

BAE Systems plc

Interim Management Statement for the period from 1 July 2010 to 20 October 2010

21 October 2010

BAE Systems plc today issues its interim management statement for the period from 1 July 2010 to 20 October 2010 in accordance with the requirements of the UK Listing Authority's Disclosure and Transparency Rules.

Trading for the period has been consistent with management expectations at the time of the half-year results announcement on 29 July 2010. Changes from the UK Strategic Defence and Security Review are expected to result in some reduction in growth for 2010. The outlook for 2010 remains subject to commercial discussions regarding cancellation of the Trinidad and Tobago offshore patrol vessel programme. Whilst the financial consequences cannot be definitively assessed at this time, as announced in September, the Group estimates a charge of up to £150m, before tax, may be required in its 2010 accounts.

The US defence market continues to generate a substantial number of business opportunities despite budgetary pressures. These pressures are leading to programme reprioritisations and a drive for greater efficiencies in procurement, which are helping to fund continued modest growth in investment on defence capability. Anticipating these changes, a restructuring of BAE Systems' operations in the US has been undertaken, reducing overhead cost to the benefit of both customers and shareholders.

Pressure to reduce government expenditure in the UK is reflected in the Comprehensive Spending Review. A UK Strategic Defence and Security Review (SDSR) was published in October. BAE Systems will now work with the UK Ministry of Defence to address the detailed implications of the changes identified by the SDSR. The Group believes that it can continue to help in achieving efficiency improvements and value for money enhancement in the way capability is generated and delivered. In aggregate, the Group anticipates some modest impact on performance of its UK business in 2010 from the changes and a reduction in the Group's financial planning assumptions resulting in an approximately one pence reduction in earnings per share, per annum, thereafter. A more detailed explanation of the potential implications of the SDSR is included in an appendix to this statement.

Previously announced actions to reduce cost across the Group include net headcount reductions of approximately 7,000 (including contractors) in the year to date.

Land & Armaments

The progress made in the Land & Armaments business in the first half year has been sustained. In August, the US Mine Resistant Ambush Protected (MRAP) Joint Program Office awarded a \$629m (£398m) contract for the upgrade of 1,700 Caiman MRAP vehicles. The contract takes new orders for mine protected vehicles to more than \$1bn (£633m) for the year to date.

Electronics, Intelligence & Support

The Electronics, Intelligence & Support businesses have seen continued demand for high technology electronics and sensor systems. Contract awards in the period included \$123m (£78m) for further production of thermal weapon sights for the US Army under a five-year, indefinite-delivery/indefinite-quantity (IDIQ) contract, bringing the total contract value to more than \$1bn (£633m) since 2004.

BAE Systems has been approved as one of multiple qualified suppliers to provide engineering and technical services to the US Army and other federal customers under a ten-year, \$16.4bn (£10.4bn) US government-wide IDIQ contract called Rapid Response - 3rd Generation (R2-3G).

BAE Systems received a multi-ship, multi-option contract, with a potential value of \$365m (£231m), for executing planning, modernisation, maintenance and repair work on 11 Arleigh Burke DDG-51 class destroyers at its Norfolk, Virginia, facility. This contract, and existing contracts for CG-47 class cruisers and amphibious ships, support work at the Group's Norfolk, San Diego and Hawaii shipyards, and positions BAE Systems as a major supplier of support services to the US Navy. This position has been enhanced further by the acquisition of Atlantic Marine Holding Company (Atlantic Marine).

Programmes & Support

The Group has continued to develop its presence in the Indian market. Following on from the previous sale of 66 Hawk aircraft for the Indian Air Force, BAE Systems signed an agreement in the period with Hindustan Aeronautics Limited to supply products and services worth over £500m to enable a further 57 Hawk Advanced Jet Trainer aircraft to be built under licence in India for the Indian Air Force and Indian Navy.

In September, BAE Systems announced that it had received written notice from the Government of Trinidad and Tobago (GORTT) that it wishes to cancel the programme under which the Group is providing three Offshore Patrol Vessels and support to the Trinidad and Tobago Coast Guard. The Group is engaged in commercial discussions with GORTT to find an equitable settlement.

M&A activity

In July, BAE Systems completed the \$352m (£232m) acquisition of Atlantic Marine. The acquisition is consistent with BAE Systems' strategy to address anticipated growth in customer support and services activities within its home markets. The acquired naval sustainment operations at Mayport and Jacksonville, Florida; Moss Point, Mississippi; and Mobile, Alabama, complement the Group's existing ship repair, maintenance and modernisation capabilities, and enhance its ability to support the US Navy's current and future home port support requirements.

In September, the Group entered into a definitive agreement to acquire L-1 Identity Solutions, Inc.'s Intelligence Services Group, which is comprised of SpecTal, LLC, Advanced Concepts, Inc. and McClendon, LLC, and is a leading provider of security and counter threat capabilities to the US government, for cash consideration of \$296m (£187m). The acquisition is conditional upon receiving certain US regulatory approvals and is expected to complete before the end of the year

In October, BAE Systems completed the acquisition of OASYS Technology, LLC, a US manufacturer of electro-optical systems and sub-assemblies, for an initial cash consideration of \$25m (£16m) and a potential earn out of up to \$30m (£19m). The acquisition complements BAE Systems' existing electro-optical capabilities, technologies and product offerings.

Outstanding issues concerning the acquisition of the Tenix Defence business in 2008, including the completion accounting process, have been resolved successfully with agreement to payments totalling A\$127.5m (£78m) from the former owners of the business.

In September, BAE Systems confirmed that it has engaged Wells Fargo and JP Morgan to advise on strategic options with regard to the Platform Solutions business, including a possible sale.

Global settlement

As previously reported, BAE Systems announced in February a global settlement with the US Department of Justice and the UK Serious Fraud Office in connection with their investigations. The Company has an ongoing dialogue with other US regulatory agencies in order to address their concerns regarding matters arising from the settlement. Under the agreement with the Serious Fraud Office, the Company agreed to pay a penalty of £30m comprising a fine yet to be determined by the Court and a charitable payment for the benefit of the people of Tanzania. The Court date for such determination has not yet been set.

Pensions

Consultations with the trustees of the Group's two largest UK pension schemes, to address implications for the schemes arising from the share repurchase programme, have been concluded with the Group agreeing to pay £137m in total to those schemes in 2010. The Group has also offered to pay a further £20m in total across the remainder of the UK schemes.

The triennial funding valuation of the Group's second largest UK pension scheme, the 2000 Plan, commenced in April. Discussions have commenced between the trustees of the scheme and the Group to determine implications for the existing deficit recovery plan.

The valuation of the Group's pension liabilities is highly sensitive to movements in real discount rates. During the period, these rates have continued to be volatile. A ten basis point movement in the rate changes the pre-tax liability by some £0.3bn.

Cash flow

The Group's programme to return up to £500m to shareholders by way of on-market purchases of shares completed in July. The average cost of shares purchased was £3.49.

In August, the Group's \$500m (£316m) 4.75% bond matured, having been pre-financed by a \$1.5bn (£949m) bond issuance last year.

Excluding M&A activity, a cash inflow continues to be anticipated in the second half of 2010. Achievement of receipts due on the Salam programme in the final quarter will be a material determinant of the year's cash flow performance.

Directors and management

On 9 July, Andy Inglis, a non-executive director of the Company, retired from the Board.

On 20 July, Larry Prior was appointed Executive Vice President, Service Sectors for BAE Systems, Inc., reporting to Linda Hudson, President and Chief Executive Officer of BAE Systems, Inc.. Following the changes to the Group's organisation in the US, Larry also joined the Group's Executive Committee.

On 22 September, Harriet Green was appointed as a non-executive director of the Company with effect from 1 November 2010.

Full year results

BAE Systems will announce its financial results for the year ending 31 December 2010 on 17 February 2011.

Appendix

BAE Systems plc - Publication of UK Strategic Defence and Security Review

BAE Systems welcomes the publication of HM Government's Strategic Defence and Security Review (SDSR). The review identifies a number of changes in priorities, with consequent implications for individual programmes. BAE Systems anticipates only relatively modest adjustments to its overall financial outlook from these changes.

BAE Systems plans its business on conservative assumptions. The budget environment and changing defence priorities required adjustments to programmes and recognising these external pressures, the Group has made allowance in its planning assumptions for possible changes and has accelerated efficiency improvements to both mitigate likely reductions in activity and to improve programme affordability for the UK customer.

The detail behind the changes will take some time to refine but the Group welcomes the removal of a number of uncertainties which have been overhanging the business in recent months.

BAE Systems will now work with the UK Ministry of Defence to address the detailed programme implications of the changes identified by the SDSR. In aggregate, the Group anticipates some modest impact on performance of its UK business in 2010 from the changes and a reduction in the Group's financial planning assumptions resulting in an approximately one pence reduction in earnings per share, per annum, thereafter.

The implications of the SDSR identified for the Group's principal UK activities include the following:

Naval

The restated commitment to continue with the construction of both Queen Elizabeth Class carriers is welcomed. Changes to the nature of operation and equipment associated with the second ship are not likely to be material to the Group.

The surface shipbuilding operations are subject to the existing Terms of Business Agreement (ToBA) which seeks to sustain key industrial capabilities and underpins a minimum volume of shipyard overhead recovery accompanied by reduced ship build costs and enhanced value for money for the customer. In the early years that volume is addressed by the Type 45 destroyer programme and the first of the Queen Elizabeth Class carriers. The ToBA extends to the start of the Type 26 Class frigate programme.

The Group's submarine business is underpinned by the Astute programme with commitments through the balance of this decade. The commitment to the procurement of seven Astute Class submarines is welcomed.

Air

The earlier than previously planned retirement from Royal Air Force service of the Harrier fleet will impact the Group's military air support activity. Support activity on the Typhoon programme is expected to rise through this period with continued deliveries of the aircraft into service. In addition, some acceleration of development of Typhoon is anticipated. The decision not to take the Nimrod MRA4 aircraft into service may result in some near term reduction of residual production activity on the programme and elimination of longer term support opportunity. The Group will now work with government to agree commercial terms resulting from changes to the Nimrod programme.

The Group has a significant work share on the F-35 Joint Strike Fighter programme. The UK Ministry of Defence has identified a requirement for F-35 aircraft including for operation from the Queen Elizabeth Class carrier. BAE Systems welcomes the UK Government's continued commitment to the F-35 programme.

Land

BAE Systems continues to support the British Army's heavy and medium armoured vehicle fleet and the announced changes are not material to the Group.

Cyber & Security

BAE Systems welcomes the decision to invest in an enhanced programme of cyber security measures and the Group looks forward to working with government to address the rapidly evolving demands in this area of security.

Cautionary statement

All statements other than statements of historical fact included in this Interim Management Statement are forward-looking statements. Such forward-looking statements, which reflect management's assumptions made on the basis of information available to it at this time, involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of BAE Systems or the market and economies in which BAE Systems operates to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Nothing in this Interim Management Statement shall be regarded as a profit forecast. BAE Systems plc and its directors accept no liability to any person in respect of this Interim Management Statement, save as would arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with Schedule 10A of the Financial Services and Markets Act 2000.

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