, sub-divided into 26 processes. These processes, which are closely interfaced – and identify activities that require attention with regard to the potential for risks to occur – precisely define how Thales works according to the roles, rules, practices and operating modes described.

This reference system gives all Group companies a shared language and a unified management process. Chorus 2.0 is also aimed at organisational alignment across the Group.

Chorus 2.0 is a vital tool to enable each entity to have its management systems certified – on a Group wide platform – in terms of quality, health, safety and environment and with regard to the norms and standards applicable to each business activity.

Chorus 2.0 is a crucial element of the Group's internal control and is a natural component of the reference systems used in the work of the Audit, Risks & Internal Control Department.

Rules of procedure of the Board of Directors

Section 3.2.1 provides more details on the Board of Directors, its rules of procedure and its operation.

Codes and guides of conduct

The code of Conduct defines the types of conduct that are prohibited as they may be construed as acts of corruption or influence peddling. The Code applies to all employees of the Group. It has been incorporated into the internal regulations of the Group's French companies and is in the process of being rolled out to its foreign subsidiaries.

It is supplemented by the Code of Ethics and a set of guides published in the Group's framework.

The Code of Ethics, published in eight languages, is the bedrock of Thales's culture of integrity. It sets out the rules of conduct and the values that the Group wants to develop. It covers relationships with customers and suppliers, partners, employees, shareholders and financial markets, as well as protection of the environment.

A business ethics reference guide is dedicated to the prevention of corruption. It describes the rules and regulations that must be respected internally.

Several business ethics conduct guides present the best practices expected from employees with regard to anti-corruption measures, gifts and hospitality, conflicts of interest, lobbying and the use of the professional whistleblowing system.

A reference guide entitled "Compliance with Export Control Regulations" describes the compliance requirements and the process of export control. It identifies stakeholders, defines their responsibilities, and sets out best practices in terms of compliance with export control regulations.

As part of its policy of preventing insider trading, the Group has adopted a Code on Insider Trading for directors, and regularly updates the list of insiders (see Section 3.2.1).

An e-learning platform also helps to educate the Group's employees on topics such as export controls, ethics and corporate responsibility.

c) Group risk mapping

The Group has mapped its major operational, strategic, compliance and financial risks. It updates this risk map each year.

Each risk factor identified is set out in risk scenarios prioritised on the basis of two analysis criteria, before and after mitigation: likelihood of occurrence and financial impact.

The Group has assigned each of these risks to a risk advisor who is responsible for coordinating the management of this risk under the supervision of the Risk Assessment Committee. This consists of characterising the risk, monitoring major incidents, overseeing the deployment of the risk management system and continuously improving it.

1.1.3.3 Principal corporate risks and their management

The section on risk factors in the Group management report (see Section 1.1.2) describes the measures taken by the Group to address operational, strategic, legal and compliance and financial risks and risks related to insurance.

a) Centralised activities

Some complex or risky transactions are carried out solely by central departments, which ensure the sharing, consistency and coordination of the Group's practices. A specific internal control mechanism has been put in place to manage the risks associated with these transactions.

Investments and divestments

Total or partial acquisitions and disposals come under the exclusive remit of the Group's corporate management. The Global Business Units propose projects at periodic meetings of the Mergers and Acquisitions Committee, made up of the main central departments.

Financing, treasury management and foreign exchange risk

The Group's financial resources, liquidity risk and interest rate risk are managed centrally by the Group Treasury and Financing department. Except in special cases, the Group's subsidiaries are not authorised to undertake financing operations themselves. According to the policy of optimising and centralising the Group's financial resources, the Group Treasury and Financing department provides funding to the subsidiaries, manages surplus cash positions in all of the Group's currencies and matches surpluses with cash requirements. The Group Treasury and Financing department is also responsible for managing the Group's currency position and hedging the associated risks (in particular the foreign exchange risks to which the subsidiaries are exposed, which are closely monitored at the subsidiary level). Foreign currency transactions are analysed prior to any financial commitment and are hedged against foreign exchange risk as soon as the likelihood of being awarded the sales contract and/or signing a purchase order becomes significant, excluding special cases.

Customer financing and hedging of contract interruption and credit risks

The International Financial Affairs department coordinates and supervises the Group's financial engineering activities (establishment of advance market commitments, customer financing (buyer or supplier credit), documentary credits or more complex transactions such as project financing or PPP). These transactions are carried out in collaboration with those responsible for the financial engineering of international activities, who report to their Finance department and also to the International Financial Affairs department.

Real estate management

All real estate transactions come under the exclusive remit of the Group's Real Estate Department. It may delegate certain operations, especially outside France, to a national organisation, or to a local company, while ensuring proper supervision.

Disputes, litigation and legal compliance

With the exception of disputes concerning relationships with employees and trade unions, which are handled by the Human Resources Department, other disputes are monitored by the Legal and Contracts Department.

Insurance and prevention (of insurable risks)

All of the insurance policies taken out by the Group are managed by the Insurance and Prevention of Insurable Risks Department. It optimises the coverage and cost of insurance for the Group, checks that the entities are guaranteed against the insurable risks they incur, and issues recommendations for their prevention. This Department also monitors any significant claims.

b) Development and processing of published financial and accounting information

Accounting and financial procedures

The Group has several procedural manuals applicable in all entities and reiterated in the processes defined in Chorus 2.0. The Finance Directors of each entity are accountable to the Group Finance department for compliance with these procedures.

Manual of accounting standards and policies

This manual provides a detailed description of the accounting standards and policies to be applied during the preparation of the consolidated financial statements in accordance with IFRS.

Budgetary control manual

This manual describes the hierarchy and reporting levels required by the Group, the financial cycles, the responsibilities of the Finance department in operational processes and the rules to be followed by all Group entities.

Reporting manual

This manual describes the content and format of periodic reports and contains a glossary to help standardise financial aggregates.

Cash management manual

This manual describes the respective roles of central teams and teams within each entity in respect of cash flow and financing operations.

It also details the procedures for short-term cash flow management, operation of the exchange risk hedging system and the related reporting rules.

Internal control questionnaire

The internal control questionnaire and the accompanying instructions provide an additional framework and help to improve the reliability of financial reporting while at the same time preventing the risk of fraud. These elements, which have gradually been incorporated into the process management framework and distributed to the entire Group, are effectively equivalent to an internal financial control manual.

Budget process

There are three stages in setting the annual budgetary targets:

- the Global Business Units draw up a strategic plan over a minimum period of four years, which can be adjusted depending on their business models; this is then presented to and approved by Group corporate management;
- each Global Business Unit, each major country, the Europe and International Operations Department and the International Development Department then present a detailed three-year budget plan to Group corporate management. This plan is based on the sales forecasts and assumptions prepared by the marketing and sales departments, in accordance with the strategic plans prepared by the Global Business Units;
- finally, Group corporate management sets targets for the Global Business Units, the main countries, the Europe and International Operations department and the International department, ensuring that they are consistent overall. The first year of the plan is then analysed monthly and is used as a reference for steering the Group.

Financial reporting

The system includes some of the key factors described earlier in this report, such as accounting and financial procedures and a centralised consolidation process supported by a single tool.

Monthly results are analysed in order to identify any budget deviations and to update annual forecasts for orders, sales, profits and cash flow. This procedure is carried out by each entity and provides a consolidated view at Global Business Unit and Group level. It also makes it possible to identify any action plans necessary to achieve the objectives set.

Consolidation of the financial statements

The teams in charge of consolidation ensure that changes in regulations and standards are taken into account. They use the same consolidation software throughout the Group, selected from those available on the market, which enables it to upload the accounting information from the Group's various entities with consistency checks carried out at source. Transfers of accounting entries to head office are authorised only after validation. Training sessions and personalised support on the tool within the Group's consolidation teams ensure that users operate the software effectively.

1.1.3.4 Ongoing improvement process

Thales has introduced internal and external assessments, based on international standards, enabling the Group to identify any areas requiring continuous improvement, to prioritise these and to monitor the associated action plans.

a) Assessment of the maturity of operational entities

Thales has developed an internal system for assessing the maturity of its operational entities, known as the Thales Integrated Maturity System. It is used for:

- bid, project and product management;
- development, production, facilities and deployment;
- purchasing, quality, support activities and services.

An assessment may cover an entire organisation or be restricted to a specific element of said organisation, such as a project or product. Whatever the scope, the system considers three components: organisation and management, resources and skills, and processes, practices and tools.

Maturity assessments are performed by experienced assessors who are recognised in their field as well as by the quality managers at each operational entity.

The maturity model covers all of the Chorus 2.0 management system processes and is fully compliant with international standards, such as:

- the international CMMI® (Capability Maturity Model Integration) model, which is recognised by many customers for its development, acquisition and services models;
- the international Supply Chain Operations Reference (SCOR®) model.

Process management

Thales has obtained and maintains, in its different activities, certifications of compliance with applicable standards and regulations that attest to its ability to manage its processes to meet the needs of its customers.

For quality and for all Group activities, the certification standard is ISO 9001, and, depending on the business activities, the following standards are also used (non-exhaustive list):

- AQAP 2110, NATO quality standard for the defence sector;
- EN 9100, European standard describing a quality assurance system for the Aerospace industry;
- EASA Part 21 subpart G for production activities (Europe);
- EASA Part 145 (Europe) and FAR 145 (USA) for maintenance activities;
- EASA Part 147 for aeronautical training and maintenance;
- ISO 14001 and OHSAS 18001 for Environment, Health & Safety at work.

b) Self-assessment and ongoing improvement of corporate risk management

Since 2007, the Group has had a corporate risk management process in place for all the businesses and subsidiaries it controls.

In 2017, the Group's risk mapping process identified and measured the potential frequency and impact of 56 risk scenarios, with operational responsibility for each being specifically allocated to one of the following three management structures:

- local entities, segments or Country Business Units;
- Global Business Units or Business Lines;
- central functions.

The processes defined in Chorus 2.0, the insurance policy, the self-assessment and internal control tools, and the internal and external audits form part of the management of these risks.

Every year, the local entities report on the risk scenarios under their responsibility, in the form of a questionnaire (yearly attestation letter), updated annually and completed by the heads of the operational entities and their management teams. In 2017, 110 questionnaires were completed by the Group's operational entities. The responses to these questionnaires are analysed by the Audit, Risks & Internal Control Department, and by the network of risk advisors. A sample of questionnaires are checked for accuracy and compliance by the Audit, Risks & Internal Control Department: in 2017, 15 questionnaires were subject to an internal audit.

c) Self-assessment and ongoing improvement of internal financial control

Drawing in particular on the AMF recommendation entitled "Reference framework for risk management and internal control systems" and in collaboration with its statutory auditors, the Group asks its financial community to complete an internal control questionnaire (ICQ) focusing on the reliability of financial processes and the prevention of fraud.

The ICQ is based on internal control objectives linked to the Group's processes and accounting cycles (customers/suppliers/fixed assets, etc.) and is designed to enable the entities to identify areas of improvement, whether these are due to control objectives that have not yet been completely achieved, insufficient control in practice, or procedures that need to be improved. In 2017, 132 questionnaires were completed, representing all of the operational entities plus the shared services.

1.1.3.5 Oversight of the internal control and risk management system

a) Monitoring and control bodies

The Board of Directors exercises control over the management of the Group, either directly or through its committees. Detailed information on the organisation of the Board's work and, more generally, the performance of the Board and its committees is given in Section 3.2.1 of the corporate governance report.

Audit and Accounts Committee

At the meetings of this committee to the Board of Directors, the resources employed, actions taken to improve internal control and risk identification and management are reviewed. In 2017, this committee met six times.

Each year, the Audit, Risks & Internal Control Department submits an audit plan to the Audit and Accounts Committee covering various aspects relating to the Group in respect of compliance with legislation and regulations, assessment of internal control and risk identification and management.

At the time of the annual closing of the accounts, the Senior Executive Vice President, Finance and Information Systems presents a report on risk exposure and significant off-balance sheet commitments to the Audit and Accounts Committee.

Risk Management Committee

This committee, chaired by the Chairman and CEO, is responsible for defining the level of risk deemed acceptable by the Group, allocating risk management and control responsibilities for these risks, defining the strategy for transferring certain risks to insurance, approving the Group's risk mapping, and more generally, ensuring that the risk assessment and management system is as comprehensive as possible in order to maximise risk mitigation. It is supported by the work of the Risk Assessment Committee. In 2017, this committee met once.

Risk Assessment Committee

This committee is chaired by the Senior Vice President, Audit, Risks & Internal Control. It is responsible for analysing risks and evolving threats; it updates and prioritises risk scenarios, ensuring that responsibility for each risk scenario is allocated within the Group, prepares risk maps and formulates recommendations for the Risk Management Committee, with a view to improving the overall management and mitigation of Group risks. In 2017, the Risk Assessment Committee met five times.

Ethics and Corporate Responsibility Committee

This committee, chaired by the Company Secretary, is composed of representatives of the functional departments and the main countries in which the Group is based. Its work is focused on three areas:

- Strategy:
  - contribute to the definition of Thales's policy on Ethics and Corporate Responsibility,
  - identifying and making recommendations with regard to the standards and procedures concerning sales, environmental, human-resource-related and social issues;
- Ownership:
  - ensuring that the internal Codes are kept up to date and implemented within Thales,
  - defining training objectives and suitable means of communication,
  - coordinating and monitoring the Country Ethics Committees and ethics officers;
- Sharing:
  - holding discussions amongst its members on good practices, experiences and the ethical issues submitted to it.

In 2017, this committee met three times.

The Ethics and Corporate Responsibility department is responsible for the Group's actions in terms of ethics and responsibility, coordinating the relevant people within the Group, and ensuring that the ethical issues submitted to it are handled and followed up correctly, through an *ad hoc* committee where necessary.

Group Internal Audit, Risks & Internal Control Department

Reporting to the Group General Secretary, the Audit, Risks & Internal Control Department principally works with the Audit and Accounts Committee, the Risk Management Committee, the Risk Assessment Committees, Group corporate management and the statutory auditors.

It ensures proper risk management and the maintenance of adequate internal control by conducting audits or providing guidance. It may have involvement throughout the Group (Thales parent company and its controlled subsidiaries) as well as with its non-controlled subsidiaries, with the agreement of the co-owner companies. Its scope of involvement covers all areas and processes (governance, administrative, accounting and financial, functional and operational, etc.).

Since 2006, the Audit, Risks & Internal Control Department has been certified by IFACI[1], which ensures that its practices comply with the international auditing standards. The last IIA/IFACI triennial certification was obtained by the Audit, Risks & Internal Control Department in March 2016. The annual progress visit made by IFACI in March 2017 confirmed the Department's capacity and that of its auditors to coordinate their activities and operate in accordance with the prerequisites and the core principles of the internal audit profession.

The actions of the Audit, Risks & Internal Control Department are governed by an Internal Audit charter (updated in June 2016) that defines the basic principles of internal control and internal audit, the scope and limits of its responsibilities and its interaction with the entities.

In 2017, 63 audits or advisory engagements, arising from the Group's risk analysis and planned according to the criteria set out and approved by the Audit and Accounts Committee, were conducted by teams from the Audit, Risks & Internal Control Department. These engagements focused on the following themes:

- Operations: bids and projects, product policy, engineering and industry;
- Compliance: ethics, export control, security of information systems, business continuity plans;
- Governance: organisation, shared services, joint ventures, monitoring of acquisition and divestment transactions;
- Internal control: auditing the accuracy of risk management and internal control questionnaires (yearly attestation letter, internal control questionnaire).

b) Audit of financial information

Each year, the Finance department reviews the financial audit manual with the statutory auditors. This manual describes the phases for the use of external auditors.

Consolidated companies are placed in one of three categories, according to their size and the risks to which they may be exposed. They may be subject to an in-depth review, a limited review or a review for statutory requirements.

In the first two types of review, as well as assessing the financial statements, the statutory auditors recommend improvements in terms of internal control. These recommendations are presented to Group management as part of the closure of the accounts at 31 December.

1.1.4 Human resources, environmental and social information

Table of reconciliation (Articles L. 225-102-1 and R. 225-105-1 of the French Commercial Code)

In accordance with the Articles L. 225-102-1 and R. 225-105-1 of the French Commercial Code on transparency obligations for companies on social and environmental matters, in its management report, Thales provides information on the Group's social, environmental and societal issues. This information is set out in full in Chapter 5 "Corporate responsibility"; an independent third-party verifier has issued a statement of completeness and limited assurance report on the consolidated social, environmental and societal information (see pages 199 *et seq.*).

(1) *Institut Français de l'Audit et du Contrôle Interne* (French Institute of Audit and Internal Control).

1.1.5 Events since year-end

Thales and Gemalto announced, with the publication of the Offer Document on 27 March 2018, that Thales is launching its recommended all-cash offer to all holders of issued and outstanding shares in the capital of Gemalto for EUR 51.00 per share, cum dividend.

1.1.6 Summary statement of transactions referred to in Article L. 621-18-2 of the French Monetary and Financial Code carried out in 2017

Details of the transactions carried out are set out in Section 4.2.3.7.

1.2 CONSOLIDATED FINANCIAL STATEMENTS

1.2.1 Consolidated profit and loss account

(in € millions)	Notes	2017	2016
Sales	Note 2	**15,795.4**	**14,884.8**
Cost of sales [(a)]		(11,951.2)	(11,276.8)
Research and development expenses		(802.2)	(736.1)
Marketing and selling expenses [(a)]		(1,040.6)	(1,023.2)
General and administrative expenses		(549.5)	(543.5)
Restructuring costs	Note 10.2	(81.1)	(100.5)
Amortisation of intangible assets acquired (PPA) [(b)]	Note 4.2	(113.0)	(107.3)
Income from operations	Note 2	**1,257.8**	**1,097.4**
Disposal of assets, changes in scope of consolidation and other	Note 3.2	(81.5)	205.1
Impairment on non-current assets		–	–
Income of operating activities before share in net income of equity affiliates		**1,176.3**	**1,302.5**
Share in net income of equity affiliates		**134.8**	**119.6**
• of which, share in net income of joint ventures	Note 5.1	88.5	72.4
• of which, share in net income of associates	Note 5.2	46.3	47.2
Income of operating activities after share in net income of equity affiliates		**1,311.1**	**1,422.1**
Interest expense on gross debt		*(16.3)*	*(11.3)*
Interest income on cash and cash equivalents		*21.3*	*17.6*
Interest income, net	Note 6.1	5.0	6.3
Other financial income (expenses)	Note 6.1	(99.3)	(80.6)
Finance costs on pensions and other employee benefits	Note 9.3	(65.5)	(77.6)
Income tax	Note 7.1	(264.2)	(255.6)
NET INCOME		**887.1**	**1,014.6**
Attributable to: **Shareholders of the parent company**		**821.7**	**946.4**
Non-controlling interests		65.4	68.2
Basic earnings per share (in euros)	Note 8.2	3.88	4.49
Diluted earnings per share (in euros)	Note 8.2	3.85	4.44

(a) The depreciation of net costs related to customer accounts was reclassified from marketing and selling expenses to cost of sales (a negative amount of €2.2 million in 2016).
(b) This item corresponds to the amortisation of acquired intangible assets (Purchase Price Allocation: PPA) of fully consolidated entities. The amortisation of PPA related to equity affiliates is included in the share in net income of equity affiliates and detailed in Note 2.1.

1.2.2 Consolidated statement of comprehensive income

(in € millions)	2017			2016		
	Total attributable to:			Total attributable to:		
	shareholders of the parent company	non-controlling interests	Total	shareholders of the parent company	non-controlling interests	Total
NET INCOME	**821.7**	**65.4**	**887.1**	**946.4**	**68.2**	**1,014.6**
Translation adjustment: subsidiaries (Note 8.1)	(88.5)	(1.9)	(90.4)	32.2	(0.3)	31.9
Deferred tax (Note 7.2)	–	–	–	1.3	–	1.3
Joint ventures (Note 5.1)	(7.9)	–	(7.9)	(26.9)	–	(26.9)
Associates (Note 5.2)	(17.5)	–	(17.5)	(30.7)	–	(30.7)
Net	**(113.9)**	**(1.9)**	**(115.8)**	**(24.1)**	**(0.3)**	**(24.4)**
Cash flow hedge: subsidiaries (Note 8.1)	384.2	17.2	401.4	49.5	3.0	52.5
Deferred tax (Note 7.2)	(107.5)	(5.5)	(113.0)	(17.4)	(1.5)	(18.9)
Joint ventures (Note 5.1)	(3.5)	–	(3.5)	(0.5)	–	(0.5)
Associates (Note 5.2)	(2.3)	–	(2.3)	0.5	–	0.5
Net	**270.9**	**11.7**	**282.6**	**32.1**	**1.5**	**33.6**
Available for sale financial assets: subsidiaries	(1.0)	–	(1.0)	3.5	–	3.5
Joint ventures (Note 5.1)	(6.7)	–	(6.7)	6.7	–	6.7
Net	**(7.7)**	**–**	**(7.7)**	**10.2**	**–**	**10.2**
Items that may be reclassified to income	**149.3**	**9.8**	**159.1**	**18.2**	**1.2**	**19.4**
Actuarial gains (losses) on pensions: subsidiaries (Note 9.3)	52.8	(3.4)	49.4	(658.1)	(2.9)	(661.0)
Deferred tax (Note 7.2)	2.9	0.3	3.2	22.6	(0.3)	22.3
Joint ventures (Note 5.1)	1.9	–	1.9	(12.7)	–	(12.7)
Associates (Note 5.2)	(0.7)	–	(0.7)	0.4	–	0.4
Items that will not be reclassified to income	**56.9**	**(3.1)**	**53.8**	**(647.8)**	**(3.2)**	**(651.0)**
Other comprehensive income (loss) for the year, net of tax	**206.2**	**6.7**	**212.9**	**(629.6)**	**(2.0)**	**(631.6)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**1,027.9**	**72.1**	**1,100.0**	**316.8**	**66.2**	**383.0**

1.2.3 Consolidated statement of changes in equity

(in € millions)	Number of shares outstanding (thousands)	Share capital	Additional paid-in capital	Retained earnings	Cash flow hedge	AFS invest-ments	Cumulative translation adjustment	Treasury shares	Total attributable to shareholders of the parent company	Non-controlling interests	Total equity
AT 1 JANUARY 2016	**210,122**	**632.9**	**3,995.4**	**404.6**	**(276.8)**	**2.2**	**(87.2)**	**(25.2)**	**4,645.9**	**295.9**	**4,941.8**
Net income	–	–	–	946.4	–	–	–	–	946.4	68.2	1,014.6
Other comprehensive income	–	–	–	(647.8)	32.1	10.2	(24.1)	–	(629.6)	(2.0)	(631.6)
Total comprehensive income for 2016	**–**	**–**	**–**	**298.6**	**32.1**	**10.2**	**(24.1)**	**–**	**316.8**	**66.2**	**383.0**
Employee share issues	1,233	3.7	41.5	–	–	–	–	–	45.2	–	45.2
Parent company dividend distribution (Note 8.1)	–	–	–	(296.8)	–	–	–	–	(296.8)	–	(296.8)
Third-party share in dividend distribution of subsidiaries	–	–	–	–	–	–	–	–	–	(48.3)	(48.3)
Share-based payments (Note 9.4)	–	–	–	16.7	–	–	–	–	16.7	–	16.7
Acquisitions/disposals of treasury shares (Note 8.1)	90	–	–	(13.8)	–	–	–	(36.4)	(50.2)	–	(50.2)
Purchase of Raytheon stake in TRS SAS	–	–	–	(52.8)	–	–	–	–	(52.8)	(85.8)	(138.6)
Other	–	–	–	12.2	(5.8)	–	–	–	6.4	(0.6)	5.8
Changes in scope of consolidation	–	–	–	7.8	(0.2)	–	1.3	–	8.9	(1.5)	7.4
AT 31 DECEMBER 2016	**211,445**	**636.6**	**4,036.9**	**376.5**	**(250.7)**	**12.4**	**(110.0)**	**(61.6)**	**4,640.1**	**225.9**	**4,866.0**
Net income	–	–	–	821.7	–	–	–	–	821.7	65.4	887.1
Other comprehensive income	–	–	–	56.9	270.9	(7.7)	(113.9)	–	206.2	6.7	212.9
Total comprehensive income for 2017	**–**	**–**	**–**	**878.6**	**270.9**	**(7.7)**	**(113.9)**	**–**	**1,027.9**	**72.1**	**1,100.0**
Employee share issues	464	1.4	16.3	–	–	–	–	–	17.7	–	17.7
Parent company dividend distribution (Note 8.1)	–	–	–	(348.9)	–	–	–	–	(348.9)	–	(348.9)
Third-party share in dividend distribution of subsidiaries	–	–	–	–	–	–	–	–	–	(68.1)	(68.1)
Share-based payments (Note 9.4)	–	–	–	21.8	–	–	–	–	21.8	–	21.8
Acquisitions/disposals of treasury shares (Note 8.1)	181	–	–	(65.4)	–	–	–	9.1	(56.3)	–	(56.3)
Other	–	–	–	23.4	–	–	0.2	–	23.6	(0.3)	23.3
Changes in scope of consolidation	–	–	–	–	–	–	–	–	–	–	–
AT 31 DECEMBER 2017	**212,090**	**638.0**	**4,053.2**	**886.0**	**20.2**	**4.7**	**(223.7)**	**(52.5)**	**5,325.9**	**229.6**	**5,555.5**

1.2.4 Consolidated balance sheet

Assets

(in € millions)	Notes	31/12/2017	31/12/2016
Goodwill, net	Note 4.1	3,447.2	3,424.4
Other intangible assets, net	Note 4.2	877.5	958.8
Property, plant and equipment, net	Note 4.2	1,819.1	1,798.9
Total non-current operating assets		**6,143.8**	**6,182.1**
Investments in joint ventures	Note 5.1	1,027.8	997.5
Investments in associates	Note 5.2	210.1	219.5
Non-consolidated investments	Note 6.3	87.7	82.3
Other non-current financial assets	Note 6.3	166.5	138.3
Total non-current financial assets		**1,492.1**	**1,437.6**
Non-current derivatives – assets	Note 6.5	17.0	27.9
Deferred tax assets	Note 7.3	858.1	975.8
NON-CURRENT ASSETS		**8,511.0**	**8,623.4**
Inventories and work in progress	Note 10.1	2,803.4	2,734.6
Construction contracts: assets	Note 10.1	2,306.0	2,331.5
Advances to suppliers	Note 10.1	451.8	348.3
Accounts, notes and other current receivables	Note 10.1	4,351.1	4,547.5
Current derivatives – assets	Note 6.5	254.4	161.7
Total current operating assets		**10,166.7**	**10,123.6**
Current tax receivable		36.6	59.8
Current financial assets	Note 6.2	332.0	265.9
Current derivatives – assets	Note 6.5	3.1	–
Cash and cash equivalents	Note 6.2	4,282.7	3,616.9
Total current financial assets		**4,617.8**	**3,882.8**
CURRENT ASSETS		**14,821.1**	**14,066.2**
TOTAL ASSETS		**23,332.1**	**22,689.6**

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Equity and liabilities

(in € millions)	Notes	31/12/2017	31/12/2016
Capital, additional paid-in capital and other reserves		5,602.1	4,811.7
Cumulative translation adjustment		(223.7)	(110.0)
Treasury shares		(52.5)	(61.6)
Total attributable to shareholders of the parent company		**5,325.9**	**4,640.1**
Non-controlling interests		229.6	225.9
TOTAL EQUITY	Note 8.1	**5,555.5**	**4,866.0**
Long-term loans and borrowings	Note 6.2	953.5	1,433.7
Non-current derivatives-liabilities	Note 6.5	2.6	–
Pensions and other long-term employee benefits	Note 9.3	2,674.3	2,785.8
Deferred tax liabilities	Note 7.3	237.6	294.6
NON-CURRENT LIABILITIES		**3,868.0**	**4,514.1**
Advances received from customers on contracts	Note 10.1	4,162.6	4,478.4
Refundable grants	Note 10.1	127.7	133.4
Construction contracts: liabilities	Note 10.1	1,278.3	1,139.4
Reserves for contingencies	Note 10.2	1,134.7	1,037.0
Accounts, notes and other current payables	Note 10.1	6,264.3	5,872.6
Current derivatives – liabilities	Note 6.5	179.7	478.3
Total current operating liabilities		**13,147.3**	**13,139.1**
Current tax payable		54.0	59.0
Short-term loans and borrowings	Note 6.2	707.3	111.4
CURRENT LIABILITIES		**13,908.6**	**13,309.5**
TOTAL EQUITY AND LIABILITIES		**23,332.1**	**22,689.6**

1.2.5 Consolidated statement of cash flows

(in € millions)	Notes	2017	2016
Net income		**887.1**	**1,014.6**
Add (deduct):			
Income tax expense (gain)		264.2	255.6
Net interest income		(5.0)	(6.3)
Share in net income of equity affiliates		(134.8)	(119.6)
Dividends received from equity accounted: joint ventures		38.5	43.6
Dividends received from equity accounted: associates		40.8	29.1
Depreciation and amortisation of property, plant and equipment and intangible assets	Note 4.2	391.1	384.6
Depreciation and amortisation of intangible assets acquired	Note 4.2	113.0	107.3
Provisions for pensions and other employee benefits	Note 9.3	191.7	170.5
Loss (gain) on disposal of assets, and other	Note 3.2	81.5	(205.1)
Provisions for restructuring, net	Note 10.2	(27.0)	(7.4)
Other items		(65.1)	31.4
Operating cash flows before working capital changes, interest and tax		**1,776.0**	**1,698.3**
Change in working capital and reserves for contingencies	Note 10.1	222.5	(63.4)
Cash contributions to pension plans and other long-term employee benefits	Note 9.3	(202.9)	(190.1)
• *UK deficit payment*		*(82.3)*	*(88.3)*
• *recurring contributions/benefits*		*(120.6)*	*(101.8)*
Interest paid		(14.0)	(21.1)
Interest received		22.3	13.6
Income tax paid		(90.6)	(99.4)
NET CASH FLOW FROM OPERATING ACTIVITIES	**- I -**	**1,713.3**	**1,337.9**
Acquisitions of property, plant and equipment and intangible assets		(438.9)	(480.3)
Disposals of property, plant and equipment and intangible assets		8.2	8.3
Net operating investments		**(430.7)**	**(472.0)**
Acquisitions of subsidiaries and affiliates, net	Note 6.4	(121.4)	(391.2)
Disposals of subsidiaries and affiliates, net	Note 6.4	41.9	296.9
Decrease (increase) in loans and non-current financial assets		(26.7)	(26.5)
Decrease (increase) in current financial assets		(70.8)	(235.6)
Net financial investments		**(177.0)**	**(356.4)**
NET CASH FLOW USED IN INVESTING ACTIVITIES	**- II -**	**(607.7)**	**(828.4)**
Parent company dividend distribution		(348.9)	(296.8)
Third party share in dividend distribution of subsidiaries		(68.1)	(48.3)
Capital increase (options exercised)		18.0	45.7
Purchase/sale of treasury shares		(56.3)	(40.8)
Issuance of debt		107.0	641.1
Repayment of debt		(32.9)	(643.7)
Net financial debts		74.1	**(2.6)**
NET CASH FLOW USED IN FINANCING ACTIVITIES	**- III -**	**(381.2)**	**(342.8)**
Effect of exchange rate variations and other	- IV -	(58.6)	–
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**I + II + III + IV**	**665.8**	**166.7**
Cash and cash equivalents at beginning of period		3,616.9	3,450.2
CASH AND CASH EQUIVALENTS AT END OF PERIOD		**4,282.7**	**3,616.9**

The Group's net cash position and the changes from one period to the next are presented in Note 6.2.

1.2.6 Notes to the consolidated financial statements

All monetary amounts included in these notes are expressed in millions of euros.

NOTE 1. ACCOUNTING STANDARDS FRAMEWORK

Thales's consolidated financial statements for the year ended 31 December 2017 were approved and authorised for issue by its Board of Directors on 5 March 2018. In accordance with French legislation, the financial statements will be deemed to be definitive once they have been adopted by the shareholders of the Group at the Annual General Meeting to be held on 23 May 2018.

Thales (parent company) is a French joint-stock company (*société anonyme*) registered with the Nanterre Trade and Companies' Register under number 552 059 024.

1.1 Basis of preparation for the 2017 consolidated financial statements

Thales's consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) approved by the European Union at 31 December 2017[1].

These accounting policies, described in Note 13, are consistent with those applied by the Group for the year ended 31 December 2016. Furthermore, the new standards that were mandatory from 1 January 2017 (Amendements to IAS 12 – Income tax and Annual Improvements Cycle 2013-2016) have no impact on the Group's financial statements. The reconciliation for the changes in financial debts of balance sheet,and cash flow from financial activities as required in the amendments to IAS 7 (Cash Flow statement), is provided in Note 6.2-c.

1.2 New standards effective from 31 december 2017

The following standards have been adopted by the IASB and will be effective for the periods indicated below pending their adoption by the European Union:

Accounting standard	Description	First-time application	EU endorsement
IFRS 15 (Revenue from Contracts with Customers)	Supersedes standards IAS 18 (Revenue) and IAS 11 (Construction contracts) and the related interpretations	1 January 2018	Yes
IFRS 9 (Financial Instruments)	Supersedes all existing standards related to Financial instruments	1 January 2018	Yes
IFRS 16 (Leases)	Supersedes IAS 17. Removes the distinction between operating leases and finance leases, all contracts now being recognised on the balance sheet	1 January 2019	Yes
IFRIC 22 (Foreign Currency Transactions and Advance Consideration)	Clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency	1 January 2018	In progress
IFRIC 23 (Uncertainty over Income Tax Treatments)	Refers to the recognition and measurement of financial risks related to income tax expense	1 January 2019	In progress
IFRS 2 amendments (Share-based Payments)	Provides a narrow-scope amendment for the classification and measurement of share-based payment transactions	1 January 2018	In progress
IAS 28 amendments (Long-term interests in associates and Joint Ventures)	Clarifies the rules applicable (particularly as regards depreciation and amortisation) to long-term investments in an associate	1 January 2019	In progress

(1) Available from: https://ec.europa.eu/info/law/international-accounting-standards-regulation-ec-no-1606-2002_en.

Implementation of IFRS 15

The Group continued to work on the implementation of IFRS 15, which became mandatory as of 1 January 2018.

Thales has opted for the full retrospective approach; the financial statements for the first half of 2018 and for the full year 2018 will include the 2017 comparative financial statements adjusted for the impact of applying the new standard. The opening balance sheet at 1 January 2017 will be presented, as adjusted.

In this context, the Group has estimated the impact of the new standard on the key indicators for 2017:

Group's key indicators	2017 Reported	Expected impacts IFRS 15	2017 Restated for IFRS 15
Oder backlog	31,914.2	150.0	32,064.2
Order intake	14,919.6	11.6	14,931.2
Sales	15,795.4	(567.9)	15,227.5
Income from operations	1,257.8	(162.3)	1,095.5
Share in net income of equity affiliates	134.8	(14.9)	119.9
Net income, attribuable to shareholders of the parent company	821.7	(141.9)	679.8

Segment information	2017 Reported	Expected impacts IFRS 15	2017 Restated for IFRS 15
Aerospace			
Sales	5,985.2	(237.9)	5,747.3
EBIT	601.5	(34.5)	567.0
Transport			
Sales	1,760.9	(37.6)	1,723.3
EBIT	71.6	(15.0)	56.6
Defence & Security			
Sales	7,983.2	(293.5)	7,689.7
EBIT	868.5	(111.9)	756.6
Other			
Sales	66.1	1.1	67.2
EBIT	1.0	(15.8)	(14.8)
Thales			
Sales	**15,795.4**	**(567.9)**	**15,227.5**
EBIT	**1,542.6**	**(177.2)**	**1,365.4**

The main sources of differences between the current rules and IFRS 15 are the following:

Order Backlog

IFRS 15 introduces the concept of accounting **order backlog** ("transaction price allocated to the remaining performance obligation"). This accounting definition compared to Thales current definition, does not lead to significant impact.

Unbundling of multiple performance obligations within a single contract

In certain situations, IFRS 15 requires the unbundling of multiple performance obligations within a single contract, with differentiated margin rates. This is the case for some contracts combining construction and maintenance services, or construction and launch of a satellite. However, the impact of this restatement on the 2017 financial statements is limited.

Recognition of revenue under the percentage of completion method

Under the current rules, revenue from construction contracts (representing over half the Group's revenue) is recognised according to the percentage of completion method.

IFRS 15 now provides for criteria proving the transfer of control over goods and services to the customer over time and allowing for the recognition of revenue under the percentage of completion method.

For complex sales of goods, it is necessary to demonstrate that the good sold has no alternative use and that the Group has an irrevocable right to payment for the work performed to date (corresponding to the costs incurred to date, plus a reasonable margin), in the event of termination for any reason other than Thales's failure to perform. Detailed analysis of the Group's contract portfolio has confirmed that, for the vast majority of contracts in progress, the criteria defined in IFRS 15 have been met.

In addition, as was the case before, revenue from services contracts will be recognised according to the percentage of completion method, with the customer receiving services as they are provided by Thales.

Percentage of completion method

Currently, the revenue and margin of construction contracts are recognised as and when the technical milestones, which confirm effective progress of a part of the works or completion of the services specified in the contract, are achieved. Under IFRS 15, the percentage of completion method used is expense based: revenue is recognised based on costs incurred to date in relation to all the costs expected upon completion. For each contract, depending on the pace of performance and the nature of the milestones achieved and costs incurred over the period, this change in method may cause shifts in revenue and margin recognition from one period to another.

Bid cost

Bid cost which were previously included in contract costs, in accordance with IAS 11, are now expensed as incurred as a line item under "marketing and selling expenses".

Other standards

The assessment of the potential impacts of these new standards for the Group's consolidated financial statements is underway.

The new IFRS 9 on financial instruments introduces:

- a new classification of financial assets based on the Group's management intention and the nature of expected flows;
- a dynamic impairment model for financial assets on expected losses;
- changes in rules relating to hedge accounting (and especially the treatment of the time value of options as a cost of hedging, which limits net income volatily).

This standard will come into effect on 1 January 2018. The review and analysis of the text is still in progress, but the Group does not at this stage anticipate any material impact on its consolidated financial statements.

The Group is also reviewing the new IFRS 16 "Leases", which is effective as from on 1 January 2019. This text, which replaces IAS 17 and the associated IFRIC and SIC interpretations, removes the distinction previously made between operating leases and finance leases. Under IFRS 16, a lessee recognises a right-of-use asset and a financial liability representative of the lease obligation. The right-of-use asset is amortised and the lease obligation is measured initially at the present value of the lease payments over the lease term, discounted at the rate implicit in the lease if that can be readily determined or at the incremental borrowing rate otherwise.

Work is under way to apply these new provisions, with most contracts concerning property leases.

1.3 Translation

The principal exchange rates used to translate financial statements of entities with a functional currency different from the euro are as follows:

	31 December 2017		31 December 2016		31 December 2015	
Euro	**Closing rate**	**Average rate**	**Closing rate**	**Average rate**	**Closing rate**	**Average rate**
Australian Dollar	1.5346	1.4795	1.4596	1.4852	1.4897	1.4837
Pound Sterling	0.8872	0.8757	0.8562	0.8227	0.7340	0.7242
U.S. Dollar	1.1993	1.1370	1.0541	1.1032	1.0887	1.1046

1.4 Main sources of estimates

The preparation of the Group's consolidated financial statements involves making estimates and assumptions, which have an impact on the valuation of the Group's performance and its consolidated assets and liabilities. These estimates are based on past experience and factor in the economic conditions prevailing at the end of the reporting period and any information available as of the date on which the financial statements are prepared.

In today's global economic environment, the degree of volatility and subsequent lack of visibility are particularly high. Future facts and circumstances could lead to changes in these estimates or assumptions which would affect the Group's financial situation, profit and loss and cash flows, notably with regard to:

Construction contracts (Note 10.1)

A significant part of the Group's revenue and current operating income stems from construction contracts recognised according to the technical percentage of completion method. These contracts often span several financial years. In the accounting closing process, the recognition of income and expenses relating to these contracts depends mainly:

- on estimates of revenue and margin upon completion, including provisions for technical and commercial risks;
- technical milestones achieved in the performance of these contracts.

Estimates of figures upon completion, and the achievement of technical milestones, are based, for each contract, on the Group's internal systems and procedures, with the project managers playing a key role. These estimates are reviewed regularly by the Operations department and the Finance department, under the supervision of the Group's Corporate Management, particularly at each reporting period-end.

Litigation (Note 11)

The Group conducts its business in France and abroad in complex, evolving legal and regulatory environments. As a result, it is exposed to legal, technical and commercial disputes.

The Group regularly identifies and reviews litigation in progress and recognises the accounting provisions that it considers to be reasonable in light of the circumstances. Any uncertainties concerning litigation in progress are described in Note 11.

Business combinations

Business combinations are accounted for in accordance with the purchase accounting method described in Note 13-b: on the date of the takeover of a company, the acquiree's identifiable assets, liabilities and contingent liabilities are measured at their fair value. These valuations are performed by independent experts who base their work on assumptions and estimate the effects of future events, which are uncertain at the acquisition date.

Goodwill (Note 4.1)

Goodwill is subject to impairment tests. The recoverable amount of goodwill is assessed based on forecast data from the strategic plans prepared in accordance with Group procedures. Sensitivity tests are carried out on key assumptions which lend greater weight to the conclusions reached.

Pensions and other long-term employee benefits (Note 9.3)

Pensions and other long-term employee benefit commitments are estimated on statistical and actuarial bases in accordance with the policies outlined in the Note 13-j. Actuarial assumptions made by the Group (discount rates, inflation rate, mortality tables, etc.) are reviewed each year with the Group's actuaries.

Deferred tax assets (Note 7)

Deferred tax assets are recognised for tax loss carryforwards and temporary differences between the book value and the tax value of assets and liabilities. Recovery of these assets is assessed on the basis of the forecast data in the strategic plans of each of the tax groups considered, and generally over a period of five years.

NOTE 2. SEGMENT INFORMATION

2.1 Information by business segment

The operational segments presented by the Group are as follows:

- the **Aerospace** segment, which combines the "Avionics" and "Space" Global Business Units that develop on-board systems, solutions and services, mainly for private sector customers (aircraft manufacturers, airlines, satellite operators, etc.) but also to a lesser extent for government/defence customers (states, space agencies and other semi-public organisations);
- the **Transport** segment, which comprises the "Ground Transportation Systems" Global Business Unit that develops systems and services for an exclusively civilian customer base of ground transportation infrastructure operators;
- the **Defence and Security** segment, which combines the "Secure Communications and Information Systems", "Land and Air Systems" and "Defence Mission Systems" Global Business Units that develop equipment, systems and services for the armed and security forces and for the protection of networks and infrastructures, mainly for a government/defence customer base.

In order to monitor the operating and financial performance of the Group entities, the Group's executives regularly consider certain key non-GAAP indicators as defined in Note 13-a, which enable them to exclude certain non-operating and non-recurring items.

In particular, EBIT, presented by business segment below, corresponds to income from operations plus the share in net income of equity affiliates, excluding amortisation of acquisiton-related intangible assets (purchase price allocation – PPA) reported under business combinations. It also excludes other expenses booked to income from operations that are directly linked to business combinations, which are unusual by nature.

1

2017	Aerospace	Transport	Defence & Security	Other, elim., and unallocated [(a)]	Thales
Order backlog – non-Group	8,850.0	4,390.5	18,605.3	68.3	31,914.2
Order intake – non-Group	5,199.9	1,780.3	7,882.8	56.6	14,919.6
Sales – non-Group	5,985.2	1,760.9	7,983.2	66.1	15,795.4
Sales – intersegment	91.9	8.6	306.3	(406.8)	–
Total sales	**6,077.1**	**1,769.5**	**8,289.5**	**(340.7)**	**15,795.4**
EBIT	601.5	71.6	868.5	1.0	1,542.6
Of which, Naval Group	–	–	–	47.9	47.9
Of which, excluding Naval Group	601.5	71.6	868.5	(46.9)	1,494.7
Capital expenditures	137.7	7.5	140.3	153.4	438.9
Dep. and amort. of property, plant and equipment and intangible assets	166.4	10.0	103.8	110.9	391.1

2016	Aerospace	Transport	Defence & Security	Other, elim., and unallocated [(a)]	Thales
Order backlog – non-Group	9,913.6	4,567.1	18,972.7	76.8	33,530.2
Order intake – non-Group	5,872.3	1,503.5	9,063.1	75.4	16,514.3
Sales – non-Group	5,812.0	1,602.8	7,390.2	79.8	14,884.8
Sales – intersegment	93.9	5.6	295.0	(394.5)	–
Total sales	**5,905.9**	**1,608.4**	**7,685.2**	**(314.7)**	**14,884.8**
EBIT	571.3	11.3	787.4	(15.5)	1,354.5
Of which, Naval Group	–	–	–	33.8	33.8
Of which, excluding Naval Group	571.3	11.3	787.4	(49.3)	1,320.7
Capital expenditures	147.0	10.3	126.4	196.6	480.3
Dep. and amort. of property, plant and equipment and intangible assets	182.5	8.3	95.3	98.5	384.6

(a) Data related to order backlog, order intake and sales included in the "Other, elim and non-allocated" column relate to Corporate activities (Thales parent company, Thales Global Services, Group R&D centers, facilities management) and the elimination of transactions between the business segments.

Non-allocated EBIT includes the Group's share (35%) in the net income of Naval Group (ex DCNS), corporate income from operations not assigned to the segments and the cost of vacant premises. Other costs (mainly the costs of foreign holding companies not invoiced and expenses related to share-based payments) are reallocated to the business segments proportionally to their respective sales (excluding Group).

The reconciliation between income from operations and EBIT is analysed as follow:

	2017	2016
Income from operations	1,257.8	1,097.4
Share in net income of equity affiliates	134.8	119.6
Sub-total	**1,392.6**	**1,217.0**
PPA amortisation related to fully consolidated entities	113.0	107.3
PPA amortisation related to equity affiliates	19.2	11.2
Expenses linked directly to business combinations	17.8	19.0
EBIT	**1,542.6**	**1,354.5**

2.2 Information by destination

Consolidated order intake (direct and indirect) by destination	2017	2016
France	4,502.6	3,509.2
United Kingdom	1,153.3	1,003.2
Rest of Europe	2,918.5	3,646.3
Europe	8,574.4	**8,158.7**
United States and Canada	1,579.2	**1,215.6**
Australia and New Zealand	670.8	**763.7**
Asia	2,097.0	3,708.5
Middle East[a]	1,206.0	1,673.9
Rest of the world[a]	792.2	993.9
Emerging markets	**4,095.2**	**6,376.3**
TOTAL	**14,919.6**	**16,514.3**

Sales (direct and indirect) by destination	2017	2016
France	3,840.0	3,580.6
United Kingdom	1,351.9	1,272.3
Rest of Europe	3,386.9	3,227.1
Europe	**8,578.8**	**8,080.0**
United States and Canada	**1,459.6**	**1,555.9**
Australia and New Zealand	**875.0**	**759.2**
Asia	2,218.8	2,047.9
Middle East[a]	1,641.5	1,515.0
Rest of the world[a]	1,021.7	926.8
Emerging markets	**4,882.0**	**4,489.7**
TOTAL	**15,795.4**	**14,884.8**

(a) The 2016 figures have been adjusted to reflect the transfer of some countries out to the "Near and Middle East" region into the "Rest of the world" region within the Group's organisation.

2.3 Sales by category of contracts

More than half of the Group's sales come from contracts specifically negotiated with the customer, who draws up the technical specifications and defines the specific provisions linked to the contract. These contracts meet different needs depending on the customer, and are generally long-term contracts.

	2017	2016
Construction contracts	8,089.6	7,312.7
Sales of goods and equipment	3,523.8	3,549.3
Services	4,110.7	3,951.3
Other	71.3	71.5
TOTAL	**15,795.4**	**14,884.8**

NOTE 3. IMPACT OF CHANGES IN SCOPE OF CONSOLIDATION

3.1 Main changes in scope of consolidation

In 2017:

In September 2017, Thales finalised the acquisition of the US company Guavus, one of the pioneers of real-time "big data" analytics, for a maximum enterprise value of $215 million, subject to the achievement of significant sales growth targets. The net cash outflow reached $109.1 million (€90.5 million) at the closing date. The purchase price was allocated to amortisable intangible assets in the amount of $84.2 million (mainly technology acquired) and a deferred tax liability of $32 million. Residual goodwill amounted to $72.2 million (€60 million). The Company is fully consolidated.

In December 2017, Thales signed an agreement with the aim of acquiring Gemalto and creating a world leader in digital security. The offer, priced at €51 per share cum dividend (i.e. a total equity value of approximately €4.8bn) is subject to customary regulatory approvals. It is expected to be completed in the second half of 2018.

In 2016:

At the end of March 2016, Thales finalised the acquisition of Vormetric, a leading provider of data protection solutions for a total of $408 million (€372.4 million). Vormetric has been consolidated since its acquisition.

As part of the transaction, Thales signed compensation agreements with key managers subject to their remaining with the company until 2020. The related amounts are being taken to income on a straight-lline basis in tranches over the vesting period. These amounts are recognised in income from operations, but excluded from EBIT as they concern an event that is unusual nature (Note 2.1).

At the end of June 2016, Thales acquired Raytheon's non-controlling interest in French company TRS SAS and sold its stake in US company TRS LLC to Raytheon for a net gain of $90 million (€81 million) in Thales' consolidated financial statements.

In Thales' consolidated financial statements, the acquisition of Raytheon's non-controlling interest in TRS SAS led to a reclassification in equity. The disposal of the interest in TRS LLC resulted in a disposal gain of €91.8 million. Thales-Raytheon Systems Air and Missile Defense Command remains jointly owned by the Group and is accounted for under the equity method.

In October 2016, Thales sold its interest in Hanwha Thales, a jointly-owned company that specialises in defence electronics in Korea, for €204.4 million. The disposal gain recognised in the consolidated financial statements amounted to €113.8 million.

3.2 Disposal of assets, changes in scope of consolidation and other

	2017	2016
Disposal of investments	**1.3**	**200.5**
Hanwha-Thales (50%)	–	113.8
Thales Raytheon Systems LLC (50%)	–	91.8
Other	1.3	(5.1)
Disposal of real estate and movable assets	**2.6**	**4.6**
Impact of settlements/amendments to pensions plans (Note 9.3)	**(21.2)**	**–**
Litigation (Note 11)	**(64.2)**	**–**
TOTAL	**(81.5)**	**205.1**

NOTE 4. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

4.1 Goodwill

a) Change in goodwill

Goodwill is allocated to cash-generating units (CGUs) or groups of CGUs corresponding to Thales' Global Business Units (GBU). The changes in goodwill attributable to fully consolidated subsidiaries is presented below.

	31/12/2016	Acquisitions	Disposals	Impairment	Changes in exchange rates and other	31/12/2017
Avionics	476.1	11.3	–	–	(15.2)	472.2
Space	481.8	8.6	–	–	(1.8)	488.6
Aerospace	**957.9**	**19.9**	**–**	**–**	**(17.0)**	**960.8**
Transport	**875.3**	**–**	**–**	**–**	**–**	**875.3**
Secure Communications & Information Systems	819.4	60.4 [(a)]	(7.0)	–	(30.8)	842.0
Land and Air Systems	309.8	–	–	–	(0.2)	309.6
Defence Mission Systems	462.0		–	–	(2.5)	459.5
Defence and Security	**1,591.2**	**60.4**	**(7.0)**	**–**	**(33.5)**	**1,611.1**
TOTAL	**3,424.4**	**80.3**	**(7.0)**	**–**	**(50.5)**	**3,447.2**

	31/12/2015	Acquisitions	Disposals	Impairment	Changes in exchange rates and other	31/12/2016
Avionics	472.0	–	–	–	4.1	476.1
Space	472.7	11.1	–	–	(2.0)	481.8
Aerospace	**944.7**	**11.1**	**–**	**–**	**2.1**	**957.9**
Transport	**875.3**	**–**	**–**	**–**	**–**	**875.3**
Secure Communications & Information Systems	625.1	189.9 [(b)]	–	–	4.4	819.4
Land and Air Systems	309.8	–	–	–	–	309.8
Defence Mission Systems	461.0	–	–	–	1.0	462.0
Defence and Security	**1,395.9**	**189.9**	**–**	**–**	**5.4**	**1,591.2**
TOTAL	**3,215.9**	**201.0**	**–**	**–**	**7.5**	**3,424.4**

(a) Goodwill on Guavus after purchase price allocation (may not be definitive).
(b) Goodwill on Vormetric after purchase price allocation.

b) Impairment tests

Goodwill is subject to annual impairment tests in accordance with the Group's budgetary timetable. Value in use is determined on the basis of discounted future operating cash flows over a three-year period and a terminal value. This calculation is based on data from the strategic plans prepared in accordance with Group procedures. In certain specific cases (recent acquisitions, non-typical annual results, etc.), the terminal value is determined based on forecasts over an appropriate period of time.

At end-2017 and end-2016, impairment tests were performed with the initial assumption of a 8.5% discount rate for all CGUs (each of which presented a similar degree of risk given that the specific CGU risks are factored into forecasts).

The assumptions used concern growth in sales and terminal values and are based on reasonable estimations in line with specific data available for each business sector (generally, terminal value is based on the average income from operations over the three years of the strategic plan, with growth capped at 2%).

At end-2017, the overall value in use of the group CGUs was higher than its carrying amount.

c) Sensitivity of values in use

The Group also tests the sensitivty of values in use based on reasonable key assumptions. At the end of 2017, a 1% increase in the discount rate, a 1% decrease in the growth rate or a 2% decrease in operating profitability of the group CGUs would not require any additional impairments.

4.2 Plant, property and equipment and other intangible assets

a) Change in net assets

	Acquired intangible assets (PPA)	Development costs	Other intangible assets	Property, plant and equipment	Total
Net value at 1 January 2016	**649.2**	**123.3**	**90.4**	**1,696.7**	**2,559.6**
Acquisitions/increases	–	6.6	45.1	428.6	480.3
Disposals	–	–	–	(8.3)	(8.3)
Amortisation of acquistion-related intangible assets	(107.3)	–	–	–	(107.3)
Other depreciation and amortisation	–	(48.1)	(39.1)	(297.4)	(384.6)
Changes in scope, exchange rates and other	232.0	(2.5)	9.2	(20.7)	218.0
Net value at 31 December 2016	**773.9**	**79.3**	**105.6**	**1,798.9**	**2,757.7**
Acquisitions/increases	–	10.4	55.5	373.0	438.9
Disposals	–	–	–	(8.2)	(8.2)
Amortisation of acquistion-related intangible assets	(113.0)	–	–	–	(113.0)
Other depreciation and amortisation	–	(35.0)	(40.5)	(315.6)	(391.1)
Changes in scope, exchange rates and other	33.7	(2.5)	10.1	(29.0)	12.3
NET VALUE AT 31 DECEMBER 2017	**694.6**	**52.2**	**130.7**	**1,819.1**	**2,696.6**

b) Breakdown by item

			31/12/2017	31/12/2016
	Gross	Depr., amort., and impairment	Net	Net
Technologies acquired	849.7	(416.3)	433.4	439.6
Customer relationships acquired	555.8	(322.3)	233.5	277.4
Order backlog acquired	271.7	(253.7)	18.0	28.5
Other	71.3	(61.6)	9.7	28.4
Intangible assets acquired (business combinations)	**1,748.5**	**(1,053.9)**	**694.6**	**773.9**
Development costs	867.6	(815.4)	52.2	79.3
Other	780.5	(649.8)	130.7	105.6
Intangible assets	**3,396.6**	**(2,519.1)**	**877.5**	**958.8**
Land	52.6	(0.8)	51.8	50.2
Buildings	1,681.7	(924.1)	757.6	712.9
Technical facilities and industrial equipment and tooling	2,424.5	(1,809.1)	615.4	646.6
Other	1,135.8	(741.5)	394.3	389.2
Property, plant and equipment	**5,294.6**	**(3,475.5)**	**1,819.1**	**1,798.9**

4.3 Lease commitments

Irrevocable lease and rental commitments at 31 December 2017 and 2016 are as follows:

Irrevocable rental commitments	Total	Less than 1 year	1 to 5 years	More than 5 years
31 December 2017	**1,190.5**	201.7	566.1	422.7
31 December 2016	1,345.4	212.5	615.9	517.0

NOTE 5. INVESTMENTS IN JOINT VENTURES AND ASSOCIATES

5.1 Joint ventures

a) Group share in net equity and net income of joint ventures

	Investments in joint ventures		Share in net income		Share in comprehensive income	
	31/12/2017	**31/12/2016**	**2017**	**2016**	**2017**	**2016**
Naval Group (35%)	730.7	713.9	29.1	23.9	18.0	26.9
Other joint ventures [a]	297.1	283.6	59.4	48.5	54.3	12.1
TOTAL	**1,027.8**	**997.5**	**88.5**	**72.4**	**72.3**	**39.0**

(a) Not individually material, the value of each investment representing less than 10% of the total.

b) Change in investments in joint ventures

	31/12/2017	31/12/2016
Investment at 1 January	**997.5**	**1,126.4**
Share in net income of joint ventures	88.5	72.4
Translation adjustment	(7.9)	(26.9)
Cash flow hedge	(3.5)	(0.5)
Available for sale financial assets	(6.7)	6.7
Actuarial gains (losses) on pensions	1.9	(12.7)
Share in comprehensive income	**72.3**	**39.0**
Dividends paid	(38.5)	(43.6)
Scope variation (Hanwha Thales Co., Ltd in 2016)	(2.6)	(112.3)
Other	(0.9)	(12.0)
INVESTMENTS AT 31 DECEMBER	**1,027.8**	**997.5**

c) Naval Group summary financial information

Thales has a 35% stake in the share capital of Naval Group, a subsidiary jointly controlled with the French State. Naval Group is a French industrial group specialised in naval defence and marine infrastructures.

The financial statements of Naval Group, after Thales restatements (mainly linked to acquisition-related intangible assets) are presented below:

Summary balance sheet based on a 100% interest	31/12/2017	31/12/2016
Non-current assets	2,057.3	2,359.9
Current assets	5,947.0	6,078.9
Total assets	**8,004.3**	**8,438.8**
Restated equity attributable to shareholders of the Company	1,253.5	1,205.3
Non-controlling interests	(13.0)	86.2
Non-current liabilities	601.2	649.6
Current liabilities	6,162.6	6,497.7
Total equity and liabilities	**8,004.3**	**8,438.8**

Consolidation by Thales	31/12/2017	31/12/2016
Restated equity attributable to shareholders of the Company	1,253.5	1,205.3
% of Thales' interests	*35%*	*35%*
Thales' share	438.7	421.9
Goodwill	292.0	292.0
Share in net assets of the joint venture	**730.7**	**713.9**

Summary profit and loss account based on a 100% interest	2017	2016
Sales	3,698.2	3,191.2
Income (loss) from operating activities after impact of equity affiliates [(a)]	56.5	4.3
Financial income	2.4	23.9
Tax	(85.9)	33.3
Restated net income [(a)]	**(27.0)**	**61.5**
• of which, attributable to shareholders of the Company	83.2	68.3
• of which, non-controlling interests	(110.2)	(6.8)

(a) After Thales restatements (mainly linked to acquisition-related intangible assets).

Consolidation by Thales	2017	2016
Restated net income attributable to shareholders of the Company	83.2	68.3
% of Thales' interests	*35%*	*35%*
Share in income of the joint venture	**29.1**	**23.9**
• of which, impact of PPA	(18.8)	(9.9)
• of which, share in income before PPA	47.9	33.8
Dividends received from the joint venture	**–**	**–**

d) Commitments toward joint ventures

At 31 December 2017, outstanding sureties, endorsements and guarantees granted by Thales S.A. (parent company) to its joint ventures amounted to €321,9 million (€238.3 million at 31 December 2016).

The Group's policy is to issue guarantees on commitments by joint ventures in proportion to its equity interest, or to secure counter-guarantees from the other shareholders in proportion to their interest.

e) Transactions with joint ventures (related parties)

The volume of transactions with joint ventures and their joint shareholders is as follows:

	2017	2016
Sales	520.3	559.7
Purchases	202.9	189.7
Loans and current accounts receivable	45.8	47.5
Borrowings and current accounts payable	5.8	12.4

5.2 Associates

The main associates are listed in Note 16. None of these companies is individually material with regard to consolidated aggregates. The mandatory disclosures are therefore presented in aggregate form in the table below:

a) Changes in investment in associates

	31/12/2017	31/12/2016
Investments in associates at 1 January	**219.5**	**359.5**
Share in net income of equity affiliates	46.3	47.2
Translation adjustment	(17.5)	(30.7)
Cash flow hedge	(2.3)	0.5
Actuarial gains (losses) on pensions	(0.7)	0.4
Total comprehensive income	**25.8**	**17.4**
Dividends paid	(40.8)	(29.1)
Changes in scope (TRS LLC in 2016)	–	(127.8)
Other	5.6	(0.5)
INVESTMENTS IN ASSOCIATES AT 31 DECEMBER	**210.1**	**219.5**

b) Commitments towards associates

The Group has no material off-balance sheet commitments towards associates.

NOTE 6. FINANCING AND FINANCIAL INSTRUMENTS

6.1 Financial income

a) Net interest income

	2017	2016
Interest expense:		
• on gross debt	(24.3)	(36.4)
• on interest rate swaps	8.0	25.1
	(16.3)	(11.3)
Interest income/cash and cash equivalents	21.3	17.6
TOTAL	**5.0**	**6.3**

b) Other financial income

	2017	2016
Foreign exchange gains (losses)	(17.4)	(2.4)
Cash flow hedge, ineffective portion	(10.9)	(5.9)
Change in fair value of currency derivatives [a]	(69.9)	(70.3)
Foreign exchange gains (losses)	**(98.2)**	**(78.6)**
Dividends received	2.6	2.8
Impairment of non consolidated investments, loans and other financial assets	(0.2)	(1.4)
Other	(3.5)	(3.4)
TOTAL	**(99.3)**	**(80.6)**

(a) Includes the change in the fair value of premiums/discounts (losses of €65.3 million in 2017 and €54.0 million in 2016), the time value of derivatives documented as future cash flow hedges (losses of €5.7 million in 2017 and €7.3 million in 2016), as well as changes in the fair value of derivatives not documented as hedges.

6.2 Net cash (net debt)

Group net cash is as follows:

	31/12/2017	31/12/2016
Current financial assets	332.0	265.9
Cash and cash equivalents	4,282.7	3,616.9
Cash and other short-term investments (I)	**4,614.7**	**3,882.8**
Borrowings and debt, long-term portion	953.5	1,433.7
Borrowings and debt, short-term portion	707.3	111.4
Fair value of interest rate derivatives [a]	(17.5)	(27.9)
Gross debt (II)	**1,643.3**	**1,517.2**
NET CASH (I-II)	**2,971.4**	**2,365.6**

(a) The value of borrowings documented as fair value hedges takes into account changes in the fair value of the hedged risk. This change in the value of the debt is offset by the remeasurement of interest-rate swaps used as hedges (Note 6.5).

a) Current financial assets

	31/12/2017	31/12/2016
Current accounts receivable with related parties	3.1	8.5
Marketable securities	325.0	250.0
Accrued interest	3.9	7.4
CURRENT FINANCIAL ASSETS	**332.0**	**265.9**

Marketable securities consist of investments in short-term deposits (3 to 12 months) with tier-one banks.

b) Cash and cash equivalents

At 31 December 2017, cash recorded under consolidated assets amounted to €4,282.7 million (€3,616.9 million in 2016) and included:

- €3,450.5 million held by the parent company and available for immediate use (€3,183.1 million in 2016). These amounts include €2,199.2 million (€2,886.2 million in 2016) in very short-term deposits with tier-one banks or money market funds;
- €832.2 million in the credit balances of subsidiaries (€433.8 million in 2016), most of them outside France. This figure includes payments received in the last days of the financial year and subsequently transferred to the cash pooling account.

c) Borrowings and debt

	31/12/2017	31/12/2016
Bond maturing in 2023	593.9	595.6
Bond maturing in 2021	312.0	315.9
Bond maturing in 2018	500.6	502.8
Interest rate derivatives (Note 6.5)	(17.5)	(27.9)
Current accounts in credit with related parties [a]	115.2	48.7
Bank overdrafts	62.0	36.6
Subscription commitments	43.8	11.2
Other debt	33.3	34.3
GROSS DEBT	**1,643.3**	**1,517.2**

(a) Of which, at the end of 2017, €103.6 million toward Leonardo (€32.2 million at the end of 2016).

Gross debt's evolution

	31/12/2016				Other changes	31/12/2017
		Cash flow	Scope	Exchange rates	Fair value and other	
Gross debt	**1,517.2**	74.1	51.7	(4.4)	4.7	**1,643.3**

Nature of bonds	Nominal value	Maturity	Nature	Nominal rate (excluding impact of hedging)	Effective rate (excluding impact of hedging)
Bond maturing in 2023	€600 million	June 2023	Fixed incl. €400 million swapped at variable rates	0.75%	0.84%
Bond maturing in 2021	€300 million	March 2021	Fixed incl. €300 million swapped at variable rates	2.25%	2.40%
Bond maturing in 2018	€500 million	March 2018	Fixed incl. €300 million swapped at variable rates	1.625%	1.74%

In January 2018, Thales issued a €500 million 0.75% fixed-rate bond maturing in 7 years. This issue will be used in particular to refinance the bond maturing in March 2018.

Breakdown of gross debt by maturity

31/12/2017	Total	2018	2019	2020	2021	> 2021
Gross debt [(a)]	**1,643.3**	704.2	45.3	1.4	295.5	596.9
Contractual cash flows	**1,684.6**	700.9	51.0	9.7	309.8	613.2

(a) After deduction of fair value of interest-rate derivatives.

31/12/2016	Total	2017	2018	2019	2020	> 2020
Gross debt [(a)]	**1,517.2**	111.4	509.4	4.3	1.4	890.7
Contractual cash flows	**1,572.3**	106.9	523.4	11.1	8.9	922.0

(a) After deduction of fair value of interest-rate derivatives.

Breakdown of gross debt by currency

	31/12/2017	31/12/2016
Euro	1,538.9	1,468.6
Livre sterling	9.4	13.7
US Dollar	38.6	11.6
Other	56.4	23.3
TOTAL	**1,643.3**	**1,517.2**

After impact of the related derivative instruments.

6.3 Non-current financial assets

a) Non-consolidated investments

	%	31/12/2017	31/12/2016
Investments held by Thales International Offsets [(a)]	N/A	14.2	28.0
Other [(b)]		73.5	54.3
TOTAL		**87.7**	**82.3**

(a) Group subsidiary in charge of negotiating and implementing indirect offset obligations.

(b) Investments of less than €25 million, including Tronics Microsystems and Spaceflight Industries investments at 31 December 2017, and Aviovision, and Tronics Microsystems investments at 31 December 2016.

b) Non-current financial assets

	31/12/2017	31/12/2016
Loans to related parties	88.2	86.6
Loans to employee shareholding	21.2	0.3
Loans and other financial assets at amortised cost	40.0	37.1
Loans and other financial assets at market value	22.0	19.3
Gross value	**171.4**	**143.3**
Impairment	(4.9)	(5.0)
NET	**166.5**	**138.3**

6.4 Changes in net cash

	2017	2016
Net cash (debt) at 1 January	**2,365.6**	**1,977.6**
Net cash flow from operating activities	1,713.3	1,337.9
Less, reduction in pension deficits	82.3	88.3
Net operating investments	(430.7)	(472.0)
Free Operating cash-flow	**1,364.9**	**954.2**
Acquisitions of subsidiaries and affiliates:	(121.4)	(391.2)
• including, Guavus	(90.5)	–
• including, Vormetric	–	(365.4)
Disposals of subsdiaries and affiliates	41.9	296.9
• including, Hanwha Thales Co. Ltd (50%)	–	204.4
• including, equalisation payment/Thales – Raytheon Systems	–	81.0
Less, reduction of U.K. pension deficits	(82.3)	(88.3)
Changes in loans	(26.7)	(26.5)
Dividends paid by the parent company	(348.9)	(296.8)
Third party share in dividend distributions of subsidiaries	(68.1)	(48.3)
Treasury shares and subscription options exercised	(38.3)	4.9
Changes in exchange rates: translation and financing operations	(63.6)	(19.8)
Other	(51.7)	2.9
Total change	**605.8**	**388.0**
Net cash (debt) at 31 December	**2,971.4**	**2,365.6**

6.5 Fair value of financial assets and liabilities

				31/12/2017		31/12/2016	
	At cost/ amortised cost	Fair value through: Equity	Profit or loss	Value in balance sheet	Fair value	Value in balance sheet	Fair value
Non-current financial assets							
Non-consolidated investments	–	87.7	–	87.7	87.7	82.3	82.3
Non-current loans and financial assets	144.5	–	22.0	166.5	166.5	138.3	138.3
Non-current derivatives documented as hedges	–	–	17.0	17.0	17.0	27.9	27.9
Current financial assets							
Derivative instruments documented as hedges	–	246.7	3.1	249.8	249.8	154.2	154.2
Derivative instruments not documented as hedges	–	–	7.7	7.7	7.7	7.5	7.5
Current financial assets	332.0	–	–	332.0	332.0	265.9	265.9
Cash and cash equivalents	3,259.1	–	1,023.6	4,282.7	4,282.7	3,616.9	3,616.9
Non-current financial liabilities							
Long-term debt	939.1	–	14.4	953.5	980.8	1,433.7	1,477.4
Non-current derivative instruments, liabilities	–	–	2.6	2.6	2.6	–	–
Current financial liabilities							
Derivative instruments documented as hedges	–	170.3	–	170.3	170.3	458.3	458.3
Derivative instruments not documented as hedges	–	–	9.4	9.4	9.4	20.0	20.0
Short-term debt	704.2	–	3.1	707.3	709.6	111.4	111.4

Receivables, payables and refundable grants are financial assets and liabilities within the meaning of IAS 32/39 and are measured at amortised cost. They are detailed in the Note 10.1.

IFRS 13 categorises valuation techniques for each financial asset and liabilitiy according to a fair value hierarchy with three levels:

- level 1: valuation is based on quoted (non adjusted) prices in active markets for identical assets or liabilities;
- level 2: valuation is based on information other than quoted market prices that is observable for the asset or liability, either directly or indirectly;
- level 3: valuation is based on unobservable information for an asset or liability.

The fair value of financial assets and liabilities recorded at amortised cost approximates their carrying amount, except for borrowings and debts.

The fair value of bond debt is based on quoted prices (level 1). The fair value of other borrowings and debt is determined for each loan by discounting the expected future cash flows at the Euribor interest rate at the closing date, adjusted for the Group's credit risk (level 2).

The fair value of monetary and non-monetary UCITS is measured based on the last known net asset value. The fair value of interest rate products (certificates of deposit, short-term deposits, negotiable medium-term notes, etc.) is based on the discounting of coupons flows (nominal and interest) over the remaining life of the product at the closing date. The discount rate used is the market rate corresponding to the maturity and product characteristics.

The fair value of derivatives is based on models commonly used to measure these financial instruments (models including observable market data). Counterparty defaut risk and credit risk have no material impact on the fair value of derivatives.

6.6 Financial risk

Thales' financial risk management policy is described in detail in the Group management report (chapter 1 of the 2017 Registration Document, see Section 1.1.2).

a) Market risk

Thales hedges its foreign exchange and interest-rate risk using over-the-counter derivatives from tier-one banks. The book value of derivatives used to manage the Group's market risk is presented below:

	31/12/2017		31/12/2016	
	Assets	Liabilities	Assets	Liabilities
Non-current derivatives:				
• foreign exchange derivatives	–	–	–	–
• interest-rate derivatives	17.0	2.6	27.9	–
Current derivatives:				
• foreign exchange derivatives	252.8	178.7	160.4	476.8
• interest-rate derivatives	4.7	1.0	1.3	1.5
Foreign exchange derivatives, net	74.1		(316.4)	
Interest-rate derivatives, net	18.1		27.7	

Foreign exchange risk

Thales hedges currency risks arising in connection with the negotiation of contracts denominated in currencies other than the main production currency, currency risks generated by ordinary commercial operations, risks relating to cash pooling and, in some cases, risks relating to its net investments in foreign operations.

At 31 December 2016 and 2017, the amount of derivatives in the portfolio can be analysed as follows:

Foreign exchange derivatives	31/12/2017					31/12/2016	
	Nominal value						
	USD	GBP	Other	Total	Market value	Nominal value	Market value
Negotiations and trade operations hedges							
Documented as hedges							
Forward currency sales	3,650.1	878.4	2,384.4	6,912.9	(144.4)	7,710.7	(179.1)
Forward currency purchases	1,471.4	992.8	1,930.6	4,394.8		4,199.2	
Currency sales (call and put options)	–	–	–	–	–	90.6	0.2
Currency purchases (call and put options)	–	–	–	–		14.8	
Not documented as hedges							
Forward currency sales	–	–	–	–	–	–	–
Forward currency purchases	–	–	–	–		–	
Currency sales (call and put options)	90.9	–	22.3	113.2	0.1	3.5	0.4
Currency purchases (call and put options)	111.1	–	1.8	112.8		11.2	
Hedges related to cash pooling							
Currency sales: currency swaps	82.5	–	270.3	352.8	(3.1)	313.7	13.8
Currency purchases: currency swaps	1.3	37.1	71.9	110.3		924.9	
Hedges related to net investments in foreign operations (hedge accounting)							
Currency sales: foreign exchange swaps	619.5	–	–	619.5	(67.3)	716.5	(124.1)
Currency purchases: foreign exchange swaps	–	532.5	–	532.5		561.0	
NET ASSET (LIABILITY)					**74.1**		**(316.4)**

Nominal amounts are translated into euros at the closing rate.

The maturity of the derivatives used to hedge commercial contracts is consistent with the average maturities of these contracts, typically less than five years. Other derivatives have a maturity of less than one year.

The change in the value of financial instruments (forward transactions) used to hedge cash flow is recognised in equity for the spot rate component. A decrease (increase) of 5% in the dollar against the main currencies (EUR, GBP and CAD) would have had a positive (negative) impact on equity of approximately €104 million at 31 December 2017 and €153 million at 31 December 2016.

The change in value of derivative instruments matched with commercial tender portfolio, which are not eligible for hedge accounting, is recognised in profit and loss.

A decrease (increase) of 5% in the dollar against the main currencies (EUR, GBP and CAD) would have no impact on profit or loss at 31 December 2017, as at 31 December 2016.

Interest-rate risk

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 interest-rate hedging policy. At 31 December 2016 and 2017, the amount of derivatives in the portfolio was as follows:

Interest-rate derivatives	31/12/2017		31/12/2016	
	Nominal	Market value	Nominal	Market value
Fair value hedge (swaps with variable rate payable):				
• swaps related to bond maturing in 2023	400.0	(2.6)	400.0	0.1
• swaps related to bond maturing in 2021	300.0	17.0	300.0	21.6
• swaps related to bond maturing in 2018	300.0	3.1	300.0	6.2
		17.5		**27.9**
Cash flow hedge (financing of projects at variable-rate swapped to fixed-rate)	**8.4**	**(0.7)**	**12.8**	**(1.3)**
Swaps not documented as hedges:				
• cross-currency swap with fixed-rate payable, hedging a loan	14.3	1.6	15.2	1.3
• swap with fixed-rate payable, hedging a loan	3.9	(0.3)	6.3	(0.2)
NET ASSET		**18.1**		**27.7**

The table below summarises the Group's exposure to interest-rate risk before and after hedging.

31/12/2017	< 1 year		> 1 year		Total	
	Fixed-rate	Variable-rate	Fixed-rate	Variable-rate	Fixed-rate	Variable-rate
Gross debt[a]	(512.1)	(192.1)	(891.8)	(47.3)	(1,403.9)	(239.4)
Financial assets, cash and cash equivalents	–	4,614.7	–	–	–	4,614.7
NET EXPOSURE BEFORE IMPACT OF DERIVATIVE INSTRUMENTS	**(512.1)**	**4,422.6**	**(891.8)**	**(47.3)**	**(1,403.9)**	**4,375.3**
Hedging derivatives	296.2	(296.2)	695.4	(695.4)	991.6	(991.6)
NET EXPOSURE AFTER IMPACT OF DERIVATIVE INSTRUMENTS	**(215.9)**	**4,126.4**	**(196.4)**	**(742.7)**	**(412.3)**	**3,383.7**

31/12/2016	< 1 year		> 1 year		Total	
	Fixed-rate	Variable-rate	Fixed-rate	Variable-rate	Fixed-rate	Variable-rate
Gross debt[a]	(14.5)	(96.9)	(1,387.1)	(18.7)	(1,401.6)	(115.6)
Financial assets, cash and cash equivalents	–	3,882.8	–	–	–	3,882.8
NET EXPOSURE BEFORE IMPACT OF DERIVATIVE INSTRUMENTS	**(14.5)**	**3,785.9**	**(1,387.1)**	**(18.7)**	**(1,401.6)**	**3,767.2**
Hedging derivatives	(4.0)	4.0	991.2	(991.2)	987.2	(987.2)
NET EXPOSURE AFTER IMPACT OF DERIVATIVE INSTRUMENTS	**(18.5)**	**3,789.9**	**(395.9)**	**(1,009.9)**	**(414.4)**	**2,780.0**

(a) After deduction of the fair value of interest-rate derivatives.

Based on the Group's average net cash (taking into account hedging instruments), a 1 point rise in interest rates would increase net interest income by €25.9million in 2017 (€21.6 million in 2016).

b) Customer credit risk

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

Risk of default by private sector customers

Non-governmental customers (aircraft manufacturers, airlines, private infrastructure operators and industry) account for approximately 25% of Thales' sales. 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' sales, profitability and financial position.

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

Credit risk relating to public sector customers

Public, government and institutional customers account for around 75% of Thales' sales. Thales works with a large number of countries. Some of them could present a significant credit risk which could, for example, lead them to suspend an order in production, or render them 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 BPIFrance) or private insurers.

At 31 December 2017, only three customers accounted for annual sales in excess of €500 million: the French State (around €2.8 billion), the UK government (around €1 billion) and the Australian government (around €0.7 billion). At 31 December 2017, these three countries had first-class or high-quality ratings (France: AA by S&P Global Ratings and Aa2 by Moody's, the United Kingdom: AA by S&P Global Ratings and Aa2 by Moody's, – Australia: AAA by S&P Global Ratings and Aaa by Moody's).

The Group's Finance department consolidates all the information relating to the Group's exposure to credit risk, notably by identifying and analysing the ageing of overdue accounts and notes receivable that have not been impaired. At 31 December 2017 and 2016, the ageing of these accounts and notes receivable is as follows:

31/12/2017	Total	Accounts and notes receivables past due		
		Less than 3 months	3 to 6 months	More than 6 months
Overdue accounts and notes receivables not impaired				
State and similar	270.9	122.5	33.1	115.3
Other	378.3	172.9	68.5	136.9

31/12/2016	Total	Accounts and notes receivables past due		
		Less than 3 months	3 to 6 months	More than 6 months
Overdue accounts and notes receivables not impaired				
State and similar	158.0	80.1	10.3	67.6
Other	517.6	274.3	101.3	142.0

Credit risk related to banking counterparties

Financial investments are diversified. They relate to first ranking debt and are negotiated with tier-one banks.

Thales Group trades over-the-counter derivatives with tier-one banks under agreements which provide for the offseting of amounts payable and receivable in the event of default by one of the contracting parties. These conditional offsetting agreements do not meet the eligibility criteria within the meaning of IAS 32 for offsetting derivative instruments recorded under assets and liabilities. However, they do fall within the scope of disclosures under IFRS 7 on offsetting.

31/12/2017	Gross value (before offset)	Offset amounts on balance sheet	Net presented in balance sheet	Impact of other offsetting agreements		Net
				Offsetting agreements	Financial collaterals	
Derivatives – Assets	274.5	–	274.5	(167.0)	–	107.5
Derivatives – Liabilities	182.3	–	182.3	(167.0)	–	15.3

31/12/2016	Gross value (before offset)	Offset amounts on balance sheet	Net presented in balance sheet	Impact of other offsetting agreements		Net
				Offsetting agreements	Financial collaterals	
Derivatives – Assets	189.6	–	189.6	(185.0)	–	4.6
Derivatives – Liabilities	478.3	–	478.3	(185.0)	–	293.3

c) Liquidity risk

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' 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 (Note 8.1);
- gross debt (listed by date of maturity in Note 6.2);
- committed, undrawn credit facilities granted by banks amounted to €1,500 million with maturing in 2021 as backup to the commercial paper programme and acting as a financing reserve.

At 31 December 2017, the Group also had an undrawn bridge loan to finance its proposed offer for the acquisition of Gemalto.

The parent company's financing programmes are rated by S&P Global Rating and Moody's. At the date of publication, Thales' credit risk ratings were as follows:

	Moody's	S&P Global Ratings
Medium and long-term loans	A2	A-
Outlook	Negative	Negative watch
Commercial paper and short-term loans	Prime-1	A-2

Moody's and S&P Global ratings downgraded their outlook (from "stable" to "negative" and "negative watch" respectively) following the announcement on 17 December 2017 of the planned cash tender offer for Gemalto. If this acquisition, partly financed from the Group's own cash flow and partly through borrowings, goes ahead, it would in all likelihood cause Thales's rating to be lowered, due mainly to the change in the Group's financing structure.

The decrease of Thales' credit risk rating would not trigger the financial covenants included in its financing contracts. The single accelerated repayment clause would apply only in the event that the French State ceased to hold its golden share and, simultaneously, the ratio of consolidated net debt to EBITDA[1] were to exceed 3x.

A lower rating would result in an increase (capped) in the margins applicable to the €1.5 billion committedcredit facility. A higher rating would lead to a decrease in the applicable margin (with a minimum threshold). No other financing arrangements are subject to covenants based on financial ratios.

NOTE 7. INCOME TAX

The income tax charge takes into account specific local tax rules, including the tax consolidation systems in France and the United States, group Relief in the United Kingdom and *Organschaft* rules in Germany.

7.1 Income tax expense

	2017	2016
Current tax	(288.8)	(262.4)
Deferred tax	24.6	6.8
TOTAL	**(264.2)**	**(255.6)**

(1) EBITDA, as defined in the financing agreements, is the sum of operating income, depreciation of non-current assets and impairment of intangible assets, net of goodwill amortisation. This indicator is calculated in accordance with French GAAP.

Tax proof

	2017	2016
Net income	887.1	1,014.6
Less: income tax	264.2	255.6
Less: share in net income of equity affiliates	(134.8)	(119.6)
Net income before tax and share in net income of equity affiliates	**1,016.5**	**1,150.6**
Theoretical average tax rate	30.8%	29.6%
Theoretical tax benefit (expense)	**(312.5)**	**(340.9)**
Reconciliation items:		
• Impact of tax credits	74.0	76.9
• Taxes not taken into account in the theoretical rate	(63.8)	(29.2)
• Impact of dividends paid	54.3	(18.8)
• Impact of change in deferred tax rates	(28.2)	(7.7)
• Change in provision for deferred tax assets	(8.3)	38.7
• Ajustments in respect of prior periods	7.4	5.2
• Impact of partial or total exemption of disposals and other	12.9	20.2
Income tax benefit (expense) recognised in profit and loss	**(264.2)**	**(255.6)**
Effective tax rate	**26.0%**	**22.2%**

The theoretical average rate corresponds to the sum of theoretical taxes of consolidated companies, divided by the consolidated net income before tax and the share in net income of equity affiliates. The theoretical tax of each consolidated company corresponds to the application of the local tax rate to net income before tax. Accordingly, the theoretical average tax rate reflects the relative contribution of the different countries to consolidated net income. France, which has a tax rate of 34.43%, represented almost 70% of income before tax in both 2016 and 2017.

The impact of tax credits includes:

- the impact of tax exemption on research tax credits (€176 million in 2017, €176.2 million in 2016) and tax credits for competitiveness and jobs (*crédit d'impôt pour la compétitivité et l'emploi* – CICE) recognised in operating income;
- the tax advantages related to research, which are recognised in income tax (notably in United States, Australia and the Netherlands).

Taxes not taken into account in the theoretical rate mainly include state taxes in the United States, IRAP in Italy, taxes on foreign establishments, and the additional contribution in France in 2017 (a negative amount of €50.3 million).

In 2016, the impact of dividends paid mainly included the 3% tax introduced in France at the end of 2012 (a negative amount of €12.9 million). This tax, deemed unconstitutional, was repaid by the French government at the end of 2017 (net impact in 2017 of €48.5 million covering financial years 2013-2017).

The impact of changes in deferred tax rates mainly includes:

- in 2016, the impact of the decrease in tax rate enacted in France with effect from 2020 (to 28.92% from 34.43%);
- in 2017, the impact of the new gradual decrease in tax rate in France (a negative amount of €7.7 million) and the impact of the reduction in the federal tax rate in the USA from 35% to 21% (a negative amount of €22.0 million).

7.2 Deferred tax recognised in equity

		2017		2016
Fully consolidated entities	**Base**	**Tax**	**Base**	**Tax**
Translation of the financial statements of foreign subsidiaries	(90.4)	–	35.8	–
Net foreign investment hedges	–	–	(3.9)	1.3
Cash flow hedges	401.4	(113.0)	52.5	(18.9)
Available for sale financial assets	(1.0)	–	3.5	–
Items reclassified to income	**310.0**	**(113.0)**	**87.9**	**(17.6)**
Actuarial gains and losses/pensions – United Kingdom	98.7	6.5	(553.0)	11.5 [a]
Actuarial gains and losses/pensions – Other countries	(49.3)	(3.3) [b]	(108.0)	10.8 [b]
Items not reclassified to income	**49.4**	**3.2**	**(661.0)**	**22.3**
Treasury shares and share-based payment		6.4		7.1
TOTAL DEFERRED TAX RECOGNISED IN EQUITY		**(103.4)**		**11.8**

(a) Release of a portion of the provision for deferred taxes linked to pensions in the United Kingdom.
(b) Including, a negative amount of €18.6 million in 2017, and a negative amount of €16.5 million in 2016, due to the tax cut with future effect in France.

7.3 Tax assets and liabilities presented in the balance sheet

	01/01/2017	Income (expense)	Equity	Cash flow	Changes in exch. rates, scope	Other	31/12/2017
Current income tax assets	59.8	–	–	(23.2)	–	–	36.6
Current income tax liabilities	(59.0)	(288.8)	–	113.8	(1.3)	181.3	(54.0)
Current income tax, net	**0.8**	**(288.8)**	**–**	**90.6**	**(1.3)**	**181.3**	**(17.4)**
Deferred tax assets	975.8	(50.7)	(103.4)	–	14.3	22.1	858.1
Deferred tax liabilities	(294.6)	75.3	–	–	(18.3)	–	(237.6)
Deferred tax, net	**681.2**	**24.6**	**(103.4)**	**–**	**(4.0)**	**22.1**	**620.5**
TOTAL		**(264.2)**	**(103.4)**	**90.6**			

	01/01/2016	Income (expense)	Equity	Cash flow	Changes in exch. rates, scope	Other	31/12/2016
Current income tax assets	70.8	–	–	(11.0)	–	–	59.8
Current income tax liabilities	(63.7)	(262.4)	–	110.4	–	156.7	(59.0)
Current income tax, net	**7.1**	**(262.4)**	**–**	**99.4**	**–**	**156.7**	**0.8**
Deferred tax assets	967.0	(37.6)	11.8	–	28.0	6.6	975.8
Deferred tax liabilities	(257.9)	44.4	–	–	(81.1)	–	(294.6)
Deferred tax, net	**709.1**	**6.8**	**11.8**	**–**	**(53.1)**	**6.6**	**681.2**
TOTAL		**(255.6)**	**11.8**	**99.4**			

a) Current income tax

Income tax paid is reported net of tax credits utilised. The allocation of tax credits is presented under "Other".

b) Deferred tax

Changes by nature

	01/01/2017	(Expense)/ Income for the period	Equity	Changes in exch. rates, scope and other	31/12/2017
Temporary differences:	**884.2**	**66.3**	**(133.4)**	**(4.3)**	**812.8**
• pensions and other employee benefits	593.3	(12.5)	(19.7)	50.8	611.9
• intangible assets	(310.1)	69.9	–	(4.8)	(245.0)
• reserve for losses at completion	141.5	(12.0)	–	3.4	132.9
• other	459.5	20.9	(113.7)	(53.7)	313.0
Tax loss carry-forwards	**192.4**	**(33.1)**	**–**	**15.2**	**174.5**
Total	**1,076.6**	**33.2**	**(133.4)**	**10.9**	**987.3**
O/w not recognised in the balance sheet	**(395.4)**	**(8.6)**	**30.0**	**7.2**	**(366.8)**
Total net deferred tax assets	**681.2**	**24.6**	**(103.4)**	**18.1**	**620.5**

	01/01/2016	(Expense)/ Income for the period	Equity	Changes in exch. rates, scope and other	31/12/2016
Temporary differences:	**846.7**	**35.8**	**80.5**	**(78.8)**	**884.2**
• pensions and other employee benefits	531.1	(21.3)	104.3	(20.7)	593.3
• intangible assets	(262.5)	32.8	–	(80.4)	(310.1)
• reserve for losses at completion	118.6	24.1	–	(1.2)	141.5
• other	459.5	0.2	(23.8)	23.6	459.5
Tax loss carry-forwards	**248.0**	**(67.7)**	**–**	**12.1**	**192.4**
Total	**1,094.7**	**(31.9)**	**80.5**	**(66.7)**	**1,076.6**
O/w not recognised in the balanche sheet	**(385.6)**	**38.7**	**(68.7)**	**20.2**	**(395.4)**
Total net deferred tax assets	**709.1**	**6.8**	**11.8**	**(46.5)**	**681.2**

1

Tax loss carry-forwards

Total tax loss carry-forwards represent a potential tax saving of €174.5 million at 31 December 2017 (€192.4 million at 31 December 2016). The corresponding expiry dates are as follows:

	31/12/2017
2018	1.1
2019-2022	0.2
Beyond 2022	44.8
Not time limited	128.4
Total	**174.5**
O/w not recognised in the balance sheet	(112.0)
Net deferred tax asset	**62.5**

	31/12/2016
2017	1.0
2018-2021	0.8
Beyond 2021	47.5
Not time limited	143.1
Total	**192.4**
O/w not recognised in the balance sheet	(112.5)
Net deferred tax asset	**79.9**

As described in Note 13-i, only deferred tax assets related to tax losses which the Group expects to recover are recognised in the balance sheet. In particular, the Group takes into account any loss carry-forward limitations.

NOTE 8. EQUITY AND EARNINGS PER SHARE

8.1 Equity

a) Share capital

At 31 December 2017, the share capital of Thales parent company, amounts to €637,976,175 and comprises 212,658,725 shares with a par value of €3, compared with 212,194,766 shares at 31 December 2016. This represents an increase of 463,959 shares resulting from the exercise of share subscription options.

b) Outstanding securities giving access to the share capital

At 31 December 2017, there are no securities that give access to the share capital of the Company, with the exception of the share subscription options described in Note 9.4.

c) Treasury shares

Thales parent company held 568,739 of its own shares at 31 December 2017. They are accounted for as a deduction from equity in the amount of €52.5million.

In accordance with the authorisations given to the Board of Directors at the Annual General Meeting, the Company carried out the following transactions in 2016 and 2017:

	2017	2016
Treasury shares at 1 January	**749,559**	**839,254**
Purchases as part of a liquidity agreement	819,512	513,001
Sales as part of a liquidity agreement	(743,512)	(472,001)
Transfer to employees as part of the employee share purchase offering	(462,167)	(41,714)
Delivery of free shares	(606,653)	(607,381)
Market purchases	852,000	575,000
Exercise of share purchase options	(40,000)	(56,600)
Treasury shares at 31 December	**568,739**	**749,559**

At 31 December 2017 and 2016, as part of a liquidity agreement managed by Kepler Cheuvreux, the following numbers of shares where held in the liquidity account:

	2017	2016
Number of shares at 31 December	126,000	50,000
Value (€ million)	23.2	29.5

d) Translation adjustments

Translation adjustments result from the translation of financial statements of companies whose functional currency is not the euro, offset as applicable by the impact of derivative instruments denominated in foreign currencies to hedge net investments in foreign operations.

Translation adjustments are recorded in equity as other comprehensive income, and are subsequently reclassified to income on disposal. They break down as follows:

	2017	2016
Translation adjustment at 1 January	**(110.0)**	**(87.2)**
Changes in value Reclassified to profit and loss	(113.9) –	21.4 (46.8)
Gross change	(113.9)	(25.4)
Deferred tax	–	1.3
Scope and other	0.2	1.3
Translation adjustment at 31 December	**(223.7)**	**(110.0)**
Of which: Hedge of net investments in foreign operations	 –	 –

e) Reserves for cash flow hedge

The Group uses foreign exchange derivatives to hedge against changes in the value of future cash flows related to commercial cash flows in foreign currencies. In the consolidated financial statements, the effective portion of changes in fair value of these derivatives is recognised directly in equity, until such time as the hedged flows affect profit and loss.

	2017	2016
Cash flow hedge at 1 January	**(250.7)**	**(276.8)**
Changes in value of derivatives	252.2	17.6
Reclassified to operating (income)/expense	33.2	27.4
Reclassified to income tax (benefit)/expense	(14.5)	(9.9)
Changes in scope and exchange rates	–	(9.0)
Cash flow hedge at 31 December [a]	**20.2**	**(250.7)**

(a) A negative balance at closing means that the exchange rates of the derivative instruments documented as hedges are generally less favorable than the exchange rates prevailing at the closing date.

f) Parent company dividend distribution

The per share dividend amounted to €1.60 in 2016 and €1.36 in 2015.

The Board of Directors decided to propose to shareholders, who will be convened to a General Meeting on 23rd May 2018, the payment of a total amount of €1.75 per share.

If approved, the ex-dividend date will be 30 May 2018 and the payment date will be 1 June 2018. The dividend will be paid fully in cash and will amount to €1.30 per share, after deducting the interim dividend of €0.45 per share paid in December 2017.

Dividends paid in 2016 and 2017 are described below:

Year	Approved by	Description	Dividend per share	Payment date	Payment method	Total
2017	Board of Directors meeting on 28 September 2017	2017 interim dividend	€0.45	12/2017	Cash	€95.2 million
	General Meeting on 17 may 2017	Balance for 2016	€1.20	06/2017	Cash	€253.7 million
	Total dividends paid in 2017					**€348.9 million**
2016	Board of Directors meeting on 22 September 2016	2016 interim dividend	€0.40	12/2016	Cash	€84.6 million
	General Meeting on 18 may 2016	Balance for 2015	€1.01	05/2016	Cash	€212.2 million
	Total dividends paid in 2016					**€296.8 million**
2015	Board of Directors meeting on 17 September 2015	2015 interim dividend	€0.35	12/2015	Cash	€73.4 million

g) Non-controlling interests

This item principally includes Leonardo's interest in sub-group Thales Alenia Space (33%), Siemens' and Philips Medical Systems International's interest in Trixell SAS (49%) and, up until 29 June 2016, Raytheon's interest in Thales-Raytheon Systems Company SAS (50%).

The individual contributions of these minority shareholders to the Group's key financial indicators are not material.

The cash of these three companies is unrestricted and is exclusively pooled with Thales' Corporate Treasury department.

8.2 Earnings per share

Basic earnings per share are calculated by dividing the attributable net income by the weighted average number of shares outstanding during the period, excluding treasury shares.

Diluted earnings per share take into account instruments with a dilutive effect on earnings per share and exclude non-dilutive instruments. The dilutive effect of share subscription and share purchase options, free share and unit allotments, is calculated using the treasury stock method, taking into account the average share price over the relevant period.

		2017	2016
Numerator (in € millions)			
Net income attributable to shareholders of the parent company	(A)	821.7	946.4
Denominator (in thousands)			
Average number of shares outstanding	(B)	211,661	210,872
Share subscription and share purchase options [a]		596	1,004
Free share and units plans [b]		984	1,432
Diluted average number of shares outstanding	(C)	213,241	213,308
Basic earnings per share (in euros)	**(A) / (B)**	**3.88**	**4.49**
Diluted earnings per share (in euros)	**(A) / (C)**	**3.85**	**4.44**
Average share price		€92.14	€77.59

(a) Only option plans with an exercise price that is lower than the average share price are taken into account in the calculation of diluted earnings per share.
(b) Performance shares/units are only taken into account when performance targets are achieved (for the portion deliverable in shares).

NOTE 9. EMPLOYEE BENEFITS

9.1 Consolidated headcount

Consolidated headcount includes all employees of fully consolidated companies. It does not include employees of equity affiliates. At end-2017, Thales' headcount stood at 64,860 versus 63,783 at end-2016.

Headcount includes three-fourth of employment grade of engineer, specialist, manager or equivalent.

9.2 Personnel expenses

	2017	2016
Wages and salaries and payroll taxes [a]	(6,120.8)	(5,875.8)
Defined benefit pension expense: current service cost (Note 9.3)	(105.0)	(92.9)
Compensation subject to presence conditions related to business combinations	(17.8)	(19.0)
Share-based payment (Note 9.4)	(48.8)	(36.9)
TOTAL	**(6,292.4)**	**(6,024.6)**

(a) Including profit-sharing, incentive plans and defined contribution pension expenses.

9.3 Pensions and other employee benefits

The Group grants its employees post-employment benefits (pensions, end-of-career indemnities, medical care, etc.) and other long-term benefits (long-service and jubilee awards, etc.).

a) Description of the plans

The Group's existing plans are either defined contribution plans or defined benefit plans.

Defined contribution plans

In certain countries, the Group pays contributions based on salaries to state organisations in charge of basic pension schemes (e.g., *Sécurité Sociale* or compulsory supplementary schemes ARRCO and AGIRC in France). Beyond these basic pension schemes, Thales also contributes to other defined contribution plans (e.g., Netherlands and United Kingdom since 2002). These plans do not impose any other obligations on the Group except for the payment of contributions: there is no related benefit obligation and contributions are expensed in the period they are incurred.

Defined benefit plans

Defined benefit plans relate to different types of advantages:

- pensions and end-of-career indemnities (legal or contractual), and other long-term benefits (jubiliee awards, etc.), notably in France. In general, these commitments are not covered by any assets;
- supplementary pension schemes, mainly in the United Kingdom where the main scheme, "Thales UK Pension Scheme" provides a pension based on the beneficiary's average salary, indexed to inflation. This plan has been closed to new entrants since 2002, and is managed by a trust according to minimum local funding regulations.

The present value of the Group's obligations and the value of plan assets are measured independantly. A provision is recognised if the value of the assets is insufficient to cover the obligations.

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b) Provisions recognised in the balance sheet

	2017	2016
Provision at 1 January	**(2,785.8)**	**(2,318.9)**
Current service cost (income from operations)	**(105.0)**	**(92.9)**
Amendments and settlements (non-recurring operating income)	**(21.2)**	**0.0**
Interest expense	(151.4)	(182.6)
Expected return on plan assets	94.2	122.0
Net interest cost	(57.2)	(60.6)
Pension fund management cost	(5.6)	(5.2)
Actuarial gains and losses on other long-term benefits	(2.7)	(11.8)
Finance costs on pensions and other long-term employee benefits	**(65.5)**	**(77.6)**
Total expense for the period	**(191.7)**	**(170.5)**
Actuarial gains and losses (other comprehensive income)	**49.4**	**(661.0)**
Benefits and contributions	**202.9**	**190.1**
• of which, deficit payment in the United Kingdom	82.3	88.3
• of which, other benefits and contributions	120.6	101.8
Translation adjustment	55.7	163.2
Changes in scope of consolidation and other	(4.8)	11.3
Provision at 31 December	**(2,674.3)**	**(2,785.8)**
Of which:		
• post-employment benefits	(2,468.0)	(2,586.9)
• other long-term benefits	(206.3)	(198.9)

c) Changes in defined benefit obligations and plans assets

31/12/2017	UK	France	Other	Total
Obligation at 1 January	**(4,605.7)**	**(1,138.1)**	**(597.3)**	**(6,341.1)**
Current service cost	(24.0)	(57.6)	(23.4)	(105.0)
Interest cost	(123.7)	(16.9)	(10.8)	(151.4)
Plan participant contributions	(10.2)	–	(2.2)	(12.4)
Amendments/settlements	(2.8)	(18.4)	–	(21.2)
Experience gains (losses)	20.8	(28.7)	5.4	(2.5)
Actuarial gains (losses)/financial assumptions	(147.0)	(35.5)	(5.3)	(187.8)
Actuarial gains (losses)/demographic assumptions	137.8	–	1.1	138.9
Actuarial gains (losses) on long-term benefits	–	(1.1)	(1.6)	(2.7)
Benefits paid by plan assets	161.5	2.6	12.7	176.8
Benefits paid by employer	0.5	75.7	18.6	94.8
Changes in scope, exchange rates and other	161.0	5.5	0.1	166.6
Obligation at 31 December	**(4,431.8)**	**(1,212.5)**	**(602.7)**	**(6,247.0)**
Plan assets at 1 January	**3,246.2**	**141.5**	**167.6**	**3,555.3**
Expected return on plan assets	88.2	2.1	3.9	94.2
Employer's contribution	98.5	4.0	5.6	108.1
Plan participant contributions	10.2	–	2.2	12.4
Amendments/settlements	–	–	–	–
Benefits paid by plans assets	(161.5)	(2.6)	(12.7)	(176.8)
Experience gains (losses)	87.0	6.9	6.9	100.8
Changes in scope, exchange rates and other	(119.9)	(0.1)	(1.3)	(121.3)
Plan assets at 31 December	**3,248.7**	**151.8**	**172.2**	**3,572.7**
PROVISIONS AT 31 DECEMBER	**(1,183.1)**	**(1,060.7)**	**(430.5)**	**(2,674.3)**

31/12/2016	UK	France	Other	Total
Obligations at 1 January	**(4,294.5)**	**(1,042.2)**	**(555.0)**	**(5,891.7)**
Current service cost	(19.9)	(51.4)	(21.6)	(92.9)
Interest cost	(148.7)	(21.4)	(12.5)	(182.6)
Plan participant contribution	(11.4)	–	(1.8)	(13.2)
Amendments/settlements	–	–	–	–
Experience gains (losses)	8.1	(11.5)	2.9	(0.5)
Actuarial gains (losses)/financial assumptions	(1,011.8)	(17.3)	(28.3)	(1,057.4)
Actuarial gains (losses)/demographic assumptions	79.7	(56.8)	2.3	25.2
Actuarial gains (losses) on long-term benefits	–	(10.1)	(1.7)	(11.8)
Benefits paid by plan assets	141.7	2.4	5.1	149.2
Benefits paid by employer	0.5	58.5	18.7	77.7
Changes in scope, exchange rates and other	650.6	11.7	(5.4)	656.9
Obligations at 31 December	**(4,605.7)**	**(1,138.1)**	**(597.3)**	**(6,341.1)**
Plan assets at 1 January	**3,274.6**	**139.2**	**159.0**	**3,572.8**
Expected return on plans assets	115.0	2.9	4.1	122.0
Employer's contribution	106.1	2.0	4.3	112.4
Plan participant contribution	11.4	–	1.8	13.2
Amendments/settlements	–	–	–	–
Benefits paid by plan assets	(141.7)	(2.4)	(5.1)	(149.2)
Experience gains (losses)	371.0	0.0	0.7	371.7
Changes in scope, exchange rates and other	(490.2)	(0.2)	2.8	(487.6)
Plan assets at 31 December	**3,246.2**	**141.5**	**167.6**	**3,555.3**
PROVISIONS AT 31 DECEMBER	**(1,359.5)**	**(996.6)**	**(429.7)**	**(2,785.8)**

d) Actuarial assumptions used

The actuarial assumptions used are determined according to the economic environment and specific criteria of each country and each system. The most sensitive assumptions are as follows:

2017	UK	France
Inflation rate	3.19%	1.35%
Discount rate	2.60%	1.20%
Average duration of the plans	17 years	10 years

2016	UK	France
Inflation rate	3.22%	1.40%
Discount rate	2.79%	1.50%
Average duration of the plans	17 years	10 years

For each country, the discount rates are obtained by reference to the Iboxx Corporate AA index which reflects the rate of return of very high-quality corporate bonds, with maturity dates equivalent to the duration of the plans being measured, and in the same currency.

At 31 December 2017, the sensitivity of the net obligation to a change in the discount rate is as follows:

Sensitivity in basis points	+0.25%	–0.25%	+0.50%	–0.50%	+1%	–1%
Decrease (increase) in provision (in € millions)	249.6	(265.6)	483.7	(548.7)	910.5	(1,172.9)

In the United Kingdom, a 25-basis-point increase in the inflation rate would lead to a €117.1 million increase in the obligation. Conversely, a 25-basis-point decrease in the inflation rate would give rise to a €135.5 million decrease in the obligation.

e) Allocation and return on plan assets

Plan assets generated an actual average return of 5.5% in 2017, compared with 14% in 2016. At 31 December 2017, the allocation of assets, mainly invested in the United Kingdom, breaks down as follows:

	2017	2016
Fixed-rate bonds	34%	32%
Index-linked investments	12%	13%
Equities	28%	33%
Alternative liquid investments	10%	8%
Alternative non-liquid investments (property, etc.)	16%	14%
TOTAL	**100%**	**100%**

f) Funding

Thales is subject to funding obligations in respect of its defined benefit pension commitments in the United Kingdom.

In accordance with the regulations in force, the level of funding for its pension obligation is remeasured every three years, further to which the suitability of a new funding plan and/or the implementation of guarantees for the plan is decided in consultation with the trustees. The latest measurement, based on the situation at end-2014, was finalised in September 2016 and led to an annual contribution of £60 million to the main Thales UK Pension Scheme (£5 million for other schemes).

Depending on changes in the degree of deficit which will be determined based on the situation at the end of 2017, future contributions to the main scheme could change from 2018 and increase to £75 milion.

Thales (parent company), in support of the contributions made by Thales UK Ltd to the British pension plans, has also guaranteed the future liabilities linked to the funding plans for the subsidiaries concerned. At 31 December 2017, the balance of these guarantees was £825.8 million, partly reduced by any sums paid into the funding plans.

9.4 Share-based payment

At 31 December 2017, the following options, shares and units were outstanding:

- 850 share purchase options with a weighted average exercise price of €38.50;
- 783,204 share subscription options with a weighted average exercise price of €34.13, including 155,427 performance shares;
- 447,860 free shares, including 360,300 performance shares;
- 1,235,940 share units, including 480,150 performance units;
- 142,180 phantom shares, payable in cash at the end of a four-year vesting period, including 103,390 performance shares.

The terms of these plans are described in the Registration Document (see section on share capital and shareholders).

The Group also implemented an employee share purchase plan, the terms of which are described as below:

a) Outstanding share purchase option plans

Date of Board decision	Exercise period	Exercise price	Number of options outstanding at 31/12/2016	Options exercised in 2017	Options cancelled in 2017	Number of options outstanding at 31/12/2017
25/11/2008	from 25/11/2012 to 24/11/2018	€38.50	850	–	–	850
04/07/2007	from 04/07/2011 to 03/07/2017	€44.77	40,000	(40,000)	–	–

b) Outstanding share subscription option plans

Date of Board decision	Exercise period	Exercise price	Number of options outstanding at 31/12/2016	Options exercised in 2017	Options cancelled in 2017	Number of options outstanding at 31/12/2017
15/09/2011 [(a)]	from 15/09/2015 to 14/09/2021	€26.34	126,322	(40,945)	–	85,377
23/09/2010 [(a)]	from 23/09/2014 to 22/09/2020	€26.34	110,150	(40,100)	–	70,050
25/06/2009	from 25/06/2013 to 24/06/2019	€32.88	362,584	(84,342)	(5,490)	272,752
01/07/2008	from 01/07/2012 to 30/06/2018	€38.50	463,237	(96,732)	(11,480)	355,025
04/07/2007	from 04/07/2011 to 03/07/2017	€44.77	258,400	(201,840)	(56,560)	–

(a) Plans contingent upon the achievement of internal performance targets over the three financial years following the grant date.

c) Allotment of free shares

Date of Board decision	Vesting period	Share price at grant date	Number of free shares at 31/12/2016	Shares allotted in 2017	Shares cancelled in 2017	Shares delivered in 2017	Number of free shares at 31/12/2017
28/09/2017	from 28/09/2017 to 28/09/2021	€94.66	–	212,540 [(a)]	–	–	212,540
27/10/2016	from 27/10/2016 to 27/10/2020	€83.10	87,860 148,070 [(a)]	– –	(300) (310)	– –	87,560 147,760
17/09/2013	from 17/09/2013 to 17/09/2017	€39.16	397,180 226,335 [(a)]	– –	(9,274) (7,638)	(387,906) (218,697)	– –
20/12/2012	from 20/12/2012 to 20/12/2016	€27.47	50 [(b)]	–	–	(50)	–

(a) Plans contingent upon the achievement of internal performance targets over the three financial years following the grant date.
(b) Adjustment after 2016.

d) Allotment of share units indexed to the value of Thales shares

Date of the allocation decision	Vesting period	Share price at grant date	Number of units at 31/12/2016	Units cancelled in 2017	Units delivered in 2017	Number of units at 31/12/2017
17/09/2015	from 17/09/2015 to 17/09/2019	€61.75	368,350[b] 229,200[a]	(9,050) (7,750)	(270) –	359,030 221,450
16/09/2014	from 16/09/2014 to 16/09/2018	€42.42	405,210 268,000[a]	(8,210) (9,300)	(240) –	396,760 258,700

(a) Plans contingent upon the achievement of internal performance targets over the three financial years following the grant date.
(b) Adjustment of 620 shares after 2016.

e) Allotment of phantom shares indexed to the value of Thales shares

Date of the allocation decision	Vesting period	Number of phantom shares at 31/12/2016	Phantom shares deliverred in 2017	Phantom shares cancelled in 2017	Number of phantom shares at 31/12/2017
28/09/2017	from 28/09/2017 to 28/09/2021	–	67,140[a]	(140)	67,000
27/10/2016	from 27/10/2016 to 27/10/2020	39,430 37,910[a]	– –	(640) (1,520)	38,790 36,390

(a) Plans contingent upon the achievement of internal performance targets over the three financial years following the grant date.

f) Employee share purchase plan

Following the decision of the Board of Directors on 27 February 2017, the Group implemented a Thales share purchase plan reserved to its employees with a discount compared to the average market price plus an employer contribution.

The subscription price of €75.93, set on 12 October 2017, corresponds to the average of the opening price of Thales shares on Euronext Paris over the twenty trading days preceding this date, discounted by 20%.

The employees also received an employer contribution corresponding to one free share for four acquired shares up to 40 shares purchased, within the limit of 10 matching shares.

This plan is part of the Group savings plan, subject to a five-year lockup period of the investment, except for the United Kingdom where the share offering is implemented in accordance with the Share Incentive Plan ("SIP").

Thus, in 2017, 377,989 shares were subscribed by employees at the subscription price of €75.93 and 84,178 bonus shares were received. The delivery of shares to UK based employees will be finalised in early 2018.

In the consolidated financial statements, the cost of this plan is measured according to the French CNC (Conseil National de la Comptabilité) recommendation, taking the five-year lock-up period into account. This approach measures the share according to a replication strategy in which the market participant would sell the share at the end of the five-year lockup period and would borrow the necessary amount to immediately buy a free share by financing the loan by the future sale and dividends paid out during the lock-up period.

Accounting cost: hypothesis taken	
Five-year free risk interest rate	0.18%
Spread of the banking system (retail)	5.00%
Financing rate for an employee	5.18%
Cost of security loan (repo)	1.0%
Cost for the Group (M€)	€6.0 M[a]

(a) Before social contributions (€1.8 million) and administrative charges.

g) Expenses related to share based payment

In the consolidated financial statements, the benefit granted to beneficiaries of the above-mentioned plans is recognised as an operating expense. These amounts break down as follows:

Plans	Residual fair value at the end of 2017	2017 expense	2016 expense
Free shares	27.0	(8.8)	(9.9)
Share units [a]	23.3	(20.7)	(19.0)
Phantom shares and others [b]	9.6	(2.0)	(0.3)
Employee share scheme	–	(6.0)	–
Social contributions related to the plans	15.4	(11.3)	(7.7)
TOTAL	**75.3**	**(48.8)**	**(36.9)**
Of which, offsetting entries:			
• Shareholders equity		21.8	16.6
• Debt		27.0	20.3

(a) The fair value of the plan, measured in accordance with the Monte Carlo model, takes into account the following assumptions respectively in 2014 and 2015: volatility rates of 22% and 23%, dividend payout rates of 2.7% and 2%, and free risk rates of 0.14% and 0.10%.
(b) In 2017, this line included the expense relating to the long-term incentive plan (LTIP) of the Chairman and CEO, consisting of a maximum of 5,000 performance units, the conditions of which are described in the 2016 Registration Document on page 153.

9.5 Compensation of directors and senior corporate officers

Expenses recognised in respect of compensation, benefits and social security contributions attributed to Directors and members of the Executive Committee are as follows:

	2017	2016
Short-term benefits:		
• Fixed compensation	5.2	4.8
• Variable compensation	4.5	3.9
• Retirement benefit	0.5	–
• Employer social security contributions	3.3	2.9
• Attendance fees	0.6	0.5
Other benefits:		
• Post-employment benefits	2.4	1.7
• Share-based payments	2.4	2.5

NOTE 10. CURRENT OPERATING ASSETS AND LIABILITIES

Current operating assets and liabilities include working capital components and reserves for contingencies. The changes in these items are presented below.

Contracts falling within the scope of IAS 11 are subject to specific classification in the consolidated balance sheet: for each contract, the balance of unbilled receivables, work in progress and reserves for contingencies are presented in assets or liabilities under "Construction contracts" (Note 13-c).

The Group is authorised to assign trade receivables, mainly from the French State, and commercial paper. At 31 December 2017, derecognised receivables amounted to €292.5million (€143.5 million at 31 December 2016). The organic change in derecognised receivables represents an increase of €149 million for 2017 (a decrease of €39.7 million in 2016).

As these assignements without recourse in case of default by the debtor involve the transfer of substantially all corresponding risks and rewards, they are derecognised. Thales' continued involvement (within the meaning of IFRS 7) in the related risks and rewards corresponds to the share of dilution risk not transferred to the bank and the remuneration received under the recovery mandate.

10.1 Change in current operating assets and liabilities

	01/01/2016	Change in WCR and reserves	Change in scope, exchange rates and reclassifications	31/12/2016	Change in WCR and reserves	Change in scope, exchange rates and reclassifications	31/12/2017
Inventories and work in progress	2,560.8	177.4	(3.6)	2,734.6	126.6	(57.8)	2,803.4
Construction contracts: assets	2,042.6	285.2	3.7	2,331.5	40.8	(66.3)	2,306.0
Advances to suppliers	383.0	(32.4)	(2.3)	348.3	110.3	(6.8)	451.8
Accounts, notes and other receivables	4,404.2	223.3	(80.0)	4,547.5	(103.1)	(93.3)	4,351.1
Current derivatives – assets	154.2	18.0	(10.5)	161.7	122.6	(29.9)	254.4
Current operating assets	**9,544.8**	**671.5**	**(92.7)**	**10,123.6**	**297.2**	**(254.1)**	**10,166.7**
Advances received from customers on contracts [a]	(4,317.2)	(193.0)	31.8	(4,478.4)	251.3	64.5	(4,162.6)
Refundable grants	(127.6)	(6.6)	0.8	(133.4)	5.0	0.7	(127.7)
Construction contracts: liabilities	(1,021.0)	(116.8)	(1.6)	(1,139.4)	(156.2)	17.3	(1,278.3)
Reserve for contingencies	(1,022.9)	5.6	(19.7)	(1,037.0)	(117.1)	19.4	(1,134.7)
Accounts, notes and other payables	(5,547.6)	(310.7)	(14.3)	(5,872.6)	(475.7)	84.0	(6,264.3)
Current derivatives – liabilities	(405.3)	21.0	(94.0)	(478.3)	–	298.6	(179.7)
Current operating liabilities	**(12,441.6)**	**(600.5)**	**(97.0)**	**(13,139.1)**	**(492.7)**	**484.5**	**(13,147.3)**
Restructuring provision [b]	**116.3**	**(7.4)**	**5.4**	**114.3**	**(27.0)**	**(1.3)**	**86.0**
INCREASE (DECREASE) IN WCR AND RESERVES FOR CONTINGENCIES		**63.4**			**(222.5)**		

(a) Advances received on construction contracts respectively amount to €3,262.8 million, €3,302.7 million and €3,024.1 million at 1 January 2016, 31 December 2016 and 2017.
(b) Included in reserves for contingencies.

10.2 Reserves for contingencies (excluding construction contracts)

	31/12/2016	Additions	Utilisation	Reversal (surplus)	Exchange rates and other	31/12/2017
Restructuring [a]	114.3	42.8	(62.8)	(7.0)	(1.3)	86.0
Litigation	125.5	84.4	(21.2)	(29.2)	(1.0)	158.5
Guarantees	255.8	120.1	(40.4)	(12.9)	1.8	324.4
Losses at completion	96.3	55.9	(43.0)	(11.5)	(10.9)	86.8
Provisions on contracts	173.5	40.0	(32.5)	(8.8)	8.4	180.6
Other [b]	271.6	112.9	(68.7)	(13.4)	(4.0)	298.4
TOTAL	**1,037.0**	**456.1**	**(268.6)**	**(82.8)**	**(7.0)**	**1,134.7**

	01/01/2016	Additions	Utilisation	Reversal (surplus)	Exchange rates and other	31/12/2016
Restructuring[a]	116.3	72.4	(68.1)	(11.7)	5.4	114.3
Litigation	127.7	33.4	(18.9)	(24.4)	7.7	125.5
Guarantees	239.7	82.2	(51.8)	(10.4)	(3.9)	255.8
Losses at completion	76.1	52.9	(27.9)	(4.8)	–	96.3
Provisions on contracts	147.4	44.9	(12.7)	(4.8)	(1.3)	173.5
Other[b]	315.7	71.1	(58.4)	(23.0)	(33.8)	271.6
TOTAL	**1,022.9**	**356.9**	**(237.8)**	**(79.1)**	**(25.9)**	**1,037.0**

(a) Net restructuring costs break down as follows:

	2017	2016
Additions for the period	(42.8)	(72.4)
Reversals for the period	69.8	79.8
Expenses for the period	(108.1)	(107.9)
Restructuring costs, net	**(81.1)**	**(100.5)**

(b) Includes technical provisions of insurance companies, provisions for tax and labour-related risks, vendor warranties, environmental guarantees and other.

10.3 Maturity of current receivables and payable

The amounts presented in the balance sheet for this item break down as follows:

			31/12/2017	31/12/2016
	Total	< 1 year	> 1 year	Total
Accounts and accrued receivables, gross	3,217.3	3,139.0	78.3	3,357.0
Provisions on accounts and notes receivable[a]	(91.6)	(53.4)	(38.2)	(94.8)
Accounts and accrued receivables, net	**3,125.7**	**3,085.6**	**40.1**	**3,262.2**
Tax receivables (excluding income tax)	893.1	753.2	139.9	966.0
Other receivables, gross	335.2	313.1	22.1	319.3
Provisions for other receivables	(2.9)	(2.9)	–	–
Net	**1,225.4**	**1,063.4**	**162.0**	**1,285.3**
Accounts, notes and other receivables	**4,351.1**	**4,149.0**	**202.1**	**4,547.5**
Accounts and notes payable	2,652.6	2,645.5	7.1	2,467.0
Accrued holiday pay and payroll taxes	1,564.4	1,541.1	23.3	1,455.6
Tax payables (excluding income tax)	698.6	698.1	0.5	679.0
Other creditors and accrued liabilities	1,348.7	1,260.5	88.2	1,271.0
Accounts, notes and other payables	**6,264.3**	**6,145.2**	**119.1**	**5,872.6**

(a) In 2017, additions to provisions for bad debts, net of reversals of surplus provision, amounted to €6.5 million (€2.1 million in 2016).

10.4 Bonds and warranties linked to commercial contracts

In the ordinary course of its activities, the Group regularly responds to invitations to tender. When requested by the customer, bid bonds are delivered in order to demonstrate the definitive nature of the bid and to indemnify the customer if the Group fails to meet its commitments. At 31 December 2017, bid bonds issued amounted to €33.6 million (€26.2 million at 31 December 2016).

From the signature of a contract up until its completion, the Group may also issue performance bonds for its customers, with a bank acting as an intermediary, in order to cover the payment of damages to the customer in the event that the Group does not meet its contractual commitments. At 31 December 2017, performance bonds amounted to €1,812.5 million (€2,288.6 million at 31 December 2016).

Technical, operational and financial costs incurred by the Group in order to meet its obligations are valued, on a contract-by-contract basis, and are included in the cost to completion of the contract. Where this is not the case, a provision is set aside in the consolidated financial statements for any potential risk, estimated on a contract-by-contract basis.

In order to finance contract execution, the Group may receive advance payments from its customers, in accordance with contractual terms, which are recognised in liabilities in the balance sheet. In order to guarantee reimbursement of these advance payments if the contractual obligations are not met, the Group may deliver, at the customer's request, an advance payment bond. At 31 December 2017, advance payment bonds amounted to €2,143.2million (€2,336.7 million at 31 December 2016).

The Group evaluates and sets aside provisions for warranty costs in order to guarantee the conformity of goods sold to the customer during the contractual warranty period. In most cases, the provisional withholding of payment contractually applying during this period can be replaced by a warranty retention bond using a bank as intermediary. At 31 December 2017, warranty retention bonds amount to €90.4million (€114.9 million at 31 December 2016).

The maturity dates of these commitments are:

	< 1 year	1 to 5 years	> 5 years	31/12/2017	31/12/2016
Bid bonds	32.0	1.3	0.3	33.6	26.2
Performance bonds	741.8	832.4	238.3	1,812.5	2,288.6
Advance payment bonds	1,094.4	824.3	224.5	2,143.2	2,336.7
Warranty retention bonds	66.1	17.9	6.4	90.4	114.9
Other bank bonds	55.9	56.7	69.9	182.5	163.2
TOTAL	**1,990.2**	**1,732.6**	**539.4**	**4,262.2**	**4,929.6**

The awarding of major contracts, particularly within the defence sector, may be subject to local or regulatory offsetting obligations, which can take the form of direct offsetting, semi-direct offsetting or indirect offsetting. The associated risks are described under "risk factors" in the management report.

Parent company guarantees

In addition, Thales may grant parent company guarantees to third parties on behalf of its subsidiaries without using a bank as an intermediary. At 31 December 2017, these guarantees amounted to €12,760.4million (€13,697.1 million at 31 December 2016).

These guarantees include all commitments given on behalf of Thales Alenia Space, which are backed by a counterguarantee from Leonardo in proportion to its interest in the capital of Thales Alenia Space (33%).

NOTE 11. 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 Group'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 involved.

In October 2017, Thales was notified of an arbitration award in a commercial dispute between the Republic of China and a group of three French manufacturers, including Thales Systèmes Aéroportés, a Thales subsidiary.

As a result of this arbitration award, which pertains to a contract signed in 1992, the manufacturers were ordered to pay a total sum of €227 million including interest, of which €64 million was payable by Thales Systèmes Aéroportés. The corresponding charge was recognised under "Disposal of assets, changes in scope of consolidation and other" in the financial statements as at 31 December 2017 (see Note 3.2).

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

NOTE 12. SUBSEQUENT EVENTS

To the best of the Group's knowledge, no significant events occurred after the end of the reporting period.

NOTE 13. ACCOUNTING POLICIES

a) Presentation of the financial statements

Consolidated profit and loss account

Expenses in the income statement are presented analytically by destination.

Income from operations is equal to income of operating activities before taking into account:

- gains and losses on disposal of disposals of property, plant and equipment and intangible assets, businesses or investments;
- the impact of changes in scope on consolidated net income (Note 13-b);
- the impact of the amendment, curtailment or liquidation of pension plans and other long-term benefits;
- the impairment of non-current operating assets;
- other operating income (expense) resulting from events that are unusual by their frequency, nature and amount.

Consolidated balance sheet

A significant portion of the Group's activities in its different business segments have long-term operating cycles. Accordingly, assets (liabilities) that are usually realised (settled) within the entities' operating cycles (inventory, accounts receivable and payable, advances, reserves, etc.) are classified in the consolidated balance sheet as current assets and liabilities, with no distinction between the amounts due within one year and those due after one year.

Consolidated statement of cash flows

The statement of cash flows provides an analysis of the change in cash and cash equivalents, as presented in the balance sheet and defined in Note 13-h. The statement of cash flows is prepared using the indirect method based on consolidated net income and is broken down into three categories:

- net cash flow from operating activities (including interest and taxes);
- net cash flow used in investing activities, including net operating investments (acquisition and disposal of property, plant and equipment and intangible assets, capitalisation of development costs) and net financial investments;
- net cash flow used in financing activities including dividends paid, from capital subscriptions (exercise of options by employees), the purchase/sale of treasury shares, the issuance and repayment of debt, and changes in bank overdrafts, etc.

The Group also presents the changes in its **net cash**, which is a non-GAAP measure and includes gross debt, net of cash and cash equivalents and liquid investments. Changes in net cash, presented in Note 6.4, notably reflect **Free operating cash flow**, defined as net cash flow from operating activites less net operating investments, plus the payment of the UK pension deficits.

Adjusted net income

In order to monitor and compare its operating and financial performances, the Group presents the following key indicators:

EBIT, corresponding to income from operations plus the share in net income of equity affiliates minus the amortisation of acquired intangible assets (purchase price allocation – PPA) recorded when significant businesses are combined. From 1 January 2016, it also excludes the other expenses recognised in current operationnal result that are directly related to business combinations, and which are unusual by nature.

Adjusted net income is regarded as pertinent by the Group as it excludes non-recurring items. It corresponds to consolidated net income attributable to shareholders of the parent company, less the following items, net of the corresponding tax impacts:

- amortisation of acquired intangible assets (PPA);
- other expenses recognised in current operationnal result that are directly related to business combinations, and which are unusual by nature;
- disposal of assets, changes in scope of consolidation and other;
- changes in the fair value of derivative foreign exchange instruments, recognised in "Other financial income";
- actuarial gains and losses on long-term employee benefits, included in "financial income on pensions and other employee benefits".

Adjusted net income per share corresponds to the adjusted net income attributable to shareholders of the parent company, divided by the average number of shares outstanding during the period concerned.

Off-balance sheet commitments

Disclosures regarding off-balance sheet commitments are presented in the following notes:

- Note 4.3: lease commitments;
- Note 9.3-f: funding obligations in respect of pensions;
- Note 10.4: commercial contract commitments.

Related parties

The Group has identified the following related parties: shareholders of Thales SA (parent company), notably the French State and Dassault Aviation, companies controlled by these shareholders, companies under joint control or significant influence, Directors and Senior Corporate Officers.

Section 4.3.3.3 of the 2017 Registration Document describes the main provisions concerning the shareholders' agreement governing relations between the French State ("public sector") and Dassault Aviation ("Industrial Partner") within Thales, the convention on the protection of national strategic interests and the specific convention binding the State and Thales.

Information related to transactions with related parties is presented in the following notes:

- sales with the French State (mainly with DGA: French defence procurement agency) in Note 6;
- transactions with companies under joint control and their joint shareholders in Note 5.1-e.

Transactions with other related parties are not material.

Expenses recognised in respect of compensation, benefits and social security contributions attributable to Directors and members of the Executive Committee are presented in Note 9.5.

b) Scope of consolidation and changes in scope

Scope of consolidation

The financial statements of material subsidiaries directly or indirectly controlled by Thales are fully consolidated. The financial statements of material subsidiaries jointly controlled by Thales (Joint Ventures) or in which the Group has significant influence (associates) are accounted for under the equity method.

The main consolidated companies are listed in Note 16.

The full list of affiliates outside of France is available on the Group's website (https://www.thalesgroup.com/en/corporate-responsibility#documents).

Business combinations

Business combinations are accounted for under the acquisition method as described in IFRS 3. Under this method, the Group recognises identifiable assets acquired and liabilities assumed at fair value on their acquisition date. It also recognises non-controlling interests in an acquiree on their acquisition date

Non-controlling interests are measured either at fair value or proportionate to the share of the identifiable net assets. This is determined on a case-by-case by the Group depending on the option it wishes to apply.

Acquisition-related costs (valuation fees, consulting fees, etc.) are recognised under "other operating expenses" as incurred.

Negative goodwill is immediately recognised in "other operating income (expenses)". Positive goodwill related to controlled companies is recognised in balance sheet assets under intangible assets. Positive goodwill related to equity affiliates is recognised under "share in net assets of equity affiliates".

Goodwill is not amortised but is subject to impairment tests each year. Goodwill impairment is booked as an expense under "impairment of non-current operating assets" and may not be reversed. Goodwill impairment related to equity affiliates is recognised in "share in net income of equity affiliates" and may be reversed.

c) Revenue recognition

The Group's sales can be divided into two main accounting categories: sales of goods and services, and construction contracts.

Sales are measured at the fair value of the consideration received or receivable. When the deferral of payment has a material effect on the determination of fair value, the amount at which sales are recognised is adjusted to take the financial impact of the deferral of payment into account.

Sales of goods and services

Income from the sales of goods and services together with royalty and licence income are recognised when future economic benefits are likely to flow to the Group and when the amount of sales can be measured reliably. The following specific criteria must also be satisfied in order for sales to be recognised:

- income from the sale of goods is recognised when the Company has transferred the principal risks and rewards inherent to ownership of the goods to the purchaser;
- income from services rendered is recognised according to the percentage-of-completion method.

The costs related to the service provided (sale of goods or services rendered) are recognised in the statement of income at the same time as the corresponding sales.

Construction contracts

A construction contract is a contract specifically negotiated for the construction of an asset or group of assets that are closely linked or interrelated in terms of their design, technology, function, purpose or use.

According to its characteristics, a notified construction contract can either be accounted for separately, be segmented into several components which are each accounted for separately, or be combined with another construction contract in progress in order to form the scope of the contract for accounting purposes in respect of which sales and expenses will be recognised.

Sales and expenses on construction contracts are recognised in accordance with the technical percentage-of-completion method. However, when there is no significant time difference between technical percentage of completion and contractual dates of transfer of ownership, the percentage of completion is determined according to the contractual transfer of ownership.

Penalties for late payment or the improper execution of a contract are recognised as a deduction from sales. In the balance sheet, provisions for penalties are deducted from assets related to the contract.

Expected losses on contracts are fully recognised as soon as they are identified.

Selling, administrative and interest expenses are directly charged to the profit and loss account in the period in which they are incurred.

Estimates of work remaining on loss-making contracts do not include sales from claims made by the Group, except when it is highly probable that such claims will be accepted by the customer.

Progress payments received on construction contracts are deducted from contract assets as the contract is completed. Progress payments received before the corresponding work has been performed are classified in "advances received from customers on contracts" in balance sheet liabilities.

The cumulative amount of costs incurred and profit recognised, less any recognised losses and progress billings, is determined on a contract-by-contract basis. If this amount is positive, it is recognised under "Construction contracts: assets" in the balance sheet. If it is negative, it is recognised under "Construction contracts: liabilities".

d) Inventories and work in progress

In the consolidated balance sheet, work in progress related to construction contracts is included under "Construction contracts: assets" or "Construction contracts: liabilities".

Inventories and work in progress are carried at their production cost (determined using the FIFO or weighted-average cost method) and written down when production cost exceeds their net realisable value. Work in progress, semi-finished and finished goods are stated at dire ct cost of raw materials, production labour and subcontractor costs incurred during production, plus an appropriate portion of production overheads and any other costs that can be directly allocated to contracts.

When material, the cost of debt incurred during the construction of a qualifying asset is incorporated in the value of the asset. When the funding is specific, the loan interest rate is used, otherwise the Group's financing rate is used.

e) Research and development expenses

A significant share of research and development expenses is funded by customers and government agencies. Internally funded research and development expenses are charged to the profit and loss account as incurred, except for project development costs which meet the criteria below. In this case, the development costs are capitalised in balance sheet assets:

- the product or process is clearly defined, and costs are separately identified and reliably measured;
- the technical feasibility of the product or project is clearly demonstrated, and the Group's experience in this area is established;
- adequate resources are available to complete the project successfully;
- a potential market for the products exists or their usefulness, in case of internal use, is demonstrated;
- the Company intends to produce and market, or use the new product or process, and can demonstrate its profitability. Profitability is assessed on the basis of prudent commercial assumptions in order to reflect contingencies inherent to the long cycles of the Group's activities, in particular Aerospace. Minimum internal rates of return are required in the case of projects deemed risky.

Capitalised development costs mainly relate to the Group's Aerospace and Security activities, for which the products developed are relatively generic and can be sold to a larger number of potential customers. By contrast, development costs linked to Defence activities are for more specific and restricted markets with a more limited number of players: the specific features of the products developed make it harder to share development work and therefore harder to capitalise the associated costs.

Development costs are then amortised over the useful life of the product. The method of amortisation is generally determined by reference to expected future quantities over the period in which future economic benefits will be earned. If the method cannot be determined reliably, linear amortisation is adopted. The period of amortisation depends on the type of activity.

Assets are also subjected to impairment loss tests. The terms and assumptions taken into account to conduct these tests are described in Note 4. These impairment losses can be reversed. Impairment loss reversal criteria are identical to those retained when first capitalising development costs on a new project.

The Group receives tax credits related to research carried out by its subsidiaries. These tax credits are considered as operating grants and are therefore included in income from operations, when their award is not dependent on the generation of taxable income. Otherwise, they are recognised as a deduction from income tax expense.

f) Restructuring costs

Provisions for restructuring costs are set aside when restructuring programs have been agreed and approved by Group management and have been announced before the balance sheet date, resulting in an obligating event of the Group to the third parties in question, as long as the Group does not expect consideration for these costs.

Such costs primarily relate to severance payments, costs for notice periods not worked and other costs linked to the closure of facilities such as write-offs of fixed assets. These costs and the costs directly linked to restructuring measures (removal costs, training costs of transferred employees, etc.) are recognised under "restructuring costs" in the profit and loss account.

g) Property, plant and equipment and intangible assets

Intangible assets

The Group's intangible assets mainly include:

- goodwill (Note 13-b);
- assets acquired in business combinations, primarily acquired technologies, customer relationships and the order backlog. These assets are recognised at fair value and amortised over their useful lives. The fair value of the assets is based on the market value. If no active market exists, the Group uses methods based on forecasts of the present value of the expected future operating cash flows (excess earnings method, royalty method, etc.);
- capitalised development costs (Note 13-e).

Intangible assets are submitted to impairment tests.

Property, plant and equipment

Property, plant and equipment is stated at cost, net of any accumulated depreciation and accumulated impairment losses. Depreciation of property, plant and equipment is generally calculated on the basis of the following typical useful lives:

- 20 years for buildings;
- 1 to 10 years for technical facilities and industrial equipment and tooling;
- 5 to 10 years for other property, plant and equipment (vehicles, fixtures, etc.).

The depreciable amount takes into account the residual value of the asset. The different components of property, plant and equipment are recognised separately when their estimated useful lives or patterns of use, and thus the period over which they are depreciated or the depreciation methods applicable to them, are materially different.

Borrowing costs that are directly attributable to the acquisition or construction of an asset are capitalised as part of the cost of that asset.

h) Financial assets, financial liabilities and derivatives

Financial assets

Financial assets are initially recorded at fair value. They are subsequently measured at either fair value or amortised cost, depending on the category they fall into, as defined by IAS 39.

- Investments are designated as "available for sale" assets and measured at fair value. The fair value corresponds to the market price for shares quoted on a regulated market. For other shares, the fair value is usually determined using valuation models provided by independent third parties, or by reference to the share in net equity held by the Group. Changes in fair value are recognised directly in equity. If an impairment indicator is identified, impairment is recognised in "other financial income (expense)". Such impairments are only written back to profit and loss at the date of disposal of the security in question.
- Receivables and financial loans are recognised at amortised cost. They are subject to impairment if an impairment indicator is identified. Such impairment, recognised in "other financial income (expense)", may subsequently be reversed through profit and loss if the conditions which led to the impairment loss being recognised cease to exist.
- Deposits that Thales intends to hold until maturity are recognised at amortised cost.
- Other financial assets are estimated at fair value, with changes in fair value recognised in profit and loss. They include money market funds and other mutual funds, and interest rate products (certificates of deposit, term deposits, medium-term negotiable notes, etc.).
- "Cash and cash equivalents" includes cash at bank and in hand as well as cash equivalents (short-term and liquid investments that are easily converted into a known amount of cash and exposed to negligible risk of a change in value).

Financial liabilities

Borrowings and other financial liabilities are measured at amortised cost using the effective interest rate. Upon initial recognition, premiums, redemption and issuance costs are included in the calculation of the effective interest rate and are recognised in the profit and loss account on an actuarial basis over the life of the loan.

Derivatives

The Group uses financial instruments to manage and reduce its exposure to risks of changes in interest rates and foreign exchange rates.

Foreign exchange derivatives eligible for hedge accounting are accounted for as follows:

- the effective portion of the change in fair value of the hedging instrument is recognised directly in equity until such time as the hedged flows affect profit and loss. The ineffective portion is recognised in profit and loss;
- the amount of the foreign currency denominated transaction is subsequently translated at the exchange rate prevailing at the date of inception of the hedge.

Changes in the fair value of premiums or discounts related to forward foreign currency contracts, as well as the time value of foreign currency options, are recognised in "other financial income (expense)" as they are excluded from the hedging relationship.

Interest-rate derivatives are used either as fair value hedges or cash flow hedges:

- a fair value hedge is a hedge of the exposure to changes in the value of assets and liabilities;
- a cash flow hedge is a hedge of the exposure to changes in the value of future cash flows (unknown future interest flows payable on existing variable-rate borrowings or on highly probable future borrowing issues, for example).

In the case of fair value hedge relationships, particularly for the portion of fixed-rate bond debt swapped for a variable rate, the financial liabilities hedged by the interest-rate derivatives are remeasured to the extent of risk hedged. Changes in the value of hedged items are recognised in profit and loss for the period and are offset by symmetrical adjustments in interest-rate derivatives.

In the case of cash flow hedging relationships, the effective portion of changes in fair value of interest-rate derivatives shown in the balance sheet is recognised directly in equity until such time as the hedged flows affect profit and loss.

i) Deferred taxation

Thales recognises deferred taxes when the tax value of an asset or liability differs from its book value.

Deferred tax assets are not recognised in the balance sheet if the company concerned does not reasonably expect to recover the tax asset. To assess its ability to recover deferred tax assets, the Group takes into account forecast taxable income of the tax entities concerned, generally over a five-year time-frame, non-recurring past events and tax strategies specific to each country.

j) Pensions and other long-term employee benefits

The Group's defined benefit plan commitments are measured by independent actuaries using the projected unit credit method on the basis of estimated salaries at the date of retirement. The calculations mainly take into account assumptions concerning discounting as well as inflation, mortality and staff turnover rates, etc.

Changes in actuarial assumptions and experience adjustments – corresponding to the effects of differences between previous actuarial assumptions and what has actually occurred – give rise to actuarial gains and losses:

- actuarial gains and losses on post-employment benefits are recognised in full within other comprehensive income, and are not subsequently reclassfied to profit and loss. Where appropriate, the same treatment is applied to adjustments linked to the ceiling on net assets for plans in surplus;
- actuarial gains and losses on other long-term benefits are recognised immediately in financial income (Note 9.3).

Past service cost, measured in cases of amendments or curtailments of plans, and plan settlements are recognised in full within non-recurring operating income in the period in which it is incurred.

Net interest expense, determined based on the discount rate of obligations, is recognised in financial income.

k) Share-based payment

Free share plans

Between 2007 and 2013, and then again in 2016 and 2017, Thales granted free shares and/or performance shares to its employees. These allotments give rise to an expense representing the fair value of services received at the grant date. This payroll expense is recognised against equity.

The fair value of the services received is calculated by reference to the fair value of the shares at the grant date, less the present value of dividends forfeited by employees during the vesting period, taking into account the presence conditions.

Internal performance conditions are taken into account only by means of an adjustment in the projected number of instruments acquired by employees at the end of the vesting period. Therefore, they are not taken into account in the fair value estimate of the instruments granted, which is determined at the grant date.

The expense related to these plans is included in the current operating income with the consolidated reserves account as counterpart without impact on total equity. As the payment of compensation is subject to presence conditions, the corresponding expense is recorded over the vesting period on a straight-line basis. When appropriate, the expense is adjusted over the vesting period to reflect any losses of rights.

Share unit plans indexed to the value of the Thales share

A share unit plan indexed to the value of Thales shares, some of which are performance shares, was implemented in 2014 and in 2015. At the maturity date, the beneficiaries will receive the value, about half of which is in the form of shares and half in the form of cash-settled share-based payment.

The proportion delivered in shares follows the same accounting policies as those applied to free share plans. The accounting treatment applicable to cash-settled share-based payments is governed by IFRS 2. Under this policy, the services acquired and the liability incurred are measured at fair value. Until the liability is settled, debt is remeasured at each reporting date, with any changes in fair value recognised in income for the period. The remeasurement of the liability at the reporting date takes into account any changes in the value of the underlying shares, as well as whether or not the presence conditions and performance criteria have been met.

Phantom shares

Since this is a cash-settled plan, IFRS 2 requires an evaluation of vested services and the liability assumed at fair value. Until the payment of the liability, the debt is remeasured at the closing date and taken to profit and loss. The remeasurement of the debt takes into account the achievement of performance and/or presence conditions, as well as the change in value of the underlying shares.

Company savings plans

Employee share offerings with a discount to the market price proposed within Company savings plans do not include any vesting period for rights but are subject to a legal five-year lock-up period. The measurement of the advantages granted to employees takes into account the cost of the five-year lock-up period.

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NOTE 14. FEES PAID TO STATUTORY AUDITORS

The amounts of fees paid to the statutory auditors of Thales SA (parent company) and their networks recognised in profit and loss for 2016 and 2017 are presented below:

Other Services cover services required by law (e.g. interim dividend, capital increase) and other services compatible with the statutory auditor's role (certification of expenditures, agreed engagements, services of a tax-related nature without material impact, etc.).

(in € thousands)	Mazars		Ernst & Young Audit		Total	
	2017	2016	2017	2016	2017	2016
Certification of accounts	**6,221**	**5,427**	**5,052**	**4,627**	**11,273**	**10,054**
• Issuer	927	779	920	856	1,847	1,635
• Subsidiaries	5,294	4,648	4,132	3,771	9,426	8,419
Other services	**690**	**526**	**1,030**	**791**	**1,720**	**1,317**
• Issuer	197	190	193	31	390	221
• Subsidiaries	493	336	837	760	1,330	1,096
TOTAL	**6,911**	**5,953**	**6,082**	**5,418**	**12,993**	**11,371**

NOTE 15. OTHER DISCLOSURES

The German group company Electronic Signalling Services (ESS) GmbH, located at 1 Thalesplatz, 71254 Ditzingen has claimed an exemption from their obligation to publish their respective German financial statements for the fiscal year 2017 by reference to Section 264 paragraph 3 of the German Commercial code.

NOTE 16. LIST OF MAIN CONSOLIDATED COMPANIES

(excluding Thales SA, the parent company)

Company name	Country	% interest 31/12/2017	% interest 31/12/2016
1. Consolidated subsdiaries [a]			
TDA Armements SAS [b]	France	–	100%
Thales Alenia Space SAS	France	67%	67%
Thales Alenia Space Italia SpA	Italy	67%	67%
Thales Air Operations SAS	France	–	100%
Thales Australia Ltd	Australia	100%	100%
Thales Avionics, Inc.	United States	100%	100%
Thales Avionics Electrical Systems SAS	France	100%	100%
Thales AVS France SAS (ex Thales Avionics SAS) [b]	France	100%	100%
Thales Canada Inc.	Canada	100%	100%
Thales Communications & Security SAS	France	100%	100%
Thales Defense & Security, Inc.	United States	100%	100%
Thales Deutschland GmbH (ex Thales Electronic Systems GmbH) [c]	Germany	100%	100%
Thales DMS France SAS (ex Thales Systèmes Aéroportés SAS) [b]	France	100%	100%
Thales Electron Devices SAS [b]	France	–	100%
Thales e-Security, Inc	United States	100%	100%
Thales Espana Grp, S.A.U.	Spain	100%	100%
Thales Ground Transportation Systems UK Ltd	United Kingdom	100%	100%
Thales Italia SpA	Italy	100%	100%
Thales LAS France SAS (ex Thales Air Systems SAS) [b]	France	100%	100%
Thales Nederland B.V.	Netherland	99%	99%
Thales Norway AS	Norway	100%	100%

Company name	Country	% interest 31/12/2017	% interest 31/12/2016
Thales Optronique SAS[b]	France	–	100%
Thales Rail Signalling Solutions AG	Suitzerland	100%	100%
Thales Services SAS	France	100%	100%
Thales Solutions Asia Pte Ltd	Singapor	100%	100%
Thales Training & Simulation SAS[b]	France	–	100%
Thales Transportation Systems GmbH[c]	Germany	–	100%
Thales Transport & Security (Hong-Kong) Ltd	Hong Kong	100%	100%
Thales Transport & Security Ltd	United Kingdom	100%	100%
Thales Underwater Systems SAS[b]	France	–	100%
Thales UK Ltd	United Kingdom	100%	100%
Trixell SAS	France	51%	51%
2. Joint ventures (equity method)			
Thales-Raytheon Systems Air and Missile Defense Command and Control SAS	France	50%	50%
Naval Group	France	35%	35%
Diehl Aerospace GmbH	Germany	49%	49%
Sofradir SAS	France	50%	50%
3. Associates (equity method)			
Aviation Communications & Surveillance Systems	United States	30%	30%
Airtanker Holdings Ltd	United Kingdom	13%	13%
Elettronica SpA	Italy	33%	33%
Telespazio SpA	Italy	33%	33%

(a) Companies with sales representing more than 0.5% of consolidated sales.
(b) In France, as at 31 December 2017, the main transactions carried out were as follows:
– Thales Air Systems SAS (now Thales LAS France SAS) absorbed the following companies:TDA Armements SAS, Thales Air Operations SAS, Thales Angénieux SAS, Thales Cryogénie SAS and Thales Optronique SAS,
– Thales Avionics SAS (now Thales AVS France SAS) absorbed the following companies: Thales Avionics LCD SAS, Thales Electron Devices SAS and Thales Training & Simulation SAS,
– Thales Systems Aéroportés SAS (now Thales DMS France SAS) absorbed the following companies: Thales Microelectronics SAS and Thales Underwater Systems SAS.
(c) Thales Transportation Systems GmbH merged into Thales Electronic Systems GmbH and was renamed Thales Deutschland GmbH.

1.2.7 Statutory auditors' report on the consolidated financial statements

This is a translation into English of the statutory auditors' report on the consolidated financial statements of the Company issued in French and it is provided solely for the convenience of English-speaking users. This statutory auditors' report includes information required by European regulation and French law, such as information about the appointment of the statutory auditors or verification of the information concerning the Group presented in the management report. This report should be read in conjunction with, and construed in accordance with, French law and professional auditing standards applicable in France.

To the Annual General Meeting of Thales,

Opinion

In compliance with the engagement entrusted to us by your annual general meetings, we have audited the accompanying consolidated financial statements of Thales for the year ended December 31, 2017.

In our opinion, the consolidated financial statements give a true and fair view of the assets and liabilities and of the financial position of the Group as at December 31, 2017 and of the results of its operations for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

The audit opinion expressed above is consistent with our report to the Audit and Accounts Committee.

Basis for opinion

- **Audit framework**

We conducted our audit in accordance with professional standards applicable in France. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the Statutory Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report.

- **Independence**

We conducted our audit engagement in compliance with independence rules applicable to us, for the period from January 1, 2017 to the date of our report and specifically we did not provide any prohibited non-audit services referred to in Article 5 (1) of Regulation (EU) No 537/2014 or in the French Code of Ethics (*Code de déontologie*) for statutory auditors.

Justification of assessments – Key audit matters

In accordance with the requirements of Articles L. 823-9 and R. 823-7 of the French Commercial Code (*Code de commerce*) relating to the justification of our assessments, we inform you of the key audit matters relating to risks of material misstatement that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period, as well as how we addressed those risks.

These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on specific items of the consolidated financial statements.

1

Recognition of construction contracts

Risk identified

A significant part of the Group's revenue and current operating income results from construction contracts accounted for using the percentage-of-completion method. These contracts are often spread over several years.

Thales determines the revenue and the expenses for construction contracts under the conditions described in Note 13-c "Revenue" to the consolidated financial statements.

The recognition of income and expenses relating to construction contracts during an accounting closing primarily depends on:

- estimates of the revenue and margin at completion, and notably the level of provisions for technical and commercial risks;
- technical milestones reached in the performance of the contracts.

For each contract, estimates of costs at completion, as well as the achievement of technical milestones, are based on the Group's internal systems and procedures, notably involving project managers. These estimates are reviewed regularly by the managements of the Global Business Units and the executive management, particularly at each closing date.

We considered the recognition of construction contracts to be a key audit matter, in view of the impact of these contracts on the consolidated financial statements of the Group and the level of estimation required by the management to determine results upon completion.

Our response

Our work notably consisted in:

- evaluating the Group's systems and procedures for estimating revenue and costs at completion and measuring technical milestones;
- reconciling the construction contract management data with the accounting data;
- selecting contracts that are significant due to their financial impact and risk profile and interviewing the account managers, the managements of the Global Business Units and the executive management on the progress made on these contracts and their assessment of the risks in order to:
  - assess the reflection in the accounts of the contractual clauses;
  - corroborate the main revenue's and costs at completion's assumptions with the costs incurred to date, the contractual data, and correspondence with the client or their representatives. These procedures take into account the experience gained in previous years on these contracts or on similar contracts;
  - assess the consistency of the revenue recognized on the contract and other items in the income statement and balance sheet in relation to the milestones reached and to the contractual conditions.

Litigation

Risk identified

The Group carries out its activities in France and abroad in legal and regulatory environments that are complex and constantly evolving. Therefore, it is exposed to legal, technical and commercial risks.

The Group's legal department centralizes and handles, with assistance from the subsidiaries concerned, all civil, commercial and criminal litigation and claims.

The assessment of these risks and litigation by the management has resulted in the Group recording liabilities and provisions for impairment. Note 11 "Litigation" to the consolidated financial statements describes potential uncertainties relating to significant litigation and their progress.

We considered the listing and evaluation of litigation and the associated risks to be a key audit matter in view of the significance of the estimates made by the management and the potential materiality of their impact on the Group's income and shareholders' equity, should these estimates change.

Our response

With regard to technical and commercial litigation, our work notably consisted in:

- Evaluated the procedures in force within the Group relating to the listing, assessment and reflection in the accounts of civil, commercial and criminal litigation and claims and assessing their correct application via sampling;
- interviewing the Finance department, the Legal Department a Group Secretary and General Council, as well as the managements of the main consolidated entities, on the status of all significant litigation;
- questioning the Group's main lawyers to confirm the listing of litigation and assess the nature of the related risks and liabilities;
- reading the meetings' minutes of the Audit and Accounts Committee and the Board of Directors in order to assess the completeness of the list of significant litigation.

Lastly, we considered whether the risks and significant litigation identified during the implementation of these procedures are described appropriately in Note 11 "Litigation" to the consolidated financial statements.

Implementation of IFRS 15 relating to revenue recognition

Risk identified	Our response
IFRS 15, which will be mandatorily applicable for the year beginning on January 1, 2018, introduces new criteria for the recognition of revenue. As from the end of 2016, the Group set up a work group to identify divergences with its current accounting methods. The Group measured the accounting impacts by relying on analyses of the contractual or general conditions applicable to its construction contracts and on a simulation tool developed internally by the Group. These differences and the expected impact relating to the Group's key figures from January 1 to December 31, 2017 are presented in Note 1.2 to the consolidated financial statements. We considered the adoption of IFRS 15 relating to the recognition of revenue to be a key audit matter, in view of the differences with the existing principles and methods, notably including the transition from the technical percentage of completion method to the percentage of completion method expense based in order to recognize the revenue from contracts which provide for criteria proving the transfer of control over time.	Our work consisted in: • assessing the compliance of the new revenue recognition principles and methods described in Note 1.2 to the consolidated financial statements with IFRS 15; • verifying of the quantified impacts presented in the notes to the consolidated financial statements concerning the adoption of IFRS 15 on shareholders' equity and the order book as at January 1, 2017, as well as on revenue and 2017 profit. For this purpose, we: – selected contracts on the basis of their financial impact and risk profile; – assessed the Group's analyses of these contracts, which allowed it to decide on the transfer of control over time or point in time and, where applicable, the identification of the various performance obligations. We evaluated the contractual conditions for termination for convenience, legal memos and margin simulations performed by the Group; – Evaluated the functioning of the simulation tool developed internally and reconciled the data used in the tool and in the analyses done by the main subsidiaries with the accounting data. Lastly, we assessed the appropriateness of the qualitative and quantitative information given in Note 1.2 to the consolidated financial statements.

Verification of the Information Pertaining to the Group presented in the management report

As required by law and in accordance with professional standards applicable in Francewe have also verified the information pertaining to the Group presented in the Board of Directors's management report.

We have no matters to report as to its fair presentation and its consistency with the consolidated financial statements.

Report on other legal and regulatory requirements

- **Appointment of the statutory auditors**

We were appointed as statutory auditors of Thales by the ordinary and extraordinary Annual General Meeting held on June 25, 1983 for MAZARS and on May 15, 2003 for ERNST & YOUNG Audit.

As at December 31, 2017, MAZARS was in the 35th year and ERNST & YOUNG Audit in the 15th year of total uninterrupted engagement.

Responsibilities of Management and those charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless it is expected to liquidate the Company or to cease operations.

The Audit and Accounts Committee is responsible for monitoring the financial reporting process and the effectiveness of internal control and risks management systems and where applicable, its internal audit, regarding the accounting and financial reporting procedures.

The consolidated financial statements were approved by the Board of Directors.

Statutory Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

- **Objectives and audit approach**

Our role is to issue a report on the consolidated financial statements. Our objective is to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with professional standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As specified in Article L. 823-10-1 of the French Commercial Code (*Code de commerce*), our statutory audit does not include assurance on the viability of the Company or the quality of management of the affairs of the Company.

As part of an audit conducted in accordance with professional standards applicable in France, the statutory auditors exercise professional judgment throughout the audit and furthermore:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence considered to be sufficient and appropriate to provide a basis for his opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management in the consolidated financial statements.
- Assess the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence

obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. This assessment is based on the audit evidence obtained up to the date of his audit report. However, future events or conditions may cause the Company to cease to continue as a going concern. If the statutory auditor concludes that a material uncertainty exists, there is a requirement to draw attention in the audit report to the related disclosures in the consolidated financial statements or, if such disclosures are not provided or inadequate, to modify the opinion expressed therein.

- Evaluate the overall presentation of the consolidated financial statements and assesses whether these statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. The statutory auditor is responsible for the direction, supervision and performance of the audit of the consolidated financial statements and for the opinion expressed on these consolidated financial statements.

- **Report to the Audit and Accounts Committee**

We submit a report to the Audit and Accounts Committee which includes in particular a description of the scope of the audit and the audit program implemented, as well as the results of our audit. We also report significant deficiencies, if any, in internal control regarding the accounting and financial reporting procedures that we have identified.

Our report to the Audit and Accounts Committee includes the risks of material misstatement that, in our professional judgment, were of most significance in the audit of the consolidated financial statements of the current period and which are therefore the key audit matters that we are required to describe in this report.

We also provide the Audit and Accounts Committee with the declaration provided for in Article 6 of Regulation (EU) No. 537/2014, confirming our independence within the meaning of the rules applicable in France as set out in particular in Articles L. 822-10 to L. 822-14 of the French Commercial Code (*Code de commerce*) and in the French Code of Ethics (*Code de déontologie*) for statutory auditors. Where appropriate, we discuss with the Audit and Accounts Committee the risks that may reasonably be thought to bear on our independence, and the related safeguards.

Courbevoie and Paris-La Défense, March 5, 2018

The Statutory Auditors
(French original signed by)

Mazars	**Ernst & Young Audit**
Anne-Laure Rousselou	Philippe Diu
Jean-Marc Deslandes	Serge Pottiez

1.3 PARENT COMPANY MANAGEMENT REPORT AND FINANCIAL STATEMENTS

1.3.1 Management report on the parent company financial statements

1.3.1.1 Activities and results

Operating income amounted to €741 million, compared with €636 million in 2016. Sales totalled €259 million, compared with €233 million in 2016.

Activities are described by sector in the accompanying notes.

Revenues mainly consist of rents re-billed to operating subsidiaries and sales of research, chiefly conducted by the Central Research and Technology department of Thales Group. The increase in revenues was mainly due to the billing of costs for rehabilitation of the site in Jouy en Josas and additional works on the sites in Elancourt and Toulouse Labège.

Other operating income amounted to €443 million, compared with €379 million in 2016. It includes royalties paid by direct operating subsidiaries, as well as expenses re-billed to those subsidiaries, including for general and specific centralised services provided by the parent company, and capitalised production. The main increase corresponds to re-billings in connection with the employee shareholding plan and the delivery of the 2013 free share plan.

Net loss from operations amounted to -€90 million, compared with a loss of -€93 million in 2016.

Net financial income was €516 million, compared with €464 million in 2016.

Provisions for equity investments and subsidiary risks totalled -€42 million in 2017 compared with -€58 million in 2016. Reversals of provisions for equity investments and subsidiary risks represented €10 million in 2017 compared with €53 million in 2016.

Income from investments amounted to €545 million in 2017, versus €496 million in 2016.

Non-recurring expense amounted to -€53 million, compared with -€17 million in 2016. The increase is mainly explained by the liquidation of Thales Belgium SA in 2017.

The Company recorded an income tax benefit of €10 million compared with €78 million in 2016, due largely to Research Tax Credits.

In 2017, non-deductible expenses pursuant to Articles 223 *quater* and 39.4 of the French Tax Code amounted to €0.2 million.

Net profit for financial year 2017 came to €384 million, compared with €431 million in 2016.

1.3.1.2 Balance sheet at 31 December 2017

The balance sheet total at year-end 2017 was €14,636 million, up €334 million from €14,302 million at year-end 2016.

The total non-current assets of €9,241 million (€9,002 million in 2016) are mainly composed of financial investments. The €211 million increase in equity investments is mainly due to the acquisition of shares in Thales Air Systems SAS for €218 million.

Other financial investments rose by €36 million, largely as a result of the acquisition of treasury shares.

Current assets rose €95 million to €5,396 million at end-December 2017. Cash and cash equivalents increased by €267 million reflecting the improved operating cash flow of subsidiaries. The €406 million decrease in "Other receivables" was mainly due to foreign exchange adjustments (-€344 million) and a decrease in tax receivables from the French government (-€91 million).

The €50 million change in "Treasury shares allocated to plans" resulted mainly from the delivery of shares under the 2013 free share plan for -€49 million.

Other investments of €325 million correspond to deposits with first-tier banks with maturities of 3 to 12 months.

The balance of Group companies' current accounts represented net debt of €4,450 million at year-end 2017, compared with €4,350 million at year-end 2016.

"Borrowings" amounted to €1,571 million at year-end 2017, *versus* €1,459 million at year-end 2016. They mainly include bond issues for a total amount €1,400 million, as well as foreign-currency and euro denominated borrowings from Group subsidiaries and associates.

At year-end 2017, share capital stood at €638.0 million and total equity came to €6,882 million, compared with €6,829 million at year-end 2016.

Customer and Supplier payment schedules

Thales pays its suppliers 60 days after invoice date, in line with the maximum period allowed under the French law on the modernisation of the economy (*Loi de modernisation de l'économie* – LME).

The table below presents the ageing of receivables and payables by invoice date:

> INVOICES RECEIVED AND ISSUED AT CLOSING DATE OF FINANCIAL YEAR JUST ELAPSED (TABLE PROVIDED FOR IN SECTION I, ARTICLE D.441-4)

	Article D.441 I.-1e: Invoices received and not settled as at closing date of financial year just elapsed						Article D.441 I.-2e: Invoices issued and not settled as at closing date of financial year just elapsed					
	Day 0 (illustrative)	**1 to 30 days**	**31 to 60 days**	**61 to 90 days**	**91 or more days**	**Total (or more days)**	**Day 0 (illustrative)**	**1 to 30 days**	**31 to 60 days**	**61 to 90 days**	**91 or more days**	**Total (1 or more days)**
A. Payment period tranches												
Number of invoices involved	245					313	400					424
Total value of invoices involved (including taxes)	45.3	2.9	0.6	0.1	0.5	4.0	44.6	18.8	6.0	1.1	3.4	29.3
Percentage of total purchases during the year (including taxes)	7.55%	0.48%	0.09%	0.01%	0.09%	0.66%						
Percentage of total sales during the year (including taxes)							5.61%	2.36%	0.75%	0.14%	0.43%	3.69%
B. Invoices excluded from (A) corresponding to debts and receivables in dispute or not posted												
Number of invoices						9						56
Total invoices excluded, define: excluding or including taxes)						0.3						1.6
C. Reference payment periods used (contractual or legal periods – Articles L.441-6 or L.443-1 of Commercial Code)												
Payment periods used for calculating payment terms						Contractual periods: 45 days end of month Legal periods: (define)						Contractual periods: 45 days end of month Legal periods: (define)

1.3.1.3 Events after the reporting period

A tax audit was carried out on Thales SA's accounting records for the 2011 to 2015 reporting periods. This audit did not result in any significant adjustments for the Company.

1.3.1.4 Outlook for the current financial year

The Company results for 2018 are expected to reflect the dividends paid by certain subsidiaries for financial year 2017 and changes in provisions for impairment of equity investments and subsidiary risks as a consequence of trends in their business and performance in 2018.

1.3.1.5 Proposed allocations of earnings and dividend policy

The Annual General Meeting, deliberating under the *quorum* and majority conditions required for annual general meetings, noted[1] that distributable earnings include:

The net profit for financial year 2017	€383,832,504.79
Less allocations to legal reserve	(€139,187.70)
Plus retained earnings at 31 December 2017	€1,605,673,272.86
Plus interim dividend in the amount of €0.45 per share paid on 8 December 2017 and deducted from retained earnings	€95,195,572.65
For a total amount of	**€2,084,562,162.60**

The Annual General Meeting decided[1] to allocate this amount as follows:

Distribution of a dividend of €1.75 per share on 212,658,725 shares bearing rights as from 1 January 2017 (including the interim dividend of €0.45 per share paid on 8 December 2017 charged to the 2017 dividend, for a total amount of €95,195,572.65)	€372,152,768.75
Retained earnings after dividend	€1,712,409,393.85
Total equivalent to distributable earnings	**€2,084,562,162.60**

The Annual General Meeting notes that, taking into account the interim dividend of €0.45 per share paid on 8 December 2017 and deducted from retained earnings, the remaining dividend to be paid out is €1.30 per share.

The ex-dividend date is 30 May 2018 and payment date for the balance of the dividend will be 1 June 2018.

The sums corresponding to the dividends which, in accordance with the provisions of the fourth paragraph of Article L. 225-210 of the French Commercial Code, have not been paid on treasury shares held by the Company, will be reallocated as retained earnings.

In accordance with Article 243 *bis* of the French Tax Code, the entire declared dividend (interim and remaining dividend amount) qualifies for the 40% tax relief for individual taxpayers whose tax residence is in France, as provided for in Article 158-3 2° of the French Tax Code. As it relates to the remaining dividend amount, the tax relief is only applicable where an express, irrevocable and general election has be made for assessment according to the progressive scale for income tax. Where such election has not been made, the remaining dividend amount due to such individual taxpayers whose tax residence is in France will be subject to the flat rate tax (*prélèvement forfaitaire unique* or PFU) introduced by the 2018 Budget Law without application of the 40% tax relief.

In accordance with the law, the amounts of dividends paid out for the past three financial years are provided below:

Financial year	Dividend per share	Total amount paid out
2014	€1.12 [a]	€230,660,829.08
2015	€1.36 [a]	€285,659,762.04
2016	**€1.60 [a]**	**€338,279,587.20**

(a) The dividend corresponds to all income distributed for the financial year. The full dividend amount was eligible for the tax relief provided for in Article 158-3 2° of the French Tax Code.

(1) Subject to the approval of the Annual General Meeting of 23 May 2018.

1.3.1.6 Parent company management report cross-reference table

In accordance with Articles L. 225-100, L. 232-1, L. 247.1 and R. 225-102 of the French Commercial Code, the parent company management report includes the following information contained in the 2017 Registration Document:

1.3.2 Thales parent company financial statements for the year ended 31 December 2017

1.3.2.1 Income statement

(in € millions)	Notes	2017	2016
Re-billing of rents		244.4	220.0
Research		14.1	13.3
Sales		**258.5**	**233.3**
Royalties		231.1	215.2
Re-billing of expenses		212.3	163.4
Other operating income		**443.4**	**378.6**
Reversals of provisions		21.3	16.0
Transfer of expenses		18.0	7.8
TOTAL OPERATING INCOME		**741.2**	**635.7**
Purchases and changes in inventories and work-in-progress		(40.2)	(27.3)
Other external charges		(533.2)	(451.2)
Taxes other than on income		(11.8)	(11.9)
Personnel expenses		(207.7)	(191.5)
Depreciation and amortisation		(20.8)	(20.9)
Increase in provisions		(17.1)	(26.1)
Total operating expenses		**(830.8)**	**(728.9)**
INCOME (LOSS) FROM OPERATIONS	Note 3	**(89.6)**	**(93.2)**
Net interest and finance costs		(1.0)	(1.1)
Income from investments		544.7	496.1
Other financial income		37.6	60.6
Other financial expenses		(65.2)	(92.1)
Financial income (expense)	Note 4	516.1	463.5
PROFIT (LOSS) FROM ORDINARY ACTIVITIES BEFORE INCOME TAX		**426.5**	**370.3**
Non-recurring income (expense)	Note 5	**(52.5)**	**(17.2)**
PROFIT (LOSS) BEFORE INCOME TAX		**374.0**	**353.1**
Income tax benefit (expense)	Note 6	**9.8**	**78.0**
PROFIT FOR THE YEAR		**383.8**	**431.1**

The Notes to the financial statements are an integral part of the parent company financial statements.

1.3.2.2 Balance sheet

Assets

(in € millions)	Notes	31/12/2017	31/12/2016
Intangible assets and property, plant and equipment, net	Note 7	112.3	120.4
Equity investments	Note 8	8,999.0	8,787.6
Treasury shares not assigned to plans	Note 14	50.3	11.6
Other financial investments	Note 9	79.1	82.1
Total non-current assets		**9,240.7**	**9,001.7**
Inventories and work in progress		11.8	12.0
Advances to suppliers	Note 16	0.4	0.1
Trade receivables	Note 16	197.1	188.8
Other receivables	Note 16	327.6	733.1
Group company current-account receivables	Note 10	1,079.3	875.8
Treasury shares assigned to plans	Note 14	–	50.0
Accrued interests		3.8	7.3
Other investments	Note 11	325.0	250.0
Cash and cash equivalents	Note 11	3,450.5	3,183.1
Total current assets		**5,395.5**	**5,300.2**
TOTAL ASSETS		**14,636.2**	**14,301.9**

Shareholders' equity and liabilities

(in € millions)	Notes	31/12/2017	31/12/2016
Share capital		638.0	636.6
Additional paid-in capital		4,053.2	4,036.9
Reserves and retained earnings		1,806.8	1,724.6
Profit for the year		383.8	431.1
Total shareholders' equity	Note 13	**6,881.8**	**6,829.2**
Provisions for contingencies and losses	Note 17	**199.0**	**197.8**
Borrowings	Note 12	1,570.7	1,459.2
Group company current-account payables	Note 10	5,528.9	5,225.8
Advances received on contracts in progress	Note 16	17.8	18.8
Trade payables	Note 16	86.8	99.5
Other liabilities	Note 16	351.2	471.6
Total liabilities		**7,555.4**	**7,472.7**
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES		**14,636.2**	**14,301.9**

The Notes to the financial statements are an integral part of the parent company financial statements.

1.3.2.3 Statement of cash flows

(in € millions)	Notes	2017	2016
Profit for the year		**383.8**	**431.1**
Add (deduct):			
Net depreciation, amortisation and impairment charges on intangible assets and property, plant and equipment	Note 7	20.8	20.9
Provisions for post-employment and other employee benefits	Note 17	5.2	5.8
Net provisions for impairment of investments and subsidiary risks	Note 4	32.3	5.3
Loss (gain) on disposals of assets	Note 5	40.4	13.0
Other items		(6.1)	0.6
Operating cash flow		**476.4**	**476.7**
Change in working capital and provisions for operating contingencies and losses		261.1	53.5
CASH FLOW FROM OPERATING ACTIVITIES	**- I -**	**737.5**	**530.2**
Payments for acquisitions of intangible assets and property, plant and equipment		(13.1)	(10.2)
Proceeds from disposal of intangible assets and property, plant and equipment		–	0.9
Net operating investment	Note 7	**(13.1)**	**(9.3)**
Investments in subsidiaries and associates	Note 8	(281.2)	(147.4)
Disposals of subsidiaries and associates	Note 8	9.8	21.7
Decrease (increase) in other investments	Note 11	(74.8)	(250.0)
Decrease (increase) in other financial investments and treasury shares		(12.4)	(60.3)
Decrease (increase) in current-account receivables		(223.3)	95.6
Net financial investment		**(581.9)**	**(340.4)**
CASH FLOW USED IN INVESTING ACTIVITIES	**- II -**	**(595.0)**	**(349.7)**
Dividend distributions	Note 13	(348.9)	(296.8)
Increase in share capital (exercise of subscription options)		18.0	45.7
Increase in borrowings		207.7	600.0
Decrease in borrowings		(128.9)	(641.8)
Increase (decrease) in current-account payables		377.0	345.7
CASH FLOW FROM FINANCING ACTIVITIES	**- III -**	**124.9**	**52.8**
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**I + II + III**	**267.4**	**233.3**
Cash and cash equivalents at the beginning of the period		3,183.1	2,949.8
Cash and cash equivalents at the end of the period		**3,450.5**	**3,183.1**

The Notes to the financial statements are an integral part of the parent company financial statements.

1.3.2.4 Statement of changes in equity

(in € millions)	Number of shares outstanding (in thousands)	Share capital	Issue premiums	Retained earnings	Profit for the year	Total shareholders' equity
At 1 January 2016	**210,961**	**632.9**	**3,995.4**	**1,149.5**	**871.9**	**6,649.7**
Allocation of 2014 profit	–	–	–	871.9	(871.9)	0.0
Dividend distribution (see Note 13.2)	–	–	–	(296.8)	–	(296.8)
Capital increase	1,234	3.7	41.5	–	–	45.2
2016 profit	–	–	–	–	431.1	431.1
At 31 December 2016	**212,195**	**636.6**	**4,036.9**	**1,724.6**	**431.1**	**6,829.2**
Allocation of 2016 profit	–	–	–	431.1	(431.1)	0.0
Dividend distribution (see Note 13.2)	–	–	–	(348.9)	–	(348.9)
Capital increase	464	1.4	16.3	–	–	17.7
2017 profit	–	–	–	–	383.8	383.8
At 31 December 2017	**212,659**	**638.0**	**4,053.2**	**1,806.8**	**383.8**	**6,881.8**

The Notes to the financial statements are an integral part of the parent company financial statements.

1.3.2.5 Notes to the parent company financial statements

All the amounts in these notes are expressed in millions of euros (€m), with the exception of information related to numbers of employees and shares.

NOTE 1. ACCOUNTING PRINCIPLES

Thales is a French public limited company (*société anonyme*) and the parent company of Thales Group.

The Thales parent company financial statements are prepared in accordance with the accounting principles applicable in France pursuant to the provisions of the French General Chart of Accounts (*Plan Comptable Général*) as defined in ANC Regulation 2017-03.

As from 1 January 2017, the accounting principles relating to forward financial instruments and hedging transactions are changing in accordance with ANC Regulation 2015-05 of 2 July 2015. This new regulation has no impact on shareholders' equity as at 1 January 2017. The impact on the presentation of the financial statements is described in Notes 16 and 20.

These principles are detailed in each note hereafter.

NOTE 2. CHANGE IN THALES'S DIRECTLY OWNED INVESTMENTS

As part of the simplification of the legal structures in France, the following operations were carried out in 2017:

1- Mergers in DMS France SAS:

In September 2017 Thales sold Thales Microelectronics SAS shares to Thales Systèmes Aéroportés SAS (€4.6 million).

In December 2017, Thales Underwater Systems SAS and Thales Microelectronics SAS merged into Thales Systèmes Aéroportés SAS, with legal effect as of 31 December 2017. Thales now owns 100% of the company, renamed Thales DMS France SAS on 1 January 2018.

The value of Thales DMS France SAS shares as at 31/12/2017 was €802.6 million corresponding to the sum of the book values of the companies' shares before the merger.

2- Mergers in LAS France SAS:

In September 2017 Thales purchased the shares of Thales Air Systems SAS held by Thales Systèmes Aéroportés SAS (€218.4 million).

In September 2017 Thales sold Thales Cryogénie SAS shares to Thales Air Systems SAS (€0.7 million) after recapitalising it (€1.0 million).

In October 2017, Thales Systems Ireland Ltd merged into Thales Air Systems SAS.

In December 2017, TDA Armements SAS, Thales Angénieux SAS, Thales Optronique SAS, Thales Air Operations SAS and Thales Cryogénie SAS merged into Thales Air Systems SAS, with legal effect as at 31 December 2017. Thales now owns 100% of the company, renamed Thales DMS France SAS at 1 January 2018.

The value of Thales LAS France SAS shares at 31 December 2017 was €754.9 million, corresponding to the sum of the book values of the companies' shares before the merger.

3- Mergers in AVS France SAS:

In September 2017, Thales recapitalised Thales Electron Devices SAS (€40.0 million).

In December 2017, Thales Avionics LCD SAS, Thales Electron Devices SAS and Thales Training & Simulation SAS merged into Thales Avionics SAS, with legal effect as at 31 December 2017. Thales now holds 93.04% of the company, renamed Thales AVS France SAS on 1 January 2018.

The value of Thales AVS France SAS shares at 31/12/2017 was €1,016 million, the sum of the book values of the companies' shares before the merger.

Thales recapitalised Thales SESO SAS (€21.8 million).

On 3 May 2017 Thales Belgium SA was dissolved and liquidated. Thales recognised a capital loss of €26.8 million (Note 5.2) and received a dividend of €25.9 million (Note 4.2). At the same time Forges de Zeebrugge was renamed Thales Belgium SA.

In 2016, Thales purchased the shares in Thales Canada Inc held by Thales Avionics SAS, Thales Overseas Ltd and Thales Nederland BV for €22.1 million, €8.6 million and €1.6 million, respectively. Thales Canada Inc is now wholly-owned by Thales.

Thales had purchased Forges de Zeebrugge from Thales Defense Armements SAS for €26.2 million and then increased the share capital by €8 million with the intention of acquiring the business of Thales Belgium SA.

NOTE 3. OPERATING PROFIT (LOSS)

In addition to its functions as a holding company (holding equity investments, managing central support functions and cash pooling), the parent company manages the real estate of its French operating subsidiaries and carries out its own research activity in France.

3.1 Operating income

Consequently, operating income includes:

- rents re-billed to operating subsidiaries and sales of research, which represent the sales of the parent company (€258.5 million in 2017 compared to €233.3 million in 2016), mainly realised in France;
- royalties paid by subsidiaries for shared services, and re-billed expenses for general and specific services provided to the subsidiaries by the parent company.

3.2 Operating expenses

Operating expenses mainly include personnel expenses (employees of Thales parent company and directors), real estate rents and related services, and other external services (notably provided by Thales Global Services, which incorporates the Group's shared services).

NOTE 4. FINANCIAL INCOME (EXPENSE)

4.1 Accounting principles

Financial income (expense) mainly includes:

- interest expenses and finance costs on net debt;
- income and expenses related to Thales' directly owned investments (dividends and depreciation, see Note 8);
- the financial component of the increase in provisions for post-employment and other employee benefits (see Note 17);
- foreign exchange gains and losses (see Note 20).

4.2 Analysis of financial income (expense)

	Notes	2017	2016
NET INTEREST AND FINANCE COSTS		**(1.0)**	**(1.1)**
Interest and financial income:		**27.9**	**32.8**
Interest on Group company current account receivables and loans to subsidiaries and associates		4.9	4.5
Interest on cash and cash equivalents		23.0	28.3
Interest and financial expenses:		**(38.6)**	**(48.4)**
Interest on Group company current account payables and borrowings from subsidiaries and associates		(6.6)	(10.2)
Interest on bonds and other borrowings		(32.0)	(38.2)
Interest on interest rate swaps hedging borrowings		**9.7**	**14.5**
INCOME FROM INVESTMENTS [a]	Note 23	**544.7**	**496.1**
OTHER FINANCIAL INCOME		**37.6**	**60.6**
Reversal of provisions related to associates [b]		9.9	53.1
Reversal of provisions for termination payments and other benefits	Note 17	–	1.2
Foreign exchange gains		23.6	0.3
Reversal of provisions for currency risks		1.8	1.7
Amounts recovered on clawback provisions		1.2	0.7
Other		1.1	3.6
OTHER FINANCIAL EXPENSES		**(65.2)**	**(92.1)**
Increase in provisions related to associates [b]		(42.2)	(58.4)
Increase in provisions for impairment of treasury shares		(2.1)	–
Increase in provisions for termination payments and other benefits	Note 17	(9.0)	(10.6)
Foreign exchange losses		(0.1)	(18.3)
Increase in provisions for currency risks		(1.9)	–
Waiver of loan		(7.5)	–
Other		(2.4)	(4.8)
FINANCIAL INCOME (EXPENSE)		**516.1**	**463.5**

(a) Including Thales Belgium SA (€25.9 million).

(b) Provisions related to subsidiaries and associates	2017		2016	
	Reversal	Increase	Reversal	Increase
Provisions for impairment of equity investments	**–**	**(27.3)**	**52.3**	**(48.5)**
Avimo Group Ltd	–	(10.4)	4.3	–
Thales SESO SAS	–	(10.3)	–	(11.2)
THALES GLOBAL SERVICES SAS	–	(6.2)	–	–
Thales Holdings UK Plc	–	–	35.1	–
Thales Belgium SA	–	–	9.6	–
Thales Microelectronics SAS	–	–	1.2	–
Thales Avionics Electrical Systems SAS	–	–	–	(33.0)
Other	–	(0.4)	2.1	(4.3)
Provisions for subsidiary risks (see Note 17.2)	**9.9**	**(14.9)**	**0.8**	**(9.9)**
Thales Digital Factory SAS	–	(7.9)	–	–
Thales Global Services SAS	–	(5.3)	–	–
Thales SESO SAS	9.9	–	–	(9.9)
Other	–	(1.7)	0.8	–
TOTAL	**9.9**	**(42.2)**	**53.1**	**(58.4)**

NOTE 5. NON-RECURRING INCOME (EXPENSE)

5.1 Accounting principles

Non-recurring income (expense) includes:

- restructuring costs:
  these primarily relate to severance payments, redundancy payments, costs for notice periods not worked and other costs linked to the closure of facilities such as site rehabilitation or asset write-offs. These costs and the costs directly linked to restructuring measures (removal costs, training costs for transferred employees, etc.) are recognised as restructuring costs in the income statement;
- capital gains or losses on disposals, particularly of businesses or equity investments. As an exception to the guidelines of the French General Chart of Accounts and in order to give a more accurate presentation of these transactions, reversals of provisions for impairment of equity investments and reversals of provisions for subsidiary risks are included in income from disposals;
- other income and expenses arising on events that are unusual as regards their frequency, nature or amount.

5.2 Analysis of non-recurring income (expense)

	2017	2016
Restructuring costs	**(11.3)**	**(7.7)**
Capital gains or losses on disposals	**(40.4)**	**(13.0)**
Liquidation of Thales Belgium SA	(26.8)	–
Disposal of Thales Microelectronics SAS	(5.3)	–
Sale of treasury shares	(1.6)	2.4
Disposal of Cryogénie SAS	(0.7)	–
Reimbursement of Thales Suisse capital	–	(13.7)
Disposal of Thales Université SAS	–	(3.4)
Disposal of Thales Geodis Freight & Logistics SA	–	3.6
Other	(6.0)	(1.9)
Reversal (increase) in provisions for non-recurring risks	**(0.8)**	**3.5**
NON-RECURRING INCOME (EXPENSE)	**(52.5)**	**(17.2)**

NOTE 6. INCOME TAX

6.1 General framework and accounting principles

Since 1 January 1992, Thales has opted for the Group tax consolidation regime. Thales is the head of a tax consolidation group that includes the majority of its French subsidiaries pursuant to the tax regime provided for by Article 223A of the French Tax Code.

In accordance with the tax consolidation agreement entered into between Thales and its subsidiaries, each subsidiary in the tax group records the amount of tax it would have paid had they been taxed separately. Any tax savings arising on the use of tax losses of subsidiaries are recorded by the parent company and recognised in the income statement. However, the parent company may have to record a corresponding tax expense, if and when these subsidiaries return to profit and are able to deduct the losses as they would have done had they been taxed separately.

The corporate income tax rate for fiscal years 2017 and 2016 was 34.43%, including the social contribution on profits. Tax loss carryforwards are attributable up to the limit of 50% of taxable profit in excess of €1 million.

In addition, the amended 2012 Finance Act had introduced a 3% tax on dividends paid. By a decision published on 6 October 2017, the French Constitutional Council overturned this tax entirely. In December 2017, Thales was reimbursed the full amount paid between 2013 and 2017, representing €41.9 million, including default interest. Against this backdrop, the amended Finance Act introduced an exceptional tax for 2017, taking the corporate tax rate for Thales from 34.43% to 44.43%. The corresponding expense amounts to €45.2 million. These amounts were deducted from/reimbursed to subsidiaries according to the existing tax consolidation agreement.

Thales also benefits from tax credits related to its research and development activities at the Palaiseau site which are recorded against income tax expense.

6.2 Current tax

The income tax benefit breaks down as follows:

	2017	2016
Income tax benefit received from tax group subsidiaries	176.3	173.4
Income tax due to the French State	(159.0)	(109.8)
Income tax benefit resulting from tax consolidation	**17.3**	**63.6**
Exceptional contribution due to Thales by beneficiary subsidiaries	25.1	–
Exceptional contribution due to the French State by Thales	(45.2)	–
Expense resulting from tax consolidation under the exceptional contribution	**(21.1)**	**–**
Reimbursement by Thales to beneficiary subsidiaries of the 3% tax on dividends	(30.4)	12.3
3% tax on dividends paid to the French State	(7.6)	(8.9)
Reimbursement by the State of the 3% tax on dividends	41.9	–
Benefit resulting from tax consolidation under the 3% tax on dividends	**3.9**	**3.4**
Research tax credit	8.6	7.7
Prior period adjustments and other taxes	1.1	3.3
INCOME TAX BENEFIT	**9.8**	**78.0**

In 2017 as in 2016, no non-deductible general expenses were reintegrated as a result of a tax audit. Expenditure excluded from deductible expenses in accordance with Articles 223 *quater* and 39.4 of the French Tax Code amounted to €0.2 million in both 2017 and 2016, reflecting excess amortisation of vehicles.

6.3 Deferred tax

The Company has available future tax savings due to temporary differences arising on the different tax and accounting treatments of income and expenses (€143.3 million at 31 December 2017 compared with €128.0 million at 31 December 2016). These mainly reflect provisions for contingencies and losses, in particular provisions for post-employment benefits, which are not deductible for tax purposes. There were no remaining tax loss carryforwards at 31 December 2017.

The corresponding deferred tax is not recognised.

NOTE 7. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

7.1 Accounting principles

Intangible assets (mainly software) and property, plant and equipment are recognised at their acquisition cost in the balance sheet. They are amortised or depreciated on a straight-line or declining-balance basis, over the period of their estimated useful lives (20 years for buildings and 3 to 10 years for other assets).

Fixed assets held under finance leases or hire purchase agreements are not recognised and are reported in off-balance sheet commitments.

7.2 Breakdown by type

	31/12/2017			31/12/2016		
	Gross value	Cumulated amort. and depr.	Net	Gross value	Cumulated amort. and depr.	Net
Intangible assets	**18.9**	**(18.8)**	**0.1**	**18.8**	**(18.7)**	**0.1**
Buildings	209.7	(122.7)	87.0	201.5	(109.5)	92.0
Industrial plant, equipment and machinery	39.5	(36.3)	3.2	44.0	(41.0)	3.0
Other property, plant and equipment	34.9	(12.9)	22.0	36.0	(10.7)	25.3
Property, plant and equipment	**284.1**	**(171.9)**	**112.2**	**281.5**	**(161.2)**	**120.3**
TOTAL	**303.0**	**(190.7)**	**112.3**	**300.3**	**(179.9)**	**120.4**

7.3 Change in net assets

	Intangible assets	Property, plant and equipment	Total
Net value at 01/01/2016	**–**	**132.2**	**132.2**
Acquisitions	0.2	10.0	10.2
Disposals	–	(0.9)	(0.9)
Depreciation and amortisation	(0.2)	(20.7)	(20.9)
Other	0.1	(0.3)	(0.2)
Net value at 31/12/2016	**0.1**	**120.3**	**120.4**
Acquisitions	0.1	13.1	13.2
Disposals	–	–	–
Depreciation and amortisation	(0.1)	(20.7)	(20.8)
Other	–	(0.5)	(0.5)
NET VALUE AT 31/12/2017	**0.1**	**112.2**	**112.3**

NOTE 8. EQUITY INVESTMENTS

8.1 Accounting principles

Equity investments are recorded at cost price and related acquisition costs are recognised in the income statement. In the event that the inventory value exceeds the book value, a provision for impairment is recorded for the difference.

The inventory value is determined based on profitability forecasts, the underlying assets, recent transactions or the market price of any listed securities.

The profitability forecasts are determined on the basis of expected future cash flows set out in the three-year strategic plans and a terminal value.

The assumptions used are prudent with forecast growth in sales and terminal values limited to 2%.

The discount rate used is calculated on the basis of the Group's weighted average cost of capital (8.5% in 2017 as in 2016), adjusted if necessary for the specific risks attributable to each equity investment. This rate is mainly based on the market risk-free rate, risk factors inherent in the Group's businesses, the Group's marginal borrowing rate and specific risks for which cash flows have not been adjusted.

Impairment tests are carried out annually at year-end in line with the Group's internal schedule for the preparation of Group entity strategic plans.

8.2 Change in equity investments

A breakdown of equity investments is presented in Note 23. Changes are presented below:

	Notes	Gross value	Provisions	Net
VALUE AT 01/01/2016		**10,005.5**	**(1,332.2)**	**8,673.3**
Acquisitions/capital subscriptions and transactions		**147.4**		**147.4**
Increase in capital of Thales Avionics Electrical Systems SAS		76.0	–	76.0
Purchase and increase in capital of Forges de Zeebrugge		34.2	–	34.2
Increase in capital of Thales Université SAS		5.0	–	5.0
Acquisition of shares in Thales Canada Inc		32.2	–	32.2
Disposals		**(21.7)**	**–**	**(21.7)**
Sale of Thales Geodis Freight & Logistics SA		(5.7)	–	(5.7)
Reimbursement of capital of Thales Suisse		(16.0)	–	(16.0)
Increase in provisions for impairment	Note 4	**–**	**(48.5)**	**(48.5)**
Reversal of provisions for impairment	Note 4	**–**	**52.3**	**52.3**
OTHER		**(41.1)**	**25.9**	**(15.2)**
VALUE AT 31/12/2016		**10,090.1**	**(1,302.5)**	**8,787.6**
Acquisitions/capital subscriptions and transactions		**281.2**	**–**	**281.2**
Increase in capital of Thales SESO SAS		21.8	–	21.8
Purchase of Thales Air Systems SAS shares		218.4	–	218.4
Increase in capital of Thales Electron Devices SAS		40.0	–	40.0
Increase in capital of Thales Cryogénie SAS		1.0	–	1.0
Disposals		**(9.8)**	**–**	**(9.8)**
Sale of Thales Microelectronics SAS		(4.6)	–	(4.6)
Sale of Thales Cryogénie SAS		(0.7)	–	(0.7)
Liquidation of Thales Belgium SA		(4.5)	–	(4.5)
Increase in provisions for impairment	Note 4	**–**	**(27.3)**	**(27.3)**
Other		**(123.3)**	**90.4**	**(32.9)**
VALUE AT 31/12/2017		**10,238.2**	**(1,239.4)**	**8,999.0**

NOTE 9. OTHER FINANCIAL INVESTMENTS

9.1 Accounting principles

Other financial investments mainly include loan agreements signed by Thales with its direct or indirect subsidiaries and associates. These loans are presented separately from the current account agreements, which are used in the daily management of cash requirements or surpluses (see Note 10).

Other financial investments also include deposits paid as part of real estate commitments and other financial receivables.

An impairment loss is recognised depending on the risk of non recovery.

9.2 Breakdown by type

	31/12/2017			31/12/2016		
	Gross value	Impair-ment	Net value	Gross value	Impair-ment	Net value
Loans to direct subsidiaries and associates (see Note 23)	26.1	(25.5)	0.6	27.1	(25.5)	1.6
Loans to other Group subsidiaries	46.7	–	46.7	64.8	–	64.8
Loans to other Group associates	3.9	–	3.9	6.3	–	6.3
Other financial investments	29.5	(1.6)	27.9	11.0	(1.6)	9.4
TOTAL	**106.2**	**(27.1)**	**79.1**	**109.2**	**(27.1)**	**82.1**

9.3 Breakdown by maturity and by currency

Breakdown by maturity	31/12/2017	31/12/2016
Less than 1 year	59.9	60.9
From 1 to 5 years	14.0	12.7
More than 5 years	5.2	8.5
TOTAL	**79.1**	**82.1**

Breakdown by currency	31/12/2017	31/12/2016
Euro	50.5	48.8
South African rand	12.4	22.3
Chinese yuan	10.3	8.3
Other currencies	5.9	2.7
TOTAL	**79.1**	**82.1**

NOTE 10. GROUP COMPANY CURRENT ACCOUNT PAYABLES

10.1 General framework and accounting principles

The Group company current account amounts presented in the parent company balance sheet represent the receivables and payables between the parent company and its subsidiaries as part of the Group's cash pooling organisation.

Under this centralised system, the cash surpluses of subsidiaries are generally transferred to the parent company. In return, the parent company meets the cash flow requirements of the subsidiaries. Except in special cases, this system applies to all subsidiaries in which Thales has majority control.

Group company current account receivables and payables are always recognised as due within one year.

10.2 Current account receivables

	31/12/2017	31/12/2016
Amounts due from direct subsidiaries and associates (see Note 23)	911.2	758.0
Amounts due from other subsidiaries	168.1	117.8
TOTAL	**1,079.3**	**875.8**

10.3 Current account payables

	31/12/2017	31/12/2016
Amounts deposited by direct subsidiaries and associates (see Note 23)	4,880.2	4,097.5
Amounts deposited by Thales Alenia Space (France and Italy)	160.2	185.7
Amounts deposited by Thales Australia Ltd	74.1	319.1
Amounts deposited by other Group subsidiaries	414.2	623.5
TOTAL	**5,528.9**	**5,225.8**

NOTE 11. CASH AND OTHER INVESTMENTS

11.1 Accounting principles

Cash and cash equivalents include cash at bank and in hand as well as short-term, liquid investments that are easily converted into a known amount of cash and exposed to negligible risk of a change in value.

11.2 Cash and cash equivalents

Cash and cash equivalents amounted to €3,450.5 million at 31 December 2017 compared with €3,183.1 million at 31 December 2016. This amount includes €2,199.4 million (€2,886.2 million at year-end 2016) of term deposits, euro-denominated money-market funds ("SICAV"), negotiable debt securities, and other investments with maturities of less than three months.

11.3 Other investments

Other investments correspond to term deposits with banks with maturities of 3 to 12 months.

NOTE 12. BORROWINGS

12.1 Accounting principles

Bonds are recognised at their redemption value. Any issue or redemption premiums are recognised under the corresponding balance sheet line item and taken to financial income (expense) on a straight-line basis. Bond issue expenses are recognised on a straight-line basis over the term of the bond.

12.2 Breakdown of borrowings

	Nominal rate	Variable rate swaps	31/12/2017	31/12/2016
Bonds maturing in June 2023	Fixed rate 0.75%	€400 million	600.0	600.0
Bonds maturing in March 2021	Fixed rate 2.25%	€300 million	300.0	300.0
Bonds maturing in March 2018	Fixed rate 1.63%	€300 million	500.0	500.0
Other borrowings			156.4	45.0
Accrued interest			14.3	14.2
GROSS BORROWINGS			**1,570.7**	**1,459.2**

At 31 December 2017, no material Group financing was subject to covenants requiring accelerated or early repayment based on the Group's credit rating or financial ratios.

At 31 December 2017, confirmed and undrawn credit facilities agreed with a pool of banks amounted to €1,500 million, expiring in 2021. These credit facilities are used as a backup to the commercial paper programme and as a financial reserve. The related agreement states that in the event that the French State no longer holds its golden share and the consolidated net debt/EBITDA ratio[1] also exceeds 3, early repayment clauses will apply.

At December 31, 2017, the Group also benefited from an unused bridge loan to finance its acquisition offer for Gemalto.

12.3 Breakdown of borrowings by maturity and by currency

Breakdown by maturity	31/12/2017	31/12/2016
Less than 1 year	670.7	59.2
From 1 to 5 years	300.0	800.0
More than 5 years	600.0	600.0
TOTAL	**1,570.7**	**1,459.2**

Breakdown by currency	31/12/2017	31/12/2016
euro	1,425.4	1,425.3
Singapore dollar	32.6	33.9
Pound sterling	112.7	–
TOTAL	**1,570.7**	**1,459.2**

NOTE 13. SHAREHOLDERS' EQUITY

13.1 Share capital

Thales' share capital of €637,976,175 at 31 December 2017, is composed of 212,658,725 shares, compared with 212,194,766 shares at 31 December 2016, with a par value of €3 each. This represents an increase of 463,959 shares resulting from the exercise of share subscription options. The breakdown of share capital is presented below:

	31/12/2017			31/12/2016		
	Shares	**% of capital**	**% voting rights**	**Shares**	**% of capital**	**% voting rights**
TSA	54,786,654	25.76%	35.75%	54,786,654	25.82%	35.86%
French State (including 1 golden share)	2,060	–	–	2,060	–	–
Public Sector[a]	54,788,714	25.76%	35.75%	54,788,714	25.82%	35.86%
Dassault Aviation[b]	52,531,431	24.70%	28.44%	52,531,431	24.76%	28.53%
Thales[c]	568,739	0.27%	–	749,559	0.35%	–
Employees	6,181,444	2.91%	3.50%	5,743,081	2.71%	3.31%
Other shareholders	98,588,397	46.36%	32.31%	98,381,981	46.36%	32.30%
TOTAL[d]	**212,658,725**	**100.00%**	**100.00%**	**212,194,766**	**100.00%**	**100.00%**

(a) Under the terms of the shareholders' agreement with Dassault Aviation (the "Industrial Partner"), the "Public Sector" (the French State) is represented by the company TSA, excluding the State directly. All Thales shares held directly and indirectly by the French State have been in directly registered form for more than two years and thus have a double voting right on 31 December 2017.
(b) As at 31 December 2017, Dassault Aviation held 42,154,349 shares in directly registered form, of which 34,654,349 shares have been held for more than two years, thus granting it double voting rights, and held 10,377,082 shares in bearer form.
(c) Treasury shares represented 126,000 bearer shares held under a liquidity contract and 442,739 directly registered shares.
(d) During 2017, 463,959 new shares bearing rights from 1 January 2017 were created as a result of the exercise of share subscription options.

At 31 December 2017, there are no securities giving access to the Company's capital, with the exception of the share subscription options described in the Note below.

(1) EBITDA is the sum of operating income, depreciation of non-current assets and impairment of intangible assets, net of goodwill amortisation. This indicator is calculated in accordance with French accounting principles.

13.2 Reserves and retained earnings

	31/12/2016	Allocation of 2016 profit	Balance of 2016 dividend	2017 interim dividend	31/12/2017
Legal reserve	63.3	0.4	–	–	63.7
Blocked reserve	8.3	–	–	–	8.3
Ordinary reserve	128.9	–	–	–	128.9
Other reserves	0.3	–	–	–	0.3
Retained earnings	1,523.8	430.7	(253.7)	(95.2)	1,605.6
TOTAL	**1,724.6**	**431.1**	**(253.7)**	**(95.2)**	**1,806.8**

Thales allocated €338.3 million of the profit for the 2016 financial year to dividends (€1.6 per share), paying a €84.6 million interim dividend in December 2016, and the balance of €253.7 million in June 2017. Thales paid a €95.2 million interim dividend in December 2017 in respect of the 2017 financial year.

NOTE 14. TREASURY SHARES

14.1 Accounting principles

Thales carries out transactions in its own shares in accordance with the authorisations granted to the Board of Directors by the Annual General Meeting.

At year-end, treasury shares are recognised and measured on the basis of their assigned function:

- treasury shares that have not been assigned are recorded under other financial investments at their acquisition cost. At the reporting date, an impairment loss is recognised if their carrying value exceeds the average stock market price for December;
- treasury shares assigned to a free share plan are recorded under marketable securities, either at their acquisition cost if the shares were assigned from the beginning of the plan, or at their net carrying value at the reclassification date if they were assigned after their acquisition.

These treasury shares are not measured at market value because they are set aside to be granted to employees. Accordingly:

- shares allocated to parent company (Thales) employees are amortised on a straight-line basis over the term of the plan (48 months) through an increase in provisions for contingencies and losses recorded in liabilities,
- shares allocated to other Group employees are maintained at historical cost, as they will be re billed to the relevant subsidiaries for the same amount.

14.2 Change in treasury shares

Change in the number of treasury shares

At 31 December 2017, Thales held 568,739 treasury shares, including 126,000 shares (0.06% of share capital) that were freely transferable.

	2017			2016		
	Freely transferable treasury shares	Treasury shares assigned to plans	Total treasury shares	Freely transferable treasury shares	Treasury shares assigned to plans	Total treasury shares
At 1 January	**126,044**	**623,515**	**749,559**	**215,830**	**623,424**	**839,254**
Purchases under the liquidity contract	819,512	–	819,512	513,001	–	513,001
Disposals under the liquidity contract	(743,512)	–	(743,512)	(472,001)	–	(472,001)
Transfer to employees under the employee share purchase plan	(462,217)	–	(462,217)	(41,714)	–	(41,714)
Stock market purchases	852,000	–	852,000	76,044	498,956	575,000
Delivery of free shares	–	(606,603)	(606,603)	–	(607,381)	(607,381)
Exercise of stock options	(40,000)	–	(40,000)	(56,600)	–	(56,600)
Reclassified shares	16,912	(16,912)	–	(108,516)	108,516	–
Net change	**442,695**	**(623,515)**	**(180,820)**	**(89,786)**	**91**	**(89,695)**
At 31 December	**568,739**	**–**	**568,739**	**126,044**	**623,515**	**749,559**

Change in the value of treasury shares

Freely transferable treasury shares	2017	2016
At 1 January	**11.6**	**8.2**
Purchases under the liquidity contract	75.4	39.4
Disposals under the liquidity contract	(69.0)	(35.4)
Transfer to employees under the employee share purchase plan	(43.6)	(1.6)
Stock market purchases	78.3	7.0
Exercise of stock options	(3.7)	(1.9)
Reclassified shares	1.3	(4.1)
At 31 December	**50.3**	**11.6**
Of which, acquisition cost	52.4	11.6
Of which, impairment	(2.1)	–
Average share price for December	€88.43	€91.16

Treasury shares assigned to plans	2017	2016
At 1 January	**50.0**	**17.0**
Delivery of free shares	(48.6)	(16.6)
Stock market purchases	–	45.5
Reclassified free shares	(1.4)	4.1
At 31 December	**–**	**50.0**
Provisions for contingencies and losses	(18.4)	(18.1)

NOTE 15. FREE SHARE PLANS AND STOCK OPTIONS GRANTED TO EMPLOYEES

At 31 December 2017, the following options, shares and units were outstanding:

- 850 share purchase options at a weighted average exercise price of €38.50;
- 783,204 share subscription options at a weighted average exercise price of €34.13, of which 155,427 are subject to performance conditions;
- 477,860 free shares, of which 360,300 are subject to performance conditions;
- 1,235,940 units, of which 480,150 are subject to performance conditions;
- 142,180 phantom shares, granting the right to a cash payment after a four-year vesting period, of which 103,390 are subject to performance conditions.

15.1 Outstanding share purchase option plans

Date of Board decision	Exercise period	Exercise price	Number of options outstanding at 31/12/2016	Options exercised in 2017	Number of options outstanding at 31/12/2017
25/11/08	from 25/11/12 to 24/11/18	€38.50	850	–	850
04/07/07	from 04/07/11 to 03/07/17	€44.77	40,000	(40,000)	–

15.2 Outstanding share subscription option plans

Date of Board decision	Exercise period	Exercise period	Number of options outstanding at 31/12/2016	Options exercised in 2017	Options cancelled in 2017	Number of options outstanding at 31/12/2017
15/09/11 [(a)]	from 15/09/15 to 14/09/21	€26.34	126,322	(40,945)	–	85,377
23/09/10 [(a)]	from 23/09/14 to 22/09/20	€26.34	110,150	(40,100)	–	70,050
25/06/09	from 25/06/13 to 24/06/19	€32.88	362,584	(84,342)	(5,490)	272,752
01/07/08	from 01/07/12 to 30/06/18	€38.50	463,237	(96,732)	(11,480)	355,025
04/07/07	from 04/07/11 to 03/07/17	€44.77	258,400	(201,840)	(56,560)	–

(a) Subject to the achievement of internal performance conditions over the three financial years following the grant date.

Options granted and exercised in 2017

	Number of options granted/ shares subscribed or purchased	Exercise price	Date of plan
1. Directors			
Options granted in 2017	None		
2. The ten biggest option awards granted to employees			
Options granted in 2017	None		
3. The ten biggest exercises of options by employees [a]			
Options exercised in 2017	8,000	€32.88	25/06/09
	7,291	€26.34	15/09/11
	7,000	€26.34	15/09/11
	5,945	€26.34	15/09/11
	5,500	€38.50	01/07/08
	5,000	€44.77	04/07/07
	4,800	€38.50	01/07/08
	4,600	€44.77	04/07/07
	4,600	€38.50	01/07/08
	4,500	€44.77	04/07/07

(a) All Group companies combined.

15.3 Allotment of free shares

Date of Board decision	Vesting period	Share price at grant date	Number of free shares at 31/12/2016	Shares granted in 2017	Shares cancelled in 2017	Shares delivered in 2017	Balance of free shares at 31/12/2017
28/09/17	from 28/09/17 to 28/09/21	€94.66	–	212,540 [a]	–	–	212,540
27/10/16	from 27/10/16 to 27/10/20	€83.10	87,860 148,070 [a]	– –	(300) (310)	– –	87,560 147,760
17/09/13	from 17/09/13 to 17/09/17	€39.16	397,180 226,335 [a]	– –	(9,274) (7,638)	(387,906) (218,697)	– –
20/12/12	from 20/12/12 to 20/12/16	€27.47	50 [b]	–	–	(50)	–

(a) Subject to the achievement of internal performance conditions over the three financial years following the grant date.
(b) Adjustment in 2016.

15.4 Allotment of share units indexed to the value of Thales shares

Date of allocation decision	Vesting Period	Share price at grant date	Number of units at 31/12/2016	Post-closing adjustments	Units cancelled in 2017	Units delivered in 2017	Balance of units at 31/12/2017
17/09/15	from 17/09/15 to 17/09/19	€61.75	367,730 229,200 [a]	(620) [b] –	(9,050) (7,750)	(270) –	359,030 221,450
16/09/14	from 16/09/14 to 16/09/18	€42.42	405,210 268,000 [a]	– –	(8,210) (9,300)	(240) –	396,760 258,700

(a) Subject to the achievement of internal performance conditions over the three financial years following the grant date.
(b) People in mobility programmes whose units were cancelled in error as their reason for leaving was incorrectly stated.

15.5 Allotment of phantom shares indexed to the value of Thales shares

Date of allocation decision	Vesting Period	Share price at grant date	Number of phantom shares at 31/12/2016	Phantom shares cancelled in 2017	Number of phantom shares at 31/12/2017
28/09/17	from 28/09/17 to 29/09/21	–	67,140 [a]	(140)	67,000
27/10/16	from 27/10/16	–	39,430	(640)	38,790
	to 27/10/20	–	37,910 [a]	(1,420)	36,390

(a) Subject to the achievement of internal performance conditions over the three financial years following the grant date.

NOTE 16. RECEIVABLES AND PAYABLES

16.1 Accounting principles

Payables and receivables denominated in foreign currencies are revalued at the closing price.

Thales (parent company) hedges currency risks related to contracts or normal commercial transactions on behalf of its subsidiaries.

Until the end of 2016, the derivatives subscribed by Thales (parent company) with banks and the foreign exchange guarantees granted to subsidiaries were recorded at their market value in the balance sheet under "Translation difference and exchange rate adjustments".

Following application of the new ANC Regulation 2015-05, unrealised results on derivatives and foreign exchange guarantees are maintained as off-balance sheet commitments.

Temporary cash offsets between the amounts received/paid to subsidiaries and Thales's cash receipts/payments to banks with regard to managing foreign exchange derivatives are recorded in the balance sheet under "Translation difference and exchange rate adjustments", using the symmetry principle applicable to hedging transactions.

16.2 Breakdown of receivables and payables

			31/12/2017	31/12/2016
	Gross	Provisions	Net	Net
Advances to suppliers	**0.4**	**–**	**0.4**	**0.1**
Trade receivables	**198.8**	**(1.7)**	**197.1**	**188.8**
Other receivables	**330.5**	**(2.9)**	**327.6**	**733.1**
Income tax receivables from the French State (mainly research tax credits)	229.7	–	229.7	320.7
Translation difference and exchange rate adjustments	12.5	–	12.5	356.5
Tax and social security receivables	30.9	–	30.9	27.2
Other	57.4	(2.9)	54.5	28.7
TOTAL	**529.7**	**(4.6)**	**525.1**	**922.0**
Advances received on contracts in progress	**17.8**	**–**	**17.8**	**18.8**
Trade payables	**86.8**	**–**	**86.8**	**99.5**
Other liabilities	**351.2**	**–**	**351.2**	**471.6**
Tax liabilities towards consolidated subsidiaries	196.8	–	196.8	152.1
Translation difference and exchange rate adjustments	14.5	–	14.5	187.5
Tax payables, excluding income tax and social security	98.1	–	98.1	82.0
Other	41.8	–	41.8	50.0
TOTAL	**455.8**	**–**	**455.8**	**589.9**

16.3 Breakdown of receivables and payables by maturity at 31 December 2017

	Net	Maturity		
		< 1 year	1 to 5 years	> 5 years
Advances to suppliers	0.4	0.4	–	–
Trade receivables	197.1	197.1	–	–
Other receivables	327.6	218.9	108.7	–
TOTAL RECEIVABLES	**525.1**	**416.4**	**108.7**	**–**
Advances received on contracts in progress	17.8	17.8	–	–
Trade payables	86.8	86.8	–	–
Other liabilities	351.2	273.4	60.4	13.8
TOTAL PAYABLES	**455.8**	**378.0**	**60.4**	**13.8**

NOTE 17. PROVISIONS FOR CONTINGENCIES AND LOSSES

17.1 Accounting principles

The Group records a provision when it recognises a legal or constructive obligation resulting from a past event for which an outflow of resources will be required and a reliable estimate can be made of the amount. Provisions are generally recorded for the following:

Provisions for post-employment and other employee benefits

The financing of post-employment benefits mainly involves statutory retirement schemes (social security, supplementary schemes such as ARRCO and AGIRC, etc.) for which the recognised expense is equal to the contributions paid. These are recorded in the year in which they are incurred.

The Company grants its employees termination payments and other long-term benefits (long-service awards and an additional week of annual leave during the employee's 35th year of service within the Group). Some senior executives also benefit from a supplementary pension plan.

In accordance with ANC Regulation 2013-02, a provision is recognised for obligations that qualify as defined benefit plans. It is calculated on the basis of an actuarial valuation, determined using the projected unit credit method and taking into account future salary levels. This method consists in assessing, for each employee, the present value of the benefits that he or she can expect at the due date, by applying assumptions concerning discount rates, inflation, mortality and staff turnover.

These plans are recognised in the Company's financial statements as follows:

- the service cost, which corresponds to the increase in the obligation during the reporting period, is recognised in income (loss) from operations;
- the costs of unwinding the net obligation as well as actuarial gains and losses due to changes in assumptions and experience adjustments (difference between projected and actual) are recognised in financial income (expense);
- the impact of plan amendments following renegotiations of employee benefits is recognised in non-recurring income (expense).

Provisions for subsidiary risks

Equity investments held by Thales are measured at the end of each reporting period and an impairment loss is recorded if necessary. In the event that the investment is fully written down and Thales's share in the shareholders' equity of the subsidiary or associate becomes negative, a provision for subsidiary risks may be recognised when considered necessary.

Provisions for restructuring

Provisions for restructuring costs are recorded when a restructuring programme has been agreed with a third party, approved by Company management and announced before the reporting date, resulting in an obligation to the third parties in question, and for which the Company does not expect any consideration for the costs.

17.2 Breakdown of provisions

	31/12/2016	Increase	Reversal	31/12/2017
Post-employment and other employee benefits (see Note 17.3)	105.1	18.3	(13.1)	110.3
Subsidiary risks	10.8	14.9	(9.9)	15.8
Restructuring	8.3	0.1	(8.1)	0.3
Free shares	18.1	7.8	(7.5)	18.4
Other	55.5	0.3	(1.6)	54.2
TOTAL	**197.8**	**41.4**	**(40.2)**	**199.0**

17.3 Post-employment and other employee benefits

The provisions in the balance sheet can be analysed as follows:

	2017		
	Post-employment benefits	Other employee benefits	Total
Provisions at 31 December 2016	**(101.6)**	**(3.5)**	**(105.1)**
Net increase in provisions of which:	**(5.0)**	**(0.2)**	**(5.2)**
Current service cost	(5.2)	(0.2)	(5.4)
Financial expense:	(10.4)	(0.1)	(10.5)
• Net interest cost	(1.5)	(0.1)	(1.6)
• Actuarial gains (losses)	(8.9)	–	(8.9)
Benefits and contributions paid	10.1	0.2	10.3
Other	0.5	(0.1)	0.4
Provisions at 31 December 2017	**(106.6)**	**(3.7)**	**(110.3)**
Of which:			
• Commitments	(156.4)	(3.6)	(160.0)
• Investments	49.7	–	49.7

The actuarial assumptions used to estimate the commitments are the following:

	31/12/2017	31/12/2016
Discount rate	1.20%	1.50%
Inflation rate	1.35%	1.40%
Average salary increase rate	2.20%	2.38%
Expected average remaining working life	8 years	7 years

NOTE 18. LEGAL AND ENVIRONMENTAL RISKS

18.1 Legal risks

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

To prevent disputes or limit their impact, Thales's policy is to systematically seek alternative dispute resolution mechanisms. This policy is reviewed on a regular basis to take into account changes in the Group'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.

In October 2017, Thales was notified of an arbitration award relating to a commercial dispute between the Republic of China and a group of three French manufacturers, including Thales Systèmes Aéroportés, a subsidiary of Thales.

This arbitration award, which falls under a contract concluded in 1992, gives rise to a financial conviction of the entities. The total amount of the award, including interest, is €227 million. The share of Thales Systèmes Aéroportés amounts to €64 million. The corresponding charge was recorded in the accounts of the subsidiary as at 31 December 2017.

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.

18.2 Environment

Due to the nature of its business, Thales is exposed to environmental risks related to potential adverse environmental and health effects resulting from its activities, the impact of the environment on its operations and non-compliance with new regulations applicable to its activities and products.

For many years, Thales has regularly analysed and updated its environmental risks on the basis of its business activities, scientific and technical developments and emerging environmental challenges.

This analysis, represented by a risk mapping, is intended to:

- ensure that employees and local residents are not exposed to health and environmental risks;
- ensure the compliance of activities and products;
- analyse the impact of new regulations, including on product design;
- identify an appropriate organisational structure and associated action plans, either at Group level or locally, according to the risk mapping results.

In support of this analysis, an environmental management system has been deployed at all sites in order to ensure the control and limitation of the environmental impacts of the Group's products and activities. This management system is deployed throughout the different business lines as part of the Group's framework. Consequently, environmental skills and know-how have been rolled out to services such as engineering, research, procurement and contracts.

At 31 December 2017, provisions for environmental risks amounted to €0.5 million.

NOTE 19. OFF-BALANCE SHEET COMMITMENTS

19.1 Deposits and guarantees

Commitments given:	**31/12/2017**	**31/12/2016**
Guarantees given by Thales under commercial contracts signed by operating entities	8,769.6	9,828.7
Guarantees given to banks for facilities granted to subsidiaries	2,314.0	2,216.9
Counter-guarantee given to trustees to hedge pension obligations in the United Kingdom	930.8	974.0
Other guarantees given to Group subsidiaries	704.7	801.8
Other guarantees given to third parties	746.0	677.5
Total [(a)]	**13,465.1**	**14,498.9**
Of which, related to direct subsidiaries (see Note 23)	3,655.3	4,576.4
Of which, related to other Group subsidiaries	9,487.9	9,632.8
Of which, related to direct and indirect associates	321.9	289.8

Commitments received	**31/12/2017**	**31/12/2016**
Debt write-offs granted to related companies with clawback provisions	6.9	120.1

(a) The decrease in guarantees given from 2016 to 2017 is explained in part by changes in exchange rates (€704.7 million).

19.2 Property leasing commitments

	31/12/2017	**31/12/2016**
Operating leases	544.0	608.4
Less than 1 year	113.9	120.9
From 1 to 5 years	293.6	326.7
More than 5 years	136.5	160.8

NOTE 20. MARKET RISKS

20.1 Accounting principles

The Thales parent company Treasury and Financing department is active in the financial markets in order to reduce the interest rate and foreign exchange risks of the Group.

Interest rate derivatives

Thales uses interest rate derivatives to manage and reduce its exposure to interest rate fluctuations. When the derivatives are designated as hedging instruments, the gains and losses on the hedge are recognised in the same period as the hedged item.

Currency derivatives

Thales hedges currency risks arising on commercial offers entered into by its subsidiaries, which are denominated in currencies other than the main operating currency.

When the hedged item has a sufficient probability of occurrence, the foreign exchange derivatives subscribed by Thales with banking counterparties qualify for hedge accounting. Gains and losses on bank derivatives are then recognised in income at the same rate as the gains and losses realised on the guarantees offered to subsidiaries, in accordance with the principle of symmetry applicable to hedging transactions. Foreign exchange premiums are amortised in the income statement on a straight-line basis over the term of the hedge.

When hedged items do not have a sufficient probability of occurrence, the foreign exchange derivatives are deemed isolated open positions. In this case, the market value of the derivative is recognised in the balance sheet as an offsetting entry in a suspense account, also in the balance sheet. A provision is recorded in the event of negative valuation. This valuation takes into account Thales's guarantee commitments to subsidiaries under these offers.

Thales hedges currency risks related to firm contracts and normal commercial transactions on behalf of its subsidiaries. As such, it guarantees its operating subsidiaries a specific exchange rate for each transaction and backs up its position by arranging currency derivatives with banking counterparts. Gains and losses on bank derivatives are then recognised in income at the same rate as the gains and losses realised on the guarantees offered to subsidiaries, in accordance with the principle of symmetry applicable to hedging transactions.

Thales hedges the currency risks related to its cash pooling system. The gains and losses on currency derivatives are offset by the gains and losses resulting from the revaluation of the hedged Group company current accounts and loans. However, gains or losses related to the derivatives' swap points are spread over the term of the hedge.

20.2 Interest rate risk management

At 31 December 2017 and 2016, Thales held the following derivative instruments, which all qualify as hedges.

	31/12/2017		31/12/2016	
	Nominal	**Market value**	**Nominal**	**Market value**
Fixed-for-floating interest rate swaps:				
• swaps backing bonds maturing in 2023	400.0	(2.5)	400.0	0.1
• swaps backing bonds maturing in 2021	300.0	16.9	300.0	21.6
• swaps backing bonds maturing in 2018	300.0	3.1	300.0	6.2
TOTAL	**1,000.0**	**17.5**	**1,000.0**	**27.9**
Floating-for-fixed interest rate swaps:				
• swap backing a loan maturing in 2019	5.1	(0.2)	6.3	(0.2)
• cross currency swap backing a loan	14.3	1.5	15.2	1.3
TOTAL	**19.4**	**1.3**	**21.5**	**1.1**

20.3 Currency risk management

At 31 December 2017 and 2016, the derivatives subscribed by Thales with bank counterparties were as follows:

	31/12/2017					31/12/2016	
	USD	**GBP**	**Other**	**Total**	**Market value**	**Total**	**Market value**
Hedges of commercial offers and transactions:							
Forward currency sales	3,650.1	878.4	2,382.7	6,911.2	144.3	7,702.3	(179.3)
Forward currency purchases	1,448.4	992.8	1,928.8	4,370.0		4,163.2	
Currency sales (call and put options)	90.9	–	22.3	113.2	–	94.1	0.6
Currency purchases (call and put options)	111.0	–	1.8	112.8		26.0	
Hedges related to cash pooling:							
Currency sales: foreign exchange swaps	702.0	–	270.3	972.3	(70.3)	1,030.2	(136.1)
Currency purchases: foreign exchange swaps	1.3	569.6	71.9	642.8		1,474.3	

In addition, Thales has granted its operating subsidiaries "mirror" foreign exchange guarantees in relation to firm contracts or normal commercial operations.

Thales has also granted its operating subsidiaries foreign exchange guarantees on commercial offers, subject to the subsidiary winning the contract.

NOTE 21. RELATED PARTIES

21.1 Definition

The Group has identified the following related parties: shareholders of Thales (the parent company), especially the French State and Dassault Aviation, companies controlled by these same shareholders, companies under joint control, companies under significant influence, directors and senior executives.

21.2 Agreements with Thales's shareholders

Section 4.3.3.3 of the 2017 Registration Document describes the main provisions of the shareholders' agreement governing relations between the French State (the "Public Sector") and Dassault Aviation (the "Industrial Partner") within Thales, in relation to the convention on the protection of strategic national interests as well as the specific convention binding the French State and Thales.

21.3 Agreements concluded with Naval Group (formerly DCNS)

As of December 2011, Thales holds 35% of the share capital of Naval Group, a subsidiary jointly controlled with the French State.

Thales and Naval Group also signed an industrial and trade cooperation agreement, with the objective of optimising the organisation of the naval business activities of both groups (market access, research and development and purchasing).

21.4 Compensation of directors and senior corporate officers[a]

The compensation, benefits and social security contributions awarded to Directors and Executive Committee members break down as follows:

	2017	2016
Short-term benefits:		
• Fixed compensation	4.7	4.3
• Variable compensation	4.2	3.7
• Post-employment benefits	0.5	–
• Social security contributions	3.1	2.7
• Attendance fees	0.6	0.5
Other benefits:		
• Post-employment benefits	2.4	1.7
• Share-based compensation[b] (Note 15)	2.4	2.5

(a) The components of compensation presented correspond to costs recognised in the Thales parent company financial statements.
(b) Measured in accordance with IFRS 2 – share-based payments.

NOTE 22. EVENTS AFTER THE REPORTING PERIOD

At the publication date of this document, no event liable to have an impact on Thales's financial position has occurred since year-end.

NOTE 23. SUBSIDIARIES AND ASSOCIATES

(in millions)			Information related to the entity (local currency)			
			Prior year sales excluding VAT	**Profit (loss) for last year ended**	**Share capital**	**Shareholders' equity other than share capital**
A. Detailed information on subsidiaries and associates whose gross value exceeds 1% of the Company's share capital						
1. Subsidiaries	THALES HOLDING UK PLC	GBP	0.0	3.4	726.8	400.1
	THALES AVS FRANCE SAS	EUR	1 733.1	63.4	213.1	315.8
	THALES ALENIA SPACE SAS	EUR	0.0	94.5	918.0	298.1
	THALES DMS FRANCE SAS	EUR	1 797.7	277.3	122.2	138.3
	THALES COMMUNICATIONS & SECURITY SAS	EUR	2 036.6	100.0	164.0	112.3
	THALES DEUTSCHLAND GMBH	EUR	0.0	−5.9	27.1	278.2
	THALES USA INC	USD	1.9	28.4	118.1	327.3
	THALES INTERNATIONAL SAS	EUR	0.0	47.7	313.0	22.3
	THALES LAS FRANCE SAS	EUR	1 881.6	421.8	199.8	210.3
	AVIMO GROUP LTD	SGD	0.0	0.5	22.1	35.1
	THALES NETHERLANDS BV	EUR	424.8	29.7	29.5	167.0
	THALES UNDERWATER SYST NV PAYS BAS	EUR	0.0	0.0	4.5	4.1
	THALES SERVICES SAS	EUR	445.9	203.3	1.5	13.3
	SIFELEC SAS	EUR	0.0	0.0	38.3	0.6
	THALES AVIONICS ELECTRICAL SYSTEMS SAS	EUR	138.8	−4.7	6.9	45.4
	THALES HOLDING NORWAY AS	NOK	0.0	0.0	419.8	−186.8
	THALES CORPORATE VENTURES SAS	EUR	0.0	0.2	15.0	14.6
	THALES CANADA INC	CAD	660.8	−5.4	6.8	−45.0
	THALES EUROPE SAS	EUR	0.0	4.7	43.2	−45.5
	TH. BELGIUM SA (Ex FZ)	EUR	39.2	0.0	14.2	−21.4
	THALES SUISSE SA	CHF	33.1	15.8	40.0	−3.3
	CMT MEDICAL TECHNOLOGIES LTD	USD	20.1	1.2	1.0	27.1
	SNC THALES MERIGNAC	EUR	50.9	2.0	20.0	−0.4
	THALES SESO SAS	EUR	21.4	−0.3	0.4	11.3
	THALES GLOBAL SERVICES SAS	EUR	541.9	−4.7	0.5	−3.6
	THALES COMMUNICATIONS LTDA	BRL	0.0	−0.1	19.8	−0.8
	SAS CHATELLERAULT BRELANDIERE	EUR	2.8	−0.1	2.0	1.5
Total subsidiaries						
2. Associates	UNITED MONOLITHIC SEMICONDUCTORS HOLDING	EUR	0.0	3.9	33.9	12.2
	ELETTRONICA SpA	EUR	0.0	18.1	0.0	74.0
	SOFRADIR	EUR	142.2	24.6	6.0	82.9
	TELESPAZIO SpA	EUR	563.7	33.3	50.0	187.8
	NAVAL GROUP	EUR	3 698.2	136.9	563.0	−177.0
Total associates						
TOTAL (A)						
B. Detailed information concerning other subsidiaries and associates						
1. Subsidiaries not listed in section A						
French subsidiaries						
Foreign subsidiaries						
Total						
2. Associates not listed in section A						
French companies						9.7
Foreign companies						7.4
Total						
TOTAL (B)						
TOTAL (A+B)						
Information concerning related companies						
Thales' direct subsidiaries (A)						
Thales' direct subsidiaries (B)						
Other Group subsidiaries						

Contribution of subsidiaries and associates to Thales' financial statements (EUR)

Carrying amount of investments (gross)	Carrying amount (net)	% share capital held	Loans and advances made by Thales not yet paid	Receivables	Liabilities	Deposits and guarantees given by Thales	Dividends received by Thales during the year
2 571.7	1 870.1	100%	0.0	1.7	111.9	0.0	0.0
1 016.0	1 016.0	93%	0.0	47.4	400.5	128.2	60.9
683.1	683.1	67%	0.0	0.0	17.3	0.0	114.4
802.6	802.6	100%	0.0	0.0	2 302.5	687.2	34.7
590.8	590.8	100%	0.0	10.1	375.5	625.2	45.3
545.0	545.0	100%	0.0	85.0	0.0	0.0	0.0
476.6	476.6	100%	0.0	37.0	0.7	729.7	0.0
398.5	398.5	100%	0.0	107.5	33.7	6.0	129.8
754.9	754.9	100%	0.0	5.1	1 353.3	314.8	100.6
250.7	66.4	100%	0.0	0.0	0.0	0.0	0.0
235.2	235.2	99%	0.0	1.1	208.8	382.3	0.0
129.2	8.5	100%	0.0	0.0	0.0	0.0	0.0
126.4	126.4	100%	0.0	17.4	0.0	0.8	2.4
111.8	38.7	100%	0.0	0.0	30.1	0.0	0.0
94.6	61.6	100%	0.0	49.3	1.0	0.0	0.0
77.2	77.2	100%	0.0	0.0	0.0	0.0	0.0
73.3	18.7	100%	0.0	0.0	13.3	0.0	0.0
51.9	51.9	100%	0.0	96.5	10.7	741.1	0.0
43.2	43.2	100%	0.0	165.5	0.0	0.0	0.0
34.2	34.2	100%	0.0	28.1	1.0	38.6	0.0
26.4	26.4	100%	0.0	0.0	0.0	0.0	7.8
21.8	21.8	100%	0.0	0.0	0.0	0.0	0.0
20.0	19.7	100%	0.0	103.5	0.0	0.0	0.0
36.4	11.5	100%	0.0	0.5	4.6	0.0	0.0
12.4	0.0	100%	0.0	47.7	0.0	1.4	0.0
11.0	0.0	100%	0.0	0.0	0.0	0.0	0.0
10.0	2.5	100%	0.0	0.4	0.0	0.0	0.0
9 204.7	**7 981.2**		**0.0**	**803.8**	**4 864.9**	**3 655.3**	**495.9**
24.3	22.8	50%	0.0	0.0	0.0	0.0	2.0
26.7	26.7	33%	0.0	0.0	0.0	0.0	4.6
26.4	26.4	50%	0.0	0.0	0.0	0.0	5.0
81.6	81.6	33%	0.0	0.0	0.0	0.0	7.2
833.7	833.7	35%	0.0	0.0	0.0	0.0	0.0
992.8	**991.3**		**0.0**	**0.0**	**0.0**	**0.0**	**18.7**
10 197.4	**8 972.4**		**0.0**	**803.8**	**4 864.9**	**3 655.3**	**514.6**
23.0	16.8		0.0	36.7	15.3	0.0	2.5
0.7	0.1		0.0	0.0	0.0	0.0	0.0
23.8	**16.9**		**0.0**	**36.7**	**15.3**	**0.0**	**2.5**
9.5		0.0	0.0	0.0	0.0	1.5	
0.1		25.5	70.6	0.0	507.0	0.1	
17.0	**9.6**		**25.5**	**70.6**	**0.0**	**507.0**	**1.6**
40.8	**26.5**		**25.5**	**107.4**	**15.3**	**507.0**	**4.1**
10 238.2	**8 999.0**		**25.5**	**911.2**	**4 880.2**	**4 162.3**	**518.8**
			0.0	803.8	4 864.9	3 655.3	
			25.5	107.4	15.3	0.0	
				0.0		507.0	

Investments made and thresholds crossed in French companies in 2017

	At 31/12/2016					At 31/12/2017				
Percentage owned	**> 5%**	**> 20%**	**> 33%**	**> 50%**	**> 66%**	**> 5%**	**> 20%**	**> 33%**	**> 50%**	**> 66%**
1. Increases										
189 Centelec SAS	–	–	–	–	100%	–	–	–	–	–
190 Centelec SAS	–	–	–	–	100%	–	–	–	–	–
191 Centelec SAS	–	–	–	–	100%	–	–	–	–	–
Thales LAS France SAS	–	–	–	–	–	–	–	–	–	100%
2. Decreases										
Thales Underwater Systems SAS	–	–	–	–	–	–	–	–	–	100%
TDA Armements SAS	–	–	–	–	–	–	–	–	–	100%
Thales Angénieux SAS	–	–	–	–	–	–	–	–	–	100%
Thales Belgium SA	–	–	–	–	–	–	–	–	–	100%
Thales Cryogénie SAS	–	–	–	–	–	–	–	–	–	100%
Thales Electron Devices SAS	–	–	–	–	–	–	–	–	–	100%
Thales Optronique SAS	–	–	–	–	–	–	–	–	–	77%
Thales Microelectronics SAS	–	–	–	–	–	–	–	–	–	100%
Thales Systems Ireland Ltd	–	–	–	–	–	–	23%	–	–	–
Revenue Collection Systems France SAS	–	–	–	–	–	–	–	–	–	100%
191 Centelec SAS	–	–		–	–	–	–	–	–	100%

NOTE 24. INFORMATION ON EXISTING BRANCHES (ARTICLE L. 232-1, II OF THE FRENCH COMMERCIAL CODE)

At 31 December 2017, Thales had a secondary facility registered in France with the commercial registry and indicated on its Kbis (company registration certificate).

1.3.2.6 Five-year financial summary of the Company

	2013	2014	2015	2016	2017
1. Share capital at year-end					
Share capital	617.2	623.5	632.9	636.6	638.0
Number of ordinary shares outstanding	205,744,500	207,841,111	210,961,404	212,194,766	212,658,725
Maximum number of shares to be created in future by exercise of share subscription options	8,186,261	5,841,789	2,615,865	1,320,693	783,154
2. Operations and results for the year					
Revenues excluding tax	205.9	224.4	208.6	233.3	258.5
Earnings before tax, employee profit-sharing, depreciation, amortisation and provisions	379.7	609.3	625.7	367.9	337.4
Income tax benefit	85.8	77.4	93.8	78.0	9.8
Earnings after tax, employee profit-sharing, depreciation, amortisation and provisions	400.6	662.9	871.9	431.1	383.8
Distributed net profit	227.6	230.7	285.6	338.3	95.2 [(a)]
3. Earnings per share					
Earnings after tax and employee profit-sharing but before amortisation, depreciation and provisions	2.26	3.30	3.41	2.10	1.63
Earnings after tax, employee profit-sharing, depreciation, amortisation and provisions	1.95	3.19	4.13	2.03	1.80
Net dividend per share	1.12	1.12	1.36	1.60	1.75 [(b)]
4. Employees					
Average headcount during the year, of which:	833	852	831	818	812
• Engineers and managers	726	749	735	727	723
• Technicians and supervisors	107	103	96	91	89
Personnel expenses, of which:	177.1	183.2	187.1	191.5	207.7
• Total salary costs for the year	123.9	130.2	131.5	137.8	151.2
• Social security and other social welfare benefits paid during the year	53.2	53.0	55.6	53.7	56.5

2013: Share capital up from €607,019,022.0 to €617,233,500.0 following a capital increase.
2014: Share capital up from €617,233,500.0 to €623,523,333.0 following a capital increase.
2015: Share capital up from €623,523,333.0 to €632,884,212.0 following a capital increase.
2016: Share capital up from €632,884,212.0 to €636,584,298.0 following a capital increase.
2017: Share capital up from €636,584,298.0 to €637,976,175.0 following a capital increase.

(a) Interim dividend.
(b) Subject to approval by the Annual General Meeting of 23 May 2018.

1.3.3 Statutory auditors' report on the financial statements

This is a translation into English of the statutory auditors' report on the financial statements of the Company issued in French and it is provided solely for the convenience of English-speaking users. This statutory auditors' report includes information required by European regulation and French law, such as information about the appointment of the statutory auditors or verification of the management report and other documents provided to the shareholders. This report should be read in conjunction with, and construed in accordance with, French law and professional auditing standards applicable in France.

To the Annual General Meeting of Thales,

Opinion

In compliance with the engagement entrusted to us by your annual general meetings, we have audited the accompanying financial statements of Thales for the year ended December 31, 2017.

In our opinion, the financial statements give a true and fair view of the assets and liabilities and of the financial position of the Company as at December 31, 2017 and of the results of its operations for the year then ended in accordance with French accounting principles.

The audit opinion expressed above is consistent with our report to the Audit and Accounts Committee.

Basis for opinion

- **Audit framework**

We conducted our audit in accordance with professional standards applicable in France. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the Statutory Auditors' Responsibilities for the Audit of the Financial Statements section of our report.

- **Independence**

We conducted our audit engagement in compliance with independence rules applicable to us, for the period from January 1, 2017 to the date of our report and specifically we did not provide any prohibited non-audit services referred to in Article 5 (1) of Regulation (EU) No 537/2014 or in the French Code of Ethics (*Code de déontologie*) for statutory auditors.

Emphasis of Matter

We draw attention to the matter described in Note 16 "Receivables and Debts" to the financial statements regarding the first-time application of Regulation 2015-05 of the French Accounting Standards Authority (*Autorité des normes comptables*). Our opinion is not modified in respect of this matter.

Justification of assessments – Key audit matters

In accordance with the requirements of Articles L. 823-9 and R. 823-7 of the French Commercial Code (*Code de commerce*) relating to the justification of our assessments, we inform you of the key audit matters relating to risks of material misstatement that, in our professional judgment, were of most significance in our audit of the financial statements of the current period, as well as how we addressed those risks.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on specific items of the financial statements.

Equity investments

Risk identified

Equity investments, recorded in the balance sheet as at December 31, 2017 for a net amount of M€ 8,999, represent a significant balance sheet item. They are recorded at their lower acquisition cost or at their value in use.

As stated in Note 8 "Equity investments" to the financial statements, the inventory value is is determined based on profitability forecasts, the underlying assets, recent transactions or the market price of any listed securities.

The estimate of the inventory value of these equity investments requires the exercise of the management's judgment in the choice of information to consider depending on the investments concerned. Depending on the situation, this information may correspond to historical information (shareholders' equity) or forecast information (value of future discounted cash flows).

We considered that the correct valuation of equity investments constituted a key audit matter.

Our response

In order to assess the reasonableness of the equity investment estimates, our work mainly consisted in:

a) For valuations based on underlying asset information:

- comparing the shareholders' equity used against the financial statements of entities which were subject to an audit or analytical procedures.

b) For valuations based on forecasts:

- assessing the reasonableness of cash flow projections in relation to the economic and financial contexts of each business;
- assessing the reliability of the process for establishing forecasts by reviewing the causes for variances between previous forecasts and actual figures;
- comparing the consistency of the cash flow projections with the most recent management estimates presented to the Board of Directors;
- evaluating the consistency of the growth rate used for the projected flows with market analyses and the consensus observed;
- evaluating the calculation of the weighted average cost of capital applied to the flow projections.

Lastly, we also assessed the appropriateness of the information provided in Note 8 to the financial statements.

Verification of the management report and of the other documents provided to the shareholders

We have also performed, in accordance with professional standards applicable in France, the specific verifications required by French law.

- **Information provided in the management report and in the Other Documents provided to the Shareholders with respect to the Company's financial position and the financial statements**

We have no matters to report as to the fair presentation and the consistency with the financial statements of the information given in the Board of Directors' management report and in the other documents provided to the Shareholders with respect to the financial position and the financial statements.

- **Report on corporate governance**

We confirm that the Board of Directors' Report on Corporate Governance sets out the information required by Articles L. 225-37-3 and L. 225-37-4 of the French Commercial Code (*Code de commerce*).

Concerning the information given in accordance with the requirements of Article L. 225-37-3 of the French Commercial Code (*Code de commerce*) relating to remunerations and benefits received by the directors and any other commitments made in their favor, we have verified its consistency with the financial statements, or with the underlying information used to prepare these financial statements and, where applicable, with the information obtained by your Company from controlling and controlled companies. Based on this work, we attest the accuracy and fair presentation of this information.

With respect to the information relating to items that your Company considered likely to have an impact in the event of a public purchase offer or exchange, provided pursuant to Article L. 225-37-5 of the French Commercial Code (*Code de commerce*), we have verified that it is in accordance with the underlying documentation provided to us. Based on our work, we have no observations to make on this information.

- **Other information**

In accordance with French law, we have verified that the required information concerning the purchase of investments and controlling interests and the identity of the shareholders and holders of the voting rights has been properly disclosed in the management report.

Report on other legal and regulatory requirements

- **Appointment of the statutory auditors**

We were appointed as statutory auditors of Thales by the ordinary and extraordinary Annual General Meeting held on June 25, 1983 for MAZARS and on May 15, 2003 for ERNST & YOUNG Audit.

As at December 31, 2017, MAZARS was in the 35th year and ERNST & YOUNG Audit in the15th year of total uninterrupted engagement.

Responsibilities of Management and those charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with French accounting principles and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless it is expected to liquidate the Company or to cease operations.

The Audit and Accounts Committee is responsible for monitoring the financial reporting process and the effectiveness of internal control and risks management systems and where applicable, its internal audit, regarding the accounting and financial reporting procedures.

The financial statements were approved by the Board of Directors.

Statutory auditors' responsibilities for the audit of the Financial Statements

- **Objectives and audit approach**

Our role is to issue a report on the financial statements. Our objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with professional standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As specified in Article L. 823-10-1 of the French Commercial Code (*Code de commerce*), our statutory audit does not include assurance on the viability of the Company or the quality of management of the affairs of the Company.

As part of an audit conducted in accordance with professional standards applicable in France, the statutory auditors exercises professional judgment throughout the audit and furthermore:

- Identifies and assesses the risks of material misstatement of the financial statements, whether due to fraud or error, designs and performs audit procedures responsive to those risks, and obtains audit evidence considered to be sufficient and appropriate to provide a basis for his opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtains an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control.
- Evaluates the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management in the financial statements.
- Assesses the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. This assessment is based on the audit evidence obtained up to the date of his audit report. However, future events or conditions may cause the Company to cease to continue as a going concern. If the statutory auditor concludes that a material uncertainty exists, there is a requirement to draw attention in the audit report to the related disclosures in the financial statements or, if such disclosures are not provided or inadequate, to modify the opinion expressed therein.
- Evaluates the overall presentation of the financial statements and assesses whether these statements represent the underlying transactions and events in a manner that achieves fair presentation.

- **Report to the Audit and Accounts Committee**

We submit a report to the Audit and Accounts Committee which includes in particular a description of the scope of the audit and the audit program implemented, as well as the results of our audit. We also report significant deficiencies, if any, in internal control regarding the accounting and financial reporting procedures that we have identified.

Our report to the Audit and Accounts Committee includes the risks of material misstatement that, in our professional judgment, were of most significance in the audit of the financial statements of the current period and which are therefore the key audit matters that we are required to describe in this report.

We also provide the Audit and Accounts Committee with the declaration provided for in Article 6 of Regulation (EU) No 537/2014, confirming our independence within the meaning of the rules applicable in France as set out in particular in Articles L. 822-10 to L. 822-14 of the French Commercial Code (*Code de commerce*) and in the French Code of Ethics (*Code de déontologie*) for statutory auditors. Where appropriate, we discuss with the Audit and Accounts Committee the risks that may reasonably be thought to bear on our independence, and the related safeguards.

Courbevoie and Paris-La Défense, March 5, 2018

The Statutory Auditors
(French original signed by)

Mazars	**Ernst & Young Audit**
Anne-Laure Rousselou	Philippe Diu
Jean-Marc Deslandes	Serge Pottiez

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BUSINESS REVIEW

2

2.1 OPERATING SEGMENTS

The Group has a matrix organisation based on:

- six Global Business Units, grouped into three operating segments: Aerospace (Avionics, Space), Transport (Ground Transportation Systems) and Defence & Security (Secure Communications and Information Systems, Land and Air Systems, and Defence Mission Systems);
- an international organisation split into the major industrial countries in which the Group is present (Germany, France, the Netherlands, the United Kingdom, Canada, the United States and Australia), other European countries and emerging markets.

2.1.1 Aerospace segment

The Aerospace segment includes the Avionics and Space Global Business Units.

The **Avionics** Global Business Unit offers a large array of equipment and functions for piloting, navigation and aircraft control systems, electrical generation and conversion, and in-flight entertainment and connectivity systems. This activity also includes simulation and training solutions for military aircraft and civilian and military helicopters as well as microwave and imaging subsystems. As a partner of the major aircraft manufacturers and airlines, Thales is a player across the entire value chain for the aviation sector, in addition to its air traffic management business.

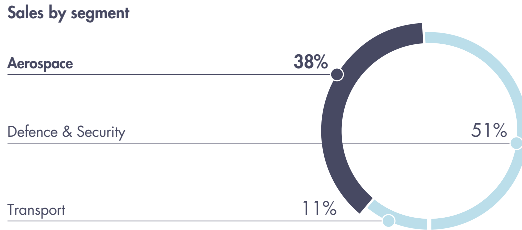
The **Space** Global Business Unit offers space systems and solutions, particularly in the fields of telecommunications, radar and optical observation of the Earth, satellite navigation and exploration of the Universe. The strategic partnership in the space sector between Thales and Leonardo – the Space Alliance – responds to the significant environmental, scientific and security challenges faced by the sector as well as the changes brought about by the expansion of the information society. It is based on the solutions offered by both Thales Alenia Space (67% owned by Thales, 33% owned by Leonardo) in satellite manufacturing and by Telespazio (33% owned by Thales, 67% owned by Leonardo) in related services.

2.1.1.1 Key data

(in € millions)	2017	2016
Order book at 31 December	8,850	9,914
Order intake	5,200	5,872
Sales	5,985	5,812
EBIT[a]	601	571
Employees under Group management	18,772	18,741

(a) Non-GAAP indicator. See definition in the section entitled "Presentation of Financial Information" on pages 8 and 9.

Sales by segment



2.1.1.2 Avionics

2.1.1.2.1 General overview

Thales supports aircraft manufacturers, the armed forces, airlines, operators, pilots, crews and passengers to improve flight efficiency, safety and comfort. The secure, natively connected systems designed by Thales allow aircraft to fly in all circumstances and to interface all elements of the aeronautic ecosystem, on the ground or in flight.

The range of avionic equipment, systems and applications covers four main areas:

- Piloting and control of the aircraft: information display solutions in cockpits are equipped with simplified "human-system" interfaces for optimised flight management and conduct and a permanent connection with airlines and air traffic control.
- Support and services: the digital solutions Thales offers simplify the tasks to be performed by the pilot and enable fleets to be tracked in real time in order to optimise operating costs and increase aircraft availability.
- Passenger experience: Airlines call upon Thales to personalise the services they offer to their passengers through the latest generation of onboard multimedia systems supported by high-speed connectivity. Thales also makes use of the latest technology in data analytics to enable companies to access new sources of revenue generated by specific applications offered to passengers depending on their profile. In addition, the Group offers cabin lighting and aircraft interior systems, provided through Diehl Aerospace.
- Simulation and training: simulator training for pilots of military aircraft and civilian and military helicopters prepare them more effectively for their missions while reducing training costs. Thales provides the flight simulators for many European and Australian defence programmes, as well as training and instruction services.

Thales also provides electric power generation and conversion solutions, and electric motors, in addition to power amplification and X-ray imaging solutions for the space and defence industries and the medical sector.

2.1.1.2.2 Competitive position

As one of the leading players in the avionics market alongside Honeywell and Rockwell Collins, Thales supplies the commercial and military aircraft manufacturers Airbus, ATR, Bell, Boeing, Bombardier, Cessna, Dassault Aviation, Embraer, Gulfstream, Leonardo, NHIndustries, Sikorsky and Sukhoi.

In the in-flight entertainment segment, Thales is one of the top two players, with Panasonic Avionics.

The Group has numerous competitors in the simulation solutions market, particularly American defence companies such as Lockheed Martin, Raytheon and L3Com.

Thales continues to be a global market leader in microwave and imaging subsystems, and its main competitors in these markets are Varian Medical Systems, CPI and L3.

2.1.1.2.3 Significant events in 2017

In commercial avionics, Thales won contracts with Airbus for the supply of flight control computers and probes. The latest standard in avionics, known as standard 3, co-developed by ATR and Thales for ATR-600 regional aircraft was certified by the EASA in July 2017 before its commissioning at the end of 2017. The Thales Pad connected portable electronic solution was selected by more than 20 airlines to optimise their operations on Boeing, Airbus and Sukhoi aircraft.

AirAsia selected Thales for the supply of avionic equipment and the maintenance of its 304 A320neo. The Brazilian company Azul also chose an avionic equipment package for its fleet of 58 A320NEO.

For the eleventh year running, Thales has consolidated its position in offering support to airlines, ranked third best supplier in the annual Airbus rankings and number one in Airbus' supplier evaluation.

In military avionics, Thales won a major software development contract for Rafale India. 2017 also saw the launch of the in-flight testing campaign for the first French A330MRTT, for which Thales is a major partner of Airbus Defence and Space.

As regards in-flight entertainment, 2017 saw the commissioning of the AVANT® system on Japan Airlines' Boeing 787-9 Dreamliners. Meanwhile, SES and Hughes announced the signature of strategic agreements aimed at optimising the availability of the in-flight connectivity service FlytLIVE™, the most efficient to date to cover the Americas.

In training and simulation, Thales secured an order for two additional flight simulator models for Airbus A400M, bringing the total number of orders to eight.

Haite Group, a Chinese leader in the supply of aeronautical services, opened its new training centre in Tianjin with the Reality-H EC135 helicopter simulator designed by Thales, who was selected for the first time in China. Airbus Helicopters chose Thales to equip the crews of Caracal helicopters in the Kuwaiti forces with a Reality-H mission simulator in addition to two coaching positions in tactical flying and training procedures.

With regard to electrical systems, Safran Landing Systems and Thales decided to combine their expertise to develop an electrical taxi system for aircraft.

In imaging and microwave subsystems, Thales was selected to supply the first Ku-band tubes for use in a telecommunications satellite. In the radiology field, Siemens stepped up the promotion of the product ARTPIX EZ2GO developed by Thales which enables hospitals to optimise the cost of ownership of their medical imaging systems while simplifying the work of their employees. Finally, the most powerful free-electron laser in the world was inaugurated in Hamburg. Thanks to the energy supplied by the klystrons and couplers manufactured by Thales, this new system will revolutionise the study of the nanoworld.

2.1.1.3 Space

2.1.1.3.1 General overview

Thales Alenia Space, a joint venture between Thales (67%) and Leonardo (33%), forms the Space Alliance with Telespazio to offer a full range of solutions including services. For over forty years, Thales Alenia Space has designed, integrated, tested, operated and delivered innovative space systems to meet its customers' needs in terms of telecommunications, navigation, Earth observation and management of the environment, exploration, science and orbital infrastructures. On the strength of unique expertise in dual missions, constellations, high-speed flexible payloads, altimetry, meteorology, optical observation, high-resolution radar and space exploration, Thales Alenia Space has been able to capitalise on its heritage while placing innovation at the heart of its strategy, in a digital, connected world in a state of flux.

Thales Alenia Space offers a full range of solutions which meet demands for planetary constellations, the supply of very high-speed geostationary satellites for connectivity purposes in particular, and the integration of a space component into 5G.

A key participant in environmental programmes

Thales Alenia Space's renowned expertise in high-resolution (sub-metric) optical and radar payloads for military, civilian or dual missions covers a wide range of uses, including information gathering, target designation, meteorology, altimetry, oceanography, climatology, cartography and crisis management. Thales Alenia Space satellites help provide a better understanding of planet Earth and how to protect it In this market segment, alternative solutions are beginning to emerge comprising low-orbit high-revisit constellations or products complementary to satellites such as HAPS (High Altitude Platforms) for instance. In conjunction with its involvement in the continuity of the European Copernicus programme and its Sentinels, and in the 3rd generation of *Meteosat*, Thales Alenia Space and Telespazio (through the Space Alliance) invest in high revisit solutions.

At the forefront of the origins of the Universe and deep space exploration

The International Space Station has generated new needs in terms of refuelling for the astronauts on board and future projects beyond Earth are under consideration. Thales Alenia Space manages key technologies for the ISS: 50% of its pressurised module, ATV refuelling cargo spacecrafts. In parallel, Cygnus validated atmospheric re-entry technologies with the success of the IXV mission while vehicles of the future such as Space Rider and soon the spacecraft Orion, rally teams for new challenges. Thales Alenia Space also plays a central role in the adventure of future scientific missions through the programmes ExoMars 2020, Solar Orbiter, Bepi Colombo, Juice, Euclid and NEXT-Step-2.

At the forefront of geolocation and navigation systems

Thales Alenia Space remains the European centre of excellence in the field of Satellite navigation systems (EGNOS, Galileo) and at the cutting edge of geolocalisation solutions including Argos NEO and its station MEOLUT Next dedicated to "Search and Rescue" services.

At the cutting-edge of innovation

Thales Alenia Space is developing the *Stratobus*, an autonomous stratospheric airship that is complementary to satellite solutions and is designed for regional telecommunications, surveillance and environmental applications.

Services for European launchers

Thales Alenia Space contributes to the European policy on access to space by supplying the on-board electronics for the Ariane rocket, the safeguard subsystem of the Soyuz launchers in French Guiana and soon that of the Ariane 6 for which the Company will also supply the telemetry transmitter.

2

2.1.1.3.2 Competitive position

We are witnessing a real transformation of the space sector triggered not only by the ruptures caused by the world of launchers (SpaceX) but also by the new requirements in terms of satellite applications and in particular by the appearance of new requirements in terms of mega-constellations. New initiatives are coming to light, innovation is becoming increasing daring and the turnaround times for development and marketing new concepts are reducing significantly. The major operators are reflecting on the most optimised solutions to address the new requirements of end users. The complementarity of satellite services from different orbits is becoming an increasingly considered option.

In the commercial satellite segment, Thales Alenia Space's main competitors are Space Systems/Loral, Airbus Group, Orbital ATK, Boeing and Lockheed Martin. It is important to also count on the gradual arrival in the commercial market of new international players (from Russia, China, India, Israel, Japan, etc.) in the fields of telecommunications and observation.

The leading competitors in the commercial and military institutional market in Europe, which is to a large extent dependent on the budgetary situation of governments, are Airbus Group and OHB – which are also sometimes partners on some programmes – as well as Boeing and Lockheed Martin for export contracts.

2.1.1.3.3 Significant events in 2017

In telecommunications, Thales Alenia Space signed a contract with Inmarsat for the construction of Inmarsat GX, a very-high-throughput satellite (VHTS) offering capacity in the Middle East, Europe and the Indian Sub-continent. The payload will be integrated in a transparent way into Inmarsat Global Xpress' (GX) existing high throughput network. Another highlight of 2017 has been the deployment of the Iridium NEXT constellation with 40 satellites already launched and the placing on the market of fully digital payloads.

In Earth observation, Thales Alenia Space won an equipment contract for the Biomass mission dedicated to the study of carbon, and a contract for the integration in the United Kingdom of the MicroCarb satellite dedicated to the measurement of CO_2, the main greenhouse gas responsible for climate change.

In science, Thales Alenia Space in the United Kingdom was entrusted with a study for the design of the payload module for the SMILE (Solar Wind Magnetospheric Ionospheric Link Explorer) mission, while Thales Alenia Space in Spain was entrusted with the communication transponders for the Indian TEAMINDUS and the Korean KPLO (Korea Pathfinder Lunar Orbiter) lunar missions.

In exploration, Thales Alenia Space signed the preliminary development contract with the European Space Agency for Space Rider, a new generation European reusable transport system from low orbit and is taking part in NASA's NEXTStep-2 adventure, to support manned space flights in proximity to the moon.

In observation and geolocalisation, Thales Alenia Space won the contract for the Argos NEO instrument for the nano-satellite demonstrator Angels for geolocalisation data collection. In addition, the MEOLUT Next solution, integrated into Cospas-Sarsat's Search & Rescue system was awarded by the SSPI (Space & Satellite Professionals International) in the "Humanitarian" category for its contribution to saving lives.

In the field of launchers, Thales Alenia Space in Belgium supplied the nozzle activation system for the Ariane 6 launcher while Thales Alenia Space in Spain will deliver the telemetry transmitter.

In 2017, Thales Alenia Space participated in the following thirteen launches: Five telecommunication satellites (Telkom 3S, SGDC, Koreasat 5A and 7, HellaSat 3/Inmarsat-S EAN), two Cygnus cargo spacecraft, one observation satellite (Mohamed VI satellite), one telecommunication payload (REDSAT) and one scientific instrument (Hexapod), 40 satellites for the Iridium NEXT constellation in batches of ten.

In 2017, Thales Alenia Space announced the creation of a new automated production site dedicated to the assembly of photovoltaic cells for solar panels on satellites in Belgium and the opening of a shared Optical Systems and On-board Instrumentation (Systèmes Optiques et Instrumentation Embarquée or SOIE) laboratory with the marseille Astrophysics Laboratory (LAM in French). The company also formalised a minority interest in Airstar Aerospace to secure the development of the *Stratobus* programme. Through its involvement in the Space Alliance, Thales Alenia Space and Telespazio joined forces through a memorandum of understanding with the US company Spaceflight to respond to the very-high revisit and low orbit Earth observation constellations market.

Thales Alenia Space launched its digital transformation and entered the industry 4.0 (smart factory) era, particularly with the introduction of robots and cobots in industrial processes, a record number in parts made using 3D manufacture (more than 1000) in orbit, the use of virtual and augmented reality, automated production chains and the creation of digital twins for future satellites.

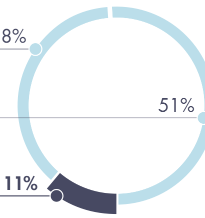
2.1.2 Transport segment

2.1.2.1 Key data

(in € millions)	2017	2016
Order book at 31 December	4,391	4,567
Order intake	1,780	1,504
Sales	1,761	1,603
EBIT [a]	72	11
Employees under Group management	7,005	6,812

(a) Non-GAAP indicator. See definition in the section entitled "Presentation of Financial Information" on pages 8 and 9.

Sales by segment



2.1.2.2 Ground Transportation Systems

2.1.2.2.1 General overview

The Group is one of the foremost global players in railway signalling and control/monitoring systems. It also offers ticketing solutions.

In its three domains, Thales provides systems for urban transport networks (metros and trams) and mainline networks (conventional, high-speed and freight). Thales capitalises on its expertise in the field of critical information systems and cybersecurity to offer transport network operators integrated and protected solutions to effectively supervise and control their operations. The systems provided by Thales also contribute to increasing the security of its customers' passengers, staff and infrastructure.

2.1.2.2.2 Competitive position

Specialised in intelligent critical systems and services, Thales sets itself apart from its "generalist" competitors, who offer product ranges dominated by rolling stock. The rapid digitisation of railway transport products, solutions and operations has made Thales a recognised leading player with strong positions in these markets.

In signalling, Thales is a key player, and its main competitors are Siemens, Alstom, Ansaldo STS, Bombardier Transport and China Railway Signal & Communication (CRSC).

2.1.2.2.3 Significant events in 2017

For **urban** integrated signalling, communications, security and monitoring **activities**:

Thales is continuing its expansion in Asia and had two new successes in Taiwan: Thales will supply the signalling and communication systems and equipment for the operational control centres for the extension of the Kaoshiung tramway and for the future Ankeng tramway programme.

Thales also won its first contract in Vietnam for the provision of a complete telecommunications, security and monitoring system for line 3 of the Hanoi metro.

In China, through its Thales SAIC Transportation System (TST) joint venture, Thales won a contract for the signalling of the first automatic driverless metro line (line 14) in the megalopolis of Shanghai. In 2017, TST also commissioned the signalling systems for eight metro lines.

In Dubai, Thales was once again selected for the extension and modernisation of the red metro line, one of the longest driverless metro lines in the world. It will transport the 25 million expected visitors to the 2020 World Expo.

In Cairo, where Thales has provided monitoring, communications and security solutions for over 30 years, a new contract was won for phase 4B of line 3.

In London, Thales continued to roll out the new signalling system for 4 metro lines; the Circle, District, Hammersmith & City and Metropolitan lines which represent 40% of the London network. The first tests involving the release into circulation of several test trains were completed successfully.

In the rest of the world, Thales continued to successfully Commission CBTC (Communications-based train control) lines: in India, in Hyderabad, in Chile with line 6 in Santiago, and in the United States with the Disney line.

For **mainline** integrated signalling, communications, security and monitoring **activities**:

In Egypt, Thales will modernise the signalling and telecommunications of the mainline networks in the 180 km stretch which connects the cities of Assyut and Nagh Hammadi. The three-year project is part of the Egyptian rail infrastructure transformation programme, financed by the World Bank; this new success comes on the back of the project to modernise the Cairo/Alexandria line, currently under deployment by Thales.

Thales also signed the contract for the maintenance of the signalling and telecommunications systems of the "North South Railway Project" in Saudi Arabia, the longest railway line in the world to be equipped with cutting-edge technology signalling systems, through an initiative in line with the Vision 2030 plan. In Eastern Europe, Thales continued to deploy the ETCS signalling system for the modernisation of the rail network in Poland, Romania and Hungary.

On the African continent, Thales won a contract in Senegal for the signalling, telecommunication systems, security and monitoring of the TER "Train Express Régional" connecting Dakar city centre with the new international airport (55 km).

In France, in a record time of 27 months Thales designed and constructed the new Ardoines signal box on behalf of the SNCF. Commissioned in June, this technical centre is a strategic link in the Île-de-France rail network.

In **ticketing** and road tolls, Thales was selected to install new tolling equipment on 38 lanes of the motorway from Mexico to Puebla.

Thales pursued its development in Egypt, winning two new ticketing contracts to equip 19 new metro stations in Cairo and in Thailand, in addition to the Blue metro line in Bangkok.

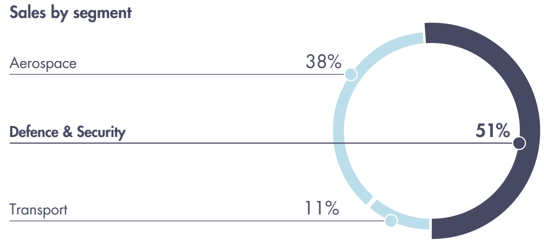
2.1.3 Defence & Security segment

2.1.3.1 Key data

(in € millions)	2017	2016
Order book at 31 December	18,605	18,973
Order intake	7,883	9,063
Sales	7,983	7,390
EBIT[a]	869	787
Employees under Group management	34,011	33,282

(a) Non-GAAP indicator. See definition in the section entitled "Presentation of Financial Information" on pages 8 and 9.

Sales by segment



2.1.3.2 Secure communications and information systems

2.1.3.2.1 General overview

The armed forces, security forces and essential operators rely on Thales for their interoperable and secure information and telecommunications systems. Central to the defence-security continuum, these activities, which include radiocommunications, networks, protection systems, critical information systems and cybersecurity, respond to the needs of markets in which the use of new digital technologies such as 4G networks, cryptography, cloud computing, artificial intelligence and big data are of the utmost importance. Thales is present throughout the value chain, from equipment through to systems and systems of systems, as well as logistical support and related services.

These activities are developed around four segments:

- radiocommunications products: Thales designs radios and embedded and tactical communications systems for all three sectors (land, air and sea), identification friend or foe (IFF) systems, radio navigation systems and solutions for electronic communications warfare. The armed forces of more than 50 countries around the world are equipped with Thales solutions. The Group is a major player in the development of interoperable, secure Software-Defined Radio (SDR) solutions and is the prime contractor for the French army's CONTACT programme;
- network and infrastructure systems: Thales designs, supplies, deploys, supports and operates fixed or mobile communications networks for the defence and security forces, and critical infrastructure operators. Its resilient, secure systems rely on the full range of military and commercial technology. In France, Thales provides the renovation of Defence communication systems through the Descartes programme, the renovation of networks linked to nuclear dissuasion and support to the information system of the Ministry of the Armed Forces. In addition, the Group also operates communication systems in theatres of operation in Afghanistan, Mali and the Central African Republic. Thales also offers satellite communication ground systems, in France with the Syracuse programme and also for export;
- protection systems: as a European leader in the digitised battlefield, Thales develops information, command and intelligence systems for the armed forces (military functions known as C4ISR – Computerized, Command, Control, Communications, Intelligence, Surveillance and Reconnaissance). Based on this technology developed for its military customers (France, NATO, Export), the Group also responds to growing security needs for critical infrastructures such as airports and other particularly sensitive sites. All of these systems are intended to enable the fastest and most relevant decision-making, whether it is automatic or by operators. Based on intelligence of the situation, thanks to a multitude of sensors, they offer users real-time, precise information on their environment and the effects of actions taken;
- critical information systems and cybersecurity: States, essential operators and companies in general are enlisting in a digital transformation process to boost their efficiency, reactivity and profitability. As a European leader in cybersecurity and a global leader in data protection, Thales contributes to ensuring a secure digital transformation for its customers thanks to its management of the design and operation of critical information systems. Thales supports its customers in the secure design of their IS or their Cloud hybridation projects and proposes solutions to protect their applications, their communication networks and their sensitive or classified data against cyber threats. In addition, Thales offers solutions for organisations to train and instruct their teams in cyber risks, to anticipate threats, detect the most advanced IT attacks and identify solutions.

2.1.3.2.2 Competitive position

Thales has a variety of competitors depending on the business and market concerned.

In defence applications – radiocommunications, networks, and command and control – the main competitors are predominantly American: Harris, General Dynamics, Raytheon and Rockwell Collins. Israel-based Elbit Systems is also a competitor in the area of integrated command and communication solutions. In Europe, the Group's main competitors are Airbus Group and – particularly in the radiocommunications sector – Rhode & Schwarz, Leonardo and Aselsan.

In security, Thales's competitors are primarily coming from the aeronautic and defence sector (Boeing, Northrop Grumman, Honeywell, Airbus Group, etc.), the equipment sector (such as Siemens and Johnson-Tyco), or from services (INEO, etc.) and information systems (including IBM, Atos and Capgemini). The latter are also competitors of Thales in critical information systems.

Finally, in cybersecurity, Thales is in competition with companies such as RSA and Gemalto in the commercial segment and BAE Systems, Ultra Electronics, Airbus Group and Secunet in defence, and also Atos, Sopra Steria and Cap Gemini in the field of Digital Services Companies.

2.1.3.2.3 Significant events in 2017

In the field of radiocommunication products, the French software-defined radio programme CONTACT designed for the land, air and sea armed forces continues, particularly with the launch of developments of the airborne component designed primarily for the combat aircraft RAFALE. In parallel, Thales completed the first part of the development of SYNAPS, the CONTACT export version, and has unveiled operational advances for collaborative and high throughput combat to its main European and global customers.

The Group was chosen by the US army to equip new brigades with the hand-held two-channel radio IMBITR. Thales also received orders from several countries for SOTAS vehicular communication systems.

In aeronautics, a high level of activity was maintained with the order for the production of the CNI (communications, navigation, identification) suite for the Rafale combat aircraft for India, and the order of a very-high-throughput connection solution for a country in the Middle East.

In naval communications, Thales received an order for the development of mid-size frigate (FTI or Frégates de taille intermédiaire in French) communications. The Group will also supply the communications electronic warfare system, and a new generation of identification equipment (IFF). In the United Kingdom, Thales secured a major contract to support the communication systems for several Royal Navy vessels. In Germany, Thales was selected for the communications of frigate K130.

In networks and infrastructure systems, Thales launched on the market its service as an operator of resilient, secure mobile networks, EIJI, and has already secured SNCF as one of its first customers.

In France, the Ministry of Defence granted Thales a 10-year service contract for the implementation of optimised logistics for the resupply of aeronautical consumables (LORCA programme). Following the contract won by the business combination comprising Thales and RUAG Defence France for the implementation of the CERBERE (Training centres representative of battlefields and reproducing engagements), the Group is also involved in the establishment of high-speed LTE 4G communications infrastructure for training ground forces.

In exports, Thales was chosen by a country of the Middle East to supply a tactical communications network, in partnership with the company Ultra. For another customer in the Middle East, Thales provided the first complete satellite-based ground military telecommunication system composed of mobile stations and anchorage integrating SYSTEM 21.

Finally, Thales finalised the deployment of the professional mobile radio infrastructure (TETRA network) for the Mexico City metro.

Thales's protection systems address both the defence and security markets. In defence, Thales was notified of the second round of the EMBR (multi-role armoured vehicle) programme of the French land forces, a key component of the SCORPION programme. For this programme, Thales was also selected alongside Nexter and Safran by the French Defence Procurement Agency for the architect-integrator contract. In exports, for Qatar, the C4I system for the Léopard 8x8 combat vehicle was formally accepted and the first vehicles were commissioned.

In security, Thales was selected as one of three protection providers for all the French military sites and for the protection of the United Nations camps in Gao and Kidal (Mali). In addition, John F. Kennedy airport in New York selected Thales's offer for the definition of protection systems for terminal 4, its busiest terminal. In the Middle East, various inaugurations reflected the progress of Thales's two major contracts in the region: security of the Port of Doha and the Dubai Smart City. In France, Thales will also provide security systems under the "PassDef" framework agreement for protection of the national military sites.

The Identification activity was sold to the Imprimerie Nationale (French printing agency) to form a French champion in secure ID documents.

In the field of critical information systems and cybersecurity

In France, in the public sector, Thales was chosen to support the secure digital transformation of major public players, such as the Ministry of Internal Affairs, the Ministries of Solidarity and Health, Employment, Education and Sports, as well as the ACOSS (Central agency for social security bodies) and IGN (National geographic institute). These missions relate in particular to the development of new digital services and the integration of applications into the ministerial Cloud. The La Poste Group and Thales also announced a 12-month trial aimed at testing the implementation of new legal provisions in cybersecurity including the deployment of the confidence probe for the detection of cyber attacks.

On the global stage, Thales performed the security assessment for the contactless payment application Samsung Pay on the smartphones Galaxy S8 and S8+, which resulted in certification of the application on the two devices.

In addition, Thales opened two centres of excellence in cybersecurity in Cambridge and Toulouse and also opened a new cybersecurity monitoring centre in Hong Kong, and a cyber training facility in Belgium.

2.1.3.3 Land and air systems

2.1.3.3.1 General overview

Thales systems and equipment help to make the airspace safer and more secure. In commercial air traffic control, Thales's portfolio ranges from conventional navigational aids to radar and air traffic control centres, surveillance systems, satellite navigation and airport management solutions.

Thales plays a key role as an architect and integrator in the future air traffic management system, particularly through the OACI's[1] "Global Air Navigation Plan – Aviation System Block Upgrades" initiative. Thales is the main industrial partner of the SESAR[2] project in Europe and a key player in the NextGen programme in the United States.

Across all continents, Thales offers one of the broadest lines of commercial and military ground-based and naval radars, on the market, for surveillance, air traffic management and fire control. 1,300 Thales radars are in service across the world and the Group equips over 70 countries with commercial radars and more than 45 countries with military radars.

In the military segment, Thales is specialised in air operations command and control systems and air defence radar systems, ensuring the protection and security of forces and resources deployed in over 45 countries. As a mission systems integrator, Thales is proud to contribute actively to major military programmes in the world such as ACCS for NATO, SCCOA for France and FLORAKO for Switzerland. Thales excels in the fields of system integration, complex programme management, real time and non-real time software, human-machine interfaces and service oriented architecture.

Thales owns 50% of Thales Raytheon Systems AMDC2, a company that specializes in Integrated Air and Ballistic Missile Defence (IAMD) Command and Control (C2) Systems. Thales Raytheon Systems AMDC2 provides NATO and the NATO Nations with Integrated Air and Missile Defence (IAMD) capability as part of the Air Command and Control System (ACCS).

Thales also offers a wide range of weapon systems for medium-range (SAMP/T), short-range (Crotale and RAPIDDefender) and very short-range markets (RAPIDFire cannon and RAPIDRanger missile system). The Group also supplies the lightweight multi-role missile (LMM) family.

In the field of optronics, the combination of optical and electronic systems, Thales designs and manufactures components and systems for day and night surveillance, reconnaissance, protection, threat detection and target acquisition on all types of land, sea (surface and subsurface) or air

(1) International Civil Aviation Organization.
(2) Single European Sky ATM Research.

platforms for defence and security customers worldwide. Thales's expertise in optics is also applicable to the commercial segment of high end zoom lenses for cinema and for ultra-high power scientific and industrial lasers.

Thales designs, manufactures and supports armoured military vehicles including the Hawkei and the Bushmaster. Thales provides integrated capability solutions at all levels of the value chain, from subsystem supplier to system integrator; mission systems design authority and prime contractor. The open architecture systems of vehicles provides highly standardised "plug and play" capability for on-board sub-systems and products, increasing vehicle capability and performance whilst reducing size, weight and operator workload and whole life system costs.

2.1.3.3.2 Competitive position

Thales's expertise in all aspects of air traffic control (automation, navigation and surveillance) is widely recognised by the world's civil aviation authorities. With over 40% of the world's airspace controlled by TopSky ATC, Thales is at the forefront of air traffic control systems and civilian radars.

Other major players in the commercial sector are the US companies Lockheed Martin and Raytheon, European companies Indra and Leonardo (Selex), and in some niche areas, Saab, Frequentis and Harris.

In the military sector, Thales's main competitors for surface radars are the US companies Lockheed Martin, Northrop Grumman, and Raytheon, and Leonardo, Airbus Group, BAE Systems, Indra and Saab in Europe.

Thales is one of Europe's leading suppliers of medium-range, short-range and very short-range missiles and weapon systems. Other principal players in this field in Europe (MBDA) and the United States (Raytheon and Lockheed Martin) are also major customers of Thales's missile electronics and key partners in weapon systems.

Thales is Europe's leading defence optronics supplier facing competition in this segment from US suppliers (Raytheon, Lockheed Martin and Flir Systems) and from Israeli suppliers (primarily Elbit). The protected vehicles systems market segment is dominated, on an international level, by BAE Systems, General Dynamics, Rheinmetall, Krauss-Maffei Wegmann and Nexter. Thales operates in Europe as an independent integrator both for its own and other suppliers' equipment within complex mission systems.

2.1.3.3.3 Significant events in 2017

In 2017, the Air Traffic Management (ATM) business line secured a variety of contracts across its full portfolio of technologies. A turnkey contract was secured for Tanzania, for the modernisation of air control infrastructures in response to the increase in traffic in the country and in East Africa. This contract includes TopSky ATC, primary and secondary radar system – Star NG RSM970S, 4 civil radars, civil engineering and training of controllers and engineers.

Thales was selected by Norway for the deployment of 14 ground-based navigational aid systems (TACAN), as part of a campaign to modernise the existing equipment and to renew the ILS navigation systems in Germany and the Netherlands.

In the area of surface radars, Thales launched some new products in 2017:

- the Ground Fire family: a range of new generation multifunction ground radars. These fully digital radars will simultaneously provide for surveillance and air defence missions;
- the new TRAC NG in-flight monitoring radar with exceptional dual capacities (commercial and military). Derived from the STAR NG radar, the most advanced approach radar in the world, the TRAC NG radar responds to requirements to increase the primary in-flight surveillance capacity of increasingly saturated air spaces and ensure heightened surveillance in secure military air space;
- in November 2017, Thales acquired Aveillant, a UK company specialised in the drone detection holographic radar technology.

In terms of commercial success, Thales, alongside the Naval Group, was notified by the Ministry of Defence of the contract for the development and production of five medium-sized frigates (FTI in French) for the French Navy, as part of a programme piloted by the French Defense Procurement Agency (DGA). The first of the five frigates will be delivered in 2023 for entry into active service in 2025. Thales-developed systems at the cutting edge of technology will equip the new frigate BELH@RRA, such as the fully digital multifunction radar SEA FIRE, equipped with four fixed panel antenna which meet the requirements of different missions, including self-defence of the vessel and extended air defence and can take control of ASTER missiles. The Sea Fire is designed to perform in the complex conditions of the littoral or in heavily jammed environments to counter conventional, asymmetric or emerging air and surface threats.

In terms of convincing past performance, during a ballistic missile exercise in the Atlantic Ocean, Thales's SMART-L radar on board the HNLMS De Ruyter successfully detected and followed a ballistic missile launched at an altitude of 300 km and a speed of more than 3 km/second. The system made the data accessible in real time to an Aegis class US Navy vessel which used this data to launch an SM-3 missile. This technology is used by the SMART-L Multi Mission radar currently under development by Thales for the four defence and air command frigates of the Netherlands Royal Navy and for two land versions for the Netherlands Royal Air Force. In parallel with the American exercise, the SMART-L Multi Mission radar installed on the test tower on Thales's site in Hengelo (Netherlands) also detected and tracked the ballistic missile.

A preliminary air defence agreement was signed between Eurosam, a European consortium between Thales and MBDA, and the Turkish manufacturers Aselsan and Roketsan in July 2017. This agreement formalises the willingness of Thales, MBDA, Aselsan and Roketsan to work together to respond to demands from the Turkish authorities to define the architecture for the future air defence and anti-ballistic missile system to enable them to fulfil their mission to protect their population and territory.

The integrated air defence solution ForceSHIELD was commissioned in Indonesia. In addition to the STARStreak air defence missiles, this solution includes the CONTROLMaster 200 surveillance and coordination system, RAPIDRanger mobile integrated weapon systems and Lightweight Multiple Launchers (LML), as well as communication, training and support equipment.

2017 was a year of successful qualification firing tests for the Lightweight Multi-role Missile (LMM) The LMM is on track for official qualification in 2018, following numerous successful firings.

In May 2017, Thales conducted a demonstration in real-life conditions of all of its operational capacities in the surveillance, identification and neutralisation of drones. This trial was carried out in cooperation with companies from the Cluster Paris Drone and Cœur Essonne, on the Brétigny-sur-Orge site near Paris.

Finally, ThalesRaytheonSystems and Lockheed Martin signed a memorandum of understanding to develop anti-ballistic missile territorial capacities for NATO's Air Command and Control System (ACCS).

2017 was a major year for the Hawkei protected tactical vehicle with the launch of the initial production phase of 1,100 armoured vehicles for the Australian army. This step follows a long programme of tests conducted to ensure the customer's demands are fully met. This new vehicle is now ready for export and is presented regularly at the different Defence trade fairs across the world, such as the recent IDEX and MSPO.

In optronics, a contract for airborne reconnaissance pods was signed in the Middle East. The land optronics activity enjoyed exports of armoured platforms from several partners, particularly in South-East Asia and the Middle East.

2.1.3.4 Defence mission systems

2.1.3.4.1 General overview

Thales manufactures electronic combat, intelligence, surveillance and reconnaissance systems, as well as naval surface and underwater combat systems.

For airborne combat missions, Thales produces, in cooperation with Dassault Aviation, radar systems and equipment for the Rafale and the Mirage 2000 fighter aircraft and for future combat unmanned aerial vehicles (UAVs), as well as electronic warfare radar systems, designed to detect threats and protect platforms.

For intelligence, surveillance and reconnaissance missions, Thales designs naval, ground and air patrol and surveillance solutions, including a range of electromagnetic-based information-gathering sensors. These systems – which are installed on aircraft or naval platforms – incorporate surveillance radars, acoustic sub-systems and measurement and data linking equipment. Thales also designs complete UAV systems with intelligence, surveillance, reconnaissance and target acquisition capabilities.

In surface naval warfare, Thales offers comprehensive combat systems that integrate on-board sensors (radar, sonar, electronic warfare, infrared sensors, etc.), weapon systems and communications and command equipment. Thales also has naval platform engineering and support capabilities.

In underwater warfare, Thales offers a broad range of products including submarine sonar suites, hull-mounted and towed array sonar for surface ships, anti-mine systems, including the use of unmanned underwater vehicles, as well as acoustic sensors for submarine guidance.

2.1.3.4.2 Competitive position

In electronic combat systems, Thales is one of the leading European players, competing with BAE Systems, Leonardo, and the US companies Raytheon, Lockheed Martin and Northrop Grumman. In intelligence, surveillance and reconnaissance systems, its main competitors are Airbus, Elbit and General Atomics.

In surface naval systems, Thales is one of the principal European players, alongside Leonardo, BAE and Saab, and competes with Lockheed Martin in the United States. In underwater warfare, Thales is one of Europe's main players along with Atlas Elektronik and Ultra Electronics, and is in competition with Lockheed Martin, Raytheon and L3 in the United States.

2.1.3.4.3 Significant events in 2017

Electronic combat systems

To meet orders for Rafale intended for France and export to Egypt, Qatar and India, the rate of production increased to two pieces of Radar and Electronic Warfare equipment per month starting in March. In addition, Thales and the Indian company Reliance Defence Ltd announced their intention to create a JV to produce a local part of the Thales contract for 36 Rafales in India and to perform part of its offset obligations.

Airborne surveillance and intelligence systems

In January, Thales and Lockheed Martin announced the awarding of a contract for the supply of a new air surveillance and control system for the Royal Navy as part of the Crowsnest programme. In March, SIMMAD (Integrated System to Maintain Aeronautical Materials in operational condition of the French Ministry of Defence) entrusted Thales, for a period of 113 months, with management of all the aeronautical material consumables used in Defence. April saw the delivery of the eighth and final Ocean Master radar for Beech 350 King Air aircraft used by the French Customs. These planes are designed for maritime surveillance missions on the Atlantic coast, Mediterranean and overseas. In June, the Chinese government ordered a DORIS (Satellite-based Integrated Orbit Determination and Radio Positioning equipment) to equip an ocean observation satellite. In July, France's Ministry of the Armed Forces announced the order for the development and production of equipment for the electronic warfare suite as part of the launch of the Mid-Size Frigates (FTI) programme.

Surface naval systems

In April, a US customer placed the first order for a Tacticos combat management system to equip the first platform of a new family of vessels. In July, Bangladesh entrusted Thales with the mid-life restoration of the combat system installed on a first heavy corvette. In August, the Canadian government announced a support contract for the re-equipment, distribution, maintenance and associated training for coastal and Arctic patrol vessels. This contract includes an initial service period of eight years as part of a maximum term of 35 years. It is the largest ever signed in the history of the Canadian Royal Navy.

Underwater warfare systems

In January, the Navy of the United Arab Emirates ordered two variable depth Captas sonars to equip two of its anti-submarine warfare capacities surface buildings. In March, a contract was signed with the Australian Royal Navy for the supply of an anti-sea mine system (SEA 1778 programme) including five surface naval drones and seven underwater naval drones. In May, as part of the restoration project of three La Fayette frigates (FLF in French), Naval Group announced a contract for three Kingklip hull-mounted sonars. In July, Naval Group also announced an order for the production of the sonar suite to equip future mid-size frigates (FTI). As part of the optimisation project for the support of sensors embedded on surface and underwater platforms of the British Royal Navy (SSOP, Sensors Support Optimisation Project), a contract for the support in service of several suites of sonars was awarded at the end of December.

2

2.2 RESEARCH AND INNOVATION

Thales needs to be able to offer increasingly sophisticated technologies, particularly in the detection, analysis and decision-making fields, in order to design and develop critical information systems. These innovative solutions serve customers in the aeronautics, space, ground transportation, defence and security markets.

Thales bases its vision of innovation on openness and partnership across multiple dimensions:

- a technological dimension, by collaborating with academic laboratories;
- an entrepreneurial dimension by forging closer ties with SMEs and start-ups;
- a "market" dimension, by jointly innovating with customers and their ecosystems to create new usages.

2.2.1 Research and development, the key to competitiveness and growth

Some 25,000 Thales employees, over 70% of them engineers, are involved in the Group's technical operations, ranging from research to engineering. In 2017, Thales spent €797 million (5% of sales) purely on self-funded R&D, an essential lever to remain competitive.

A significant portion of this budget is devoted to upstream research in order to develop:

- new technologies;
- new system and product concepts;
- new engineering tools and methods for critical information systems.

2.2.2 Four key technical domains

Governance of research and development for key technologies is split into four domains:

- hardware technologies: electronics, electromagnetism, optronics, acoustics, radiofrequency techniques and management of thermal constraints;
- software technology: processing computers, real-time on-board systems, distributed systems, service-oriented architectures, model-driven engineering, and cybersecurity;
- information and cognitive sciences: Artificial Intelligence, big data processing, autonomous systems, synthetic environments, and human factors;
- systems: focused on systems design architecture, this area provides support for methodology, processes and expertise.

FOCUS 1

A world first in 2017, the artificial nano-neuron from the Thales/CNRS joint physics laboratory

In 2017, a team from the CNRS/Thales joint physics unit, in collaboration with American and Japanese researchers unveiled, in the prestigious science journal Nature, the first artificial nano-neuron with the ability to recognise numbers spoken by different individuals. This electronic nano-neuron is a breakthrough in artificial intelligence and its applications.

To achieve this result, an exceptionally stable magnetic oscillator was used. Each gyration of this nano-compass generates an electrical output, which imitates the electrical impulses produced by biological neurons.

Interconnected by artificial synapses, these nano-neurons will process and classify, almost instantaneously, the masses of data that will be produced in future years by the billions of connected objects which are gradually invading all sectors of economic life.

2.2.3 Thales at the heart of innovation ecosystems

Wherever it is located, Thales seeks to build partnerships within innovation ecosystems, with academic partners, design centres, innovative businesses and industrial groups for joint innovation on applications, business models and technologies.

To develop the technologies it needs, the Group relies heavily on cooperation between its research teams and the academic world. Thales Research & Technology (TRT), an international network of corporate laboratories, is responsible for building relationships with academic partners.

TRT has facilities in France, the United Kingdom, the Netherlands, Singapore and Canada. In France, the Palaiseau laboratory, located on the École Polytechnique campus, is involved in the world-class science and technology complex in Saclay,

While the Singapore centre has partnered with Nanyang Technological University and with France's national research institute CNRS, in one of the few joint international research units with an industrial partner.

In France, Thales has numerous strategic partnerships, for example, with the CNRS, the CEA, École Polytechnique, Telecom Paris Tech, and Université Pierre et Marie Curie (UPMC-Paris VI).

This heavy involvement of the Group in research in close partnership with the public research sector was recently highlighted by the journal Nature, which publishes the list of the "Top 100 Corporate research institutions: the leading corporate institutions for high-quality science". In this list, Thales ranks second in France and 27th in the world, streaks ahead of all the other companies in its sector.

The most advanced form of partnership is the joint laboratory, such as those operated by Thales with the CNRS for physics, with CEA-LETI as part of the III-V Lab (an EIG whose members are NOKIA, Thales and CEA-LETI), with CEA-LIST for artificial vision and formal approaches to the development of critical software, and with UPMC in artificial intelligence, etc.

Thales is a major player in various international competitiveness centres and a founding member of the *Institut de Recherche Technologique Saint-Exupéry* technological research institute.

In the United Kingdom, TRT has direct links with several major Universities through its R&T centre, including Bristol. Thales is an active member of many collaborative partnerships in the United Kingdom: the Centre for Secure Information Technologies (CSIT), based at Queen's University Belfast; the Centre for Smart Infrastructure and Construction (CSIC) and the Institute for Manufacturing (IfM), based at Cambridge University; the UK Defence Growth Partnership (DGP); the mobile Virtual Centre of Excellence (mVCE), with numerous Universities; the Defence Academic Pathways (DAP) and the UK Catapults, particularly the Digital Catapult where Thales has contributed to the emergent IoT defining the security implications of pervasive digital Sensors and their associated data.

In Canada, the Group regularly works with research networks and institutions such as CRIAQ (*Consortium de Recherche et Innovation en Aérospatiale au Québec*), the University of Toronto, McGill University, the *École Polytechnique de Montréal* and Laval University, with which Thales has entered into an agreement for a joint research unit in urban sciences.

FOCUS 2

The smart sensor: from physics to artificial intelligence

Sensor technologies form part of the Group's DNA. Combining physics, electronics, signal processing and imaging, in the future these devices will be embedded with an increasing amount of intelligence as close as possible to raw data.

Thales has developed an artificial intelligence solution capable of detecting elements of interest in real time in optronic images taken during air missions. Built into the sensor, this Artificial Intelligence will offer assistance to pilots during a mission. This technology will achieve the "short loop", so long awaited by operational experts from detection through to engagement in a considerably reduced time.

Also in radars, artificial intelligence will come into play immediately after signal digitisation. A new concept of antenna already implements this paradigm, by combining direct digitisation of the signal and intelligence, for the detection, location and identification of hostile signals.

In 2017, Thales created CortAIX, an artificial intelligence laboratory with around fifty people, to develop the use of AI in Thales's systems. The laboratory is situated in Montreal, in the heart of one of the world's leading artificial intelligence ecosystems. Thales researchers from CortAIX are forming collaborations with MILA (the Quebec Institute of Artificial Intelligence), IVADO (Data Optimisation Institute), the Quebec Artificial Intelligence Institute and the Vector Institute in Toronto.

In emerging countries, the Group is developing its R&D activities by establishing innovation platforms locally, using the tried and tested principles of joint innovation with local players and, in so doing, building long-term, trust-based relationships.

In 2017, Thales continued to step up its work with start-ups.

Already a founding member of Starburst, a specialised incubator in the aeronautics and space field, Thales was selected by the world's largest incubator Station F to run its cybersecurity programme. Thales selected nine start-ups adding value to the Group's cyber security offer. Thales and the start-ups selected will offer their customers solutions covering the entire cybersecurity chain (see Focus 3).

Training also forms part of the overall strategy of linking the Group with the academic world. The Group supports around 200 doctoral students worldwide. They work on subjects directly connected with the technical issues facing Thales, which therefore reinforces its appeal to young scientists. Thales also supports six teaching chairs in subjects that are in line with its technical priorities.

FOCUS 3

At the heart of the cybersecurity ecosystem

Harnessing innovation where it is most dynamic, is one aspect of Thales's innovation strategy. By becoming a leading partner of Station F for cybersecurity in 2017, Thales tests the solutions proposed by the start-ups who join the programme.

One such start-up, KeeeX, a French start-up founded in 2014, has developed a unique universal embedded digital signature technique which relies on distributed blockchain architecture. This innovation guarantees the integrity and authenticity of the data/documents exchanged, which is a major breakthrough in the digital transformation.

2.2.4 A dynamic approach to intellectual property management

Thales supports its R&D activities with a dynamic approach to intellectual property management.

The Group filed more than 300 new patent applications in 2017. The continued large number of patent applications in recent years reflects Thales's commitment to innovation and its ability to translate research results into competitive advantages.

The Thales portfolio, which includes more than 15,000 patents and patent applications, is regularly adapted to operational requirements, particularly to protect Thales's market share.

In 2017, Thales was once again included in the Top 100 Global Innovators ranking compiled by Clarivate Analytics, with the Group standing out for the volume, success and influence of its patents. This achievement underlines Thales's commitment to innovating, protecting its ideas and bringing its inventions to market. Thales has been included in this prestigious ranking five times since 2011, which testifies to the importance the Group places on implementing an active and ambitious intellectual property management strategy.

FOCUS 4

The digital factory: the driving force behind the Group's digitisation

Created in 2017, the Digital Factory will unite 150 world-class experts in digital technologies, recruited internally and externally, to serve Thales's customers in all its businesses, through the extensive introduction of mass data processing and intelligence technologies to the Group's solutions, while also providing data security – a fundamental requirement of the digital economy.

It will host a digital platform ("Digital Platform Foundry") which will maximise economies of scale and synergies, based on which new "As a Service" offers will be developed for customers of the Group.

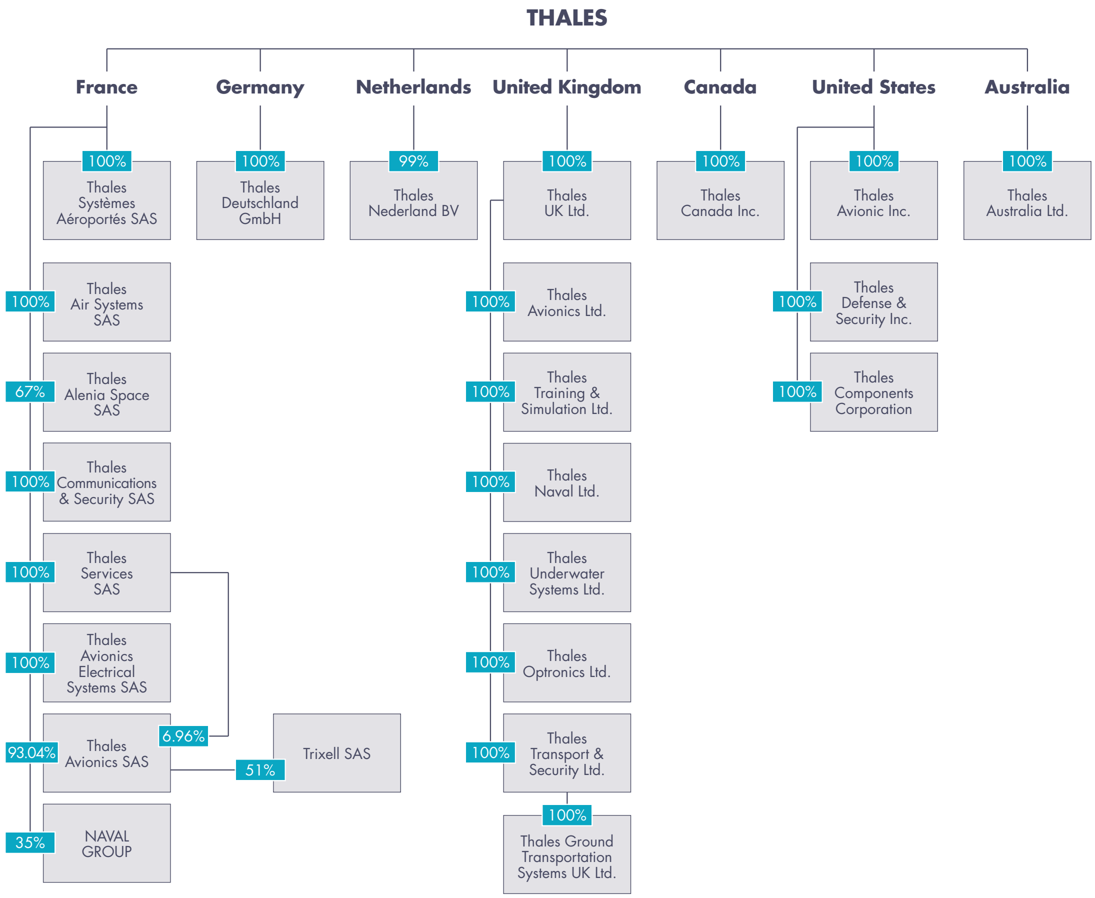
It will also host an incubator for internal and external start-ups and a digital academy designed to disseminate the digital culture within the Group.

2.3 RELATIONS BETWEEN THALES AND ITS SUBSIDIARIES

2.3.1 Simplified organisational chart at 31 December 2017

This simplified organisational chart includes fully consolidated companies that account for more than 0.5% of consolidated sales, in the main countries in which the Group operates.

The companies consolidated under the equity method are not included in this chart (with the exception of NAVAL GROUP).



2.3.2 Role of Thales (parent company) within the Group

Thales (parent company) acts as a holding company for the Group:

- it holds shares in the Group's major subsidiaries;
- it manages central functions such as Group strategy, trading policy, legal and financial policy, operational monitoring, human resources policy and communications;
- it provides subsidiaries with specialist assistance, including legal, tax and financial expertise, for which the subsidiaries pay a fee;
- it provides financing, cash pooling and, where necessary, guarantees.

In addition to these functions, Thales (parent company) conducts its own research, described beginning on pages 130 *et seq*.

A list of the main consolidated companies can be found below.

2.3.3 Financial flows between Thales (parent company) and its subsidiaries

Thales (parent company) receives dividends from its subsidiaries, as approved by their respective Annual General Meetings, and in accordance with the applicable legislation and regulations in their countries of operation.

In addition to these dividends and the payment of fees for shared services, the main financial flows between Thales (parent company) and its subsidiaries relate to cash pooling.

As a rule, the cash surpluses of subsidiaries are transferred to the parent company under a centralisation system known as cash pooling. In return, Thales (parent company) meets the cash flow requirements of the subsidiaries. The parent company conducts operations in financial markets to arrange the necessary investments and loans, in the context of cash pooling, to meet its own requirements and those of its subsidiaries. Except in special cases, this system applies to all subsidiaries in which Thales has majority control.

2.4 INFORMATION ABOUT MAJOR OPERATIONAL SUBSIDIARIES AND MANUFACTURING SITES

2.4.1 List of main consolidated companies

As part of the simplification of legal structures in France, several mergers came into effect on 31 December 2017:

- Thales Air Systems SAS (which became Thales LAS France SAS on 1 January 2018), absorbed the companies TDA Armements SAS, Thales Optronique SAS, Thales Angénieux SAS, Thales Air Operations SAS and Thales Cryogénie SAS;
- Thales Avionics SAS (which became Thales AVS France SAS on 1 January 2018) absorbed the companies Thales Electron Devices SAS, Thales Training & Simulation SAS and Thales Avionics LCD SAS;
- Thales Systèmes Aéroportés SAS (which became Thales DMS France SAS on 1 January 2018), absorbed the companies Thales Underwater Systems SAS and Thales Microelectronics SAS.

The materiality criteria used to prepare these tables have also been applied to the list of the main consolidated companies in Note 17 to the consolidated financial statements.

Company name	Country	% of capital held by Thales	% of voting rights held
1. Controlled companies (fully consolidated)			
Thales Alenia Space SAS	France	67%	67%
Thales Alenia Space Italia SpA	Italy	67%	67%
Thales Air Systems SAS	France	100%	100%
Thales Australia Ltd	Australia	100%	100%
Thales Austria GmbH	Austria	100%	100%
Thales Avionics SAS	France	100%	100%
Thales Avionics Inc	United States	100%	100%
Thales Avionics Electrical Systems SAS	France	100%	100%
Thales Canada Inc	Canada	100%	100%
Thales Communications & Security SAS	France	100%	100%
Thales Defence & Security Inc	United States	100%	100%
Thales Deutschland GmbH	Germany	100%	100%
Thales e-Security, Inc	United States	100%	100%
Thales Espana Grp SAU	Spain	100%	100%
Thales Italia SpA	Italy	100%	100%
Thales Nederland BV	Netherlands	99%	99%
Thales Norway AS	Norway	100%	100%
Thales Polska Sp. z.o.o.	Poland	100%	100%
Thales Ground Transportation Systems UK Ltd	United Kingdom	100%	100%
Thales Rail Signalling Solutions AG	Switzerland	100%	100%
Thales Security Solutions & Services Company	Saudi Arabia	100%	100%
Thales Services SAS	France	100%	100%
Thales Solutions Asia Pte Ltd	Singapore	100%	100%
Thales Systèmes Aéroportés SAS	France	100%	100%
Thales Transport & Security (Hong Kong) Ltd	Hong Kong	100%	100%
Thales Transport & Security Ltd	United Kingdom	100%	100%
Trixell SAS	France	51%	51%
Thales UK Ltd	United Kingdom	100%	100%