

BAE Systems plc

Preliminary Announcement 2020

Results in brief

| Financial performance measures as defined by the Group ¹ | | | Financial performance measures defined in IFRS ² | | |
|---|------------------|----------|---|-----------------|----------|
| | 2020 | 2019 | | 2020 | 2019 |
| Sales | £20,862m | £20,109m | Revenue | £19,277m | £18,305m |
| Underlying EBITA | £2,132m | £2,117m | Operating profit | £1,930m | £1,899m |
| Underlying earnings per share excluding one-off tax benefit (2019 only) | 46.8p | 45.8p | Basic earnings per share | 40.7p | 46.4p |
| including one-off tax benefit (2019 only) | 46.8p | 50.8p | | | |
| Free cash flow ³ excluding £1bn pension contribution (2020 only) | £1,367m | £850m | Net cash flow from operating activities | £1,166m | £1,597m |
| including £1bn pension contribution (2020 only) | £367m | £850m | | | |
| Net debt | £(2,718)m | £(743)m | Order book | £36.3bn | £37.2bn |
| Order intake ⁴ | £20,915m | £18,447m | | | |
| Order backlog ⁴ | £45.2bn | £45.4bn | | | |
| Post-employment benefits and dividend | | | | | |
| | 2020 | 2019 | | | |
| Dividend per share | 23.7p | 9.4p | | | |
| Dividend per share – in respect of 2019 performance | 13.8p | - | | | |
| Group's share of the net post- employment benefits deficit | £(4.5)bn | £(4.5)bn | | | |

Charles Woodburn, Chief Executive, said: "Thanks to the outstanding efforts of our employees and close cooperation with our customers, suppliers and trades unions, we have delivered a strong set of results against a challenging backdrop of the global pandemic. Throughout 2020, we focused on keeping our people safe and supporting our communities, whilst continuing to deliver for our customers.

"In 2021, we will continue to drive operational performance, progress our sustainability agenda and invest in high-end discriminating technologies to meet our customers' priorities, which will ensure we are well positioned to grow the business and contribute to the economic prosperity of the countries in which we operate."

Our financial highlights

Financial performance measures as defined by the Group¹

- Sales increased by £0.8bn to £20.9bn, a 4% increase, excluding the impact of currency translation⁵.
- Underlying EBITA increased to £2,132m, a 1% increase on a constant currency basis⁵.
- Underlying earnings per share increased by 2% to 46.8p, excluding the impact of the prior year one-off tax benefit⁶.
- Free cash flow³ was £367m after the impact of the £1bn contribution into the UK pension scheme. Excluding this contribution free cash flow was £1.4bn.
- Net debt increased to £2,718m, following the £1bn bond issuance to fund the UK pension scheme, and the \$2.2bn (£1.7bn) acquisitions of the Airborne Tactical Radios and Military Global Positioning System businesses.
- Order intake⁴ increased to £20.9bn.
- Order backlog⁴ of £45.2bn.

Financial performance measures defined in IFRS²

- Revenue increased by £1.0bn to £19.3bn.
- Operating profit increased by £31m to £1,930m, including the non-recurring credit of £19m (2019 £27m charge).
- Basic earnings per share decreased by 12% to 40.7p. 2019 included the impact of the one-off tax benefit of £161m.
- Net cash flow from operating activities decreased by £431m to £1,166m, including the effect of the £1bn contribution to the UK pension scheme.
- Order book of £36.3bn (2019 £37.2bn).

Post-employment benefits and dividend

- Group's share of the pre-tax accounting net post-employment benefits deficit was in line with the prior year at £4.5bn.
- Final dividend of 14.3p per share making a total of 23.7p per share in respect of the year ending 31 December 2020. The total of 37.5p per share for the year 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.

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. For alternative performance measure definitions see glossary on page 12).
2. International Financial Reporting Standards.
3. During 2020 the Group has determined that Free cash flow is 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. Including share of equity accounted investments.
5. Current year compared with prior year translated at current year exchange rates.
6. The one-off tax benefit in 2019 is described on page 15.

Operational and strategic key points

Air

- Contract secured to support the production of 38 Typhoon aircraft for the German Air Force
- Qatar Typhoon and Hawk aircraft programme met its contractual milestones in the year
- F-35 programme Lots 12 to 14 contract definitised following price agreement. 126 rear fuselage assemblies completed in the year, below the contracted level as a result of COVID-19 disruption. Ramp up to full-rate production in 2021
- Governments of Italy and Sweden committed to working with the UK to develop next-generation combat air capability
- A further six Hawk aircraft assembled in Saudi Arabia were accepted and entered service in-Kingdom
- The design and production readiness phase of the Hunter Class Frigate programme for the Royal Australian Navy continues to make good progress
- Sale of Advanced Electronics Company to Saudi Arabian Military Industries completed in February 2021

Maritime

- The fourth Astute Class submarine, HMS Audacious, left our Barrow site in April to begin sea trials with the Royal Navy
- Construction of the first two Dreadnought Class submarines continues to advance
- The build phase of the River Class Offshore Patrol Vessel programme is now complete, with the fourth ship, HMS Tamar, handed over to the Royal Navy in March, and HMS Spey, the fifth and final ship, handed over in October
- Construction of the first two City Class Type 26 frigates for the Royal Navy continues to progress
- Acquisition of Techmodal, a UK data consultancy and digital services business, completed in August
- Announcement of a 15-year agreement with the UK Ministry of Defence to supply the Next Generation Munitions Solution between 2023 and 2037
- RBSL has secured its share of the Mechanised Infantry Vehicle Boxer programme

Electronic Systems

- Airborne Tactical Radios and Military Global Positioning System acquisitions completed, performing well and integrations are progressing
- F-35 electronic warfare systems for Lot 12 completed, surpassing cumulative programme deliveries of 800 electronic warfare systems as of year end
- Successful demonstration of APKWS[®] ground-launch capability
- Terminal High Altitude Area Defense (THAAD) seeker executing at full-rate production, and receipt of additional order to design and manufacture next-generation infrared seekers
- Continued classified work
- Demand in the commercial business lines of Controls & Avionics Solutions and Power & Propulsion Solutions has been negatively impacted by COVID-19

Platforms & Services (US)

- Delivery of the first production Armored Multi-Purpose Vehicles took place in the second half; one of each of the five variants delivered by year end
- Amphibious Combat Vehicle programme moved to full-rate production phase after Initial Operational Capability declared
- Delivery of more than 50 production Bradley A4 vehicles
- New US Navy contract modifications totalling \$114m (£83m) for Mk45 Mod 4 upgrades
- Initial deliveries of Virginia Payload Module tubes completed
- Ship Repair secured more than \$1bn (£0.7bn) in US Navy maintenance and modernisation orders
- Ordnance Systems received \$233m (£170m) in modernisation contracts
- Contracted to provide five 57Mk3 and ten 40Mk4 naval gun systems for the UK Royal Navy's Type 31 frigates
- Operational delays and disruptions related to the COVID-19 pandemic were experienced across manufacturing and shipyard facilities

Cyber & Intelligence

Intelligence & Security

- US-based Intelligence & Security business continues to maintain its bid pipeline, perform on existing contracts and win new orders. All three businesses delivered a book to bill¹ ratio of over one.
- Awarded a seven-year, \$495m (£362m) contract on Instrumentation Range Support Programme
- Multi-year Indefinite Delivery, Indefinite Quantity contract received to provide electronic hardware and engineering services for a US government customer
- Our Federated Secure Cloud technology approach and processes are being employed to maintain and secure US Army Cyber Command's virtual desktop infrastructure

Applied Intelligence

- Strong order intake, revenue and profitability performance in the core underlying business driven by the Government business unit
- Significant profit growth year-on-year due to cycling the restructuring of the Technology & Commercial business in 2019
- Sale of the US-based software-as-a-service business completed in November

1. Ratio of Order intake to Sales.

Guidance for 2021

Whilst 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 2020 are provided in the Group financial review on pages 14 to 19.

Group guidance

With a strong year behind us against a challenging backdrop of the global pandemic, we look forward to another year of top line growth, with a year of margin expansion and good cash flow, all reflected in our Group guidance. Guidance is provided on the basis of an exchange rate of \$1.35:£1.

For the year ending 31 December 2021, the Group's sales are expected to grow in the 3% to 5% range over 2020. Excluding the impact of foreign exchange, we expect growth to be between 5% to 7%.

Sales growth is expected in Air and Electronic Systems, including the full year impact of the acquisitions, partially offset by continued weakness in commercial aerospace revenues. Approximately 80% of expected sales is already in Order backlog.

Underlying EBITA is expected to increase in the range of 6% to 8%. Excluding the impact of foreign exchange, we anticipate growth in excess of 10%, with improved performance in Platforms & Services (US), continued expansion in Applied Intelligence, and a full year of contribution from the acquisitions in Electronic Systems.

Finance costs are expected to be approximately £270m with an effective tax rate expected to be around 18%, and non-controlling interest expected to be around £85m.

Underlying earnings per share is expected to increase in the range of 3% to 5%. A 10 cent movement in the exchange rate impacts underlying EPS by around 2 pence.

Free cash flow for 2021 is anticipated to be in excess of £1bn, with a three-year target for 2021 to 2023 in excess of £4bn.

Segment guidance

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

| | Electronic Systems | Cyber & Intelligence | Platforms & Services (US) | Air | Maritime |
|--|----------------------|----------------------|---------------------------|--------------------|--------------------|
| Sales | | | | | |
| Guidance (\$1.35:£1) | Up 4% to 6% | Down 3% to 5% | Down 3% to 5% | Up 7% to 9% | Up 2% to 4% |
| <i>Constant currency basis¹</i> | <i>Up 10% to 12%</i> | <i>Stable</i> | <i>Stable</i> | <i>Up 7% to 9%</i> | <i>Up 2% to 4%</i> |
| Underlying EBITA margin² | 15% to 16% | 7% to 8% | 8% to 9% | 10% to 12% | 9% to 10% |

1. Constant currency growth rates eliminate the impact of foreign exchange translation.

2. Underlying EBITA as percentage of Sales.

HQ costs are expected to be 10% lower than 2020.

Revised profit performance measures

During 2021, management will adopt the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the underlying EBITA measure, as it reflects a better measure of underlying profitability. Underlying earnings per share will also be recalculated to ensure consistency with the updated operational profitability measures. Revised guidance for these updated measures will be issued in due course. The change in profit measure has no impact on the Group's existing business performance or cash guidance.

For further information please contact:

Investors

Martin Cooper,
Investor Relations Director

Telephone: +44 (0) 1252 383455

Email: investors@baesystems.com

Media Relations

Kristina Anderson,
Director, Media Relations

Telephone: +44 (0) 7540 628673

Email: kristina.anderson@baesystems.com

Analyst and investor presentation

A presentation, for analysts and investors, of the Group's Results for 2020 will be available via webcast at 9am today (25 February 2021).

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 89,600 people¹ 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

Introduction

During 2020, we have been resilient and agile in managing our response to the challenges created by the COVID-19 pandemic. As we faced up to the global pandemic, we focused on protecting our employees and helping the communities in which we operate, as well as ensuring continued support for our customers. We entered the year in a position of strength, and addressed the pandemic-related challenges whilst also completing two major strategic actions in the year: firstly, the two US-based acquisitions; and secondly, accelerating payments into the UK pension scheme.

Demand for our capabilities remains high and we recognise our role not only in supporting national security, but also in contributing to the economic prosperity of the countries in which we operate.

Through a continuous drive on operational performance and with progress on our strategic objectives we are well placed to deliver a long-term sustainable business and generate shareholder value.

Overview

BAE Systems delivered a strong and resilient set of results in the face of a global pandemic, with higher year-on-year orders, sales, profit and free cash flow¹, thanks to the outstanding efforts of our employees. Pandemic-related disruptions did impact profit in the first half of the year but the second half was stronger, enabling the Company to deliver higher year-on-year profit.

Our strategy remains consistent and is delivering results. We completed two key strategic actions in the year, which should benefit our outlook in the short and long term. Firstly, two acquisitions for a combined \$2.2bn (£1.7bn) were announced and completed in the US. The Military Global Positioning System and Airborne Tactical Radios business acquisitions were opportunistic, arising from the Raytheon and United Technologies merger. Both are strategically attractive, complementary to our Electronic Systems portfolio and represent unique opportunities to purchase high quality, technology-based businesses with market-leading capabilities and long histories of innovation in their respective fields. We were delighted to welcome the employees from these businesses into BAE Systems. The businesses are performing well and the integrations are progressing smoothly, benefiting from positive levels of engagement by the teams. Secondly, we made a £1bn one-off cash injection into the UK pension scheme, to accelerate the deficit reduction and give increased certainty to all our stakeholders. From a business perspective, it is anticipated this will give us additional cash flow looking forward and therefore opportunities for further generation of shareholder value.

BAE Systems has proven to be a resilient company and has long-term strength from its programmes, technologies, customer relationships and sustainability agenda. The Group maintained its strong sales balance between production and aftermarket services. The geographic mix of the business continued to evolve as our US business grew and our UK and Kingdom of Saudi Arabia revenues remained stable. The geographic mix and reach, the programme spread and longevity of the positions which mean we are not dependent on a small number of programmes, are key factors in our resilience and also the strength of our outlook.

Our response to COVID-19

The safety and wellbeing of our employees is paramount and it was our primary consideration as we managed our response to the global pandemic. The professionalism, agility and understanding of our employees, customers, trades unions and suppliers was outstanding, as we embarked on the implementation of new working practices such as scaled-up home-working capabilities, reconfigured floorplans, shift patterns, enhanced cleaning regimes and other appropriate safe working measures.

By taking these actions to build in resilience for a prolonged period of disruption, we were able to continue to deliver critical work for our customers and, where operations were impacted, ensure that site-critical workers were able to safely return to work. These actions and ways of working have endured into 2021 with the reintroduction of lockdown measures in many of our locations.

1. Excluding the £1bn UK pension scheme contribution.

We coordinated closely with our supply chains to mitigate disruptions where possible and maintain resilience, in some cases advancing payments where required. Overall the response up and down the supply chains was outstanding.

Support for the defence industry from the governments in our key markets has been exceptional around prioritisation of capabilities, cash flows, recognition of the need to maintain strong supply chains and collaborative working to maintain critical defence and security programmes.

We in turn looked to help our customers by being agile in our working practices to deliver critical work and, where needed, prioritising the social needs of our governments and communities as we all responded to the challenges arising from the pandemic.

Throughout the crisis, we supported governments and communities in the countries where we operate as they responded to the pandemic. We deployed our 3D printing capabilities and collaborated with our supply chain to donate more than 150,000 items of Personal Protective Equipment (PPE) to healthcare workers in the US and the UK. We are proud to have supported ventilator production as part of the VentilatorChallengeUK consortium. We also supported our communities in our principal markets through the provision of online educational resources for young people, as well as financial support to healthcare providers and local charities to enable them to provide care packages and food relief to the most vulnerable. Much of our outreach work has been supported by our employees who volunteered their time and skills to help local relief efforts.

Evolving to a sustainable business

Sustainability is important to us and 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. The long-term outlook for the Company 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 have set ourselves the target of achieving net zero greenhouse gas emissions across our operations by 2030. All of these are underpinned by sound governance at the core of our business. 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. This sustainability agenda is fundamental to our business performance and aligns stakeholder priorities with the Group's Environmental, Social and Governance (ESG) risks and opportunities so that we can drive the success of the business for the benefit of all of our stakeholders.

2020 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.

Based on the acquisitions and organic operations, our US defence electronics business delivered another standout performance in 2020, especially in our core franchise positions in the high-technology areas of electronic warfare, precision-guided munitions, Intelligence, Surveillance and Reconnaissance, and electro-optics. The Electronic Systems business closed with a record order backlog supplemented by the acquisitions.

Within Electronic Systems, our Controls and Avionics franchises in the civil aerospace market of engine and flight controls were negatively impacted by the pandemic. We have scaled the business appropriately, worked closely with our key customers and maintained our leading positions and capabilities to meet the expected return of long-term demand once COVID-19 vaccine prevalence is achieved.

Platforms & Services (US) work is predominantly on military contracts. Some schedule adjustments have occurred on the fixed price contracts in US Ship Repair and on the less mature combat vehicle programmes such as the Armored Multi-Purpose Vehicle. These operational challenges resulted from a combination of COVID-19 cases, supply chain disruptions and the ongoing investments and refinements in our vehicle designs and production processes that are integral to the early programme stages of low rate initial production. Notwithstanding these challenges, our Combat Mission Systems business continues to make progress towards achieving consistent quality and production throughput across multiple programmes as the investment in new production capabilities, processes, and applying lessons learned take hold.

Our US-based Intelligence & Security business delivered a highly resilient performance in the year and maintained its bid pipeline to deliver an enhanced backlog position at year end.

In our Applied Intelligence business, our UK Government division performed well, driving the whole business into a profit this year. We completed the disposal of the Applied Intelligence US-based software-as-a-service business and exited the UK-based managed security services business.

In the Air sector profitability was impacted in the second quarter as our global operations had to adjust to operating under pandemic conditions. The Air sector responded to deliver a strong overall operational performance. Highlights included the meeting of key milestones on the Qatar build programmes, preparations for the continued ramp up of F-35 production and the delivery of in-service support on Typhoon, Tornado and Hawk for international customers. The Tempest programme is progressing at pace, with Tempest partners currently working on more than 60 technology demonstrations.

In Maritime, significant progress was made on our operational performance in the year, working closely with the Royal Navy to deliver a number of key milestones. The fourth Astute Class submarine, HMS Audacious, was accepted and left our Barrow site in April during lockdown conditions, the final two Offshore Patrol Vessels, HMS Tamar and HMS Spey, were accepted and the work to bring the Queen Elizabeth Class Carriers to operational status continued with a particular highlight being HMS Queen Elizabeth going to sea with the UK's new Carrier Strike Group for the first time as part of a NATO exercise. Maintaining this level of improved operational performance is vital as we progress with production on the Type 26 and Dreadnought programmes, the mainstays of the Maritime business for the next decade.

Driving competitiveness and efficiency

We will not forget the lessons learned during the response to the pandemic and there are a number of areas where the enforced changes in working practices may be able to provide learning and improvements to future business operations, all contributing to our strategic priority of competitiveness and providing value for money for our customers and shareholders. 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.

Advancing and further leveraging our technology

The Group has world-class engineering capabilities and high-end discriminating technologies, well aligned to the current and future requirements of our customers.

We have the ability and intention to advance our technology further and are working hard to drive forward our strategy, in partnership with our customers. We will do this through investing more in self-funded research and development, making acquisitions to enhance our exposure to high-growth areas – as shown by investing more than \$2bn for the two US acquisitions and smaller bolt-ons this year – and working with our customers, industry partners, SMEs and academia.

Our technology strategy is driven by the challenges that our customers face now and in the future, given the multiplying threats they face, ranging from daily cyber attacks to the novel weapons being devised by potential adversaries. As a result, our systems and products need to be more adaptable and competitive than ever before. In addition to continuing to advance our portfolio in the more traditional domains of air, sea and land, we are focused on developing a number of technologies that support long-

term market trends in our sector including: cyber capabilities; multi-domain autonomous systems and networking; delivery of military capability from space; and sustainability-driven product innovation.

In addition, the Electronic Systems and Air sectors remain focused on investment in emerging technologies and leveraging customer funding to maintain, develop and grow our strong market positions.

Demand outlook

We have a large order backlog and exceptional programme positions, providing visibility of growth. Orders in 2020 exceeded expectations, with pleasing progression in our US-managed businesses with a book-to-bill ratio² of over one, as well as our workshare on the German award for 38 Typhoon aircraft.

Our defence and security capabilities remain highly relevant in an uncertain global environment with complex threats and with the additional need for governments to drive a domestic economic prosperity agenda in a post-pandemic world.

There are good prospects in existing and new international markets for our products and services in air, maritime, land and cyber security. Defence and security remain high on national agendas with the need in many cases to recapitalise or upgrade ageing equipment.

The US continues to represent the world's largest defence budget and accounts for around 45% of our sales. The Group's US-based portfolio remains well aligned to customer priorities, growth areas, and the US National Defense Strategy, which we expect to continue under the new administration. The backlog for the US-based business has continued to grow both organically and through the two acquisitions successfully closed during the year. This backlog provides good visibility of growth in the US business.

In the UK, where we are the largest defence contractor, defence and security spending is set to increase over the next four years. The Integrated Foreign Policy, Defence and Security Review is due to be published early in 2021, and the UK government has made a series of recent programme announcements related to the review. Similarly in Australia, where we are the leading defence contractor, the business is set to grow significantly in the coming years as the Hunter Class Frigate programme matures. The government announcement in July to increase its ten-year investment in new and upgraded defence capabilities from A\$195bn to A\$270bn should provide further opportunities to enhance and extend our growth profile.

In Europe, a number of nations are increasing their defence budgets to address the threat environment and move towards their 2% of GDP NATO commitments. We remain well placed through our positions on the Eurofighter Typhoon, our shareholding in MBDA and our BAE Systems Hägglunds Sweden-based land vehicles business.

In our Middle East markets, our long-standing relationships at government and company levels, continued regional instability and in many areas the nature of our long-term contracts, mean we expect defence and security to remain a priority despite the impacts of the current low oil price.

The civil aerospace market accounts for around 5% of Group sales. COVID-19 significantly impacted this market, and a recovery to 2019 levels is likely to be some years away. Despite the near-term challenges, 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.

Brexit

BAE Systems will support the UK government in achieving its aim to ensure that the UK maintains its key role in European security and defence post-Brexit and to strengthen bilateral relationships with key partners in Europe. This will be important for ongoing collaboration in the development of defence capabilities.

The Group has relatively limited UK-EU trading and the majority of persons employed in the UK are UK nationals, with only limited movement of EU nationals into and out of the Group's UK businesses. We have been working with our supply chain throughout the Brexit process to mitigate any major disruptions. Accordingly, the resulting impacts of Brexit across the business are expected to be limited.

2. Ratio of Order intake to Sales.

Balance sheet and capital allocation

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.

Consistent with this approach, the Group expects to continue to meet its pension obligations, invest in research and technology and pursue 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. Investment in value-enhancing acquisitions and returns to shareholders through a share buyback will be considered in line with our clear and consistent strategy and capital allocation policy.

In April, BAE Systems issued \$1.3bn (£1.0bn) of ten-year bonds to fund the £1bn contribution into the BAE Systems Pension Scheme. In September, BAE Systems issued \$2.0bn (£1.5bn) of bonds, the proceeds of which were applied in the repayment of the \$1.9bn bridge loan facility that had been drawn to fund the acquisition of the Military GPS business.

Post-employment benefits schemes

The Group's share of the pre-tax accounting net post-employment benefits deficit remained in line with the prior year at £4.5bn. The impact of significantly lower discount rates increased liabilities, which offset asset returns and the Group's contributions into the schemes.

Under the funding deficit recovery plan agreed in February 2020, a one-off payment of £1bn was made in April along with approximately £240m of funding payable in the scheme year ending 31 March 2020. In December we took the opportunity to make our March 2021 deficit payment of £161m ahead of schedule. The next triennial review is scheduled for 2022.

Board and Executive Committee changes

Brad Greve, Tom Arseneault and Jane Griffiths were appointed to the Board on 1 April 2020 and Nick Anderson was appointed to the Board on 1 November 2020. Peter Lynas and Jerry DeMuro retired from the Board on 31 March 2020, Revathi Advaiti retired from the Board on 25 June 2020, and Paula Rosput Reynolds and Nick Rose retired from the Board on 31 December 2020. On 11 February 2021 the Company announced the appointments of Dame Carolyn Fairbairn and Dr Ewan Kirk as non-executive directors, with effect from 1 March and 1 June 2021, respectively.

At the start of 2020 Ben Hudson was appointed as Chief Technology Officer, replacing Nigel Whitehead who announced his intention to retire.

Summary

As demonstrated this year, through execution of our strategy, BAE Systems is well placed to maximise opportunities, deal with the challenges, and deliver a business focused on sustainability and generating shareholder value.

In this challenging year we have built resilience into the business, returned the defence business to a near normal operational tempo, and completed our two US acquisitions smoothly. Relationships with, and support from our customers remains strong, with governments in our key markets continuing to prioritise defence and security. We are investing in technology aligned to our customers' priorities. Our large order backlog, incumbent programme positions and evolving pipeline of opportunities mean we are well placed to deliver profitable top-line growth with increasing cash conversion in the coming years.

Dividends

The Board has recommended a final dividend of 14.3p for a total of 23.7p in respect of the year ending 31 December 2020. The total of 37.5p per share for the year 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. Subject to shareholder approval at the 2021 Annual General Meeting, the dividend will be paid on 1 June 2021 to holders of ordinary shares registered on 23 April 2021.

Glossary

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.

| | 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. | Allows management to monitor the sales performance of subsidiaries and equity accounted investments. |
| Underlying EBITA | Operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBITA), and non-recurring items ¹ . | Provides a measure of operating profitability that is comparable over time. |
| Return on sales | Underlying EBITA as a percentage of sales. | Provides a measure of operating profitability that is comparable over time. |
| Underlying earnings per share | Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items ¹ . | Provides a measure of underlying performance 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. | Allows management to monitor the operational cash generation of the Group. |
| Free cash flow | Net cash flow from operating activities, including net capital expenditure and lease principal amounts, financial investment, dividends from equity accounted investments and net interest paid. | Allows management to monitor utilisation of cash in line with the Group's capital allocation policy. |
| Net debt | 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 the indebtedness of the Group. |
| 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 subsidiaries and equity accounted investments. |
| 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. Items that are not relevant to an understanding of the Group's underlying performance (see page 44).

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

Income statement

| | 2020 £m | 2019 £m |
|--|----------------------------|--------------|
| Financial performance measures as defined by the Group¹ | | |
| Sales | 20,862 | 20,109 |
| Underlying EBITA | 2,132 | 2,117 |
| Return on sales ² | 10.2% | 10.5% |
| Financial performance measures defined in IFRS³ | | |
| Revenue | £m 19,277 | £m 18,305 |
| Operating profit | 1,930 | 1,899 |
| Return on revenue ⁴ | 10.0% | 10.4% |
| Reconciliation of sales to revenue | | |
| | £m | £m |
| Sales | 20,862 | 20,109 |
| Deduct Share of sales by equity accounted investments | (2,652) | (2,878) |
| Add Sales to equity accounted investments | 1,067 | 1,074 |
| Revenue | 19,277 | 18,305 |
| Reconciliation of underlying EBITA to operating profit | | |
| | £m | £m |
| Underlying EBITA | 2,132 | 2,117 |
| Non-recurring items | 19 | (27) |
| Amortisation of intangible assets | (137) | (109) |
| Impairment of intangible assets | (4) | (6) |
| Financial expense of equity accounted investments | (32) | (23) |
| Taxation expense of equity accounted investments | (48) | (53) |
| Operating profit | 1,930 | 1,899 |
| Net finance costs | (334) | (273) |
| Taxation expense | (225) | (94) |
| Profit for the year | 1,371 | 1,532 |
| Underlying net interest expense ⁵ | (255) | (257) |
| Net interest expense on post-employment benefit obligations | (70) | (117) |
| Fair value and foreign exchange adjustments on financial instruments and investments | (41) | 78 |
| Net finance costs (including equity accounted investments) | (366) | (296) |
| Exchange rates | | |
| | 2020 | 2019 |
| Average | | |
| £/\$ | 1.283 | 1.277 |
| £/€ | 1.125 | 1.141 |
| £/A\$ | 1.862 | 1.836 |
| Year end | | |
| £/\$ | 1.367 | 1.324 |
| £/€ | 1.117 | 1.180 |
| £/A\$ | 1.770 | 1.884 |
| Sensitivity analysis | | |
| | £m | |
| Estimated impact on sales of a ten cent movement in the average exchange rate | | |
| \$ | 700 | |
| € | 100 | |
| A\$ | 40 | |

1. For alternative performance measure definitions see glossary on page 12.

2. Underlying EBITA a percentage of Sales.

3. International Financial Reporting Standards.

4. Operating profit as a percentage of Revenue.

5. Underlying net interest expense is defined as 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.

Sales increased by £0.8bn to £20.9bn (2019 £20.1bn), a 4% increase on a constant currency basis¹.

Underlying EBITA increased to £2,132m (2019 £2,117m), giving a return on sales² of 10.2% (2019 10.5%). Excluding the impact of exchange translation, the increase was 1%.

Revenue increased by £1.0bn to £19.3bn (2019 £18.3bn).

Operating profit increased by £31m to £1,930m (2019 £1,899m).

Non-recurring items in 2020 reflect a credit of £19m. This comprises 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. Non-recurring charges in 2019 of £27m comprised a £36m software intangible derecognition charge and a net gain relating to acquisitions and disposals of £9m.

Amortisation of intangible assets is £137m (2019 £109m), the increase mainly a result of intangible assets arising from the acquisitions.

Impairment of intangible assets in 2020 is £4m (2019 £6m).

Net finance costs, including equity accounted investments, were £366m (2019 £296m). The underlying interest charge, excluding pension accounting, and fair value and foreign exchange adjustments on financial instruments and investments was £255m (2019 £257m). Net interest expense on the Group's pension deficit was £70m (2019 £117m). There was a charge in respect of fair value and foreign exchange adjustments of £41m (2019 £78m credit) on exchange translation of US dollar-denominated bonds.

Taxation expense, including equity accounted investments, of £273m reflects the Group's underlying effective tax rate for the year of 17%. The 2019 charge of £147m reflected the Group's underlying effective tax rate for that year of 19%, less a £161m credit in respect of two items. Following agreements reached in respect of overseas tax matters, a one-off benefit was recognised; and following review of the April 2019 EU Commission decision that concluded that the UK's Controlled Foreign Company regime partially represented State Aid, a provision was recognised for the estimated exposure.

The calculation of the underlying effective tax rate is shown in note 4 on page 46.

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

2. Underlying EBITA as a percentage of Sales.

Earnings per share

| | 2020 | 2019 |
|---|----------------|---------|
| Financial performance measures as defined by the Group¹ | | |
| Underlying earnings (excluding the 2019 one-off tax benefit) | £1,493m | £1,457m |
| Underlying earnings per share (excluding the 2019 one-off tax benefit) | 46.8p | 45.8p |
| Underlying earnings (including the 2019 one-off tax benefit) | £1,493m | £1,618m |
| Underlying earnings per share (including the 2019 one-off tax benefit) | 46.8p | 50.8p |
| Financial performance measures defined in IFRS² | | |
| Profit for the year attributable to equity shareholders | £1,299m | £1,476m |
| Basic earnings per share | 40.7p | 46.4p |
| Reconciliation of underlying EBITA to underlying earnings | | |
| | £m | £m |
| Underlying EBITA | 2,132 | 2,117 |
| Underlying net interest expense (including equity accounted investments) ³ | (255) | (257) |
| | 1,877 | 1,860 |
| Taxation expense (at the underlying effective tax rate, excluding the 2019 one-off tax benefit) | (312) | (347) |
| Non-controlling interests | (72) | (56) |
| Underlying earnings (excluding the 2019 one-off tax benefit) | 1,493 | 1,457 |
| One-off tax benefit | - | 161 |
| Underlying earnings (including the 2019 one-off tax benefit) | 1,493 | 1,618 |
| Reconciliation of underlying earnings to profit for the year attributable to equity shareholders | | |
| | £m | £m |
| Underlying earnings (excluding the 2019 one-off tax benefit) | 1,493 | 1,457 |
| Non-recurring items, post tax | 15 | (18) |
| Amortisation and impairment of intangible assets, post tax | (117) | (93) |
| Net interest expense on post-employment benefit obligations, post tax | (58) | (95) |
| Fair value and foreign exchange adjustments on financial instruments and investments, post tax | (34) | 64 |
| One-off tax benefit (2019) | - | 161 |
| Profit for the year attributable to equity shareholders | 1,299 | 1,476 |
| Non-controlling interests | 72 | 56 |
| Profit for the year | 1,371 | 1,532 |

Underlying earnings per share for the year increased by 2% to 46.8p (2019 45.8p, excluding the one-off tax benefit).

Basic earnings per share was 40.7p (2019 46.4p).

Orders

| | 2020 | 2019 |
|---|-----------------|----------|
| Financial performance measures as defined by the Group | | |
| Order intake ⁴ | £20,915m | £18,447m |
| Order backlog ⁴ | £45.2bn | £45.4bn |
| Financial performance measures defined in IFRS² | | |
| Order book | £36.3bn | £37.2bn |

Order intake⁴ increased by £2.5bn to £20,915m (2019 £18,447m). Our US-managed businesses had a book to bill ratio⁵ of more than one.

Order backlog⁴ decreased by £0.2bn to £45.2bn.

Order book decreased by £0.9bn to £36.3bn.

1. For alternative performance measure definitions see glossary on page 12.

2. International Financial Reporting Standards.

3. Underlying net interest expense is defined as 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.

4. Including share of equity accounted investments.

5. Ratio of Order intake to Sales.

Cash flow

| | 2020 £m | 2019 £m |
|--|----------------|------------|
| Financial performance measures as defined by the Group¹ | | |
| Free cash flow ² | 367 | 850 |
| Financial performance measures defined in IFRS³ | £m | £m |
| Net cash flow from operating activities | 1,166 | 1,597 |
| Reconciliation from free cash flow to net cash flow from operating activities | £m | £m |
| Free cash flow | 367 | 850 |
| Add back Interest paid, net of interest received | 208 | 205 |
| Add back Taxation | 251 | 252 |
| Operating business cash flow⁴ | 826 | 1,307 |
| Add back Net capital expenditure and financial investment | 392 | 454 |
| Add back Principal element of lease payments and receipts | 226 | 230 |
| Deduct Dividends received from equity accounted investments | (27) | (142) |
| Deduct Taxation | (251) | (252) |
| Net cash flow from operating activities | 1,166 | 1,597 |
| Net capital expenditure and financial investment | (392) | (454) |
| Principal element of finance lease receipts | 10 | 9 |
| Dividends received from equity accounted investments | 27 | 142 |
| Interest received | 19 | 28 |
| Acquisitions and disposals | (1,701) | 43 |
| Net cash flow from investing activities | (2,037) | (232) |
| Interest paid | (227) | (233) |
| Equity dividends paid | (746) | (724) |
| Partial disposal of shareholding in subsidiary undertaking | 27 | 31 |
| Dividends paid to non-controlling interests | (19) | (56) |
| Principal element of lease payments | (236) | (239) |
| Cash flow from matured derivative financial instruments (excluding cash flow hedges) | 16 | 40 |
| Movement in cash collateral | (2) | 1 |
| Net cash flow from loans | 2,160 | (782) |
| Net cash flow from financing activities | 973 | (1,962) |
| Net increase/(decrease) in cash and cash equivalents | 102 | (597) |
| (Deduct)/add back Net cash flow from loans | (2,160) | 782 |
| Foreign exchange translation | 220 | 72 |
| Other non-cash movements | (137) | (96) |
| (Increase)/decrease in net debt | (1,975) | 161 |
| Opening net debt | (743) | (904) |
| Net debt | (2,718) | (743) |

1. For alternative performance measure definitions see glossary on page 12.

2. During 2020 the Group has determined that Free cash flow is 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.

3. International Financial Reporting Standards.

4. Operating business cash flow is defined as Net cash flow from operating activities excluding taxation and including net capital expenditure and lease principal amounts, financial investments and dividends from equity accounted investments.

Free cash flow¹ was £367m (2019 £850m), which includes the impact of the Group's £1bn contribution into the UK pension scheme. The remaining inflow reflects the Group's strong focus on liquidity.

Net cash inflow from operating activities was £1,166m (2019 £1,597m), including the effect of the £1bn contribution to the UK pension scheme.

Taxation payments were in line with the prior year at £251m.

Net capital expenditure and financial investment was £392m (2019 £454m).

Dividends received from equity accounted investments of £27m (2019 £142m). The prior year included a dividend from MBDA of £73m.

Interest received was £19m (2019 £28m).

The cash outflows 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). The cash inflows in 2019 of £43m represented the disposal of Aircraft Accessories and Components Company (£26m), the disposal of the UK-based land vehicles business into the RBSL joint venture (£29m), the reduction in the shareholding in OMC (£31m), less the investment in Riptide Autonomous Solutions (£9m) and the Prismatic acquisition (£3m).

Interest paid was £227m (2019 £233m).

Equity dividends paid in 2020 represents the two 2020 interim dividends. The first of these reflects the dividend proposed but subsequently deferred in respect of the year ended 31 December 2019 which was paid in September (£444m). The second interim dividend is in respect of the half year ended 30 June 2020 and was paid in November (£302m).

Dividends paid to non-controlling interests decreased to £19m (2019 £56m), reflecting a lower payment by Saudi Maintenance & Supply Chain Management Company, in which the Group has a 51% shareholding.

There was a **cash inflow from matured derivative financial instruments** of £16m (2019 £40m), 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.

1. During 2020 the Group has determined that Free cash flow is 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.

Net debt

| Components of net debt | 2020 £m | 2019 £m |
|---|--------------------|--------------------|
| Cash and cash equivalents | 2,768 | 2,587 |
| Debt-related derivative financial instruments (net) | (62) | 67 |
| Loans – non-current | (4,957) | (3,020) |
| Loans and overdrafts – current | (467) | (377) |
| Net debt | (2,718) | (743) |

The Group's **net debt** at 31 December 2020 is £2,718m, a net increase of £1,975m from the position at the start of the year. This is primarily a result of funding the two US acquisitions and the contribution to the UK pension scheme, partly offset by strong operational cash generation.

Cash and cash equivalents of £2,768m (2019 £2,587m) are held primarily for the repayment of debt securities, pension deficit funding, payment of the 2020 final dividend 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 2020 had a material impact on the Group or required the Group to change its accounting policies.

Segmental review

The Group reports its performance through five principal reporting segments.

Year ended 31 December 2020

| | As defined by the Group | | | | | | Defined in IFRS ¹ | | | | |
|-------------------------------------|-------------------------|---------------------------|--------------------------------------|--|------------------------------------|--------------------------------------|------------------------------|--------------------------------------|--|--|----------------------|
| | Sales £m | Underlying EBITA £m | Return on sales ² % | Operating business cash flow £m | Order intake ³ £m | Order backlog ³ £bn | Revenue £m | Operating profit/ (loss) £m | Return on revenue ⁴ % | Net cash flow from operating activities £m | Order book £bn |
| Electronic Systems | 4,557 | 684 | 15.0 | 580 | 4,722 | 6.5 | 4,557 | 648 | 14.2 | 767 | 5.3 |
| Cyber & Intelligence | 1,812 | 136 | 7.5 | 221 | 1,987 | 1.7 | 1,812 | 138 | 7.6 | 251 | 1.1 |
| Platforms & Services (US) | 3,503 | 195 | 5.6 | 382 | 4,137 | 6.1 | 3,399 | 183 | 5.4 | 458 | 5.6 |
| Air | 7,910 | 941 | 11.9 | 718 | 6,494 | 22.5 | 6,593 | 862 | 13.1 | 917 | 16.5 |
| Maritime | 3,257 | 306 | 9.4 | 243 | 3,772 | 9.1 | 3,195 | 272 | 8.5 | 317 | 8.5 |
| HQ ⁵ | 190 | (130) | | (1,318) | 171 | – | 40 | (173) | | (1,293) | – |
| Deduct Intra-group | (367) | | | | (368) | (0.7) | (319) | | | | (0.7) |
| Deduct Taxation ⁶ | | | | | | | | | | (251) | |
| Total | 20,862 | 2,132 | 10.2 | 826⁷ | 20,915 | 45.2 | 19,277 | 1,930 | 10.0 | 1,166 | 36.3 |

1. International Financial Reporting Standards.
2. Underlying EBITA as a percentage of Sales.
3. Including share of equity accounted investments.
4. Operating profit as percentage of Revenue.
5. HQ comprises the Group's head office activities, together with a 49% interest in Air Astana.
6. Taxation is managed on a Group-wide basis.
7. At a Group level, the key cash flow metric is Free cash flow, defined as Operating business cash flow less interest paid (net) and taxation. In 2020 Free cash flow was £367m (2019 £850m).

Segmental performance: Electronic Systems

Electronic Systems, with 16,600 employees¹, 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

- Airborne Tactical Radios and Military Global Positioning System acquisitions completed, performing well and integrations are progressing.
- F-35 electronic warfare systems for Lot 12 completed, surpassing cumulative programme deliveries of 800 electronic warfare systems as of year end.
- Successful demonstration of APKWS[®] ground-launch capability.
- Terminal High Altitude Area Defense (THAAD) seeker executing at full-rate production, and receipt of additional order to design and manufacture next-generation infrared seekers.
- Continued classified work.
- Demand in the commercial business lines of Controls & Avionics Solutions and Power & Propulsion Solutions has been negatively impacted by COVID-19.

Financial performance

| Financial performance measures as defined by the Group ² | Financial performance measures defined in IFRS ³ | |
|---|---|---------|
| | 2020 | 2019 |
| Sales | £4,557m | £4,439m |
| Underlying EBITA | £684m | £687m |
| Return on sales | 15.0% | 15.5% |
| Operating business cash flow | £580m | £672m |
| Order intake ¹ | £4,722m | £5,023m |
| Order backlog ¹ | £6.5bn | £6.0bn |

- Sales in our Electronic Systems defence business grew by 12%, with almost half of that growth coming from our acquisitions.
- Our commercial operations were impacted by COVID-19, though overall segment sales growth was around 3%.
- Underlying EBITA was in line with the prior year, although return on sales was lower reflecting the fall in higher margin commercial revenues.
- The sector continued to deliver high cash conversion⁴ levels.
- Order backlog benefited from orders for F-35 electronic warfare systems, the Precision Strike business and the C4ISR programmes.

Operational performance and COVID-19 impact

The defence electronics businesses were generally able to maintain operational workflows despite the COVID-19 pandemic. This lesser impact on defence operations helped to offset the significantly reduced demand for commercial avionics products and related aftermarket services, as well as the sector's urban transit bus solutions. As a result, the business adjusted its US workforce accordingly to reflect the reduced requirements. While impacts on the air travel and mass transit markets are being realised in the near term, as a virus vaccine becomes available and the pandemic recovery proceeds, we would expect an eventual return of overall demand for which the business is well positioned.

Electronic Combat Solutions

The F-35 Lightning II programme completed deliveries for Lot 12 and has delivered a cumulative total of 830 electronic warfare systems as of year end. We also continue to support the Block 4 modernisation efforts under multiple contracts worth approximately \$400m (£293m), and we continue to operate under

a five-year Performance-Based Logistics contract to provide material availability and support for the F-35 sustainment programme.

Executing on our current 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 support the testing on F-15E test aircraft at both Eglin and Edwards Air Force Bases. The programme passed a critical Department of Defense milestone in late 2020, culminating in the programme's approval to enter the Low-Rate Initial Production phase in December.

We are also under contract to install the Digital Electronic Warfare System on new and existing F-15 aircraft to provide advanced electronic warfare capability, and to provide spare units and modules for domestic and 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.

Under a \$140m (£102m) contract with Lockheed Martin for Lots 2 and 3, we are producing the sensor technology for the Long Range Anti-Ship Missile (LRASM). We are also executing a Diminishing Material Sources contract for the next configuration of LRASM and have received a \$38m (£28m) contract for the LRASM Improvement Program to enhance the overall performance of the missile.

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 technologies in support of our US military customers and our allies.

Countermeasure & Electromagnetic Attack Solutions

The Compass Call programme is currently executing contracts worth in excess of \$600m (£439m). The team continues to sustain and upgrade prime mission equipment on the existing EC-130H fleet, and is progressing the cross-decking of the mission system to a special-mission Gulfstream G550 jet. This aircraft will be designated as the EC-37B and is targeted to field in 2024.

We received \$179m (£131m) in US Army funding for the Limited Interim Missile Warning System programme for the first two production lot orders, and to advance efforts to enable fielding on other Army rotary-wing aircraft. In parallel, the team continues to support government testing.

Precision Strike & Sensing Solutions

The acquisition of the Military Global Positioning System business in July advances our world-class Navigation & Sensor Systems offerings with the development of next-generation GPS technologies for the US military and its allies. In November, we were among three companies to collectively receive US Space Force awards totalling more than \$550m (£402m) over five years from the Space and Missile Systems Center to develop and produce next-generation integrated circuit cards for military GPS receivers that are compatible with the secure M-Code signal.

The APKWS® laser-guided rocket programme provides guidance sections for 70mm rockets for US military rotary- and fixed-wing platforms. In addition to generating international interest, the programme announced a successful demonstration of ground-launch capability. The programme is executing under two Indefinite Delivery contracts, with awards totalling \$385m (£282m) received.

The Terminal High Altitude Area Defense (THAAD) seeker programme was awarded a contract and is executing at full-rate production, providing critical targeting technology that helps to protect the US and its allies from ballistic missiles. The programme has also initiated work to design and manufacture the next-generation THAAD infrared seekers.

C4ISR Systems

In May, we acquired the assets of the Airborne Tactical Radios business, advancing our strategic objective to pursue and deliver long-term growth and expand our full spectrum communications portfolio with multi-band radios and advanced cryptographic technologies. Under a legacy Indefinite Delivery, Indefinite Quantity (IDIQ) contract from the US Army, we were awarded \$83m (£61m) in delivery orders for 1,124 ARC-231A radio systems at full-rate production levels. The ARC-231A is software-defined and can accommodate rapid upgrades without requiring the radio to be removed from its platform.

We affirmed our position as a leader in Link 16 technology, receiving a contract worth up to nearly \$1bn (£0.7bn) to produce, retrofit, and sustain joint tactical radios for the US Navy through our Data Link Solutions venture with Collins Aerospace.

We are experiencing steady growth in signals intelligence, where we captured a development and production programme worth up to \$190m (£139m) for a new mission, advanced SIGINT payload. In the space domain, we remain a leading provider of resilient, space-qualified subsystems and components. We were awarded a sole-source contract worth up to \$188m (£138m) to continue a vital national security mission.

Controls & Avionics Solutions

The business continues to develop the integrated flight control electronics and remote electronic units for the new Boeing 777X airplane family. The flight control system is performing as expected during flight testing and we continue to complete software updates and systems verification testing in support of aircraft certification. Boeing has also restarted production of the 737 MAX and the aircraft has returned to service.

The business was selected to develop the flight control system for Aerion's AS2 supersonic jet, reaffirming our market-leading position in flight controls.

Our engine control product line continues to perform well across our legacy portfolio with FADEC International and FADEC Alliance, a joint venture between GE Aviation and FADEC International (our joint venture with Safran Electronics & Defense). The next-generation engine control for the engine that powers the 777X aircraft received FAA certification and continues to support the flight test programme.

Our active inceptors received certification and are now in service on the Gulfstream G500 and G600, with initial production and flight testing ongoing for the G700. A derivative, LinkEdge™ (Active Parallel Actuation Subsystem), is in qualification for the Chinook CH-47.

Development of the F-35 vehicle management computer technology refresh is proceeding to plan, and we are actively working towards a sustainment contract for the active inceptor systems.

We also continue to progress our autonomous mission technologies and were awarded an IDIQ contract by the US Air Force for the Skyborg programme. The next call is to compete for the digital design phase for a low-cost attritable vehicle.

Power & Propulsion Solutions

In the first half of the year, Alexander Dennis Limited selected BAE Systems' clean propulsion systems to power up to 600 buses for the new fleet of the Republic of Ireland's National Transport Authority. In addition, New York City Transit solidified its commitment to green technology by maximising the full order of 435 BAE Systems-powered electric drive buses, and our Series-ER (Electric Range) electric drive propulsion solution is helping San Francisco address green zones set up in population-dense areas affected by air pollution. The business has also begun to address emerging demand for similar technology in the marine and military sectors.

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 glossary on page 12.
3. International Financial Reporting Standards.
4. Operating business cash flow as a percentage of underlying EBITA.

Segmental performance: Cyber & Intelligence

Cyber & Intelligence, with 9,700 employees¹, 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. All three businesses delivered a book to bill ratio of over one².
- Awarded a seven-year, \$495m (£362m) contract on the Instrumentation Range Support Programme.
- Multi-year Indefinite Delivery, Indefinite Quantity contract received to provide electronic hardware and engineering services for a US government customer.
- Our Federated Secure Cloud technology approach and processes are being employed to maintain and secure US Army Cyber Command's virtual desktop infrastructure.

Applied Intelligence

- Strong order intake, revenue and profitability performance in the core underlying business driven by the Government business unit.
- Significant profit growth year-on-year due to cycling the restructuring of the Technology & Commercial business in 2019.
- Sale of the US-based software-as-a-service business completed in November.

Financial performance

| Financial performance measures as defined by the Group ³ | 2020 | | Financial performance measures defined in IFRS ⁴ | 2019 | |
|---|----------------|---------|---|----------------|---------|
| | 2020 | 2019 | | 2020 | 2019 |
| Sales | £1,812m | £1,732m | Revenue | £1,812m | £1,732m |
| Underlying EBITA | £136m | £91m | Operating profit | £138m | £80m |
| Return on sales | 7.5% | 5.3% | Return on revenue | 7.6% | 4.6% |
| Operating business cash flow | £221m | £68m | Cash flow from operating activities | £251m | £99m |
| Order intake ¹ | £1,987m | £1,846m | Order book | £1.1bn | £1.1bn |
| Order backlog ¹ | £1.7bn | £1.8bn | | | |

- Sales grew by 5%. Applied Intelligence was stable with more than 10% growth in its Government Services business, offset by weaker demand in Financial Services. The US Intelligence & Security business grew sales by 7%, with growth across all three of its businesses.
- Underlying EBITA improved as Applied Intelligence returned to profitability following the action taken on restructuring.
- Operating business cash flow benefited throughout the year from accelerated collections on a number of government contracts.
- Order backlog was slightly reduced, mainly as a result of the Silversky disposal.

Operational performance and COVID-19 impact

Intelligence & Security

In response to the COVID-19 pandemic, we activated a Pandemic Management Response Plan to ensure continued support of our customers' missions while mitigating any impacts to our employees' safety.

We implemented measures to protect the health and wellbeing of all sector employees, to include social distancing through 60% of our employees working remotely, and others moving to shift work to reduce on-site workforce numbers. Where employees are required to work on location, we have fulfilled guidelines on social distancing, PPE, quarantines and enhanced cleaning measures.

Supply chain issues resulting from COVID-19 were minimised through supplier outreach and monitoring. Proactive customer notifications helped to identify effective mitigation strategies and resulted in revised delivery schedules to maintain on-time delivery metrics. Contract modifications were secured that

allowed billing for programmes impacted by COVID-19 as contemplated by the CARES (Coronavirus Aid, Relief, and Economic Security) Act Section 3610.

Actions were taken to support business liquidity, to include partnering with our Intelligence Community customers to minimise revenue impacts through CARES Act Section 3610, and the implementation of strong cash management and appropriate cost reduction measures to mitigate COVID-19's profit impact.

Across our government customers, the pandemic has caused some delays in the acquisition process as requests for proposals, as well as re-compete and new contract awards have been pushed back.

Air Force Solutions

We were awarded a seven-year, \$495m (£362m), Indefinite Delivery, Indefinite Quantity contract on the Instrumentation Range Support Programme (IRSP) to provide logistics sustainment support to the US Space Force for instrumentation tracking (radar, telemetry and optics) systems located around the world. Under IRSP, we have been a radar sustainment contractor of choice since 1985, providing support, sustainment and maintenance services for instrumentation systems at test ranges around the world. This single award contract has a ceiling value of \$945m (£691m) over the seven-year performance period.

On the US Air Force Intercontinental Ballistic Missile Integration Support Contractor programme, we continue to provide programme management, systems engineering, integration and testing, sustainment and cyber defence support, and cumulative funding is approaching the \$1.1bn (£0.8bn) contractual ceiling.

We were awarded a multi-year Indefinite Delivery, Indefinite Quantity contract with an expected lifecycle value of \$474m (£347m) to provide electronic hardware and engineering services for a US government customer.

We were awarded a five-year, \$67m (£49m) contract for obsolescence management services across multiple platforms and weapon systems for the US Air Force, which we have been supporting for nearly 30 years.

Our Enterprise IT Solutions business won a re-compete for a five-year \$85m (£62m) contract with the Air Force Research Laboratories for systems engineering, evaluation, and analysis.

We won a multi-year US Navy award worth \$27m (£20m) for KC-130J Large Aircraft Infrared Countermeasures installations.

Internationally, we also received \$48m (£35m) in firm fixed-price awards for new radar and mid-life upgrade systems from the French Directorate General of Armaments.

Integrated Defense Solutions

We are executing the fifth year of a five-year, \$368m (£269m) sole-source contract to support weapon systems on board US Ohio and UK Vanguard Class submarines, as well as future US Columbia Class and UK Dreadnought Class submarines.

We were awarded a five-year, \$94m (£69m), US Navy contract to provide engineering, test, and evaluation support for sensors and communication, control, and weapons systems for various manned and unmanned airborne platforms.

After 15 years of strong performance, we were awarded a five-year, \$66m (£48m), follow-on contract to provide platform integration, systems analysis, and In-Service Engineering Agent support for US Marine Corps future systems and other fielded tactical Air Traffic Control systems for the US Navy, US Marine Corps, US Army, and US Air Force.

The business was awarded a five-year, \$188m (£138m) US Navy contract to provide critical large-scale system engineering, integration and testing expertise for the AEGIS Weapons and Combat Systems aboard the Navy's surface combatant ships.

The US Navy awarded us a prime position on a ten-year, Indefinite Delivery, Indefinite Quantity contract with an expected lifecycle value of \$150m (£110m) to provide full-rate production of mission system avionics and aircraft components, and production and installation of modification kits for the Naval Air Warfare Center Aircraft Division.

We were awarded a ten-year renewal of our Bankruptcy Noticing Center contract with a lifecycle value of \$106m (£78m) to distribute documents for the US Bankruptcy Courts to creditors.

Intelligence Solutions

We successfully completed designing, building, deploying, and testing the secure IT infrastructure for multiple networks at the new headquarters for US Army Cyber Command at Fort Gordon, Georgia. Our performance earned us a \$12m (£9m) contract for operations, support, and maintenance services, which will utilise our Federated Secure Cloud approach and processes to implement and maintain the US Army Cyber Command's Multiple Independent Levels of Security virtual desktop infrastructure.

We were awarded one of three contracts by the US Marine Corps to develop a prototype design of a new state-of-the-art Wargaming Center in Quantico, Virginia. Our award, valued at \$19m (£14m), represents new work for us and will integrate advanced technologies, including artificial intelligence, machine learning, game theory, multi-domain modelling and simulation, and predictive data analytics to bring rigour to many wargaming processes.

We were selected as a subcontractor to support prime teams for two new opportunities: the seven-year Federal Systems Integration and Management Center Pathfinder contract with an expected lifecycle value of \$50m (£37m) to provide professional services for operations and intelligence support and management; and the five-year Joint Artificial Intelligence Center Joint Warfighting National Mission Initiative contract with an expected lifecycle value of \$90m (£66m) to provide a full spectrum of technical support and deliver AI-enabled systems.

Applied Intelligence

Applied Intelligence delivered a significant increase in profit during 2020 driven by strong operational performance and the cycling of restructuring charges incurred in 2019 relating to the divestment of the legacy Technology & Commercial business. During 2020 the divestment activity was concluded with the sale of the US-based software-as-a-service business (Silversky) completing in November following the divestment of the Enterprise Managed Security Services in April. The underlying core business has continued to deliver positive revenue growth, driven by strong order intake in the Government business, and improved profitability from high levels of productivity and a significant focus on cost reduction.

The business has continued to operate at full capacity throughout the global pandemic. Significant focus has been directed to employee wellbeing and remote working in order to enable teams to continue to deliver effectively. The health and safety of employees is always a priority, with the large majority of employees working from home and investments made in creating COVID-19 secure office spaces where necessary.

Government

The Government business has delivered strong order intake driven by the International and Central Government business units. Revenue growth has benefited from a strong performance in the National Security business, following the large multi-year deals signed in 2019, and the Defence business which has benefited from growth in major Ministry of Defence programmes. The business has delivered a strong operational performance, with high levels of utilisation benefiting revenue generation and profitability.

Financial Services

The Financial Services business launched NetReveal 360° in July. This new product opens up a wider market of customers looking for a comprehensive and competitively-priced compliance solution hosted in the cloud. The business has seen some slippage in order intake throughout the year due to the pandemic. Focus on operational efficiency and cost reduction has limited impacts on profitability.

Looking forward

Forward-looking information for the Cyber & Intelligence reporting segment is provided on page 37.

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

Segmental performance: Platforms & Services (US)

Platforms & Services (US), with 12,600 employees¹, 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

- Delivery of the first production Armored Multi-Purpose Vehicles took place in the second half; one of each of the five variants delivered by year end.
- Amphibious Combat Vehicle programme moved to full-rate production phase after Initial Operational Capability declared.
- Delivery of more than 50 production Bradley A4 vehicles.
- New US Navy contract modifications totalling \$114m (£83m) for Mk45 Mod 4 upgrades.
- Initial deliveries of Virginia Payload Module tubes completed.
- Ship Repair secured more than \$1bn (£0.7bn) in US Navy maintenance and modernisation orders.
- Ordnance Systems received \$233m (£170m) in modernisation contracts.
- Contracted to provide five 57Mk3 and ten 40Mk4 naval gun systems for the UK Royal Navy's Type 31 frigates.
- Operational delays and disruptions related to the COVID-19 pandemic were experienced across manufacturing and shipyard facilities.

Financial performance

| Financial performance measures as defined by the Group ² | | | Financial performance measures defined in IFRS ³ | | |
|---|----------------|---------|---|----------------|---------|
| | 2020 | 2019 | | 2020 | 2019 |
| Sales | £3,503m | £3,337m | Revenue | £3,399m | £3,185m |
| Underlying EBITA | £195m | £267m | Operating profit | £183m | £239m |
| Return on sales | 5.6% | 8.0% | Return on revenue | 5.4% | 7.5% |
| Operating business cash flow | £382m | £241m | Cash flow from operating activities | £458m | £305m |
| Order intake ¹ | £4,137m | £4,020m | Order book | £5.6bn | £5.1bn |
| Order backlog ¹ | £6.1bn | £5.8bn | | | |

- Sales grew by 5% as the ramp in US combat vehicle continued. US Ship Repair and M777 sales to India were challenged due to COVID-19 with volumes down compared to the prior year.
- Underlying EBITA was lower than the prior year, primarily due to the impacts of COVID-19 in Ship Repair and on the Armored Multi-Purpose Vehicle programme where less developed supply chains were particularly affected.
- Operating business cash flow was higher, from improved working capital in combat vehicles, an advance payment received for Switzerland's CV90 programme, and lower customer cash retentions in Ship Repair.
- Orders worth more than \$2.6bn (£1.9bn) were received on multiple combat vehicle programmes, and more than \$1bn (£0.7bn) in the Ship Repair business.

Operational performance and COVID-19 impact

Overall, our manufacturing facilities and shipyards have continued to operate with the implementation of pandemic safety measures. Despite these measures, operational disruptions have resulted in delivery delays on most vehicle programmes, some stemming from a temporary pause in manufacturing operations at our York, Pennsylvania manufacturing hub to implement expanded preventative measures. In addition, significant interruptions, delays and performance challenges were experienced in shipyard work and awards.

Whilst the majority of office-based employees are working remotely, employee furloughs have occurred during the year where programme demand has slowed, and some reductions were taken to address changing business needs across the segment. We are working with our customers to meet programme requirements, and when there is a COVID-19 impact, we are engaging quickly to determine levels of disruption and maintaining open dialogues to establish new delivery schedules as appropriate.

Combat Mission Systems

While some schedule adjustments have been required due to the pandemic, related supply chain impacts and challenges associated with the early phases of new programmes, Combat Mission Systems continues to make progress towards achieving consistent production throughput across multiple programmes. Investments in facilities and new manufacturing technologies, including automation and robotic welding, are delivering long-term benefits. Despite the effects of the pandemic, we more than tripled our monthly vehicle production in 2020.

We continue to deliver Amphibious Combat Vehicles (ACVs) to the US Marine Corps under Low-Rate Initial Production contracts totalling \$599m (£438m) for 116 vehicles. Design and development have begun on new ACV mission variants, and a 30mm gun system for the ACV-30 weapons variant was selected. The Marine Corps declared Initial Operational Capability for the ACV, and in December awarded a \$184m (£135m) contract for full-rate production of 36 ACVs.

We continue to work on the US Army's Armored Multi-Purpose Vehicle (AMPV) programme under contracts worth \$1.3bn (£1.0bn). The first production AMPVs were delivered in August, and deliveries of each of the five variants followed later in the second half.

Progress continues on the M109A7 programme under cumulative awards totalling approximately \$1.5bn (£1.1bn) for 204 vehicle sets. Following the full-rate production decision, we received a \$339m (£248m) contract in March for 48 vehicle sets. We are also supporting the customer-led integration efforts for the Extended Range Cannon Artillery on the M109A7 to nearly double the range of the gun system.

Work has begun to upgrade Bradley vehicles to the A4 configuration. Following the June award, we have received contracts totalling \$848m (£620m) for 491 vehicles, with more than 50 delivered by year end.

We are executing on a \$32m (£23m) prototype contract received in July 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, including under a contract valued at \$148m (£108m) to upgrade 43 vehicles from the M88A1 to the M88A2 HERCULES configuration, and a \$318m (£233m) contract to develop and test upgrades for the next-generation M88A3 configuration to restore single-vehicle recovery capability. In October, we secured a \$127m (£93m) contract for 38 M88A2 HERCULES vehicles – 19 for the US Army and 19 for Kuwait.

In addition, we have continued delivering on a programme for 36 Assault Amphibious Vehicles under a US government Foreign Military Sale.

In the weapon systems product line, we are producing Vertical Launch System missile canisters for the US Navy under initial awards totalling \$166m (£121m), which could reach \$955m (£699m) over five years if all options are exercised.

In addition to 2019 orders, we are working to deliver Mk45 Mod 4 gun systems to the US Navy, including 2020 contract modifications valued at \$114m (£83m). Under a \$19m (£14m) award, we started work to provide the US Navy and Coast Guard with Mk38 machine gun systems.

Initial deliveries began of the 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, with a total of \$233m (£170m) in modernisation orders received in the year. Operationally, implementing necessary, updated pandemic safety guidelines resulted in minor schedule and cost impacts. The Army is progressing towards a five-year extension for Radford operations and competition for the operation at Holston.

At Holston, modernisation activities continue, including the construction of a Weak Acid Recovery Plant, and multiple contracts for a natural gas-fired steam facility, a waste water management facility, and the design, construction and commissioning of new production facilities.

At Radford, 2020 marked significant progress towards completion of construction of a modern nitrocellulose facility. We are actively managing subcontractor performance, cost, and schedule issues and disputes as we work towards commissioning of the facility.

US Ship Repair

The US Ship Repair business continues to conduct modernisation and maintenance activities for the US Navy's non-nuclear fleet, but experienced performance challenges throughout the year. We continue to monitor volume and timing impacts related to COVID-19, with delays in both contract awards and the start of work owing to availability issues. In 2020, we secured orders totalling approximately \$1bn (£0.7bn), including a \$200m (£146m) award to service the USS Boxer in San Diego. Additionally, we received a \$197m (£144m) contract to sustain the USS Wasp in Norfolk and an \$84m (£61m) award that could total \$212m (£155m) to consecutively service the guided-missile destroyers USS Carney and USS Winston Churchill in Jacksonville.

As previously announced, we have begun to cease operations at our Hawaii shipyard, ahead of its closure in 2021.

BAE Systems Hägglunds

The Netherlands has started work to upgrade and extend the life of its CV9035 fleet, and we are working under a previous contract to integrate the Elbit Systems Iron Fist Active Protection System and an anti-tank guided-missile system on the vehicles. In October, we received a contract to convert the Dutch fleet of CV90s to composite band track, and a new contract worth over \$500m (£366m) for mid-life upgrades was received in early 2021.

Work is progressing to refurbish the Swedish CV90 fleet, and deliveries are in process for the 40 CV90-based Mjölner mortar systems.

In November, we received a contract to extend the expected life of 186 Swiss Army CV90s to 2040. Discussions are underway with Finland and Norway for life extension of CV90s in their inventories. The Czech Republic's competitive procurement for a new fleet of infantry combat vehicles has been delayed due to COVID-19.

In our all-terrain vehicle portfolio, significant interest continued for new procurements to replace ageing BV 206 vehicles. We proposed our Beowulf unarmoured vehicle for the US Army's Cold Weather All-Terrain Vehicle prototype programme.

BAE Systems Bofors

We continue to deliver on Swedish and US Army contracts for the 155mm BONUS ammunition, including a US Army contract received in the first half. We are nearing completion of 24 additional ARCHER systems for Sweden. ARCHER was selected by the US Army for further evaluation for its wheeled howitzer requirements.

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.

Weapon Systems UK

Production of 145 M777s for the Indian Army continues under a \$542m (£397m) Foreign Military Sales contract. UK production resumed after a brief pause due to the pandemic. Due to COVID-19, 36 guns originally to be built in-country will now be assembled in Barrow, UK.

FNSS

FNSS, our land systems joint venture based in Turkey, continues to produce 8x8 wheeled armoured vehicles for the Royal Malaysian Army. Deliveries continue under a contract with Oman for PARS wheeled armoured vehicles in 8x8 and 6x6 configurations, and work began to supply medium weight tanks to Indonesia.

Multiple contracts for the Turkish Armed Forces worth in excess of €670m (£600m) are progressing, including contracts for air defence vehicles, 27 assault amphibious vehicles, and 100 special purpose 8x8 and 6x6 vehicles. Production began for 260 anti-tank vehicles, and a modernising programme for 133 armoured combat vehicles was also signed.

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 glossary on page 12.
3. International Financial Reporting Standards.

Segmental performance: Air

Air, with 29,300 employees¹, comprises the Group's UK-based air activities for European and International Markets, and US Programmes, and its businesses in Saudi Arabia and Australia, together with its 37.5% interest in the European MBDA joint venture.

Operational and strategic key points

- Contract secured to support the production of 38 Typhoon aircraft for the German Air Force.
- Qatar Typhoon and Hawk aircraft programme met its contractual milestones in the year.
- F-35 programme Lots 12 to 14 contract definitised following price agreement. 126 rear fuselage assemblies completed in the year, below the contracted level as a result of COVID-19 disruption. Ramp up to full-rate production in 2021.
- Governments of Italy and Sweden committed to working with the UK to develop next-generation combat air capability.
- A further six Hawk aircraft assembled in Saudi Arabia were accepted and entered service in-Kingdom.
- The design and production readiness phase of the Hunter Class Frigate programme for the Royal Australian Navy continues to make good progress.
- Sale of Advanced Electronics Company to Saudi Arabian Military Industries completed in February 2021.

Financial performance

| Financial performance measures as defined by the Group ² | | | Financial performance measures defined in IFRS ³ | | |
|---|----------------|---------|---|----------------|---------|
| | 2020 | 2019 | | 2020 | 2019 |
| Sales | £7,910m | £7,457m | Revenue | £6,593m | £6,153m |
| Underlying EBITA | £941m | £887m | Operating profit | £862m | £777m |
| Return on sales | 11.9% | 11.9% | Return on revenue | 13.1% | 12.6% |
| Operating business cash flow | £718m | £408m | Cash flow from operating activities | £917m | £497m |
| Order intake ¹ | £6,494m | £4,594m | Order book | £16.5bn | £18.3bn |
| Order backlog ¹ | £22.5bn | £23.9bn | | | |

- Air sales grew by 6%, driven by F-35, Typhoon activity, and the ramp up in production on the Qatar Typhoon and Hawk programmes.
- Air delivered strong underlying EBITA in the second half, overcoming a significant amount of Q2 under-recoveries, and continued to save costs and retire risk on the back of good programme execution.
- Operating business cash flow benefited from advances received on the German Typhoon programme and enhanced funding on the F-35 programme.
- Orders included our share of the German Typhoon award, orders for radar upgrades, further F-35 awards and continued good demand through MBDA.

Operational performance and COVID-19 impact

The COVID-19 pandemic affected all markets and countries in the Air sector, with the priority throughout, the delivery of customer-critical activity whilst ensuring the safety and wellbeing of employees. Swift enactment of business continuity plans enabled safe systems of work to be developed and significant mitigation against the adverse financial effects of the pandemic, ensuring continuity of cash flow both from customers and into the supply chain.

Operations have been stable across our main markets with a significant number of employees continuing to work from home. Where roles cannot be performed at home, we have employees working at BAE Systems sites and customer locations, including Air Force bases, where we collaborate closely to ensure a safe system of work. The business has continued to adapt and enhance its protective measures, in particular with the emergence of second and third waves of the pandemic in the UK and with a number of our sites being located in areas with high rates of infection. Nonetheless, key outputs have been maintained and the productivity of remote working has continued to improve via enhancements to IT infrastructure and tools. Safe systems of work continue to be adapted to the local situation as required.

In Australia, there have continued to be intermittent outbreaks which have resulted in the imposition of varying restrictions by the states. The business is managing activity on site versus at-home working on a site-by-site basis to reflect these regional variations. International travel to and from Australia is likely to remain restricted until late 2021.

In Saudi Arabia, COVID-19 levels have reduced significantly over the last six months and the Saudi government has partially lifted the international air, land and sea border restrictions. This change has come as a welcome relief to employees and dependants alike. Operations returned to a normal level of activity in the last quarter of the year.

MBDA initiated its own business continuity plans in response to restrictions in Germany, Italy, France, and the UK. All sites remain operational with appropriate safe and remote-working practices in place.

Across all markets, the business continues to work closely with its supply chain to manage any impacts from the COVID-19 pandemic and the downturn in the commercial aircraft market. Where suppliers have schedule or liquidity risk, mitigating actions have been implemented, as well as looking at dual source opportunities.

European & International Markets

We secured an order in excess of £1.2bn to support the production of a further 38 aircraft for the German Air Force to replace its original Typhoon Batch 1 aircraft.

Activity on the 24 Typhoon and nine Hawk aircraft and associated support and training contract for the Government of the State of Qatar progresses well, with all milestones achieved in the year.

Seven deliveries of major units under the Kuwait Typhoon contract, secured by Italian Eurofighter partner Leonardo, occurred in the period, with the remainder planned by 2022.

The final Tranche 3 Typhoon aircraft was delivered to Italy in October.

The UK Typhoon fleet continues to achieve the contracted flying hours, under its ten-year partnership arrangement. BAE Systems continues to support the European Partner Nations' own support arrangements.

During the first half of the year, the Group was asked to enter into negotiations with the Omani customer regarding a transition to a reduced scope support solution for the Typhoon fleet. These negotiations have concluded successfully, and an amended scope of work has been agreed to secure Typhoon support services in Oman until mid-2022.

Support to the Royal Air Force's UK fleet of Hawk fast jet trainer aircraft continues, with an interim extension to the availability contract received. We remain in discussions concerning the follow-on arrangement to support the Royal Air Force's UK fleet of Hawk fast jet trainer aircraft through a long-term availability contract.

The future electronically scanned European Common Radar Solution is progressing with initial entry into service contracted on Kuwait and Qatar aircraft. German and Spanish Air Forces have awarded contracts to enhance the capability of their in-service aircraft by upgrading some of their fleet with the new electronically scanned radar standard. The UK continues to fund activity for the future UK standard of weapon system and sensors.

The next phase of the Tempest technology maturation programme is progressing well. The UK, Swedish and Italian governments are engaged to develop the next-generation combat air capability.

The Group continues to invest in promising new and innovative technologies for the future. The PHASA-35[®] solar-electric powered unmanned aircraft successfully completed its maiden flight in February, and completed 72 hours of continuous ground testing including communications payload. Discussions with a range of customers continue in the development of this technology and a range of services.

Our employees in Turkey continue to support the design and development phase of an indigenous fifth-generation fighter jet for the Turkish Air Force.

US Programmes

The production of F-35 rear fuselage assemblies will ramp up to full rate in 2021. In the year, 126 rear fuselage assemblies were completed on the production contracts across Lots 11 to 14, falling below the contracted level as a result of the COVID-19 disruption. Contract negotiations for Lots 15 to 17 have commenced during the second half of the year and are likely to conclude during 2021.

We continue to support the Royal Navy and Royal Air Force in integrating the F-35 aircraft into its operational fleet and forward deployments.

BAE Systems continues to play a significant role on the F-35 sustainment programme including the supply of spares and technical support, software products, upgrades and specialist workforce services.

Saudi Arabia

Through the restructuring of the Group's portfolio of interests in its Kingdom of Saudi Arabia industrial companies, we are working in partnership with Saudi Arabian Military Industries (SAMI) to explore how we can collaborate to deliver further In-Kingdom Industrial Participation, in line with the Kingdom's National Transformation Plan and Vision 2030.

The Group is reliant on the continued approval of export licences by a number of governments in order to continue supplies to the Kingdom of Saudi Arabia. Following extensions granted by the German government to a number of export licences on joint collaborative programmes, we are working closely with industry partners and the UK government to continue to fulfil the contractual support arrangements in Saudi Arabia on the key European collaboration programmes. BAE Systems continues to perform on the contract secured in 2018 to provide Typhoon support services to the Royal Saudi Air Force through to 2022. Through this contract, the business also supports the Industrialisation of Defence capabilities in Saudi Arabia.

The Saudi British Defence Co-operation Programme five-year funding agreement through to 2021 comprises a number of contracts, including support to the Tornado fleet and provision of training for the Royal Saudi Air Force, as well as engineering and logistics services for the Royal Saudi Naval Forces. While we continue to meet the key contractual obligations under these contracts, there has been some disruption because of the COVID-19 pandemic.

A total of 12 Hawk aircraft assembled in-Kingdom have now been completed and entered service with the Royal Saudi Air Force, including six in the year. The Company has delivered all 22 major units to meet this final assembly programme.

We continue to reorganise our portfolio of interests in a number of industrial companies in Saudi Arabia. Riyadh Wings Aviation Academy LLC (RW) increased its ownership to 49% in the Group's Overhaul and Maintenance Company (OMC) subsidiary, completing the contract for RW to acquire this shareholding.

The SAMI purchase of Advanced Electronics Company completed in February 2021.

Australia

The Royal Australian Navy Hunter Class Frigate programme initial design and production readiness phase has successfully progressed into prototyping and remains on track for cut steel on Ship 1 in December 2022. BAE Systems Maritime Australia (formerly ASC Shipbuilding) has been fully integrated into the Australian operations and the handover of the new shipyard completed to schedule despite the COVID-19 pandemic.

The Jindalee Operational Radar Network continues to meet operational targets and the optimised delivery strategy on the upgrade programme is being implemented with the Commonwealth of Australia.

Rectification of outstanding warranty items continues to progress under the Landing Helicopter Docks Acquisition contract and the route to contract closure is being agreed.

Hawk Lead-in Fighter availability was affected by supply chain quality issues, however pilot training requirements for the Australian Defence Force have been met. Supply chain remediation has returned availability to required levels with some operational impacts still being resolved.

A bid submission to extend the service to 2031 was made in the year, with contract award expected in 2021.

Sustainment capability continues to grow for the regional F-35 fleet at our Williamtown facility, with 30 aircraft now on base, and aircraft depot-level maintenance work scheduled to commence in 2021.

Research and development activity in Australia has increased, with progress made supporting the Boeing Australia Loyal Wingman programme, the Australian Army Land Autonomy experimentation, and in data analytics for hypersonic missile defence.

MBDA

During 2020, MBDA continued to secure domestic and export orders. The business continues to expect to benefit from defence spending in a number of European countries and from International opportunities with several significant bids underway.

Orders for the Brimstone Capability Upgrade Programme, Spear 3 development and manufacturing contracts for the UK Armed Forces' air platforms, the Mid-Life Update of the Aster Air Defence missile for the French customer and the Teseo Mk2E development contract for the Italian customer were secured. The Future Cruise/Anti-Ship Weapon Assessment Phase contract (the Anglo/French co-operation programme to replace Storm Shadow/Harpoon in the UK and SCALP/Exocet in France) is now expected to be awarded in 2021.

Since the German TLVS (Ground-Based Air Defence System) down select decision in 2015, the MBDA/Lockheed Martin consortium provided its final offer in 2020, however, following the subsequent German Federal Ministry of Defence announcement to re-evaluate German Air Defence in its entirety, a TLVS contract is no longer planned for 2021.

MBDA has successfully adapted working practices during the COVID-19 pandemic, enabling good progress on a number of development programmes (including Spear 3, MICA NG and Aster Block 1 New Technology), continuing with production deliveries and providing support to its domestic and export customers.

Looking forward

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

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

Segmental performance: Maritime

Maritime, with 17,400 employees¹, comprises the Group's UK-based maritime and land activities.

Operational and strategic key points

- The fourth Astute class submarine, HMS Audacious, left our Barrow site in April to begin sea trials with the Royal Navy.
- Construction of the first two Dreadnought Class submarines continues to advance.
- The build phase of the River Class Offshore Patrol Vessel programme is now complete, with the fourth ship, HMS Tamar, handed over to the Royal Navy in March, and HMS Spey, the fifth and final ship, handed over in October.
- Construction of the first two City Class Type 26 frigates for the Royal Navy continues to progress.
- Acquisition of Techmodal, a UK data consultancy and digital services business, completed in August.
- Announcement of a 15-year agreement with the UK Ministry of Defence to supply the Next Generation Munitions Solution between 2023 and 2037.
- RBSL has secured its share of the Mechanised Infantry Vehicle Boxer programme.

Financial performance

| Financial performance measures as defined by the Group ² | Financial performance measures defined in IFRS ³ | | | | |
|---|---|---------|-------------------------------------|----------------|---------|
| | 2020 | 2019 | 2020 | 2019 | |
| Sales | £3,257m | £3,116m | Revenue | £3,195m | £3,071m |
| Underlying EBITA | £306m | £268m | Operating profit | £272m | £253m |
| Return on sales | 9.4% | 8.6% | Return on revenue | 8.5% | 8.2% |
| Operating business cash flow | £243m | £150m | Cash flow from operating activities | £317m | £289m |
| Order intake ¹ | £3,772m | £2,875m | Order book | £8.5bn | £8.4bn |
| Order backlog ¹ | £9.1bn | £8.6bn | | | |

- Maritime sales grew by 4%, driven by the continued ramp up in Dreadnought activity, which now represents sales of more than £1bn per annum.
- Underlying EBITA benefited from improved programme performance.
- Cash flow improved on better programme performance and completion of the Offshore Patrol Vessel build programme.
- Order backlog benefited from ongoing Dreadnought funding. The Land business received the Next Generation Munitions Solution award, and the flow down of work to RBSL for the Boxer programme.

Operational performance and COVID-19 impact

Maritime

Essential operations in support of the Royal Navy and other customers have been maintained throughout the COVID-19 pandemic. We continue to sustain operations, with approximately 9,000 employees working on our sites and the remainder working from home. On our sites, a range of safety measures have been implemented including reducing the number of employees on site, enhanced cleaning regimes, additional cleaning stations, reconfiguration of workspaces, social distancing, temperature checks, mandatory wearing of face coverings and the provision of appropriate PPE where required. At Submarines, a COVID-19 test and trace programme has been established for employees and visitors attending the business' sites with more than 8,000 tests being undertaken on average each week.

In parallel, while the pandemic has caused schedule pressures on a number of the sector's programmes, our businesses continue to work collaboratively with our main customer, the Ministry of Defence, and their supply chains to ensure that business and service continuity is maintained through the pandemic.

Naval Ships

All five River Class Offshore Patrol Vessels have now been accepted by the Ministry of Defence, with the final ship, HMS Spey, leaving Glasgow and arriving at her home port of Portsmouth Naval Base in October. The build phase of this programme is now complete with all five ships designed, constructed, commissioned and delivered in six years.

The first three City Class Type 26 frigates are on contract with construction underway on the first two ships. The programme continues to progress with all units of the first of class, HMS Glasgow, in construction. HMS Glasgow remains on track to be delivered to the Royal Navy in the mid-2020s. The second ship, HMS Cardiff, entered the manufacturing phase in August 2019 and approximately one-third of the units of the vessel are in construction. In the second half of 2020 a further five contracts were placed with UK suppliers worth more than £100m, supporting 250 jobs. The programme sustains more than 4,000 jobs in total across the UK.

The Canadian Surface Combatant team continues to work closely with Lockheed Martin Canada and Irving Shipbuilding, Inc. on the Preliminary Design Phase of the programme. With the signing of the Support Services contract in Q2 2020, the team is working closely with Irving Shipbuilding, Inc. to transfer product and process knowledge and shared experience of complex operations.

Submarines

BAE Systems Submarines is a member of the Dreadnought Alliance, working alongside the Submarine Delivery Agency and Rolls-Royce to deliver the replacement for the Royal Navy's Vanguard Class, which carries the UK's independent nuclear deterrent. The value of the programme to the Company to date is £5.9bn, with contract funding of £0.6bn received in 2020. 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 new facilities complete and in operation.

The first four Astute Class submarines have now been delivered to the Royal Navy, with the fourth boat, HMS Audacious, setting sail in April for its home naval base. The remaining three boats are at an advanced stage of construction, and the naming ceremony for the fifth boat, HMS Anson, took place in December. HMS Anson is scheduled to begin sea trials in 2022.

Maritime Services

Our Maritime Services business is responsible for management and maintenance of HM Naval Base Portsmouth and supports the Royal Navy's Portsmouth-based surface fleet, including the Type 45 destroyers, Queen Elizabeth Class aircraft carriers, Type 23 frigates and Hunt Class mine countermeasure vessels through the Maritime Support Delivery Framework contract. The Royal Navy's Offshore Patrol Vessels, including the new River Class Batch 2 ships, are also supported from Portsmouth under availability contracts.

HMS Queen Elizabeth, HMS Diamond, HMS Defender and HMS Kent were all successfully prepared and supported for the first deployment of the UK's new Carrier Strike Group as part of a NATO exercise in October.

All warship upkeeps, fleet time support periods and capability insertion periods were delivered to agreed schedules. The upkeep of HMS Dauntless was completed in May, and the ship was the first Type 45 to enter the Power Improvement Programme, being delivered by BAE Systems, Cammell Laird and BMT. New diesel generators have been installed and the ship is now approaching the commissioning phase.

We continue to deliver the £230m Torpedo Repair and Maintenance contract. Progress also continued on the £270m Spearfish torpedo upgrade programme. A seven-year contract worth up to £87m was secured with the US Navy for the manufacture, delivery and support of Archerfish mine neutralisers. This is the fourth consecutive Archerfish contract awarded by the US to BAE Systems since 2003.

We continue to provide radar support, upgrades and enhancements to the Royal Air Force and the Royal Navy.

The delivery of a new support system for HMS Victory under a contract to the National Museum of the Royal Navy was successfully completed.

We acquired Techmodal, a UK data consultancy and digital services business, in August. The acquisition supports both the BAE Systems digital and data strategy and the UK's Armed Forces digital transformation.

Land UK

Our Munitions business provides UK and international customers with a wide range of light and heavy munitions, as well as offering complementary support services for development, testing and evaluation.

Following the conclusion of negotiations with the UK Ministry of Defence, we announced a 15-year agreement with the UK Ministry of Defence to supply the Next Generation Munitions Solution between 2023 and 2037.

Our RBSL joint venture has secured the contract for its share of the work on the Mechanised Infantry Vehicle programme. RBSL will produce approximately half of the British Army's Boxer vehicles from its Telford facility. This marks a significant milestone for the programme and will create and sustain skilled jobs in and around Telford, as well as throughout the UK supply chain.

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 glossary on page 12.
3. International Financial Reporting Standards.

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 is expected to take several years to recover to 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.

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 the change in administration and shifting government priorities. The US business remains well positioned and will continue to leverage its established market positions and reputation for reliable and adaptable performance to meet customer demands for innovative, cost-effective and cyber-hardened solutions to pursue both re-competed contracts and new business across its portfolio of sustainment, integration and modernisation solutions for military and intelligence customers.

Applied Intelligence

The services and products we offer in our Government business ensure that we are well placed to deliver growth as UK cyber budgets increase and cyber security becomes an increasingly important part of a nation's security. We continue to shape the Financial Services division to deliver growth given cyber is, and will continue to be, a core element of stewardship for companies in a sophisticated and persistent threat environment.

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 growing 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, Amphibious Combat Vehicle, M88, 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. The team is working on, and is

closely following, the US Army's acquisition plans for its next generation of combat vehicles, in particular the Mobile Protected Firepower and Robotic Combat Vehicle programmes.

In the maritime domain, the sector has a strong position on naval gun programmes and US Navy ship repair activities where the business has invested in facilities in key home ports. This capitalised infrastructure represents a high barrier to entry, and 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 under previously awarded contracts.

Air

Air comprises the Group's UK-based air activities for European and International Markets, and US Programmes, and 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, which would extend current production revenues. Production of rear fuselage assemblies for the F-35 will increase in 2021 and is expected to be sustained at these levels. The business plays a significant role in the F-35 sustainment programme in support of Lockheed Martin, and revenues are set to grow as the number of aircraft deployed increases over the coming years. Defence and security remains a priority for the UK government. 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 seek 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.

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. Within Submarines, the business is executing on two long-term programmes. The Astute Class programme has three remaining boats 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 through the decade and beyond 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 support contracts and the contracted workshare on the Mechanised Infantry Vehicle programme. 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.

Consolidated income statement

for the year ended 31 December

| | Notes | 2020 | | 2019 | |
|--|-------|------|-----------------|------|-------------|
| | | £m | Total £m | £m | Total £m |
| Continuing operations | | | | | |
| Revenue | 2 | | 19,277 | | 18,305 |
| Operating costs | | | (17,686) | | (16,724) |
| Other income | | | 270 | | 150 |
| Share of results of equity accounted investments | | | 69 | | 168 |
| Operating profit | 2 | | 1,930 | | 1,899 |
| <i>Financial income</i> | | | 17 | | 27 |
| <i>Financial expense</i> | | | (351) | | (300) |
| Net finance costs | 3 | | (334) | | (273) |
| Profit before taxation | | | 1,596 | | 1,626 |
| Taxation expense | 4 | | (225) | | (94) |
| Profit for the year | | | 1,371 | | 1,532 |
| Attributable to: | | | | | |
| Equity shareholders | | | 1,299 | | 1,476 |
| Non-controlling interests | | | 72 | | 56 |
| | | | 1,371 | | 1,532 |
| Earnings per share | | | | | |
| | 5 | | | | |
| Basic earnings per share | | | 40.7p | | 46.4p |
| Diluted earnings per share | | | 40.5p | | 46.1p |

Consolidated statement of comprehensive income

for the year ended 31 December

| | 2020 | | | 2019 | | |
|---|----------------------|-------------------------|----------------|----------------------|-------------------------|-------------|
| | Other reserves £m | Retained earnings £m | Total £m | Other reserves £m | Retained earnings £m | Total £m |
| Profit for the year | – | 1,371 | 1,371 | – | 1,532 | 1,532 |
| Other comprehensive income | | | | | | |
| Items that will not be reclassified to the income statement: | | | | | | |
| Subsidiaries: | | | | | | |
| Remeasurements on post-employment benefit schemes | – | (1,361) | (1,361) | – | (556) | (556) |
| Tax on items that will not be reclassified to the income statement | – | 330 | 330 | – | 57 | 57 |
| Equity accounted investments (net of tax) | – | (55) | (55) | – | (38) | (38) |
| Items that may be reclassified to the income statement: | | | | | | |
| Subsidiaries: | | | | | | |
| Currency translation on foreign currency net investments | (224) | – | (224) | (327) | – | (327) |
| Reclassification of cumulative currency translation reserve on disposal of subsidiary | (35) | – | (35) | (8) | – | (8) |
| Fair value gain arising on hedging instruments during the period | 46 | – | 46 | 11 | – | 11 |
| Cumulative fair value loss/(gain) on hedging instruments reclassified to the income statement | 42 | – | 42 | (7) | – | (7) |
| Tax on items that may be reclassified to the income statement | (16) | – | (16) | – | – | – |
| Equity accounted investments (net of tax) | (3) | – | (3) | 6 | – | 6 |
| Total other comprehensive income for the year (net of tax) | (190) | (1,086) | (1,276) | (325) | (537) | (862) |
| Total comprehensive income for the year | (190) | 285 | 95 | (325) | 995 | 670 |
| Attributable to: | | | | | | |
| Equity shareholders | (176) | 213 | 37 | (320) | 940 | 620 |
| Non-controlling interests | (14) | 72 | 58 | (5) | 55 | 50 |
| | (190) | 285 | 95 | (325) | 995 | 670 |

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 2020 | 87 | 1,249 | 6,156 | (2,085) | 5,407 | 104 | 5,511 |
| <i>Profit for the year</i> | – | – | – | 1,299 | 1,299 | 72 | 1,371 |
| <i>Total other comprehensive income for the year</i> | – | – | (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 |
| Balance at 1 January 2019 | 87 | 1,249 | 6,481 | (2,363) | 5,454 | 72 | 5,526 |
| <i>Profit for the year</i> | – | – | – | 1,476 | 1,476 | 56 | 1,532 |
| <i>Total other comprehensive income for the year</i> | – | – | (320) | (536) | (856) | (6) | (862) |
| Total comprehensive income for the year | – | – | (320) | 940 | 620 | 50 | 670 |
| Share-based payments (inclusive of tax) | – | – | – | 75 | 75 | – | 75 |
| Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax) | – | – | (5) | – | (5) | – | (5) |
| Ordinary share dividends | – | – | – | (724) | (724) | (56) | (780) |
| Partial disposal of shareholding in subsidiary undertaking | – | – | – | (13) | (13) | 38 | 25 |
| At 31 December 2019 | 87 | 1,249 | 6,156 | (2,085) | 5,407 | 104 | 5,511 |

Consolidated balance sheet

as at 31 December

| | Notes | 2020 £m | 2019 £m |
|---|-------|-----------------|-----------------|
| Non-current assets | | | |
| Intangible assets | | 11,745 | 10,371 |
| Property, plant and equipment | | 2,655 | 2,437 |
| Right-of-use assets | | 1,053 | 1,138 |
| Investment property | | 128 | 137 |
| Equity accounted investments | | 409 | 428 |
| Other investments | | – | 13 |
| Other receivables | | 506 | 484 |
| Post-employment benefit surpluses | 6 | 408 | 302 |
| Other financial assets | | 248 | 350 |
| Deferred tax assets | | 972 | 726 |
| | | 18,124 | 16,386 |
| Current assets | | | |
| Inventories | | 858 | 835 |
| Trade, other and contract receivables | | 5,491 | 5,458 |
| Current tax | | 6 | 19 |
| Other financial assets | | 189 | 210 |
| Cash and cash equivalents | | 2,768 | 2,587 |
| Assets held for sale | | 94 | 135 |
| | | 9,406 | 9,244 |
| Total assets | | 27,530 | 25,630 |
| Non-current liabilities | | | |
| Loans | | (4,957) | (3,020) |
| Lease liabilities | | (1,020) | (1,116) |
| Contract liabilities | | (524) | (527) |
| Other payables | | (1,164) | (954) |
| Post-employment benefit obligations | 6 | (4,893) | (4,757) |
| Other financial liabilities | | (282) | (227) |
| Provisions | | (386) | (385) |
| | | (13,226) | (10,986) |
| Current liabilities | | | |
| Loans and overdrafts | | (467) | (377) |
| Lease liabilities | | (236) | (238) |
| Contract liabilities | | (3,238) | (3,536) |
| Trade and other payables | | (4,898) | (4,390) |
| Other financial liabilities | | (181) | (232) |
| Current tax | | (72) | (55) |
| Provisions | | (291) | (300) |
| Liabilities held for sale | | – | (5) |
| | | (9,383) | (9,133) |
| Total liabilities | | (22,609) | (20,119) |
| Net assets | | 4,921 | 5,511 |
| Capital and reserves | | | |
| Issued share capital | | 87 | 87 |
| Share premium | | 1,249 | 1,249 |
| Other reserves | | 5,923 | 6,156 |
| Retained earnings – deficit | | (2,616) | (2,085) |
| Total equity attributable to equity holders of BAE Systems plc | | 4,643 | 5,407 |
| Non-controlling interests | | 278 | 104 |
| Total equity | | 4,921 | 5,511 |

Approved by the Board of BAE Systems plc on 24 February 2021 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 | 2020 £m | 2019 £m |
|--|-------|----------------|------------|
| Profit for the year | | 1,371 | 1,532 |
| Taxation expense | 4 | 225 | 94 |
| Research and development expenditure credits | | (28) | (12) |
| Share of results of equity accounted investments | | (69) | (168) |
| Net finance costs | | 334 | 273 |
| Depreciation, amortisation, impairment and derecognition | | 675 | 660 |
| Gain on investment revaluation | | (6) | – |
| Profit on disposal of property, plant and equipment, and investment property | | (25) | (9) |
| Profit on sale and leaseback | | (21) | – |
| Loss/(gain) in respect of held for sale assets and business disposals | | 5 | (9) |
| Cost of equity-settled employee share schemes | | 74 | 74 |
| Movements in provisions | | (30) | (73) |
| Decrease in liabilities for post-employment benefit obligations | | (1,396) | (214) |
| (Increase)/decrease in working capital: | | | |
| Inventories | | 24 | (76) |
| Trade, other and contract receivables | | – | (481) |
| Trade and other payables, and contract liabilities | | 122 | 258 |
| Research and development expenditure credits – cash received | | 162 | – |
| Taxation paid | | (251) | (252) |
| Net cash flow from operating activities | | 1,166 | 1,597 |
| Dividends received from equity accounted investments | | 27 | 142 |
| Interest received | | 19 | 28 |
| Principal element of finance lease receipts | | 10 | 9 |
| Purchase of property, plant and equipment, and investment property | | (385) | (360) |
| Purchase of intangible assets | | (92) | (110) |
| Proceeds from sale of property, plant and equipment, and investment property | | 68 | 21 |
| Proceeds from sale of intangible assets | | – | 1 |
| Proceeds from sale of non-current other investments | | 19 | – |
| Equity accounted investment funding | | (2) | (6) |
| Purchase of subsidiary undertakings, net of cash and cash equivalents acquired | | (1,706) | (12) |
| Cash flow in respect of held for sale assets and business disposals, net of cash and cash equivalents disposed | | 5 | 55 |
| Net cash flow from investing activities | | (2,037) | (232) |
| Interest paid | | (227) | (233) |
| Equity dividends paid | 7 | (746) | (724) |
| Dividends paid to non-controlling interests | | (19) | (56) |
| Partial disposal of shareholding in subsidiary undertaking | | 27 | 31 |
| Principal element of lease payments | | (236) | (239) |
| Cash flow from matured derivative financial instruments (excluding cash flow hedges) | | 16 | 40 |
| Cash flow from movement in cash collateral | | (2) | 1 |
| Cash inflow from loans | | 2,666 | – |
| Cash outflow from repayment of loans | | (506) | (782) |
| Net cash flow from financing activities | | 973 | (1,962) |
| Net increase/(decrease) in cash and cash equivalents | | 102 | (597) |
| Cash and cash equivalents at 1 January | | 2,587 | 3,232 |
| Effect of foreign exchange rate changes on cash and cash equivalents | | (22) | (48) |
| Cash and cash equivalents at 31 December | | 2,667 | 2,587 |
| Comprising: | | | |
| Cash and cash equivalents | | 2,768 | 2,587 |
| Overdrafts | | (101) | – |
| Cash and cash equivalents at 31 December | | 2,667 | 2,587 |

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 EU-endorsed International Financial Reporting Standards (IFRS) and the Companies Act 2006 applicable to companies reporting under IFRS.

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 sales by equity accounted investments | | Add Sales to equity accounted investments | | Revenue | |
|---------------------------|---------------|------------|---|------------|---|------------|---------------|------------|
| | 2020 £m | 2019 £m | 2020 £m | 2019 £m | 2020 £m | 2019 £m | 2020 £m | 2019 £m |
| Electronic Systems | 4,557 | 4,439 | (45) | (114) | 45 | 114 | 4,557 | 4,439 |
| Cyber & Intelligence | 1,812 | 1,732 | – | – | – | – | 1,812 | 1,732 |
| Platforms & Services (US) | 3,503 | 3,337 | (108) | (153) | 4 | 1 | 3,399 | 3,185 |
| Air | 7,910 | 7,457 | (2,289) | (2,221) | 972 | 917 | 6,593 | 6,153 |
| Maritime | 3,257 | 3,116 | (65) | (50) | 3 | 5 | 3,195 | 3,071 |
| HQ | 190 | 387 | (151) | (344) | 1 | – | 40 | 43 |
| | 21,229 | 20,468 | (2,658) | (2,882) | 1,025 | 1,037 | 19,596 | 18,623 |
| Intra-group sales/revenue | (367) | (359) | 6 | 4 | 42 | 37 | (319) | (318) |
| | 20,862 | 20,109 | (2,652) | (2,878) | 1,067 | 1,074 | 19,277 | 18,305 |

Operating profit/(loss) by reporting segment

| | Underlying EBITA | | Non-recurring items ¹ | | Amortisation and impairment of intangible assets | | Financial and taxation expense of equity accounted investments | | Operating profit/(loss) | |
|-------------------------------|---------------------|------------|-------------------------------------|------------|--|------------|---|------------|----------------------------|------------|
| | 2020 £m | 2019 £m | 2020 £m | 2019 £m | 2020 £m | 2019 £m | 2020 £m | 2019 £m | 2020 £m | 2019 £m |
| Electronic Systems | 684 | 687 | 15 | – | (51) | (15) | – | – | 648 | 672 |
| Cyber & Intelligence | 136 | 91 | 3 | – | (1) | (11) | – | – | 138 | 80 |
| Platforms & Services (US) | 195 | 267 | 7 | (13) | (6) | (11) | (13) | (4) | 183 | 239 |
| Air | 941 | 887 | – | (28) | (31) | (32) | (48) | (50) | 862 | 777 |
| Maritime | 306 | 268 | – | 14 | (31) | (25) | (3) | (4) | 272 | 253 |
| HQ | (130) | (83) | (6) | – | (21) | (21) | (16) | (18) | (173) | (122) |
| | 2,132 | 2,117 | 19 | (27) | (141) | (115) | (80) | (76) | 1,930 | 1,899 |
| Net finance costs | | | | | | | | | (334) | (273) |
| Profit before taxation | | | | | | | | | 1,596 | 1,626 |
| Taxation expense | | | | | | | | | (225) | (94) |
| Profit for the year | | | | | | | | | 1,371 | 1,532 |

1. Non-recurring items in 2020 reflect a credit of £19m. This comprises a settlement gain on a US pension annuity buy-out of £64m, partly offset by acquisition-related costs of £20m, a £13m impairment charge relating to the legacy US Commercial Shipbuilding business, a Guaranteed Minimum Pension equalisation charge of £7m, and a loss on business disposals of £5m. Non-recurring charges in 2019 of £27m comprised a £36m charge relating to the derecognition of ERP software intangibles, charges of £13m relating to legal disputes arising from historical disposals, a gain of £14m upon formation of the RBSL joint venture, and a gain of £8m relating to the disposal of AACC.

3. Net finance costs

| | 2020 £m | 2019 £m |
|--|--------------|--------------|
| Interest income on cash and other financial instruments | 16 | 26 |
| Interest income on finance lease receivables | 1 | 1 |
| Financial income | 17 | 27 |
| Interest expense on bonds and other financial instruments | (196) | (187) |
| Facility fees | (4) | (4) |
| Interest expense on lease liabilities | (44) | (48) |
| Net present value adjustments on provisions and other payables | (8) | (28) |
| Net interest expense on post-employment benefit obligations | (68) | (114) |
| Loss on remeasurement of financial instruments at fair value through profit or loss ^{1,2} | (158) | (73) |
| Foreign exchange gains ^{2,3} | 127 | 154 |
| Financial expense | (351) | (300) |
| Net finance costs | (334) | (273) |

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

| | 2020 £m | 2019 £m |
|---|--------------|--------------|
| Net finance costs: | | |
| Group | (334) | (273) |
| Share of equity accounted investments | (32) | (23) |
| | (366) | (296) |
| Analysed as: | | |
| Underlying net interest expense ¹ : | | |
| Group | (235) | (240) |
| Share of equity accounted investments | (20) | (17) |
| | (255) | (257) |
| Other: | | |
| Group: | | |
| Net interest expense on post-employment benefit obligations | (68) | (114) |
| Fair value and foreign exchange adjustments on financial instruments and investments ² | (31) | 81 |
| Share of equity accounted investments: | | |
| Net interest expense on post-employment benefit obligations | (2) | (3) |
| Fair value and foreign exchange adjustments on financial instruments and investments | (10) | (3) |
| | (366) | (296) |

1. Underlying net interest expense is defined as 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.

2. The net loss (2019 gain) primarily reflects foreign exchange translational losses (2019 gains) on US dollar-denominated bonds held by BAE Systems plc.

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.

| | 2020 £m | 2019 £m |
|--|--------------|------------|
| Profit before taxation | 1,596 | 1,626 |
| UK corporation tax rate | 19% | 19% |
| Expected income tax expense | (303) | (309) |
| Effect of tax rates in foreign jurisdictions, including US state taxes | (45) | (52) |
| Expenses not tax effected | (6) | (14) |
| Income not subject to tax | 54 | 61 |
| Research and development tax credits and patent box benefits | 12 | 10 |
| Non-taxable non-recurring items | (1) | 4 |
| Chargeable gains | (1) | (3) |
| Utilisation of previously unrecognised tax losses | 1 | 3 |
| Current year losses not tax effected | (3) | (3) |
| Adjustments in respect of prior years | 44 | 192 |
| Adjustments in respect of equity accounted investments | 13 | 32 |
| Tax rate adjustment | 20 | (1) |
| Other | (10) | (14) |
| Taxation expense | (225) | (94) |

Calculation of the underlying effective tax rate

| | 2020 £m | 2019 £m |
|---|--------------|------------|
| Profit before taxation | 1,596 | 1,626 |
| Add back: Taxation expense of equity accounted investments | 48 | 53 |
| Add back/(deduct): Non-taxable non-recurring items | 4 | (22) |
| Adjusted profit before taxation | 1,648 | 1,657 |
| Taxation expense | (225) | (94) |
| Taxation expense of equity accounted investments | (48) | (53) |
| Exclude: One-off tax benefit ¹ | – | (161) |
| Adjusted taxation expense (including equity accounted investments) | (273) | (308) |
| Underlying effective tax rate | 17% | 19% |

1. The one-off tax benefit in 2019 is described on page 15.

5. Earnings per share

| | 2020 | | | 2019 | | |
|---|--------------|-----------------------|-------------------------|-------|-----------------------|-------------------------|
| | £m | Basic pence per share | Diluted pence per share | £m | Basic pence per share | Diluted pence per share |
| Profit for the year attributable to equity shareholders | 1,299 | 40.7 | 40.5 | 1,476 | 46.4 | 46.1 |
| Add back/(deduct): | | | | | | |
| Amortisation and impairment of intangible assets, post tax ¹ | 117 | | | 93 | | |
| Net interest expense on post-employment benefit obligations, post tax ¹ | 58 | | | 95 | | |
| Fair value and foreign exchange adjustments on financial instruments and investments, post tax ¹ | 34 | | | (64) | | |
| Non-recurring items, post tax ¹ | (15) | | | 18 | | |
| Underlying earnings, post tax | 1,493 | 46.8 | 46.5 | 1,618 | 50.8 | 50.5 |
| One-off tax benefit | – | | | (161) | | |
| Underlying earnings, excluding one-off tax benefit | 1,493 | 46.8 | 46.5 | 1,457 | 45.8 | 45.5 |

| | Millions | Millions | Millions | Millions |
|--|----------|----------|----------|----------|
| Weighted average number of shares used in calculating basic earnings per share | 3,191 | 3,191 | 3,183 | 3,183 |
| Incremental shares in respect of employee share schemes | | 19 | | 18 |
| Weighted average number of shares used in calculating diluted earnings per share | | 3,210 | | 3,201 |

1. The tax impact is calculated using the underlying effective tax rate of 17% (2019 19%). The calculation of the underlying effective tax rate is shown in note 4.

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 49. 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 funding valuations as at 31 March 2020 are ongoing for the BAE Systems Executive Pension Scheme, Royal Ordnance Pension Scheme and Royal Ordnance Senior Staff Pension Scheme. The valuations are expected to be concluded during the first half of 2021.

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 2017 £bn |
|--|--|--|
| Market value of assets | 20.6 | 2.2 |
| Present value of liabilities | (22.5) | (2.0) |
| Funding (deficit)/surplus | (1.9) | 0.2 |
| Percentage of accrued benefits covered by the assets at the valuation date | 92% | 110% |

The valuations in 2017 and 2019 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 – 90 |
| Life expectancy of a male currently aged 45 (years) | 88 – 92 |
| Life expectancy of a female currently aged 45 (years) | 90 – 93 |

The discount rate assumptions used in the 2017 and 2019 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 2020.

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 2020, total employer contributions to the Group's pension schemes were £1,701m (2019 £461m), including amounts funded by equity accounted investments of £133m (2019 £40m), and included approximately £1,422m (2019 £231m) of deficit recovery payments in respect of the UK schemes and £70m (2019 £nil) in respect of the US schemes.

As part of the 31 October 2019 valuation agreement, the Company agreed to pay £1bn into the Main Scheme representing an advancement of £1bn in deficit contributions that were due, under the 2017 valuation deficit recovery plan, between 2022 and 2026. This was paid in April 2020. The annual payment for 2021 was also accelerated and paid in December 2020. No further annual payments are now due, subject to the contingency plan discussed above.

The Group does not plan to make any cash contributions to the US pension schemes in 2021.

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 | | |
|---|-----------|-----------|-----------|------|------|------|
| | 2020 | 2019 | 2018 | 2020 | 2019 | 2018 |
| Financial assumptions | | | | | | |
| Discount rate – past service (%) | 1.4 | 2.1 | 2.9 | 2.4 | 3.1 | 4.2 |
| Discount rate – future service (%) | 1.6 | 2.2 | 3.0 | 2.4 | 3.1 | 4.2 |
| Retail Prices Index (RPI) inflation (%) | 2.7 | 2.8 | 3.1 | n/a | n/a | n/a |
| Rate of increase in salaries (%) | 2.7 | 2.8 | 3.1 | n/a | n/a | n/a |
| Rate of increase in deferred pensions (%) | 2.0/2.7 | 2.0/2.8 | 2.1/3.1 | n/a | n/a | n/a |
| Rate of increase in pensions in payment (%) | 1.6 – 3.6 | 1.5 – 3.6 | 1.6 – 3.7 | n/a | n/a | n/a |
| Demographic assumptions | | | | | | |
| Life expectancy of a male currently aged 65 (years) | 86 – 88 | 87 – 88 | 86 – 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) | 87 – 89 | 88 – 89 | 88 – 90 | 87 | 87 | 87 |
| Life expectancy of a female currently aged 45 (years) | 89 – 91 | 89 – 91 | 90 – 91 | 88 | 89 | 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 2020 | (4,111) | (668) | (4,779) |
| Actual return on assets excluding amounts included in net interest expense | 1,146 | 572 | 1,718 |
| Increase in liabilities due to changes in financial assumptions | (3,067) | (474) | (3,541) |
| Decrease in liabilities due to changes in demographic assumptions | – | 7 | 7 |
| Experience gains/(losses) | 344 | (12) | 332 |
| Contributions in excess of service cost | 1,398 | 60 | 1,458 |
| Past service cost – plan amendments | (9) | (1) | (10) |
| Settlements | – | 64 | 64 |
| Net interest expense | (63) | (9) | (72) |
| Foreign exchange adjustments | – | (5) | (5) |
| Movement in other schemes | – | (17) | (17) |
| Total net IAS 19 deficit at 31 December 2020 | (4,362) | (483) | (4,845) |
| Allocated to equity accounted investments | 360 | – | 360 |
| Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 31 December 2020 | (4,002) | (483) | (4,485) |

In October 2020, \$872m (£679m) of the US pension liabilities were removed from the US pension scheme and transferred to an insurance company. The premium of \$790m (£615m) was approximately 91% of the IAS 19 liability carrying value, creating a one-off accounting gain of £64m. This gain has been recognised as non-recurring in the income statement.

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 31 December 2020 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 | 0.6 | (0.3) |
| 0.1 percentage point decrease | (0.6) | 0.3 |
| Inflation: | | |
| 0.1 percentage point increase | (0.5) | 0.2 |
| 0.1 percentage point decrease | 0.5 | (0.2) |

1. Before allocation to equity accounted investments.

The sensitivity of the valuation of the liabilities to changes in the inflation assumption presented above assumes that a 0.1 percentage point change to expectations of future inflation results in a 0.1 percentage point change to all inflation-related assumptions (rate of increase in salaries, rate of increase in deferred pensions and rate of increase in pensions in payment) used to value the liabilities. The broad discount rate impact of a change of more than 0.1 percentage point can be extrapolated from the figures above. However, the majority of inflation-linked benefits have upper and lower limits applied, therefore a change in the underlying expectation of future inflation would result in a smaller change to the inflation-related benefits, and hence a smaller absolute change to the valuation of the liabilities. Accordingly, extrapolation of the above results beyond the specific sensitivity figures shown may not be appropriate. To illustrate this, the (increase)/decrease in the defined benefit pension obligation resulting from larger changes in the inflation assumption would be as follows:

| | (Increase)/decrease in pension obligation ¹ £bn |
|-------------------------------|--|
| Inflation: | |
| 0.5 percentage point increase | (1.7) |
| 0.5 percentage point decrease | 1.5 |
| 1.0 percentage point increase | (3.6) |
| 1.0 percentage point decrease | 3.1 |

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 | (1.5) |
| One-year decrease | 1.5 |

1. Before allocation to equity accounted investments.

7. Equity dividends

| | 2020 £m | 2019 £m |
|--|------------|------------|
| Final 13.2p dividend per ordinary share paid in the year in respect of year ended 31 December 2018 | – | 423 |
| Interim 13.8p dividend per ordinary share paid in the year in respect of year ended 31 December 2019 | 444 | – |
| Interim 9.4p dividend per ordinary share paid in the year (2019 9.4p) | 302 | 301 |
| | 746 | 724 |

After the balance sheet date, the directors proposed a final dividend of 14.3p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 1 June 2021 to shareholders registered on 23 April 2021. The ex-dividend date is 22 April 2021.

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 7 May 2021.

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 would expect to realise in the current market environment.

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

| | 2020 | | 2019 | |
|--|-----------------|----------------|-----------------|------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| | £m | £m | £m | £m |
| Financial instruments measured at fair value: | | | | |
| Non-current | | | | |
| Equity investments at fair value through profit and loss | – | – | 13 | 13 |
| Other financial assets | 248 | 248 | 350 | 350 |
| Other financial liabilities | (282) | (282) | (227) | (227) |
| Current | | | | |
| Other financial assets | 189 | 189 | 210 | 210 |
| Money market funds | 966 | 966 | 680 | 680 |
| Other financial liabilities | (181) | (181) | (232) | (232) |
| Financial instruments not measured at fair value: | | | | |
| Non-current | | | | |
| Loans | (4,957) | (5,737) | (3,020) | (3,315) |
| Current | | | | |
| Cash and cash equivalents (excluding money market funds) | 1,802 | 1,802 | 1,907 | 1,907 |
| Loans and overdrafts | (467) | (479) | (377) | (380) |

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 £226m (2019 £52m).

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 2020 £m | Year ended 31 December 2019 £m |
|--|---|---|
| Sales to related parties | 1,067 | 1,074 |
| Purchases from related parties | 831 | 664 |
| | 31 December 2020 £m | 31 December 2019 £m |
| Amounts owed by related parties | 69 | 53 |
| Amounts owed to related parties ¹ | 1,379 | 1,359 |

1. At 31 December 2020, £967m (2019 £862m) was owed by BAE Systems plc and £412m (2019 £497m) by other Group subsidiaries.

11. Acquisition of subsidiaries

Subsidiaries acquired during 2020

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 provisional fair values of the assets and liabilities acquired and the consideration for all acquisitions in the year 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 fair values acquired are provisional figures, being the best estimates currently available.

The net outflow of cash in respect of the purchase of businesses is 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.

Coupled with the Group's Electronic Systems sector, the Airborne Tactical Radios business will enhance its positions in airborne communications with broad spectrum, multi-band, multi-channel radios including battle-proven, robust,

anti-jam, and encryption capabilities. The Airborne Tactical Radios business brings both complementary waveform expertise and a long-trusted partnership with the US Army. The Group will achieve operating synergies by expanding capacity in its existing Fort Wayne facility for all Airborne Tactical Radios manufacturing operations. Forecasted revenue synergy opportunities include the capture of future radio new starts and upgrade programmes with enhanced competitiveness through the ability to offer a more complete radio system with a broad selection of communication and networking waveforms.

The Military GPS business has key products with a production horizon of five to ten years and the business is well positioned to capture follow-on work with the M-Code transition. Congress has mandated all Department of Defense systems utilise M-Code for new procurements which include GPS requirements. The integration of the Military GPS business presents opportunities for integrating BAE Systems' M-Code GPS into such systems. There are further synergy opportunities in core technology, including in the areas of advanced microelectronics packaging, signal processing, gun-hardened electronics, and core components such as oscillators.

Goodwill of at least £1,028m is expected to be deductible for tax purposes.

No impairment losses have been recognised in respect of goodwill in the year ending 31 December 2020.

The acquisitions contributed £181m to the Group's revenue and £53m to the Group's underlying EBITA¹ between the date of acquisition and 31 December 2020.

If each acquisition had been completed on 1 January 2020, the Group's revenue would have been £19,480m, and underlying EBITA¹ would have been £2,207m for the year ending 31 December 2020.

Acquisition-related costs of £20m have been included as a non-recurring item in operating costs in the Consolidated income statement for the year ending 31 December 2020.

Contractual cash flows on trade, other and contract receivables are expected to be collected in full. No contingent liabilities have been recognised or require disclosure in respect of these acquisitions.

1. Underlying EBITA is an alternative performance measure, defined as operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments and non-recurring items. Further detail on alternative performance measures can be found on page 12.

Subsidiaries acquired during 2019

All acquisitions which took place during the year ended 31 December 2019 were immaterial, both individually and collectively.

12. Assets and liabilities held for sale and business disposals

Assets and liabilities of disposal groups classified as held for sale comprise assets and liabilities that are expected to be recovered primarily through sale rather than continuing use. Assets and liabilities of disposal groups classified as held for sale are measured at the lower of their carrying value and fair value less costs to sell.

Advanced Electronics Company

In 2019, the Group's Overhaul and Maintenance Company (OMC) subsidiary entered into a heads of terms for the sale of its 50% shareholding in Advanced Electronics Company (AEC) to Saudi Arabian Military Industries (SAMI). The sale of AEC completed in February 2021. AEC is included in the Air segment.

Silversky

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

Business disposals

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 |

The loss on disposal is included in the profit for the year from continuing operations, as a component of operating costs.

The net assets of the respective disposal groups at the dates of their disposal were as follows:

| | 2020 | 2019 | | |
|---------------------------------------|-----------------|--------------------------------------|------------|-------------|
| | Silversky £m | UK-based Combat Vehicles £m | AACC £m | Total £m |
| Intangible assets | 32 | 87 | – | 87 |
| Property, plant and equipment | 3 | 9 | 8 | 17 |
| Deferred tax assets | 5 | – | – | – |
| Inventories | – | 2 | 17 | 19 |
| Trade, other and contract receivables | 7 | 15 | 9 | 24 |
| Cash and cash equivalents | 5 | 2 | – | 2 |
| Trade and other payables | (1) | (15) | (8) | (23) |
| Provisions | – | (7) | – | (7) |
| Net assets disposed | 51 | 93 | 26 | 119 |

Assets and liabilities held for sale

Assets and liabilities presented as held for sale comprise:

| | 2020 | 2019 | | |
|---------------------------------------|-----------|-----------------|-----------|-------------|
| | AEC £m | Silversky £m | AEC £m | Total £m |
| Intangible assets | 17 | 31 | 17 | 48 |
| Property, plant and equipment | 6 | 3 | 8 | 11 |
| Equity accounted investments | 71 | – | 66 | 66 |
| Deferred tax assets | – | 5 | – | 5 |
| Trade, other and contract receivables | – | 5 | – | 5 |
| Assets held for sale | 94 | 44 | 91 | 135 |
| | | | | |
| Trade and other payables | – | (5) | – | (5) |
| Liabilities held for sale | – | (5) | – | (5) |

13. Events after the reporting period

On 23 February 2021, the Group completed the sale of its holding in its equity accounted investment Advanced Electronics Company (AEC).

14. Annual General Meeting

This year's Annual General Meeting will be held on 6 May 2021. 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 2021.

15. Other information

The financial information for the year ended 31 December 2020 contained in this preliminary announcement was approved by the Board on 24 February 2021. 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 2019 have been delivered to the Registrar of Companies. Statutory accounts for the year ended 31 December 2020 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.