BAE Systems plc
Preliminary Announcement 2021

Results in brief

Financial performance measures as defined by the Group[1]

	2021	2020
Sales	**£21,310m**	£20,862m
Underlying EBIT[3]	**£2,205m**	£2,037m
Underlying earnings per share[3]		
excluding one-off tax benefit (2021 only)[4]	**47.8p**	44.3p
including one-off tax benefit (2021 only)[4]	**50.7p**	44.3p
Free cash flow[3]		
excluding £1bn pension contribution (2020 only)	**£1,864m**	£1,367m
including £1bn pension contribution (2020 only)	**£1,864m**	£367m
Net debt (excluding lease liabilities)	**£(2,160)m**	£(2,718)m
Order intake[5]	**£21,458m**	£20,915m
Order backlog[5]	**£44.0bn**	£45.2bn

Financial performance measures derived from IFRS[2]

	2021	2020
Revenue	**£19,521m**	£19,277m
Operating profit	**£2,389m**	£1,930m
Basic earnings per share	**55.2p**	40.7p
Net cash flow from operating activities	**£2,447m**	£1,166m
Order book	**£35.5bn**	£36.3bn
Dividend per share[6]	**25.1p**	23.7p
Group's share of net post-employment benefits deficit	**£(2.1)bn**	£(4.5)bn

Charles Woodburn, Chief Executive, said: "Our strong results reflect the outstanding efforts of our employees who have continued to adapt and work closely with our customers, suppliers and trades unions to deliver capabilities which keep nations and citizens safe.

"We are continuing to evolve our business, increasing our investments in advanced technologies to deliver differentiated solutions to meet our customers' priorities.

"Our diverse portfolio, together with our focus on programme execution, cash generation and efficiencies, is helping us to navigate the challenging operating environment, meaning we are well positioned for sustained top line and margin growth in the coming years."

Our financial highlights

Financial performance measures as defined by the Group[1]

- Sales increased by £0.4bn to £21.3bn, a 5% increase, excluding the impact of currency translation[7].
- Underlying EBIT[3] increased to £2,205m, a 13% increase on a constant currency basis[7].
- Underlying earnings per share[3] increased by 12% on a constant currency basis[7] to 47.8p, excluding the impact of the current year one-off tax benefit[4].
- Free cash flow[3] was £1,864m (2020 inflow of £1,367bn, excluding the £1bn contribution into the UK pension scheme).
- Net debt (excluding lease liabilities) decreased to £2,160m (2020 £2,718m).
- Order intake[5] increased by £0.6bn to £21.5bn (2020 £20.9bn).
- Order backlog[5] decreased by £1.2bn to £44.0bn (2020 £45.2bn).

Financial performance measures derived from IFRS[2]

- Revenue increased by £0.2bn to £19.5bn.
- Operating profit increased by £459m to £2,389m (2020 £1,930m).
- Basic earnings per share was 55.2p (2020 40.7p).

- Net cash flow from operating activities was £2,447m (2020 £1,166m, including the effect of the £1bn contribution to the UK pension scheme).
- Order book decreased by £0.8bn to £35.5bn.
- Group's share of the pre-tax accounting net post-employment benefits deficit decreased to £2.1bn, driven by higher discount rates and strong asset performance (2020 deficit of £4.5bn).

Dividends and share buyback

- Final dividend of 15.2p per share making a total of 25.1p per share in respect of the year ending 31 December 2021, an increase of 6% over dividends in respect of the year ended 31 December 2020 of 23.7p per share. The total of 37.5p per share for 2020 includes an interim dividend of 13.8p per share in respect of the year ended 31 December 2019, which was originally proposed as a 2019 final dividend but subsequently deferred in the light of the COVID-19 pandemic.
- The £500m share buyback programme announced on 29 July 2021 was completed in February 2022.

1. We monitor the underlying financial performance of the Group using alternative performance measures. These measures are not defined in International Financial Reporting Standards (IFRS) and therefore are considered to be non-GAAP (Generally Accepted Accounting Principles) measures. Accordingly, the relevant IFRS measures are also presented where appropriate. The purposes and definitions of non-GAAP measures are provided in the Financial glossary on page 12.
2. International Financial Reporting Standards.
3. With effect from 2021, the Group adopted the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the underlying EBITA measure. It reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business. Underlying earnings per share has also been recalculated to ensure consistency with the updated operational profitability measure. The underlying performance for 2020 of segments and the Group has been re-presented on this new basis. During 2020 the Group determined that Free cash flow was its key performance measure for utilisation of cash at a Group level. The Group continues to use Operating business cash flow as its key segment metric, to monitor operational cash generation.
4. A one-off tax benefit of £94m was recognised in the year, in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime.
5. Including share of equity accounted investments.
6. The 2020 dividend per share of 23.7p is in respect of the year ended 31 December 2020. An interim dividend of 13.8p per share was paid in 2020, in respect of the year ended 31 December 2019, having been proposed as a 2019 final dividend but deferred in light of the pandemic.
7. Current year compared with prior year translated at current year exchange rates.

Operational and strategic key points

Electronic Systems

- Cumulatively more than 1,000 electronic warfare systems delivered on F-35 programme
- Limited Interim Missile Warning System indefinite delivery, indefinite quantity sustainment and support contract awarded worth $872m (£644m) over ten years
- EPAWSS testing underway on F-15E and F-15EX aircraft
- Contract received from Defense Logistics Agency valued at more than $640m (£473m) to deliver Increment 1 M-Code devices
- Rising demand for low and zero emission vehicles in our Power & Propulsion Solutions business
- Demand in our Controls & Avionics Solutions commercial markets starting to recover from pandemic impacts

Platforms & Services (US)

- Selected to participate in the design concept phase for the US Army's Optionally Manned Fighting Vehicle programme
- Consistent deliveries of the M109A7 Self-Propelled Howitzer enabled the programme to surpass 350 cumulative system deliveries
- Received a $600m (£443m) sustainment and technical support services contract for Armored Multi-Purpose Vehicle, and AMPV deliveries continued against the rebaselined customer schedule
- Amphibious Combat Vehicle deliveries against LRIP and design development have begun on mission variants
- Contract received worth approximately $200m (£148m) from Sweden for 127 BvS10s
- Contract received exceeding $500m (£369m) for mid-life upgrades of Dutch CV90s
- US Ship Repair was significantly impacted by the pandemic, but has seen some recent signs of recovery
- Ordnance Systems awarded additional contracts for modernisation projects at Holston

Air

- Qatar Typhoon and Hawk programme is progressing well, with first Qatar Typhoon flight achieved in November and deliveries on schedule to commence in 2022
- F-35 rear fuselage production reached full rate levels, with 151 assemblies completed in the year
- Production progressing to plan on the German Typhoon programme
- Initial entry into service of the future electronically scanned European Common Radar Solution was achieved in December
- Tempest next-generation Future Combat Air System programme continues to progress well, with initial Concept & Assessment Phase contract secured
- Air sector continues to work closely with industry partners and the UK government to continue to fulfil contractual support arrangements in Saudi Arabia
- Australia Hunter Class Frigate programme continues through prototyping, with good engagement with the Commonwealth to agree revised schedule for production to commence
- MBDA won several export orders on air platforms

Maritime

- Construction of first three City Class Type 26 frigates for the Royal Navy is now underway
- Canadian Surface Combatant programme entered a key design milestone in December, ahead of moving into the next Functional Design phase
- Fifth Astute Class submarine, Anson, launched in April, with final installation and commissioning activities continuing to ready her for scheduled exit in 2022
- Construction of the first two Dreadnought Class submarines continues to advance
- Contract awarded and early design and concept work underway on Royal Navy's next generation of submarines
- Contracts worth more than £1bn received under UK Ministry of Defence's Future Maritime Support Programme
- Maritime Services provided preparation and support capabilities to the UK's Carrier Strike Group ahead of, and during, its first operational deployment
- RBSL secured the Challenger 3 Main Battle Tank upgrade contract

Cyber & Intelligence

Intelligence & Security

- US-based Intelligence & Security business continues to maintain its bid pipeline, perform on existing contracts and win new orders
- Awarded a five-year, up to $478m (£353m) Systems Engineering and Integration Support Services contract from the US Navy Strategic Systems Programs office
- Awarded classified contracts from Department of Defense and Intelligence Community customers in excess of $0.8bn (£0.6bn) to deliver mission-enabling engineering services
- Agreement announced for the proposed acquisition of Bohemia Interactive Simulations, a global software developer of simulation and training solutions for allied military customers

Applied Intelligence

- Strong order intake and revenue growth driven by the government- and defence-facing business units
- Increasing profitability, supported by strong programme execution, productivity and cost base optimisation. Financial Services' profitability benefited from restructuring in 2020
- Acquisition of In-Space Missions, a UK-based satellite and satellite systems company, to accelerate our Space capabilities

Guidance for 2022

While the Group is subject to geopolitical and other uncertainties, the following guidance is provided on current expected operational performance.

The guidance is based on the measures used to monitor the underlying financial performance of the Group. Reconciliations from these measures to the financial performance measures defined in International Financial Reporting Standards for 2021 are provided in the Group financial review on pages 12 to 20.

Group guidance

With a strong year behind us, we look forward to continued top-line growth with margin expansion and good cash delivery against our rolling targets. Guidance is provided on the basis of an exchange rate of $1.38:£1, which is in line with the actual 2021 exchange rate, therefore guidance is the same for both reported and constant exchange rates.

For the year ending 31 December 2022, the Group's sales are expected to grow in the 2% to 4% range over 2021. Sales growth is expected in the Electronic Systems, Air, Maritime and Cyber & Intelligence segments, whilst Platforms & Services (US) is expected to be stable. Approximately 75% of the expected sales are already in the order backlog.

Underlying EBIT is expected to increase in the range of 4% to 6%.

Finance costs are expected to be approximately £240m, with an effective tax rate expected to be around 20%, and non-controlling interest expected to be around £70m.

Underlying earnings per share is expected to increase in the range of 4% to 6%. Sensitivity to EPS is around one pence for every five cent movement.

Free cash flow for 2022 is anticipated to be in excess of £1bn, with a three-year target for 2022 to 2024 in excess of £4bn. The three-year cash flow target for the period 2020 to 2022, originally set at £3.5bn to £3.8bn, has been upgraded to be in excess of £4bn.

Segment guidance[1]

The following table provides guidance by segment, aligned to the Group guidance:

Year ended 31 December 2022	**Expected sales**	**Expected underlying EBIT margin**[2,3]
Electronic Systems	Up 2% to 4%	16% to 17%
Platforms & Services (US)	Stable	8% to 9%
Air	Up 2% to 4%	10% to 11%
Maritime	Up 3% to 5%	8% to 9%
Cyber & Intelligence	Up 3% to 5%	8% to 9%

1. The above guidance ranges do not reflect the establishment, in 2022, of the Group's new Digital Intelligence business nor the transition of our BAE Systems Australia business from the Air segment to the Maritime segment. The re-presentation of 2021 segments to reflect these changes will be issued in due course.
2. Underlying EBIT as percentage of Sales.
3. In 2022, HQ underlying EBIT is expected to be broadly similar to 2021 (expense of £120m).

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Analyst and investor presentation

A presentation, for analysts and investors, of the Group's Results for 2021 will be available via webcast at 11am today (24 February 2022).

Details can be found on **investors.baesystems.com**, together with presentation slides and a pdf copy of this report. A recording of the webcast will be available for replay later in the day.

About BAE Systems

At BAE Systems, we provide some of the world's most advanced, technology-led defence, aerospace and security solutions.

We employ a skilled workforce of 90,500 people[1] in more than 40 countries. We help our customers to stay a step ahead when protecting people and national security, critical infrastructure and vital information. We also work closely with local partners to support economic development through the transfer of knowledge, skills and technology.

1. Including share of equity accounted investments.

Preliminary results statement

Overview

At the start of 2021, we set out a refreshed investment case reflecting the Group today, our competitive advantages, operational focus areas to accelerate our evolution, and the financial outputs we are seeking to drive. Against the backdrop of the ongoing global pandemic and associated global macro impacts, we are pleased at the progress we have made against these key operational themes.

Thanks to the outstanding efforts of our employees we have been resilient and agile in adapting to the ever-evolving environment, to address and meet customer requirements.

We delivered a strong set of financial results across all our key measures as positive momentum from last year was maintained on operational and cash flow performance, enabling us to increase our returns to shareholders through a higher dividend and also through the buyback programme announced in July 2021. This reflects our confidence in the outlook and our ongoing focus on a balanced and efficient capital allocation policy of investing in the business and shareholder returns. The Group maintained its strong sales balance between production and aftermarket services.

Our strategy remains consistent and is delivering results. This year we have focused on our operational performance, continued to invest in technology, made progress on our competitiveness and accelerated our sustainability agenda.

We have long-term strength from our programmes, technologies and customer relationships, with continued demand for our products and services and we are leveraging our leading capabilities in evolving markets. We take great pride in our role not only in supporting national security, but also in contributing to the economic prosperity of the countries in which we operate.

Our geographically diverse portfolio is aligned with growing defence budgets and as expected, the near-term Brexit impacts across the business have been limited. This geographic mix, the programme spread and longevity of the positions mean we are not overly dependent on a small number of programmes. These are key factors in our resilience against a number of global macro challenges and also underline the strength of our outlook.

Safety and wellbeing

The safety and wellbeing of our employees is paramount and it remained our primary consideration as we continued to manage our response to the global pandemic throughout the year. Our response highlighted the positive societal impact this business can bring as we deployed our capabilities, people and time, and worked with our supply chains to support our communities and health services. We are hugely proud of how our employees responded to the day-to-day challenges. The strength of the relationships and collaborative working with our customers, suppliers and trades unions has been exceptional and a huge testament to all. Like all businesses, we experienced challenges during this pandemic. We have had to be agile and adapt, and make difficult decisions, but thanks to the early actions we took to enhance the resilience of our business and the remarkable fortitude of our people, we have continued to deliver on our customers' priorities whilst also supporting the social needs of our governments and communities.

As we worked to strengthen our culture of safety, we faced additional challenges from the pandemic, which has required significant changes in how we work. We remain focused on safety across our enterprise and we are targeting our most challenging sites through a comprehensive improvement plan including campaigns across employee groups, implementing virtual reality safety training, and introducing new and improved systems to reduce risk related to safety, health, and environmental impacts.

The importance of our employees' wellbeing has been enhanced during the pandemic as we have balanced work and personal commitments. Our wellbeing programmes support employees in managing their work and personal responsibilities. We continue to promote mental health awareness programmes across the business and have worked hard this year to increase our communications and engagement along with introducing training for employees.

ESG

2021 has been about evolving, accelerating and integrating our sustainability agenda which is fundamental to our business performance. It aligns stakeholder priorities with the Group's ESG risks and opportunities so that we can drive the success of the Company for the benefit of our stakeholders.

We recognise that the way we do business and the actions and behaviours we demonstrate are vital for the future strength of our business and we want to continue to increase our ambitions and accelerate our progress. We made some real strides in 2021, with some notable highlights being: setting ourselves the target of achieving net zero greenhouse gas emissions across our operations by 2030 and joining the United Nations 'Race to Zero' campaign; driving a bolder set of diversity ambitions to be recognised as a leading employer in defence and security for valuing diversity and inclusion; committing to cease handling white phosphorus; and gaining accreditation as a real living wage UK employer. All are examples of accelerated progress achieved through stakeholder engagement underpinned by a strategic rationale.

The long-term outlook for the Group and the defence industry means we need to anticipate change and ensure that we can continue to improve upon what we do today, and into the future. We are committed to building a sustainable future by having a clear sustainability agenda focused on valuing and developing our people, making a positive social and economic contribution to our communities, developing innovative technology and collaborating with our supply chains and reducing the environmental impacts of our operations and products.

We will continue to review ways to integrate sustainability practices holistically into our business, driven through, and aligned with, our strategic objectives as we look to develop sustainable solutions to meet ever-evolving customer requirements. The progress we are making on our sustainability agenda has been reflected with an improvement in our CDP score, and we have maintained our AA leader class rating with MSCI.

2021 operational performance

Execution on the key strategic objectives of operational excellence, competitiveness and technological innovation is vital for the successful delivery of our order backlog, to deliver future growth and a high-performing sustainable business.

Continually pushing operational performance improvement is central to our strategy to ensure delivery of our order backlog and improvements in long-term cash generation.

We have been pleased with our operational performance in 2021 and it is a great testament to our people that we can talk about an almost 'normal' delivery given the environment in which we have been operating over the last two years. We will look to make further improvements and our increasing confidence in our programme execution capabilities underlines our outlook for sales growth, margin expansion and our rolling three-year cash targets.

Electronic Systems delivered another year of growth and good programme execution. Sales were up 5% but were held back in the last quarter as the Omicron surge tightened an already pandemic-constrained labour market, and caused some supply chain delays and disruptions. These challenges dampened what were positive contributions from the 2020 acquisitions and strong execution across key franchises, such as the electronic warfare and precision-guided munition programmes. Our civil market operations continue to be impacted by the COVID-19 pandemic, though there are some signs of demand recovery in the commercial Controls & Avionics Solutions and Power & Propulsion Solutions businesses where we have leading positions.

In Platforms & Services (US), combat vehicle deliveries continued, with the investment in new production capabilities and processes enabling the business to consistently deliver at increased volumes over multiple programmes. Compared to last year, vehicle delivery volumes increased by more than 60%. US Ship Repair made good progress resolving several challenged ship modernisation programmes and recovering from COVID-19 and other operational impacts. Work remains to be done to return to pre-pandemic levels of performance.

The Air sector grew and maintained good operational performance. Production moved to full rate levels on F-35 rear fuselage assemblies, Typhoon production and support revenues increased as we delivered on our build programmes, and we continued to provide Typhoon operators with ongoing support and training services to deliver availability, maintenance and upgrade enhancements. The Tempest technology maturation programme is progressing well and we secured the first contract for the Future Combat Air System Concept & Assessment Phase.

In Maritime, we sustained the performance improvements seen last year. Manufacturing levels increased on Type 26 with the first three ships now in production and we launched the fifth Astute Class submarine. Construction of the first two Dreadnought submarines is progressing and in the Maritime Services business we successfully supported the first major UK Carrier Strike Group deployment.

Cyber and Intelligence delivered an increase in margin with Applied Intelligence delivering much-improved profitability, benefiting from heightened demand in the Government sector, together with the results of our restructuring. Intelligence & Security delivered growth in sales and profit as it performed on its long-term support contracts, some of which are on the most sensitive and critical US national security programmes. The business maintained its bid pipeline to deliver a strong, stable backlog position at year end.

Driving competitiveness and efficiency

On competitiveness, we have a number of programmes to achieve efficiency and simplification across the Group building on the lessons learned in the last year on working practices and cost savings. We are also bringing data analytics to bear across the Group to benchmark and improve efficiency, as well as investment in new technologies and production techniques to maintain our drive to continuously improve operational performance and value for our customers.

Areas highlighted to date include the streamlining of processes, general and administration cost savings, office footprint requirements, flexible working practices and how we can be more agile and adaptable to deliver our commitments in different ways.

Portfolio

We continue to evaluate and increase value creation from our portfolio through acquisitions and disposals as we align to our customer needs and priorities in addressing the evolving threat environment. The US acquisitions completed in 2020 are performing well and construction is progressing on the new facility for the GPS business to maintain delivery of market-leading technologies. In respect of disposals, we sold the Filton and Broughton sites generating a good cash result, the BAE Systems Rokar International business, and our stake in Advanced Electronics Company, one of our Saudi Arabian portfolio companies. We completed two new acquisitions in 2021, both in the UK, firstly a small technology bolt-on which enhances our data and digital capabilities, and secondly In-Space Missions, a company that designs, builds and operates satellites and satellite systems, enabling us to combine BAE Systems' experience in highly secure satellite communications with In-Space Missions' full lifecycle satellite capability. We also announced we had entered into a definitive agreement to acquire Bohemia Interactive Simulations, a leading developer of advanced military simulation and training software, headquartered in the US.

Advancing and further leveraging our technology

Investment in advanced technology and innovation is a benefit which spans the breadth of the business, supporting operational performance, competitiveness, our sustainability objectives and growth aspirations. The threat environment consists not just of the physical risks but also those in the grey zone which need to be addressed. It is critical to our customers to have a fully integrated combination of capabilities to negate these threats. Against this backdrop we are increasing our self-funded research and development investments and positioning the Group towards future growth areas aligned to our customer priorities, by identifying collaboration opportunities and investing in our leading capabilities and technologies across electronic warfare, combat aircraft, precision weaponry, cyber and the underwater battlespace. From these established positions we are developing, linking and transitioning solutions into priority areas such as multi-domain networks, data analysis, autonomy, space and sustainability-driven technology developments. While our R&D investments are important, we sustain our leading positions through collaboration with our customers, educational institutions and in partnership with defence laboratories and research institutions such as the Defence Science and Technology Laboratory, DARPA, the Air Force Research Laboratory and the Office of Naval Research. Additionally we accelerate the pace and reach of our innovation by collaborating across our global enterprise.

Reflecting the importance of technology investment, in 2022 we launched the BAE Systems Digital Intelligence business which brings together many of our digital transformation, cyber security, complex data analysis and communication and information systems capabilities from across the Group. We have exceptional talent and world-leading innovation in these areas and the new business will allow greater collaboration across the Group, and in time bring a greater range of capabilities to our customers.

Demand outlook

We have a large order backlog and exceptional programme positions, providing visibility of growth which was further supported by order flow in 2021 that exceeded targets.

Our defence and security capabilities remain highly relevant in an uncertain global environment with complex threats, the requirement in many cases to recapitalise or upgrade ageing equipment, and with the additional need for governments to drive a domestic economic prosperity agenda in a post-pandemic world. This backdrop has resulted in good prospects in existing and new international markets for our products and services in air, maritime, land, space and cyber security.

The US continues to represent the world's largest defence budget and accounts for around 46% of our revenues.

Through a range of innovative technologies and proven capabilities, our US business continues to sustain its robust backlog and diverse portfolio of long-term defence programmes for the US Armed Forces and international allies. The business portfolio remains closely aligned with enduring customer priorities and key focus areas outlined in the US National Defense Strategy, to modernise and maintain military readiness, which we expect to continue with the upcoming 2022 National Defense Strategy. The business has been operating under extended Continuing Resolutions in fiscal year 2022. While the Congressional budget and appropriations impasse is not without risk, the threat environment remains and is expected to result in continued support for US defence spending in the coming years.

In the UK, the Defence Command Paper renewed commitments to our major long-term programmes in complex warship, submarine and combat aircraft design and build, allowing for long-term investment in these key sovereign capabilities, as well as strong support for cyber. The opportunity pipeline is positive with domestic, export and collaboration opportunities identified. We also have the capabilities to support our UK customer with its space ambitions.

Our portfolio is well positioned to benefit from increased defence spending in Asia Pacific through our Australia business, which is already set to grow significantly due to our contracted positions, and through export opportunities from our UK, US and Australian business to the region. The AUKUS announcement in September 2021 is strategically significant. As the largest defence provider in the UK and Australia and a top ten prime contractor to the US Department of Defense we are well positioned to support our government customers in these nations as discussions progress. This is a clear example of how nations are looking to coordinate capabilities in multi-domain operations to address the threat environment.

In Europe, a number of nations including Germany and France continue to increase their defence budgets to address the threat environment and in order to meet their NATO commitments. We remain well placed through our positions on the Eurofighter Typhoon, our shareholding in MBDA and our BAE Systems Hägglunds land business based in Sweden, and we are pursuing a number of significant opportunities in the region.

In the Middle East, our long-standing relationships at government and company levels, continued regional instability and the nature of our long-term contracts, mean we expect defence and security to remain a priority. The renewal of certain existing long-term support contracts is tracking in line with expectations and we continue to progress a number of opportunities with existing customers.

The civil aerospace market accounts for around 3% of Group sales. COVID-19 has significantly impacted this market, and a recovery to 2019 levels is likely to be a number of years away. We are seeing some signs of recovery and this remains an important franchise for us in which we have leading capabilities in flight and engine controls across new, developing and more mature programmes with capabilities transferable from defence air platforms.

Balance sheet and capital allocation

The Group recognises the importance to investors of a clear and consistent capital allocation policy. The Group's balance sheet is managed conservatively in line with its policy to retain its investment grade credit rating and to ensure operating flexibility. The Group expects to continue to meet its pension obligations, invest in research and technology and other organic investment opportunities, and plans to pay dividends in line with its policy of long-term sustainable cover of around two times underlying earnings.

Consistent with this approach, the Group initiated a share repurchase programme of up to £500m on 30 July which was completed in February 2022. Investment in value-enhancing acquisitions will continue to be considered where market conditions are right, where they deliver on the Group's strategy and where they offer greater long-term value than repurchasing the Group's own shares.

Post-employment benefit schemes

The Group's share of the pre-tax accounting net post-employment benefits deficit improved to a year end position of £2.1bn from £4.5bn, driven by higher discount rates and strong asset performance.

Under the funding deficit recovery plan agreed in February 2020 all scheduled lump sum Company contributions were made in 2020.

Board and Executive Committee changes

Dame Carolyn Fairbairn, Dr Ewan Kirk and Crystal E. Ashby were appointed to the Board as non-executive directors of the Company on 1 March, 1 June and 1 September 2021 respectively.

At the end of 2021 Cliff Robson was appointed Group Managing Director of the Air sector, replacing Chris Boardman who retired.

Following the formation of the Group's new Digital Intelligence business with effect from 2022, the following changes were made to the Executive Committee. David Armstrong was appointed Group Managing Director, Digital Intelligence. Karin Hoeing was appointed Group ESG, Culture & Business Transformation Director, and was succeeded as Group Human Resources Director by Tania Gandamihardja. Gabby Costigan was appointed Group Managing Director, Business Development. She was succeeded as Chief Executive, BAE Systems Australia by Ben Hudson. In turn, Julian Cracknell was appointed Chief Technology & Information Officer. Simon Barnes, Managing Director, BAE Systems Saudi Arabia, also joined the Executive Committee.

Summary

The fundamentals of our business remain strong, and the strategy of the Group is unchanged. Our business benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia. Relationships with, and support from, our customers remain strong, with defence and security continuing to be a priority for governments in our key markets, with continued demand for our capabilities. This backdrop, together with our focus on programme execution, positions us to grow our sales profitably and increase cash conversion in the coming years. We are evolving the business to have an appropriate sustainability agenda embedded at its core, with a constant focus on operational performance and value creation. As demonstrated this year, higher cash generation gives us increased strategic flexibility focused on technology and aligned to our customers' priorities, and enables us to deliver increased cash returns to shareholders.

Dividends

The Board has recommended a final dividend of 15.2p for a total of 25.1p for the full year. Subject to shareholder approval at the May 2022 Annual General Meeting, the dividend will be paid on 1 June 2022 to holders of Ordinary shares registered on 22 April 2022.

Financial glossary

We monitor the underlying financial performance of the Group using alternative performance measures (APMs). These measures are not defined in International Financial Reporting Standards (IFRS) and, therefore, are considered to be non-GAAP (Generally Accepted Accounting Principles) measures. Accordingly, the relevant IFRS measures are also presented where appropriate.

The Group uses these APMs as a mechanism to support year-on-year business performance and cash generation comparisons, and to enhance management's planning and decision making on the allocation of resources. The APMs are also used to provide information in line with the expectations of investors, and when setting guidance on expected future business performance. The Group presents these measures to the users to enhance their understanding of how the business has performed in the year, and do not consider them to be more important than, or superior to, their equivalent IFRS measures.

Measure	Definition	Purpose
Financial performance measures as defined by the Group		
Sales	Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments.	Enables management to monitor the revenue of both the Group's own subsidiaries as well as its strategically important equity accounted investments, to ensure programme performance is understood and in line with expectations.
Underlying EBIT[1]	Operating profit excluding amortisation of programme, customer-related and other intangible assets, impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBIT), and non-recurring items[2]. The exclusion of amortisation of acquisition-related intangible assets is to allow consistent comparability internally and externally between our businesses, regardless of whether they have been grown organically or via acquisition.	Provides a measure of operating profitability, excluding one-off events, to enable management to monitor the performance of recurring operations over time, and which is comparable across the Group.
Return on sales	Underlying EBIT as a percentage of sales.	Provides a measure of operating profitability, excluding one-off events, to enable management to monitor the performance of recurring operations over time, and which is comparable across the Group.
Underlying earnings per share[1]	Profit for the year attributable to shareholders, excluding post-tax impact of amortisation of programme, customer-related and other intangible assets, impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items[2] attributable to shareholders, being underlying earnings, divided by number of shares as defined for Basic EPS in accordance with IAS 33 Earnings per Share.	Provides a measure of the Group's underlying performance, which enables management to compare the profitability of the Group's recurring operations over time.
Underlying interest	Net finance costs for the Group and its share of equity accounted investments, excluding net interest expense on post-employment benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.	Provides a measure of finance costs associated with the operational borrowings of the Group that is comparable over time.

Measure	Definition	Purpose
Underlying effective tax rate	Taxation expense for the Group and its share of equity accounted investments, excluding any one-off tax benefit/expense, as a percentage of adjusted profit before taxation, being Profit before tax plus taxation expense of equity accounted investments, adjusted for non-recurring items[2].	Provides a measure of taxation for the Group, excluding one-off items, that is comparable over time.
Operating business cash flow	Net cash flow from operating activities excluding taxation and including net capital expenditure and lease principal amounts, financial investment and dividends from equity accounted investments.	Provides a measure of cash generated by the Group's operations, to service debt and meet tax obligations, and in turn available for use in line with the Group's capital allocation policy.
Free cash flow	Operating business cash flow less interest paid (net) and taxation.	Provides a measure of cash generated by the Group's operations after servicing debt and tax obligations, available for use in line with the Group's capital allocation policy.
Net debt (excluding lease liabilities)	Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments). Net debt does not include lease liabilities.	Allows management to monitor indebtedness of the Group, to ensure the Group's capital structure is appropriate and capital allocation policy decisions are suitably informed.
Order intake	Funded orders received from customers including the Group’s share of order intake of equity accounted investments.	Allows management to monitor the order intake of the Group's own subsidiaries as well as its strategically important equity accounted investments, providing insight into future years' sales performance.
Order backlog	Funded and unfunded unexecuted customer orders including the Group’s share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.	Supports future years’ sales performance of subsidiaries and equity accounted investments.

1. With effect from 2021, the Group adopted the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the previously reported underlying EBITA measure, as it reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business. Underlying earnings per share has also been recalculated to ensure consistency with the updated operational profitability measure. The underlying performance for 2020 of segments and the Group has been re-presented on this new basis.
2. Items that are not relevant to an understanding of the Group’s underlying performance (see page 15).

Measure	Definition
Financial performance measures derived from IFRS	
Revenue	Income derived from the provision of goods and services by the Company and its subsidiary undertakings.
Operating profit	Profit for the year before finance costs and taxation expense. This measure includes finance costs and taxation expense of equity accounted investments.
Return on revenue	Operating profit as a percentage of revenue.
Basic earnings per share	Basic earnings per share in accordance with IAS 33 Earnings per Share.
Net cash flow from operating activities	Net cash flow from operating activities in accordance with IAS 7 Statement of Cash Flows.
Order book	The transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.
Net post-employment benefits deficit	Net IAS 19 Employee Benefits deficit, excluding amounts allocated to equity accounted investments.
Dividend per share	Interim dividends paid and final dividend proposed per share.

Income statement summary

	2021 £m	2020 £m
Financial performance measures as defined by the Group[1]		
Sales	**21,310**	20,862
Underlying EBIT	**2,205**	2,037
Return on sales	**10.3%**	9.8%
Financial performance measures derived from IFRS[2]	**£m**	£m
Revenue	**19,521**	19,277
Operating profit	**2,389**	1,930
Return on revenue	**12.2%**	10.0%
Reconciliation of sales to revenue	**£m**	£m
Sales	**21,310**	20,862
Deduct Group's share of revenue of equity accounted investments	**(2,979)**	(2,652)
Add Subsidiaries' revenue from equity accounted investments	**1,190**	1,067
Revenue	**19,521**	19,277
Reconciliation of underlying EBIT to operating profit	**£m**	£m
Underlying EBIT	**2,205**	2,037
Non-recurring items	**350**	19
Amortisation of programme, customer-related and other intangible assets	**(86)**	(42)
Impairment of intangible assets	**(15)**	(4)
Financial expense of equity accounted investments	**(27)**	(32)
Taxation expense of equity accounted investments	**(38)**	(48)
Operating profit	**2,389**	1,930
Net finance costs	**(279)**	(334)
Taxation expense	**(198)**	(225)
Profit for the year	**1,912**	1,371
Underlying interest expense	**(241)**	(255)
Net interest expense on post-employment benefit obligations	**(67)**	(70)
Fair value and foreign exchange adjustments on financial instruments and investments	**2**	(41)
Net finance costs (including equity accounted investments)	**(306)**	(366)

Exchange rates

	2021	2020
Average		
£/$	**1.376**	1.283
£/€	**1.163**	1.125
£/A$	**1.832**	1.862
Year end		
£/$	**1.354**	1.367
£/€	**1.191**	1.117
£/A$	**1.863**	1.770

Sensitivity analysis	**£m**
Estimated impact on sales of a ten cent movement in the average exchange rate	
$	**625**
€	**115**
A$	**45**

1. The purposes and definitions of non-GAAP measure are provided in the Financial glossary on page 12.
2. International Financial Reporting Standards.

Sales increased by £0.4bn to £21.3bn (2020 £20.9bn), a 5% increase on a constant currency basis[1].

Underlying EBIT increased to £2,205m (2020 £2,037m), giving a return on sales of 10.3% (2020 9.8%). Excluding the impact of exchange translation, the increase was 13%.

Revenue increased by £0.2bn to £19.5bn (2020 £19.3bn).

Operating profit increased by £459m to £2,389m (2020 £1,930m).

Non-recurring items in 2021 reflect a gain of £350m, comprising a gain in HQ on the sale of the Filton and Broughton sites of £182m, gains on disposal of Advanced Electronics Company in the Air sector (£132m, of which £63m is attributable to non-controlling interests) and on disposal of a business in our Electronic Systems segment (£26m), and a net £10m gain relating to historical and current year acquisitions. The credit of £19m in 2020 comprised a settlement gain on a US pension annuity buy-out of £64m, offset by charges relating to acquisitions and disposals of £38m and a Guaranteed Minimum Pension equalisation charge of £7m.

Amortisation of programme, customer-related and other intangible assets is £86m (2020 £42m), the increase being driven by amortisation charges in the Electronic Systems businesses acquired during 2020.

Impairment of intangible assets in 2021 is £15m (2020 £4m).

Net finance costs, including equity accounted investments, were £306m (2020 £366m). The underlying interest charge, excluding pension accounting, and fair value and foreign exchange adjustments on financial instruments and investments was £241m (2020 £255m). Net interest expense on the Group's pension deficit was £67m (2020 £70m).

Taxation expense, including equity accounted investments, of £236m reflects the Group's underlying effective tax rate for the year of 18%, plus the tax charge on non-recurring items, less a one-off tax benefit of £94m in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime and the impact of the UK tax rate adjustment (see note 4). The 2020 charge of £273m reflected the Group's underlying effective tax rate for the year of 17%.

The calculation of the underlying effective tax rate is shown in note 4 on page 48.

1. Current year compared with prior year translated at current year exchange rates.

Earnings per share

	2021	2020
Financial performance measures as defined by the Group[1]		
Underlying earnings (excluding the 2021 one-off tax benefit)	**£1,523m**	£1,414m
Underlying earnings per share (excluding the 2021 one-off tax benefit)	**47.8p**	44.3p
Underlying earnings (including the 2021 one-off tax benefit)	**£1,617m**	£1,414m
Underlying earnings per share (including the 2021 one-off tax benefit)	**50.7p**	44.3p
Financial performance measures derived from IFRS[2]		
Profit for the year attributable to equity shareholders	**£1,758m**	£1,299m
Basic earnings per share	**55.2p**	40.7p

Reconciliation of underlying EBIT to underlying earnings	**£m**	£m
Underlying EBIT	**2,205**	2,037
Underlying interest expense	**(241)**	(255)
	1,964	1,782
Taxation expense (at the underlying effective tax rate, excluding the 2021 one-off tax benefit)	**(350)**	(296)
Non-controlling interests	**(91)**	(72)
Underlying earnings (excluding the 2021 one-off tax benefit)	**1,523**	1,414
One-off tax benefit	**94**	-
Underlying earnings (including the 2021 one-off tax benefit)	**1,617**	1,414

Reconciliation of underlying earnings to profit for the year attributable to equity shareholders	**£m**	£m
Underlying earnings (excluding the 2021 one-off tax benefit)	**1,523**	1,414
Non-recurring items, post tax	**279**	15
Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles, post tax	**(84)**	(38)
Net interest expense on post-employment benefit obligations, post tax	**(55)**	(58)
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	**1**	(34)
One-off tax benefit (2021)	**94**	-
Profit for the year attributable to equity shareholders	**1,758**	1,299
Non-controlling interests	**154**	72
Profit for the year	**1,912**	1,371

Underlying earnings per share for the year (excluding the one-off tax benefit) increased by 12%, excluding the impact of exchange translation, to 47.8p (2020 44.3p).

Basic earnings per share was 55.2p (2020 40.7p).

Orders

Financial performance measures as defined by the Group[1]	**2021**	2020
Order intake[3]	**£21,458m**	£20,915m
Order backlog[3]	**£44.0bn**	£45.2bn
Financial performance measures derived from IFRS[2]		
Order book	**£35.5bn**	£36.3bn

Order intake[3] increased by £543m to £21,458m (2020 £20,915m). Our US-managed businesses had a book-to-bill ratio[4] of more than one.

Order backlog[3] decreased by £1.2bn to £44.0bn.

Order book decreased by £0.8bn to £35.5bn.

1. The purposes and definitions of non-GAAP measure are provided in the Financial glossary on page 12.
2. International Financial Reporting Standards.
3. Including share of equity accounted investments.
4. Ratio of Order intake to Sales.

Cash flow

	2021 £m	2020 £m
Financial performance measures as defined by the Group[1]		
Free cash flow	**1,864**	367
Financial performance measures derived from IFRS[2]	**£m**	£m
Net cash flow from operating activities	**2,447**	1,166
Reconciliation from free cash flow to net cash flow from operating activities	**£m**	£m
Free cash flow	**1,864**	367
Add back Interest paid, net of interest received	**224**	208
Add back Taxation	**234**	251
Operating business cash flow	**2,322**	826
Add back Net capital expenditure and financial investment	**209**	392
Add back Principal element of lease payments and receipts	**207**	226
Deduct Dividends received from equity accounted investments	**(57)**	(27)
Deduct Taxation	**(234)**	(251)
Net cash flow from operating activities	**2,447**	1,166
Net capital expenditure and financial investment	**(209)**	(392)
Principal element of finance lease receipts	**10**	10
Dividends received from equity accounted investments	**57**	27
Interest received	**23**	19
Acquisitions and disposals	**185**	(1,701)
Net cash flow from investing activities	**66**	(2,037)
Interest paid	**(247)**	(227)
Equity dividends paid	**(777)**	(746)
Purchase of own shares	**(368)**	-
Partial disposal of shareholding in subsidiary undertaking	**28**	27
Dividends paid to non-controlling interests	**(202)**	(19)
Principal element of lease payments	**(217)**	(236)
Cash flow from derivative financial instruments (excluding cash flow hedges)	**(88)**	16
Movement in cash collateral	**(18)**	(2)
Net cash flow from loans	**(367)**	2,160
Net cash flow from financing activities	**(2,256)**	973
Net increase in cash and cash equivalents	**257**	102
Add back/(deduct) Net cash flow from loans	**367**	(2,160)
Foreign exchange translation	**(50)**	220
Other non-cash movements	**(16)**	(137)
Decrease/(increase) in net debt (excluding lease liabilities)	**558**	(1,975)
Opening net debt (excluding lease liabilities)	**(2,718)**	(743)
Net debt (excluding lease liabilities)	**(2,160)**	(2,718)

1. The purposes and definitions of non-GAAP measure are provided in the Financial glossary on page 12.
2. International Financial Reporting Standards.

Free cash flow was £1,864m (2020 £367m, including the impact of the Group's £1bn contribution into the UK pension scheme). The strong inflow in the year was driven by our sharp focus on liquidity, good operational performance and improved working capital management including some accelerated collections.

Net cash inflow from operating activities was £2,447m (2020 £1,166m, including the effect of the £1bn contribution to the UK pension scheme).

Taxation payments were £234m (2020 £251m).

Net capital expenditure and financial investment was £209m (2020 £392m) which includes the impact of an inflow from the proceeds of the site sales of £271m.

Dividends received from equity accounted investments amounted to £57m (2020 £27m).

Interest received was £23m (2020 £19m).

Cash flows in respect of acquisitions, disposals and held for sale assets comprises a net inflow of £185m, primarily in relation to the divestment of the Advanced Electronics Company. The cash outflows in 2020 in respect of **acquisitions, disposals, held for sale assets** and the **partial disposal of shareholdings** in subsidiary undertakings primarily represent the two US acquisitions and that of Techmodal, with an inflow of £27m from the reduction in the Group's shareholding in Overhaul and Maintenance Company (OMC).

Interest paid was £247m (2020 £227m).

Equity dividends paid in 2021 represents the 2020 final dividend (£461m) and the 2021 interim dividend (£316m).

The **share buyback** saw an outflow of £368m in the year. The full £500m programme completed in February 2022.

Dividends paid to non-controlling interests were £202m (2020 £19m), primarily reflecting payments made by our partially-owned subsidiaries in Saudi Arabia.

There was a **cash outflow from derivative financial instruments** of £88m (2020 £16m inflow), arising from rolling hedges relating to balances within the Group’s subsidiaries and equity accounted investments.

Foreign exchange translation primarily arises in respect of the Group’s US dollar-denominated borrowing.

Net debt

Components of net debt (excluding lease liabilities)	2021 £m	2020 £m
Cash and cash equivalents	**2,917**	2,768
Debt-related derivative financial instruments (net)	**(16)**	(62)
Loans – non-current	**(4,604)**	(4,957)
Loans and overdrafts – current	**(457)**	(467)
Net debt (excluding lease liabilities)	**(2,160)**	(2,718)

The Group's **net debt** (excluding lease liabilities) at 31 December 2021 is £2,160m, a net decrease of £558m from the position at the start of the year. This is primarily a result of the strong Free cash flow performance, partially offset by dividends paid and the share buyback.

Cash and cash equivalents of £2,917m (2020 £2,768m) are held primarily for the repayment of debt securities, pension deficit funding when required, payment of the 2021 final dividend, funding of the completion of the share buyback programme announced in July 2021 and management of working capital.

Accounting policies

Changes in accounting policies

No new or amended standards which became applicable for the year ending 31 December 2021 had a material impact on the Group or required the Group to change its accounting policies.

Segmental review

The Group reports its performance through six reporting segments.

	Year ended 31 December 2021										
	As defined by the Group						Derived from IFRS[1]				
	Sales £m	Underlying EBIT £m	Return on sales %	Operating business cash flow £m	Order Intake[2] £m	Order Backlog[2] £bn	Revenue £m	Operating profit £m	Return on revenue %	Net cash flow from operating activities £m	Order book £bn
Electronic Systems	4,491	766	17.1	774	4,923	7.2	4,491	715	15.9	951	5.7
Platforms & Services (US)	3,395	259	7.6	287	3,236	5.6	3,318	252	7.6	351	5.3
Air	8,321	856	10.3	628	7,186	20.3	6,913	930	13.5	743	14.7
Maritime	3,416	288	8.4	321	4,336	9.9	3,340	289	8.7	457	9.4
Cyber & Intelligence	1,752	156	8.9	173	1,817	1.6	1,752	152	8.7	202	1.0
HQ[3]	307	(120)		139	320	–	36	51		(23)	–
Deduct Intra-group	(372)				(360)	(0.6)	(329)				(0.6)
Deduct Taxation[4]										(234)	
Total	**21,310**	**2,205**	**10.3**	**2,322**[5]	**21,458**	**44.0**	**19,521**	**2,389**	**12.2**	**2,447**	**35.5**

1. International Financial Reporting Standards.
2. Including share of equity accounted investments.
3. HQ comprises the Group's head office activities, together with a 49% interest in Air Astana.
4. Taxation is managed on a Group-wide basis.
5. At a Group level, the key cash flow metric is Free cash flow (see Financial glossary on page 12). Free cash flow was £1,864m (2020 £367m).

Segmental performance: Electronic Systems

Electronic Systems, with 16,400 employees[1], comprises the US- and UK-based electronics activities, including electronic warfare systems, navigation systems, electro-optical sensors, military and commercial digital engine and flight controls, precision guidance and seeker solutions, next-generation military communications systems and data links, persistent surveillance capabilities, space electronics and electric drive propulsion systems.

Operational and strategic key points

- Cumulatively more than 1,000 electronic warfare systems delivered on F-35 programme.
- Limited Interim Missile Warning System indefinite delivery, indefinite quantity sustainment and support contract awarded worth $872m (£644m) over ten years.
- EPAWSS testing underway on F-15E and F-15EX aircraft.
- Contract received from Defense Logistics Agency valued at more than $640m (£473m) to deliver Increment 1 M-Code devices.
- Rising demand for low and zero emission vehicles in our Power & Propulsion Solutions business.
- Demand in our Controls & Avionics Solutions commercial markets starting to recover from pandemic impacts.

Financial performance

Financial performance measures as defined by the Group[2]

	2021	2020
Sales	**£4,491m**	£4,557m
Underlying EBIT	**£766m**	£674m
Return on sales	**17.1%**	14.8%
Operating business cash flow	**£774m**	£580m
Order intake[1]	**£4,923m**	£4,722m
Order backlog[1]	**£7.2bn**	£6.5bn

Financial performance measures derived from IFRS[3]

	2021	2020
Revenue	**£4,491m**	£4,557m
Operating profit	**£715m**	£649m
Return on revenue	**15.9%**	14.2%
Cash flow from operating activities	**£951m**	£767m
Order book	**£5.7bn**	£5.3bn

- Sales grew by 5%[4] with growth from the Electronic Combat Solutions and Precision Strike & Sensing Solutions businesses.
- Commercial revenues were flat as the pandemic continued to impact.
- Return on sales of 17.1% on strong operational performance and significant contribution from 2020 acquisitions.
- Increase in operating business cash flow reflected good working capital management and programme execution.
- Key orders secured on F-35, Precision Strike and C4ISR programmes.

Operational performance

Electronic Combat Solutions

The F-35 Lightning II programme completed deliveries for Lot 13 and has delivered a cumulative total of more than 1,000 electronic warfare (EW) systems. We are also supporting the Block 4 modernisation efforts under multiple contracts worth over $870m (£642m), and we continue to operate under a five-year Performance-Based Logistics contract to provide EW module availability and support for the F-35 sustainment programme.

Under contract from Boeing, we continue to deliver our next-generation electronic warfare Eagle Passive Active Warning Survivability System to support the upgrade of the US Air Force F-15 platform and testing on F-15E and F-15EX test aircraft at both Eglin and Edwards Air Force bases. During 2021 BAE Systems was awarded $210m (£155m) for the low-rate initial production phase, hardware redesign for cost reduction, obsolete parts provisioning, and other support requirements.

We are also under contract to install the Digital Electronic Warfare System on new and existing F-15 aircraft for multiple international customers, including the provision of hardware and software to support the first successful flight of the F-15QA fighter under a Qatar Foreign Military Sale programme.

We continue to collaborate with Boeing in the pursuit of all F-15 EW upgrade opportunities, both domestic and international.

We are providing Lots 2 and 3 of the sensor hardware/software functionality for the Long Range Anti-Ship Missile (LRASM), and in April we received a contract totalling $117m (£86m) from Lockheed Martin for LRASM sensor production Lots 4 and 5. We are also executing Diminishing Material Sources contracts for the next configuration of LRASM.

Due to the sensitive nature of electronic combat systems and technology, many of our programmes are classified. These include our work as a world leader in electronic warfare providing next-generation defence technologies.

Countermeasure & Electromagnetic Attack Solutions

The Compass Call programme is currently executing contracts valued at more than $1bn (£0.7bn), focused on the cross-decking of prime mission equipment to the new EC-37B aircraft while sustaining and upgrading the existing EC-130H fleet. Integration and test of the EC-37B mission system is ongoing, as well as a second phase of testing to demonstrate the Small Adaptive Bank of Electronic Resources technology on the EC-130H. The EC-37B platform is targeted to field in 2024.

We received an indefinite delivery, indefinite quantity contract from the US Army to provide life cycle sustainment and technical support to the Limited Interim Missile Warning System programme. The ten-year contract has a ceiling value of $872m (£644m).

Precision Strike & Sensing Solutions

The APKWS® guidance kit programme is executing at full-rate production under an indefinite delivery contract, with awards worth over $100m (£74m) received in the first half. Government qualification on the Block Upgrade Variant is complete, and the new version is approved and on contract. The upgraded guidance kits are now in production and will be delivered to customers starting in early 2022.

Navigation and Sensor Systems was awarded a contract valued at more than $325m (£240m) from the Defense Logistics Agency to deliver Increment 1 M-Code devices through to 2030. An additional contract option executed by the Defense Logistics Agency in November is valued at $316m (£233m).

The Terminal High Altitude Area Defense (THAAD) seeker programme is executing at full-rate production levels, providing critical targeting technology that helps to protect the US and its allies from ballistic missiles. The programme is currently working to design and manufacture next-generation THAAD infrared seekers valued at $150m (£111m).

On 1 April, we completed the sale of BAE Systems Rokar International Ltd., an international defence electronics company, to Elbit Systems for approximately $31m (£22m). We continue to work with Rokar as an important supplier under licences and other agreements.

C4ISR Systems

We continue to progress our strategic integration of last year's acquisition to advance our presence in the communications marketplace, bringing together technology in communications, cryptography, and navigation to compete and grow our portfolio in joint all-domain command and control markets. We completed a successful prototype demonstration implementing modular open system architecture for the US Army's Enduring Fleet while providing a path to support Future Vertical Lift and Ground platforms. We have been competitively down selected for Airborne High Frequency Radio Modernization with an anticipated award in 2022.

We successfully captured a highly competitive space technology development programme. The team will demonstrate and qualify the next-generation, radiation-hardened Application Specific Integrated Circuit (ASIC) Library technology, and will develop the infrastructure to offer ASIC design services. This win positions us well to continue as a leading provider in the space domain.

We continue to experience steady growth in our signals intelligence portfolio. Within our classified programmes, we had a successful customer design review in April leading to future system upgrades.

Controls & Avionics Solutions
We are seeing a continued uptick in airline traffic and, more importantly, in business travel. Consequently, demand for Original Equipment Manufacturer deliveries and aftermarket services is showing an improvement. Long-term fundamentals remain strong and underpin the demand for more than 40,000 new aircraft over the next two decades. We also see a trend towards more electric aircraft, specifically in the emerging advanced air mobility segment, for which the business is developing energy management and power conversion systems.

The business continues to develop the integrated flight control electronics and remote electronic units for the new Boeing 777X aircraft family. The flight control system is performing as expected during flight testing, and we continue to incorporate software updates and conduct systems verification testing.

Our engine control products, offered through FADEC International (our joint venture with Safran Electronics & Defense) and FADEC Alliance (a joint venture between GE Aviation and FADEC International), continue to perform well across our entire portfolio. The LEAP® FADEC family achieved a major milestone, delivering the 10,000th unit, making it our fastest ramp-to-rate engine control product. On the military side, the GE T901 FADEC is under development, the T700 engine replacement for the UH-60 Black Hawk and AH-64 Apache along with the US Army's Future Attack Reconnaissance Aircraft.

Deliveries of the F-35 vehicle management computer and active inceptor systems have successfully ramped up, and we are enabling the first US Depot stand-up scheduled for 2022. Development of the advanced vehicle control system for the UK Dreadnought submarine programme remains on plan.

We continue to progress and mature our autonomous control technologies through a series of successful crewed-uncrewed teaming flight test events, including a recently successful capstone flight demonstration event, on a US Department of Defense funded programme. The objective of this programme is to develop autonomous technologies and mission capabilities for US military platforms.

Power & Propulsion Solutions
Despite the impacts on travel from the pandemic, the demand for low and zero emission vehicles is rising as air quality and climate change ascend the global agenda. In addition to existing low emission electric hybrid and zero emission battery electric options, BAE Systems now offers a hydrogen fuel cell electric propulsion system in collaboration with Plug Power, Inc.

Hybrid bus procurements continue in cities such as Namur, Belgium and Boston, Massachusetts, in the US, and we anticipate large procurements in Philadelphia, Pennsylvania and Mississauga in Canada. Bus manufacturer Nova Bus has successfully integrated our Gen3 electric drive system to power its new LFSe+ battery electric buses and has sold these electric buses into ten transit properties, including San Francisco Municipal Transportation Authority, which will begin to transition its fleet from BAE Systems-supplied electric hybrid systems to our Gen3 fully electric drive system.

We are expanding our clean energy footprint in the maritime domain, receiving multiple contracts to deliver low and zero emission passenger transport and research vessels. We are taking hydrogen fuel cells to the waterways, with Switch Maritime's Sea Change undergoing sea trials using our electric drive propulsion system. In addition, we secured an opportunity to collaborate with other maritime industry leaders to demonstrate our proven maritime propulsion solutions for use on the River Thames in London. In the air domain, we continue to progress technologies that will enable lighter weight, cost-competitive energy storage solutions for hybrid engines in aircraft.

Looking forward

Forward-looking information for the Electronic Systems reporting segment is provided on page 37.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see Financial glossary on page 12.
3. International Financial Reporting Standards.
4. Constant currency basis.

Segmental performance: Platforms & Services (US)

Platforms & Services (US), with 12,300 employees[1], has operations in the US, UK and Sweden. It manufactures and upgrades combat vehicles, weapons and munitions, and delivers services and sustainment activities, including naval ship repair, and the management and operation of government-owned munitions facilities.

Operational and strategic key points

- Selected to participate in the design concept phase for the US Army's Optionally Manned Fighting Vehicle programme.
- Consistent deliveries of the M109A7 Self-Propelled Howitzer enabled the programme to surpass 350 cumulative system deliveries.
- Received a $600m (£443m) sustainment and technical support services contract for Armored Multi-Purpose Vehicle, and AMPV deliveries continued against the rebaselined customer schedule.
- Amphibious Combat Vehicle deliveries against LRIP and design development have begun on mission variants.
- Contract received worth approximately $200m (£148m) from Sweden for 127 BvS10s.
- Contract received exceeding $500m (£369m) for mid-life upgrades of Dutch CV90s.
- US Ship Repair was significantly impacted by the pandemic, but has seen some recent signs of recovery.
- Ordnance Systems awarded additional contracts for modernisation projects at Holston.

Financial performance

Financial performance measures as defined by the Group[2]

	2021	2020
Sales	**£3,395m**	£3,503m
Underlying EBIT	**£259m**	£190m
Return on sales	**7.6%**	5.4%
Operating business cash flow	**£287m**	£382m
Order intake[1]	**£3,236m**	£4,137m
Order backlog[1]	**£5.6bn**	£6.1bn

Financial performance measures derived from IFRS[3]

	2021	2020
Revenue	**£3,318m**	£3,399m
Operating profit	**£252m**	£183m
Return on revenue	**7.6%**	5.4%
Cash flow from operating activities	**£351m**	£458m
Order book	**£5.3bn**	£5.6bn

- Sales grew by 3%[4] on higher combat vehicle deliveries and ramp up of CV90 upgrade programmes.
- Return on sales grew by more than 200bps with continued recovery and operational improvement in Combat Mission Systems and Ship Repair.
- Operating business cash flow was lower as 2020 benefited from pandemic-related customer actions and advances on exports.
- Multiple combat vehicle programme orders of $2.7bn (£2.0bn) and almost $700m (£517m) of new work in Ship Repair.

Operational performance

Combat Mission Systems

Combat Mission Systems continues to make progress towards achieving consistent production throughput, with volumes at a heightened level across multiple programmes. Throughout the period, the team has worked closely with customers to address pandemic-related disruptions and schedule impacts. Investments in facilities and new manufacturing technologies, including automation and robotic welding, are delivering positive returns, and we look to leverage these process improvements to benefit our performance as we move to full rate production across a number of platforms.

We continue to deliver Amphibious Combat Vehicles (ACVs) to the US Marine Corps under low-rate initial production contracts totalling approximately $600m (£443m) for 116 vehicles, and two full-rate production contracts for an additional 105 vehicles at a value of $552m (£408m). Design and development has begun on new ACV mission variants to include integrating a 30mm unmanned gun system for the ACV-30 variant and studying reconnaissance capabilities for the ACV.

On the US Army's Armored Multi-Purpose Vehicle (AMPV) programme, we are working under production contracts worth $1.3bn (£1.0bn). Deliveries of the five variants continued this year according to the rebaselined customer schedule, which was contractually agreed with the Army in December. In July we also received a contract worth up to $600m (£443m) for AMPV sustainment and technical support services.

Progress continues on the M109A7 programme under cumulative low rate initial production totalling approximately $1.5bn (£1.2bn) for 204 vehicle sets. We received a $339m (£250m) full-rate production contract for 48 vehicle sets in 2020. In the second half of the year, we received early order material awards totalling $97m (£72m) to support further production.

Work to upgrade Bradley vehicles to the A4 configuration continues. Following several modifications, the contract is valued at $809m (£597m) for 459 vehicles and spares.

We are executing on a $32m (£24m) prototype contract received last year from the US Army's Rapid Capabilities and Critical Technologies Office to integrate a hybrid-electric drive system onto Bradley Fighting Vehicles.

We continue to produce and sustain the US Army's M88 recovery vehicles under previously awarded contracts, upgrading 43 vehicles from the M88A1 to the M88A2 HERCULES configuration, and developing the next-generation M88A3 configuration to restore single-vehicle recovery capability. In December we received a $79m (£58m) contract to deliver the first M88A3 prototypes.

In July, we were selected to participate in the design concept phase for the US Army's Optionally Manned Fighting Vehicle programme.

We are producing Mk 41 Vertical Launching System (VLS) missile canisters for the US Navy under awards totalling $350m (£258m), with a total potential value of more than $695m (£513m) if all options are exercised. In April, we successfully competed for a $164m (£121m), five-year contract to remain the Navy's design agent for missile canisters and the mechanical portion of the VLS.

Under 2019 and 2020 contract modifications, we are working to deliver Mk45 Mod 4 gun systems to the US Navy. In October, we received a $26m (£19m) contract to provide 57mm Mk110 naval gun systems for the Navy's new Constellation class frigates and Coast Guard Argus class patrol cutters. In December, we received a $24m (£18m) contract to deliver Mk38 Mod 3 25mm machine gun systems designed to counter unmanned aerial gun systems to the Navy.

Deliveries continue on a contract to provide 37 Virginia Payload Module tubes for the US Navy's Block V Virginia Class submarines.

Ordnance Systems

We continue to operate and modernise the US Army's Radford and Holston ammunition plants under a total of $1.7bn (£1.3bn) in modernisation contracts. The Army has awarded a two-year extension for Radford operations as we make progress towards a cumulative five-year extension for Radford and a competition for the operation of Holston.

At Holston, modernisation activities continue, including the construction of a Weak Acetic Acid Recovery Plant, multiple contracts for a natural gas-fired steam facility, a wastewater management facility, and the design, construction and commissioning of new production facilities. Contracts totalling $372m £(275)m were awarded in the year for energetics facilities at Holston in continuation of the Army's $1bn (£0.7bn) investment to increase production capabilities.

At Radford, construction of a modern nitrocellulose facility has been completed, and the facility is in the commissioning and product qualification phase.

US Ship Repair

The US Ship Repair business continues to conduct modernisation and maintenance activities for the US Navy's non-nuclear fleet. Our shipyards and programmes were significantly impacted by the COVID-19 pandemic, though recent trends show a lessening of those impacts, coupled with higher than usual levels of customer-added work to existing contracts. Our investments in operational excellence and additional resources are delivering benefits as we address several challenged ship modernisation programmes and work to recover from pandemic and other operational disruptions.

During the year, we received contracts with a cumulative value of $651m (£481m) for maintenance and modernisation, including on the USS Detroit, USS Minneapolis-St. Paul, USS St. Louis and USS Winston S. Churchill in our Jacksonville yard; the USS Makin Island, USS Manchester, USS Russell and USS San Diego in our San Diego shipyard; and the USS Mitscher and post-construction work on three LPD 17 class ships, starting with USS Fort Lauderdale in our Norfolk shipyard.

BAE Systems Hägglunds

We are executing on a contract with the Netherlands to upgrade and extend the life of its CV9035 fleet, including the integration of Elbit Systems' Iron Fist Active Protection System and an anti-tank guided-missile system. Under a 2020 contract to convert the Dutch fleet of CV90s to rubber band track, we delivered the first vehicle on time, cost and quality in 2021. A new contract exceeding $500m (£369m) for mid-life upgrades was received in 2021.

Work is progressing to refurbish the Swedish CV90 fleet, and deliveries of 40 Mjölner mortar systems were finalised on time, at cost and quality.

Under a 2020 contract, we are extending the expected life of 186 Swiss Army CV90s to 2040. Norway awarded us a contract exceeding $50m (£37m) in February for an additional 20 vehicles. We continue to pursue the Czech Republic's procurement for new fighting vehicles.

We received a contract worth approximately $200m (£148m) from Sweden for 127 BvS10s. Our Beowulf unarmoured variant was selected along with a competitor to participate in trials this year for the US Army's Cold Weather All-Terrain Vehicle programme.

Additionally, we received a contract from the French Army to sustain and maintain readiness of its BvS10 fleet.

BAE Systems Bofors

We continue to deliver on Swedish and US Army contracts for 155mm BONUS ammunition, including a third order in October. The 24 additional ARCHER systems for Sweden are nearing completion, and ARCHER successfully demonstrated its capabilities during a US Army evaluation.

We are under multiple export contracts to deliver 40Mk4 and 57Mk3 naval gun systems, including a recent order for five 57Mk3s and ten 40Mk4s for the UK Royal Navy's Type 31 frigates. We are also delivering 57mm (Mk110) gun systems to the US Navy and Coast Guard. In February, we were selected to provide 12 40Mk4s to the Belgian and Dutch navies in a joint procurement.

Weapon Systems UK

Production of 145 M777s for the Indian Army continues under a $542m (£400m) Foreign Military Sales contract. We proposed plans to cease M777 manufacturing operations at our Barrow-in-Furness site due to lower projected workload.

FNSS

FNSS, our land systems joint venture based in Turkey, continues to produce 8x8 wheeled armoured vehicles for the Royal Malaysian Army. Production has started on medium-weight tanks for delivery to Indonesia, and work has started for specialist engineering vehicles for the Philippines.

Multiple contracts for the Turkish Armed Forces worth in excess of €800m (£672m) are progressing. These include contracts for air defence vehicles, assault amphibious vehicles, and special purpose 8x8 and 6x6 vehicles. In September a contract extension was signed for a further 84 anti-tank vehicles in addition to the 260 already delivered or in production. Work has also started on a programme to modernise 133 armoured combat vehicles for the Turkish Armed Forces.

Looking forward

Forward-looking information for the Platforms & Services (US) reporting segment is provided on page 37.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see Financial glossary on page 12.
3. International Financial Reporting Standards.
4. Constant currency basis.

Segmental performance: Air

Air, with 29,700 employees[1], comprises the Group's UK-based air activities for European and International Markets, US Programmes, and development of Future Combat Air Systems, alongside its businesses in Saudi Arabia and Australia, together with its 37.5% interest in the European MBDA joint venture.

Operational and strategic key points

- Qatar Typhoon and Hawk programme is progressing well, with first Qatar Typhoon flight achieved in November and deliveries on schedule to commence in 2022.
- F-35 rear fuselage production reached full rate levels, with 151 assemblies completed in the year.
- Production progressing to plan on the German Typhoon programme.
- Initial entry into service of the future electronically scanned European Common Radar Solution was achieved in December.
- Tempest next-generation Future Combat Air System programme continues to progress well, with initial Concept & Assessment Phase contract secured.
- Air sector continues to work closely with industry partners and the UK government to continue to fulfil contractual support arrangements in Saudi Arabia.
- Australia Hunter Class Frigate programme continues through prototyping, with good engagement with the Commonwealth to agree revised schedule for production to commence.
- MBDA won several export orders on air platforms.

Financial performance

Financial performance measures as defined by the Group[2]

	2021	2020
Sales	**£8,321m**	£7,910m
Underlying EBIT	**£856m**	£909m
Return on sales	**10.3%**	11.5%
Operating business cash flow	**£628m**	£718m
Order intake[1]	**£7,186m**	£6,494m
Order backlog[1]	**£20.3bn**	£22.5bn

Financial performance measures derived from IFRS[3]

	2021	2020
Revenue	**£6,913m**	£6,593m
Operating profit	**£930m**	£861m
Return on revenue	**13.5%**	13.1%
Cash flow from operating activities	**£743m**	£917m
Order book	**£14.7bn**	£16.5bn

- Sales growth of nearly 6%[4], driven by F-35, Typhoon support activity, continued ramp in production on Qatar programmes, commencement of German Typhoon programme and MBDA volumes.
- Return on sales of 10.3% delivered by good operational performance, with increased R&D on Tempest programme and maturity mix of projects driving the margin reduction compared to 2020.
- Operating business cash flow reflects some utilisation of advances and timing on supplier spend.
- Orders included initial Tempest Concept & Assessment phase, Typhoon upgrades, further F-35 awards, strong MBDA demand and Hawk support contract renewal in Australia.

Operational performance

European and International Markets

Activity on the 24 Typhoon and nine Hawk aircraft and associated support and training contract for the State of Qatar is progressing well. The first five Hawk aircraft have been accepted by the customer and entered into service at RAF Leeming, in line with the agreement to base the Qatari Hawk aircraft in the UK. A Qatar Typhoon aircraft completed its first flight in November, in advance of Typhoon deliveries commencing in 2022.

Eight deliveries of major units under the Kuwait Typhoon contract, secured by Italian Eurofighter partner Leonardo, were completed during the year. The five remaining Kuwait major unit deliveries are planned to be completed during 2022.

Production progresses to plan with ten front fuselages in build on the £1.3bn German Air Force order for 38 aircraft to replace its original Typhoon Tranche 1 aircraft, received at the end of 2020.

The UK Typhoon fleet continues to achieve the contracted flying hours under its ten-year partnership arrangement and support to the Royal Air Force's UK fleet of Hawk fast jet trainer aircraft continues under an interim agreement. The follow-on arrangement for the long-term Hawk availability is expected to be contracted in the first half of 2022.

Initial entry into service of the export standard electronically scanned European Common Radar was achieved in December with delivery of the first two Kuwait Typhoon aircraft by Leonardo, and this capability will be extended to Qatar in 2022. National radar variants for the UK, German, Italian and Spanish Air Forces will continue post completion of export standard radar development activities. The UK continues to fund development activity for the future UK Typhoon weapon system and sensors, as part of the Partner Nations' commitment to the ten-year Typhoon capability enhancement programme.

Future Combat Air System

The Tempest technology maturation programme is progressing well.

During the year, the Group secured an initial £250m order for the Future Combat Air System Concept & Assessment Phase. Working with industry partners and the Ministry of Defence, the contract will enable development of a range of digital concepts, embedding new tools and techniques to design, evaluate and shape the final design and capability requirements of Tempest.

The Defence Information business is well positioned for future opportunities across the multi-domain, information and digital areas identified in the UK Defence Command Paper.

The Group continues to invest in promising new and innovative technologies for the future. Discussions are underway with a number of customers across a range of potential services for the PHASA-35® solar-electric powered unmanned aircraft. Development of the platform continues with the first stratospheric flight planned for in 2022.

US Programmes

F-35 rear fuselage manufacturing reached full rate production during 2021 with 151 rear fuselage assemblies completed for the contracts Lots 12, 13, 14, and 15 in line with customer expectations. Pricing has now been agreed on Lots 15 to 17.

The global F-35 sustainment strategy continues to transition towards multi-year service agreements. In line with this, a five-year contract from January 2021 to December 2025 was awarded during the year, covering the provision of manpower services in support of key sustainment activities located in both the UK and the US.

Saudi Arabia

In Saudi Arabia, the In-Kingdom Industrial Participation programme continues to make good progress consistent with our long-term strategy, as well as the Saudi Arabian government's National Transformation Plan and Vision 2030, with examples of the benefits of the programme including our in-Kingdom employee base reflecting a 75% Saudisation rate, 94% of our in-Kingdom female employees being Saudi nationals and the development of our footprint across seven locations, resulting in demonstrable contributions to our local communities.

The Group is reliant on the continued approval of export licences by a number of governments in order to continue to support programme operations in the Kingdom of Saudi Arabia. We are working closely with industry partners and the UK government to continue to fulfil our contractual support arrangements in the Kingdom.

BAE Systems continues to perform against the contract secured in 2018 to provide Typhoon support services to the Royal Saudi Air Force through to the end of 2022. Through this contract, the business also supports the Industrialisation of Defence capabilities in Saudi Arabia.

Under the Saudi British Defence Cooperation Programme (SBDCP) agreement, the Group discharges a number of contracts, including support to the Tornado fleet, provision of officer and aircrew training and technician training for the Royal Saudi Air Force, as well as technical training, engineering and logistics services for the Royal Saudi Naval Forces.

The current five-year SBDCP funding arrangement concluded on 31 December 2021, and agreement has been reached in principle with the Saudi Arabian government for BAE Systems to continue to provide services for a further five years, to 31 December 2026. Negotiations regarding this have progressed well with initial orders received to ensure continuity of activities. Full contract award for these services is planned to be concluded during 2022.

19 of the contracted 22 Hawk aircraft assembled in-Kingdom have now been completed and formally accepted by the Royal Saudi Air Force, including 14 during the year. The remaining aircraft are scheduled to be completed during the first half of 2022.

We continue to review our portfolio of interests in a number of industrial companies in Saudi Arabia. The Saudi Arabia Military Industries purchase of Advanced Electronics Company completed in February 2021. We continue to explore opportunities to collaborate with key local partners, including Saudi defence entities, to deliver further In-Kingdom Industrial Participation, in line with the Kingdom's National Transformation Plan and Vision 2030.

Australia

Work on the Hunter Class Frigate programme continues with progress seen through prototyping where the first unit has successfully validated a number of the new shipyard processes. Design Separation and the Systems Definition Review have both been successfully achieved during the year. Work continues to agree a revised schedule with the Commonwealth of Australia following the announcement of an 18-month delay that will maximise ship design maturity before production commences.

The Jindalee Operational Radar Network programme has been re-baselined and a revised contract agreed with the customer. The programme is delivering against this schedule and operational support to the systems continues to meet availability requirements.

Hawk Mk127 Lead-In Fighter aircraft availability continues to meet customer expectations for Australian Defence Force pilot training. An extension of our In-Service-Support contract to 2031 was signed during the year, this included a contract for the upgrade of 33 engines across the Australian Hawk fleet.

Sustainment activity continues at our F-35 South Pacific Regional Airframe Depot at Williamtown, with the completion of the first F-35 airframe maintenance events. The ANZAC frigate upgrade programme continues to meet customer requirements.

Research and development activity in Australia has continued to grow, with progress made supporting both the Boeing Australia Loyal Wingman programme, which achieved its first flight in March 2021, and the Australian Army assessment of autonomous M113 armoured personnel carriers.

MBDA

During 2021, MBDA has continued to win domestic and export orders, with several key bids underway. The business is well placed to benefit from defence spending in a number of European countries and International opportunities.

In the year, a number of new contracts were signed, including the development of the SAMP/T NG (New Generation) ground-based air defence system for the French and Italian customers, Aster air defence missile Mid-Life Update for the UK and Italian customers, additional batches of MICA NG next-generation interception, combat and self-defence missiles for the French customer, the F-35 integration contract for Meteor/Spear and the Assessment Phase contract for the Future Cruise/Anti-Ship Weapon (the Anglo/French cooperation programme to replace Storm Shadow/Harpoon in the UK and SCALP/Exocet in France). In export markets, contracts for weapons packages in Greece, Saudi Arabia and Egypt were received.

Good progress continues on several development programmes including MICA Next Generation, Spear Capability 3, Brimstone 3, Teseo Mk2 Evolved, Aster Block 1 New Technology, as well as the MHT battlefield engagement missiles to be integrated on the Tiger Mk3 attack helicopter and Enforcer for the German Armed Forces.

Looking forward

Forward-looking information for the Air reporting segment is provided on page 37.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see Financial glossary on page 12.
3. International Financial Reporting Standards.
4. Constant currency basis.

Segmental performance: Maritime

Maritime, with 18,200 employees[1], comprises the Group's UK-based maritime and land activities.

Operational and strategic key points

– Construction of first three City Class Type 26 frigates for the Royal Navy is now underway.
– Canadian Surface Combatant programme entered a key design milestone in December, ahead of moving into the next Functional Design phase.
– Fifth Astute Class submarine, Anson, launched in April, with final installation and commissioning activities continuing to ready her for scheduled exit in 2022.
– Construction of the first two Dreadnought Class submarines continues to advance.
– Contract awarded and early design and concept work underway on Royal Navy's next generation of submarines.
– Contracts worth more than £1bn received under UK Ministry of Defence's Future Maritime Support Programme.
– Maritime Services provided preparation and support capabilities to the UK's Carrier Strike Group ahead of, and during, its first operational deployment.
– RBSL secured the Challenger 3 Main Battle Tank upgrade contract.

Financial performance

Financial performance measures as defined by the Group[2]	2021	2020
Sales	**£3,416m**	£3,257m
Underlying EBIT	**£288m**	£279m
Return on sales	**8.4%**	8.6%
Operating business cash flow	**£321m**	£243m
Order intake[1]	**£4,336m**	£3,772m
Order backlog[1]	**£9.9bn**	£9.1bn

Financial performance measures derived from IFRS[3]	2021	2020
Revenue	**£3,340m**	£3,195m
Operating profit	**£289m**	£272m
Return on revenue	**8.7%**	8.5%
Cash flow from operating activities	**£457m**	£317m
Order book	**£9.4bn**	£8.5bn

– Sales grew by 5%, driven by continued ramp in Dreadnought and Type 26 activity.
– Return on sales of 8.4% driven by continued strong operational performance across highly complex programmes.
– Operating business cash flow reflects good programme execution and working capital management.
– Orders included ongoing Dreadnought funding, contracts under UK Ministry of Defence Future Maritime Support Programme, and RBSL flow down of work on Challenger 3 Main Battle Tank programme.

Operational performance

Naval Ships

The Type 26 programme continues to progress, with construction now underway on the first three City Class Type 26 frigates. All units of first of class, Glasgow, have completed fabrication and the forward and aft blocks have now been linked as one ship. The second of class, Cardiff, now has 70% of her units in construction. Belfast, third of class, entered the manufacturing phase at our Govan yard in June 2021 at a ceremony led by HRH Duke of Cambridge.

The Canadian Surface Combatant Programme entered its Preliminary Design Review in December 2021, a key design gate ahead of moving into the next Functional Design phase of the programme. This will achieve a design consideration for the modifications required to the Type 26 core design to serve Canada's needs.

In our Combat Systems business, the successful delivery of major upgrades to the combat system capabilities on board both HMS Queen Elizabeth and HMS Prince of Wales enabled Carrier Strike Group tasking whilst achieving 99.5% equipment availability for the fleet.

Submarines

Our Submarines business is a member of the Dreadnought Alliance, working alongside the Submarine Delivery Agency (SDA) and Rolls-Royce to deliver the replacement for the Royal Navy's Vanguard Class, which carries the UK's nuclear deterrent. The value of the programme to the Group to date is £7.8bn, with additional contract funding of £1.9bn received in 2021. Four Dreadnought Class submarines will be built in Barrow, with the first of these due to be in operational service in the early 2030s. Construction of the first and second submarines continues to advance.

The major programme of investment to redevelop the Barrow site to support the delivery of Dreadnought is progressing, with a number of newly-constructed facilities now in operation.

Four Astute Class submarines have been delivered to the Royal Navy, while the fifth, Anson, was launched in April. Final installation and commissioning activities continue to ready her for exit, which is scheduled to take place in 2022. The remaining two submarines, Agamemnon and Agincourt, are at an advanced stage of construction at our Barrow site.

The business has also commenced early design and concept work on the Royal Navy's next generation of submarines, under an £85m contract from the Ministry of Defence announced in September 2021. BAE Systems will work alongside the SDA, Rolls-Royce, Babcock and other industry partners on a new class of nuclear powered attack submarines, which will eventually replace the Astute class. The programme currently supports approximately 250 highly-skilled jobs.

Maritime Services

Our Maritime Services business secured two HM Naval Base Portsmouth contracts, Ship Engineering Management, and, in a joint venture with KBR, Hard Facilities Management and Alongside Services, worth more than £1bn under the UK Ministry of Defence's Future Maritime Support Programme (FMSP). Service delivery under these contracts came into effect on 1 October and will continue for at least five years. The KBS Maritime joint venture with KBR was established and is delivering the Hard Facilities Management and Alongside Services contract.

The UK's Carrier Strike Group 2021 deployment was supported from Portsmouth and in various locations along the deployment route. BAE Systems coordinated the support to all vessels in the group. In addition to deployed support to the Mediterranean, Indian Ocean and Pacific Ocean for the Carrier Strike Group, all five of the Royal Navy's Batch 2 Offshore Patrol Vessels are being supported around the globe by our teams.

In the Underwater Weapons business stream, the Torpedo Repair and Maintenance contract for in-service support to the UK's Royal Navy continues to perform well. The £270m Spearfish torpedo upgrade programme, delivered for the UK Ministry of Defence and Royal Navy, continues and the Ministry of Defence granted approval for Defence Munitions to proceed with the build of the upgraded weapons in October. This represents a key milestone towards concluding the development and initial manufacture phase of the programme.

A £119m export order for our Commander land radar was secured. The development of a new production line at our Cowes site is underway to support the delivery of this contract.

Techmodal, the applied data science consultancy we acquired in August 2020, secured a number of contracts and was selected in October as the Royal Navy's digital services programme partner for data science.

The Maritime Services business continues to support a range of customer trials and experimentation programmes to develop and implement new technologies. In 2021, these have included Navy X trials of our autonomous RIB with HMS Argyll, the Royal Navy's submarine firing trials of the upgraded Spearfish torpedo, and the testing of enhanced radar capabilities during the NATO Formidable Shield 21 exercise.

Land UK

Following the award of the Next Generation Munitions Solution (NGMS) contract in November 2020, the business enacted plans to ensure an effective transition between the current munitions supply contract and NGMS. Transition plans are progressing well and the business is on-track to meet the jointly agreed timeline for the closure of the current contract. In support of the new contract, the business has commenced a £90m programme to update and expand its manufacturing equipment and infrastructure.

Mobilisation of the Challenger 3 contract, secured in 2021 by the RBSL joint venture, is progressing well. The contract, worth £300m to BAE Systems, will see RBSL upgrade 148 Challenger 2 Main Battle Tanks into the Challenger 3 configuration for the British Army.

Challenger 3 will be a network-enabled, digital Main Battle Tank with state-of-the-art lethality, upgraded survivability, plus world-class surveillance and target acquisition capabilities. The vehicles will be manufactured at RBSL's Telford facility, with support from other RBSL sites near Bristol, Newcastle and Bovington.

The programme is expected to create and sustain more than 200 skilled jobs within RBSL and provide opportunities to more than 60 apprentices over the coming years. The contract will also create and sustain more than 450 jobs across the UK supply chain, helping to protect engineering and manufacturing skills. The Challenger 3 contract, together with the Mechanised Infantry Vehicle contract, secured at the end of 2020, will provide workload for the business for the next ten years.

Looking forward

Forward-looking information for the Maritime reporting segment is provided on page 38.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see Financial glossary on page 12.
3. International Financial Reporting Standards.

Segmental performance: Cyber & Intelligence

Cyber & Intelligence, with 9,600 employees[1], comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber security, secure government and commercial financial security activities.

Operational and strategic key points

Intelligence & Security

– US-based Intelligence & Security business continues to maintain its bid pipeline, perform on existing contracts and win new orders.
– Awarded a five-year, up to $478m (£353m) Systems Engineering and Integration Support Services contract from the US Navy Strategic Systems Programs office.
– Awarded classified contracts from Department of Defense and Intelligence Community customers in excess of $0.8bn (£0.6bn) to deliver mission-enabling engineering services.
– Agreement announced for the proposed acquisition of Bohemia Interactive Simulations, a global software developer of simulation and training solutions for allied military customers.

Applied Intelligence

– Strong order intake and revenue growth from the government- and defence-facing business units.
– Increasing profitability, supported by strong programme execution, productivity and cost base optimisation. Financial Services' profitability benefited from restructuring in 2020.
– Acquisition of In-Space Missions, a UK-based satellite and satellite systems company, to accelerate our Space capabilities.

Financial performance

Financial performance measures as defined by the Group[2]

	2021	2020
Sales	**£1,752m**	£1,812m
Underlying EBIT	**£156m**	£135m
Return on sales	**8.9%**	7.5%
Operating business cash flow	**£173m**	£221m
Order intake[1]	**£1,817m**	£1,987m
Order backlog[1]	**£1.6bn**	£1.7bn

Financial performance measures derived from IFRS[3]

	2021	2020
Revenue	**£1,752m**	£1,812m
Operating profit	**£152m**	£138m
Return on revenue	**8.7%**	7.6%
Cash flow from operating activities	**£202m**	£251m
Order book	**£1.0bn**	£1.1bn

– Sales in Applied Intelligence were stable as growth in government and defence businesses was offset by impact of commercial businesses disposed of in 2020.
– US Intelligence & Security business saw sales growth of 3% excluding the impact of exchange translation.
– Return on sales expanded by 140bps as both Applied Intelligence and Intelligence & Security delivered strong programme performance, high utilisation levels and more efficient cost structures.
– Operating business cash flow reflects good programme execution.
– Applied Intelligence saw high demand in its government and defence business, with a book-to-bill[4] ratio of 1.1.

Operational performance

Intelligence & Security

Air & Space Force Solutions

On the US Air Force Intercontinental Ballistic Missile Integration Support Contractor (ISC) programme, we continue to provide programme management, systems engineering, integration and testing, sustainment and cyber defence support, with cumulative funding approaching the $1.1bn (£0.8bn) contractual ceiling. We submitted a proposal for the recompete of the programme in January 2021 for the next 18-year contract. The US government advised us that it expects to announce the ISC 2.0 award in the first quarter of 2022. As a result, the US Air Force approved a one-year ISC 1.0 contract extension modification of $185m (£137m).

We were awarded Delivery Order 3 valued at $32m (£24m), taking our total award value to $70m (£52m) on a multi-year Indefinite Delivery, Indefinite Quantity contract to provide electronic hardware and engineering services for a US government customer, with an expected lifecycle value of $474m (£350m).

We were awarded Lots 15 to 19 of the Network Daughter Board production on the F-35 programme with Lockheed Martin, valued at $42m (£31m).

Integrated Defense Solutions

We were awarded a five-year, $478m (£353m) sole-source contract to continue supporting weapon systems on board US Ohio and UK Vanguard Class submarines, as well as future US Columbia Class and UK Dreadnought Class submarines.

Continuing more than 30 years of strong performance for the Naval Air Warfare Center, we were awarded a five-year, $140m (£103m) follow-on contract to provide research and development, evaluation, engineering, integration, testing, logistics, alteration, installation, training and hardware support services across a variety of fixed and mobile, shipboard and shore-based and airborne platforms.

We were awarded a five-year, $68m (£50m) contract to provide air traffic control and landing systems (ATC&LS) platform sustainment and engineering services to develop, produce, equip, test, sustain and update key expeditionary ATC aviation systems.

We were awarded two contracts totalling $140m (£103m) by the Defense Logistics Agency to provide preventative and corrective maintenance for Automated Fuel Systems around the globe.

We were awarded a five-year, Indefinite Delivery, Indefinite Quantity, contract worth up to $154m (£114m) to support the US Navy with rapid integration and sustainment of command, control, communications, computers, combat systems, intelligence, surveillance and reconnaissance (C5ISR) systems.

We also were awarded a five-year, $137m (£101m) US Navy contract to provide lifecycle sustainment of C5ISR systems, including integrated product support, configuration management and technical and project management.

Intelligence Solutions

BAE Systems is executing on a $506m (£374m) contract to provide industry-leading and multi-disciplinary analytic support capabilities supporting first responders, warfighters and policy makers. These tailored analytic services span a multitude of mission specifications and operating environments. Services include, but are not limited to: source discovery and collection; time-dominant and long-term analytic assessments; cartographic production; and multi-media content generation.

We are delivering a transformative software delivery approach increasing the pace and responsiveness of enabling business systems on a $108m (£80m) contract provided by a US government customer. BAE Systems is leveraging a user experience-driven design methodology to understand the nuances of end-user requirements and accelerating capability delivery through DevSecOps. Additionally, BAE Systems is pioneering the implementation of the Portfolio Delivery model to ensure end-to-end utility and satisfaction across stakeholder groups.

Following our 2020 award of one of three Phase I contracts from the US Marine Corps to develop a state-of-the-art wargaming system for the new Wargaming Center in Quantico, Virginia, we were subsequently down-selected as the single prime contractor in Phase II. As the Lead Systems Integrator, we are conducting integrated prototyping of modelling and simulation tools, developing a cloud-based environment which will be deployed for operations during Phase III.

We have seen strong growth in our Federal Civilian business as we continue to execute cybersecurity and cloud programmes for agencies such as Federal Emergency Management Agency, Cybersecurity and Infrastructure Security Agency and the Department of Justice.

In November we announced the proposed acquisition of Bohemia Interactive Simulations (BISim), a privately held global software developer of simulation and training solutions for military organisations around the world. BISim is headquartered in Orlando, Florida, with more than 325 employees in the US, UK, Australia, the Czech Republic, and Slovakia. The acquisition is subject to regulatory approvals and other pre-closing conditions.

Applied Intelligence

The business performed strongly in 2021, delivering revenue growth and a further increase in profitability. We have continued to see strong levels of demand for our products and services, as our core customers continue to invest in building cyber, data, digital and analytical capabilities. This has resulted in further growth in order intake, driven by our National Security and Defence & Space business units in particular. Ongoing investment in resourcing, learning and development has supported growth in our headcount which, coupled with strong levels of utilisation and productivity, has enabled us to drive significant revenue growth. Programme execution continues to be strong and well controlled across all areas supporting underlying margin growth. Operating costs have reduced compared with the prior year as the impact of a restructuring and operational efficiency initiative continues to deliver positive results.

In September we announced the acquisition of In-Space Missions, a UK-based company that designs, builds and operates satellites and satellite systems. This acquisition supports our ambition to accelerate our space capabilities to include a range of satellites and systems, reflecting government prioritisation of space to defend and protect their nations, people and businesses in a digital world. This acquisition and associated technological developments will further help deliver information advantage for our customers in the continued integration of land, sea, air, space and cyber domains.

Government

The National Security business continues to grow strongly supported by increasing government investment in operational cyber and digital transformation within the National Security community. Key customers have continued to demonstrate their confidence in our business through multi-year deals and frameworks that will enable us to grow and deliver capability to best support their strategic aims. The business continues to invest in training and development academies in addition to recruiting experienced cleared resources to drive future growth.

The International Government business has delivered revenue growth driven by new work across key accounts and continued positive delivery on major programmes. Travel limitations have had some minor impacts on delivery but these have been largely overcome by effective remote working and ongoing optimisation of operating costs.

The UK Central Government business has delivered significant revenue growth as a result of a number of new account wins and ongoing involvement in a number of major programmes across central government departments. A particularly significant programme relates to the data and digital work being undertaken with the UK Home Office supporting UK Border Force in its strategy to create the most effective border in the world.

Within our Defence & Space business unit we are seeing increasing levels of demand due to increased levels of defence funding and the UK Strategic Command commitment to substantial investment in data, digitisation, intelligence and cyber. This has resulted in strong demand for our solutions in cyber and electromagnetic activities, digital transformation and complex communications, driving an increase in order intake and revenue for the business unit. The acquisition of In-Space Missions in addition to ongoing organic investment is supporting our ambition to develop space capability, recognising space as an area for increasing investment and focus for customers. Resourcing and investment in skills remains a key focus to drive further growth going forward.

Financial Services

The Financial Services business has delivered a significant improvement in profitability in the year, the result of the restructuring activity completed in 2020. Order intake has grown year on year boosted by large account wins in North America and Europe. Ongoing investment in our market-leading NetReveal platform continues to deliver anti-money laundering regulatory compliance and anti-fraud capabilities to our global customer base.

Looking forward

Forward-looking information for the Cyber & Intelligence reporting segment is provided on page 38.

1. Including share of equity accounted investments.
2. For alternative performance measure definitions see Financial glossary on page 12.
3. International Financial Reporting Standards.
4. Ratio of Order intake to Sales.

Segmental looking forward

Electronic Systems

Electronic Systems comprises the US- and UK-based electronics activities, including electronic warfare systems, navigation systems, electro-optical sensors, military and commercial digital engine and flight controls, precision guidance and seeker solutions, next-generation military communications systems and data links, persistent surveillance capabilities, space electronics and electric drive propulsion systems.

Electronic Systems is well positioned for growth in the medium term as it continues to address current and evolving US defence priority programmes from its strong franchise positions in electronic warfare, navigation systems, precision guidance and seeker solutions. Electronic Systems has a long-standing programme of research and development. Its focus remains on maintaining a diverse portfolio of defence and commercial products and capabilities for US and international customers. The business expects to benefit from its ability to apply innovative technology solutions that meet defence customers' changing requirements. As a result, the business is well positioned for the medium term with significant roles on F-35 Lightning II, F-15 upgrade, M-Code GPS upgrades and classified programmes, as well as with specific products such as APKWS®. Over the longer term, the business is poised to leverage its technology strength in emerging areas of demand such as precision weaponry, space resilience, hyper-velocity and autonomous vehicles. With our electric drive propulsion capabilities we are well placed to continue to address the need for low and zero emission technology across an increasing number of platforms.

The commercial aviation market has been negatively impacted by the pandemic and whilst we are seeing a degree of recovery it is expected to take several years to reach previous levels. The business has been scaled appropriately and Electronic Systems' technology innovations are enabling the business to maintain its long-standing customer positions and adjust as the market evolves.

Platforms & Services (US)

Platforms & Services (US), with operations in the US, UK and Sweden, manufactures and upgrades combat vehicles, weapons and munitions, and delivers services and sustainment activities, including naval ship repair and the management and operation of government-owned munitions facilities.

Combat Mission Systems is underpinned by a strong order backlog and incumbencies on key franchise programmes. These include the US Army's Armored Multi-Purpose Vehicle, M109A7 self-propelled howitzer, Bradley upgrade programmes, M88 HERCULES recovery vehicle, the US Marine Corps' Amphibious Combat Vehicle, as well as the CV90 and BvS10 export programmes from BAE Systems Hägglunds. FNSS continues to execute on its order book of both Turkish and international orders. These long-term contracts and franchise positions make the combat vehicles business well placed for growth in the medium term.

In the maritime domain, the sector has a strong position on naval gun and missile launch programmes and US Navy ship repair activities where the business has invested in capitalised infrastructure and its facilities in key home ports. The business remains well aligned to the US Navy's operational strategy and projected fleet increase.

The Group remains a leading provider of gun systems and precision strike capabilities and in the complex ordnance manufacturing business, continues to manage and operate the US Army's Radford and Holston munitions facilities.

Air

Air comprises the Group's UK-based air activities for European and International Markets, US Programmes, and development of Future Combat Air Systems, alongside its businesses in Saudi Arabia and Australia, together with its 37.5% interest in the European MBDA joint venture.

Future Typhoon production and support sales are underpinned by existing contracts. Discussions continue in relation to potential further contract awards for Typhoon. Production of rear fuselage assemblies for the F-35 has reached full rate levels and is expected to be sustained at these current levels. The business plays a significant role in the F-35 sustainment programme in support of Lockheed

Martin. The UK Combat Air Strategy provides the base to enable long-term planning and investment in a key strategic part of the business.

In Saudi Arabia, the In-Kingdom Industrial Participation programme continues to make good progress consistent with our long-term strategy, as well as the Saudi Arabian government's National Transformation Plan and Vision 2030. Our in-Kingdom support business is expected to remain stable underpinned by long-standing contracts renewed every five years.

In order to provide ongoing capability to international customers, the Group is reliant on the continued approval of export licences by a number of governments. The withholding of such export licences may have an adverse effect on the Group's provision of capability to the Kingdom of Saudi Arabia and the Group will continue to work closely with the UK government to manage the impact of any such occurrence.

The Australian business has long-term sustainment and upgrade activities in maritime, air, wide-area surveillance, missile defence and electronic systems. It has expanded into ship design and production on the Hunter Class Frigate programme, which will drive growth in the coming years and is pursuing a number of further opportunities.

MBDA has a strong order backlog supporting future years' sales. Development programmes continue to improve the long-term capabilities of the business in air, land and sea domains.

Maritime

Maritime comprises the Group's UK-based maritime and land activities.

Maritime

The outlook is stable based on long-term contracted positions with a number of UK domestic and international opportunities to further this outlook. Within Submarines, the business is executing on two long-term programmes. On the Astute Class programme, the fifth of class is undergoing final commissioning activities and the two remaining boats are in build. On the Dreadnought programme, manufacturing activities continue on the first two boats of a four-boat programme. Investment continues in the Barrow facilities in order to provide the capabilities to deliver these long-term programmes through the decade and beyond. In shipbuilding, sales are underpinned by the manufacture of Type 26 frigates. The through-life support of surface ship platforms provides a sustainable business in technical services and mid-life upgrades.

Land UK

Future work will be underpinned by existing in-service support contracts and the contracted workshare on the Mechanised Infantry Vehicle and Challenger 3 Main Battle Tank programmes. Munitions supply continues under the Munitions Acquisition Supply Solution partnering agreement which will be followed in 2023 by the recently-agreed 15-year Next Generation Munitions Solution.

Cyber & Intelligence

Cyber & Intelligence comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber security, secure government and commercial financial security activities.

Intelligence & Security

The outlook for the US government services sector is stable with the opportunity for modest mid-term growth, although market conditions remain highly competitive and continue to evolve in response to shifting government priorities. The Intelligence & Security (I&S) business will continue to leverage its established market positions, reputation for reliable performance and its proven digital engineering expertise to support the government's modernisation initiatives. As a trusted partner, I&S is well positioned to meet customer demands for innovative, cost-effective and cyber-hardened solutions to pursue both recompete contracts and new business across its portfolio of sustainment, system integration and modernisation solutions for military, intelligence and Federal Civilian agency customers.

Applied Intelligence

The services and products we offer in our Government businesses ensure that we are well placed to deliver growth as UK cyber, data and digital budgets increase and cyber security and information advantage continue to be an important part of a nation's security and economic prosperity.

We continue to invest in the Financial Services division to deliver growth given the ongoing market demand for anti-fraud and regulatory compliance solutions.

Effective from 2022, a new operating business, BAE Systems Digital Intelligence, has been formed, bringing together many of our world-leading digital transformation, cybersecurity, complex data analysis, and communication and information capabilities from across the Group. This includes the whole of the Applied Intelligence business.

This activity will enable even closer collaboration across the Group to help our customers operate successfully, safely and efficiently in the digital world, and in time bringing a greater range of capabilities to our customers.

Consolidated income statement

for the year ended 31 December

	Notes	**2021** £m	**2021** Total £m	2020 £m	2020 Total £m
Continuing operations					
Revenue	2		**19,521**		19,277
Operating costs			**(17,743)**		(17,686)
Other income			**472**		270
Share of results of equity accounted investments			**139**		69
Operating profit	2		**2,389**		1,930
Financial income		**32**		17	
Financial expense		**(311)**		(351)	
Net finance costs	3		**(279)**		(334)
Profit before taxation			**2,110**		1,596
Taxation expense	4		**(198)**		(225)
Profit for the year			**1,912**		1,371
Attributable to:					
Equity shareholders			**1,758**		1,299
Non-controlling interests			**154**		72
			1,912		1,371
Earnings per share	5				
Basic earnings per share			**55.2p**		40.7p
Diluted earnings per share			**54.7p**		40.5p

Consolidated statement of comprehensive income

for the year ended 31 December

	2021			2020		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Profit for the year	**–**	**1,912**	**1,912**	–	1,371	1,371
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Consolidated:						
Remeasurements on post-employment benefit schemes	**–**	**2,451**	**2,451**	–	(1,361)	(1,361)
Tax on items that will not be reclassified to the income statement	**–**	**(394)**	**(394)**	–	330	330
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method (net of tax)	**–**	**64**	**64**	–	(55)	(55)
Items that may be reclassified to the income statement:						
Consolidated:						
Currency translation on foreign currency net investments	**32**	**–**	**32**	(224)	–	(224)
Reclassification of cumulative currency translation reserve on disposal of subsidiary	**(9)**	**–**	**(9)**	(35)	–	(35)
Fair value gain arising on hedging instruments during the period	**11**	**–**	**11**	46	–	46
Cumulative fair value (gain)/loss on hedging instruments reclassified to the income statement	**(32)**	**–**	**(32)**	42	–	42
Tax on items that may be reclassified to the income statement	**4**	**–**	**4**	(16)	–	(16)
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method (net of tax)	**(4)**	**–**	**(4)**	(3)	–	(3)
Total other comprehensive income for the year (net of tax)	**2**	**2,121**	**2,123**	(190)	(1,086)	(1,276)
Total comprehensive income for the year	**2**	**4,033**	**4,035**	(190)	285	95
Attributable to:						
Equity shareholders	**(3)**	**3,882**	**3,879**	(176)	213	37
Non-controlling interests	**5**	**151**	**156**	(14)	72	58
	2	**4,033**	**4,035**	(190)	285	95

Consolidated statement of changes in equity

for the year ended 31 December

	Attributable to equity holders of BAE Systems plc						
	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
Balance at 1 January 2021	87	1,249	5,923	(2,616)	4,643	278	4,921
Profit for the year	–	–	–	1,758	1,758	154	1,912
Total other comprehensive income for the year	–	–	(3)	2,124	2,121	2	2,123
Total comprehensive income for the year	–	–	(3)	3,882	3,879	156	4,035
Share-based payments (inclusive of tax)	–	–	–	94	94	–	94
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)	–	–	(35)	–	(35)	–	(35)
Ordinary share dividends	–	–	–	(777)	(777)	(202)	(979)
Purchase of own shares	(2)	–	2	(371)	(371)	–	(371)
Unclaimed assets programme proceeds	–	3	–	–	3	–	3
At 31 December 2021	**85**	**1,252**	**5,887**	**212**	**7,436**	**232**	**7,668**
Balance at 1 January 2020	87	1,249	6,156	(2,085)	5,407	104	5,511
Profit for the year	–	–	–	1,299	1,299	72	1,371
Total other comprehensive income for the year	–	–	(176)	(1,086)	(1,262)	(14)	(1,276)
Total comprehensive income for the year	–	–	(176)	213	37	58	95
Share-based payments (inclusive of tax)	–	–	–	73	73	–	73
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)	–	–	(35)	–	(35)	–	(35)
Ordinary share dividends	–	–	–	(746)	(746)	(28)	(774)
Partial disposal of shareholding in subsidiary undertaking	–	–	(22)	(71)	(93)	144	51
At 31 December 2020	87	1,249	5,923	(2,616)	4,643	278	4,921

Consolidated balance sheet

as at 31 December

	Notes	2021 £m	2020 £m
Non-current assets			
Intangible assets		**11,716**	11,745
Property, plant and equipment		**2,852**	2,655
Right-of-use assets		**1,091**	1,053
Investment property		**67**	128
Equity accounted investments		**554**	409
Other investments		**76**	–
Other receivables		**551**	506
Post-employment benefit surpluses	6	**483**	408
Other financial assets		**305**	248
Deferred tax assets		**622**	972
		18,317	18,124
Current assets			
Inventories		**811**	858
Trade, other and contract receivables		**4,825**	5,491
Current tax		**71**	6
Other financial assets		**194**	189
Cash and cash equivalents		**2,917**	2,768
Assets held for sale		**–**	94
		8,818	9,406
Total assets		**27,135**	27,530
Non-current liabilities			
Loans		**(4,604)**	(4,957)
Lease liabilities		**(1,083)**	(1,020)
Contract liabilities		**(519)**	(524)
Other payables		**(1,248)**	(1,164)
Post-employment benefit obligations	6	**(2,607)**	(4,893)
Other financial liabilities		**(302)**	(282)
Deferred tax liabilities		**(77)**	–
Provisions		**(331)**	(386)
		(10,771)	(13,226)
Current liabilities			
Loans and overdrafts		**(457)**	(467)
Lease liabilities		**(212)**	(236)
Contract liabilities		**(2,874)**	(3,238)
Trade and other payables		**(4,636)**	(4,898)
Other financial liabilities		**(214)**	(181)
Current tax		**(27)**	(72)
Provisions		**(276)**	(291)
		(8,696)	(9,383)
Total liabilities		**(19,467)**	(22,609)
Net assets		**7,668**	4,921
Capital and reserves			
Issued share capital		**85**	87
Share premium		**1,252**	1,249
Other reserves		**5,887**	5,923
Retained earnings/(deficit)		**212**	(2,616)
Total equity attributable to equity holders of BAE Systems plc		**7,436**	4,643
Non-controlling interests		**232**	278
Total equity		**7,668**	4,921

Approved by the Board of BAE Systems plc on 23 February 2022 and signed on its behalf by:

C N Woodburn
Chief Executive

B M Greve
Group Finance Director

Consolidated cash flow statement

for the year ended 31 December

	Notes	2021 £m	2020 £m
Profit for the year		**1,912**	1,371
Taxation expense	4	**198**	225
Adjustment in respect of research and development expenditure credits		**(16)**	(28)
Share of results of equity accounted investments		**(139)**	(69)
Net finance costs		**279**	334
Depreciation, amortisation and impairment		**720**	675
Gain on investment revaluation		**–**	(6)
Profit on disposal of property, plant and equipment, and investment property		**(192)**	(25)
Profit on sale and leaseback		**–**	(21)
(Gain)/loss in respect of held for sale assets and business disposals		**(158)**	5
Cost of equity-settled employee share schemes		**92**	74
Movements in provisions		**(66)**	(30)
Difference between pension funding contributions paid and the pension charge		**(18)**	(1,396)
(Increase)/decrease in working capital:			
Inventories		**54**	24
Trade, other and contract receivables		**610**	–
Trade and other payables, and contract liabilities		**(615)**	122
Research and development expenditure credits – cash received		**20**	162
Taxation paid		**(234)**	(251)
Net cash flow from operating activities		**2,447**	1,166
Dividends received from equity accounted investments		**57**	27
Interest received		**23**	19
Principal element of finance lease receipts		**10**	10
Purchase of property, plant and equipment, and investment property		**(366)**	(385)
Purchase of intangible assets		**(96)**	(92)
Purchase of non-current other investments		**(15)**	–
Proceeds from sale of property, plant and equipment, and investment property		**271**	68
Proceeds from sale of non-current other investments		**–**	19
Equity accounted investment funding		**(3)**	(2)
Purchase of subsidiary undertakings, net of cash and cash equivalents acquired		**(30)**	(1,706)
Cash flow in respect of held for sale assets and business disposals, net of cash and cash equivalents disposed		**215**	5
Net cash flow from investing activities		**66**	(2,037)
Interest paid		**(247)**	(227)
Equity dividends paid	7	**(777)**	(746)
Purchase of own shares		**(368)**	–
Dividends paid to non-controlling interests		**(202)**	(19)
Partial disposal of shareholding in subsidiary undertaking		**28**	27
Principal element of lease payments		**(217)**	(236)
Cash inflow from derivative financial instruments (excluding cash flow hedges)		**61**	59
Cash outflow from derivative financial instruments (excluding cash flow hedges)		**(149)**	(43)
Cash flow from movement in cash collateral		**(18)**	(2)
Cash inflow from loans		**–**	2,666
Cash outflow from repayment of loans		**(367)**	(506)
Net cash flow from financing activities		**(2,256)**	973
Net increase in cash and cash equivalents		**257**	102
Cash and cash equivalents at 1 January		**2,667**	2,587
Effect of foreign exchange rate changes on cash and cash equivalents		**(7)**	(22)
Cash and cash equivalents at 31 December		**2,917**	2,667
Comprising:			
Cash and cash equivalents		**2,917**	2,768
Overdrafts		**–**	(101)
Cash and cash equivalents at 31 December		**2,917**	2,667

Notes to the accounts

1. Preparation

Basis of preparation and statement of compliance

The consolidated financial statements of BAE Systems plc have been prepared on a going concern basis and in accordance with UK-adopted International Financial Reporting Standards (IFRS) and the Companies Act 2006 applicable to companies reporting under IFRS. These condensed consolidated 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 2021. The comparative figures for the year ended 31 December 2020 are not the Group's statutory accounts for that financial year. Those financial statements have been reported upon by the Group's auditor and delivered to the registrar of companies. The report of the auditor was unqualified, did not include a reference to any matters to which the auditor 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.

The consolidated financial statements are presented in pounds sterling and, unless stated otherwise, rounded to the nearest million. They have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities (including derivative instruments).

2. Segmental analysis and revenue recognition

Sales and revenue by reporting segment

	Sales		Deduct Share of revenue of equity accounted investments		Add Subsidiaries' revenue from equity accounted investments		Revenue	
	2021 £m	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m
Electronic Systems	**4,491**	4,557	**(54)**	(45)	**54**	45	**4,491**	4,557
Platforms & Services (US)	**3,395**	3,503	**(79)**	(108)	**2**	4	**3,318**	3,399
Air	**8,321**	7,910	**(2,505)**	(2,289)	**1,097**	972	**6,913**	6,593
Maritime	**3,416**	3,257	**(79)**	(65)	**3**	3	**3,340**	3,195
Cyber & Intelligence	**1,752**	1,812	**–**	–	**–**	–	**1,752**	1,812
HQ	**307**	190	**(271)**	(151)	**–**	1	**36**	40
	21,682	21,229	**(2,988)**	(2,658)	**1,156**	1,025	**19,850**	19,596
Intra-group sales/revenue	**(372)**	(367)	**9**	6	**34**	42	**(329)**	(319)
	21,310	20,862	**(2,979)**	(2,652)	**1,190**	1,067	**19,521**	19,277

Operating profit/(loss) by reporting segment

	Underlying EBIT[1]		Non-recurring items[2]		Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles		Financial and taxation expense of equity accounted investments		Operating profit/(loss)	
	2021 £m	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m
Electronic Systems	**766**	674	**33**	15	**(84)**	(40)	**–**	–	**715**	649
Platforms & Services (US)	**259**	190	**–**	7	**(1)**	(1)	**(6)**	(13)	**252**	183
Air	**856**	909	**132**	–	**(13)**	–	**(45)**	(48)	**930**	861
Maritime	**288**	279	**6**	–	**(2)**	(4)	**(3)**	(3)	**289**	272
Cyber & Intelligence	**156**	135	**(3)**	3	**(1)**	–	**–**	–	**152**	138
HQ	**(120)**	(150)	**182**	(6)	**–**	(1)	**(11)**	(16)	**51**	(173)
	2,205	2,037	**350**	19	**(101)**	(46)	**(65)**	(80)	**2,389**	1,930
Net finance costs									**(279)**	(334)
Profit before taxation									**2,110**	1,596
Taxation expense									**(198)**	(225)
Profit for the year									**1,912**	1,371

1. With effect from 2021, the Group adopted the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the previously reported underlying EBITA measure, as it reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business. Underlying earnings per share has also been recalculated to ensure consistency with the updated operational profitability measure. The underlying performance for 2020 of segments and the Group has been re-presented on this new basis.
2. Non-recurring items in 2021 reflect a gain of £350m, comprising a gain in HQ on the sale of the Filton and Broughton sites (£182m), gains on disposal of Advanced Electronics Company in the Air sector (£132m, of which £63m is attributable to non-controlling interests), and on disposal of a business in our Electronic Systems segment (£26m), and a net £10m gain relating to historical and current year acquisitions. Non-recurring items in 2020 comprises a settlement gain on a US pension annuity buy-out of £64m, partially offset by acquisition-related costs of £20m, a £13m impairment charge relating to Platforms & Services (US)'s legacy Commercial Shipbuilding business which the business exited in 2018, a Guaranteed Minimum Pension equalisation charge of £7m and a loss on business disposals of £5m.

3. Net finance costs

	2021 £m	2020 £m
Interest income on cash and other financial instruments	**29**	16
Interest income on finance lease receivables	**1**	1
Net present value adjustments	**2**	–
Financial income	**32**	17
Interest expense on bonds and other financial instruments	**(206)**	(196)
Facility fees	**(3)**	(4)
Interest expense on lease liabilities	**(43)**	(44)
Net present value adjustments on provisions and other payables	**–**	(8)
Net interest expense on post-employment benefit obligations	**(65)**	(68)
Loss on remeasurement of financial instruments at fair value through profit or loss[1,2]	**(29)**	(158)
Foreign exchange gains[2,3]	**35**	127
Financial expense	**(311)**	(351)
Net finance costs	**(279)**	(334)

1. Comprises gains and losses on derivative financial instruments, including derivative instruments to manage the Group's exposure to interest rate fluctuations on external borrowings and exchange rate fluctuations on balances with the Group's subsidiaries and equity accounted investments.
2. The net gain or loss on remeasurement of financial instruments at fair value through profit or loss and the net gain or loss on foreign exchange are presented within finance costs as the gains and losses relate to the same underlying transactions.
3. The foreign exchange gains primarily reflect exchange rate movements on US dollar-denominated borrowings.

Additional analysis

	2021 £m	2020 £m
Net finance costs:		
Group	**(279)**	(334)
Share of equity accounted investments	**(27)**	(32)
Total of Group and equity accounted investments' finance costs	**(306)**	(366)
Analysed as:		
Underlying net interest expense:		
Group	**(220)**	(235)
Share of equity accounted investments	**(21)**	(20)
	(241)	(255)
Other:		
Group:		
Net interest expense on post-employment benefit obligations	**(65)**	(68)
Fair value and foreign exchange adjustments on financial instruments and investments	**6**	(31)
Share of equity accounted investments:		
Net interest expense on post-employment benefit obligations	**(2)**	(2)
Fair value and foreign exchange adjustments on financial instruments and investments	**(4)**	(10)
Total of Group and equity accounted investments' finance costs	**(306)**	(366)

4. Taxation expense

Reconciliation of taxation expense

The following table reconciles the theoretical income tax expense, using the UK corporation tax rate, to the reported tax expense. The reconciling items represent, besides the impact of tax rate differentials and changes, non-taxable benefits or non-deductible expenses arising from differences between the local tax base and the reported financial statements.

	2021 £m	2020 £m
Profit before taxation	**2,110**	1,596
UK corporation tax rate	**19%**	19%
Expected income tax expense	**(401)**	(303)
Effect of tax rates in foreign jurisdictions, including US state taxes	**(56)**	(45)
Expenses not tax effected	**(5)**	(6)
Income not subject to tax	**70**	54
Research and development tax credits	**23**	12
Non-recurring items	**48**	(1)
Chargeable gains	**(3)**	(1)
Utilisation of previously unrecognised tax losses	**2**	1
Current year losses not tax effected	**–**	(3)
Adjustments in respect of prior years	**109**	44
Adjustments in respect of equity accounted investments	**26**	13
Tax rate adjustment	**10**	20
Other	**(21)**	(10)
Taxation expense	**(198)**	(225)

Calculation of the underlying effective tax rate

	2021 £m	2020 £m
Profit before taxation	**2,110**	1,596
Add back: Taxation expense of equity accounted investments	**38**	48
(Deduct): Taxable non-recurring items	**(347)**	–
(Deduct)/add back: Non-taxable non-recurring items	**(3)**	4
Adjusted profit before taxation	**1,798**	1,648
Taxation expense	**(198)**	(225)
Taxation expense of equity accounted investments	**(38)**	(48)
Exclude: One-off tax benefit[1]	**(94)**	–
Exclude: Taxation adjustments in respect of taxable non-recurring items	**19**	–
Exclude: Tax rate adjustment	**(10)**	–
Adjusted taxation expense (including equity accounted investments)	**(321)**	(273)
Underlying effective tax rate	**18%**	17%

1. The one-off tax benefit of £94m in 2021 is in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime.

The Group's underlying effective tax rate is sensitive to the geographic mix of profits and may be impacted when multiple territories implement the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting (BEPS) 2 model guidance. It is not currently possible to accurately assess the impact of the model rules, but we will continue to monitor their progress as they proceed towards statutory enactment.

5. Earnings per share

	2021 £m	2021 Basic pence per share	2021 Diluted pence per share	2020 £m	2020 Basic pence per share	2020 Diluted pence per share
Profit for the year attributable to equity shareholders	**1,758**	**55.2**	**54.7**	1,299	40.7	40.5
Add back/(deduct):						
Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles, post tax[1]	**84**			38		
Net interest expense on post-employment benefit obligations, post tax[1]	**55**			58		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax[1]	**(1)**			34		
Non-recurring items attributable to shareholders, post tax[2]	**(279)**			(15)		
Underlying earnings, post tax	**1,617**	**50.7**	**50.4**	1,414	44.3	44.0
One-off tax benefit	**(94)**			–		
Underlying earnings, excluding 2021 one-off tax benefit	**1,523**	**47.8**	**47.4**	1,414	44.3	44.0

	2021 Millions	2021 Millions	2020 Millions	2020 Millions
Weighted average number of shares used in calculating basic earnings per share	**3,187**	**3,187**	3,191	3,191
Incremental shares in respect of employee share schemes		**24**		19
Weighted average number of shares used in calculating diluted earnings per share		**3,211**		3,210

1. The tax impact is calculated using the underlying effective tax rate of 18% (2020 17%). The calculation of the underlying effective tax rate is shown in note 4.
2. In 2021, £63m of the gain on disposal of AEC was attributable to non-controlling interest. Therefore, only the gain attributable to shareholders has been removed in calculating the underlying earnings attributable to shareholders. See note 12 for more details. The tax on non-recurring items has been determined using the actual tax due on those items, see note 4 for details.

6. Post-employment benefits

Funding

Introduction

The majority of the UK and US defined benefit pension schemes are funded by the Group's subsidiaries and equity accounted investments. The individual pension schemes' funding requirements are based on actuarial measurement frameworks set out in their funding policies.

For funding valuation purposes, pension scheme assets are included at market value at the valuation date, whilst the liabilities are measured on an actuarial funding basis using the projected unit credit method and discounted to their present value based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The funding valuations are performed by professionally qualified independent actuaries and include assumptions which differ from the actuarial assumptions used for IAS 19 accounting purposes shown on page 51. The purpose of the funding valuations is to design funding plans which ensure that the schemes have sufficient funds available to meet future benefit payments.

UK valuations

Funding valuations of the Group's UK defined benefit pension schemes are performed every three years. Following the merger of several of the Group's UK pension schemes in October 2019, the Company and trustees agreed to carry out an early triennial funding valuation for the Main Scheme as at 31 October 2019.

The results of the most recent triennial valuations are shown below. These valuations and, where necessary, deficit recovery plans were agreed with the trustees and certified by the scheme actuaries after consultation with The Pensions Regulator in the UK.

	Main Scheme as at 31 October 2019 £bn	Other schemes as at 31 March 2020 £bn
Market value of assets	20.6	2.1
Present value of liabilities	(22.5)	(2.0)
Funding (deficit)/surplus	(1.9)	0.1
Percentage of accrued benefits covered by the assets at the valuation date	92%	105%

The valuations in 2019 and 2020 were determined using the following mortality assumptions:

Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	87 – 91
Life expectancy of a male currently aged 45 (years)	87 – 91
Life expectancy of a female currently aged 45 (years)	89 – 92

The discount rate assumptions used in the 2019 and 2020 valuations were directly based on prudent levels of expected returns for the assets held by the schemes, reflecting the planned investment strategies and maturity profiles of each scheme. The discount rates are curves which provide a different rate for each year into the future.

The inflation assumptions were derived using data from the Bank of England which is based on the difference between the yields on index-linked and fixed interest long-term government bonds. The inflation assumption is a curve which provides a different rate for each year into the future.

The funding valuations resulted in a significantly lower deficit than under IAS 19, largely due to lower liabilities reflecting the higher discount rate assumption. Under IAS 19, the discount rate for accounting purposes is based on third-party AA corporate bond yields whereas, for funding valuation purposes, the discount rate is based on a prudent level of expected returns from the broader and mixed types of investments reflected in the schemes' investment strategies, which are expected overall to yield higher returns than bonds.

The 2019 funding agreement is underpinned by a contingency plan, which includes a commitment by the Group to a further £50m of deficit funding in each of 2021 and 2022 into the Main Scheme prior to the next triennial valuation in the event that the scheme funding level were to fall below pre-determined parameters. In addition, the Group would be required to pay £187m in respect of the Main Scheme if the funding level were to fall significantly and were to remain at or below those levels for nine months.

There have been no changes to the contributions or benefits, as set out in the rules of the schemes, for pension scheme members as a result of the new funding valuations.

The results of future triennial valuations and associated funding requirements will be impacted by a number of factors, including the future performance of investment markets and anticipated members' longevity.

US valuations
The Group's US pension schemes are valued annually, with the latest valuations performed as at 1 January 2021.

Contributions
Under the terms of the trust deeds of the UK schemes, the Group is required to have a funding plan determined at the conclusion of the triennial funding valuations.

Equity accounted investments make regular contributions to the schemes in which they participate in line with the schedule of contributions and are allocated a share of deficit funding contributions.

In 2021, total employer contributions to the Group's pension schemes were £324m (2020 £1,701m), including amounts funded by equity accounted investments of £39m (2020 £133m), and included approximately £90m (2020 £1,422m) of deficit recovery payments in respect of the UK schemes and no contributions (2020 £70m) in respect of the US schemes.

The Group does not plan to make any cash contributions to the US pension schemes in 2022.

IAS 19 accounting

Principal actuarial assumptions

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the long-term nature of the obligation covered, may not necessarily occur in practice.

	UK			US		
	2021	2020	2019	**2021**	2020	2019
Financial assumptions						
Discount rate – past service (%)	**1.9**	1.4	2.1	**2.8**	2.4	3.1
Discount rate – future service (%)	**1.9**	1.6	2.2	**2.8**	2.4	3.1
Retail Prices Index (RPI) inflation (%)	**3.1**	2.7	2.8	**n/a**	n/a	n/a
Rate of increase in salaries (%)	**3.1**	2.7	2.8	**n/a**	n/a	n/a
Rate of increase in deferred pensions (%)	**2.4/3.1**	2.0/2.7	2.0/2.8	**n/a**	n/a	n/a
Rate of increase in pensions in payment (%)	**1.7 – 3.7**	1.6 – 3.6	1.5 – 3.6	**n/a**	n/a	n/a
Demographic assumptions						
Life expectancy of a male currently aged 65 (years)	**86 – 89**	86 – 88	87 – 88	**87**	87	87
Life expectancy of a female currently aged 65 (years)	**88 – 90**	88 – 90	88 – 90	**89**	89	89
Life expectancy of a male currently aged 45 (years)	**86 – 90**	87 – 89	88 – 89	**87**	87	87
Life expectancy of a female currently aged 45 (years)	**89 – 91**	89 – 91	89 – 91	**89**	88	89

Summary of movements in post-employment benefit obligations

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2021	(4,362)	(483)	(4,845)
Actual return on assets excluding amounts included in net interest expense	2,274	49	2,323
Decrease in liabilities due to changes in financial assumptions	1,145	220	1,365
Decrease/(increase) in liabilities due to changes in demographic assumptions	74	(8)	66
Experience losses	(1,109)	(8)	(1,117)
Contributions in excess of service cost	64	(9)	55
Past service cost – plan amendments	(3)	–	(3)
Net interest expense	(56)	(10)	(66)
Transfer to other investments[1]	–	(56)	(56)
Foreign exchange adjustments	–	6	6
Movement in other schemes	–	(14)	(14)
Total net IAS 19 deficit at 31 December 2021	**(1,973)**	**(313)**	**(2,286)**
Allocated to equity accounted investments	162	–	162
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 31 December 2021	**(1,811)**	**(313)**	**(2,124)**

1. £56m of the US pension assets have been reclassified as Other Investments. These relate to deferred compensation schemes which hold assets associated with the US unfunded pension obligation.

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2021 and keeping all other assumptions as set out above.

Financial assumptions

The estimated impact of changes in the discount rate and inflation assumptions on the defined benefit pension obligation, together with the estimated impact on scheme assets, is shown in the table below. The estimated impact on scheme assets takes into account the Group's risk management activities in respect of interest rate and inflation risk. The sensitivity analysis on the defined benefit obligation is measured on an IAS 19 accounting basis and, therefore, does not reflect the natural hedging in the discount rate used for funding valuation purposes.

	(Increase)/decrease in pension obligation[1] £bn	Increase/(decrease) in scheme assets[1] £bn
Discount rate:		
0.1 percentage point increase	0.5	(0.3)
0.1 percentage point decrease	(0.6)	0.3
0.5 percentage point increase	2.5	(1.5)
0.5 percentage point decrease	(2.9)	1.7
Inflation:		
0.1 percentage point increase	(0.5)	0.2
0.1 percentage point decrease	0.5	(0.2)
0.5 percentage point increase	(1.5)	1.1
0.5 percentage point decrease	1.5	(1.0)
1.0 percentage point increase	(3.0)	2.4
1.0 percentage point decrease	2.9	(1.9)

1. Before allocation to equity accounted investments.

Demographic assumptions

Changes in the life expectancy assumption, including the benefit of longevity swap arrangements, would have the following effect on the total net IAS 19 deficit:

	(Increase)/decrease in net deficit[1] £bn
Life expectancy:	
One-year increase	(1.4)
One-year decrease	1.4

1. Before allocation to equity accounted investments.

7. Equity dividends

	2021 £m	2020 £m
Interim 13.8p dividend per ordinary share paid in the year in respect of year ended 31 December 2019	**–**	444
Final 14.3p dividend per ordinary share paid in the year (2020 nil)	**461**	–
Interim 9.9p dividend per ordinary share paid in the year (2020 9.4p)	**316**	302
	777	746

After the balance sheet date, the directors proposed a final dividend of 15.2p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 1 June 2022 to shareholders registered on 22 April 2022. The ex-dividend date is 21 April 2022.

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 11 May 2022.

8. Fair value measurement

Fair value of financial instruments

Certain of the Group's financial instruments are held at fair value.

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the balance sheet date.

The fair values of financial instruments held at fair value have been determined based on available market information at the balance sheet date, and the valuation methodologies listed below:

– the fair values of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates;

– the fair values of both interest rate and cross-currency swaps are calculated by discounting expected future principal and interest cash flows and translating at the appropriate balance sheet rates; and

– the fair values of money market funds are calculated by multiplying the net asset value per share by the investment held at the balance sheet date.

Due to the variability of the valuation factors, the fair values presented at 31 December may not be indicative of the amounts the Group will realise in the future.

Fair value hierarchy

The fair value measurement hierarchy is as follows:

– Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;

– Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

– Level 3 – Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

Carrying amounts and fair values of certain financial instruments

	2021		2020	
	Carrying amount £m	**Fair value £m**	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:				
Non-current				
Other investments at fair value through profit and loss	**76**	**76**	–	–
Other financial assets	**305**	**305**	248	248
Other financial liabilities	**(302)**	**(302)**	(282)	(282)
Current				
Other financial assets	**194**	**194**	189	189
Money market funds	**1,171**	**1,171**	966	966
Other financial liabilities	**(214)**	**(214)**	(181)	(181)
Financial instruments not measured at fair value:				
Non-current				
Loans	**(4,604)**	**(5,045)**	(4,957)	(5,737)
Current				
Cash and cash equivalents (excluding money market funds)	**1,746**	**1,746**	1,802	1,802
Loans and overdrafts	**(457)**	**(462)**	(467)	(479)

All of the financial assets and liabilities measured at fair value are classified as level 2 using the fair value hierarchy, except for money market funds, which are classified as level 1. There were no transfers between levels during the year.

Financial assets and liabilities in the Group's Consolidated balance sheet are either held at fair value or their carrying value approximates to fair value, with the exception of loans, which are held at amortised cost. The fair value of loans presented in the table above is derived from market prices, classified as level 1 using the fair value hierarchy.

9. Financial risk management

Currency risk

The Group's objective is to reduce its exposure to transactional volatility in earnings and cash flows from movements in foreign currency exchange rates, mainly the US dollar, euro, Saudi riyal and Australian dollar.

The Group is exposed to movements in foreign currency exchange rates in respect of foreign currency denominated transactions. All material firm transactional exposures are hedged using foreign exchange forward contracts and the Group aims, where possible, to apply cash flow hedge accounting to these transactions.

The Group is exposed to movements in foreign currency exchange rates in respect of the translation of net assets and income statements of foreign subsidiaries and equity accounted investments. The Group does not hedge the translation effect of exchange rate movements on the income statements or balance sheets of foreign subsidiaries and equity accounted investments it regards as long-term investments.

The estimated impact on foreign exchange gains and losses in net finance costs of a ten cent movement in the closing sterling to US dollar exchange rate on the retranslation of US dollar-denominated bonds held by BAE Systems plc is approximately £203m (2020 £226m).

Credit risk
For trade receivables, contract receivables, amounts due from equity accounted investments and finance lease receivables, the Group measures a provision for expected credit losses at an amount equal to lifetime expected credit losses, estimated by reference to past experience and relevant forward-looking factors.

The Group's assessment is that credit risk in relation to defence-related sales to government customers or subcontractors to governments is extremely low as the probability of default is insignificant; therefore the provision for expected credit losses is immaterial in respect of receivables from these customers. For all non-government commercial customers, the Group assesses expected credit losses, including risk arising amid the COVID-19 pandemic; however, this is not considered material to the financial statements. The Group considers that default has occurred when a receivable is past 180 days overdue, because historical experience indicates that these receivables are generally not recoverable. The Group recognises a provision of 100% against all receivables over 180 days past due unless there is evidence that individual receivables in this category are recoverable.

For contract receivables, amounts due from equity accounted investments and finance lease receivables the expected credit loss provision is immaterial as the probability of default is insignificant.

Cash management
Cash flow forecasting is performed by the businesses on a monthly basis. The Group monitors a rolling forecast of its liquidity requirements to ensure that there is sufficient cash to meet operational needs and maintain adequate headroom.

10. Related party transactions

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

	Year ended 31 December 2021 £m	Year ended 31 December 2020 £m
Sales to related parties	**1,190**	1,067
Purchases from related parties	**586**	831

	31 December 2021 £m	31 December 2020 £m
Amounts owed by related parties	**34**	69
Amounts owed to related parties[1]	**1,137**	1,379

1. At 31 December 2021, £907m (2020 £967m) was owed by BAE Systems plc and £230m (2020 £412m) by other Group subsidiaries.

11. Acquisition of businesses

Businesses acquired during 2021
On 4 March 2021, the Group acquired 100% of the share capital of Pulse Power and Measurement Limited for a consideration of £21m. The provisional net assets acquired, including intangible assets identified, have been valued at £11m, resulting in a provisional goodwill of £10m.

On 14 September 2021, the Group acquired 100% of the share capital of In-Space Missions Limited for a fair value consideration of £15m. The provisional net assets acquired, including intangible assets identified, have been valued at £5m, resulting in a provisional goodwill of £10m.

Businesses acquired during 2020
All fair values provisionally disclosed in 2020 have been finalised, with no change in the provisional values recognised.

On 2 May 2020, the Group completed the acquisition of the assets and liabilities of Raytheon Technologies Corporation's Airborne Tactical Radios business (Airborne Tactical Radios business), for consideration of £216m. The acquisition augments the Group's Electronic Systems portfolio in airborne communications with broad-spectrum, multi-band, multi-channel radios that feature robust anti-jamming and encryption capabilities.

On 31 July 2020, the Group completed the acquisition of the assets and liabilities of the Collins Aerospace Military Global Positioning System business (Military GPS business) from Raytheon Technologies Corporation, for consideration of £1,472m. The acquisition augments the Group's Electronic Systems portfolio, adding technology that advances the Group's existing GPS and precision-guided munitions capabilities.

On 19 August 2020, the Group completed the acquisition of Techmodal Limited (Techmodal), a UK-based consultancy and digital services company, for consideration of £38m. Techmodal has a number of long-term contracts with the UK Ministry of Defence and complements the Group's existing digital, data and technical service capabilities.

The results and financial position of all three acquired businesses have been consolidated from the date of acquisition.

Purchase consideration and fair value of net assets acquired
The fair values of the assets and liabilities acquired and the consideration for all acquisitions in 2020 were as follows:

	Airborne Tactical Radios business £m	Military GPS business £m	Techmodal £m	Total £m
Identifiable intangible assets	84	468	14	566
Property, plant and equipment	8	20	–	28
Right-of-use assets	3	9	–	12
Inventories	4	53	–	57
Trade, other and contract receivables	13	28	3	44
Cash and cash equivalents	–	–	5	5
Lease liabilities	(3)	(9)	–	(12)
Trade and other payables	(8)	(17)	(4)	(29)
Deferred tax	–	–	(3)	(3)
Provisions	(3)	(1)	–	(4)
Net identifiable assets acquired	98	551	15	664
Goodwill arising	118	921	23	1,062
Net assets acquired	**216**	**1,472**	**38**	**1,726**
Satisfied by:				
Cash	216	1,472	23	1,711
Contingent consideration	–	–	15	15
Total consideration	**216**	**1,472**	**38**	**1,726**

The contingent consideration due for Techmodal has been finalised, and resulted in a gain being recognised in non-recurring items of £6m.

The net outflow of cash in respect of the purchase of businesses in 2020 was as follows:

	Airborne Tactical Radios business £m	Military GPS business £m	Techmodal £m	Total £m
Cash consideration	216	1,472	23	1,711
Cash and cash equivalents acquired	–	–	(5)	(5)
Net cash outflow in respect of the purchase of businesses	**216**	**1,472**	**18**	**1,706**

The goodwill recognised on these acquisitions is primarily attributable to expected synergies.

12. Business disposals

Business disposals during 2021

Advanced Electronics Company

In December 2020, the Group's Overhaul and Maintenance Company (OMC) entered into a heads of terms for the sale of its 50% shareholding in Advanced Electronics Company Limited (AEC) to Saudi Arabian Military Industries, and was reported in the financial statements for the year ending 31 December 2020 as assets held for sale. The sale was completed on 23 February 2021. AEC was included in the Air segment.

The gain recognised on disposal was as follows:

	2021 £m
Cash received or receivable:	
Cash	**182**
Deferred consideration	**32**
Total disposal consideration	**214**
Carrying amount of net assets sold (see below)	**(91)**
Gain on sale before tax and reclassification of foreign currency translation reserve	**123**
Reclassification of foreign currency translation reserves	**9**
Gain on sale before tax	**132**
Attributable to:	
Equity shareholders	**69**
Non-controlling interests	**63**
	132
Net cash inflow arising on disposal:	
Cash consideration received	**193**
Less: cash and cash equivalents disposed	**–**
	193

Of the total consideration receivable, £32m was deferred to be received over the 18 months following disposal. £11m of this contingent consideration was received in 2021 in relation to the sale of AEC, in addition to the cash received on disposal. The gain on disposal has been included in the profit for the period from continuing operations, as a component of Other income, and recognised as a non-recurring item.

The Group's share of the net assets of AEC as at the date of disposal was as follows:

	£m
Intangible assets including goodwill	**16**
Property, plant and equipment	**8**
Equity accounted investments	**67**
Net assets disposed	**91**

BAE Systems Rokar International

On 1 April 2021 BAE Systems agreed the sale of BAE Systems Rokar International Limited (Rokar) for \$31m (£22m) net of cash held by Rokar. This resulted in consideration received of \$47m (£34m), a disposal of net assets of \$12m (£8m), including \$16m (£12m) of cash, and a gain before tax on disposal of \$35m (£26m) which has been included in the profit for the period from continuing operations as a component of Other income, and recognised as a non-recurring item. Rokar was within the Electronic Systems segment.

Business disposals during 2020

Silversky

The divestment of the Silversky business completed on 2 November 2020. Silversky was included in the Cyber & Intelligence segment.

The loss recognised on the disposal of Silversky was as follows:

	2020 £m
Fair value of consideration received	14
Net assets disposed	(51)
Expenses incurred on disposal	(3)
Cumulative currency translation gain	35
Loss on disposal	(5)
Net cash inflow arising on disposal:	
Cash consideration received	10
Less: cash and cash equivalents disposed	(5)
	5

13. Events after the reporting period

There were no events after the reporting period which would materially impact the balances reported in this Annual Report.

14. Annual General Meeting

This year's Annual General Meeting will be held on 5 May 2022. Details of the resolutions to be proposed at that meeting will be included in the notice of Annual General Meeting that will be sent to shareholders at the end of March 2022.

15. Other information

The financial information for the year ended 31 December 2021 contained in this preliminary announcement was approved by the Board on 23 February 2022. This announcement does not constitute statutory accounts of the Company within the meaning of Section 435 of the Companies Act 2006, but is derived from those accounts.

Statutory accounts for the year ended 31 December 2020 have been delivered to the Registrar of Companies. Statutory accounts for the year ended 31 December 2021 will be delivered to the Registrar of Companies following the Company's Annual General Meeting.

The auditors have reported on those accounts. Their reports were not qualified, 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 a statement under Section 498(2) or (3) of the Companies Act 2006.

Cautionary statement:
All statements other than statements of historical fact included in this document, including, without limitation, those regarding the financial condition, results, operations and businesses of BAE Systems and its strategy, plans and objectives and the markets and economies in which it operates, 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 markets 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. BAE Systems plc and its directors accept no liability to third parties in respect of this report 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. It should be noted that Schedule 10A and Section 463 of the Companies Act 2006 contain limits on the liability of the directors of BAE Systems plc so that their liability is solely to BAE Systems plc.