

Delivering Total Performance

**Cover image:** Customer Support and Services: BAE Systems and Australian Army personnel inspect an upgraded M113AS4 Armoured Personnel Carrier at Bandiana, Victoria.

BAE Systems is a global defence, security and aerospace company delivering a full range of products and services for air, land and naval forces, as well as advanced electronics, security, information technology solutions and customer support services.

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## RESULTS IN BRIEF, HIGHLIGHTS AND OUTLOOK

### Results in brief

Results from continuing operations	Six months ended 30 June 2010	Restated <sup>1</sup> Six months ended 30 June 2009
Sales <sup>2</sup>	<b>£10,643m</b>	£9,747m
Underlying EBITA <sup>3</sup>	<b>£1,114m</b>	£978m
Operating profit	<b>£866m</b>	£507m
Underlying earnings <sup>4</sup> per share	<b>20.4p</b>	17.9p
Basic earnings/(loss) per share <sup>5</sup>	<b>16.1p</b>	(2.1)p
Order book <sup>6</sup>	<b>£43.6bn</b>	£44.3bn
Other results including discontinued operations		
Interim dividend per share	<b>7.0p</b>	6.4p
Cash (outflow)/inflow from operating activities	<b>£(185)m</b>	£448m
Net debt as defined by the Group <sup>7</sup>	<b>£(1,202)m</b>	£(316)m

### Highlights

- Sales<sup>2</sup> growth of 9%
- Underlying EBITA<sup>3</sup> up 14% to £1,114m
- Underlying earnings<sup>4</sup> per share increased by 14%
- Operating cash outflow of £185m
- Interim dividend increased by 9% to 7.0p per share
- £449m market purchase of shares

### Outlook

In aggregate, and despite a planned lower level of land vehicle activity, the Group continues to expect growth for 2010, based on constant exchange rate assumptions.

1 Restated following the sale of half of the Group's 20.5% shareholding in Saab AB (see note 4).

2 Including share of equity accounted investments.

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

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

5 Basic earnings/(loss) per share in accordance with International Accounting Standard 33.

6 Including share of equity accounted investments' order books and after the elimination of intra-group orders of £1.8bn (2009 £1.9bn).

7 See definition on page 4.

## INTERIM MANAGEMENT REPORT

BAE Systems has continued to perform well in the first half of 2010.

### **BAE Systems has continued to perform well in the first half of 2010. The first half year's performance continues to support the Group's previously stated outlook for the full year.**

Headline sales<sup>2</sup> growth in the six months was 9%. On a like-for-like basis, sales<sup>2</sup> increased by 7%. Growth in underlying EBITA<sup>3</sup> on a like-for-like basis was 12%. As anticipated, there was a cash outflow from operating activities of £185m.

The Group anticipates a challenging trading environment as governments look for cost savings to address budgetary pressures and enhance value for money. A substantial programme of cost reduction and efficiency improvements is already well underway within the Group to address such issues. This cost reduction programme, including a net headcount<sup>2</sup> reduction of 3,300 during the first half year, will be of sustained benefit to the Group's performance. It will also enhance competitiveness and deliver further improved value for customers.

Following a review of markets and customers' needs in the US, changes to the Group's organisation are being implemented to realign BAE Systems, Inc. to better deliver its strategy. Reductions in costs, benefiting both the Group and its customers, will flow from a simplified organisation. This will result in the business in the US being more competitive in a challenging environment and more agile in responding effectively to customer needs.

The US Quadrennial Defense Review (QDR) was released in early February. The accompanying US defence budget for Fiscal Year 2011 identified growth in the investment account allocations. The QDR restated the US's commitment to the large, next generation, F-35 Lightning II combat aircraft programme. BAE Systems, through both its US and UK businesses, is a significant participant on this programme.

A Strategic Defence and Security Review is underway in the UK and is expected to initially report in the Autumn. The review is expected to provide greater clarity as to the UK's defence and security priorities over the coming years.

As a key step in the Group's strategy to develop India as one of its home markets, a new, land systems-focused, joint venture defence company, Defence Land Systems India Private Limited, was formed with Mahindra & Mahindra Limited in April. BAE Systems has a 26% investment in the joint venture.

A key differentiator for BAE Systems in the defence and security markets is its substantial presence in customer support and services activities. These activities include provision of cyber and security services to, primarily, government customers, and readiness and sustainment business in the air, land and naval sectors of defence. The Group has successfully grown this customer support and services business, delivering enhanced capabilities whilst reducing costs for its customers.

In July, the Group completed the acquisition of Atlantic Marine Holding Company, a naval services and marine fabrication business, for \$352m (£235m). The business employs approximately 1,000 people at Mayport and Jacksonville, Florida,

Moss Point, Mississippi, and Mobile, Alabama. The acquisition will complement BAE Systems' existing ship repair and upgrade capabilities serving the US Navy. The Group anticipates continued strong demand for naval support capabilities in the US and the acquisition is consistent with BAE Systems' strategy to address anticipated growth in customer support and services activity in its home markets.

In June, BAE Systems completed the sale of half of its 20.5% shareholding in Saab AB for cash consideration of SEK1,041m (£92m). The sale of the Group's remaining investment in Saab is expected in due course.

BAE Systems announced in February a global settlement with the UK Serious Fraud Office and the US Department of Justice in connection with their long-running investigations. These settlements were reflected in the Group's 2009 published accounts. 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. In March, the Company paid a fine of \$400m (£266m) in respect of the settlement with the US Department of Justice and made additional commitments concerning its ongoing compliance. The Company has an ongoing dialogue with other US regulatory agencies in order to address their concerns regarding matters arising from the settlement with the Department of Justice.

### **Cash flow and balance sheet**

The cash outflow in the first half included the anticipated working capital outflow on the Salam programme following the Group's strong inflow in the second half of 2009. There were a number of other material movements, including the regulatory penalty of £266m and the repurchase of 127 million shares for £449m. The Group is in consultation with the trustees of its UK pension schemes and the Pensions Regulator to address any implications for the schemes arising from this repurchase programme. Total pension deficit funding for the period amounted to £182m, including £25m contributed into Trust for the benefit of the Group's main pension scheme. Net interest, tax and dividend payments totalled £700m. A cash inflow is anticipated in the second half of 2010.

The share repurchase has addressed the near-term inefficiency in the balance sheet. Going forward, the Group will continue with a balanced approach to capital allocation, addressing pension deficits, organic investment to develop the business, selective acquisitions, and a policy of progressive dividend growth. Whilst there are no current plans for a further share repurchase, such a programme remains an option for the Group.

### **Directors and management**

On 8 February 2010, Nick Rose was appointed a non-executive director of the Company. Phil Carroll, a non-executive director, retired from the Board on 5 May 2010 and Andy Inglis, also a non-executive director, retired from the Board on 9 July 2010.

## Summarised income statement – continuing operations

	Six months ended 30 June 2010 £m	Restated <sup>1</sup> Six months ended 30 June 2009 £m
<b>Sales<sup>2</sup></b>	<b>10,643</b>	9,747
<b>Underlying EBITA<sup>3</sup></b>	<b>1,114</b>	978
Loss on disposal of businesses	–	(9)
Regulatory penalties	<b>(18)</b>	–
<b>EBITA</b>	<b>1,096</b>	969
Amortisation of intangible assets	<b>(211)</b>	(154)
Impairment of intangible assets	<b>(8)</b>	(302)
Finance costs <sup>2</sup>	<b>(66)</b>	(528)
Taxation expense <sup>2</sup>	<b>(240)</b>	(48)
<b>Profit/(loss) for the period</b>	<b>571</b>	(63)
Underlying earnings <sup>4</sup> per share	<b>20.4p</b>	17.9p
Basic earnings/(loss) per share <sup>5</sup>	<b>16.1p</b>	(2.1)p
Dividend per share	<b>7.0p</b>	6.4p

## Exchange rates

	Six months ended 30 June 2010	Six months ended 30 June 2009
£/\$ – average	<b>1.524</b>	1.493
£/\$ – period end	<b>1.497</b>	1.647
£/€ – average	<b>1.150</b>	1.119
£/€ – period end	<b>1.221</b>	1.174

## Segmental analysis – continuing operations

	Sales <sup>2</sup>		Underlying EBITA <sup>3</sup>	
	Six months ended 30 June 2010 £m	Restated <sup>1</sup> Six months ended 30 June 2009 £m	Six months ended 30 June 2010 £m	Restated <sup>1</sup> Six months ended 30 June 2009 £m
Electronics, Intelligence & Support	<b>2,624</b>	2,862	<b>296</b>	268
Land & Armaments	<b>3,074</b>	3,219	<b>316</b>	262
Programmes & Support	<b>3,035</b>	2,399	<b>316</b>	277
International	<b>2,078</b>	1,416	<b>218</b>	160
HQ & Other Businesses	<b>141</b>	133	<b>(32)</b>	11
Intra-group	<b>(309)</b>	(282)	–	–
	<b>10,643</b>	9,747	<b>1,114</b>	978

## Income statement – continuing operations

**Sales<sup>2</sup>** in the first half of 2010 increased by 9% to £10,643m (2009 £9,747m). Like-for-like sales<sup>2</sup> growth, after adjusting for the impact of exchange translation, and acquisitions and disposals, was 7%. This was largely driven by deliveries of Typhoon aircraft and support to the Kingdom of Saudi Arabia.

**Underlying EBITA<sup>3</sup>** increased by 14% to £1,114m (2009 £978m). Return on sales increased to 10.5% (2009 10.0%).

**Regulatory penalties** of £18m (2009 £nil) reflects the US dollar exchange rate movement on payment of the global settlement of the regulatory investigation by the US Department of Justice.

**Impairment of intangible assets** in the prior period of £302m included £256m reflecting the weaker outlook for the US-based Products Group business and £34m relating to the discontinued financial services element of the Detica business.

**Net financial expense<sup>2</sup>** was £66m (2009 £528m). The underlying interest charge was £96m (2009 £89m). Net income of £30m (2009 net expense £439m) arose from pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements. The net expense in 2009 largely reflected the impact of movements in exchange rates on the unhedged element of an intercompany loan from the UK to the US business. That loan has subsequently been capitalised.

**Taxation expense<sup>2</sup>** reflects the Group's effective tax rate for the period of 29% (2009 28%).

**Underlying earnings<sup>4</sup> per share** for the period increased by 14% to 20.4p compared with 2009 (17.9p).

**Basic earnings per share<sup>5</sup>** for the period was 16.1p (2009 loss 2.1p).

## Discontinued operations

Following the sale of half of the Group's 20.5% shareholding in Saab AB, its share of the results of Saab are shown within discontinued operations for the current and prior periods.

Details are provided in note 4.

## Dividend per share

The Board has declared an interim dividend of 7.0p per share (2009 6.4p), representing an increase of 9%.

1 Restated following the sale of half of the Group's 20.5% shareholding in Saab AB (see note 4).

2 Including share of equity accounted investments.

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

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

5 Basic earnings/(loss) per share in accordance with International Accounting Standard 33.

## INTERIM MANAGEMENT REPORT CONTINUED

### Reconciliation of cash flow from operating activities to net cash/(debt)

	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m
Cash (outflow)/inflow from operating activities	(185)	448
Capital expenditure (net) and financial investment	(143)	(246)
Dividends received from equity accounted investments	24	14
Assets contributed to Trust	(25)	(125)
Operating business cash flow	(329)	91
Interest	(83)	(87)
Taxation	(257)	(233)
Free cash flow	(669)	(229)
Acquisitions and disposals	90	(7)
Debt acquired on acquisition of subsidiaries	–	(1)
Purchase of equity shares (net)	(466)	(20)
Equity dividends paid	(335)	(307)
Dividends paid to non-controlling interests	(25)	(5)
Cash (outflow)/inflow from matured derivative financial instruments	(82)	138
Movement in cash collateral	11	(13)
Movement in cash received on customers' account <sup>6</sup>	11	1
Foreign exchange	(227)	260
Other non-cash movements	87	(172)
Movement in net cash/(debt) as defined by the Group	(1,605)	(355)
Opening net cash as defined by the Group	403	39
<b>Closing net debt as defined by the Group</b>	<b>(1,202)</b>	<b>(316)</b>

### Components of net debt as defined by the Group

	2010	2009
Debt-related derivative financial assets	108	31
Other investments – current	246	49
Cash and cash equivalents	2,492	3,007
Loans – non-current	(2,978)	(3,144)
Loans and overdrafts – current	(800)	(129)
Cash received on customers' account <sup>6</sup>	(9)	(6)
Less: Assets held in Trust	(261)	(124)
<b>Net debt as defined by the Group</b>	<b>(1,202)</b>	<b>(316)</b>

### Operating business cash flow

	Six months ended 30 June 2010 £m	Restated <sup>1</sup> Six months ended 30 June 2009 £m
Electronics, Intelligence & Support	267	127
Land & Armaments	465	164
Programmes & Support	(50)	(47)
International	(553)	122
HQ & Other Businesses	(462)	(278)
Discontinued operations	4	3
<b>Operating business cash flow</b>	<b>(329)</b>	<b>91</b>

### Cash flows

**Cash outflow from operating activities** was £185m (2009 inflow £448m) reflecting working capital utilisation in the International operating group primarily on the Salam programme and the payment of the regulatory penalty to the US Department of Justice (£266m). Additional contributions into the UK pension schemes were £81m (2009 £74m).

There was an outflow from **net capital expenditure and financial investment** of £143m (2009 £246m). 2009 included £50m in respect of new residential and office facilities in Saudi Arabia.

**Dividends from equity accounted investments**, primarily Eurofighter, FNSS and Saab, amounted to £24m (2009 £14m).

**Assets contributed to Trust** comprises £25m of payments made into Trust during the period for the benefit of the Group's main pension scheme (2009 £125m).

**Acquisitions and disposals** in the period mainly comprises the proceeds from the disposal of half of the Group's 20.5% shareholding in Saab (£92m).

The **net purchase of equity shares** of £466m (2009 £20m) includes 127 million shares purchased under the buyback programme announced in February at a cost of £449m.

**Foreign exchange** translation during the period, primarily in respect of the Group's US dollar-denominated borrowing, increased reported net debt by £227m.

### Net debt

The Group's net debt at 30 June 2010 was £1,202m (2009 £316m), a net outflow of £1,605m from the net cash position of £403m at the start of the period.

A \$500m 4.75% bond is due to be repaid in August 2010. This repayment, together with a \$1bn 6.4% bond due to be repaid in 2011, has been financed by the \$1.5bn raised in the US bond market in 2009.

### Going concern

After making due enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue operational existence for the foreseeable future and therefore continue to adopt the going concern basis in preparing the accounts.

### Principal risks

The principal risks facing the Group for the remaining six months of the year are unchanged from those reported in the Annual Report 2009.

These risks, together with the Group's risk management process, are detailed on pages 48 to 51 of the Annual Report 2009, and relate to the following areas:

- defence spending;
- large contracts;
- government contracts;
- contract timing;
- fixed-price contracts;
- component availability, subcontractor performance and key suppliers;
- global market;
- export controls and other restrictions;
- consortia and joint ventures;
- competition;
- pension funding;
- acquisitions;
- laws and regulations; and
- exchange rates.

<sup>6</sup> Cash received on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance. It is included within trade and other payables in the Group's balance sheet.

## ELECTRONICS, INTELLIGENCE & SUPPORT

Electronics, Intelligence & Support, with 30,500 employees<sup>1</sup>, provides a wide range of electronic systems and subsystems for military and commercial applications, technical and professional services for US national security and federal markets, and ship repair and modernisation services.

	Six months ended 30 June 2010	Six months ended 30 June 2009	Year ended 31 December 2009
Sales <sup>1</sup>	<b>£2,624m</b>	£2,862m	£5,637m
Underlying EBITA <sup>2</sup>	<b>£296m</b>	£268m	£575m
Return on sales	<b>11.3%</b>	9.4%	10.2%
Cash inflow <sup>3</sup>	<b>£267m</b>	£127m	£380m
Order intake <sup>1</sup>	<b>£2,674m</b>	£2,781m	£5,416m
Order book <sup>1</sup>	<b>£4.8bn</b>	£4.5bn	£4.5bn

In the first half of 2010, Electronics, Intelligence & Support achieved underlying EBITA<sup>2</sup> of £296m, an increase of 10% over 2009, on sales<sup>1</sup> of £2,624m (2009 £2,862m) and generated an operating cash inflow<sup>3</sup> of £267m (2009 £127m).

On a like-for-like basis, sales<sup>1</sup> declined in the first half year by 7% primarily reflecting the impact of contracting delays caused by the extended continuing resolution funding at the end of 2009. Return on sales increased to 11.3% (2009 9.4%) reflecting good programme execution, and ongoing cost reduction and efficiency programmes.

### Electronic Solutions

The F-35 Lightning II System Development and Demonstration programme completed its first mission systems flight test in March. BAE Systems is performing well in Low-Rate Initial Production of electronic warfare suites and other subsystems.

US Army orders for the Common Missile Warning System totalled \$34m (£23m) in the first half and combat flight time reached 1.4 million hours. In addition, through a Quick Reaction Capability programme, the US Army selected an advanced laser-based version of the system valued at \$62m (£41m).

The Driver's Vision Enhancer Family of Systems, which delivers improvements in safety and mission effectiveness for ground vehicles, completed hardware qualification. Production deliveries are underway with sales of \$53m (£35m) in the period. In addition, the combat-proven Check-6<sup>®</sup> thermal camera system, which incorporates infrared cameras in vehicle taillights, generated \$80m (£52m) in hardware deliveries.

### Information Solutions

The Information Solutions business received contracts worth up to \$500m (£334m) over a five-year period for information technology services from the US intelligence community. These represent a wide range of intelligence and security solutions and services, including support to cybersecurity and intelligence missions.

The re-compete of the US Air Force's contract for enterprise mission planning solutions was won in the period. These solutions provide aircrews with enhanced capabilities for flight, refuelling, airdrop and electronic combat planning through the integration of Global Positioning System, aircraft flight performance, and target and intelligence threat data. The anticipated contract value is \$165m (£110m) over five years.

BAE Systems was selected to provide joint intelligence, surveillance and reconnaissance capabilities through the US Navy's Distributed Common Ground System, which links ships and shore sites to a national intelligence network. The initial award of \$80m (£53m) is expected to grow throughout the five-year contract term.

### Platform Solutions

In June, the business secured an extension to 2019 from 2012 on a long-term agreement with Boeing to supply and support original

equipment commercial electronics on Boeing 737, 747, 767 and 777 aircraft, with a potential value of some \$800m (£534m).

The business continues to expand in the urban transit market, delivering its first HybriDrive<sup>®</sup> propulsion system to British bus builder Alexander Dennis Limited under the UK Green Bus Fund initiative. In the US, the business began developing a hydrogen fuel cell system for SunLine Transit and delivered its first production bus to the Seattle transit system. More than 2,500 buses using HybriDrive<sup>®</sup> technology now carry more than a million passengers daily.

Addressing the military's increasing demand for electric power, BAE Systems was selected to develop an onboard vehicle power management system for US Marine Corps High Mobility Multipurpose Wheeled Vehicles. The system, currently used on the US Army's Paladin Integrated Management vehicle, more than doubles the vehicles' electric power and provides exportable power for a variety of uses.

The business also announced its entry into the European and North American rail markets with advanced propulsion and power management technology that offers improved system performance, lighter weight and greater energy efficiency.

### Support Solutions

The US Ship Repair business received a multi-ship, multi-option US Navy contract for executing planning, modernisation, maintenance and repair work on 11 Arleigh Burke-class destroyers. The contract has a potential value of \$365m (£244m).

In July, BAE Systems completed the acquisition of Atlantic Marine Holding Company, a naval services and marine fabrication business with four sites in the US.

The business continues to perform on three significant US defence programmes with a combined potential value of more than \$900m (£601m): the Human Terrain Teams programme that supports urgent needs for recruitment, development and operational support of US counterinsurgency efforts; the counter-Improvised Explosive Device (IED) programme providing operations and mission support; and the US Navy C4ISR<sup>4</sup> programmes providing operations support.

The business received a \$95m (£63m) contract to upgrade security systems at US Army bases. Sophisticated scanning equipment will record information on approaching vehicles, check vehicle owner backgrounds and forward the information to a network of federal databases.

### Looking forward

The business remains focused on winning strategic contracts in information technology, cyber, and support and services. The business will continue to capitalise on its leadership in electronic warfare and infrared technologies, and expand its diverse mix of commercial and civil government business in areas such as ship repair and information technology.

1 Including share of equity accounted investments.

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

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

4 Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance.

## LAND & ARMAMENTS

The Land & Armaments operating group, with 18,300 employees<sup>1</sup> and headquartered in the US, designs, develops, produces, supports and upgrades combat vehicles, tactical wheeled vehicles, naval guns, missile launchers, artillery systems, munitions and law enforcement products.

	Six months ended 30 June 2010	Six months ended 30 June 2009	Year ended 31 December 2009
Sales <sup>1</sup>	<b>£3,074m</b>	£3,219m	£6,738m
Underlying EBITA <sup>2</sup>	<b>£316m</b>	£262m	£604m
Return on sales	<b>10.3%</b>	8.1%	9.0%
Cash inflow <sup>3</sup>	<b>£465m</b>	£164m	£480m
Order intake <sup>1</sup>	<b>£1,734m</b>	£1,990m	£3,934m
Order book <sup>1</sup>	<b>£6.9bn</b>	£9.3bn	£7.8bn

In the first half of 2010, Land & Armaments achieved underlying EBITA<sup>2</sup> of £316m, an increase of 21% over 2009, on sales<sup>1</sup> of £3,074m (2009 £3,219m). Operating cash inflow<sup>3</sup> was strong at £465m (2009 £164m).

On a like-for-like basis, sales<sup>1</sup> for the first six months decreased by 5%. Return on sales increased to 10.3% (2009 8.1%) benefiting from both performance on the Family of Medium Tactical Vehicles (FMTV) programme, and continuing rationalisation and efficiency programmes. Underlying EBITA<sup>2</sup> in the prior period included £42m of costs associated with the unsuccessful Mine Resistant Ambush Protected (MRAP) All-Terrain Vehicles (ATV) bid.

### United States

BAE Systems' support of the US Army Heavy Brigade Combat Team continued, with the business providing re-manufacture, reset and support for a large installed base. The Group was awarded \$242m (£162m) in contracts for Bradley Fighting Vehicles and \$56m (£37m) in contracts for the M113 in the first half of 2010.

In partnership with Northrop Grumman, the bid for the technology development phase of the US Army's new Ground Combat Vehicle programme was submitted in May.

New-build MRAP contracts were secured, with \$64m (£43m) for the supply of 58 RG33s for US armed forces and \$213m (£142m) for associated support work.

The personnel protection systems business secured \$132m (£88m) in contracts for individual soldier equipment, including Modular Lightweight Load-Carrying Equipment and 120,000 lightweight helmets for US armed forces.

BAE Systems is currently performing ahead of contract on the FMTV programme, delivering 4,586 vehicles in the first six months of the year. The programme will complete in early 2011. The impairment to goodwill and intangible assets arising from the loss of the follow-on contract was reflected in the Group's 2009 published accounts.

### United Kingdom

In the munitions business, the 15-year partnership with the UK Ministry of Defence (MoD) continues to progress successfully with a schedule adherence rate in excess of 99%. Delivery rates on small arms ammunition continued at an average of one million rounds per day in support of current operations.

The vehicles business secured a strategic win with a contract for qualification of the CTA International 40mm cased telescoped cannon and ammunition for use by the British and French armies.

The Terrier engineering vehicle development and production programme continues on schedule with the manufacture of the first production hull in January. The business continues to work closely with the MoD to complete reliability trials.

On the Engineering Tank System contract, operational fielding of the Trojan vehicle has been achieved ahead of schedule and it is performing well, delivering critical capability to the British Army.

In March, the UK government announced that it had not selected BAE Systems' proposal for the Future Rapid Effect System (FRES) Specialist Vehicles requirement.

### Sweden

In the first half year, the business secured a £135m contract for 48 Archer 155mm self-propelled artillery gun systems for the Swedish and Norwegian armed forces.

The business delivered the last of 24 BvS10 Viking mine protected vehicles in the new up-armoured Mk 2 variant to the UK MoD. Production continues on BvS10 Mk 2 vehicles for the French armed forces. Deliveries and support of the CV90 vehicle continue to customers around the world, including the Netherlands, Denmark and the Swedish Defence Materiel Administration (FMV).

BAE Systems has submitted a bid on the new Armoured Wheeled Vehicle programme for the FMV following its successful legal appeal against the previous award. The proposed vehicle is a modular 8x8 named Alligator.

### South Africa

The South African business continued to deliver mine protected RG vehicles to customers around the world, securing a new, \$8m (£5m) order for 16 RG32 vehicles from Finland, as well as an additional 250 RG31 MRAP vehicle order to the US worth \$173m (£116m).

Building on the success of the RG range of vehicles, the business has also designed and built a new RG41 8x8 mine protected vehicle which was displayed in June at the Eurosatory show in Paris.

### Joint ventures

FNSS, a 49% owned joint venture with Nurol Group of Turkey, has signed a letter of intent for approximately \$500m (£334m) with DEFTECH of Malaysia for the design and manufacture of 250 DEFTECH AV-8 armoured wheeled vehicles for the Malaysian armed forces.

### Looking forward

As previously anticipated, sales will reduce in 2011 on completion of the current US FMTV contract and a lower level of Bradley reset activity.

In the near term, Land & Armaments is focused on delivering value through bottom line performance driven by ongoing restructuring and continuous improvement programmes that will also retain an agile competitive position. The business will continue to make selective investments and develop clear discriminators across its global markets to win key programmes that drive long-term value as both an Original Equipment Manufacturer and a provider of readiness and sustainment solutions. This focused approach is improving the profit margins of the business.

## PROGRAMMES & SUPPORT

The Programmes & Support operating group, with 32,400 employees<sup>1</sup>, primarily comprises the Group's UK-based air, naval and security activities.

	Six months ended 30 June 2010	Six months ended 30 June 2009	Year ended 31 December 2009
Sales <sup>1</sup>	<b>£3,035m</b>	£2,399m	£6,298m
Underlying EBITA <sup>2</sup>	<b>£316m</b>	£277m	£670m
Return on sales	<b>10.4%</b>	11.5%	10.6%
Cash (outflow)/inflow <sup>3</sup>	<b>£(50)m</b>	£(47)m	£285m
Order intake <sup>1</sup>	<b>£2,441m</b>	£3,916m	£8,789m
Order book <sup>1</sup>	<b>£23.7bn</b>	£21.2bn	£24.3bn

In the first half of 2010, Programmes & Support achieved underlying EBITA<sup>2</sup> of £316m (2009 £277m) on sales<sup>1</sup> of £3,035m (2009 £2,399m), generating a return on sales of 10.4% (2009 11.5%).

On a like-for-like basis, the sales<sup>1</sup> growth of 16% over the first half of 2009 is largely due to increased aircraft deliveries and support on the Saudi Typhoon programme, and increased activity on the Type 45 destroyer and Queen Elizabeth Class carrier contracts.

### Military Air Solutions

Deliveries of Typhoon aircraft to the four European partner nations, Austria and the Royal Saudi Air Force totalled 17 aircraft in the first half of the year, bringing the cumulative total to 225. Upgrade work on Tranche 1 aircraft continues to provide the UK Royal Air Force (RAF) with increased operational capability.

In the period, the business has secured a number of customer support and services contracts.

A five-year, £150m contract was awarded for the delivery of Typhoon Avionics Equipment Repair to the air forces of Germany, Spain and the UK. Combined with the £400m Radar and Defensive Aids Sub-System (DASS) contract awarded last year, this halves the customer's avionic repair through-life support costs for Typhoon.

A four-year contract was awarded for Hawk Mk128 Advanced Jet Trainer (AJT) fleet availability for training the RAF's future fast jet pilots at RAF Valley.

Aircraft acceptances of the Hawk AJT for the RAF continue to progress, with 24 of 28 accepted as at 30 June 2010.

BAE Systems is expected to play a significant role as a supplier in the follow-on licence build programme for 57 Indian Hawk AJT aircraft.

The first Nimrod production MRA4 has now been accepted by the UK customer and support to initial RAF crew training has commenced.

The main focus for the F-35 Lightning II programme is now Low-Rate Initial Production (LRIP). With all development aircraft and the first two LRIP lots delivered, production has now started on LRIP Lot 3, which includes the first two UK Operational Test & Evaluation Aircraft. At the structural test facility in Brough, the first F-35 airframe successfully completed its test schedule ahead of programme. The business continues to lead the Short Take Off and Vertical Landing (STOVL) flight-test programme in the US where the first vertical landing and first flight of the Carrier variant have been achieved.

BAE Systems continues to leverage its expertise and capabilities in Unmanned Aircraft Systems. Successful flight trials of the Mantis

advanced technology demonstrator programme have taken place and overseas trials of the Herti utility unmanned aircraft system continue.

Headcount reductions identified by the business during 2009 are underway.

### BAE Systems Surface Ships

On the Type 45 programme, the first two ships, HMS Daring and HMS Dauntless, continue to be supported under the Type 45 Support contract as they undergo final Royal Navy trials prior to entry into service. The other four ships remain on schedule.

Design and construction of the first of the two Queen Elizabeth Class aircraft carriers, HMS Queen Elizabeth, is progressing with the build of the mid-ship and stern blocks in Glasgow and Portsmouth well advanced. In excess of £1.2bn of contracts for key materials and equipment have been placed throughout the supply chain.

The export contracts for Oman and Trinidad & Tobago remain significantly behind contract schedule and are incurring additional losses. The fair values of these contracts at acquisition have been updated accordingly (see note 8). The first Oman vessel is in the final stages of integration, and the first of the Trinidad & Tobago ships has completed its sea trials and is undergoing acceptance.

Surface Ships continues to support the Royal Navy as its long-term partner in the management of the Portsmouth Naval Base and the Portsmouth-based fleet.

Under the 15-year Terms of Business Agreement with the UK MoD, the business is on target to exceed the minimum targeted efficiency savings over the period of the agreement.

In March, BAE Systems was awarded a four-year, £127m contract by the UK MoD to start development of a new generation of combat ships for the Royal Navy, the Type 26 class, to replace the existing Type 22 and Type 23 frigates currently in service.

### Submarine Solutions

Astute, the first of class submarine for the Royal Navy, continues her customer acceptance programme. Deep dive, and initial speed and noise trials have been undertaken during the period. Platform sea trials are forecast to complete at the end of 2010, when the boat will be handed over to the customer. The second boat, Ambush, is scheduled to be launched at the end of the year. Construction of the third and fourth boats, Artful and Audacious, is underway.

A £360m order to commence construction of the fifth Astute class submarine and long lead procurement for the sixth boat has been received. Follow-on orders for Astute are key to retaining the skill base necessary to design and build the next-generation nuclear deterrent submarine.

1 Including share of equity accounted investments.

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

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

## PROGRAMMES & SUPPORT *CONTINUED*

### **Detica**

Detica's national security business, which focuses on cybersecurity and information assurance, countering terrorism and organised crime, and border security, continues to deliver sales growth in the UK market despite increased government budgetary pressures.

Detica's experience in innovative digital technologies has secured a new framework contract with the Technology Strategy Board as a partner to help shape, deliver and enable the UK government's Digital Britain programme. Detica continues to deliver existing system integration contracts into the Metropolitan Police Service and HM Revenue and Customs.

On 22 July 2010, the Home Office terminated the e-Borders contract. As a subcontractor on that programme, the business is currently evaluating the implications.

The Detica NetReveal® solution for detecting fraud and organised crime continues to deliver global sales growth.

By combining its security domain knowledge, information intelligence products, and investment in new systems integration and managed-service capabilities, Detica has started to reposition its UK business as a trusted solution integrator to help customers deliver their critical business services more effectively and economically.

### **Integrated System Technologies (Insyte)**

The Falcon secure deployable broadband communication system for the British Army and RAF is undertaking its Technical Field Evaluation, prior to System Field Trials and acceptance of the equipment into service.

The Seawolf mid-life update programme continues on the first of class Type 22 frigate, with 'In Service' declaration on schedule for the second half of 2010.

The business has offered a re-baselined Maritime Composite Training System technical solution to the MoD and a revised date for the commencement of full training services is planned for the second half of 2011.

The Artisan 3D Medium Range Radar programme is progressing to schedule and successfully passed the Critical Design Review, a key milestone, in June.

The Sting Ray lightweight torpedo main production order for the Royal Navy completed production deliveries in May. The delivery contract for the government of Norway is meeting schedule.

The Insyte redundancy programme for 642 people announced in November 2009 will fully complete in 2011.

### **Looking forward**

Programmes & Support is driven by its existing order book and the level of future UK MoD funding to meet current UK armed forces operational requirements. The Strategic Defence and Security Review initiated by the newly-elected government is expected to have a significant influence on future UK defence spending priorities. However, the Group is well positioned with a strong order book of long-term committed programmes, an enduring support business and cost reduction programmes in place.

In Military Air Solutions, growth is linked to increased combat aircraft production activity and in-service support performance both in the UK and on export programmes.

Surface Ships is underpinned by the Type 45 destroyer programme, the manufacturing phase of the Queen Elizabeth Class carrier programme, export contracts and the 15-year Terms of Business Agreement with the UK MoD.

The Submarine Solutions business remains focused on the Astute programme and the delivery of the concept design for the Vanguard Successor programme, the replacement submarine to deliver the UK deterrent capability.

Although government budgetary pressures are expected to continue, Detica is positioned to benefit from continued focus on intelligence, security and resilience both in the UK and overseas markets.

## INTERNATIONAL

The International operating group, with 17,200 employees<sup>1</sup>, comprises the Group's businesses in Saudi Arabia, Australia, India and Oman, together with a 37.5% interest in the pan-European MBDA joint venture and a 49% shareholding in Air Astana.

	Six months ended 30 June 2010	Restated <sup>4</sup> Six months ended 30 June 2009	Restated <sup>4</sup> Year ended 31 December 2009
Sales <sup>1</sup>	<b>£2,078m</b>	£1,416m	£3,828m
Underlying EBITA <sup>2</sup>	<b>£218m</b>	£160m	£419m
Return on sales	<b>10.5%</b>	11.3%	10.9%
Cash (outflow)/inflow <sup>3</sup>	<b>£(553)m</b>	£122m	£813m
Order intake <sup>1</sup>	<b>£1,092m</b>	£2,376m	£4,564m
Order book <sup>1</sup>	<b>£9.6bn</b>	£10.8bn	£11.0bn

In the first half of 2010, International achieved underlying EBITA<sup>2</sup> of £218m (2009 £160m) on sales<sup>1</sup> of £2,078m (2009 £1,416m), generating a return on sales of 10.5% (2009 11.3%).

On a like-for-like basis, sales<sup>1</sup> growth of 41% was achieved both in Saudi Arabia, reflecting increased trading across the Saudi British Defence Co-operation Programme (SBDCP), and in Australia, predominantly for progress on the Landing Helicopter Dock programme. The 10.5% return on sales is broadly consistent with the second half of 2009.

The cash outflow of £553m in the period reflects an increase in working capital on the Salam programme.

### Saudi Arabia

BAE Systems has a major presence in the Kingdom of Saudi Arabia (KSA). It acts as a prime contractor for the UK/KSA government-to-government defence agreement and also holds certain direct contracts with the Saudi government. Progress remains ongoing to modernise the Saudi armed forces in line with the Understanding Document signed in December 2005 between the UK and KSA governments.

Around 5,200 people are employed by the Group in KSA of whom approximately half are Saudi Nationals. The business remains committed to developing a greater indigenous capability in the Kingdom. This is being enhanced by the entry into service of the Typhoon aircraft and associated development of the Typhoon industrial base in Saudi Arabia.

Of the 72 Typhoon aircraft contracted in 2007 under the Salam programme, 12 have been delivered to date. Performance against the initial support solution remains on programme.

The business continues to support the operational capability of both the Royal Saudi Air Force and Royal Saudi Naval Force through the SBDCP. Discussions have commenced with the customer on the next phase of the SBDCP which will commence in January 2012. It is expected that the customer will place greater emphasis on performance-based availability contracting.

The C4i<sup>5</sup> programme continues to be challenging and discussions are continuing with the customer to agree a suitable way forward, in particular on the solution definition to meet the customer's requirement.

Tactica land vehicles continue to be delivered to the Saudi Arabia National Guard and work has commenced under the Tactica

Support contract as they enter service. The business continues to look to secure further opportunities in support of the Royal Saudi Land Forces' programme of capability enhancements and equipment upgrades.

### Australia

The business continues to engage fully with its major customer, the Australian Defence Materiel Organisation, to achieve the significant efficiencies and savings required under the Australian government's Strategic Reform Programme.

Construction of the first of 36 modules that will form the hulls of the three new Air Warfare Destroyers is underway. The programme to deliver two Landing Helicopter Dock ships to the Royal Australian Navy is also progressing.

During the period, two Offshore Patrol Vessels were handed over to the Royal New Zealand Navy, completing deliveries under the Protector contract.

The business is a sub-contractor to Boeing on the Wedgetail Airborne Early Warning and Control aircraft programme. The business has now completed development of the electronic support measures and electronic warfare self-protection subsystems, and will continue to support Boeing to achieve customer acceptance of both systems around the end of the year.

The business was not down-selected as a preferred tenderer for the Land 121 Phase 3 project to supply medium and heavy tactical vehicles to the Australian Defence Force.

The completion accounting process continues with the former owners of the Tenix Defence business in Australia.

### MBDA (37.5% interest)

MBDA achieved important new orders in the first half of 2010 on UK Team Complex Weapons, especially the development and early manufacture contract for Fire Shadow Loitering Munition, and the assessment phase, the development and early manufacture for SPEAR (Selectable Precision Effects At Range) weapons, and other assessment phases for other programmes.

Key domestic deliveries so far this year included Mica air-to-air missiles and Taurus stand-off missiles. In addition, key export deliveries included Exocet anti-ship missiles, Mistral surface-to-air missiles and Milan anti-armour missiles.

1 Including share of equity accounted investments.

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

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

4 Restated following the sale of half of the Group's 20.5% shareholding in Saab AB (see note 4).

5 Command, Control, Communications, Computers and Intelligence.

## INTERNATIONAL CONTINUED

Development programmes continue to progress well with significant milestones being passed on the Naval Cruise Missile programme, MEADS air-defence programme, Meteor air-to-air missile programme and all assessment phases of the Team Complex Weapons programme.

The cause of issues which arose during last year's Sea Viper firings has been investigated and identified. A rectification plan has been established and is progressing. In June, successful trials test firing of the Aster missile validated modifications to the munition and enabled the programme to move forward towards test firings from the Type 45 destroyer later this year.

### India

The business continues to develop its position in India, the Group's seventh home market, with the objective of becoming an integral part of the Indian defence industry. It is actively pursuing a number of large programmes in India that are expected to be awarded over the coming years.

In the land sector, Defence Land Systems India Private Limited, the joint venture with Mahindra & Mahindra, started operations in April. The joint venture has a number of existing products and also launched a new vehicle, the Mine Protected Vehicle India. BAE Systems is also participating in trials for the competitive procurement of M777 Ultra Lightweight Howitzers and towed FH-77B 155mm howitzers.

### Oman

The business has strengthened its presence in Oman during the period and significant activity is ongoing to agree an order for the supply of Typhoon aircraft to the Royal Air Force of Oman. A number of other longer term prospects are being pursued, and the business is also developing strategies to improve its customer support and services offerings across the significant installed and anticipated future product base.

### Looking forward

In Saudi Arabia, the Group seeks to sustain its long-term presence through current programmes and industrialisation plans, and developing new business, including in the land sector.

The Australian business will continue to work closely with its customer to address the impacts of the Strategic Reform Programme and is well-positioned to participate in increased customer support and services opportunities.

The strong order book of MBDA has been further enhanced in the period.

Progress has been made to establish a position from which to address growth opportunities in India as the Group's seventh home market.

## HQ & OTHER BUSINESSES

HQ & Other Businesses, with 2,500 employees<sup>1</sup>, comprises the regional aircraft asset management and support activities, head office and UK shared services activity, including research centres and property management.

	Six months ended 30 June 2010	Six months ended 30 June 2009	Year ended 31 December 2009
Sales <sup>1</sup>	<b>£141m</b>	£133m	£254m
Underlying EBITA <sup>2</sup>	<b>£(32)m</b>	£11m	£(71)m
Cash outflow <sup>3</sup>	<b>£(462)m</b>	£(278)m	£(366)m
Order intake <sup>1</sup>	<b>£108m</b>	£100m	£175m
Order book <sup>1</sup>	<b>£0.4bn</b>	£0.4bn	£0.4bn

In the first half of 2010, HQ & Other Businesses reported an underlying loss<sup>2</sup> of £32m (2009 profit<sup>2</sup> £11m) and had an operating cash outflow<sup>3</sup> of £462m (2009 £278m).

The Regional Aircraft business reported underlying EBITA<sup>2</sup> of £17m (2009 £39m).

The operating cash outflow<sup>3</sup> of £462m (2009 £278m) includes the payment of the regulatory penalty to the US Department of Justice (£266m).

### Regional Aircraft

Conditions in the commercial aviation sector remain challenging, but the business has secured 21 aircraft placements to new and existing customers in the period. Lease and sale discussions continue with operators with regard to current and future fleet requirements and support needs. Marketing activity continues to focus on both uncontracted idle aircraft and those returning off lease.

Whilst market conditions have impacted airline profitability and the levels of financing available to airlines globally, the portfolio customer base remains relatively robust and the business continues to closely monitor operator performance against default risk.

Support revenues have remained under pressure reflecting the current trading conditions. This has been offset by good performance within the engineering business and a reduced cost base.

The balance sheet carrying value of aircraft in the Regional Aircraft business (£189m) is based on the net present value of forecast net leasing or disposal income.

### Looking forward

Trading conditions are anticipated to remain challenging given the economic downturn and availability of credit to operators.

<sup>1</sup> Including share of equity accounted investments.

<sup>2</sup> Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 3).

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

## RESPONSIBILITY STATEMENT

Each of the directors (as detailed opposite) confirms that, to the best of his/her knowledge, this condensed set of financial statements has been prepared in accordance with International Accounting Standard (IAS) 34, *Interim Financial Reporting*, as adopted by the European Union, and that the interim management report herein includes a fair review of the information required by the Disclosure and Transparency Rules of the UK's Financial Services Authority, paragraphs DTR 4.2.7R and DTR 4.2.8R.

For and on behalf of the directors:

**R L Olver** *Chairman*

28 July 2010

### Directors

Dick Olver	Chairman
Ian King	Chief Executive
Linda Hudson	President and Chief Executive Officer of BAE Systems, Inc.
George Rose	Group Finance Director
Paul Anderson	Non-executive director
Michael Hartnall	Non-executive director
Sir Peter Mason	Non-executive director
Roberto Quarta	Non-executive director
Nick Rose	Non-executive director
Carl Symon	Non-executive director
Ravi Uppal	Non-executive director

## INDEPENDENT REVIEW REPORT TO BAE SYSTEMS PLC

### Introduction

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2010 which comprises the Condensed Consolidated Income Statement, the Condensed Consolidated Statement of Comprehensive Income, the Condensed Consolidated Statement of Changes in Equity, the Condensed Consolidated Balance Sheet, the Condensed Consolidated Cash Flow Statement and the related explanatory notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the Disclosure and Transparency Rules (the DTR) of the UK's Financial Services Authority (the UK FSA). Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

### Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FSA.

The annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union (EU). The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with IAS 34, *Interim Financial Reporting*, as adopted by the EU.

### Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

### Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2010 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA.

### A G Cates

#### for and on behalf of KPMG Audit Plc

Chartered Accountants

8 Salisbury Square

London

EC4Y 8BB

28 July 2010

## CONDENSED CONSOLIDATED INCOME STATEMENT

	Notes	Six months ended 30 June 2010		Restated <sup>1</sup> Six months ended 30 June 2009		Restated <sup>1</sup> Year ended 31 December 2009	
		£m	£m	£m	£m	£m	£m
<b>Continuing operations</b>							
<b>Combined sales of Group and equity accounted investments</b>	2	<b>10,643</b>		9,747		21,990	
Less: share of sales of equity accounted investments	2	(479)		(655)		(1,616)	
<b>Revenue</b>	2	<b>10,164</b>		9,092		20,374	
<b>Operating costs</b>		<b>(9,416)</b>		(8,718)		(20,060)	
<b>Other income</b>		<b>67</b>		61		465	
<i>Group operating profit excluding amortisation and impairment of intangible assets</i>							
		<b>1,034</b>		891		2,038	
Amortisation	2	(211)		(154)		(286)	
Impairment	2	(8)		(302)		(973)	
<b>Group operating profit</b>		<b>815</b>		435		779	
<i>Share of results of equity accounted investments excluding finance costs and taxation expense</i>							
		<b>62</b>		78		210	
Financial income of equity accounted investments	3	2		16		2	
Taxation expense of equity accounted investments		(13)		(22)		(25)	
<b>Share of results of equity accounted investments</b>		<b>51</b>		72		187	
<i>EBITA<sup>2</sup> excluding non-recurring items</i>							
	2	<b>1,114</b>		978		2,197	
(Loss)/profit on disposal of businesses <sup>3</sup>	2	–		(9)		68	
Pension curtailment gains <sup>3</sup>	2	–		–		261	
Regulatory penalties <sup>4</sup>	2	(18)		–		(278)	
<i>EBITA<sup>2</sup></i>		<b>1,096</b>		969		2,248	
Amortisation	2	(211)		(154)		(286)	
Impairment	2	(8)		(302)		(973)	
Financial income of equity accounted investments	3	2		16		2	
Taxation expense of equity accounted investments		(13)		(22)		(25)	
<b>Operating profit</b>		<b>866</b>		507		966	
<b>Finance costs</b>	3						
Financial income		908		1,206		1,573	
Financial expense		(976)		(1,750)		(2,273)	
		<b>(68)</b>		(544)		(700)	
<b>Profit/(loss) before taxation</b>		<b>798</b>		(37)		266	
<b>Taxation expense</b>							
UK taxation		(94)		27		(105)	
Overseas taxation		(133)		(53)		(222)	
		<b>(227)</b>		(26)		(327)	
<b>Profit/(loss) for the period – continuing operations</b>		<b>571</b>		(63)		(61)	
<b>Profit/(loss) for the period – discontinued operations</b>	4	<b>54</b>		(7)		16	
<b>Profit/(loss) for the period</b>		<b>625</b>		(70)		(45)	
<b>Attributable to:</b>							
BAE Systems shareholders		<b>618</b>		(82)		(67)	
Non-controlling interests		<b>7</b>		12		22	
		<b>625</b>		(70)		(45)	
<b>Earnings/(loss) per share</b>							
	5						
Basic earnings/(loss) per share		<b>17.7p</b>		(2.3)p		(1.9)p	
Diluted earnings/(loss) per share		<b>17.7p</b>		(2.3)p		(1.9)p	
<b>Earnings/(loss) per share – continuing operations</b>							
	5						
Basic earnings/(loss) per share		<b>16.1p</b>		(2.1)p		(2.3)p	
Diluted earnings/(loss) per share		<b>16.1p</b>		(2.1)p		(2.3)p	

1 Restated following the sale of half of the Group's 20.5% shareholding in Saab AB (see note 4).

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.

3 Included in other income.

4 Included in operating costs.

## CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Restated <sup>1</sup> Year ended 31 December 2009 £m
<b>Profit/(loss) for the period</b>	<b>625</b>	<b>(70)</b>	<b>(45)</b>
<b>Other comprehensive income</b>			
Currency translation on foreign currency net investments:			
Subsidiaries	243	(307)	(246)
Equity accounted investments	(29)	(104)	(56)
Amounts charged to hedging reserve	(93)	(406)	(393)
Gain on revaluation of step acquisition	–	–	29
Net actuarial losses on defined benefit pension schemes:			
Subsidiaries	(595)	(1,480)	(2,008)
Equity accounted investments	(9)	(132)	(54)
Fair value movements on available-for-sale investments	14	(1)	2
Recycling of cumulative currency translation reserve on disposal	(17)	–	–
Recycling of cumulative net hedging reserve on disposal	(4)	–	–
Current tax on items taken directly to equity	18	31	76
Deferred tax on items taken directly to equity:			
Subsidiaries	194	494	565
Equity accounted investments	3	38	16
<b>Total other comprehensive income for the period (net of tax)</b>	<b>(275)</b>	<b>(1,867)</b>	<b>(2,069)</b>
<b>Total comprehensive income for the period</b>	<b>350</b>	<b>(1,937)</b>	<b>(2,114)</b>
<b>Attributable to:</b>			
Equity shareholders	343	(1,949)	(2,136)
Non-controlling interests	7	12	22
	<b>350</b>	<b>(1,937)</b>	<b>(2,114)</b>

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity holders of the parent					Non-controlling interests £m	Total equity £m
	Issued share capital £m	Share premium £m	Other reserves <sup>2</sup> £m	Retained earnings £m	Total £m		
At 1 January 2010 (restated <sup>1</sup> )	90	1,243	5,404	(2,141)	4,596	72	4,668
Profit for the period	–	–	–	618	618	7	625
Total other comprehensive income for the period (see above)	–	–	124	(399)	(275)	–	(275)
Share-based payments	–	–	–	26	26	–	26
Share options:							
Proceeds from shares issued	–	5	–	–	5	–	5
Purchase of own shares	–	–	–	(22)	(22)	–	(22)
Purchase of treasury shares	–	–	–	(464)	(464)	–	(464)
Other	–	–	–	–	–	2	2
Ordinary share dividends	–	–	–	(335)	(335)	(32)	(367)
<b>At 30 June 2010</b>	<b>90</b>	<b>1,248</b>	<b>5,528</b>	<b>(2,717)</b>	<b>4,149</b>	<b>49</b>	<b>4,198</b>
At 1 January 2009	90	1,238	5,974	(68)	7,234	55	7,289
(Loss)/profit for the period	–	–	–	(82)	(82)	12	(70)
Total other comprehensive income for the period (see above)	–	–	(704)	(1,163)	(1,867)	–	(1,867)
Share-based payments	–	–	–	22	22	–	22
Share options:							
Proceeds from shares issued	–	4	–	–	4	–	4
Purchase of own shares	–	–	–	(24)	(24)	–	(24)
Other	–	–	–	–	–	(2)	(2)
Ordinary share dividends	–	–	–	(307)	(307)	(5)	(312)
<b>At 30 June 2009</b>	<b>90</b>	<b>1,242</b>	<b>5,270</b>	<b>(1,622)</b>	<b>4,980</b>	<b>60</b>	<b>5,040</b>

1 Other reserves restated by £59m following changes to the provisional fair values recognised on acquisition of the 45% shareholding in BVT Surface Fleet Limited held by VT Group plc on 30 October 2009 (see note 8).

2 The net increase in other reserves in 2010 of £124m comprises translation reserve (£197m), less hedging reserve (£73m). The decrease in other reserves in 2009 of £1704m comprises translation reserve (£411m) and hedging reserve (£293m).

## CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	30 June 2010 £m	30 June 2009 £m	Restated <sup>1</sup> 31 December 2009 £m
<b>Non-current assets</b>				
Intangible assets		<b>11,547</b>	11,025	11,302
Property, plant and equipment		<b>2,632</b>	2,332	2,552
Investment property		<b>126</b>	110	111
Equity accounted investments		<b>687</b>	887	846
Other investments		<b>11</b>	6	6
Other receivables		<b>222</b>	178	201
Other financial assets		<b>204</b>	158	133
Deferred tax assets		<b>1,697</b>	1,414	1,517
		<b>17,126</b>	16,110	16,668
<b>Current assets</b>				
Inventories		<b>711</b>	1,023	887
Trade and other receivables including amounts due from customers for contract work		<b>3,964</b>	3,573	3,764
Current tax		<b>49</b>	16	17
Other investments		<b>246</b>	49	211
Other financial assets		<b>287</b>	219	216
Cash and cash equivalents		<b>2,492</b>	3,007	3,693
		<b>7,749</b>	7,887	8,788
<b>Total assets</b>	2	<b>24,875</b>	23,997	25,456
<b>Non-current liabilities</b>				
Loans		<b>(2,978)</b>	(3,144)	(2,840)
Trade and other payables		<b>(664)</b>	(536)	(522)
Retirement benefit obligations	6	<b>(5,261)</b>	(4,662)	(4,679)
Other financial liabilities		<b>(343)</b>	(240)	(261)
Deferred tax liabilities		<b>(8)</b>	–	(8)
Provisions		<b>(400)</b>	(447)	(377)
		<b>(9,654)</b>	(9,029)	(8,687)
<b>Current liabilities</b>				
Loans and overdrafts		<b>(800)</b>	(129)	(453)
Trade and other payables		<b>(8,956)</b>	(8,728)	(10,353)
Other financial liabilities		<b>(165)</b>	(206)	(94)
Current tax		<b>(598)</b>	(477)	(649)
Provisions		<b>(504)</b>	(388)	(552)
		<b>(11,023)</b>	(9,928)	(12,101)
<b>Total liabilities</b>		<b>(20,677)</b>	(18,957)	(20,788)
<b>Net assets</b>		<b>4,198</b>	5,040	4,668
<b>Capital and reserves</b>				
Issued share capital		<b>90</b>	90	90
Share premium		<b>1,248</b>	1,242	1,243
Other reserves		<b>5,528</b>	5,270	5,404
Accumulated losses		<b>(2,717)</b>	(1,622)	(2,141)
<b>Total equity attributable to equity holders of the parent</b>		<b>4,149</b>	4,980	4,596
<b>Non-controlling interests</b>		<b>49</b>	60	72
<b>Total equity</b>		<b>4,198</b>	5,040	4,668

1 Restated following changes to the provisional fair values recognised on acquisition of the 45% shareholding in BVT Surface Fleet Limited held by VT Group plc on 30 October 2009 (see note 8).

## CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Six months ended 30 June 2010 £m	Restated <sup>1</sup> Six months ended 30 June 2009 £m	Restated <sup>1</sup> Year ended 31 December 2009 £m
Profit/(loss) for the period – continuing operations	571	(63)	(61)
Profit/(loss) for the period – discontinued operations	54	(7)	16
<b>Profit/(loss) for the period</b>	<b>625</b>	<b>(70)</b>	<b>(45)</b>
Taxation expense	227	26	327
Share of results of equity accounted investments – continuing operations	(51)	(72)	(187)
Share of results of equity accounted investments – discontinued operations	(2)	7	(16)
Net finance costs	68	544	700
Depreciation, amortisation and impairment	393	607	1,600
Gain on disposal of property, plant and equipment	(6)	(5)	(17)
Loss/(gain) on disposal of businesses – continuing operations	–	9	(68)
Gain on disposal of businesses – discontinued operations	(52)	–	–
Cost of equity-settled employee share schemes	26	22	52
Movements in provisions	(54)	7	52
Decrease in liabilities for retirement benefit obligations	(112)	(105)	(657)
Decrease/(increase) in working capital:			
Inventories	228	(253)	6
Trade and other receivables	(109)	78	52
Trade and other payables	(1,366)	(347)	433
Cash (outflow)/inflow from operating activities	(185)	448	2,232
Interest paid	(97)	(115)	(250)
Interest element of finance lease rental payments	(1)	(2)	(2)
Taxation paid	(257)	(233)	(350)
<b>Net cash (outflow)/inflow from operating activities</b>	<b>(540)</b>	<b>98</b>	<b>1,630</b>
Dividends received from equity accounted investments – continuing operations	20	11	74
Dividends received from equity accounted investments – discontinued operations	4	3	3
Interest received	15	30	66
Purchase of property, plant and equipment	(159)	(238)	(483)
Purchase of investment property	(4)	–	–
Purchase of intangible assets	(11)	(19)	(42)
Proceeds from sale of property, plant and equipment	30	11	36
Proceeds from sale of investment property	1	–	–
Purchase of subsidiary undertakings	–	(9)	(357)
Cash and cash equivalents acquired with subsidiary undertakings	–	–	33
Purchase of equity accounted investments	(2)	–	(1)
Proceeds from sale of subsidiary undertakings	–	2	2
Proceeds from sale of equity accounted investments – continuing operations	–	–	70
Proceeds from sale of equity accounted investments – discontinued operations	92	–	–
Purchase of other deposits/securities	(26)	(50)	(209)
<b>Net cash outflow from investing activities</b>	<b>(40)</b>	<b>(259)</b>	<b>(808)</b>
Capital element of finance lease rental payments	(7)	(11)	(13)
Proceeds from issue of share capital	5	4	5
Purchase of treasury shares	(449)	–	–
Purchase of own shares	(22)	(24)	(25)
Equity dividends paid	(335)	(307)	(534)
Dividends paid to non-controlling interests	(25)	(5)	(5)
Cash (outflow)/inflow from matured derivative financial instruments	(82)	138	36
Cash inflow/(outflow) from movement in cash collateral	11	(13)	(11)
Cash inflow from loans	527	920	920
Cash outflow from repayment of loans	(248)	(79)	(133)
<b>Net cash (outflow)/inflow from financing activities</b>	<b>(625)</b>	<b>623</b>	<b>240</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(1,205)</b>	<b>462</b>	<b>1,062</b>
Cash and cash equivalents at 1 January	3,678	2,605	2,605
Effect of foreign exchange rate changes on cash and cash equivalents	8	(75)	11
<b>Cash and cash equivalents at end of period</b>	<b>2,481</b>	<b>2,992</b>	<b>3,678</b>
Comprising:			
Cash and cash equivalents	2,492	3,007	3,693
Overdrafts	(11)	(15)	(15)
<b>Cash and cash equivalents at end of period</b>	<b>2,481</b>	<b>2,992</b>	<b>3,678</b>

1. Restated following the sale of half of the Group's 20.5% shareholding in Saab AB (see note 4).

## NOTES TO THE CONDENSED HALF-YEARLY FINANCIAL STATEMENTS

### 1. Accounting policies

#### Basis of preparation and statement of compliance

These condensed consolidated half-yearly financial statements of BAE Systems plc (the Group) have been prepared in accordance with International Accounting Standard (IAS) 34, *Interim Financial Reporting*, and have been prepared on the basis of International Financial Reporting Standards (IFRSs) as adopted by the European Union that are effective for the year ending 31 December 2010. They do not include all of the information required for full annual financial statements. These condensed consolidated half-yearly financial statements do not comprise statutory accounts within the meaning of Section 435 of the Companies Act 2006, and should be read in conjunction with the Annual Report 2009. The comparative figures for the year ended 31 December 2009 are not the Group's statutory accounts for that financial year. Those accounts have been reported upon by the Group's auditors and delivered to the registrar of companies. The report of the auditors was unqualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and did not contain statements under section 498(2) or (3) of the Companies Act 2006.

Except as described below, the accounting policies adopted in the preparation of these condensed consolidated half-yearly financial statements to 30 June 2010 are consistent with the policies applied by the Group in its consolidated financial statements as at, and for the year ended, 31 December 2009.

#### Changes in accounting policies

The following amendments to published standards and interpretations are effective for the Group for the half year ended 30 June 2010:

- IFRS 3 (revised 2008), *Business Combinations*;
- Amendment to IAS 27, *Consolidated and Separate Financial Statements*;
- Amendment to IAS 39, *Financial Instruments: Recognition and Measurement: Eligible Hedged Items*;
- Amendment to IFRS 2, *Share-based Payment: Group Cash-settled Share-based Payment Transactions*;
- Improvements to IFRSs 2009;
- International Financial Reporting Interpretations Committee (IFRIC) 17, *Distributions of Non-cash Assets to Owners*; and
- IFRIC 18, *Transfers of Assets from Customers*.

The Group has reviewed the effect of these amendments and interpretations, and has concluded that they have no material impact on these condensed consolidated half-yearly financial statements.

## 2. Segmental analysis

	Combined sales of Group and equity accounted investments		Less: sales by equity accounted investments		Add: sales to equity accounted investments		Revenue	
	Restated <sup>1</sup>		Restated <sup>1</sup>					
	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m
Electronics, Intelligence & Support	2,624	2,862	–	–	22	–	2,646	2,862
Land & Armaments	3,074	3,219	(12)	–	–	–	3,062	3,219
Programmes & Support	3,035	2,399	(582)	(759)	538	495	2,991	2,135
International	2,078	1,416	(476)	(428)	–	–	1,602	988
HQ & Other Businesses	141	133	–	–	–	–	141	133
	10,952	10,029	(1,070)	(1,187)	560	495	10,442	9,337
Intra-operating group sales/revenue	(309)	(282)	8	8	23	29	(278)	(245)
	10,643	9,747	(1,062)	(1,179)	583	524	10,164	9,092

	Underlying EBITA <sup>2</sup>		Non-recurring items <sup>3</sup>		Amortisation of intangible assets		Impairment of intangible assets		Operating group result	
	Restated <sup>1</sup>								Restated <sup>4</sup>	
	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m
Electronics, Intelligence & Support	296	268	–	–	(12)	(15)	(6)	(8)	278	245
Land & Armaments	316	262	–	–	(157)	(94)	(2)	(260)	157	(92)
Programmes & Support	316	277	–	(9)	(29)	(24)	–	(34)	287	210
International	218	160	–	–	(12)	(21)	–	–	206	139
HQ & Other Businesses	(32)	11	(18)	–	(1)	–	–	–	(51)	11
	1,114	978	(18)	(9)	(211)	(154)	(8)	(302)	877	513
Financial income of equity accounted investments									2	16
Taxation expense of equity accounted investments									(13)	(22)
<b>Operating profit</b>									<b>866</b>	<b>507</b>
Finance costs									(68)	(544)
<b>Profit/(loss) before taxation</b>									<b>798</b>	<b>(37)</b>
Taxation expense									(227)	(26)
<b>Profit/(loss) for the period – continuing operations</b>									<b>571</b>	<b>(63)</b>

	Total assets		
	30 June 2010 £m	30 June 2009 £m	Restated <sup>4</sup> 31 December 2009 £m
	Electronics, Intelligence & Support	7,184	6,989
Land & Armaments	6,051	6,919	6,108
Programmes & Support	3,207	1,871	3,197
International	2,925	2,857	2,877
HQ & Other Businesses	866	809	841
	20,233	19,445	19,937
Tax	1,746	1,430	1,534
Pension prepayment	50	35	42
Cash as defined by the Group	2,846	3,087	3,943
<b>Consolidated total assets</b>	<b>24,875</b>	<b>23,997</b>	<b>25,456</b>

1 Restated following the sale of half of the Group's 20.5% shareholding in Saab AB (see note 4).

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

3 Non-recurring items in 2010 comprise the US dollar exchange rate movement on payment of the global settlement of the regulatory investigation by the US Department of Justice. Non-recurring items in 2009 comprised loss on disposal of businesses.

4 Restated following changes to the provisional fair values recognised on acquisition of the 45% shareholding in BVT Surface Fleet Limited held by VT Group plc on 30 October 2009 (see note 8).

NOTES TO THE CONDENSED HALF-YEARLY FINANCIAL STATEMENTS *CONTINUED*

## 3. Finance costs

	Six months ended 30 June 2010 £m	Restated <sup>1</sup> Six months ended 30 June 2009 £m	Restated <sup>1</sup> Year ended 31 December 2009 £m
Net finance costs – Group	(68)	(544)	(700)
Net financial income – share of equity accounted investments	2	16	2
	<b>(66)</b>	<b>(528)</b>	<b>(698)</b>
Analysed as:			
Net interest:			
Interest income	8	30	66
Interest expense	(93)	(115)	(228)
Facility fees	(2)	(2)	(4)
Net present value adjustments	(13)	(16)	(35)
Share of equity accounted investments	4	14	8
	<b>(96)</b>	<b>(89)</b>	<b>(193)</b>
Other finance costs:			
Group:			
Net financing charge on pensions	(45)	(64)	(123)
Market value and foreign exchange movements on financial instruments and investments <sup>2</sup>	77	(377)	(376)
Share of equity accounted investments	(2)	2	(6)
	<b>(66)</b>	<b>(528)</b>	<b>(698)</b>

1 Restated following the sale of half of the Group's 20.5% shareholding in Saab AB (see note 4).

2 The loss in 2009 primarily reflected net foreign exchange movements on the unhedged portion of an intercompany loan from the UK to the US businesses.

## 4. Discontinued operations

On 3 June 2010, the Group sold half of its 20.5% shareholding in Saab AB to Investor AB for a cash consideration of SEK1,041m (£92m). Following the loss of significant influence over the company, the Group has discontinued the use of the equity method and the remaining shareholding in Saab is shown within other financial assets as a financial asset at fair value through profit or loss at 30 June 2010. The Group's share of the results of Saab is shown within discontinued operations for the current and prior periods.

The results from discontinued operations which have been included in the condensed consolidated income statement are as follows:

	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Year ended 31 December 2009 £m
Share of results of equity accounted investments	2	1	16
Impairment in respect of equity accounted investments	–	(8)	–
<b>Contribution from equity accounted investments</b>	<b>2</b>	<b>(7)</b>	<b>16</b>
<b>Profit/(loss) for the period</b>	<b>2</b>	<b>(7)</b>	<b>16</b>
Profit on disposal of discontinued operations	52	–	–
<b>Profit/(loss) for the period – discontinued operations</b>	<b>54</b>	<b>(7)</b>	<b>16</b>

The profit on disposal of discontinued operations is calculated as follows:

	£m
Cash consideration	92
Fair value of retained 10.25% investment	97
Transaction costs accrued	(3)
Carrying value of 20.5% shareholding	(155)
Cumulative net hedging gain	4
Cumulative currency translation gain	17
<b>Profit on disposal of discontinued operations</b>	<b>52</b>

Following the classification of Saab as a discontinued operation, combined sales of Group and equity accounted investments in the comparatives for the six months ended 30 June and year ended 31 December 2009 have been reduced by £194m and £425m, respectively.

## 5. Earnings per share

	Six months ended 30 June 2010			Restated <sup>1</sup> Six months ended 30 June 2009		
	£m	Basic pence per share	Diluted pence per share	£m	Basic pence per share	Diluted pence per share
Profit/(loss) for the period attributable to equity shareholders	<b>618</b>	<b>17.7</b>	<b>17.7</b>	(82)	(2.3)	(2.3)
Represented by:						
<i>Continuing operations</i>	<b>564</b>	<b>16.1</b>	<b>16.1</b>	(75)	(2.1)	(2.1)
<i>Discontinued operations</i>	<b>54</b>	<b>1.6</b>	<b>1.6</b>	(7)	(0.2)	(0.2)
Add back/(deduct):						
Loss on disposal of businesses, post tax	–			9		
Regulatory penalties	<b>18</b>			–		
Net financing charge on pensions, post tax	<b>33</b>			48		
Market value movements on derivatives, post tax	<b>(55)</b>			273		
Amortisation and impairment of intangible assets, post tax	<b>155</b>			199		
Impairment of goodwill	–			180		
<b>Underlying earnings, post tax</b>	<b>769</b>	<b>22.0</b>	<b>22.0</b>	627	17.8	17.8
Represented by:						
Continuing operations	<b>715</b>	<b>20.4</b>	<b>20.4</b>	630	17.9	17.9
Discontinued operations	<b>54</b>	<b>1.6</b>	<b>1.6</b>	(3)	(0.1)	(0.1)
	<b>769</b>	<b>22.0</b>	<b>22.0</b>	627	17.8	17.8
		<b>Millions</b>	<b>Millions</b>		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		<b>3,495</b>	<b>3,495</b>		3,529	3,529
Incremental shares in respect of employee share schemes			<b>2</b>			5
Weighted average number of shares used in calculating diluted earnings per share			<b>3,497</b>			3,534

1 Restated following the sale of half of the Group's 20.5% shareholding in Saab AB (see note 4).

Underlying earnings per share is presented in addition to that required by IAS 33, *Earnings per Share*, to align the adjusted earnings measure with the performance measure reviewed by the directors. The directors consider that this gives a more appropriate indication of underlying performance.

In accordance with IAS 33, the diluted earnings per share are without reference to adjustments in respect of outstanding share options where the impact would be anti-dilutive.

NOTES TO THE CONDENSED HALF-YEARLY FINANCIAL STATEMENTS *CONTINUED*

## 6. Retirement benefit obligations

	UK £m	US and other £m	Total £m
Deficit in defined benefit pension plans at 1 January 2010	(5,006)	(567)	<b>(5,573)</b>
Actual return on assets below expected return	(344)	(107)	<b>(451)</b>
Increase in liabilities due to changes in assumptions	(40)	(200)	<b>(240)</b>
One-off contributions	81	–	<b>81</b>
Recurring contributions in excess of/(below) service cost	98	(22)	<b>76</b>
Past service cost	(30)	–	<b>(30)</b>
Net financing (charge)/credit	(64)	7	<b>(57)</b>
Exchange translation	–	(44)	<b>(44)</b>
Deficit in defined benefit pension plans at 30 June 2010	(5,305)	(933)	<b>(6,238)</b>
US healthcare plans			<b>(36)</b>
<b>Total IAS 19 deficit</b>			<b>(6,274)</b>
Allocated to equity accounted investments and other participating employers			<b>1,063</b>
<b>Group's share of IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments and other participating employers</b>			<b>(5,211)</b>
Represented by:			
Pension prepayments (within trade and other receivables)			<b>50</b>
Retirement benefit obligations			<b>(5,261)</b>
			<b>(5,211)</b>

**Group's share of IAS 19 deficit of equity accounted investments** **(137)**

Certain of the Group's equity accounted investments participate in the Group's defined benefit plans as well as Airbus SAS, the Group's share of which was disposed of during the year ended 31 December 2006. As these plans are multi-employer plans the Group has allocated an appropriate share of the IAS 19 pension deficit to the equity accounted investments and to Airbus SAS based upon a reasonable and consistent allocation method intended to reflect a reasonable approximation of their share of the deficit. The Group's share of the IAS 19 pension deficit allocated to the equity accounted investments is included in the balance sheet within equity accounted investments. In the event that an employer who participates in the Group's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Group considers the likelihood of this event arising as remote.

During 2010, the Group contributed an additional £25m into Trust for the benefit of the Group's main pension scheme (31 December 2009 £225m). The cumulative contributions totalling £250m are reported within other investments – current (£246m after cumulative fair value gains of £11m), and cash and cash equivalents (£15m) in the consolidated balance sheet at 30 June 2010, and the use of these assets is restricted under the terms of the Trust. However, the Group considers this contribution to be equivalent to the other one-off contributions it makes into the Group's pension schemes and, accordingly, presents below a definition of the pension deficit to include this contribution.

	30 June 2010 £m	30 June 2009 £m	31 December 2009 £m
Group's share of IAS 19 deficit	<b>(5,211)</b>	(4,627)	(4,637)
Assets held in Trust	<b>261</b>	124	227
<b>Pension deficit as defined by the Group</b>	<b>(4,950)</b>	(4,503)	(4,410)

The above deficit is £3,399m (31 December 2009 £2,980m) after tax.

## 7. Dividends

	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m
<b>Equity dividends</b>		
Prior year final 9.6p dividend per ordinary share paid in the period (2009 8.7p)	<b>335</b>	307

The directors have declared an interim dividend of 7.0p per ordinary share (2009 6.4p), totalling £238m (2009 £227m). The dividend will be paid on 30 November 2010 to shareholders registered on 22 October 2010. The ex-dividend date is 20 October 2010.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 9 November 2010.

## 8. Acquisitions

### BVT (now BAE Systems Surface Ships)

On 30 October 2009, the BVT joint venture became a wholly-owned subsidiary of the Group after VT Group plc exercised its option to sell its 45% shareholding in BVT to BAE Systems. Consideration paid including transaction costs for the remaining 45% interest was £348m. The now wholly-owned company has been renamed BAE Systems Surface Ships Limited. The Group previously held a 55% interest in BVT, and accounted for its share of the results and net assets of BVT in accordance with IAS 31, *Interests in Joint Ventures*.

Total provisional goodwill arising amounted to £584m, which comprised £225m on the initial formation of the BVT joint venture in the year ended 31 December 2008 and £359m arising on the acquisition of the 45% interest.

Further to additional losses being identified on the export ship contracts amounting to £135m, £108m post tax, an interim update of the fair values arising on acquisition has been undertaken at the half year. Goodwill has increased by £49m to £633m reflecting 45% of the post-tax losses. In accordance with IFRS 3, *Business Combinations*, the portion of these losses relating to the Group's original 55% interest in the joint venture has been reflected in the revaluation reserve (£59m), leaving a cumulative credit on that reserve of £15m.

As the losses relate to a period prior to 1 July 2008 and the net revaluation remains positive, the Group concluded that the revaluation reserve is the appropriate treatment for these losses. Comparatives for the year ended 31 December 2009 have been restated accordingly.

The acquisition of BVT has had the following effect on the Group's assets and liabilities (the figures in the table represent a 100% interest in BVT):

	Book value £m	Accounting policy alignments £m	Fair value adjustments £m	Fair value £m
Intangible assets	–	–	225	225
Property, plant and equipment	136	–	–	136
Inventories	61	–	–	61
Receivables	225	–	–	225
Deferred tax assets	2	–	8	10
Payables	(433)	–	(299)	(732)
Current tax (liabilities)/assets	(16)	–	22	6
Deferred tax liabilities	(6)	–	(63)	(69)
Provisions	(12)	–	–	(12)
Cash and cash equivalents	33	–	–	33
<b>Net liabilities acquired</b>	<b>(10)</b>	<b>–</b>	<b>(107)</b>	<b>(117)</b>
<b>Goodwill</b>				<b>633</b>
<b>Fair value of net liabilities acquired and goodwill arising</b>				<b>516</b>

## 9. Related party transactions

The Group has a related party relationship with its directors and key management, its equity accounted investments and the pension plans.

Transactions occur with the equity accounted investments in the normal course of business and are priced on an arm's-length basis and settled on normal trade terms. The more significant transactions are disclosed below:

	Six months ended 30 June 2010 £m	Six months ended 30 June 2009 £m	Year ended 31 December 2009 £m
Sales to related parties	583	524	1,241
Purchases from related parties	200	159	426
Amounts owed by related parties	252	204	207
Amounts owed to related parties	1,099	1,313	1,353

## 10. Events after the balance sheet date

On 13 July 2010, BAE Systems completed the acquisition of all of the stock of Atlantic Marine Holding Company, a naval services and marine fabrication business in the US, for a cash consideration of \$352m (£235m).

## 11. Annual General Meeting

The Annual General Meeting of BAE Systems plc will be held on 4 May 2011.

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