Annual Report 2020
BAE Systems plc

baesystems.com



BAE SYSTEMS

Navigating our Annual Report

Strategic report

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Please note that some of the images featured in this report were taken before the COVID-19 pandemic, and therefore do not reflect the precautionary measures we now have in place.

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.

Our purpose

At BAE Systems we serve, supply and protect those who serve and protect us, in a corporate culture that is performance driven and values led.

We have an important role in society because we:

– help our customers to provide security and safety;

– contribute to the economic prosperity of the places where our people live and work;

– support high value jobs in our business and in our supply chains;

– value our people and their diversity so they can fulfil their potential in an inclusive and supportive working environment;

– seek to identify opportunities for individuals from disadvantaged backgrounds;

– support employees' rights in relation to freedom of association;

– inspire and excel in the work we do – the technologies we develop and the talent we build;

– develop cutting-edge technologies to sustain the competitive strength of the Company in global markets;

– create best-in-class products and services by forging strong relationships with our suppliers and partners;

– care for and support our local communities; and

– use our knowledge and technologies to reduce the environmental impacts of our activities. We have set ourselves the target of achieving net zero greenhouse gas emissions across our operations by 2030.

Through careful long-term sustainable management and governance of our business we will continue to create value for our stakeholders.

How our purpose connects to our strategy

– We never lose sight of who are the users of our products and services – often members of the armed forces and security services – and the critical work they do to keep us safe.
– Our strategy sets out our actions for investing in the long-term future of the Company based on driving operational excellence, continuously improving our competitiveness and efficiency, and advancing and further leveraging our technology. By doing this we will fulfil the needs of customers and build a sustainable future for our business for the benefit of our stakeholders.

Page 04
Our strategic framework

How our purpose connects to our culture

– We are proud of the work we do to serve and equip those who protect us. We know our customers rely on us so we constantly innovate and go the extra mile in the products that we make, the quality we deliver and the services we offer.
– We recognise we are entitled to nothing and must earn everything.
– We are accountable for all that we do and seek to do the right thing at all times.
– Our culture values diversity and rewards integrity and merit so that everyone can fulfil their potential.
– The safety and wellbeing of our employees is paramount and we have a deep commitment to supporting the communities in which we work and to reduce the environmental impacts of our activities.
– At the heart of our business we are performance driven and values led.

Page 08
Our stakeholders

Further information can be found online by visiting
baesystems.com

Our business at a glance

BAE Systems has strong, established positions in the air, maritime, land and cyber domains.



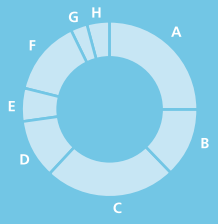
Air

Sales[1] by domain

55%

- Manufacture, development, upgrade and in-service support of Typhoon combat aircraft
- Workshare partner for the design and manufacture of major sub-assemblies and systems, and provision of support for F-35 Lightning II combat aircraft
- Design, manufacture and support of electronics equipment for military aircraft
- Manufacture, upgrade and in-service support of Hawk trainer aircraft
- In-service support of Tornado combat aircraft
- Development of next-generation unmanned and future air system capabilities under the Tempest programme, and defence information systems
- Design, manufacture and support of avionics equipment for commercial aircraft
- Design and manufacture of missiles and missile systems through a 37.5% interest in MBDA

Sales[1] by line of business (%)



A	Typhoon	25%
B	F-35 Lightning II	13%
C	Defence electronics	24%
D	Tornado	11%
E	Commercial avionics	6%
F	Weapon systems	14%
G	Hawk	3%
H	Other	4%



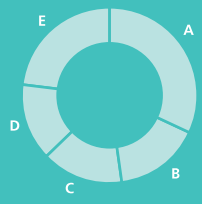
Maritime

Sales[1] by domain

24%

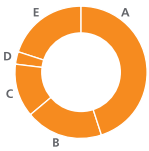
- Design and manufacture of submarines
- Design and manufacture of complex warships
- Provision of naval ship repair and modernisation services in the US
- Provision of in-service support to surface ships and facilities management in the UK
- Design, manufacture and support of naval gun systems, torpedoes, radars, and naval command and combat systems
- Design and delivery of training systems and services for maritime platforms and equipment
- Newly acquired Techmodal business supports the Group's digital and data capabilities

Sales[1] by line of business (%)



A	Submarines	32%
B	Complex warships	16%
C	US naval ship repair	15%
D	UK naval support	14%
E	Other	23%

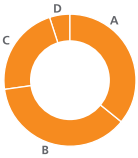
Sales[1] by destination



BAE Systems has leading positions in its principal markets – the US, UK, the Kingdom of Saudi Arabia and Australia – as well as established positions in a number of other international markets.

A	US	45%
B	UK	19%
C	Saudi Arabia	13%
D	Australia	3%
E	Other international markets	20%

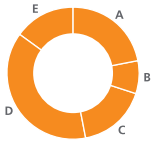
Sales[1] by activity



BAE Systems has a diverse portfolio, broadly balanced between an enduring services and support business, long-term platform and product programmes, electronic systems, and activities in cyber and intelligence.

A	Platforms	36%
B	Military and technical services and support	37%
C	Electronic systems	22%
D	Cyber	5%

Sales[1] by reporting segment



BAE Systems reports its performance through five principal reporting segments.

A	Electronic Systems	22%
B	Cyber & Intelligence	8%
C	Platforms & Services (US)	17%
D	Air	38%
E	Maritime	15%



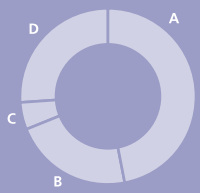
Land

- Design, manufacture, upgrade and support of tracked and amphibious combat vehicles
- Manufacture of ammunition and precision munitions for US, UK and other armed forces
- Design and manufacture of electric drive propulsion systems
- Design and manufacture of artillery systems and missile launchers for US, UK and other armed forces
- Development and demonstration of autonomous and unmanned capabilities

Sales[1] by domain

16%

Sales[1] by line of business (%)



A	Combat vehicles	47%
B	Munitions	22%
C	Commercial	5%
D	Weapon systems/other	26%



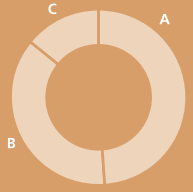
Cyber

- Supply of cyber, intelligence and security capabilities to US government agencies
- Supply of cyber, intelligence and security capabilities to UK and other government agencies
- Supply of defence-grade cyber solutions for the commercial market

Sales[1] by domain

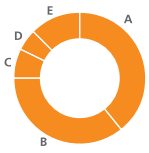
5%

Sales[1] by line of business (%)



A	US government	49%
B	UK and other governments	37%
C	Commercial	14%

Employees by location



BAE Systems employs a skilled workforce of 89,600 people[2] in more than 40 countries.

A	UK	35,300
B	US	31,900
C	Saudi Arabia	6,700
D	Australia	4,500
E	Other	11,200
Total employees[2]		**89,600**

2020 sales[1]

£20,862m

2020 revenue

£19,277m

Page 10 Our markets
Page 56 Group financial review
Page 66 Segmental review
Page 34 Sustainability
Page 14 Our key programmes and franchises

1. Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments. Sales is an Alternative Performance Measure as defined by the Group. Note 1 to the financial statements on page 196 provides a reconciliation to the IFRS Revenue measure.
2. Including share of equity accounted investments.

Our strategic framework

Our strategy is comprised of five key long-term areas of focus that will help us to achieve our vision and mission. It is centred on maintaining and growing our core franchises and securing growth opportunities through advancing our three strategic priorities and demonstrating Company Behaviours.

Our vision

To be the premier international defence, aerospace and security company

Our mission

To provide a vital advantage to help our customers to protect what really matters

Our strategy

	Progress during the year	Outlook
Maintain and grow our defence business	– Defence sales growth of 7% – Two US acquisitions totalling $2.2bn completed and integrations progressing in Electronic Systems – US business book-to-bill ratio[1] of over one – Number of major programmes ramping up in Electronic Systems, US Combat Vehicles, Air and Maritime – German Typhoon contract award – 15-year munitions contract extension signed in UK – Increased self-funded R&D spend	– Strong order backlog and established positions on long-term programmes provide a strong platform to deliver growth in the mid term – Opportunities in Air – Typhoon orders, F-35 sustainment, MBDA – Opportunities in Electronic Systems to maintain growth outlook – Opportunities in US Combat Vehicles – growth expected from existing programmes and international opportunities – Geopolitical risks still remain
Continue to grow our business in adjacent markets	– Work continued on a number of key controls and avionics development programmes including the 777X – Selected to develop the flight control system for Aerion's A2s supersonic jet – BAE Systems' clean propulsion system selected for 600 new buses for the Republic of Ireland – US Commercial Avionics business affected by COVID-19 impact on air travel	– Cyber security opportunities with allied governments and global financial services markets – Our electric drive propulsion technology is well placed as demand for low and zero emission technology grows – Commercial aerospace market is likely to be impacted for a number of years
Develop and expand our international business	– Qatar programme ramping up – MBDA revenue growth – CV90 upgrade awards in Netherlands and Switzerland – Continue to widen reach and relationships in targeted markets	– Opportunities to further positions in current International markets and develop new markets – Strong bid pipeline in Europe, Middle East and Asia-Pacific – Defence budget increase in a number of international markets should create further bid opportunities
Inspire and develop a diverse workforce to drive success	– Implemented behaviour-based approach to performance management that informs future skills planning – Introduced new talent management model to deliver robust succession planning – Initiated recruitment transformation programme to improve process effectiveness and candidate experience – Strengthening our approach to strategic workforce planning to align with our strategic aspirations – Focusing on talent development and succession planning, extending the talent pipeline further into the organisation – Invested in dedicated team and technology to drive skills development and talent management – Increased women in engineering roles, including leadership, by 3%, with broader gender diversity targets set for 2021	– Building stronger employee value proposition and brand to drive future skills recruitment – Broadening diversity and inclusion into our processes, practices, policies, systems and training – Strengthening Employee Resource Groups/employee networks to play a vital role in fostering a diverse and inclusive workplace – Recruiting a record 1,250 UK graduates and apprentices in 2021, and launching a future talent development programme – Relaunching our flagship education programmes and partnerships with the RAF and Royal Navy
Enhance financial performance and deliver sustainable growth in shareholder value	– Good financial performance given disruptions and challenges from the global pandemic – Increased orders, sales, underlying EPS and cash generation[2] over the last year – Acquisitions made and action taken to accelerate UK pension deficit contributions	– Strong order backlog and established positions on long-term programmes provide a strong platform to deliver mid-term growth – Focus on improving cash conversion and margin expansion

1. Ratio of Order intake to Sales. 2. Before £1bn contribution to UK pension scheme.

Through successful execution of this strategy we target the delivery of a high-performing, well-run sustainable business which will generate long-term shareholder value.

Our strategic priorities

Our three strategic priorities, which are embedded throughout the Group, provide the link between our longer-term strategy and near-term business objectives for all our employees.

Drive operational excellence

Successes in 2020

- Effective response to COVID-19, maintaining delivery of critical customer priorities
- Astute Boat 4 delivered under lockdown conditions
- Offshore Patrol Vessel programme completed
- Amphibious Combat Vehicle Initial Operational Capability achieved
- Management continued to be strengthened with a blend of internal promotions and external hires
- Engineering leaders development programme roll-out
- Applied Intelligence delivered improved profitability

Our priorities for 2021

- US Combat Vehicles long-term multi-programme delivery
- Type 26/Hunter Class programme ramp up
- US acquisition integration and delivery
- Full rate production on F-35
- Improved profitability in Platforms & Services (US) and Applied Intelligence
- Enhance recruitment practices and further leverage strategic workforce planning to deliver business plans
- Supplier quality (right first time) and supplier delivery (on time, in full) performance to support programme delivery
- Accelerate sustainability agenda
- Working capital management

Continuously improve competitiveness and efficiency

Successes in 2020

- Focused on supply chain resilience in response to COVID-19 and preparation for Brexit transition, ensuring critical programmes remained on track
- Financial assistance provided to those suppliers who were vulnerable and/or critical to our operations
- Continued to drive value from our external spend and worked to further relationships with our strategic suppliers
- Process improvements and robotic welding machines installed in US Combat Vehicles
- Savings and efficiencies achieved in COVID-19 conditions to help maintain productivity

Our priorities for 2021

- Continue to drive supply chain savings and 'Partner to Win' programme
- Maintain lessons learnt from cost savings achieved in COVID-19 operating environment
- Increased collaboration across the Group and with industry partners
- Continued focus on identifying and securing talent and critical skills to fulfil future requirements
- Continue to drive best value from external spend and manage payment performance to optimise cash management
- Automate and digitise our core supply chain processes as far as possible to maximise our productivity and efficiency
- Aggregate our supply chain risk and illuminate lower levels of our supply chain to manage risk and support programme delivery

Advance and further leverage our technology

Successes in 2020

- Military GPS and Airborne Tactical Radios US acquisitions
- Techmodal acquisition
- PHASA-35® successfully completed critical endurance flight trials
- Our PAC-24 autonomous sea boat purchased by the Royal Navy and undergoing trials
- Tempest programme advancement: 60+ technology demonstrations underway
- Increased level of classified work
- FAST Labs™ awards for leading-edge technology development to include advancing machine-learning and autonomous capabilities
- Riptide new product launched

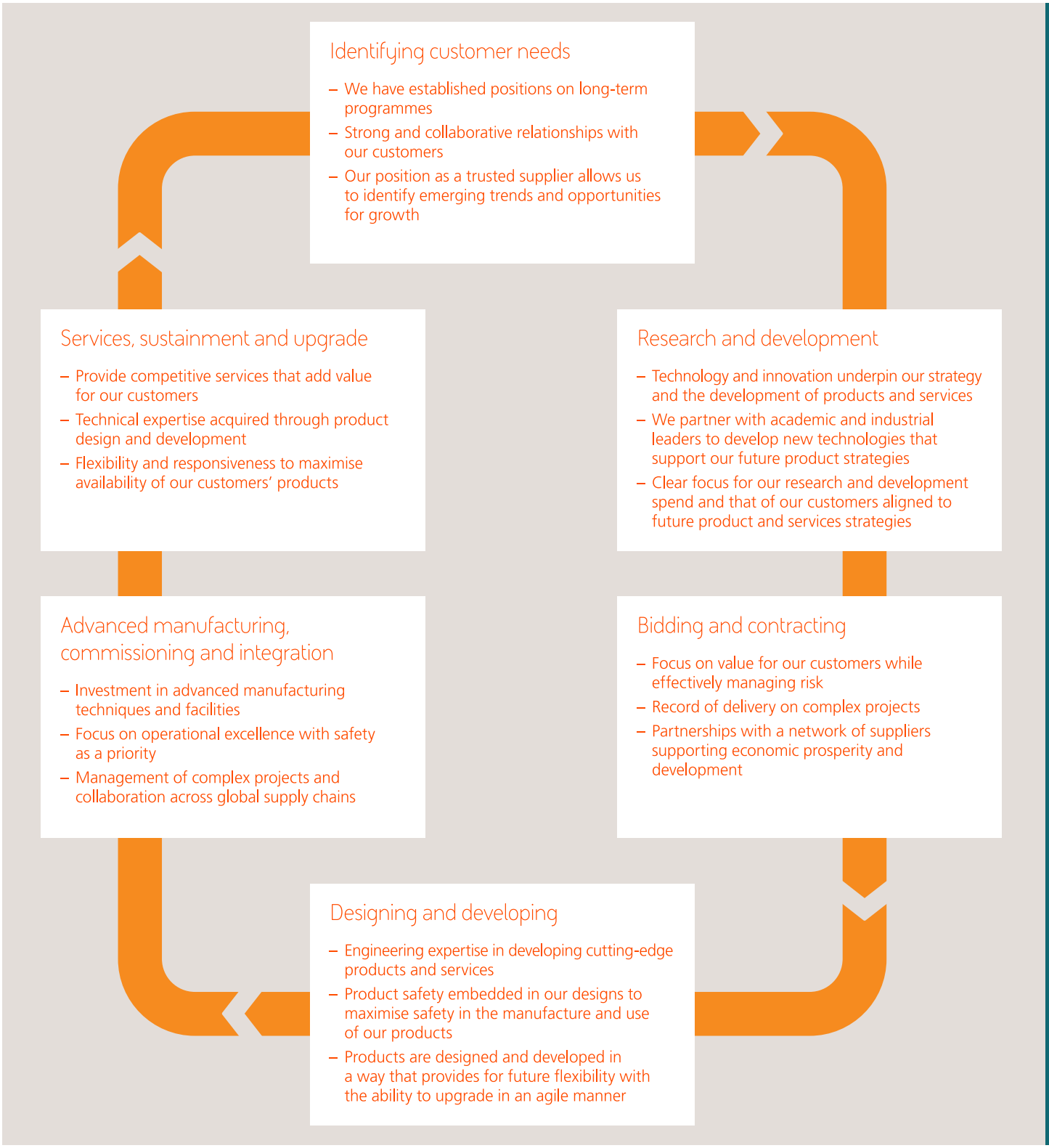
Our priorities for 2021

- Target further increases in self-funded research and development spend and technology bolt-on acquisitions, focusing on multi-domain integration, autonomy and sustainability
- Continue to accelerate our investment in Electronic Systems' strategic priority areas
- Further develop our Industry 4.0 Factory of the Future work, which will support Tempest programme and shipbuilding in Australia
- Continue to develop UK university partnerships, working on technologies including advanced materials, quantum sensing, data science, autonomy and sustainability

Our values Trusted Innovative Bold

Our business model

We serve, supply and protect those who serve and protect us, in a corporate culture that is performance driven and values led. Through careful long-term sustainable management and governance of our business we will continue to create value for our stakeholders.



Our business model is underpinned by:



Our values

Our values of Trusted, Innovative and Bold and our Company Behaviours ensure our focus is on how we create value rather than simply how much money we make. Our people are empowered to make the right decisions and know where to go to seek help.

Page 04
Our strategic framework



Our people

Our culture values diversity and rewards integrity and merit so that everyone can fulfil their potential. We are committed to nurturing talent and developing highly skilled people. We are training the next generation of engineers and business leaders to be able to drive innovation and solve complex challenges.

Page 42
Social



Our technology

We focus on technology innovation and engineering excellence, prioritising and investing in next-generation research and development programmes to deliver competitive solutions to meet our customers' needs now and in the future.

Page 18
Our investment in innovation



Our partners and key relationships

We recognise the important contribution provided by our suppliers and partners and we maintain close relationships with them which help us to create best-in-class, cost-effective products and services.

Page 55
Responsible supply chain



Responsible sourcing and impact

We take pride in managing our operations responsibly. We use our expertise to reduce the environmental impacts we have around the globe and to develop products and services for our customers which reduce their impacts on the environment. Our goal is to develop and implement a strategy to meet our net zero targets.

Page 36
Environment



Our governance framework

We are accountable for all that we do – our robust governance framework sets out how we do business. Together with our Code of Conduct, which requires our employees to conduct business in an ethical way, it enables us to earn and maintain the trust of our stakeholders.

Page 102
Board governance

Generating sustainable value

Customers

Our largest customers are governments, but we also sell to large prime contractors and commercial businesses. We never lose sight of who the users of our products and services are and the critical work they do to keep us safe. We take on and solve some of their most complex and challenging engineering and technology projects to give them a competitive edge and help them to protect what matters most.

Employment

High-value jobs are supported in our business and in our supply chains. We support jobs through direct employment, through the indirect impact of the employees employed as a result of our supply chain spending and through those jobs supported by the consumer spending of our employees and of those in our supply chain.

Contribution to local communities

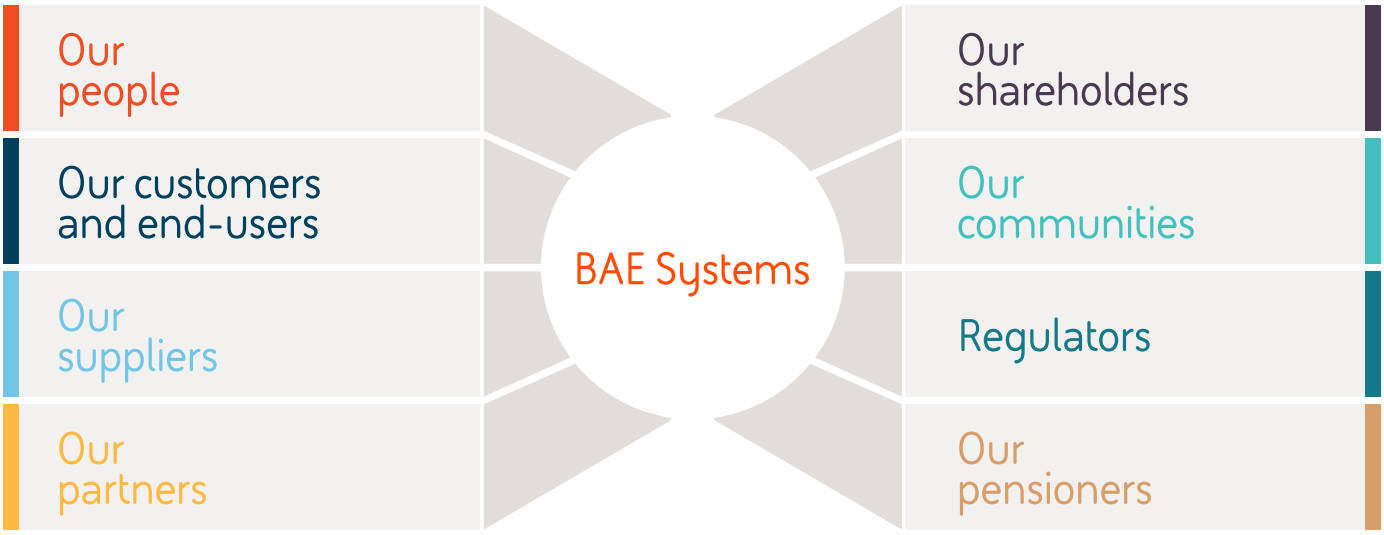
We take our role in communities seriously. We contribute to the economic prosperity of the places where our people live and work. Supporting causes that have meaning to our business and the communities in which we operate is vitally important to us and our employees.

Returns for shareholders

Through the careful long-term sustainable management and governance of our business we are well placed to continue to generate good returns for our shareholders.

Our stakeholders

Understanding and aiming to exceed the expectations of our stakeholders is critical to the long-term sustainability of our business and the vital role we play in helping our customers to protect people, information and nations.



Stakeholders	Description	Areas of interest	Why we engage	How we engage
Our people Page 43 More information	Employees of BAE Systems	– Safety and wellbeing – Ensuring our people can fulfil their potential at work – Recruitment – Training and development – Reward and recognition – Diversity and inclusion – How we work together – Environmental and social considerations	The skills, capabilities and commitment of our people are critical to ensuring the long-term sustainability of our business and delivering the innovation needed to solve our customers' complex challenges. Effective engagement enables our employees to contribute to improving business performance and helps us to create an environment in which everyone is valued and can fulfil their potential.	We keep employees informed about what is happening across the business using a variety of channels, including our employee app, intranet, email, through podcasts, newsletters, leadership blogs and trades union forums, and also through virtual and face-to-face leadership briefings and team meetings where we seek to listen to employees' views and opinions. Employees are encouraged to share their views through our channels and employee surveys. We also engage with trades unions in Australia and the UK and labour unions in the US.
Our customers and end-users Page 55 More information	Large governments and their procurement bodies, large prime contractors and commercial businesses The people who use our products and services, often members of the Armed Forces and Security Services	– Value for money – Quality of products and services – Risk management – Timely delivery – Safety and wellbeing – Environmental and social considerations – Reliability of our teams to rectify issues quickly	Understanding our customers' needs and challenges is central to our strategy and how and where we invest in technologies and infrastructure. Our end-users protect people, information and nations.	Through regular dialogue, virtual and face-to-face meetings, integrated project teams, joint reviews of programme performance, events and exhibitions. We work very closely with the people who use our products and services, in some instances our people work alongside them at their facilities or bases. We also engage through regular dialogue, virtual and face-to-face meetings.
Our suppliers Page 55 More information	The companies we work with to deliver products and services to our customers	– Labour and skills requirements – Cost of materials and operations – Terms of trade – Timely payment – Sustainable sourcing	Our suppliers and an effective, efficient and sustainable supply chain are essential to enable us to deliver for our customers and end-users.	Through performance reviews, forums, regular dialogue and best practice sharing.

Stakeholders	Description	Areas of interest	Why we engage	How we engage
Our partners Page 40 More information	Other industry companies or academic institutions who we work with	– Product and service development – R&D investment	We benefit from partnering with other organisations to leverage expertise or technology so that we can offer the best possible products and services to our customers.	Through regular dialogue, virtual and face-to-face meetings, forums and conferences and integrated project teams.
Our shareholders Page 32 More information	Investors who provide capital to the business	– Profitability, growth potential and cash generation – Capital allocation; returns via dividend and buyback – Operational performance – Quality of management – Environmental, social and governance considerations – Share price performance	To ensure the owners of our shares and potential investors in the Company have a full understanding of our business including the strategy, growth potential and risks in the business as well as the overall performance of the business.	Through a regular dialogue with analysts and investors conducted through investor meetings and roadshows, capital market days, results presentations, Annual General Meeting, regulatory disclosures, our website and investor relations app.
Our communities Page 50 More information	The people who live where we work and charitable organisations we support	– The value we bring to the communities in which we operate – Employment – Local community factors including environmental and social considerations	To ensure we maintain the trust of the communities where we work. To understand and respond to any issues important to our communities. To provide employment opportunities and contribute to the economic prosperity of the places where our people live and work.	Through community forums, volunteering and fundraising, STEM initiatives, Schools Roadshows and programmes such as Movement to Work.
Regulators Page 53 More information	Bodies that supervise industry or business activities	– Industry or business policies and regulations	In order to have a constructive dialogue with those who impact the regulations which can influence our business.	Through regular dialogue and via trade associations.
Our pensioners Page 30 More information	Members and trustees of our pension schemes	– Company performance – Member benefits – Pension fund investment strategy – Deficit recovery	To inform our pensioners on how we continue to meet our commitments to them. To ensure our pensioners have access to all the information they need to manage their pension.	Through newsletters, our website and pensions contact centres.

We also engage with other organisations who have a focus on business or defence and security issues to understand factors that can impact our business and how we operate.

Our markets

BAE Systems has leading positions in its principal markets – in the US, UK, the Kingdom of Saudi Arabia and Australia – as well as established positions in a number of other international markets. We are one of the largest global defence and security companies.

Supporting our customers

Our strategy is focused on providing a vital advantage to our customers around the world. In particular, we have built strong positions aligned with our core defence platforms to support our customers in our principal markets. These principal markets – the US, UK, the Kingdom of Saudi Arabia and Australia – have been identified as having a significant and sustained commitment to defence and security. BAE Systems has established strong and enduring relationships in these markets and is recognised as playing a key role in the industrial capability of each of these countries.

Our unique position and capabilities

Our strong position in the US through the Special Security Agreement, together with our standing as the leading defence contractor in the UK, provides us with unique capabilities that can be leveraged across the Group to support our customers. In addition, our diverse portfolio of capabilities in the air, maritime, land and cyber domains provides us with a comprehensive offering for our customers around the world, making us one of the broadest and most geographically diverse major defence companies.

Programme diversity and longevity

The Group has a wide diversity of capabilities and geographical spread of its operations meaning it is not overly reliant on a few key programmes or franchises. Additionally, these programmes and franchises in a number of cases are well positioned to extend beyond their funded backlog for many years (see Our key programmes and franchises on page 14).

Responding to changes in defence and security requirements

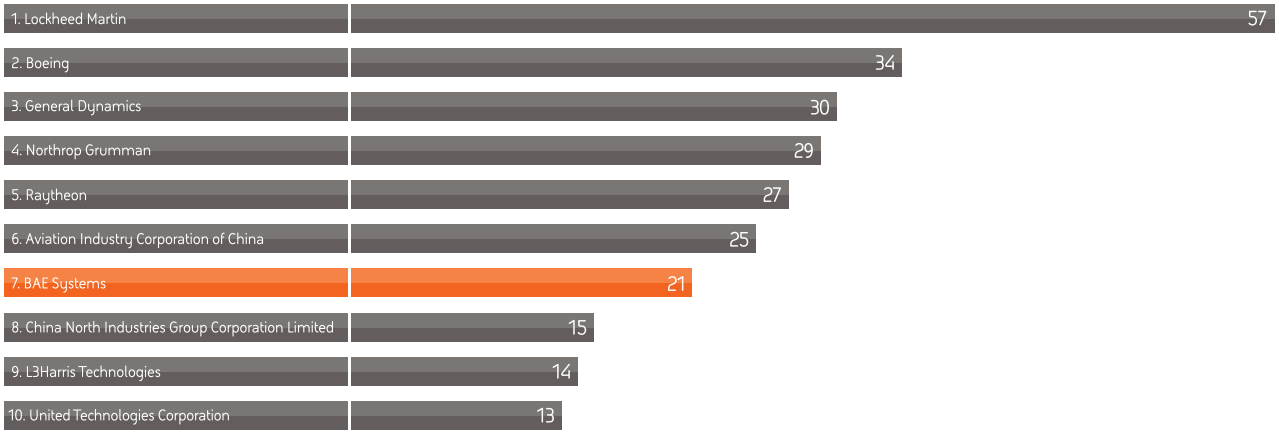
Our business continues to respond to geopolitical and technology trends that will influence and shape our customers' defence and security requirements now and in the future. Our excellence in complex engineering, developing cutting-edge technology and seeking innovative solutions enables us to respond to our customers' requirements for greater agility, global reach, and advanced technology products and services.

Growth aspirations

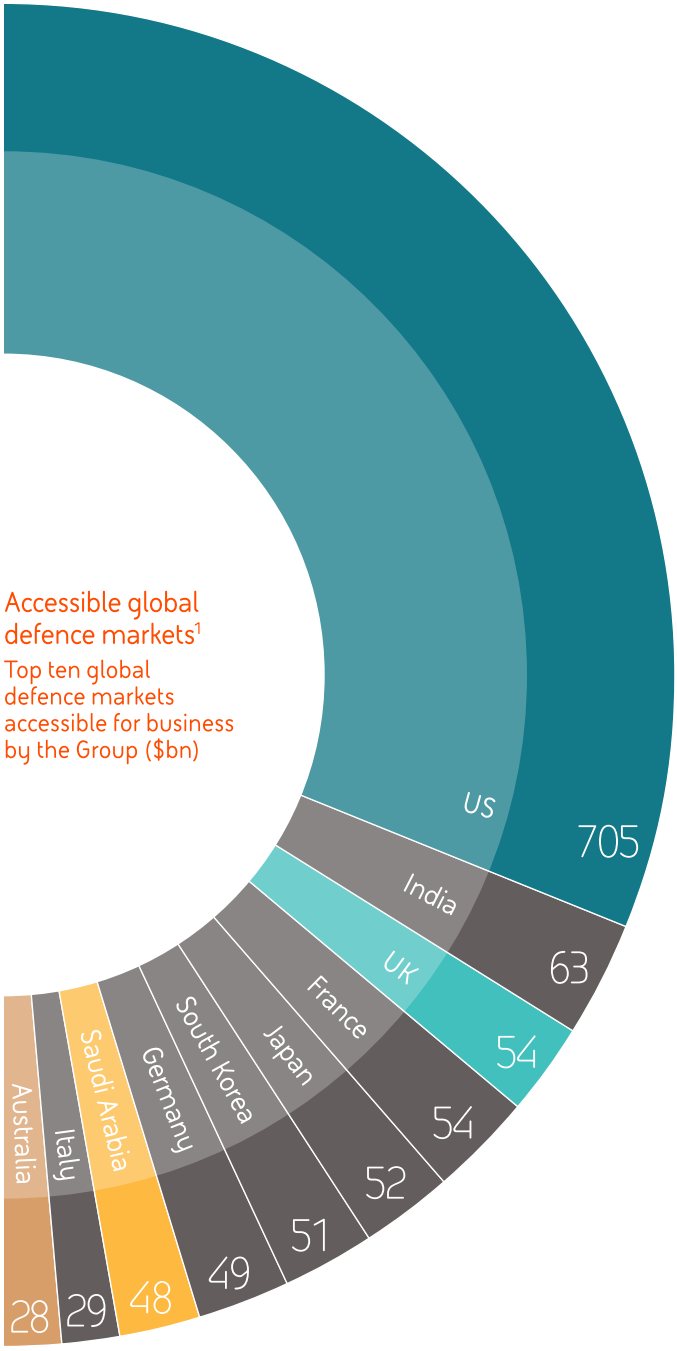
Budgetary growth and contract wins in a number of our principal markets in recent years has provided a growth platform for the Group in the coming years. Through long-standing customer relationships and the development of new ones, combined with the ability to leverage our range of capabilities around the Group, we continue to see further opportunities in a number of international markets as these nations increase defence spending in response to a multi-faceted threat environment.

BAE Systems' global defence market position

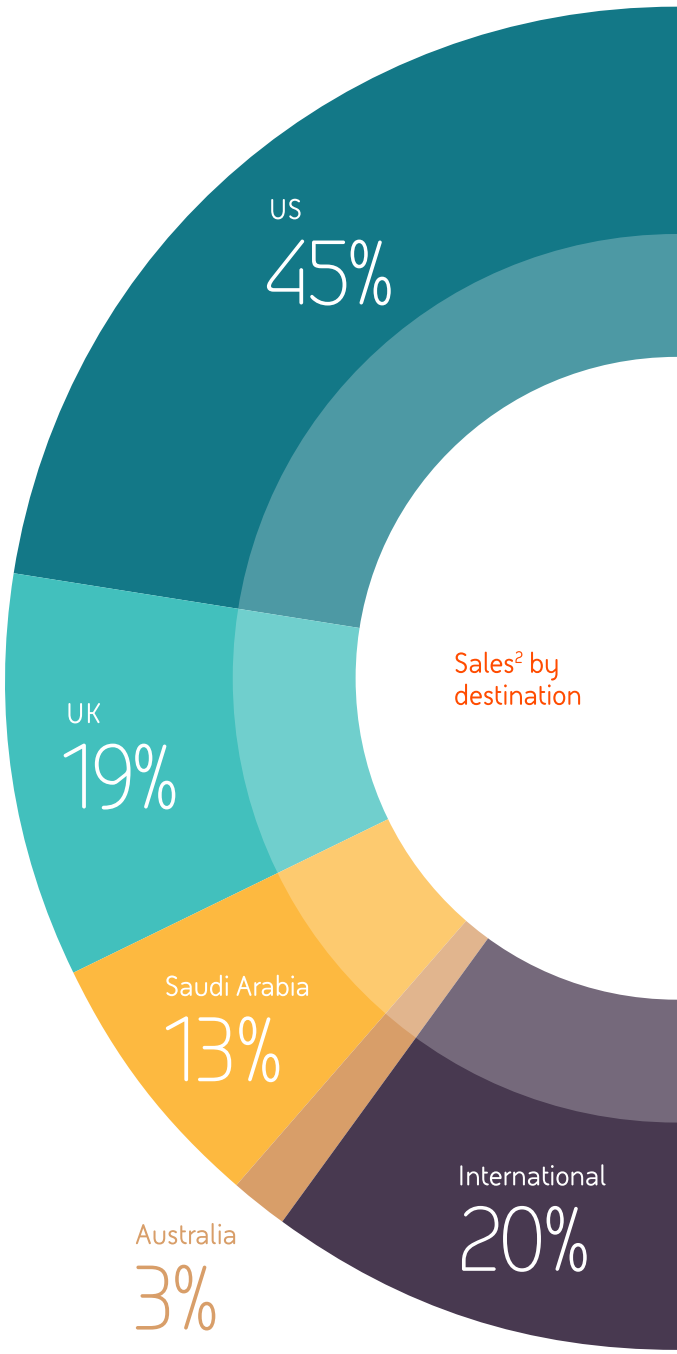
Top ten global defence contractors' revenue ($bn)



Source: Defense News Top 100 for 2020 (based on 2019 numbers). Exchange rate applied to BAE Systems is $1.277/£1.



Source: 2019 US budget as shown in the Department of Defense Fiscal Year 2021 Budget Request and, outside the US, Jane's Defence Budgets (based on 2019 total defence budgets and constant 2020 US dollars).



1. Markets inaccessible for business by BAE Systems are excluded.
2. Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments.

Our markets
continued

US

The US continues to represent the single largest defence market in the world. BAE Systems is a top ten defence supplier in the US.

The Group's US-based portfolio is well aligned to customer priorities and growth areas, which we expect to continue under the new administration. These include electronic warfare, precision-guided munitions, hypersonics and space security, naval ship repair and modernisation services and combat vehicles.

The two-year budget deal enacted in 2019 established a defence spending level of approximately $740bn for fiscal year 2021 and with bi-partisan support for defence, the budget is aligned with our medium-term planning assumptions and maintains positive support for military readiness and modernisation programmes. The backlog for the US-based business has continued to grow organically and through the two acquisitions made earlier this year. This backlog provides good visibility of growth in the US business.

BAE Systems is a leader in advanced electronic systems, real-time intelligence and analysis, naval gun systems, naval ship repair and modernisation and tracked combat vehicles. Our position is supported by strong positions on a number of franchise US defence programmes, including F-35 Lightning II, M109 self-propelled howitzer, Armored Multi-Purpose Vehicle and Amphibious Combat Vehicle.

In addition to our position on US defence programmes, the US-based portfolio is also focused on Foreign Military Sales and direct international sales to allied nations. We continue to deliver on and enhance existing commercial programmes, including engine and flight controls, and electric drive propulsion systems.

Opportunities: Budget increases or prioritisation towards our capabilities; increased Foreign Military Sales; civil aerospace recovery earlier than expected; expanded workscope platform positions; and commercial operation expansion.

Risks: Budget cuts in future years driven by US debt levels or spend priorities; slower civil aerospace recovery cycle post COVID-19.

Sales[1]

£9,315m

UK

BAE Systems is the largest defence company in the UK, with strong and long-standing relationships with the Ministry of Defence and our supply chains.

In the UK, the government has re-stated its commitment to meeting the NATO target of spending of at least 2% of Gross Domestic Product on defence. While the government's Integrated Foreign Policy, Defence and Security Review is due to be published early in 2021, the UK government has made a series of recent programme announcements related to the review and we welcome the UK government's increased investment in defence and security.

As a result, we have long-term visibility and a stable outlook for our major UK operations of submarine build, complex warship building and associated support, and a growth outlook in UK air support as increased numbers of F-35s come into service, along with investments in the next generation of air capabilities in line with the UK Combat Air Strategy.

As one of the UK's largest employers of engineers we have a central role in the engineering and manufacturing fabric of the country and we are currently training around 2,500 apprentices and graduates on our early careers programmes. We collaborate with suppliers, SMEs and regional partners, including universities, to support and deliver long-term economic growth and productivity, technological know-how and the development of skills.

The Group has limited UK-EU trading and the majority of the UK workforce consists of UK nationals. Accordingly, any resulting near-term Brexit impacts across the business are likely to be limited.

Opportunities: Leveraging our expertise and capabilities into export sales and partnerships.

Risks: Long-term spending in some capabilities comes under pressure due to economic priorities.

Sales[1]

£3,965m

Saudi Arabia

The Kingdom of Saudi Arabia continues to be a leading military power and one of the largest defence markets globally.

BAE Systems continues to work closely with industry partners and the UK government to ensure that the export licences required to enable the Group to fulfil its contractual obligations in the Kingdom are in place.

Saudi Arabia has a strong commitment to defence and security spending driven by regional security instability. Saudi Arabia's Vision 2030 strategy to promote in-Kingdom industrialisation and diversification away from reliance on oil continues to shape our activities, in support of Saudi Arabia's national objectives of technology development, local skills, and the development of an indigenous defence industry and capability. We are working with Saudi Arabian Military Industries (SAMI) to explore how we can collaborate to deliver further In-Kingdom Industrial Participation. This is through the restructuring of the Group's portfolio of interests in a number of industrial companies, along with sustaining current industrialised capability, and by building on our strong history in Saudi Arabia. We remain well placed as a leading in-country contractor in support of air defence platforms and training systems for the Royal Saudi Air Force, as well as support for mine countermeasure vessels for the Royal Saudi Naval Forces.

Opportunities: Securing orders for additional support and training, new equipment, upgrades and defence infrastructure programmes.

Risks: Scope changes to long-term support contract renewals, changes in spending priorities, nation-to-nation relations and licensing changes.

Sales[1]

£2,716m

Australia

BAE Systems is the largest defence company in Australia, with strong activities across all domains and the business is set to grow significantly in the coming years as the Hunter Class Frigate programme matures.

Regional instability, the impact of the COVID-19 pandemic, and the rapid pace of military modernisation and technology advancement in the Asia-Pacific region continue to drive the government's commitment to defence spending, with major recapitalisation programmes underway in the air, maritime and land domains. Underpinned also by its policies of developing a strong, sustainable and secure Australian defence industry and supporting leading-edge technological innovation, the Australian government continues its policy of approving a ten-year funding model for defence. The government announcement in July to increase their 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.

As part of this commitment, the government has made clear its objective to build a robust, resilient and internationally competitive domestic defence industry to ensure the expertise resident in the industrial base effectively supports Australia's national security.

We believe we are well positioned to assist the Australian government to meet its defence and security objectives through an established business and workforce based at more than 25 sites across the country, in addition to a strong ability to leverage BAE Systems' international positions to support domestic products in international markets.

Opportunities: Securing additional workshare from the increased spending outlook.

Risks: Long-term spending in some capabilities comes under pressure due to change of government priorities.

Sales[1]

£665m

International

BAE Systems has many strong and enduring relationships in international markets.

Regional security tensions, the growing emphasis on indigenous capabilities and varying economic conditions continue to influence defence spending internationally. BAE Systems has developed and seeks to further relationships with partners and customers in a number of countries.

In Qatar, the build contracts for 24 Typhoon and nine Hawks are progressing well and our relationships are strengthening as we implement our support and training commitments with the Qatari Armed Forces.

Through our shareholding in MBDA, our position in the missiles and missile systems market continues to grow in European domestic and other international markets. MBDA and the Eurofighter consortium are well placed to benefit from the expected European defence spending increases as a number of countries look to move nearer to their NATO commitments. In addition to Germany's order for 38 new Typhoon aircraft in November, Germany and Spain are considering future Typhoon orders, and other Typhoon and support opportunities are being pursued in the Middle East and Europe.

We have a strong presence in Sweden through BAE Systems Hägglunds supplying and supporting tracked vehicles for international customers, and Sweden is one of the international partners on the Tempest programme.

In Canada, BAE Systems is the warship design partner on the Canadian Surface Combatant programme of 15 ships for the Royal Canadian Navy. We are working on other prospects in Canada.

In Oman we provide support to Typhoon and Hawk aircraft and naval vessels.

Our US businesses export combat vehicles and precision weapon systems to a number of international customers and leverage further international markets through our partnerships in defence and commercial electronics.

In India, we have long-established relationships with local industry partners, Hindustan Aeronautics Limited on Hawk aircraft and Mahindra Defence Services Limited on M777 howitzers.

In Turkey we are collaborating on the initial development phase of the indigenous fifth-generation fighter jet, TF-X, for the Turkish Air Force and we maintain our position in armoured combat vehicles for Turkish and international customers through the FNSS joint venture.

In Asia-Pacific, we are a supplier to a number of armed forces, both directly and through joint ventures.

Sales[1]

£4,201m

1. Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments.

Our key programmes and franchises

BAE Systems has strong, established and growing positions supplying defence equipment, electronics and services, as well as cyber, intelligence and security solutions for governments.

The programmes and franchises underpinning these positions are primarily long-term in nature giving our business high visibility of its order backlog. This allows for long-term planning to ensure we have the right people, processes and facilities to enable delivery. We also have positions in adjacent commercial markets which our strategy targets to expand over time.

Electronic Systems
Cyber & Intelligence
Platforms & Services (US)
Air
Maritime

Defence electronics

Design, manufacture and support of avionics equipment across a range of US and other allied nations' military aircraft programmes, including a leadership position in the electronic warfare market. Our leading position on the US fixed and rotary wing platforms, an increasing number of which are coming into service, and a strong demand for capability and solutions to defeat increasingly sophisticated threats, are expected to provide this franchise with a solid platform for the coming years.

Commercial avionics equipment

Design, manufacture and support of avionics equipment across multiple commercial aircraft platforms, including engine and flight controls, and cabin and cockpit systems, together with aftermarket support services. BAE Systems is a leading supplier of engine controls for GE, and is a major supplier of flight control electronics for Boeing and other aircraft platforms. Revenues have reduced due to COVID-19 impacts on the civil aerospace sector and we have scaled the business appropriately, working with our key customers. However, we have maintained our capabilities to meet the expected return of long-term demand as business operations normalise.

Weapon systems and munitions

Design and manufacture of naval gun systems, munitions, torpedoes, radars, naval command and combat systems, artillery systems, missile launchers and, through a 37.5% interest in MBDA, missiles and missile systems. BAE Systems also manages and operates complex ammunition plant operations for the US Army to produce insensitive munitions and propellant grains. The increasing number of new platforms entering service in the coming years will create opportunities within this broad set of capabilities.

F-35 Lightning II

Design and manufacture of sub-assemblies in the UK, including the aft fuselage and empennage. Provision of equipment in the US, including the electronic warfare suite. BAE Systems has a significant workshare on the world's largest defence programme. Full-rate production is expected to be achieved in 2021 with production then expected to be maintained for over a decade, based on a programme of record of more than 3,000 aircraft.

Air support and training

Provision of support to operational capability, including maintenance, support and training for Typhoon aircraft in service with the UK, Saudi Arabian and Omani air forces. Under the Saudi British Defence Co-operation Programme, delivery of contracts for labour, logistics and training, training aircraft (including Hawk) and upgrades to Tornado aircraft in Saudi Arabia. Contracts to support Hawk aircraft across 14 countries and support for the F-35 Lightning II fleet and systems across the UK, US and Australia.

Typhoon and Hawk manufacture and capability development

Manufacture of Typhoon major units and final assembly of aircraft. Expansion of the capabilities of the aircraft with the E-Scan radar for Typhoon contracted in 2020 and ongoing development of new technologies aligned with the UK Combat Air Strategy and forward progress on the Tempest programme. Current backlog includes the Qatar contract signed in 2017 to provide Typhoon and Hawk aircraft along with a bespoke support and training package. Typhoon manufacturing is currently underpinned by the orders from Qatar and Germany which will ensure continuity of production of major units into the mid-2020s.

Submarines

Design and manufacture of seven Astute Class nuclear-powered attack submarines for the Royal Navy. The first three Astute Class submarines are in operational service with the Royal Navy, while the fourth boat left Barrow for sea trials in April. The remaining three boats are at an advanced stage of build, and the final boat is expected to enter service in the mid-2020s. Design and manufacture of four Dreadnought Class nuclear-powered submarines to carry the UK's Trident ballistic missiles. Manufacture of the first two Dreadnought Class boats is under way, with production on the programme to continue into the 2030s.



Our teams are building on decades of leadership in designing, delivering and sustaining electronic warfare systems to develop next-generation systems for the world's most advanced aircraft.

Naval ship repair and support

Provision of naval ship repair and modernisation services in the US and UK, together with support to the navies of the US, UK and Australia, at home and on deployment. In the US, BAE Systems has facilities located on the Atlantic and Pacific coasts. In the UK, we operate HM Naval Base Portsmouth on behalf of the Ministry of Defence. Our key customers in the US, UK, Australia and Canada are looking to extend and modernise the size of their fleets in the coming years which will create further support opportunities.

Complex warships

Design and manufacture of up to eight Type 26 frigates for the Royal Navy. The first Type 26 is expected to enter service in the mid-2020s. Contract signed in 2018 with the Australian government that provides the framework for the design and manufacture of up to nine Hunter Class Frigates. Provider of the warship design for the Canadian Surface Combatant programme. This business is accordingly well positioned for sales growth in the coming years.

Unmanned and future air system capabilities

Development of future air system capabilities, including joint investment with the UK government and industry in next-generation combat air systems under the Tempest programme, which was launched in 2018 in support of the UK Combat Air Strategy. The Tempest programme is progressing at pace, with Tempest partners currently working on more than 60 technology demonstrations.

Combat vehicles

Upgrade of tracked vehicles, including: Bradley Fighting Vehicles; M88 recovery vehicles; design and manufacture of the M109 self-propelled howitzer and Armored Multi-Purpose Vehicle; and development of light combat vehicles under the Mobile Protected Firepower programme for the US Army. Manufacture of amphibious vehicles for the US Marine Corps and international customers. More than 1,300 vehicles in the US Combat Mission Systems backlog are to be delivered in the coming years, and together with expected domestic demand beyond that and combined with recent upgrade awards on CV90, the franchise has good visibility. Design, manufacture and support of the CV90 and BvS10 combat vehicles for international customers. Vehicle upgrade and support to the British Army through a joint venture with Rheinmetall.

Cyber security

Delivery of a broad range of services to enable the US military and government to recognise, manage and defeat threats. Support to UK and other government agencies in their intelligence missions. Provision of defence-grade solutions for the financial services sector. The increasingly sophisticated threat environment is leading to increased government cyber spend in markets such as the US, UK and Australia, and we are well placed to support our customers in these markets.

Our operational highlights

In 2020, we delivered on our customer-critical key programmes in a highly challenging global environment.



Effective response to COVID-19

The impact of the COVID-19 pandemic was effectively managed across the business. Our response demonstrated the Group's resilience and agility, as well as the remarkable efforts of our employees.



F-35 approaches full-rate production in 2021

F-35 production ramp up continues towards full-rate production in 2021, with support to the UK Ministry of Defence in the successful achievement of the F-35 Initial Operational Capability and preparation for Australian depot operations.



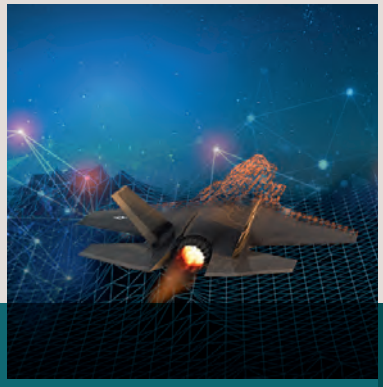
Qatar contract milestones achieved

Qatar Typhoon and Hawk aircraft programme met its contractual milestones in the year.



Integrating US business acquisitions

Integration of the acquired Military Global Positioning System and Airborne Tactical Radios businesses continues, with seamless deliveries to customers and successful new business wins.



F-35 electronic warfare systems

Electronic Systems surpassed a cumulative delivery milestone of more than 800 F-35 electronic warfare systems by year end.



Global Combat Ship continues to progress in the UK, Australia and Canada

Type 26 City Class frigate construction for the Royal Navy continues, with design and production readiness for the Australian Hunter Class programme and design for the Canadian Surface Combatant programme progressing.



Queen Elizabeth Carrier Class

HMS Queen Elizabeth went to sea as part of the UK's new Carrier Strike Group for the first time.



Amphibious Combat Vehicle programme achieves multiple milestones

The Amphibious Combat Vehicle programme transitioned to the full-rate production phase after Initial Operational Capability was declared by the US Marine Corps.



Armored Multi-Purpose Vehicle variant deliveries begin

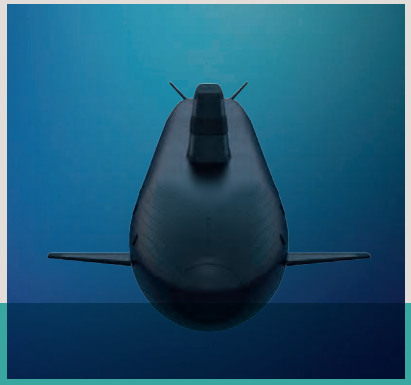
Initial deliveries of the first production Armored Multi-Purpose Vehicles in each of the five variants began in the year.



M109A7 vehicle deliveries progressing

After receiving the full-rate production decision from the US Army, M109A7 vehicles were consistently delivered.





Construction of Dreadnought Class submarines

Construction on Boat 1 and Boat 2 continues on the Dreadnought Class of submarines.



Offshore Patrol Vessel programme completed in the year

The final two Offshore Patrol Vessels, HMS Tamar and HMS Spey, were accepted by the customer.



Fourth Astute Class submarine delivered under lockdown conditions

Astute Boat 4, HMS Audacious, delivered to the customer for sea trials under lockdown conditions.

Our investment in innovation

Technology and innovation are central to our business, they underpin our strategy and the development of our products and services. Developing innovative technologies is a key part of the work we do to ensure we have a sustainable business that will continue to create value for our stakeholders.

In 2020, many of our customers strengthened their intention to increase integration across their operational domains, allowing land, sea, air and cyber forces to work together more closely. There is also growing awareness of the weaponisation of space, as well as the danger posed by the proliferation of hypersonic weapons.

In addition, many customers have also reiterated their commitment to increasing the sustainability of their platforms, operating bases and supply chains, through reducing their environmental impact. We share this commitment and are working on a range of technologies to help them to fulfil this ambition, as well as working to reduce the environmental impact of our own activities.

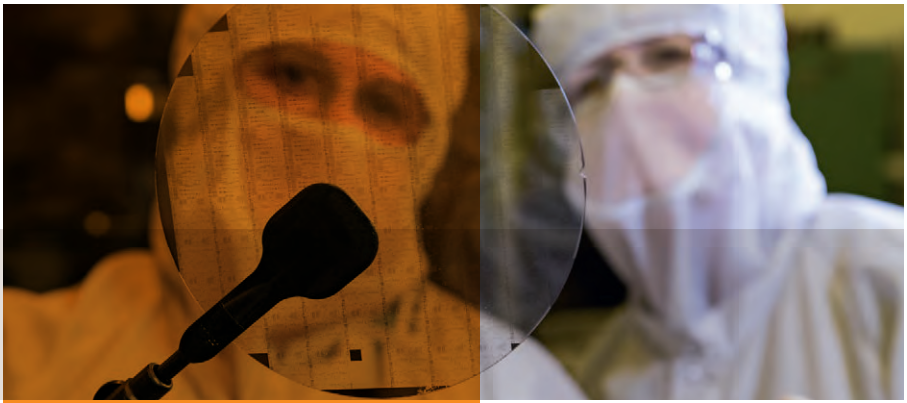
Our technology investments reflect this operating environment.

We have a broad portfolio across all defence domains and are well positioned to develop multi-domain capabilities to meet the growing customer need in this area. For example, our Intelligence, Surveillance and Reconnaissance (ISR) Gateway enables data to be shared securely between systems at different levels of classification, using metadata to control security access. As well as providing communications across domains, this enables allies to share complex data in real-time.

At the core of the US Electronic Systems business, our FAST Labs™ innovation hub supports technological advances across the enterprise, developing and proving new technologies to accelerate their transition into customer programmes. Our scientists and engineers create and evolve capabilities across multiple domains, with focus areas spanning advanced electronics, autonomy, cyber, electronic warfare, and sensors and processing. One such multiple-domain capability is FAST Labs' Fox Shield™ cyber protection technology that can be integrated into ground, air, and space vehicles to help platforms detect, respond and recover from cyber attacks in real time. The system's cyber resilience capabilities provide protection from cyber attacks designed to access and degrade mission capabilities.

Enabling cyber-secure rapid access to a variety of data sources will be vital in detecting hypersonic threats. Our Red Ochre Labs team in Australia is developing the capability to collate a variety of data sources, use artificial intelligence to detect potential weapon launches and give allies more time to take mitigating action.

In the UK, we are supporting the Ministry of Defence in space by delivering a key package in its Serapis framework, which involves working with UK SMEs on projects such as satellite operation, space surveillance from earth and the development of new launch equipment. In the US, we are developing a new suite of software-defined radios, which have the potential to be used in lighter weight, multi-purpose satellites that could then be used simultaneously as radio communications devices, GPS signal provision and surveillance devices – rather than having several satellites that perform these operations individually.



We continue to develop our capabilities in autonomy. The Royal Navy is trialling our PAC-24 autonomous sea boat, the first of its kind in the world. It is capable of taking on dangerous pursuit, monitoring and engagement missions, while constantly sharing a live data feed with operators. In Australia, we have demonstrated an autonomous land vehicle, bringing this new capability to the Australian Army's M113, while the BAE Systems, Inc. team has been selected to provide autonomous systems to the US Air Force's Skyborg Unmanned Aerial Vehicle programme.

We are also changing how we design and build our products, with the development of our Factory of the Future in North West England. This is being created to help us engineer Tempest, the UK's next-generation fighter aircraft, in half the time and at half the cost of previous generations. Collaborating with more than 40 blue-chip and SME companies along with academic institutions, we are creating automated robots and using virtual and augmented reality to increase speed, precision and efficiency. Our new intelligent workstation, developed in collaboration with The University of Sheffield's Advanced Manufacturing Research Centre and Fairfield Control Systems, is already delivering benefits on the Typhoon production line. It uses a system which recognises operators and automatically delivers tailored instructions using 'pick by light' technologies.

Research & development (R&D)

We structure our R&D activities around our business and product strategy, ensuring a clear focus for our R&D spend. We also continually scan the horizon for new technologies and developments in defence technology around the world.

In 2020, we spent £1.6bn (2019 £1.5bn) on R&D, of which £236m (2019 £237m) was funded by BAE Systems. In addition, the Group's share of the R&D expenditure of its equity accounted investments in 2020 was £0.4bn (2019 £0.3bn).

We continue to protect our investments in technologies and have a portfolio of patents and patent applications covering approximately 2,500 inventions worldwide. Combined with a clear strategy for managing our intellectual property, we seek to create additional value through licences and sales of rights to other organisations.



Collaboration

As well as partnering with our customers, we work with other companies and academia to invest in technologies and assets that complement our existing capabilities or our future product strategy.

Defence technology also drives the R&D ecosystem. Over the last ten years we have placed more than £125m with universities around the UK, much of that our own money, as well as investment from our customers and government. In the UK, we work directly with our five Strategic University Partners on new technologies and currently sponsor more than 90 PhD students under the Industrial Collaborative Awards in Science and Engineering programme, which allows postgraduate research students to receive high-quality research training in collaboration with a commercial partner. In 2020, the award-winning project proved how active noise control could reduce underwater noise from ships, which could reduce harm to marine wildlife.

In our Electronic Systems sector in the US, we often partner with the US Defense Advanced Research Projects Agency, universities, commercial technology companies and other research laboratories, to solve complex challenges across the defence, aerospace and security domains. In particular, our FAST Labs™ R&D teams leverage internal resources, the broader external innovation ecosystem, and funding from US Department of Defense research organisations to accelerate the velocity of our innovation – moving faster and with a stronger sense of direction to more effectively address customers' requirements for the rapid development of new technologies. FAST Labs™ has teamed with the US Army's Advanced Teaming Demonstration Program (A-Team) to develop autonomous capabilities that will be critical components of the Future Vertical Lift programme. The Army developed the A-Team programme to create an automated system to offload the cognitive burden on pilots while enabling them to command swarms of unmanned aircraft. BAE Systems was selected to deliver a highly automated system to provide situational awareness, information processing, resource management, and decision-making that is beyond human capabilities.

We also use seedcorn funding to invest in technology or ideas that have the potential to deliver tremendous value, but are too new or untested for our usual funding mechanisms. Over the last six years we have funded more than 60 such projects. Around half the projects have moved into product lines – in line with expectations for early-stage research and development programmes – and the potential business returns run into many times that value. The development of the PAC-24 autonomous sea boat, mentioned above, was funded through this route.

Technology in our business

The use of technology, innovations and advanced manufacturing techniques across our business is essential in driving greater efficiency and increased productivity. Our Chief Technology Officer's team is dedicated to advancing and applying new technology throughout our business. Key to this is our digital strategy, which is moving us towards common digital systems for areas such as design and manufacturing, supply chain management, managing human resources and online collaboration.

2021 priorities

BAE Systems has world-leading capabilities across sub-sea, sea, land, air, cyber and growing work in space. Going forward we will use this wider experience to help our customers integrate these domains to share and use information more effectively.

In the US, FAST Labs™ will continue to invest and leverage external technologies and advances through both scouting and collaborative partnerships, to drive rapid transition of disruptive capabilities.

We will continue working with academic and industry partners to develop and apply new technology, including in deploying Industry 4.0. This will build on the success of our Factory of the Future launched in 2020, allowing us to increase the speed and efficiency of digital design and manufacture. This will also underpin our progress on the Tempest programme.

Autonomy is another area vital to our customers. We had proven success in 2020 with our PAC-24 autonomous sea boat for the Royal Navy and M113 Armored Personnel Carrier demonstrator for the Australian Army, so we are looking at new projects to make greater use of this technology.

We continue our work to increase sustainability, both at the facilities we operate and in the products we supply to customers. As well as incorporating new power sources – as we have done with our Hybrid-Electric Drive system on a US Army Bradley Fighting Vehicle – we are also using artificial intelligence to run existing equipment more efficiently, such as the Royal Navy's Type 45 Destroyer. We expect to see further results in this area in 2021.

See examples of how we are using technologies to reduce the impact of our operations on pages 40 and 41.

Our financial highlights

We monitor the underlying financial performance of the Group using alternative performance measures. These measures are not defined in IFRS[1] and are therefore considered to be non-GAAP[2] measures. Accordingly, the relevant IFRS[1] measures are also presented where appropriate.

- Sales increased by £0.8bn, a 4% increase excluding the impact of currency translation[3].
- Underlying EBITA increased to £2,132m, a 1% increase on a constant currency basis[3].
- Underlying earnings per share increased by 2% to 46.8p, excluding the impact of the prior year one-off tax benefit[4].
- Free cash flow[5] was £367m after the impact of the £1bn contribution into the UK pension scheme. Excluding this contribution free cash flow was £1,367m.
- 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 intake[6] of £20.9bn.
- Order backlog[6] of £45.2bn.

KPI

References to Key Performance Indicators (KPIs) throughout the Annual Report.

BONUS

75% of the UK executive directors' bonuses are based on the achievement of financial KPIs (see page 144).

Financial performance measures as defined by the Group

Sales

KPI

£20,862m

(2019 £20,109m)

Definition: Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments.

Purpose: Allows management to monitor the sales performance of subsidiaries and equity accounted investments.

Net debt

BONUS KPI

£(2,718)m

(2019 £(743)m)

Definition: Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments). Net debt does not include lease liabilities.

Purpose: Allows management to monitor the indebtedness of the Group.

Underlying EBITA

KPI

£2,132m

(2019 £2,117m)

Definition: Operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBITA), and non-recurring items[7].

Purpose: Provides a measure of operating profitability that is comparable over time.

Order intake[6]

BONUS KPI

£20,915m

(2019 £18,447m)

Definition: Funded orders received from customers including the Group's share of order intake of equity accounted investments.

Purpose: Allows management to monitor the order intake of subsidiaries and equity accounted investments.

Underlying earnings per share[4]

BONUS KPI

46.8p

(2019 45.8p) Excluding one-off tax benefit

(2019 50.8p) Including one-off tax benefit

Definition: Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items[7].

Purpose: Provides a measure of underlying performance that is comparable over time.

Order backlog[6]

£45.2bn

(2019 £45.4bn)

Definition: 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.

Purpose: Supports future years' sales performance of subsidiaries and equity accounted investments.

Free cash flow[5]

KPI

£1,367m

Before £1bn UK pension scheme contribution

(2019 £850m)

£367m

After £1bn UK pension scheme contribution

Definition: 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.

Purpose: Allows management to monitor utilisation of cash in line with the Group's capital allocation policy.

Reconciliations from the financial performance measures as defined by the Group to the financial performance measures defined in IFRS[1] are provided in the Group financial review on pages 56 to 63.

- Revenue increased by £1.0bn to £19.3bn.
- Operating profit increased by £31m to £1,930m, including a 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.
- Order book of £36.3bn (2019 £37.2bn).
- 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 making a total of 23.7p per share in respect of the year ended 31 December 2020. The total 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 light of the COVID-19 pandemic.

Financial performance measures defined in IFRS[1]

Revenue

£19,277m
(2019 £18,305m)

Definition: Income derived from the provision of goods and services by the Company and its subsidiary undertakings.

Operating profit

£1,930m
(2019 £1,899m)

Definition: Profit for the year before finance costs and taxation expense. This measure includes finance costs and taxation expense of equity accounted investments.

Basic earnings per share

40.7p
(2019 46.4p)

Definition: Basic earnings per share in accordance with International Accounting Standard 33 Earnings per Share.

Net cash flow from operating activities

£1,166m
(2019 £1,597m)

Definition: Net cash flow from operating activities in accordance with International Accounting Standard 7 Statement of Cash Flows.

Order book

£36.3bn
(2019 £37.2bn)

Definition: The transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.

Other financial highlights

Group's share of the net post-employment benefits deficit

£(4.5)bn
(2019 £(4.5)bn)

Definition: Net International Accounting Standard 19 Employee Benefits deficit excluding amounts allocated to equity accounted investments.

Dividend per share

23.7p (2019 9.4p)

Definition: Interim dividends paid and final dividend proposed per share.

13.8p
interim dividend in respect of 2019 performance

1. International Financial Reporting Standards.
2. Generally Accepted Accounting Principles.
3. Current year compared with prior year translated at current year exchange rates.
4. The one-off tax benefit in 2019 is described on page 59.
5. 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.
6. Including share of equity accounted investments.
7. Items that are not relevant to an understanding of the Group's underlying performance (see page 58).

Chairman's letter

Operationally, the business has shown itself to be robust, resilient and agile. The foundations are strong, the sustainability agenda is accelerating and the business is evolving positively.



Sir Roger Carr
Chairman

Reflections on the year

There is no doubt that in my own business lifetime of over half a century, I have never witnessed a more challenging year than 2020. The scourge of COVID-19 has created a degree of unparalleled corporate, social, and economic upheaval against a backdrop of political turbulence across the world.

It is against this background of material challenge, however, that I am pleased to report the Company has fared well – strengthening its order book, successfully integrating two new acquisitions in the US, delivering growth in sales, orders, profit and free cash flow[1], and rewarding our shareholders with an increased dividend for the seventeenth consecutive year.

None of this could have been achieved without the extraordinary commitment of our people across the globe, in adapting to new ways of working, adopting new behaviours and consistently delivering an outstanding performance against all the odds.

I have felt very privileged to chair such a remarkable company as it has risen to overcome the daily difficulties of the pandemic. The leadership given by Charles Woodburn, supported by Tom Arseneault and Brad Greve and the executive team, has been exceptional as have the efforts made by everyone in the Group, all over the world, on site or at home, in contributing to our success.

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

Five-year dividend history (pence)



Dividend (pence)[2]

23.7p
+2%

2. 2020 does not include the interim dividend paid of 13.8p per share paid in September in respect of 2019 performance. This amount is reflected in the 2019 dividend history.

It is clear that in these difficult times the defence industry in general has been resilient and BAE Systems has been able to navigate the pandemic better than many other business sectors. Our resilience has stemmed from our deep and long order backlog, and our geographic footprint, delivering products and services of national importance to customers who value, respect and reward us for what we do.

Self-help has been our watch-word throughout. I am pleased to confirm that in delivering this performance, we did not take advantage of the UK government's funded furlough scheme and we have not borrowed any money under government borrowing facilities that have been made available to address the COVID-19 challenge.

In the same spirit, we have worked in close harmony with our suppliers, providing support in dealing with the pandemic including financial assistance where required.

Our commitment to apprenticeships has remained undiluted, recognising that educating and supporting our young people today with the assistance of our exceptional workforce protects all our prospects in the longer term.

In summary, in the midst of a pandemic that has cruelly affected the lives and livelihoods of so many, we have endeavoured to act thoughtfully, caringly and responsibly throughout for the benefit of our stakeholders.

Meeting the challenges

There is no doubt that adversity often brings out the best in businesses and people, and in the last 12 months at BAE Systems, we have seen how good things can come from difficult times. I would like to comment on just three examples.

First, team spirit. Everyone has worked together better than ever. A bond that has been strengthened in overcoming obstacles we have all faced and underpinned by a more informal leadership style – more collegiate, more approachable, more personal.

Second, the higher the hurdle, the higher we have jumped. We recognise what we do is important. Those that we work for have seen us lean in, go the extra mile, whether supporting our supply chains or servicing our customers. Our customers and suppliers have themselves faced fresh challenges and valued our efforts, noted our support, seeing that we have stepped up when it really counts, and strengthened a partnership that lies at the very heart of our business.

Third, the visibility of our values. Across the globe our values have been evident in caring for each other, prioritising safety, working in the local community and for the nations we serve, whether building ventilators, providing PPE or simply standing up for social justice at a time when diversity and inclusion must be part of the DNA of our business. Our people have ensured that there is a warm welcome for everyone joining as new members of our corporate family, in the form of businesses acquired or as individuals. The ethics of the Company have ensured that talent, irrespective of background, is valued and appreciated.

Lessons learned

In many ways we have seen our business at its best in the worst of times. We have learned to be more agile, flexible, caring and concerned, for our customers and each other, reinforcing our long-held purpose to be performance driven and values led.

On this broader front we are responding to the increasing demands of society for conducting our business with a clear focus on setting and meeting high standards in our environmental, societal, and governance responsibilities.

We are clear that to our investors, customers, colleagues and future employees, it has never been more important to concentrate on how we make money, not simply how much money we make.

To meet the demands, we are fortunate in having a Board that is populated by people with great experience, deep convictions, and strong opinions, who are united in their belief in both the business and our role in society. The discussions are always robust, thoughtful, and constructive, with an appropriate mix of challenge and support when reviewing our purpose, priorities and performance.

For much of the year, our Board meetings have been conducted virtually, but in the brief period that permitted groups to gather together, socially distanced, the UK members of the Board met together in London, with our US colleagues joining from Washington DC via videoconference.

It was one small step towards the normality we all hope for in the year ahead.

As a Board, we have all learned much from the pandemic and recognise how vulnerable we all are to risks that appear remote, but are potentially catastrophic. The virus has made us more aware of our human frailty, our mutual dependency, and the need to care for the mental and physical health of colleagues at all times. It has brought to the forefront the vulnerabilities to the planet, such that our business priorities must encompass caring for the environment.

These lessons learned will be evident in both what we say and what we do, and reflected in our behaviours and reporting in the years ahead.

Our strategy

Our core strategy remains unchanged (see pages 4 and 5). This includes continuing to focus on the design, development, and delivery of products and services as a world leader in the defence industry and to employ our skills to succeed in adjacent markets.

The operational imperatives set by the Chief Executive include advancing technology, improving competitiveness and driving operational excellence.

The cash we generate from our operational performance is employed to fulfil a hierarchy of needs, encompassing supporting our pension commitments, investing in technology and other organic opportunities, completing relevant acquisitions when available, and rewarding our shareholders with a dividend. Surplus cash may, of course, be used to strengthen shareholder returns when appropriate.

During 2020, the execution of our strategic plan has been evident in the acquisitions made in the US to strengthen our Electronic Systems business, the continued investment in projects and people, and the maintenance of our dividend in the midst of the pandemic.

Chairman's letter
continued

Our strategy is, of course, an evolving item and subject to regular review by the Board.

Our relationships with all our major customers remain strong and their commitment to defence expenditure undimmed in a turbulent world. The nature of defence, however, continues to reflect the changing battlespace, and to that end, we aim to grow our own interests to encompass multi-domain autonomous systems and networking, low earth orbit space and sustainability-driven product innovation. These developments are a natural extension of existing capabilities, and building on these strong foundations will ensure that those that follow will have a legacy on which to secure a long-term future.

Non-executive directors

The preservation of a deep knowledge of the Company has been particularly important in a period of extreme turbulence. It was in recognition of this need that we were fortunate to receive the support of shareholders in extending the terms of both Nick Rose and Paula Rosput Reynolds by approximately one year, but sadly their extensions expired and both non-executive directors stood down from the Board in December 2020. Both Nick and Paula made an outstanding contribution to the Company as non-executive directors and committee chairs for which they will both be long remembered and much missed.

In anticipation of their departure, we conducted a comprehensive search in 2020 for individuals of similar experience and equal calibre, and were fortunate to secure Dr Jane Griffiths and Nick Anderson who joined the Board in April and November respectively. Both bring a wealth of international experience and strengthen our operational, environmental and scientific skillset.



Across our UK businesses safe systems of work were put in place to ensure safe and efficient operations. F-35 production line, Samlesbury, UK.

We have announced recently that Dame Carolyn Fairbairn and Dr Ewan Kirk will join the Board as non-executive directors on 1 March and 1 June respectively. Dame Carolyn, who was until recently Director-General of the Confederation of British Industry, brings extensive business leadership and commercial experience across multiple business sectors, and Ewan brings a deep insight and knowledge of emergent digital technologies, that have been the basis for a successful business career. We are looking forward to them joining the Board and adding further to the quality of our deliberations and oversight. To complete the planned changes to the Board, we will be looking to make one further non-executive appointment later this year.

Executive directors

During the course of the year, Jerry DeMuro retired from the Board as the Chief Executive Officer of BAE Systems, Inc., and Peter Lynas retired as the Group Finance Director. Both executive directors contributed enormously to strengthening the rigour, discipline and performance of the Company and their service was valued and appreciated.

Following their retirement, there was a seamless transition in the US through the promotion of Tom Arseneault from President and Chief Operating Officer to President and Chief Executive Officer of BAE Systems, Inc., and to Brad Greve as Group Finance Director, who had been recruited for that role some months before.

Charles Woodburn completed his third year as an outstanding and highly effective Chief Executive, with the newly-appointed directors now fused into a strong leadership team. The complete refreshment of the executive board in recent times has been an important step in reinvigorating the Company and providing a secure platform on which to build a promising future in the interests of all stakeholders.

Summary

In summary, we are pleased to have delivered another year of strong performance, especially against the backdrop of a global pandemic, with sales of £20.9bn, underlying earnings per share of 46.8p, underpinned by an order backlog of £45.2bn and free cash flow of £367m.

In a challenging environment, the business has performed well and my thanks go to all of our colleagues, suppliers, customers and stakeholders who have made this possible.

None of us will ever forget 2020, but as the new year begins, I am confident that the Company has stronger foundations than at any time during my tenure as Chairman, and is well placed to face whatever is ahead.

The Board, therefore, has recommended a final dividend of 14.3p for a total of 23.7p for the full year. Subject to shareholder approval at the May 2021 Annual General Meeting, the dividend will be paid on 1 June 2021 to holders of ordinary shares registered on 23 April 2021.



Sir Roger Carr
Chairman

Chief Executive's review

During 2020, we focused on ensuring support for our customers and protecting our employees. Against the challenging backdrop of the global pandemic, we delivered a strong set of results.



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. I am very proud of the response of our businesses and the outstanding efforts of our employees in these challenging times.

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.



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."

Charles Woodburn
Chief Executive

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 flow[1], 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.



Page 34
Sustainability

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.

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. I am exceptionally proud of how our people and the business have responded, it was truly inspiring.

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.

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

Chief Executive's review
continued

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 ratio[1] 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.

1. Ratio of Order intake to Sales.

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.

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. Approximately £261m of funding was paid in the year, and in December, we also took the opportunity to make our March 2021 deficit payment of £161m ahead of schedule. The next triennial review is scheduled for 2022.

Executive Committee changes

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.



Charles Woodburn
Chief Executive

The work of the Board

The directors of BAE Systems – and those of all UK companies – must act in accordance with a set of general duties. These include a duty under Section 172 of the Companies Act to promote the success of the Company, and in doing so the directors must have regard (amongst other things) to certain stakeholders and other factors. In this statement, we highlight some of the key decisions and discussions undertaken by the Board during 2020.

Overview of the year

The COVID-19 pandemic had a significant impact on business and communities in 2020, and that was also the case for BAE Systems and the Board. At the start of the pandemic, a great deal of Board and executive time was focused on understanding what was required to safeguard our employees, our local communities and support our defence and national security customers in the vital roles they play. During this period of uncertainty, the Board took important decisions to manage cash resources in the near term, until the risks to the business were better understood.

The first few months of the crisis provided additional insight as to the culture and underlying resilience of our people and our businesses, and our ability to adapt. As the year progressed, and after a tremendous effort by all involved, the Board was able to focus once more on longer-term decisions, including how best to incorporate what had been learned from how the Company had dealt with that initial crisis.

As a result of the various global restrictions, the Board was unable to complete its planned programme of non-boardroom activities, which originally included site visits and the associated face-to-face engagement with employees, customers and shareholders. Where possible, the programme was adapted to seek stakeholder feedback and engage remotely but, as felt by much of society, this did not entirely replicate the richness of first-hand engagement.

In the second half of the year, with the first phase of the pandemic behind us, the Company's performance stabilised and the Board was able to consider the long-term trends in defence and the changes in technology that are driving these. This deep understanding of future trends is integral to how the Board allocates capital and invests to secure the long-term success of the Company.

Throughout the year, the Board has been listening to customers, suppliers, shareholders, employees and our local communities in respect of our wider responsibilities to society. The Board appreciates and understands its responsibility for maintaining our reputation for high standards of business conduct, and it recognises that social and environmental responsibility are a key element of these high standards. These important matters will be on the Board's agenda for 2021 and beyond.

February

Pension funding

In February last year, the Board made an important decision on the funding of our commitments to the UK pension scheme.

In October 2019, six of our nine UK pension schemes were consolidated into a single scheme, with nearly 165,000 members – of whom 150,000 have defined benefit arrangements. The consolidation helped to facilitate discussions between the Company and the trustee on a proposal to accelerate funding into the defined benefit sections of the main UK Scheme. Following completion of an actuarial valuation to determine the level of funding deficit and engagement with the trustee, the Board reviewed the proposal to agree a new deficit recovery plan. Under the proposal, the Company would make a one-off £1bn payment in April 2020 (to be funded by way of a bond issue), followed by fulfilment of the existing funding commitments of £490m by 31 March 2021.

The Board agreed the accelerated deficit funding plan as proposed. In doing so it had regard to a number of the factors detailed in the Section 172 duty, including:

- the likely consequences of the decision in the long term;
- the interest of employees and former employees participating in the pensions scheme; and
- the important stakeholder relationships with the trustees and The Pensions Regulator in the UK.

The decision was also important in terms of the Board's capital allocation policy. Meeting its pension funding obligations is one of the stated aims of this policy and the use of debt finance to accelerate deficit funding has enabled the Board to meet its employee and pensioner stakeholder commitments, whilst providing increased flexibility in terms of other funding priorities.

March – December

Supporting employees

The Board's principal focus in the second quarter of 2020 was the health and wellbeing of our employees and supporting our customers, suppliers and local communities.

Providing safe on-site working environments was essential to maintaining our performance and continuing to support our defence and national security customers. The Board considered how vital Personal Protective Equipment (PPE) supplies were being utilised and how workplaces were being adapted to create safe working environments in compliance with COVID-19 regulations. As part of this, it received updates on our close working relationship with the trades unions in the UK and their support in helping us manage workplace safety matters during such difficult times.

Board members were keen to understand the steps taken to maintain communication with employees, who were working from home or on site in new and challenging circumstances. Directors were pleased to see the agile and rapid deployment of various means of communication across the Company. These included the enhanced roll-out of an employee app, which allowed us to update employees directly and immediately through their personal devices and receive feedback from them. In subsequent Board meetings following the initial impact of COVID-19, directors dedicated a significant amount of time to better understanding workforce matters. One such matter was that of employee wellbeing, resilience and mental health, particularly in regard to the implications of lockdown and the associated changes in work environment and personal circumstances.

Non-financial information statement

The following sections of the Strategic report entitled 'The work of the Board' and 'Sustainability' (pages 30 to 55) constitute the Non-Financial Information Statement as required by the Companies Act 2006 as amended, together with the sections 'Our business model' (pages 6 and 7) and 'Our stakeholders' (pages 8 and 9) which are incorporated in this non-financial information statement by reference.

The Board engagement programme was adapted to allow a degree of direct engagement with employees. In the second half of the year, the Chairman and non-executive directors held a number of video conferences with a variety of colleagues from across our global employee base. In these conversations, directors sought feedback on the Company's response to the pandemic and heard first-hand accounts of the impact of COVID-19 on employees. They also shared experiences of how we were adapting to support customers, suppliers and their communities.

Faced with the COVID-19 crisis, the Board carefully considered the key steps to be taken to safeguard the Company. Cash expenditure was curtailed but it was agreed that wherever possible we would continue to fund matters that were important to the long-term success of the Company. This included our investment in the recruitment and training of those just starting their careers. As a result, we maintained our UK apprentice programme, recruiting approximately 750 apprentices in 2020, and honoured our commitment to over 230 individuals recruited under our UK graduate programmes and 260 graduates within our US business. During the year in Australia, the Hunter Class Future Frigate programme continues to ramp up, creating and sustaining over 5,000 jobs, including 1,000 apprentice and graduate roles over the life of the programme.

Supporting suppliers and serving customers

We have always understood the importance of our suppliers to our performance, and consequently our ability to serve our customers. From the onset of the pandemic we knew that the effectiveness of our supply chain would be critical. We have 21,000 directly-contracted suppliers worldwide. Given the nature of our products, replacing a supplier at short notice is difficult, as everything from major sub-assemblies to simple electrical connectors are subject to engineering and quality certification requirements.

At the beginning of the COVID-19 pandemic, the Board set out to understand the steps being taken to monitor supply chain performance and our ability to take action where necessary. It understood that maintaining cash flow through the supply chain was critical. Our government customers also appreciated this and they provided excellent support in maintaining payments – and in turn, we were able to continue payments to suppliers. This flow down of cash was essential to the wellbeing of many companies within our supply chain that had to cope with hugely challenging trading conditions. The Board also agreed that additional cash funding should be made available from our resources to maintain the viability of key suppliers, and thereby support our performance and our ability to serve customers. As a result, in 2020 we provided £151m of financial support, by way of early or advance payments, to around 200 suppliers across the Company.

April

Community support

During the year, the Board and the Corporate Responsibility Committee regularly discussed the impact of COVID-19 on our local communities and the ways in which we could provide support.

The Board was proud of the Company's membership of the VentilatorChallengeUK consortium. We were able to support the communities in which we operate as they responded to the pandemic through donations of approximately 150,000 items of PPE to healthcare workers in the US and UK. Additionally we were pleased to have been able to provide financial support to healthcare providers and local charities.

We have a large share register with thousands of individual shareholders. We appreciate the importance of maintaining contact with shareholders but nevertheless, over time, for various reasons we lose contact with some shareholders. Having reviewed our register, there were a number of shareholders who we had not been able to contact for over 12 years, we therefore implemented an intensive tracing and asset reunification programme to try to reunite these shareholders with their unclaimed assets.

A number of companies have utilised provisions within their Articles of Association and undertaken unclaimed asset exercises with the proceeds from the sale of such assets used to fund good causes. Our Articles of Association are similar, and it was proposed that we undertake such an exercise.

The Board reviewed a proposal for an unclaimed asset programme, with the net proceeds from any shares sold used to support the local communities in which we operate. The proposal was put to the Board and, having regard to community and social interests, it was approved. The share forfeiture was completed during the year, with £3.6m being made available to fund community support projects – this being in addition to our regular funding for community initiatives.

Stakeholder engagement

The Company engages with a variety of stakeholders on a regular basis. Feedback is received at a number of different levels and helps inform numerous decisions made on a delegated basis across the Company – but within the highly developed governance structure approved and overseen by the Board. Stakeholder feedback is also received by the directors, either directly, via executive management or through formal reporting processes. Further information on stakeholders and how we engage can be found in the following sections of this Annual Report:

- Page 08 Our stakeholders
- Page 43 People
- Page 50 Supporting our local communities
- Page 116 Corporate Responsibility Committee report

Companies Act 2006, Section 172(1)

"A director of a company must act in the way, he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the following factors:

(a) the likely consequences of any decision in the long term;

(b) the interests of the company's employees;

(c) the need to foster the company's business relationships with suppliers, customers and others;

(d) the impact of the company's operations on the community and the environment;

(e) the desirability of the company maintaining a reputation for high standards of business conduct; and

(f) the need to act fairly as between members of the company."

The work of the Board
continued

April – July

Dividend decisions

As with many businesses, the lockdown measures used to manage the COVID-19 pandemic required the Board to understand urgently the possible stresses that a lengthy shutdown of operations would have on finances. Facilitated by the Group Finance Director, the Board reviewed the output from a scenario-based exercise, which modelled potential impacts of the pandemic. These ranged from moderate disruption to activity and supply chain effectiveness, through to severe operational disruptions for an extended period of time. Cash flow was the key consideration in all the scenarios, and measures were taken immediately to conserve cash.

The Board held a special meeting at the beginning of April to consider the potential impact the pandemic could have on employees, customers, suppliers and our finances, and take any short-term actions as may be necessary to protect the Company and promote its success in the longer term.

Given the level of uncertainty at the beginning of April, the Board considered whether it would be prudent to defer the payment of the final dividend for 2019, due to be paid in June and requiring a cash outflow of approximately £442m. It considered the various stakeholders that had an interest in the long-term success of the Company – including employees, customers and suppliers. The Board was equally conscious of the importance of the dividend to shareholders. Having weighed up the various factors, and taking into account the high level of uncertainty at the time, the Board believed that it was in the best interest of all stakeholders to defer the final dividend in the short term and review the matter later in the year when there would be greater clarity as to the impact of the pandemic.

The Board reconsidered the payment of dividends at the end of July, when the half-year results were available. A great deal had been achieved in the four months since the dividend deferment decision, and many of our defence operations had well over 90% of employees working. There was real evidence of the Company's adaptability and resilience, plus we had supported our customers and they had supported us through a very difficult period. We engaged with many of our larger shareholders, and also heard from a number of smaller shareholders, and understood the importance of corporate dividends to the wider economy and to individuals for whom this was a significant part of their income.

Having considered what was in the best long-term interests of the Company and having had regard to shareholder and broader stakeholder interests, the Board agreed that the deferred dividend should be paid in September. Based on the performance of the Company in the year to date, it also decided that an interim dividend should be paid in November, in line with our usual dividend timetable.

October – November

Shareholder engagement

COVID-19 restrictions meant that the non-executive directors were unable to meet personally with a number of major shareholders as originally planned for 2020. However, we did hold a Board governance event by videoconference, which was attended by 30 shareholders and investors. The Chairman and the non-executive chairs of our principal board committees led the event, and they answered questions submitted by attendees. We also maintained our usual investor relations programme throughout 2020, with the Chief Executive and Group Finance Director holding investor meetings, albeit virtually.

The Chairman held regular meetings with shareholders during the year. These were focused largely on governance matters, rather than the financial and operational performance agenda that is the principal focus of the investor meetings conducted by the executive directors. The latest series of these meetings was in October, when the Chairman met with 13 major shareholders based in the UK and US. A range of matters were discussed, including capital allocation policy, Board development, how the Board facilitates its understanding of the changes in technology and the need to ensure that Environmental, Social and Governance (ESG) reporting was focused on the key metrics widely used by shareholders. In November, we hosted a Governance seminar wherein we provided investors with an overview of the Board governance, culture, purpose and our response to COVID-19. The Chairs of each Committee gave an overview of activities of their respective committees during the year and forward-looking plans into 2021 and beyond. The Chairman produced detailed reports on each meeting and shared the feedback with all Board members. This helped facilitate an item on the November Board meeting agenda on shareholder engagement, during which the directors considered what we had heard from shareholders in the second half of the year.

Our major programmes and markets update gave investors an opportunity to hear from our Chief Executive, Group Finance Director and President and Chief Executive Officer, BAE Systems, Inc. Investors were given an overview of the performance of our businesses and a market update.

November

Strategy and long-term decision-making

The Board is responsible for setting the Company's strategy and promoting the long-term sustainable success of the Company. The annual review of strategy is a key part of the Board's annual programme, providing time for all directors to consider strategic changes in markets and technology, make decisions on our priorities for future growth and understand the actions required to achieve our strategic aims. At the same meeting, the directors review and agree the latest iteration of our rolling five-year business plan and make decisions regarding the risk appetite in pursuit of the business plan. In 2020, the Board considered the likely long-term market trends in defence and aerospace markets, focusing on:

- multi-domain autonomous systems and networking;
- low earth orbit space; and
- sustainability-driven product innovation.

The Board reviewed these markets and their alignment with our existing products and technology, over the next decade and beyond. For example, it was recognised that we currently have a significant presence in the hybrid-electric transit bus market – founded on the power management capabilities in our US electronic aircraft engine controls business. We are developing all-electric bus solutions and see longer-term opportunities to use our power management expertise for other transport solutions, including electric propulsion in aircraft. The Board confirmed its commitment to developing our position in this market and continuing to assess the opportunities that may be available to us in adjacent sectors.

The Board will continue to review progress in developing our approach to future business and the long-term alignment of the Company to access agreed strategic growth paths.

December

Retention of the Chief Executive

During the last quarter of 2020 our Chief Executive received an unsolicited offer of a role in another major international company. Given his commitment to the Company, prior to making a decision, he chose to share details of the opportunity with the directors. The Board valued the significant contribution he has made since his appointment and recognised the importance of his leadership role at a critical time in the development of the Company. Accordingly, the directors decided that steps should be taken to secure his leadership of the Company.

In the three years that he has been in post, considerable progress has been made in the strategic development and operational performance of the business. The directors considered the risks to the Company and its stakeholders that could result from the loss of a high-performing Chief Executive and the difficulty in replacing him given not only the demands of the role but also the UK nationality requirement enshrined in our Special Share provisions.

As part of its long-term succession plans, the directors had successfully managed changes to the other two board-level executive roles earlier in the year. With those recent changes in mind, the directors agreed that it was particularly important to maintain the continuity of leadership and experience provided by the Chief Executive.

The directors were also aware of their Section 172 duty to promote the success of the Company and in doing so have regard to certain stakeholder considerations. Consequently, the Board reviewed the likely consequences of their decision in the long term and, amongst others, the interests of shareholders, customers and employees.

As detailed opposite, during October and November the Chairman had met with a number of major shareholders and, during discussions largely on governance matters, had sought views on the management of the Company, and the performance of the Chief Executive in particular. This feedback, which was relayed to the directors by the Chairman, had been universally positive.

Given the nature of the issue, it was not possible to consult with shareholders prior to considering the matter but subsequent engagement with shareholders, whose holdings represent around 60% of our issued share capital, has been positive and broadly supportive of the decision.

Based on previous feedback from customers, the directors also believed that continuity in leadership was crucial in maintaining customer relationships and in sustaining the progress made in the execution of major defence programmes that are vital to the long-term success of the Company.

Having considered the interests of various stakeholders and what was in the best long-term interest of the Company, the directors determined that they should seek to retain Dr Woodburn. They also agreed that his then remuneration appeared to no longer reflect his value to the Company or, in light of the offer he had received, his standing in the market. It asked the Remuneration Committee to review the matter with a view to retaining Charles Woodburn as Chief Executive. Details of the one-off and exceptional decisions it subsequently made are detailed in the Remuneration Committee Report on pages 124 to 128.

High standards of business conduct

Our Code of Conduct, Operational Framework and Supplier Principles – Guidance for Responsible Business, set out our expectations for employees, business partners and suppliers. We believe upholding high standards of business conduct is essential in promoting the long-term sustainable success of the Company, and is crucial to our relationship with stakeholders.

To ensure that the Code of Conduct remains current and continues to reflect best practice, it is subject to a triennial review process. Such a process was completed in 2020 and the Board reviewed and approved the revised Code.

The defence industry is subject to strict regulatory controls. In line with customer and other stakeholder expectations, we maintain rigorous internal controls which govern what we sell and who we sell to.

Our Product Trading Policy and Responsible Trading Principles help us to thoroughly evaluate the opportunities we pursue and underpin all of our business activity:

- we understand and support our customers' national security and other requirements;
- we work to our values in all that we do;
- we assess carefully our products and services with the objective that neither we nor our customers are exposed to significant reputational risk; and
- we are as open as practicable about the nature of our business.

During 2020 we commenced a review of our Supplier Principles which will be concluded in 2021 to further strengthen our sustainability agenda.

We regularly engage with our customers and review a variety of stakeholder feedback in order to ensure we continue to meet stakeholder expectations in the conduct of our business operations.

Environmental commitment

We recognise the environmental impact of our global operations and are committed to the development and implementation of a long-term decarbonisation strategy. Our Chief Executive is the owner of the Environmental Policy that explains our commitment to address the environmental impacts resulting from our operations and products. The Board and Corporate Responsibility Committee support the Chief Executive in ensuring that there is an appropriate environment and climate change programme across the Group.

We sought the views of our stakeholders to ensure that we were aligned in our environmental ambitions. Our customers' views and country goals in respect of carbon reduction were taken into account when formulating our environmental ambitions. Throughout the year, the Chairman met with investors and discussed our Environmental, Social and Governance (ESG) agenda. This gave shareholders the opportunity to provide their views on the Company's obligations in respect of the environment and particularly our responsibilities in tackling climate change. Additionally, during virtual get-together meetings hosted by the Chairman and the Chief Executive, employees sought to understand the Company's approach to reducing carbon emissions and employees were given the opportunity to provide feedback.

In September, taking into account various stakeholder views, the Corporate Responsibility Committee reviewed a proposal for the Company's net zero strategy and sought to understand the infrastructure and activity required.

Following a thorough review, the Company was able to set the target of achieving net zero greenhouse gas emissions across our operations by 2030.

Our sustainability agenda and governance

We are a business that operates responsibly and sustainably, supporting performance by managing both current and future risks and opportunities.

Introduction

Sustainability is important to us and to all of our stakeholders. At BAE Systems we serve, supply and protect those who serve and protect us, in a corporate culture that is performance driven and values led. Our sustainability agenda supports this purpose and our important role in society by reducing the environmental impacts of our operations and products, valuing and developing our people, making a positive social and economic contribution to our communities, developing innovative technologies and collaborating with our supply chains.

This approach 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 deliver positive outcomes for our stakeholders.

Our sustainability agenda

Our sustainability agenda incorporates the following priorities.

Environment

- **Environment and climate change** – the risk that climate change will have a significant and lasting impact on global economic growth and prosperity is a factor that we recognise and are responding to.

Social

- **People** – our ability to deliver against our strategy is dependent on recruiting and retaining people with appropriate skills.
- **Safety and wellbeing** – ensuring a safe and constructive working environment is a fundamental responsibility.
- **Human rights** – we are committed to respecting and upholding human rights wherever we operate, in respect of activities under the full, direct control of the Company.
- **Social impact** – making a positive social and economic contribution to the communities in which we live and work by contributing to activities and organisations that align with our values and business objectives.
- **Investment in technology and research and development** – technology and innovation underpin our strategy and the development of our products and services.

Governance

- **Governance and business conduct** – our licence to trade is dependent upon adherence to all relevant laws and regulations, robust governance and policies and high standards of conduct and behaviour.
- **Responsible supply chain** – our responsibilities and ability to operate require a sustainable supply chain. We also recognise the potential risks associated with an extensive supplier network, such as modern slavery and human trafficking.

Our approach to Environmental, Social and Governance factors

Our sustainability agenda incorporates Environmental, Social and Governance (ESG) considerations that affect the success of our business. Our agenda provides a framework for how we do business. It is driven from the top by our Chief Executive who has primary responsibility for delivery of the Group's strategy. He is supported on sustainability matters by the Group Director Governance, Conduct and Sustainability who advises on our sustainability strategy with input from a wide range of stakeholders.

Our Board Corporate Responsibility Committee is dedicated to the oversight of many aspects of the Company's performance in sustainability, including governance and ethics, and it takes a longer-term view in reviewing challenges and opportunities in this area (see page 116).

Investors are increasingly reviewing ESG issues that influence companies' long-term success and considering these factors in their decision-making.

When we think about what is material, we consider how our approach to sustainability will drive success, contribute to our wider communities and reduce our impact on the environment. Our global footprint and wide range of products and services means that our markets are subject to significant shifts and challenges in geopolitics, public spending and security priorities, and engineering and cyber technology. We monitor and respond to these changes as part of our business operations.

Our approach to UN Sustainable Development Goals

We support the UN Sustainable Development Goals (SDGs) and remain committed to driving progress on specific goals that are aligned to our sustainability agenda. The SDGs provide a framework for development and address the challenges that the global population faces from tackling climate change and environmental risks through to managing societal needs and building economic growth.

During 2020, we reviewed the SDGs that the Company can directly contribute to by progressing its sustainability agenda. The Company is committed to contributing to the four SDGs on the following page, by leveraging the individual elements of our sustainability agenda which will drive change for the Company and its wider stakeholders and communities. The global nature of our business means that some of our programmes may influence other SDGs.

Our sustainability agenda contributes to the following Sustainable Development Goals:

Quality education

We work closely with schools, colleges and universities as well as engineering and business organisations in our principal markets to promote and inspire people to pursue careers in Science, Technology, Engineering and Maths.

We create employment opportunities across our organisation via our apprentice, graduate, career development and recruitment programmes to help increase youth and adult employment.

We will continue to support and encourage our employees to develop their skills to engage in lifelong learning via our training and development programmes.

- Approximately 750 apprentices recruited as part of our 2020 intake in the UK.
- 170 graduates recruited in the UK in 2020 as well as 60 undergraduates (12-month industrial placement).

Decent work and economic growth

We contribute to economic productivity by investing in people, skills and innovation throughout our value chain. This investment is strengthened by our commitment to continue to create a diverse and inclusive work environment, underpinned by safe work practices promoting employee wellbeing, maintaining robust governance systems and efficiently using natural resources.

- 81[1] hours of training per employee[2] in 2020.
- £1,700[1] invested in training per employee in 2020.
- 40% of global hires recruited into STEM roles.

1. UK figure.
2. Average hours per full-time employee.



Industry, innovation and infrastructure

We structure our R&D activities around our business and product strategy, ensuring a clear focus for our R&D spend. We also continuously scan the horizon for new technologies and developments in defence technology around the world.

As well as partnering with our customers, we work with other companies and academia to invest in technologies and assets that complement our existing capabilities and our future product development.

- £236m invested in research and development by the Company in 2020.
- Patents and patent applications covering approximately 2,500 inventions internationally.
- £11bn spent with 21,000 directly contracted suppliers.

Responsible consumption and production

We are committed to reducing the environmental impact of our operations and value chain by actively managing the energy and resources that we use.

Our products are built to be in active service for decades and we work with our customers and suppliers to develop innovative technology that is designed to reduce the environmental impacts of such products.

- Target set to achieve net zero greenhouse gas emissions across our operations by 2030.
- Working towards a net zero value chain by 2050.
- Alignment of our business with the goals of the Paris Agreement.

Our programmes influence these Sustainable Development Goals:



Environment

Our goal is to develop and implement a long-term strategy that reduces the impact of our activities and products on the environment, whilst progressing our ambition of net zero greenhouse gas emissions across our operations and value chain. We aim to improve energy efficiency, introduce cleaner technologies, collaborate across our value chain, and mitigate climate-related risk, both physical and transitional.

Task Force on Climate-Related Financial Disclosures (TCFD)

The TCFD was founded in 2015 by the Financial Stability Board, to improve and increase reporting of climate-related financial information. In 2017, the TCFD made its first recommendations designed to help companies provide better information to support stakeholders in understanding a company's exposure to climate-related risk.

We are committed to implementing the recommendations of the TCFD, to ensure we are aligned to them by the end of 2021 and beginning to report our status in 2022. They are an important step towards enabling a net zero economy.

Environmental strategy

We recognise that all of our operations have an impact on the environment, from the energy and resources we use, to the products we manufacture and the waste we generate. We are committed to high standards of environmental management and undertake activities with the aim of reducing the environmental impact of our operations, products and supply chain.

To do this, we have taken a business-led approach to setting reduction targets and driving improvement programmes and activities to reduce our environmental impacts.

Activities have included installing a solar array on company land, moving to LED lighting systems, decommissioning carbon intensive coal fired boilers, installing a reed bed to clean effluent, designing buildings to meet BREEAM standards, re-using heat in a maritime platform and installing a Combined Heat and Power plant at the Portsmouth Naval Base and changing behaviours through implementing energy management systems.

Our ambition to achieve net zero

We recognise the need to accelerate our response in relation to climate change including the alignment of our business with the goals of the Paris Agreement. As a result, during 2020, environmental leads and functional representatives from across the business worked together to scope a net zero ambition for the Group. Following this first phase of work, BAE Systems can now outline its ambition to get to net zero.

We define net zero as achieving a state in which our activities result in no net impact on the climate from greenhouse gas emissions.

We have set ourselves the target of:

- achieving net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030. We aim to do this by reducing our emissions as a minimum in line with the 1.5°C pathway; and
- working towards a net zero value chain by 2050.

We recognise we cannot do this alone. We intend to collaborate with our suppliers and customers, and partner with researchers and technologists to innovate for a net zero future.

During 2021 we will move to the next phases of our net zero programme.

Phase two of our programme will focus on developing a net zero roadmap and will consider the use of several strategic levers, to enable emissions to be reduced as far as possible, including activities relating to:

- low/zero carbon products;
- our supply chains;
- renewable energy;
- energy efficiency in our facilities and buildings; and
- business travel.

In phase three our operating model and the capabilities that will be required to transition to a net zero organisation will be assessed and key performance metrics and interim targets identified.

Phase four will involve implementing the changes required to deliver our net zero strategy.

Governance of environment

Responsibility for climate change and environmental issues sits with our Chief Executive. He is the owner of our Environmental Policy, which details our commitment to addressing environmental impacts related to our products and activities, including climate change.

He is supported by the Board and Corporate Responsibility Committee in ensuring that an appropriate climate change and environment programme and performance objectives are set and flowed down across the business. These objectives are intended to reduce the Group's environmental impact, including climate change impact, in the immediate and long term, to enable the Group to deliver against its climate change and environmental commitments. The Corporate Responsibility Committee monitors progress in this area.

Our net zero programme



Our Environmental Policy mandates that we have an environmental management system (EMS) in place for all of our businesses. Short- and long-term risks outlined below are built into business EMS systems. Part of the EMS process is to define issues and set appropriate targets for the reduction of environmental and climate change impacts and risks.

Environmental risk management

Our approach to identifying and assessing environmental risks is embedded within our approach to risk management (see page 90). Environmental risks may present as financial or non-financial risks depending on the extent to which their impacts can be quantified, and how they have been classified.

The Group operates in a highly regulated environment across many jurisdictions and is subject to regulations relating to environmental factors including but not limited to climate change, therefore consideration of current and emerging regulation within our environmental management system is key to mitigating risk. Identified regulatory risks include energy-related taxes and the increased costs of compliance with energy-related schemes.

Understanding how the business may be impacted by its environmental factors is also a key component of mitigating emerging, medium- and longer-term risk. Water scarcity is an example of an environmental factor that has the potential to impact our operations, for example, if a site extracts water for process use.

Extreme weather events are another key environmental factor. These weather events, primarily flood risks, have the potential to directly impact our operations and, in turn, programme schedules. BAE Systems uses analytical tools to apply natural catastrophe classifications to each of its sites worldwide. This has informed our strategy as to where to target a programme of specific flood, windstorm and earthquake assessments of our sites and implement the subsequent risk reduction recommendations. The relocation of our Fort Wayne site is a good example of where we have worked to mitigate the risk of future river flood events. In 2020, we conducted a refresh of this data and during 2021 we will be modelling climate scenarios for 2030, 2050 and 2085.

Other direct environmental risks include:

- breaches of environmental requirements resulting in fines and/or the termination of permits;
- advancing technology and innovation;
- changes in regulatory requirements; and
- social and political change, differing legislation and policy in our various markets.

Indirect environmental risk includes the impact of use of products by customers and supply chain risk.

Risks associated with the transition towards net zero are also identified and these will be further assessed as part of our net zero programme via the phased approach outlined above. We also continue to take into account opportunities associated with climate change, including the ways in which we can use our advanced engineering capabilities to develop new products and services that support low carbon or reduced emissions requirements.

Our approach to environmental targets

Due to the differences in geography and stage of manufacture of platforms and programmes, each business implements its own environmental targets and initiatives. Businesses set objectives to improve the performance of their operations and reduce energy used and the generation of waste, emissions and other discharges, such as effluents. Our businesses also set targets to reduce water consumption.

During 2020 we have implemented energy efficiency measures at a number of sites across multiple business units and geographies. The most notable include the continuation of a steam rationalisation project to reduce energy consumption associated with steam, LED lighting replacements at several sites, replacement of current single panel windows with double glazed units and improvements to HVAC controls. Additionally, several sites continue to implement ISO[1] 50001 which demonstrates their commitment to energy management and energy efficiency best practices. We purchased 173,502 MWh of renewable energy attributes under the Renewable Energy Guarantees of Origin scheme during 2020.

Across the Group, we aim for the efficient use of resources and a reduction in waste across the full lifecycle of our products, from design through to manufacturing, use and end-of-life.

2020 key environment data[1]

Water consumption

	2020 cubic metres	2019 cubic metres
Mains	**2,039,777**	2,264,302
Abstracted	**3,584,015**	90,607,341
Total	**5,623,792**	92,871,643
Recycled	**19.3%**	1.3%

Waste production

	2020 tonnes	2019 tonnes
Non-hazardous	**39,211**	67,719
Hazardous	**15,922**	88,549
Total	**55,133**	156,268
Recycled[2]	**80%**	70%

Electricity consumption[3]

	2020 kWh	2019 kWh
Grid	**752,188,305**	880,610,015
Renewable[4]	**7,288,830**	13,093,192
Total	**759,477,135**	893,703,207

1. While operational performance improvements have contributed to the downward trend for 2020 across the environmental data, the most significant factor in the reductions seen is the removal of two facilities from our reporting boundary as noted on page 38.
2. Includes both non-hazardous and hazardous waste recycling.
3. Includes only those facilities that record their electricity consumption via the Group's environmental database.
4. Includes only directly-produced renewable electricity.

1. International Organization for Standardization.

Greenhouse gas emissions

Our aim is to continually improve energy efficiency and the decarbonising of our energy supply to reduce greenhouse gas emissions. Once implemented our net zero programme will provide the framework to accelerate reductions.

The majority of our operational greenhouse gas emissions come from the gas and electricity we use across our facilities. Our focus is on making our facilities more efficient and generating electricity from lower-emission sources.

During 2020, we removed two facilities from our organisational reporting boundary, as we do not have operational control of these facilities. Another business entity includes the emissions from these facilities within their environmental reporting obligations. As a result of these changes energy and emissions for the Group have reduced and our top ten site listing has been revised.

Our top ten largest sites accounted for 54% of our total energy consumption. By these sites setting energy reduction targets, they have the biggest influence in reducing our energy use and, in turn, our direct and indirect greenhouse gas emissions.

The majority of these sites operate environmental management systems certified to ISO[1] 14001, with an aim to reduce their energy consumption and in turn greenhouse gas emissions. Other sites certified to 14001 will set appropriate objectives and targets to improve environmental performance.

During the financial year, Group-wide greenhouse gas emissions have reduced by 50% and total greenhouse gas emissions per employee by 55%. While the implementation of energy efficiency projects has contributed to this decrease, the most significant factor in the Group-wide reductions is the removal of two sites from our reporting boundary. Reported Scope 3 emissions have been effected by a decrease in business travel due to COVID-19. We will continue our focus on improving and reducing emissions going forwards.

Greenhouse gas emissions data

Absolute energy consumption

	2020		2019	
	Global kWh	**UK kWh**	Global kWh	UK kWh
Energy consumption Scope 1 and 2	**1,700,834,942**	**669,133,482**	3,351,428,765	690,707,464

Greenhouse gas emissions data[1]

	2020		2019	
Scope definition	**Global tonnes CO_2e**	**UK tonnes CO_2e**	Global tonnes CO_2e	UK tonnes CO_2e
1 Emissions from activities which BAE Systems owns or controls (Scope 1)	**151,190**	**69,948**	480,392	84,206
2 Emissions from the electricity and steam purchased for BAE Systems' use (Scope 2 – location-based)	**336,207**	**73,221**	484,504	82,896
Total gross Scope 1 and 2 emissions	**487,397**	**143,169**	965,436	167,102
3 Emissions from employee business travel which BAE Systems does not own or control (Scope 3)[2]	**54,769**	**11,941**	138,020	47,705

Greenhouse gas emissions per employee[3]

	2020		2019	
	Global tonnes CO_2e	**UK tonnes CO_2e**	Global tonnes CO_2e	UK tonnes CO_2e
Per each full-time equivalent employee (Scope 1 and 2)	**5**	**4**	11	5

1. 2020 emissions data has been subject to limited assurance verification by Ramboll US Consulting, Inc.
2. Relevant reporting period 1 November 2019 to 31 October 2020.
3. Including share of equity accounted investments.

1. International Organization for Standardization.

Methodology

The greenhouse gas emissions data is reported in line with the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard 'Operational Control' method. Emission factors for fuels and electricity are published at www.gov.uk/government/collections/government-conversion-factors-for-company-reporting, and emission factors for US electricity are published at www.epa.gov/energy/emissions-generation-resource-integrated-database-egrid.

For the 2020 reporting cycle, the 2020 UK government emissions factors published by the Department for Business, Energy and Industrial Strategy (BEIS) have been utilised. The most up-to-date Emissions and Generation Resource Integrated Database (eGRID) factors published by US Environmental Protection Agency (EPA) are utilised for US electricity. For the 2020 reporting cycle, the most up-to-date US factors are from the year 2018.

The principal record of the Group's worldwide facilities is its Global Property Database.

Energy consumption figures are calculated using energy consumption records reported via the Group's global environmental database or, where actual usage data is not available, by estimating consumption based on the type of building. The energy consumption figures are used to calculate greenhouse gas emissions.

Greenhouse gas emissions related to business travel include air travel data for the majority of the global business, rail data for business units operating in the UK and US, and vehicle (including hire car, company car and personal car) data for business units operating in the UK, US and Australia. These data sets are taken from suppliers' procurement records.

Emissions from pension scheme properties not occupied by the Group and joint ventures are not included. Where a business or facility is acquired during a reporting year, it will be included in our reporting in the next full reporting year after the change.

The Scope 2 Greenhouse Gas Emissions associated with the Greenhouse Gas Protocol 'Market-Based' Method have been calculated as 413,434 tCO_2e. Supplier-specific emission factors have been sought for our most significant operating regions but were either deemed of insufficient quality to use at present or were unavailable. Therefore, in line with the Greenhouse Gas Protocol Guidance, this figure has been calculated using residual-mix emission factors where available for our UK, US and Swedish operations. In our other significant operating regions, residual-mix emission factors are either unavailable or the resulting absolute emissions at group level are within the margin of error and therefore country-specific emissions factors have been used in line with the Greenhouse Gas Protocol Guidance.

UK Streamlined Energy & Carbon Reporting (SECR)

The SECR requirements are mandatory reporting standards that build on the existing UK greenhouse gas reporting requirements to encourage businesses to implement energy efficiency measures and reduce greenhouse gas emissions.

2021 priorities

During 2021, we will aim to:

- progress our net zero programme including developing our net zero road map and developing our net zero operating model;
- continue to set environmental goals and undertake supporting initiatives to reduce environmental impacts at a business level; and
- model climate scenarios for 2030, 2050 and 2085.

Sustainability

Technology

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

Our technology strategy is driven by the challenges that our customers are facing now and will face in the future. We are focused on developing a number of technologies that support long-term market trends in our sector which includes sustainability-driven product innovation.

Please see Our investment in innovation on pages 18 to 19 which sets out our approach to technology and innovation and why it is a key part of the work we do to ensure we have a sustainable business that will continue to create value for our stakeholders.

Using technologies to reduce the impacts of our activities



Advancing technology to power environmentally-friendly urban transit

Cities and bus operators around the globe use BAE Systems' low-emission technology to solve complex transportation challenges. The San Francisco Municipal Transit Agency has established nine 'green zones' and selected our electric drive propulsion solution for its buses in these zones to help reduce emissions in disadvantaged neighbourhoods experiencing high rates of air pollution and respiratory illness. The Massachusetts Bay Transportation Authority operates the same BAE Systems electric drive propulsion technology to reduce emissions in its contained underground tunnels and neighbourhoods. Tourist areas in Nashville, Tennessee, and Brighton, UK, have also embraced the use of our GPS-enabled system to run buses on full electric power in high-traffic areas to achieve similar environmental aims.

As a world leader in electric propulsion for urban transit buses, we advanced our capabilities in 2020 when we delivered the first plug-in capable electric propulsion systems to Alexander Dennis Limited. Their new buses for Ireland will employ the Series-ER (Electric Range) systems, which build on our decades of innovation and proven technology on a globally-installed base of more than 13,000 buses. In addition to plugging into the grid for power, the Series-ER system can use the efficient onboard generator to charge itself while the bus is on the move, giving operators another way to recharge their buses and enabling the buses to run for up to five kilometres at a time with the engine turned off – a capability that provides towns and cities with another opportunity to improve air quality.

Shipyard sustainability

The team working on the Osborne shipyard in Australia, where the Hunter Class frigates will be built, has the ambition to create not only the most digitally advanced shipyard in the world, but also the most sustainable.

While BAE Systems has only recently started running the shipyard, our local partnerships are already being built around improving sustainability. Flinders University located at the Tonsley Innovation District in Adelaide is an academic partner on the project and helping to develop our workforce and new technologies for use on site.

It is an exciting chance to transform the sustainability of shipbuilding. We are exploring the range of technologies we can use including large-scale solar on the shipyard buildings. This would provide us with more electricity than we will need during the summer months, potentially allowing us to store energy for later re-use. Our collaboration partner is a leader in this field, having recently installed Australia's largest hydrogen electrolyser – the type of device we could power with our excess solar energy. We will also investigate opportunities to integrate resource circularity throughout our operations and ship build, and focus on integrating technological solutions to sustainability challenges across the lifecycle of the programme.

Physical prototyping work began in December 2020, so the team is mobilising to bring as many sustainable technologies online as possible in parallel, to align with steel cutting on the first Hunter Class Frigate in 2022.



Courtesy Australian Naval Infrastructure Pty Ltd

Synthetic training for pilots

We completed nearly 9,200 training events in UK synthetic pilot training facilities in 2020, representing nearly 13,000 hours. Performing this training virtually rather than in a real aircraft saved around 75 million litres of aviation fuel – equivalent to 184,000 tonnes of CO_2.

This approach provides clear operational and safety benefits as well as environmental benefits. Pilots are able to gain valuable experience by training in a hyper-realistic environment prior to flying in a real aircraft. This is particularly true for landing on an aircraft carrier, which is widely considered to be one of the most difficult flight manoeuvres a pilot can carry out. Before we developed the ability to accurately model the air flow dynamically between the aircraft and the carrier's complex deck, pilots had no lifelike way to train for this in advance of doing it for real.

Maritime Services

In our Maritime Services business we have been working to decarbonise our in-house facilities as well as our portfolio of products and services. Using COVID-19 as a catalyst to transform the way we work, we are adapting our office space and reducing commuting and business travel, whilst transitioning to on-site sustainable energy generation with intelligent energy management.

Working with our customers and supply chain, we are evolving our products and services to enable our collective ambition around increased sustainability and military operational advantage. By exploiting digital data, augmented reality and artificial intelligence, we are enabling intelligent asset management and operational efficiency while reducing resource usage. We are also introducing new technologies into our product lines to enable automation, utilise more sustainable materials and optimise system efficiency. In addition, we are transitioning to sustainable power generation through electric propulsion systems, alternative fuels and waste energy capture, storage and recycling.

Social

Safety and wellbeing

The safety and wellbeing of our employees is paramount. The global COVID-19 pandemic drove many of our safety and wellbeing initiatives in 2020, and will continue to do so in 2021, with a specific focus on ensuring employee safety for both those continuing to work on site and those working from home. Operationally, we did not meet our 2020 safety targets although we did marginally improve on 2019 major injuries recorded.

COVID-19 challenges

Throughout the pandemic, our priority has been, and continues to be, the health and wellbeing of our employees. In line with government and World Health Organization guidelines, and working alongside our trades unions and employee representatives, we introduced a number of measures to return employees safely back to work where their role could not be carried out from home. Measures included: return to work inductions outlining new working practices; additional hygiene measures and temperature checks; increased provision of PPE; introduction of physical distancing practices where possible which included reconfiguring our workplaces and practices such as elongated shift patterns to maintain output and staggered shift changes to improve personnel flows; capping the number of workers on site at any given time; and zoning systems to keep groups of workers together in bubbles. Through these and other measures, we reduced the risks of COVID-19 spread and preserved our ability to deliver a number of critical milestones for our customers.

We bolstered our IT network capacity and provided additional hardware and software so that employees who could carry out their roles at home could do so. To assist home-working, we developed guides to support employees in maintaining their safety, security, wellbeing and productivity whilst working effectively from home.

Employee wellbeing

Our wellbeing programmes support employees in balancing their work and personal responsibilities. It is important that we support our employees in navigating wider issues that they may face in their daily lives, especially throughout this unexpected and persistent COVID-19 pandemic. We extended the reach of our Employee Assistance Programme to cover our international locations and delivered a series of online resources, including wellbeing webinars for employees to attend virtually. In the US, the team also launched a Resilience Hub to offer physical, emotional, financial and mindfulness ideas and activities to encourage a healthy focus on total wellbeing.

Our Employee Assistance Programme provides assistance to employees across a range of issues, including mental and financial wellbeing. Assistance comes in the form of face-to-face and telephone counselling. We continue to promote mental health awareness programmes across the business, which this year included virtual wellbeing and resilience sessions to support employees during the pandemic. We have trained mental health first aiders and champions to support employees experiencing a mental health issue or emotional distress at work or whilst working from home.

Our safety programme

The nature of our manufacturing activities presents a range of risks. These include slips, trips and falls, work in confined spaces, machinery operation and working at height, amongst others. We monitor and aim to eliminate, mitigate and manage all risks. Our approach to identifying and assessing safety risks is embedded within our approach to risk management (see page 90).

We strive for world-class safety conditions and performance. Our management focus on this objective is necessarily strong and tailored towards achieving a world-class safety standard that is embedded in our Safety Policy. We have a number of programmes focused on the health, safety and wellbeing of our employees. We also ensure employees exposed to identified/known hazards have the protective equipment they need and we continually monitor our operations to ensure the working environment is as safe as possible.

Safety objectives

To ensure an improving safety culture and to incentivise leadership in this area, the Board continues to prioritise safety through the inclusion of a specific safety objective that is designed to be realistic, but stretching.

Performance against the safety element of the executive bonus is determined by the Corporate Responsibility Committee, taking account of the level of significant risk reduction and improvement in safety culture, as well as targeted improvements against key safety indicators, including a reduction in recordable accidents.

Line managers are incentivised to achieve the desired safety culture and additional personal objectives are identified through the Performance Development Review process.

Recordable Accident Rate (per 100,000 employees)[1]

BONUS KPI



Major injuries recorded[1]

BONUS



BONUS

3% of the UK executive directors' bonuses are based on the achievement of safety KPIs (see page 144).

We use the Recordable Accident Rate as a key performance indicator to assess workplace safety improvements. This metric, along with the number of major injuries and progress on culture and risk reduction, is used to determine an element of executive bonus.

During 2020, we did not meet the overall Recordable Accident Rate reduction target of 10%[2]. Several of our businesses did however meet or exceed the 10% reduction target. Our Air, Maritime and Land sectors exceeded the 10% target with the Air sector achieving a 25% reduction on 2019 numbers. The health and safety of our employees continues to be our highest priority and we continue to push for zero injuries across all of our businesses.

The portion of executive bonus associated with safety performance has been assigned accordingly with those achieving the targets receiving a payout commensurate with a strong performance and those who did not meet the target receiving zero. At Group level, a small part of the available award was made in 2020.

2021 priorities

During 2021, we will aim to:

- reduce the overall significant safety risk rating;
- build on the improvements seen in 2020;
- drive improvements in behavioural safety; and
- demonstrate improvements against key safety indicators.

1. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes and controls are in place to collate and validate this data.
2. We define recordable injuries in line with the US Occupational Health and Safety Administration reporting standard.

Human rights

We are committed to respecting and upholding human rights wherever we operate, in respect of activities under the full, direct control of the Company. This applies equally to our employees, our suppliers and business partners, all of whom are expected to adopt the same or similarly high standards of ethical behaviour. We are committed to conducting business responsibly and to maintaining and improving systems and processes to minimise the risk of slavery and human trafficking in our business or supply chain. Our human rights statement outlines our approach to responsible business behaviour, including in relation to anti-corruption, the environment, as well as our workplace, supply chain, local communities and products.

Our approach to human rights constitutes:

- maintaining high ethical standards and acting in a socially responsible manner in accordance with applicable laws;
- respecting and supporting the communities in which our businesses are located;
- maintaining and improving global policies and processes which relate to human rights wherever we operate, in respect of activities under the full, direct control of the Company;
- respecting the labour and workplace rights of our employees in accordance with national laws;
- responsible product development; and
- appointing and working with suppliers and business partners who are expected to adopt high standards of ethical behaviour and business conduct, consistent with our own, in accordance with applicable national laws.

Our Code of Conduct and other global policies and processes mandated under the Operational Framework, together with our supporting principles and guidance, support our commitment to human rights and are regularly reviewed. This results, for example, in due diligence being carried out during the supplier evaluation stage against non-financial risks.

We publish our response to the UK Modern Slavery Act and a statement in response to the California Transparency in Supply Chains Act on our website.

Our approach to identifying and assessing human rights risks is embedded within our approach to risk management (see page 90).

For more information on our human rights approach and statement visit baesystems.com/humanrights.

Social impact

We contribute to the economic prosperity of the places where our people live and work by supporting high value jobs in our business and in our supply chains and caring for and supporting our local communities.

We support jobs through direct employment, through the indirect impact of the employees employed as a result of our supply chains' spending and through those jobs supported by the consumer spending of our employees and of those in our supply chains.

We are a technology-driven company and are proud of the key role we play in the industrial capability of our principal markets. We collaborate with suppliers, SMEs and regional partners, including academic institutions to develop some of the most technically advanced defence, aerospace and security technologies. Working with our partners we are able to support and deliver technological know-how and the development of skills.

We invest in people, technologies and infrastructure across our sites to ensure we remain at the forefront of innovation. We focus on supporting STEM activities and enable social mobility through our investment in skills and apprenticeships.

People

Inspiring and enabling our people to fulfil their potential

Our ability to take on and solve some of our customers' most complex and demanding engineering and technology challenges – and to continue to deliver our customers' critical requirements through a year unlike any other – depends on the commitment, skill and talent of our people. We strive to create an inclusive, agile environment in which everyone can do their best work for our customers and feels valued for their contribution.

Our People strategy

Our People strategy sets out how we inspire and develop high-performing teams and individuals, able to fulfil their potential in inclusive and supportive working environments. Our People Policy lays the foundations, setting out our people management expectations, including in relation to diversity and inclusion, training and development, reward and employee engagement. Our Group Human Resources (HR) Director reports directly to the Chief Executive and chairs the Global HR Council, ensuring our People strategy supports the Integrated Business Plan and People Policy in order to meet the needs of our business and our customers.

During 2020, we maintained our focus on identifying, securing and developing the diverse range of skills and capabilities required to meet our customers' current and future needs.

Our business is dependent on our ability to recruit and retain a diverse workforce with the talent and skills to deliver excellence to our customers, including engineers, designers, software developers and project managers. We have identified this as a principal risk (see page 99) and we continue to take a range of actions to mitigate the risk.

In 2020, we further embedded strategic workforce planning to ensure that our Integrated Business Plan takes account of the people, skills, technology and facilities we will need to deliver our future plans. This foresight helped us to meet elevated recruitment requirements in some of our major markets in 2020, including surpassing 1,000 employees on the Hunter Class Frigate programme in Australia, and hiring over 500 more people in the UK than in the previous year. It is also enabling us to identify and fulfil requirements for key manufacturing, engineering and software engineering skills, and to proactively manage knowledge transfer ahead of forecast peaks in retirements. Robust strategic workforce planning and analysis were also instrumental in monitoring the impact of COVID-19 and supporting swift returns to productivity.

Our learning and development strategy is also key to building the skills and capabilities we will need to meet our customers' future needs. We support employees to fulfil their potential through career frameworks, face-to-face and virtual training and development programmes.

In 2020, for markets outside of BAE Systems, Inc., we launched a mobile learning app giving employees off-network access to a wide range of digital learning opportunities. As teams adapted to new ways of working in light of the pandemic, we were able to quickly offer line managers and employees anytime access to relevant guidance and support through the app, including how to inspire virtual teams and to maintain wellbeing.

In BAE Systems, Inc. we supported managers and employees through virtual learning activities including workshops on topics such as wellbeing and resilience, and resources to support leaders in maintaining engagement across their teams.



Developing highly-skilled people

FIRST® Robotics – partnering to inspire the next generation of innovators

For nearly three decades we have partnered with the non-profit organisation FIRST® to advance a shared mission: inspiring young people to become future science and technology leaders and innovators.

In 2020, BAE Systems was named a FIRST® strategic partner, joining a select number of companies recognised for their dedication to engaging students in science, technology, engineering, and mathematics. Our Electronic Systems business led the way in our early support of FIRST®, and since then engagement has expanded across our organisation in the US. Over the years, we have invested more than $9m in FIRST®'s youth robotics programmes, given thousands of hours through employee volunteering and mentorship, directly sponsored hundreds of robotics teams and granted a number of scholarships. Support of FIRST® teams has also grown internationally to include our business in Australia. This community partnership extends well beyond building robots by inspiring students to develop their collaboration, critical thinking and creativity skills – all of which are vital in developing our future workforce.

Movement to Work

In the UK, BAE Systems has supported Movement to Work – an employer-led initiative to tackle youth unemployment – since 2014 and has committed support until 2023. The initiative provides a pathway into employment or training for disadvantaged and unemployed young people through quality work experience and employability skills training. In our four-week face-to-face Movement to Work programme, young people spend two weeks at one of BAE Systems' facilities and experience an introduction to life at work, meet role models and develop their employability and teambuilding skills. In total, BAE Systems provided 620 placements for young people between 2014 and 2020. Typically, per annum we offer 30 permanent apprenticeship positions through Movement to Work and in 2019, 80% of young people who undertook a placement with us went on to gain employment with BAE Systems or another organisation, or pursued further education. Last year, BAE Systems did suspend its involvement in Movement to Work as a result of the pandemic but we relaunched the programme in our business in November 2020 on a virtual basis. We have also agreed to extend our support to the young unemployed in 2021 by taking on 30 young people through the UK government's Kickstart initiative.



Saudi National Advanced Apprenticeship Programme (SNAAP)

In a new model for education and business partnerships, SNAAP has been launched to support the Kingdom of Saudi Arabia achieve its Vision 2030 goals. The programme is the first of its kind in the Kingdom and trains Saudi national youth in project management principles and application so they can directly enter the labour market, including employment with BAE Systems Saudi Arabia. As part of their degree courses, students work in a project environment in our business and this experience helps to instil values, culture and standards in the way of working. SNAAP has been developed in strategic collaboration with Al-Faisal University and will deliver a sustainable source of future employment while addressing the problem of employee retention. It will also help to bring some diversity in age for management positions, bridging the current skill gap and transferring knowledge to the next generation of Saudis.

BAE Systems Maritime Australia apprentices and graduates

In 2020, BAE Systems Maritime Australia onboarded the first intake of 18 high school students in its plans to provide 1,000 early careers opportunities including apprentices, graduates and trainees for the multi-decade Hunter Class Frigate programme. The new employees are learning essential skills to build nine world-class ships for the Royal Australian Navy. The apprenticeship programme allows students to embark on training while still completing school and incorporates the steelwork, mechanical and electrical trades that will be central to ensure the right breadth and depth of skilled workers. By the time the nine anti-submarine warfare frigates are built, it is estimated that three-quarters of the programme workforce, including senior executives, will have started as graduates or apprentices. The students from the first intake were recruited from more than ten South Australian schools, as part of a regular and rolling intake of apprentices each year.

We are taking an increasingly collaborative and future-focused approach to talent management and succession planning. This has facilitated a purposeful balance of internal talent moves and external hires into key strategic leadership roles, to strengthen our leadership teams and further enhance our talent pipeline across our markets and sectors. Despite the challenges presented by the pandemic, many of our sectors achieved targets for cross-sector talent moves through the year, aimed at giving our future leaders broader and deeper experience of the organisation. For example, across BAE Systems, Inc. we achieved our targets to move or promote 20% of the successors to top roles, and to move or promote 20% of those employees identified as either female or people of colour in the talent pipeline.

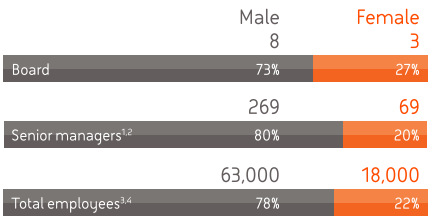
We continued to recruit throughout 2020, focusing on improving the efficiency and effectiveness of our recruitment processes, and enhancing the experience of our candidates and new employees. In the UK we have significantly reduced our internal time-to-hire processes and consolidated our induction and onboarding support to increase accessibility and agility. In the US, the rapid deployment of a virtual recruitment process enabled over 6,100 jobs to be filled in 2020, despite the impacts of the pandemic, with our offer acceptance rate increasing to 91% (up from 84% in 2019). Developing virtual onboarding processes also increased our flexibility, efficiency and effectiveness as many new starters began their employment working from their homes.

As the economic impact of the pandemic led to redundancies in other companies, we coordinated our response to outplacement providers to match people with our vacancies across the UK and Saudi Arabia. By the end of the year, we had processed more than 500 applications for employment through outplacement providers, resulting in more than 150 interviews and 60 people starting work with us. This work continues into 2021.

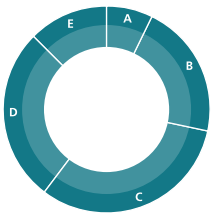
Gender pay gap

We have published our fourth annual gender pay gap report in line with UK regulations. For 2020, the average gender pay gap for our UK workforce was 9.1% (2019 10.3%) which is 6.4% lower than the current UK national average of 15.5%. We rely on employing large numbers of employees with STEM qualifications and we, like other companies, face challenges recruiting females with these qualifications because there are significantly fewer women who study and work in these fields. As a result, a greater proportion of our workforce and our senior leadership population is male and this is a major factor in our gender pay gap. We continue to work hard to improve our gender balance and remain steadfast in our commitment to delivering the plans we have in place to increase the number of women in BAE Systems and support the progression of women into senior executive positions.

Gender diversity



Age diversity[3,4]



A	24 years and younger	**6,000**
B	25–34 years	**17,000**
C	35–49 years	**26,000**
D	50–59 years	**22,000**
E	60 years and older	**10,000**

Through 2020 we intensified our focus on creating a diverse and inclusive environment in which colleagues from any background can fulfil their potential.

Our Company Behaviours, launched in 2019, build on our organisational strengths and focus us, individually and collectively, on the characteristics that will underpin our success into the future. They define the way we want to work – with each other and with our partners and customers – and are key to creating an inclusive culture in which everyone can thrive. During the pandemic, these Behaviours came to the fore. Qualities such as adaptability, creativity, collaboration and integrity enabled us to meet unprecedented challenges.

During 2020, we have further embedded our Behaviours in our performance management, talent management, recruitment and reward processes as we continue to measure, recognise and reward not just what our people achieve but also how they achieve it.

Our line managers across the world play a key role in inspiring individuals and teams to perform at their best and support them in this ongoing priority. In 2020 we launched a comprehensive new line manager development programme which is being rolled out across our markets outside of the US. This programme and its established equivalents in our US business, help set the specific standards expected of line managers at BAE Systems, supporting them in role-modelling our Company Behaviours to enhance engagement and performance.

Increasing the diversity of our workforce and building diversity and inclusion into our processes, practices, policies, systems and training remains an area of strategic focus for the organisation. We have clear, common objectives focused on attracting and retaining a diverse workforce that reflects market availability at all levels of the organisation, and advancing an inclusive workplace where employees feel that their differences are valued.

Our leaders are held accountable for progress against these objectives through targets, measured through robust data analysis of the demographic profile of our workforce. We are working with our employees to obtain data to help us to build a rich picture of our diversity today and set meaningful targets and improvement plans.

In line with our diversity targets for 2020, we increased female representation across our global workforce by 0.5%. In Saudi Arabia, we met our target to increase female representation in the workforce and launched our two-year fast-track development programme for women, preparing them for senior roles and supporting the country's Vision 2030. Additionally, BAE Systems, Inc. met its goal to increase representation of both women and people of colour at leadership levels.

Attracting and bringing on board candidates from a diverse range of backgrounds and experiences is a key focus of our recruitment practices. In 2020 we launched additional diversity training for recruiting managers in the UK and realigned our recruitment suppliers' objectives to increase their focus on identifying diverse talent. We also enhanced our early careers selection process to ensure it opens opportunities to applications from all groups, including those from disadvantaged backgrounds. Through our ongoing commitment to the Movement to Work programme in the UK we provide a pathway into employment or training for disadvantaged and unemployed young people through quality work experience (see page 45). Having also welcomed apprentices made redundant from other organisations as a result of the pandemic in 2020, we are extending our support to the young unemployed in 2021 by taking on 30 young people through the UK government's Kickstart initiative.

Our award-winning apprenticeship and graduate programmes bring new talent into our business and help individuals develop foundational skills for a rewarding career. In the 2020 cycle we recruited around 750 apprentices and nearly 180 graduates into our UK businesses – one of our highest intakes in recent years. We have just over 420 graduate scheme members in the UK and 63 undergraduate students on a 12-month industrial placement.

In 2020, 40% of our global hires (almost 3,700 positions) were into Science, Technology, Engineering and Maths (STEM) roles.

1. Senior managers are defined as employees (excluding executive directors) who have responsibility for planning, directing or controlling the activities of the Group or a strategically significant part of the Group and/or who are directors of subsidiary companies.
2. Excludes executive directors.
3. Excluding share of equity accounted investments and rounded to the nearest thousand employees.
4. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes and controls are in place to collate and validate this data.

Trades unions/labour unions

We seek to maintain constructive relationships with trades unions in Australia and the UK and labour unions in the US, providing a foundation for a positive and productive working environment. Of our UK workforce, 69% are covered by collective bargaining agreements and approximately 55% of the UK workforce are trades union members. In the US approximately 10.5% of the workforce is covered by a collective bargaining agreement; in Australia this number is approximately 20% of the workforce. In the UK, participation and engagement is positive, open and constructive. The main organisations are involved in regular meetings with Company representatives from the Chief Executive to local business leaders, through our Corporate Trade Union Constitution. In our response to the COVID-19 pandemic, these strong relationships enabled us to work swiftly and effectively with employee representatives to devise, implement and evolve new, COVID-19-safe practices and systems of work on our sites to help keep our people safe and maintain productivity on critical programmes.

To help address the STEM skills shortage and increase the diversity of the pipeline of STEM talent in our major markets, we continue our long-term commitment to engage children and young adults in STEM subjects and careers. While opportunities to engage with young people face-to-face, at events and in schools, were reduced in 2020 due to the pandemic, we adapted and found creative ways to engage young people: in the UK, our home-learning resources were accessed by just under 9,000 individuals and our virtual participation in the Big Bang Digital and WorldSkills events reached tens of thousands of students.

In the US, we continue to sponsor championship events with FIRST® Robotics, engaging young people in exciting, mentor-based programmes that build STEM skills, inspire innovation and develop communication and leadership skills.

Throughout 2020 our leaders have been visible and active in their support of diversity themes, initiatives and events, embedding inclusive leadership as an everyday habit for themselves and among their teams.

In the UK we ran our first Inclusion Week, inviting all employees to take part in a range of virtual events and discussions with our leaders, to explore others' experiences and perspectives and understand how we can all build greater inclusion. In the US, the BAE Systems, Inc. senior leadership team participated in VITAL (Valuing Inclusion Through Adaptive Leadership), an immersive development programme designed to enhance cultural competence and build skills to lead inclusive work environments. During 2020, our US businesses also facilitated Courageous Conversations for senior leaders and over 1,000 employees to have honest dialogue about race in the workplace.

In 2020 we broadened and strengthened a number of our Employee Resource Groups (ERGs), which play a vital role in fostering a diverse and inclusive workplace. Our ERGs include: Gender (UK, US, Saudi Arabia and Australia); Veterans (UK, US); Disability (UK, US and Saudi Arabia); Race (UK, US); LGBTQ+ (UK, US); as well as Hispanic/Latino, Black/African American and Asian/Pacific Islanders; and inter-generational ERGs in the US. Over 8,700 employees across our geographically diverse enterprise have signed up to be a member of one of our ERGs.

In response to heightened tensions regarding racial injustice in the US in 2020, BAE Systems, Inc. launched CARE: Colleagues Advancing Racial Equity, bringing together a diverse group of over 130 employees to recommend actions to increase diversity and inclusion in the business.

To help create an inclusive and supportive environment in which employees can balance their work commitments and personal priorities, we have a range of policies including Maternity, Paternity, Adoption and Shared Parental Leave policies, agile and flexible working practices and career breaks. As we look to sustain the benefits of the agility and flexibility our teams have demonstrated over the course of the pandemic – opening up the possibilities for new ways of working and broader talent pools less bound by geography – we have developed guidance to help our people adopt effective hybrid working across different locations.

Keeping our people connected, informed and engaged has never been more important as employees in all of our markets experienced unprecedented impact on their personal circumstances and ways of working through the pandemic. We used a range of channels to make sure our people had access to the information and support they needed throughout the year, as well as keeping employees informed about the performance, developments and prospects of the business. This included engagement through our intranet, employee app, email, videos, podcasts, newsletters, leadership communications, virtual discussions and briefings, and through our line managers who played a key role in keeping their teams connected and engaged. We continue to focus on two-way communications, ensuring we have channels through which employees can express their views, feedback and any concerns, helping us understand employee sentiment on an ongoing basis and respond appropriately.

We provide our employees with competitive reward packages which reflect their individual responsibilities and contribution to business performance and we recognise individual and team successes through a variety of financial and non-financial recognition schemes across the organisation. We also offer post-employment benefits aligned to competitive practice in each relevant home market. We encourage employees to become shareholders in BAE Systems and, where appropriate, offer share schemes to support this.

2021 priorities

During 2021, we will aim to:

- support business objectives by maintaining a robust pipeline of talent and critical skills to fulfil our customers' future requirements, through ongoing focus on strategic workforce planning, training, development, performance management and succession planning;
- embed the benefits of new ways of working adopted in 2020, including increased flexible and hybrid working where appropriate;
- leverage technology to enhance our employees' experiences, empowering them with greater access to information, benefits and opportunities;
- evolve organisational design to improve efficiency and effectiveness and facilitate greater collaboration;
- increase the diversity of our workforce and continue to build diversity and inclusion into our processes, practices, policies, systems and training;
- continue to build a high-performing culture focused on demonstrating our Company Behaviours and delivering our shared strategic objectives; and
- embed practices to gather quantitative and qualitative insight into employee sentiment across the Group.

Social continued

Supporting families in need in Saudi Arabia

Many people have been negatively impacted by COVID-19, and found themselves in need of help. Within our business in Saudi Arabia, we worked with seven charitable organisations to support families in need during the month of Ramadan. Some 1,100 families across seven cities were given care packages with basic essential products to support their health and wellbeing during the holy month. The initiative was part of our work with the Ministry of Human Resources and Social Development.

At the same time, our team in the Kingdom of Saudi Arabia worked with the Ministry of Health to support the production of an animated video targeted at children aged four to eight years old, outlining how they could protect themselves against the COVID-19 virus.

Supplying PPE at volume to healthcare providers and creating a new ventilator

In March it was clear that UK industry had to step up to the challenge facing the country and play its role. The most critical areas where we could help were in providing PPE to healthcare providers and helping create new ventilators quickly, in response to the government's ventilator challenge.

A call from a local doctor to our site in Barrow alerted us to the PPE shortage. We immediately began both designing our own PPE we could manufacture in-house as well as contacting our suppliers to rapidly scale up production. Within 24 hours our first in-house produced face shield was with the GP and we had quotes from suppliers for thousands more. Between late March and mid-May we supplied more than 150,000 face shields to over 250 individual healthcare providers across the UK. Our employees helped identify the greatest need in their communities so we could direct our efforts.

Simultaneously, our teams in Portsmouth, Guildford, Hillend near Edinburgh and Lancashire worked tirelessly to design, produce and start regulatory approval of a brand new ventilator in three weeks – a process that usually takes years. While the ventilators were ultimately not required, it was a profound experience for our people to do their part.

Supporting OzHarvest

BAE Systems supported OzHarvest in Australia as they experienced an increased demand for their services in the wake of the COVID-19 pandemic. This demand came on the back of additional need following the bushfires and droughts which had impacted the country earlier in the year.

OzHarvest is a national charity that collects quality excess food from commercial outlets and delivers it directly to more than 1,300 charities and schools in an effort to help eliminate hunger. With a donation from BAE Systems together with employee fundraising, our support enabled the charity to provide an additional 100,000 meals to vulnerable Australians, many of whom are located in our local communities.



PPE Rapid Response in the US

In the early days of the pandemic, employees of Platforms & Services (US) joined together to offer rapid support for frontline responders, to include a rush delivery of more than 3,000 Tyvek coverall suits to safeguard healthcare workers in New York City, and a donation of six pallets of disposable gloves, gowns, hand sanitiser, masks, safety glasses, and toilet paper to a hospital in York, Pennsylvania.

When it became clear there was a critical shortage of face shields in hospitals, Electronic Systems' additive manufacturing team responded by rapidly exploring how to use its in-house 3D printing capabilities to make frames for face shields. The team sourced the frames in partnership with strategic suppliers and collaborated with colleagues in Platforms & Services for extra production support. More than 7,000 face shield frames were shipped to local healthcare organisations in New Hampshire, Massachusetts, Alabama, New York, Indiana, California, New Jersey and Virginia, and they were shipped with extra clear shields to allow them to be used for about 70,000 shield assemblies over time.





Supporting our stakeholders during COVID-19

Supporting our local communities





Australian bushfires

When the bushfires in Australia devastated more than 11 million hectares of land at the end of 2019 and early 2020, BAE Systems stepped up to support with donations valued at more than A$250,000. It was truly inspiring to see the response of our people not only from Australia, but across the globe. Employees came together to highlight the impact of the bushfires and supported with fundraising events and personal donations, which BAE Systems matched alongside a Company contribution. In addition, many of our people were deployed with the Australian Defence Force Reserves to support clean-up efforts. Whilst the impact of the bushfires is still felt long after they have been put out, coming together at a time of national crisis instilled a real sense of pride into our employees.





All images courtesy of the CFS Foundation.

Be the Business

Working with Be the Business in the UK on their successful Productivity through People initiative has been something BAE Systems has been proud to support for a number of years. Supporting at a national level over the last four years, our backing has contributed to the development of the academic content of a training course and provided expertise and coaching for delegates. The initiative is now being delivered at scale across the UK in multiple regions and across multiple sectors. During 2020, in addition to our financial contribution, some 116 of our employees got involved by providing more than 700 hours of mentoring for 152 small- and medium-sized enterprises. Whilst this clearly has a positive impact on the delegates and their businesses, by mentoring individuals, our employees not only provide practical tools to assist them, but in return they gain invaluable personal development from the initiative.

University Collaboration Programme

One of the leading national programmes created by BAE Systems and its partner companies in the Kingdom of Saudi Arabia is the University Collaboration Programme. Working with six Saudi universities, the programme supports the Saudi Vision 2030, focusing on supporting education for male and female students. The unique programme encompasses specialised lectures in the fields of engineering, administration, IT, safety and the environment. Training opportunities have also been a successful element of the partnership, where students have been invited to spend time with employees at our Saudi headquarters.

Engaging in this programme enables us to demonstrate our commitment to supporting development opportunities for young people in the Kingdom as they consider their future in the labour market.

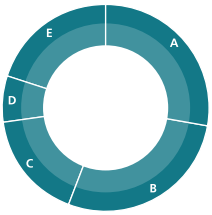
Warrior Integration Program welcomes US combat veterans

Our focus on creating a diverse and inclusive environment in which colleagues from any background can fulfil their potential is demonstrated by our Warrior Integration Program.

The three-year rotational programme taps into the rich talent of US military veterans and is designed to enhance the integration of post-9/11 combat veterans into BAE Systems. The programme provides US military veterans with a meaningful, challenging and rewarding future, and incorporates extensive mentorship aspects to enhance the warriors' transition to civilian life and to support the translation of their military job skills and leadership capabilities into corporate opportunities and careers. This growing programme is serving veterans of the US Army, Air Force, Navy and Marine Corps who are working at our sites in New Hampshire, Alabama and Texas.

We are proud to welcome combat-wounded, injured, or ill service members through the Warrior Integration Program to provide a clear and supported path for these veterans to seamlessly transfer their military experience to advance and achieve our BAE Systems mission.

Community investment by type[1]



A	Customer	**28%**
B	Education	**28%**
C	Community	**17%**
D	Heritage	**7%**
E	Other	**20%**

Fostering strong community partnerships

It is important to us to support the local communities in which we operate through charitable donations and sponsorships.

During 2020 the Group contributed £10m[1] to local, national and international charities and not-for-profit organisations through our community investment programmes. This includes charitable sponsorships, donations, employee fundraising and volunteering. In addition, £1.5m was directed to a charitable foundation supporting our US Employee Relief Fund to support those affected by the COVID-19 pandemic.

Our impact

We collaborate with organisations that can demonstrate a positive impact and encourage our employees to volunteer in support of their work. These include not-for-profit organisations and education providers.

In 2020 we aided organisations and initiatives in support of the COVID-19 response. We were able to react to the unfolding situation and apply our contributions where possible to the communities where we are based to enable greater social impact.

Our employees volunteered, fundraised and donated throughout the year, in support of our established and new emerging charity partners, alongside the donations and support provided by the Company. We worked with charity partners to expand the criteria of our funding where possible and provide greater flexibility to the charities whilst they navigated the challenging environment created by the COVID-19 pandemic.

1. Deloitte LLP has provided limited assurance on the total value of community investment programme donations.

We use the B4SI Framework methodology to define the value of our support and its impact on our community partners, in comparison with our peers and other organisations. Our reporting data is externally assured every year. All community investment-related expenditure and any associated employee fundraising is reported through an online system and validated by an external assurance provider.

As well as donations, sponsorship and employee fundraising, we develop and support structured education programmes and enable our employees to volunteer their skills and time. Volunteering remains an important part of our employees' career journey and can be pursued as a personal development goal. We actively seek partnerships where our employees can be involved and show their support. In Saudi Arabia and the UK our education ambassadors have offered their time to encourage school-age children to pursue STEM subjects and careers. In the UK in 2020 we saw an increase in employees providing mentoring to SMEs and individuals seeking career support.

We have strong ties with armed forces charities across a number of our markets, and an important strand of our strategy is support for organisations that assist active service personnel, veterans and their families. In Australia we partner with Soldier On to support the health, wellbeing and employment of Australia's returned service personnel and their families. In the UK we are supporting Team Invictus UK on their journey to the Invictus Games The Hague 2020 (subsequently postponed due to COVID-19), a partnership which has enabled a number of employees to be directly involved through volunteering. In the US we partner with The Mission Continues, which empowers veterans to continue their service in transformative ways within their communities and supports their transition to new careers that draw upon their military service.

Based on local practices, we apply matched funding within our established focus areas and offer volunteering opportunities, including virtual options, to encourage our employees to support our charitable partners and communities in alignment with our Global Community Investment Strategy and guidelines.

Our communications team also supports our community investment efforts by raising awareness and promoting projects and employee engagement in our communities.

Partnering on education in the supply chain

It is important to us that we work with our suppliers to deliver aspects of our sustainability agenda. A key area of focus is the development and education of the current and future workforce. In the UK, we encourage our suppliers to be involved with apprenticeship schemes and other career development programmes. We take a leadership role in the development of new apprenticeship standards crucial to employers and chair both the Aerospace & Airworthiness, and Maritime Defence Trailblazer Groups. These groups involve other employers and supply chain employers in our sector, both large and small, as well as professional engineering institutions, awarding organisations and the Civil Aviation Authority.

Our approach

Our approach, aligned to our Community Investment Policy, aims to build and nurture mutually beneficial relationships between our business, our people and local stakeholders. We partner with organisations on initiatives that have meaning and impact to our business and employees.

We have key criteria, where measurable impact can be demonstrated, and these are:

- Armed forces – supporting active service personnel, veterans and their families;
- Education and skills – inspiring young people to consider STEM subjects and careers; and
- Local community – working to support the communities in which we operate.

Our community investment programme is governed by an overarching global strategy, and supported by market-level programmes. This approach allows markets to ensure their programme is relevant to their lines of business, charitable needs, culture and local communities, whilst being aligned to the overall Group approach.

Our policy does not allow payments to third-party fundraisers nor directly to individuals, and is focused on ensuring the charitable organisation receives funding directly.

To avoid the risk of conflicts of interest, any community investment activity is tested against the principle that it does not place, or does not appear to place, actual or potential customers, suppliers or government officials under any obligations.

We have a Global Community Investment Committee which governs our approach, and there is a robust process (through our Operational Framework) in place to approve requests for community investment spend. This Committee reports to the Executive Committee on all community investment activities, including employee fundraising activities.

2021 priorities

During 2021, we will continue to focus on supporting the armed forces through established and new partnerships, and we will drive engagement with young people through our education programmes. Building on the support we provided during 2020 in relation to COVID-19, and recognising the changing landscape in our communities going forward, we will focus on identifying initiatives with greater social impact in our local communities. We will also look for opportunities to provide more in-kind support with knowledge, skills and expertise to our partners and demonstrate greater value to the wider community.

Sustainability

Governance

Governance and business conduct

Our success depends on us being trusted by all our stakeholders to uphold high standards of governance and business conduct. Robust governance remains at the core of our business as detailed in the Governance section on page 102 and underpins the sustainability of the business. Our Operational Framework sets out our approach and the policies, processes and standards to which we adhere and apply everywhere we operate, more detail of which is set out on page 102. Our approach to risk management, including our principal risks, is covered on page 90.

Our policies, processes and due diligence along with our Code of Conduct and Supplier Principles – Guidance for Responsible Business cover all aspects of our sustainability agenda and outline expectations for employees and business partners.

Anti-corruption programme

Each employee has a vital role to play in ensuring that we maintain the high standards of ethical conduct that our customers, shareholders, partners and colleagues expect. BAE Systems has a zero tolerance policy regarding corruption in all its forms.

Our anti-corruption programme is designed to ensure adherence to the relevant legal and regulatory requirements recognising the bribery and corruption risks faced by the Company. Clear policies and principles inform our business decisions and provide our employees with practical guidance. It also helps employees to understand what is expected of them and to create an environment in which employees feel they can ask questions and raise issues and concerns.

We continually check and test the effectiveness of our programme receiving both internal and external oversight and assurance, including encouraging feedback internally from our employees and externally from independent third parties. Risk-based due diligence procedures have been implemented to address bribery, corruption and other financial and non-financial risk, and our policies include processes for risk-based internal and external approvals, ongoing monitoring and repeat due diligence.

We drive improvements in the programme annually to ensure it continues to meet best practice. The programme also includes our Code of Conduct and training which covers scenarios our employees may face, defines the standards and behaviours we aspire to every day and gives guidance on where to go for further advice.

For the principal risks relating to compliance with anti-bribery and anti-corruption regulations and how the risk is mitigated, see the laws and regulations risk description on page 98.

Employee ethics programme

During 2020, we updated our Code of Conduct to include changes to our internal processes and policies and incorporate external best practice. The Code will be rolled out across our business during early 2021.

All employees are required to complete training annually. During 2020, with the backdrop of COVID-19, we adapted our ethics training, Scenarios for Team Discussions, to be fully accessible online to address employees working remotely or working under different conditions at Company locations. Managers and employees across the business could download ethical scenarios to discuss during virtual or socially distanced team meetings.

97% of our employees completed this training, with the majority of those who did not complete being employees on secondment, maternity leave, sick leave or other long-term absence. These employees will complete the training in due course on their return to the business.

Anti-corruption programme

Our anti-corruption programme is embedded in our Operational Framework, through key policies and processes below, including due diligence:

- **Advisers Policy** – which governs the appointment, management and payment of third parties who are engaged to assist with our sales and marketing activities or the strategic development of the Group;
- **Gifts and Hospitality Policy** – which governs the offering, giving or receiving of gifts or hospitality;
- **Conflict of Interest Policy** – designed to ensure that personal conflicts of interest do not impair employees' judgement and damage the Group's integrity and interests; and
- **Facilitation Payments Policy** – designed to ensure that facilitation payments are not paid and that the Group and its employees seek to eliminate the practice of facilitation payments.

Other policies include: Community Investment Policy; Finance Policy; Fraud Prevention Policy; Export Control Policy; Lobbying, Political Donations and Other Political Activity Policy; Offset Policy; and Procurement Policy, which include measures to address bribery and corruption risks.

The anti-corruption programme guides and supports our employees in making responsible decisions.

Governance continued

Total ethics enquiries[1]

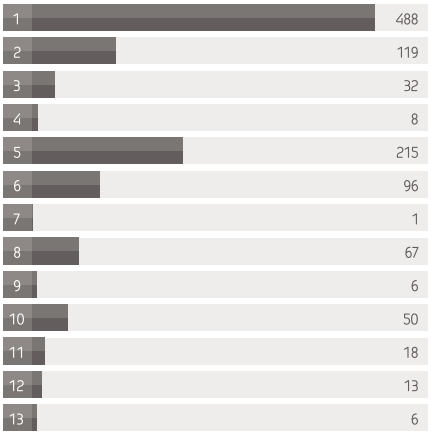


Anonymity rate

32%

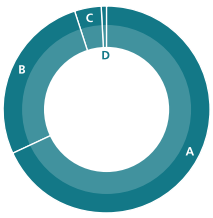
(2019 35%)

2020 ethics enquiries by type[1,2]



1	Enquiries that led to guidance and advice
Enquiries that led to investigations	
2	Accounting charge practices
3	Anti-corruption
4	Data, technology and trade controls
5	Employee conduct
6	Employee relations
7	Financial misconduct
8	Management practices
9	Policy, process and trading
10	Safety, health and environment
11	Sales, manufacturing and delivery
12	Security and misuse of assets
13	Supplier and procurement

2020 ethics enquiries by region



A	US	**763**
B	UK	**302**
C	Saudi Arabia	**45**
D	Australia	**9**

We collect data on ethics enquiries and dismissals for reasons relating to unethical behaviour.

During 2020, we received 1,119 enquiries, a decrease of 21.8% compared to 2019. This downward trend is attributed to the change in working patterns as a result of COVID-19. For example, working from home means people are less likely to observe poor behaviour in co-workers.

Of the 1,119 enquiries received, 631 (56%) required investigation, 34% of which were substantiated. The top five categories for investigation were: employee conduct; accounting practices; management practices; Safety, Health and Environment; and anti-corruption. Of the 631 investigations for 2020, 537 were closed and 94 remain open. These will be closed out during 2021.

Six ethics enquiries were received about our suppliers. Four required investigation, of which one was substantiated and three are ongoing investigations.

68.2% of ethics enquiries came from the US. The number of ethics reports varies by region. Factors influencing this include the number of individuals working in that region and the cultural propensity of individuals from that region to utilise Speak Up mechanisms.

We value openness, and strive to create a culture where people feel they can speak up freely. We measure this with two main metrics – anonymity rate and contacts made directly to one of our 207 Ethics Officers (one for every 386 employees) across our business. When someone decides to remain anonymous, it tells us that there may be a fear of retaliation. In 2020 our anonymity rate was 32% – down 3% from 2019, and well below the benchmark rate of 59%[3].

45% of reports were made directly to Ethics Officers in 2020 – we particularly encourage this route for making reports, as it allows for an immediate response by someone familiar with the local situation.

Dismissals for reasons relating to unethical behaviour[1]



In 2020, 236 employees were dismissed for breaches of the Code, an 8% decrease from 2019.

Our Code of Conduct training actively encourages all employees to speak up if they have a concern or talk to someone if they need guidance. We recommend employees talk to a colleague, their manager, HR or a Legal contact. We also actively promote our Ethics Officers and Ethics Helpline across our businesses, which means employees can raise issues or seek guidance in person and in confidence.

Improving industry standards

We play our part in supporting others too. We set an example for business partners and seek to help improve standards across our industry. The Company takes a proactive leadership role in its engagement with the defence industry, governments, NGOs and other interested parties to develop initiatives that will address the key ethical issues affecting the defence industry.

Examples of this include taking leadership positions on our industry body for ethics, the International Forum on Business Ethical Conduct (IFBEC) and in the US the Defense Industry Initiative (DII). We also regularly interact and support the Institute of Business Ethics (IBE) and Ethics & Compliance Institute (ECI), and are proactive members of both the Aerospace and Defence Industries Association of Europe and the Aerospace, Defence, Security and Space trade associations. Recent projects that we have collaborated on are the development of the IFBEC Model Supplier Code, supporting the IBE in its upcoming Training Good Practice Guide and developing the DII small business tool kit and supplier code of conduct.

1. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes and controls are in place to collate and validate this data.
2. We have updated our ethics enquiry reporting categories internally to reflect trends in reporting and to achieve greater commonality in reporting categories across the business.
3. Navex 2020 anonymity benchmark.

Customers' requirements and expectations

The defence industry is subject to strict regulatory controls. We maintain stringent internal controls that govern what we sell and to whom. Our Product Trading Policy and Responsible Trading Principles help us to make informed decisions about the business opportunities we pursue in accordance with our values.

Export of controlled goods and technology must be authorised in advance by governments. Failure to comply with all applicable laws and regulations could result in serious penalties for BAE Systems and the individuals concerned and could harm national security and foreign policy interests. Our Export Control Policy and Procedures are designed to comply with applicable laws and regulations, as well as to detect and provide timely responses to actual or potential violations, including prompt investigations and appropriate remedial actions.

2021 priorities

During 2021, we will aim to:

- launch our updated Code of Conduct and roll-out supporting employee training.

For more information on our anti-corruption programme visit baesystems.com/ethicsandanti-corruption.

Responsible supply chain

We create best-in-class products and services through extensive collaboration spending more than £11bn with more than 21,000 directly contracted suppliers worldwide. These relationships are usually long-lasting due to the complex nature of our products and their long lifecycles.

Governance of our supply chain

It is important that we work with suppliers who share our values and who embrace standards of ethical behaviours consistent with our own. In order to do business ethically, how our third parties behave is of the utmost importance. Our supply chain management and Supplier Principles – Guidance for Responsible Business (the Supplier Principles) are focused on high achievement of our standards.

Risk-based due diligence is undertaken for all third parties with whom we engage, whether supplier, adviser, potential joint venture partner, acquisition opportunity or other third party. Where required, this may include establishing the identity of the third party in terms of beneficial ownership and gathering of sufficient information to assess relevant bribery and corruption risks. At the contracting stage we ensure that contracts contain appropriate anti-corruption and anti-bribery provisions and stipulate the expectation to comply with our standards on ethical business conduct, compliance, Supplier Principles, safety, environment and human rights.

Once a supplier has been approved and a contract has been signed, we continue to actively manage and monitor that supplier throughout the life of their contract. This includes managing any significant changes in our relationship with the supplier as well as ongoing risk-based due diligence.

To clarify what we expect from our suppliers and their supply chains we have developed the Supplier Principles, which reflect the standards we set for our suppliers. During 2020 we commenced a review of our Supplier Principles. In 2021 that review will be concluded to further strengthen our sustainability agenda.

The Supplier Principles expect compliance with all relevant national and international laws and set out best practice guidance in relation to matters such as anti-corruption behaviours, environmental issues, responsible payment, conflict minerals and how employees are treated.

We use the Supplier Principles as part of a risk management framework to assess new suppliers. They are also used as an integral part of our supplier evaluation, selection and approval processes.

During 2020, we undertook supply chain assurance activity to assess compliance with our Supplier Principles. Our assessments covered 20% of global spend. 14 low-level risks were identified and resolved. We also continued to collaborate with suppliers during these unprecedented times to facilitate best practice sharing and champion the sustainability agenda.

Supporting our supply chain during COVID-19

Our supply chains are the critical links which make much of what we do possible. During 2020, our activities focused on responding to pandemic-related disruption by reinforcing supply chain resilience and sharing best practices across our business and supply chain (where feasible). In 2020, in response to COVID-19, we provided £151m of financial support, by way of early or advance payments, to around 200 suppliers across the Group.

In 2020, in response to the global pandemic and to further strengthen our supply chain resilience, we identified suppliers globally that were critical to programme delivery. These were defined as suppliers that are required in direct support of business critical activities, either on site or off site and for both goods and services. We engaged critical suppliers and carried out financial assessments to ensure continuity of supply and to understand the impacts of COVID-19 on their business and supplying our programmes. We worked closely with our supply chains to mitigate disruptions where possible and maintain resilience, in some cases advancing payments where required.

We continued to support our supply chain and have seen a £102m increase in spend with our suppliers in the first half of 2020 compared with 2019.

We continue to monitor local operational situations with particular focus on our supply chains as we manage fragility in certain areas.

2021 priorities

During 2021, we will aim to:

- develop a Sustainable Procurement Charter which sets out our responsible environmental, social and economic procurement principles;
- continue to extend coverage of Supplier Principles assurance; and
- continue to assess our business partners and suppliers on the adoption of our Supplier Principles.

Our UK Modern Slavery Act and California Transparency in Supply Chain Act statements can be viewed at: baesystems.com.

Group financial review

We monitor the underlying financial performance of the Group using the alternative performance measures defined on page 20. These measures are not defined in IFRS[1] and, therefore, are considered to be non-GAAP[2] measures. Accordingly, the relevant IFRS[1] measures are also presented where appropriate.



Brad Greve
Group Finance Director

1. International Financial Reporting Standards.
2. Generally Accepted Accounting Principles.

Financial performance

Measures as defined by the Group

Sales
KPI

£20,862m
(2019 £20,109m)

Underlying EBITA
KPI

£2,132m
(2019 £2,117m)

Underlying earnings per share[2]
BONUS KPI

46.8p
(2019 45.8p)
Excluding one-off tax benefit

(2019 50.8p)
Including one-off tax benefit

Free cash flow
KPI

£1,367m
Before £1bn UK pension scheme contribution
(2019 £850m)

£367m
After £1bn UK pension scheme contribution

Net debt
BONUS KPI

£(2,718)m
(2019 £(743)m)

Order intake[3]
BONUS KPI

£20,915m
(2019 £18,447m)

Order backlog[3]

£45.2bn
(2019 £45.4bn)

Measures defined in IFRS[1]

Revenue

£19,277m
(2019 £18,305m)

Operating profit

£1,930m
(2019 £1,899m)

Basic earnings per share

40.7p
(2019 46.4p)

Net cash flow from operating activities

£1,166m
(2019 £1,597m)

Order book

£36.3bn
(2019 £37.2bn)

KPI References to Key Performance Indicators (KPIs) throughout the Annual Report.

BONUS 75% of the UK executive directors' bonuses are based on the achievement of financial KPIs (see page 144).

Page 20
Alternative performance measure definitions

1. International Financial Reporting Standards.
2. The one-off tax benefit in 2019 is described on page 59.
3. Including share of equity accounted investments.

Group financial review
continued

Income statement

Sales increased by £0.8bn to £20.9bn (2019 £20.1bn), a 4% increase on a constant currency basis[1].

Underlying EBITA increased to £2,132m (2019 £2,117m), giving a return on sales[2] 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.

Income statement

Financial performance measures as defined by the Group		2020 £m	2019 £m
Sales	KPI	**20,862**	20,109
Underlying EBITA	KPI	**2,132**	2,117
Return on sales[2]		**10.2%**	10.5%

Financial performance measures defined in IFRS[3]	£m	£m
Revenue	**19,277**	18,305
Operating profit	**1,930**	1,899
Return on revenue[4]	**10.0%**	10.4%

Reconciliation of sales to revenue		£m	£m
Sales	KPI	**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	KPI	**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 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

Average	2020	2019
£/$	**1.283**	1.277
£/€	**1.125**	1.141
£/A$	**1.862**	1.836

Sensitivity analysis

Estimated impact on sales of a ten cent movement in the average exchange rate	£m
$	**700**
€	**100**
A$	**40**

1. Current year compared with prior year translated at current year exchange rates.
2. Underlying EBITA as percentage of Sales.
3. International Financial Reporting Standards.
4. Operating profit as 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.

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 6 to the Group accounts on page 203.

Earnings per share

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

Order intake[3] increased by £2.5bn to £20,915m (2019 £18,447m). Our US-managed businesses had a book-to-bill[4] ratio of more than one.

Order backlog[3] decreased by £0.2bn to £45.2bn.

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

Earnings per share

Financial performance measures as defined by the Group		2020	2019
Underlying earnings (excluding the 2019 one-off tax benefit)		**£1,493m**	£1,457m
Underlying earnings per share (excluding the 2019 one-off tax benefit)	KPI	**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 IFRS[1]		
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)[2]	**(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

Orders

Financial performance measures as defined by the Group		2020	2019
Order intake[3]	KPI	**£20,915m**	£18,447m
Order backlog[3]		**£45.2bn**	£45.4bn

Financial performance measures defined in IFRS[1]		
Order book	**£36.3bn**	£37.2bn

1. International Financial Reporting Standards.
2. 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.
3. Including share of equity accounted investments.
4. Ratio of Order intake to Sales.

Group financial review
continued

Cash flow

Free cash flow[1] 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.

Cash flow

Financial performance measures as defined by the Group		2020 £m	2019 £m
Free cash flow[1]	KPI	**367**	850
Financial performance measures defined in IFRS[2]		**£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	KPI	**367**	850
Add back Interest paid, net of interest received		**208**	205
Add back Taxation		**251**	252
Operating business cash flow[3]	KPI	**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	KPI	**(2,718)**	(743)

Pages 244 and 246
Notes 27 and 29 to the Group accounts

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.
2. International Financial Reporting Standards.
3. 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.

Balance sheet

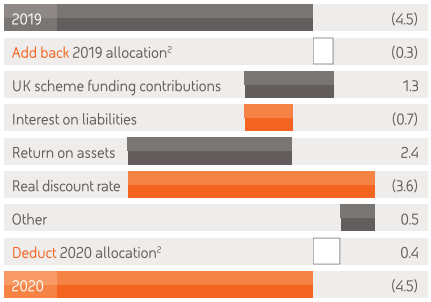
Summarised balance sheet		2020 £m	2019 £m
Intangible assets		**11,745**	10,371
Property, plant and equipment, right-of-use assets and investment property[1]		**3,158**	3,188
Equity accounted investments and other investments		**409**	441
Working capital[1]		**(3,021)**	(2,854)
Lease liabilities		**(1,203)**	(1,291)
Group's share of net IAS 19 post-employment benefits deficit		**(4,485)**	(4,455)
Net tax assets and liabilities		**906**	690
Net other financial assets and liabilities		**36**	34
Net debt	KPI	**(2,718)**	(743)
Net assets held for sale		**94**	130
Net assets		**4,921**	5,511

Components of net debt		£m	£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	KPI	**(2,718)**	(743)

Exchange rates

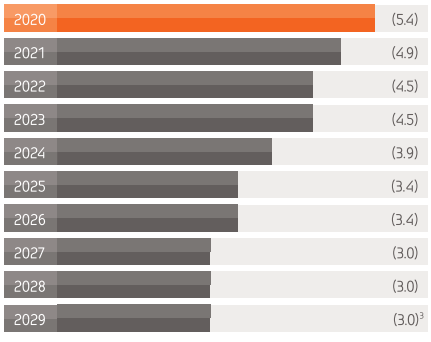
Year end	2020	2019
£/$	**1.367**	1.324
£/€	**1.117**	1.180
£/A$	**1.770**	1.884

Accounting net pension deficit – bridge (£bn)



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Note 24 to the Group accounts

Maturity of the Group's borrowings (£bn)



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Note 21 to the Group accounts

1. Funding received of £678m (2019 £524m) from the UK government for property, plant and equipment at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme included in working capital in the Consolidated balance sheet is presented here in property, plant and equipment, and investment property.
2. Amounts allocated to equity accounted investments.
3. Repayable in 2030 (£0.9bn), 2031 (0.7bn), 2041 (£0.3bn), 2044 (£0.4bn) and 2050 (£0.7bn).

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

Balance sheet

The £1.3bn increase in **intangible assets** to £11.7bn (2019 £10.4bn) mainly reflects goodwill and intangible assets arising on the US acquisitions.

Property, plant and equipment, right-of-use assets and investment property is £3.2bn (2019 £3.2bn).

Equity accounted investments and other investments was £409m (2019 £441m) mainly reflecting the Group's share of profit for the year (£69m), offset by the pension deficit allocation (£70m) and dividends received (£27m).

The **Group's share of the net IAS 19 post-employment benefits deficit** was in line with the prior year at £4.5bn. The £1bn contribution into the UK pension scheme and favourable asset returns were offset by an increase in liabilities driven by lower discount rate assumptions. The major movements in the net deficit are shown in the bridge chart on this page.

Details of the Group's post-employment benefits schemes are provided in note 24 to the Group accounts on page 229.

A net deferred tax asset of £0.8bn (2019 £0.8bn) relating to the Group's pension deficit is included within **net tax assets and liabilities**.

In aggregate, there was a £0.2bn decrease in **working capital** largely reflecting the strong focus on liquidity in the year.

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. The maturity of the Group's borrowings is shown in the chart on this page.

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.

Net assets held for sale represent the Advanced Electronics Company in Saudi Arabia. The 2019 net assets held for sale comprised the Applied Intelligence US-based software-as-a-service business, the disposal of which completed in October 2020, and Advanced Electronics Company.

Group financial review
continued

Accounting policies

Critical accounting policies

Certain of the Group's significant accounting policies are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the consolidated financial statements.

Revenue and profit recognition
Revenue £19.3bn (year ended 31 December 2020)
See note 1 to the Group accounts

Carrying value of goodwill
Goodwill £10.8bn (at 31 December 2020)
See note 8 to the Group accounts

Deferred tax asset on post-employment benefits obligations
Deferred tax asset on post-employment scheme deficit £0.8bn (at 31 December 2020)
See note 15 to the Group accounts

Tax provisions
Tax provisions £185m (at 31 December 2020)
See note 17 to the Group accounts

Post-employment benefits obligations
Group's share of the net IAS 19 post-employment scheme deficit £4.5bn (at 31 December 2020)
See note 24 to the Group accounts

Page 186
Critical accounting policies

Changes in accounting policies

No new or amended standards which became applicable for the year ended 31 December 2020 had a material impact on the Group or required the Group to change its accounting policies.

Capital

Objectives

Maintain the Group's investment grade credit rating and ensure operating flexibility, whilst:

- meeting its pension obligations;
- investing in research and technology and pursuing other organic investment opportunities;
- paying dividends in line with the Group's policy of long-term sustainable cover of around two times underlying earnings;
- making accelerated returns of capital to shareholders when the balance sheet allows and when the return from doing so is in excess of the Group's Weighted Average Cost of Capital; and
- investing in value-enhancing acquisitions, where market conditions are right and where they deliver on the Group's strategy.

Policies

The Group funds its operations through a mixture of equity funding and debt financing, including bank and capital market borrowings.

The capital structure of the Group reflects the judgement of the directors of an appropriate balance of funding required. Three credit rating agencies publish credit ratings for the Group:

Rating	Outlook	Category
Moody's Investors Service		
Baa2	Stable	Investment grade
Standard & Poor's Ratings Services		
BBB	Stable	Investment grade
Fitch Ratings		
BBB	Stable	Investment grade

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Note 26 to the Group accounts

Dividends

As part of the Group's capital allocation policy, the Group plans to pay dividends in line with its policy of long-term sustainable cover of around two times underlying earnings.

The Board has recommended a final dividend of 14.3p per share making a total of 23.7p per share in respect of the year ended 31 December 2020. An interim dividend of 13.8p was also paid in September, reflecting the dividend proposed but subsequently deferred in respect of the year ended 31 December 2019. At this level, the annual dividend is covered two times by underlying earnings. 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. The ex-dividend date is 22 April 2021.

At 31 December 2020, the Company had retained earnings of £2.7bn (2019 £3.0bn), the non-distributable portion of which is £827m (2019 £767m) (see page 256). Total external dividends relating to the year ended 31 December 2020 are £762m (2019 £745m). The 2020 dividends consist of the interim dividend in respect of the year ended 31 December 2019 (£444m), the interim dividend paid during the year in respect of the first half of 2020 of £302m (2019 £301m) and the final dividend proposed of approximately £460m (2019 £nil). On an annual basis, the Company receives dividends from its subsidiaries to increase its distributable reserves and, accordingly, the Company expects to have sufficient distributable reserves to support its dividend policy.

The Group's dividend policy is underpinned by its viability and going concern statements (see pages 109 and 110).

Treasury

The Group's treasury activities are overseen by the Treasury Review Management Committee (TRMC). Two executive directors are members of the TRMC, including the Group Finance Director who chairs the Committee. The TRMC also has representatives with legal and tax expertise. The Group operates a centralised treasury department that is accountable to the TRMC for managing treasury activities in accordance with the treasury policies approved by the Board.

Objectives/policies

Net debt

Maintain a balance between the continuity, flexibility and cost of debt funding through the use of borrowings from a range of markets with a range of maturities, currencies and interest rates, reflecting the Group's risk profile.

– Material borrowings are arranged by the central treasury department and funds raised are lent onward to operating subsidiaries as required.

Interest rates

Manage the exposure to interest rate fluctuations on borrowings through varying the proportion of fixed rate debt relative to floating rate debt with derivative instruments, including interest rate and cross-currency swaps.

– A minimum of 50% and a maximum of 90% of gross debt is maintained at fixed interest rates.

Liquidity

Maintain adequate undrawn committed borrowing facilities.

– An undrawn committed Revolving Credit Facility of £2bn contracted to April 2025 is available to meet general corporate funding requirements.

Monitor and control counterparty credit risk and credit limit utilisation.

– The Group adopts a conservative approach to the investment of its surplus cash. It is deposited with financial institutions with strong credit ratings for short periods.

Currency

Reduce the Group's exposure to transactional volatility in earnings and cash flows from movements in foreign currency exchange rates.

– All material firm transactional exposures are hedged.

– The Group does not hedge the translation effect of exchange rate movements on:

(a) the income statements or balance sheets of foreign subsidiaries; and

(b) equity accounted investments it regards as long-term investments.

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Note 14 to the Group accounts

Tax strategy

The Group's tax strategy is to:

– ensure compliance with all applicable tax laws and regulations; and

– manage the Group's tax expense in a way that is consistent with its values and its legal obligations in all relevant jurisdictions.

The Group does not tolerate activities designed to facilitate tax evasion offences.

The Group promotes collaborative professional working with tax authorities in order to build open, transparent and trusted relationships. As part of this, the Group engages in open and early dialogue to discuss tax planning, strategy, risks and significant transactions, and discloses any significant uncertainties in relation to tax matters. Queries and information requests by tax authorities are responded to in a timely fashion and the Group ensures that tax authorities are kept informed about how issues are progressing.

The Group seeks to resolve issues in real time and before returns are filed where possible. Fair, accurate and timely disclosures are made in tax returns, reports and documents that the Group files with, or submits to, tax authorities. Where disagreements over tax arise, the Group works proactively to seek to resolve all issues by agreement (where possible) and reach reasonable solutions. In the UK, the Group is subject to an annual risk assessment by HM Revenue & Customs and strives to achieve as low a risk rating as can be achieved by a group of BAE Systems' size and complexity.

Whilst the Group aims to maximise the tax efficiency of its business transactions, it does not use structures in its tax planning that are contrary to the intentions of the relevant legislature. The Group interprets relevant tax laws in a reasonable way and ensures that transactions are structured in a way that is consistent with a relationship of co-operative compliance with tax authorities. It also actively considers the implications of any planning for the Group's wider corporate reputation.

The Group is open and transparent with regard to decision-making, governance and tax planning in its business, keeping tax authorities informed of who has responsibility, how decisions are reached, how the business is structured and where different parts of the business are located.

BAE Systems operates internationally and is subject to tax in many different jurisdictions. The Group employs professional tax managers and takes appropriate advice from reputable professional firms. The Group is routinely subject to tax audits and reviews which can take a considerable period of time to conclude. Provision is made for known issues based on management's interpretation of country-specific legislation and the likely outcome of negotiations or litigation. The assessment and management of tax risks are regularly reviewed by the Audit Committee, as is the Group's tax strategy.

Arm's-length principles are applied in the pricing of all intra-group transactions of goods and services in accordance with Organisation for Economic Co-operation and Development guidelines. Where appropriate, the Group engages with governments in relation to proposed legislation and tax policy.

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Note 6 to the Group accounts

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 56 to 63.

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. The guidance reflects the Group's move to its new measure of operating profitability (see page 65). Guidance is provided on the basis of an exchange rate of $1.35:£1.

Sales

Growth in the 3% to 5% range over 2020.

- Excluding the impact of foreign exchange, we expect growth to be between 5% to 7%
- Growth expected in Air and Electronic Systems, including full year impact of acquisitions, partially offset by continued weakness in commercial aerospace revenues
- Approximately 80% of expected sales already in Order backlog

Old EBITA basis		New EBIT basis
Underlying EBITA expected to increase in the range of **6% to 8%** Excluding the impact of foreign exchange, we expect growth in excess of 10% 2020: £2,132m	→	**Underlying EBIT** expected to increase in the range of **6% to 8%** Excluding the impact of foreign exchange, we expect growth in excess of 10% 2020: £2,037m (new basis – see page 65)
Underlying EPS expected to increase in the range of **3% to 5%** 2020: 46.8p	→	**Underlying EPS** expected to increase in the range of **3% to 5%** 2020: 44.3p (new basis – see page 65)

Free cash flow target for 2021 in excess of **£1bn**

Three-year free cash flow target (2021 to 2023) in excess of **£4bn**

Exchange rate assumption of $1.35:£1

A 10 cent movement in the exchange rate impacts EPS by around 2 pence

Finance costs expected to be around £270m

Group effective tax rate expected to be around 18%

Non-controlling interest expected to be around £85m

As communicated in the Preliminary Announcement of 25 February, the Group will, with effect from 2021, use underlying EBIT as its key measure of operational profitability.

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

Segmental 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%
Constant currency basis[1]	Up 10% to 12%	Stable	Stable	Up 7% to 9%	Up 2% to 4%
Underlying EBIT margin[2]					
New basis – see below	15% to 16%	7% to 8%	8% to 9%	10% to 11%	8% to 9%

1. Constant currency growth rates eliminate the impact of foreign exchange translation.
2. Underlying EBIT as percentage of Sales.

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

Revised profit performance measures

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

The underlying financial performance for 2020 of segments and the Group is re-presented below on this new basis, along with reconciliations from the previous underlying performance measures. The re-presented underlying financial performance for 2020 forms the new basis for Guidance for 2021.

Re-presented underlying financial performance for the year ended 31 December 2020

Year ended 31 December 2020	Sales £m	Underlying EBITA £m	Underlying EBITA margin[1] %	Software and development intangible amortisation £m	Underlying EBIT £m	Underlying EBIT margin[2] %
Electronic Systems	4,557	684	15.0	(10)	674	14.8
Cyber & Intelligence	1,812	136	7.5	(1)	135	7.5
Platforms & Services (US)	3,503	195	5.6	(5)	190	5.4
Air	7,910	941	11.9	(32)	909	11.5
Maritime	3,257	306	9.4	(27)	279	8.6
HQ/intra-Group	(177)	(130)		(20)	(150)	
Group	**20,862**	**2,132**	**10.2**	**(95)**	**2,037**	**9.8**
Underlying net interest		(255)			(255)	
Underlying taxation expense		(312)		16	(296)	
Non-controlling interest		(72)			(72)	
Underlying earnings		**1,493**		**(79)**	**1,414**	
Underlying EPS (pence)		**46.8p**		**(2.5)p**	**44.3p**	

1. Underlying EBITA as percentage of Sales.
2. Underlying EBIT as percentage of Sales.

Segmental review

The Group reports its performance through five principal reporting segments.

Financial performance measures

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
	KPI	KPI		KPI	KPI						
Page 68 Electronic Systems	4,557	684	15.0	580	4,722	6.5	4,557	648	14.2	767	5.3
Page 72 Cyber & Intelligence	1,812	136	7.5	221	1,987	1.7	1,812	138	7.6	251	1.1
Page 76 Platforms & Services (US)	3,503	195	5.6	382	4,137	6.1	3,399	183	5.4	458	5.6
Page 80 Air	7,910	941	11.9	718	6,494	22.5	6,593	862	13.1	917	16.5
Page 84 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**	**826[7]**	**20,915**	**45.2**	**19,277**	**1,930**	**10.0**	**1,166**	**36.3**

We use financial performance measures as defined by the Group to monitor the underlying financial performance of the Group's reporting segments. Reconciliations from these measures to the financial performance measures defined in IFRS[1] are provided in the Group financial review on pages 56 to 63. Reconciliations by reporting segment for revenue and operating profit are included in note 1 to the Group accounts (see page 194) and for net cash flow from operating activities in note 27 to the Group accounts (see page 244).

1. International Financial Reporting Standards.
2. Underlying EBITA as 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).

Our people have continued to enable F-35 aircraft and trained aircrew in advance of the UK Carrier Strike Group's first operational deployment in 2021.



Image copyright Lockheed Martin.

Electronic Systems

Segmental review continued

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 Combat Solutions designs, builds and supports integrated electronic warfare systems for platform prime and government customers, and is an affordable and dependable mission systems provider for all three electronic warfare missions: electronic attack; electronic protection; and electronic support.

Countermeasure & Electromagnetic Attack Solutions provides next-generation threat detection, countermeasure, and attack solutions that deliver full-spectrum electronic warfare capabilities to enhance mission survivability.

Precision Strike & Sensing Solutions designs and manufactures state-of-the-art systems and technology that enable our customers to execute their precision strike missions.

C4ISR Systems provides actionable intelligence through innovative technical solutions for airborne persistent surveillance, identification systems, signals intelligence, underwater and surface warfare solutions, and space resiliency products.

Controls & Avionics Solutions develops and produces electronics for military and commercial aircraft, including fly-by-wire flight controls, full authority digital engine controls, cabin management systems and mission computers.

Power & Propulsion Solutions delivers propulsion and power management performance with innovative electrification products and solutions that advance vehicle mobility, efficiency, and capability.

At our Manassas, Virginia facility, we produce resilient, space-qualified subsystems and space components.

16,600
Employees[1]

£4,557m
Sales

Page 20
Alternative performance measure definitions

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

		2020	2019
Sales	KPI	**£4,557m**	£4,439m
Underlying EBITA	KPI	**£684m**	£687m
Return on sales		**15.0%**	15.5%
Operating business cash flow	KPI	**£580m**	£672m
Order intake[1]	KPI	**£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%.

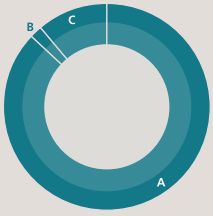
Financial performance measures defined in IFRS[2]

	2020	2019
Revenue	**£4,557m**	£4,439m
Operating profit	**£648m**	£672m
Return on revenue	**14.2%**	15.1%
Cash flow from operating activities	**£767m**	£833m
Order book	**£5.3bn**	£4.9bn

- 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 conversion[3] levels.
- Order backlog benefited from orders for F-35 electronic warfare systems, the Precision Strike business and C4ISR programmes.

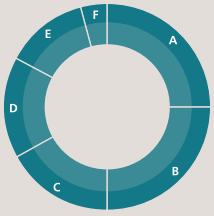
1. Including share of equity accounted investments.
2. International Financial Reporting Standards.
3. Operating business cash flow as a percentage of underlying EBITA.

Sales by domain (%)



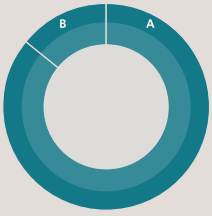
A	Air	87%
B	Maritime	2%
C	Land	11%

Sales by line of business (%)



A	Electronic Combat	25%
B	C4ISR Systems	25%
C	Precision Strike & Sensing	17%
D	Countermeasure & Electromagnetic Attack	16%
E	Controls & Avionics	13%
F	Power & Propulsion	4%

Sales analysis: Defence and commercial (%)



A	Defence	86%
B	Commercial	14%

Electronic Systems

Segmental review continued

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 later in this report.

Page 88
Segmental looking forward



Navigation & Sensor Systems employees are developing next-generation GPS technology for the US military and its allies.

More online
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Cyber & Intelligence

Segmental review continued

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.





Our Applied Intelligence business helps nations, governments and businesses around the world defend themselves against cybercrime, reduce their risk in the connected world, comply with regulation and transform their operations.

Intelligence & Security comprises the three US-based businesses.

Air Force Solutions focuses on providing the US Air Force, US Space Force and the combatant commands with innovative systems engineering and integration solutions to help to modernise, maintain, test, and cyber-harden aircraft, radars, strategic missile systems, mission applications, and information systems that detect, deter and dissuade threats to national security.

Integrated Defense Solutions provides the US Army, Navy, and federal civilian markets with systems engineering, integration, and sustainment services for critical weapons and C5ISR systems and enterprise IT networks and cyber security that enhance mission effectiveness. Our solutions are deployed across platforms and networks in the air, maritime, land, and cyber domains.

Intelligence Solutions provides innovative mission-enabling solutions and services to enhance the collection, analysis, and processing of data through automation, augmented analytics, and artificial intelligence/machine learning across US civilian and military intelligence communities. Our business also develops and deploys high-assurance networks that facilitate the secure sharing of data amongst intelligence agencies in support of national security.

Applied Intelligence provides data intelligence solutions which enable governments and commercial organisations to defend against national-scale threats, protect their networks and data against sophisticated attacks and operate successfully in cyberspace. Our solutions are delivered as licensed technologies and via consulting and systems integration projects.

Government is focused on delivering national security and intelligence solutions to the UK and allied international governments. The business also delivers enterprise-level data and digital services to UK government departments.

Financial Services delivers anti-fraud and regulatory compliance solutions to banking and insurance customers across Europe, North America, the Middle East, Africa and Asia-Pacific.

9,700
Employees[1]

£1,812m
Sales

Page 20
Alternative performance measure definitions

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[2] 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.

Financial performance

Financial performance measures as defined by the Group

		2020	2019
Sales	KPI	**£1,812m**	£1,732m
Underlying EBITA	KPI	**£136m**	£91m
Return on sales		**7.5%**	5.3%
Operating business cash flow	KPI	**£221m**	£68m
Order intake[1]	KPI	**£1,987m**	£1,846m
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.

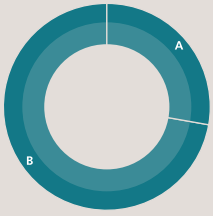
Financial performance measures defined in IFRS[3]

	2020	2019
Revenue	**£1,812m**	£1,732m
Operating profit	**£138m**	£80m
Return on revenue	**7.6%**	4.6%
Cash flow from operating activities	**£251m**	£99m
Order book	**£1.1bn**	£1.1bn

- 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.

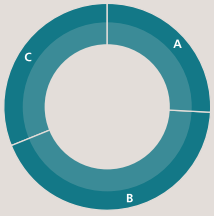
1. Including share of equity accounted investments.
2. Ratio of Order intake to Sales.
3. International Financial Reporting Standards.

Sales by business (%)



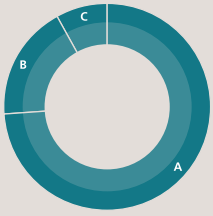
A	Applied Intelligence	28%
B	Intelligence & Security	72%

Sales by line of business: Intelligence & Security (%)



A	Air Force Solutions	26%
B	Integrated Defense Solutions	43%
C	Intelligence Solutions	31%

Sales analysis: Applied Intelligence (%)



A	Government	74%
B	Financial Services	18%
C	Technology & Commercial	8%

Cyber & Intelligence

Segmental review continued

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 recompete 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 recompete 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.



More online
baesystems.com

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 later in this report.

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Segmental looking forward

Platforms & Services (US)

Segmental review continued

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.





ACV launches from the well deck of the USS Somerset during sea-based testing.

Combat Mission Systems focuses on a portfolio of tracked combat vehicles, amphibious vehicles, protection systems, naval weapons, artillery, advanced weapons and precision munitions for the US military and international customers.

Ordnance Systems is the operator of the US Army's Holston and Radford facilities under government-owned, contractor-operated arrangements, and focuses on high explosives, propellants, and facility modernisation.

US Ship Repair is a major provider of non-nuclear ship repair, modernisation, overhaul and conversions to the US Navy, government and commercial maritime customers. It has four operational sites in the US located on the Atlantic and Pacific coasts, and Hawaii.

BAE Systems Hägglunds focuses on the tracked vehicle market for Swedish and international customers.

BAE Systems Bofors provides advanced land and maritime weapons and precision-guided munitions.

Weapon Systems UK is a provider of land-based artillery systems with the M777 towed ultra-lightweight howitzer as its main product.

FNSS, the Turkish land systems business in which BAE Systems holds a 49% interest, produces and upgrades tracked and wheeled military vehicles for Turkish and international customers.

12,600
Employees[1]

£3,503m
Sales

Page 20
Alternative performance measure definitions

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

		2020	2019
Sales	KPI	**£3,503m**	£3,337m
Underlying EBITA	KPI	**£195m**	£267m
Return on sales		**5.6%**	8.0%
Operating business cash flow	KPI	**£382m**	£241m
Order intake[1]	KPI	**£4,137m**	£4,020m
Order backlog[1]		**£6.1bn**	£5.8bn

- Sales grew by 5% as the ramp in US combat vehicles 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.

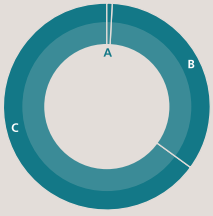
Financial performance measures defined in IFRS[2]

	2020	2019
Revenue	**£3,399m**	£3,185m
Operating profit	**£183m**	£239m
Return on revenue	**5.4%**	7.5%
Cash flow from operating activities	**£458m**	£305m
Order book	**£5.6bn**	£5.1bn

- 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.

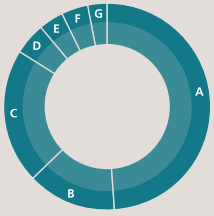
1. Including share of equity accounted investments.
2. International Financial Reporting Standards.

Sales by domain (%)



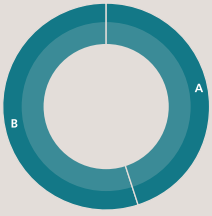
A	Air	1%
B	Maritime	34%
C	Land	65%

Sales by line of business (%)



A	Combat Mission Systems	49%
B	Ordnance Systems	14%
C	US Ship Repair	21%
D	BAE Systems Hägglunds	5%
E	BAE Systems Bofors	4%
F	Weapon Systems UK	4%
G	FNSS	3%

Sales analysis: Platforms and services (%)



A	Platforms	45%
B	Services	55%

Platforms & Services (US)

Segmental review continued

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 wastewater 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 later in this report.

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Segmental looking forward



The Fleet Support team completes an overhaul of a Mk110 (57Mk3) Naval Gun System.

More online
baesystems.com

Air

Segmental review continued

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.



A concept model of Tempest, our future combat air system.

Our **UK-based** business includes programmes for the production of Typhoon combat and Hawk trainer aircraft, support, training and upgrades for Typhoon, Tornado and Hawk aircraft, and development of next-generation Air Systems and defence information systems, as well as the UK-based F-35 Lightning II manufacture, engineering development and support activity.

In **Saudi Arabia**, the business provides operational capability support to the country's air and naval forces through UK/Saudi government-to-government programmes. The Saudi British Defence Co-operation Programme and Salam Typhoon project provide for multi-year contracts between the governments.

In **Australia**, the business primarily delivers upgrade and support programmes for customers in the defence and commercial sectors across the air, maritime and land domains. The business is also contracted for the Hunter Class nine-ship Future Frigate programme. Services contracts include the provision of sustainment, training solutions and upgrades.

MBDA is a leading global prime contractor of missiles and missile systems across the air, maritime and land domains.

29,300
Employees[1]

£7,910m
Sales

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Alternative performance measure definitions

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

		2020	2019
Sales	KPI	**£7,910m**	£7,457m
Underlying EBITA	KPI	**£941m**	£887m
Return on sales		**11.9%**	11.9%
Operating business cash flow	KPI	**£718m**	£408m
Order intake[1]	KPI	**£6,494m**	£4,594m
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.

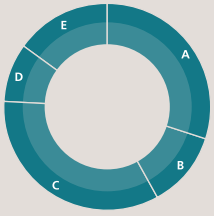
Financial performance measures defined in IFRS[2]

	2020	2019
Revenue	**£6,593m**	£6,153m
Operating profit	**£862m**	£777m
Return on revenue	**13.1%**	12.6%
Cash flow from operating activities	**£917m**	£497m
Order book	**£16.5bn**	£18.3bn

- 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.

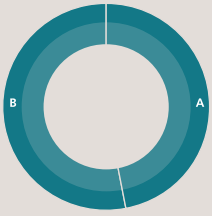
1. Including share of equity accounted investments.
2. International Financial Reporting Standards.

Sales by line of business (%)



A	European and International Markets	**30%**
B	US Programmes	**12%**
C	Saudi Arabia	**34%**
D	Australia	**9%**
E	MBDA	**15%**

Sales analysis: Platforms and services (%)



A	Platforms	**47%**
B	Services	**53%**

Air

Segmental review continued

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 and 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 assembles 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 later in this report.

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Segmental looking forward

Maritime

Segmental review continued

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



The two Queen Elizabeth Class aircraft carriers alongside at HM Naval Base Portsmouth.

Maritime programmes include the construction of seven Astute Class submarines for the Royal Navy, as well as the design and production of the Royal Navy's Dreadnought Class submarine and Type 26 frigate. Additionally the Maritime portfolio includes in-service support, including the delivery of training services and management of HM Naval Base Portsmouth and the design and manufacture of combat systems, torpedoes and radars.

Land UK's munitions business designs, develops and manufactures a comprehensive range of munitions products serving a number of customers including its main customer, the UK Ministry of Defence. Its RBSL joint venture with Rheinmetall is a UK-based military land vehicle design, manufacturing and support business. Land UK also develops and manufactures cased-telescoped weapons through its CTA International joint venture.

17,400
Employees[1]

£3,257m
Sales

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Alternative performance measure definitions

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

		2020	2019
Sales	KPI	**£3,257m**	£3,116m
Underlying EBITA	KPI	**£306m**	£268m
Return on sales		**9.4%**	8.6%
Operating business cash flow	KPI	**£243m**	£150m
Order intake[1]	KPI	**£3,772m**	£2,875m
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.

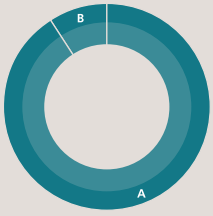
Financial performance measures defined in IFRS[2]

	2020	2019
Revenue	**£3,195m**	£3,071m
Operating profit	**£272m**	£253m
Return on revenue	**8.5%**	8.2%
Cash flow from operating activities	**£317m**	£289m
Order book	**£8.5bn**	£8.4bn

- 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.

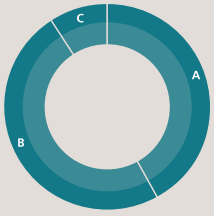
1. Including share of equity accounted investments.
2. International Financial Reporting Standards.

Sales by domain (%)



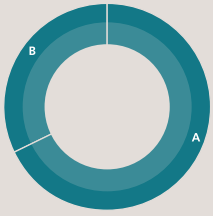
A	Maritime	91%
B	Land	9%

Sales by line of business (%)



A	Naval Ships	42%
B	Submarines	49%
C	Land UK	9%

Sales analysis: Platforms and services (%)



A	Platforms	68%
B	Services	32%

Maritime

Segmental review continued

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 later in this report.

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Segmental looking forward



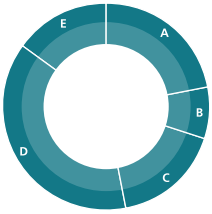
Shell filling at our munitions site in Glascoed, South Wales.

More online
baesystems.com

Segmental looking forward

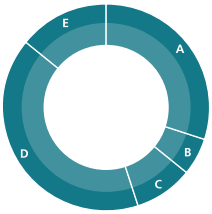
BAE Systems has five principal reporting segments, Electronic Systems, Cyber & Intelligence, Platforms & Services (US), Air and Maritime, which align with the strategic direction of the Group.

2020 Sales[1]



A	Electronic Systems	**22%**
B	Cyber & Intelligence	**8%**
C	Platforms & Services (US)	**17%**
D	Air	**38%**
E	Maritime	**15%**

2020 Underlying EBITA[2]



A	Electronic Systems	**30%**
B	Cyber & Intelligence	**6%**
C	Platforms & Services (US)	**9%**
D	Air	**41%**
E	Maritime	**14%**

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 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 recompeted 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.

1. Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments.
2. Operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBITA), and non-recurring items.

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Our markets

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Alternative performance measure definitions

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

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.

How we manage risk

Effective management of risks is essential to the delivery of the Group's strategic objectives and the creation of sustainable shareholder value.

Board

The Board has overall responsibility for determining the nature and extent of the risk the Group is willing to take, and ensuring that risks are managed effectively across the Group.

Risk is a regular agenda item at Board meetings and the Board reviews risk as part of its annual strategy review process. This provides the Board with an appreciation of the key risks within the business and oversight of how they are being managed.

The Board delegates oversight of certain risk management activities to the Audit and Corporate Responsibility Committees:

Audit Committee

The Audit Committee monitors the Group's key risks identified by the risk assessment processes and reports its findings to the Board twice a year. It is also responsible for reviewing in detail the effectiveness of the Group's system of internal control policies, and procedures for the identification, assessment and reporting of risk.

Corporate Responsibility Committee

The Corporate Responsibility Committee monitors the Group's performance in managing the Group's significant non-financial risks, including those arising in respect of business conduct, health and safety and the environment. The Committee reports its findings to the Board on a regular basis.

Approach

The Group's Risk Management Policy is set out in the Operational Framework, the Group's detailed governance framework.

The Group's approach to risk management is aimed at the early identification of key risks, mitigating the effect of those risks before they occur and dealing with them effectively if they crystallise.

The Group is committed to the protection of its assets, which include human resources, intellectual and physical property, and financial resources, through an effective risk management process, underpinned where appropriate by insurance.

Reporting within the Group is structured so that key issues are escalated through the management team and ultimately to the Board where appropriate. The underlying principles of the Group's risk management processes are that risks are monitored continuously, associated action plans reviewed, appropriate contingencies provisioned and this information reported through established management control procedures.

The Board has conducted a review of the effectiveness of the Group's systems of risk management and internal control processes, including financial, operational and compliance controls and risk management systems, in accordance with the UK Corporate Governance Code. The Company has developed a system of internal controls that was in place throughout 2020 and to the date of this report.

As with any system of internal control, the policies and processes that are mandated in the Operational Framework are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

Financial and non-financial risks

Financial risks expose the Group to potential costs which are quantifiable on the basis that their probability and impact can be understood adequately and related to the financial statements.

Non-financial risks cannot be assessed readily in financial terms and, therefore, cannot be reflected reliably in the financial statements.

Process

Businesses

The responsibility for risk identification, analysis, evaluation and mitigation rests with the line management of the businesses. They are also responsible for reporting and monitoring key risks in accordance with established processes under the Group's Operational Framework.

The Group's risk management process is set out in the Risk Management Policy, a mandated policy under the Operational Framework, and, in respect of projects, in the Lifecycle Management Framework, a core business process under the Operational Framework. Further guidance is provided by a Risk Management Maturity self-assessment tool.

Identified risks are documented in risk registers showing: the risks that have been identified; characteristics of the risk; the basis for determining mitigation strategy; and what reviews and monitoring are necessary. Each risk is allocated an owner who has authority and responsibility for assessing and managing it.

Project risks are reported and monitored in Group-mandated format Contract Review Packs, which are reviewed by management at monthly Contract Reviews. The financial performance of projects is reported and monitored using Contract Status Reports, which form part of the Contract Review Pack.

These include programme margin metrics, which are reviewed regularly by the Executive Committee and Board. Project margin is recognised after making suitable allowances for technical and other risks related to performance milestones yet to be achieved.

In addition, every six months, the businesses and Group functions complete an Operational Assurance Statement (OAS), which is a mandated policy under the Operational Framework. The OAS is in two parts: a self-assessment of compliance with the Operational Framework; and a report showing the key financial and non-financial risks for the relevant business and Group functions. Together with reviews undertaken by Internal Audit and the work of the external auditors, the OAS forms the Group's process for reviewing the effectiveness of the system of internal controls.

Executive Committee

The key financial and non-financial risks identified by the businesses from the risk assessment processes are collated and reviewed by the Executive Committee to identify those issues where the cumulative risk, or possible reputational impacts, could be significant.

Management responsibility for the management of the Group's most significant non-financial risks is determined by the Executive Committee.

The OAS and non-financial risk registers are reviewed regularly by the Executive Committee to monitor the status and progression of mitigation plans. These key risks are reported to the Board on a regular basis.

Principal and emerging risks

The Board has carried out a robust assessment of the emerging and principal risks facing the Group. Emerging and principal risks have been identified, and are managed or mitigated, through the application of the policies and processes outlined above.

Principal risks include those that would threaten the Group's business model, future performance, solvency, liquidity or reputation. Risks have been identified as principal based on the likelihood of occurrence, the potential impact on the Group and the timescale over which they might occur. The principal risks, together with details of how they are being mitigated and managed, are detailed on pages 93 to 99.

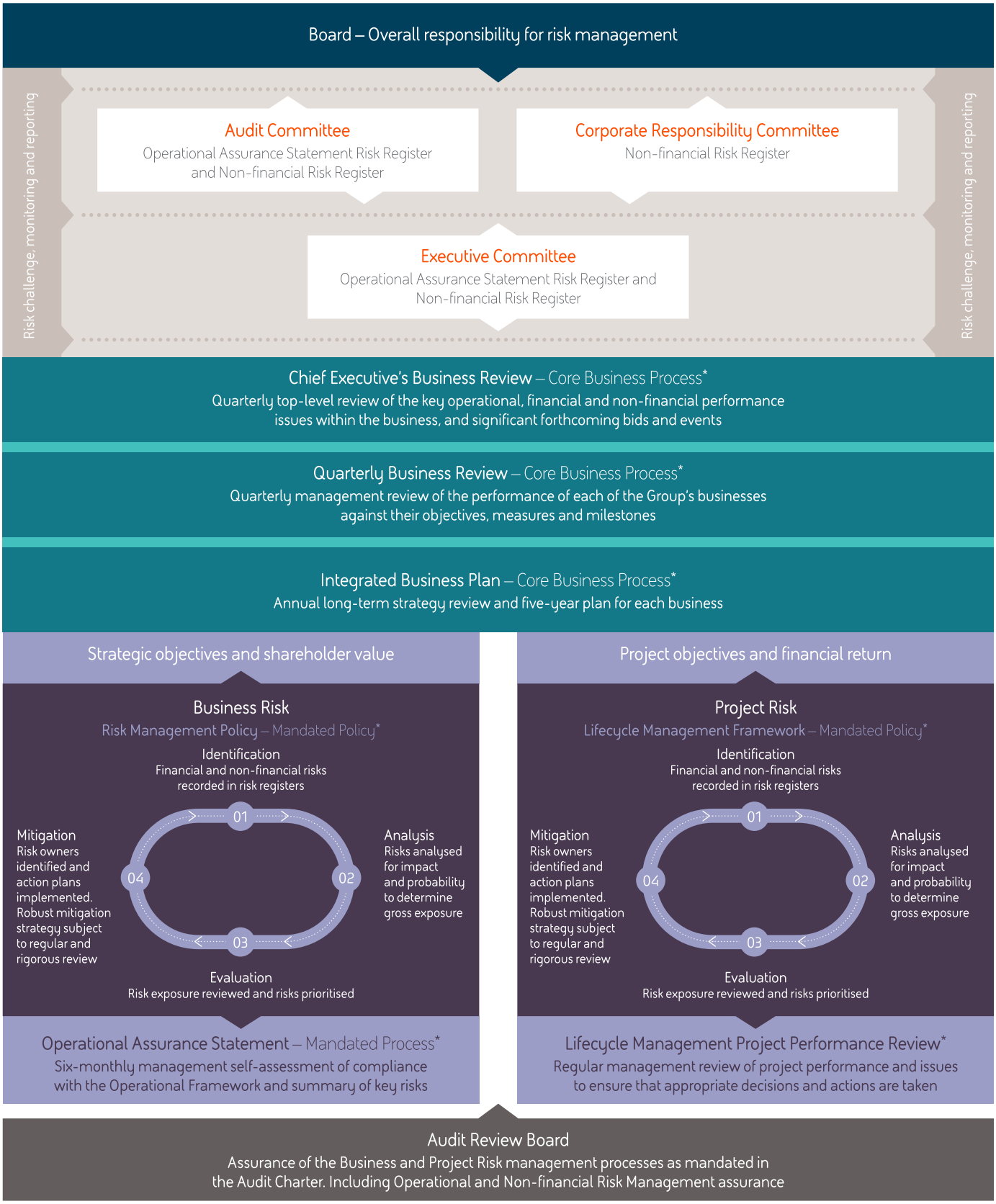
As mentioned in the Group's 2020 Half-yearly Report, and with the advent of the COVID-19 pandemic, the Group has identified as a new principal risk since the 2019 Annual Report that the outbreak of contagious diseases may have an adverse effect on the Company's business, financial condition and results of operations.

Since the 2019 Annual Report, in view of the evolving nature of the climate change risk, the Group has also identified as a new principal risk that the Group may be impacted by environmental factors, including those relating to climate change. The directors have considered the relevance of the risks of climate change and transition risks associated with the Company's net zero greenhouse gas emissions targets when preparing and signing off the Company's accounts.

Page 92
Our risk management framework

Page 93
Our principal risks

Our risk management framework



Page 102
*As defined in the Group's Operational Framework

Our principal risks

Risks are identified based on the likelihood of occurrence and the potential impact on the Group. The Group's principal risks are identified below, together with a description of how we mitigate those risks.

Description	Impact	Mitigation
Outbreak of contagious diseases		
The outbreak of contagious diseases may have an adverse effect on the Company's business, financial condition and results of operations.		
There is currently a COVID-19 pandemic across the world and governments are taking a number of steps to mitigate the impact of this pandemic. Many people have contracted the disease across the world and many deaths have occurred. Although there have been recent positive developments in relation to the approval of vaccines and the commencement of immunisation programmes, it is not clear for how long this pandemic will last or how much more extensive it will become, or the further measures that will be taken by governments and others to seek to control this pandemic and its impact. The COVID-19 pandemic could also result in changes to the outlook in the Group's markets.	Contagious diseases can have an adverse effect on the Group's business, financial condition and results of operations. While the Group is liaising closely with its customers and suppliers to understand any changes in requirements and priorities during this time, the uncertainties surrounding the development of this pandemic make it difficult to predict the extent to which the Group may be affected. Areas of the Group's business that could be impacted include a decrease in spending by the Group's major defence and commercial customers; an increase in taxation by governments; the failure to obtain awards for defence and commercial contracts; the failure of suppliers to deliver parts to the Group; the requirement for the Group or its suppliers to reduce site operational levels or close sites; the inability of the Group to meet contractual delivery requirements on time; the inability to adequately staff and manage the business; and an increase in the cost or lack of availability of funding. If the Group were unable to obtain appropriate funding, it could be forced to make reductions in spending, seek to extend payment terms with suppliers and/or suspend or curtail planned programmes. Any of the above could have a material adverse effect on the Group's business, financial condition and results of operations.	Since the outbreak of the COVID-19 pandemic, the Group has taken a number of responsive measures including reducing site operational levels and introducing new cleaning regimes, safe working distance measures and protective equipment for our employees. A significant proportion of the Group's employees are working from home. By taking these measured actions to build in resilience for a prolonged period of disruption, we have continued to deliver critical work for our customers and, where operations were impacted, ensured that site-critical workers have now been able to safely return to work where possible. Support for the defence industry from the governments in our key markets has been strong around prioritisation of capabilities, cash flows, recognising the need to maintain a strong supply chain and working collaboratively to maintain critical defence and security programmes.

Our principal risks
continued

Description	Impact	Mitigation
International markets The Group operates in international markets.		
BAE Systems is an international company conducting business in a number of regions, including the US and the Middle East. The risks of operating in some countries include: social and political changes impacting the business environment; economic downturns, political instability and civil disturbances; the imposition of restraints on the movement of capital; the introduction of burdensome taxes or tariffs; change of export control and other government policy and regulations in the UK, US and all other relevant jurisdictions; and the inability to obtain or maintain the necessary export licences.	The occurrence of any such events could have a material adverse effect on the Group's future results and financial condition. The risk of the Group's inability to obtain and maintain the necessary export licences for our business in Saudi Arabia could affect the Group's provision of capability to the country.	The Group has a balanced portfolio of businesses across a number of markets internationally. The Group benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia. The Group's contracts are often long-term in nature and, consequently, it may be able to mitigate these risks over the term of those contracts. Political risk insurance is held in respect of export contracts not structured on a government-to-government basis. BAE Systems has a well-established legal and regulatory compliance structure aimed at ensuring adherence to regulatory requirements and identifying restrictions that could adversely impact the Group's activities, including export control requirements.
The Group is exposed to volatility arising from movements in currency exchange rates, particularly in respect of the US dollar, euro, Saudi riyal and Australian dollar. There has been volatility in currency exchange rates in the period since the EU referendum in the UK and due to the impact of the COVID-19 pandemic on the global economy.	Significant fluctuations in exchange rates to which the Group is exposed could have a material adverse effect on the Group's future results and financial condition.	The Group's policy is to hedge all material firm transactional currency exchange rate exposures.
While the terms of the UK's relationship with the EU after the end of the transition phase on 31 December 2020 have now been clarified by the entry by the UK and the EU into the Trade and Cooperation Agreement, the UK is now a third country for the purposes of EU-funded defence projects. There remains the risk that, as a result of the UK leaving the EU, the Group's ability to take part in new European collaborative defence programmes, whether under such EU-funded projects or otherwise, could be hampered.	If the UK is excluded from new European collaborative defence programmes, this could impact the Group's future results and financial condition.	BAE Systems benefits from a large order backlog with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia and there is relatively limited UK-EU trading. BAE Systems has key roles in major ongoing European programmes, such as Eurofighter, which are only likely to be marginally affected by 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 in the post-Brexit environment, and to strengthen bilateral relationships with key partners in Europe. This will be important for ongoing collaboration with such partners in Europe on the development of defence capabilities.

Description	Impact	Mitigation
Defence spending The Group is dependent on defence spending.		
In 2020, 95% of the Group's sales were defence-related. Defence spending by governments can fluctuate depending on change of government policy, other political considerations, budgetary constraints, specific threats and movements in the international oil price. There have been constraints on government expenditure in a number of the Group's principal markets. Defence spending by governments has also been impacted by the COVID-19 outbreak due to reprioritisation of funds.	Lower defence spending by the Group's major customers could have a material adverse effect on the Group's future results and financial condition.	The business is geographically spread across US, UK and international defence markets: – in the US, the two-year budget deal enacted in 2019 established a defence spending level of approximately $740bn for fiscal year 2021 and, with a demonstrable bi-partisan support for defence, it maintains support for our medium-term planning assumptions and positive momentum for military readiness and modernisation programmes; – in the UK, the government has re-stated its commitment to meeting the NATO target of spending of at least 2% of Gross Domestic Product on defence. While the government's Integrated Foreign Policy, Defence and Security Review is due to be published early in 2021, the UK government has made a series of recent programme announcements related to the review and we welcome the UK government's increased investment in defence and security; – in Saudi Arabia, regional tensions continue to dictate that defence remains a high priority; and – in Australia, regional instability and the rapid pace of military modernisation and technology advancement in the Asia-Pacific region continue to drive the government's commitment to defence spending, with major recapitalisation programmes underway in the air, maritime and land domains, underpinned also by its policies of developing a strong, sustainable and secure Australian defence industry and supporting leading-edge technical innovation. The Australian government continues its policy of providing a ten-year funding model for defence. As part of this commitment, the Australian government has made clear its objective to build a robust, resilient and internationally competitive domestic defence industry to ensure the expertise resident in the industrial base effectively supports Australia's national security. The diverse product and services portfolio is marketed across a range of defence markets. BAE Systems benefits from a large order backlog, with established positions on long-term programmes in the US, UK, Saudi Arabia and Australia. BAE Systems has a portfolio of commercial businesses, including commercial avionics.

Our principal risks
continued

Description	Impact	Mitigation
Competition in international markets		
The Group's business is subject to significant competition in international markets.		
The Group's business plan depends upon its ability to win and contract for high-quality new programmes, an increasing number of which are expected to be in markets outside the US and UK. The Group is dependent upon US and UK government support in relation to a number of its business opportunities in export markets.	The Group's business and future results may be adversely impacted if it is unable to compete adequately and obtain new business in the markets in which it operates.	The Group has an international, multi-market presence, a balanced portfolio of businesses, leading capabilities and a track record of delivery on its commitments to its customers. The Group continues to invest in research and development, and to reduce its cost base and improve efficiencies, to remain competitive. In the UK, export contracts can be structured on a government-to-government basis and government support can also involve military training, ministerial support for promotional activities and financial support through UK Export Finance. In the US, most of the Group's defence export sales are delivered through the Foreign Military Sales process, under which the importing government contracts with the US government.
Contract risk and execution		
The Group has many contracts, including a small number of large contracts and fixed-price contracts.		
In 2020, 49% of the Group's sales were generated by its 15 largest programmes. At 31 December 2020, the Group had nine programmes with order backlog in excess of £1bn. A significant portion of the Group's revenue is derived from fixed-price contracts. Actual costs may exceed the projected costs on which the fixed prices are agreed and, since these contracts can extend over many years, it can be difficult to predict the ultimate outturn costs. It is important that the Group maintains a culture in which it delivers on its projects within tight tolerances of quality, time and cost performance in a reliable, predictable and repeatable manner.	The inability of the Group to deliver on its contractual commitments, the loss, expiration, suspension, cancellation or termination of any one of its large contracts or its failure to anticipate technical problems or estimate accurately and control costs on fixed-price contracts could have a material adverse effect on the Group's future results and financial condition.	Contract-related risks and uncertainties are managed under the Group's mandated Lifecycle Management process. A leadership development programme for project directors continues to be deployed across the Group, covering the leadership competencies required to manage complex projects containing significant levels of risk and uncertainty. A significant proportion of the Group's largest contracts are with the UK Ministry of Defence. In the UK, development programmes are normally contracted with appropriate levels of risk being initially held by the customer and contract structures are used to mitigate risk on production programmes, including where the customer and contractor share cost savings and overruns against target prices. The Group has a well-balanced spread of programmes and significant order backlog which provides forward visibility. The Group has limited exposure to fixed-price design and development activity which is in general more risk intensive than fixed-price production activity. Robust bid preparation and approvals processes are well established throughout the Group, with decisions required to be taken at the appropriate level in line with clear delegations of authority.

Description	Impact	Mitigation
Government customers		
The Group's largest customers are governments.		
The Group has long-standing relationships and security arrangements with a number of its government customers, including its three largest customers, the governments of the US, UK and Saudi Arabia, and their agencies. It is important that these relationships and arrangements are maintained. In the defence and security industries, governments can typically modify contracts for their convenience or terminate them at short notice. Long-term US government contracts, for example, are funded annually and are subject to cancellation if funding appropriations for subsequent periods are not made. The risk of modification, termination or cancellation of government contracts has recently increased due to the reprioritisation of government funds as a result of the outbreak of the COVID-19 pandemic. Governments also from time to time review their terms of trade and underlying policies and seek to impose such new terms and policies when entering into new contracts. The Group's performance on its contracts with some government customers is subject to financial audits and other reviews which can result in adjustments to prices and costs.	Deterioration in the Group's principal government relationships resulting in the failure to obtain contracts or expected funding appropriations, adverse changes in the terms of its arrangements with those customers or their agencies, or the termination of contracts could have a material adverse effect on the Group's future results and financial condition.	Government customers have sophisticated procurement and security organisations with which the Group can have long-standing relationships with well-established and understood terms of business. In the event of a customer terminating a contract for convenience, the Group would typically be paid for work done and commitments made at the time of termination.
Contract awards and cash profiles		
The Group is dependent on the award timing and cash profile of its contracts.		
The Group's profits and cash flows are dependent, to a significant extent, on the timing of, or failure to receive, award of defence contracts and the profile of cash receipts on its contracts. The timing of cash receipts could be impacted by the reprioritisation of government funds as a result of the outbreak of the COVID-19 pandemic.	Amounts receivable under the Group's defence contracts can be substantial and therefore, the timing of, or failure to receive, awards and associated cash advances and milestone payments could materially affect the Group's profits and cash flows for the periods affected, thereby reducing cash available to meet the Group's cash allocation priorities, potentially resulting in the need to arrange external funding and impacting its investment grade credit rating.	The Group's balance sheet continues to be managed conservatively in line with its policy to retain an investment grade credit rating and to ensure operating flexibility. The Group monitors a rolling forecast of its liquidity requirements to ensure that there is sufficient cash to meet its operational needs and maintain adequate headroom.

Our principal risks
continued

Description	Impact	Mitigation
Pension funding		
The Group has an aggregate funding deficit in its defined benefit pension schemes.		
In aggregate, there is an actuarial deficit between the value of the projected liabilities of the Group's defined benefit pension schemes and the assets they hold. The funding deficits may be adversely affected by changes in a number of factors, including investment returns and members' anticipated longevity.	Increases in pension scheme deficits may require the Group to increase the amount of cash contributions payable to these schemes, thereby reducing cash available to meet the Group's other cash allocation priorities.	In the UK, new employees have been offered membership of defined contribution rather than defined benefit schemes since April 2012 and, in the US, employees have not accrued salary-related benefits in defined benefit schemes since January 2013. In October 2019 the assets and liabilities of six of the Group's pension schemes were consolidated into a single scheme. This was carried out to drive long-term efficiencies. Following the merger, the Company and Trustees agreed to carry out an early triennial funding valuation as at 31 October 2019. In February 2020 that valuation and deficit recovery plan were agreed with the Trustees after consultation with The Pensions Regulator in the UK. The funding deficit as at 31 October 2019 was £1.9bn. As part of the valuation agreement, the Company paid £1bn into the Scheme in April 2020, representing an advancement of £1bn of deficit contributions due between 2022 and 2026. The UK triennial funding valuations for the other smaller UK pension schemes dated 31 March 2020 are being finalised. As at the previous valuations these schemes were in surplus.
Laws and regulations		
The Group is subject to risk from a failure to comply with laws and regulations.		
The Group operates in a highly-regulated environment across many jurisdictions and is subject, without limitation, to regulations relating to import-export controls, money laundering, false accounting, anti-bribery and anti-boycott provisions. It is important that the Group maintains a culture in which it focuses on embedding responsible business behaviours and that all employees act in accordance with the requirements of the Group's policies, including the Code of Conduct, at all times. Export restrictions could become more stringent and political factors or changing international circumstances could result in the Group being unable to obtain or maintain necessary export licences.	Failure by the Group, or its sales representatives, marketing advisers or others acting on its behalf, to comply with these regulations could result in fines and penalties and/or the suspension or debarment of the Group from government contracts or the suspension of the Group's export privileges, which could have a material adverse effect on the Group. Reduced access to export markets could have a material adverse effect on the Group's future results and financial condition.	BAE Systems has a well-established legal and regulatory compliance structure aimed at ensuring adherence to regulatory requirements and identifying restrictions that could adversely impact the Group's activities. Internal and external market risk assessments form an important element of ongoing corporate development and training processes. A uniform global policy and process for the appointment of advisers engaged in business development is in effect. BAE Systems continues to reinforce its ethics programme globally, driving the right behaviours by supporting employees in making ethical decisions and embedding responsible business practices.
Information technology security		
The Group could be negatively impacted by information technology security threats.		
The security threats faced by the Group include threats to its information technology infrastructure, unlawful attempts to gain access to its proprietary or classified information and the potential for business disruptions associated with information technology failures.	Failure to combat these risks effectively could negatively impact the Group's reputation among its customers and the public, cause disruption to its business operations, and could result in a negative impact on the Group's future results and financial condition.	The Group has a broad range of measures in place, including appropriate tools and techniques, to monitor and mitigate this risk.

Description	Impact	Mitigation
People		
The Group's strategy is dependent on its ability to recruit and retain people with appropriate talent and skills.		
Delivery of the Group's strategy and business plan is dependent on its ability to compete to recruit and retain people with appropriate talent and skills, including those with innovative technological capabilities. The Group's business plan is targeting an increasing level of business in international export markets outside the US and UK. It is important that the Group recruits and retains management with the necessary international skills and experience in the relevant jurisdictions.	The loss of key employees or inability to attract the appropriate people on a timely basis could adversely impact the Group's ability to deliver its strategy, meet the business plan and, accordingly, have a negative impact on the Group's future results and financial condition.	The Group recognises that its employees are key to delivering its strategy and business plan, and focuses on developing the existing workforce and hiring talented people to meet current and future requirements. The Group has well-established graduate recruitment and apprenticeship programmes and, in order to maximise the contribution that its workforce can make to the performance of the business, has an effective through-career capability development programme. In order to seek to maximise its talent pool, the Group is committed to creating a diverse and inclusive environment for its employees.
Acquisitions		
The anticipated benefits of acquisitions may not be achieved.		
BAE Systems considers investment in value-enhancing acquisitions where market conditions are right and where they deliver on its strategy. Whether BAE Systems realises the anticipated benefits from these transactions depends upon the successful integration of the acquired businesses as well as their post-acquisition performance in the markets in which they operate.	The diversion of management attention to integration efforts and the performance of the acquired businesses below expectations could adversely affect BAE Systems' business and create the risk of impairments arising on goodwill and other intangible assets.	The Group has established policies in place to manage the acquisition process, monitor the integration and performance of acquired businesses, and identify potential impairments.
Climate change and the environment		
The Group may be impacted by environmental factors, including those relating to climate change.		
The Group is subject to comprehensive environmental laws and regulations in each of the countries in which it operates, including those relating to the impacts of climate change. Such laws and regulations impose standards with respect to air emissions, wastewater discharges, the use, handling and storage of hazardous wastes and materials, remediation of soil and groundwater contamination and the prevention of pollution. They can also include energy-related taxes and the increased costs of compliance with energy-related schemes. The Group may also be impacted by environmental factors, including those arising from climate change, such as scarcity of water and other resources as well as extreme weather events such as, for example, flooding and storms.	Environmental factors, including those relating to climate change, have the potential to materially impact our business and operations. Increasing changes in environmental laws and regulations can expose the Company to increasing capital and operating costs associated with compliance, remediation and protection of the environment. Breaches of such laws and regulations can result in substantial costs, including fines, penalties or other sanctions, investigations and clean-up costs, and third-party claims for property damage or personal injury as well as the termination of permits.	We have taken a business-led approach to setting reduction targets and driving improvement programmes and activities to reduce our environmental impacts. We have an environmental management system in place for all of our businesses and short- and long-term risks relating to the environment and climate change, including those arising from current and emerging regulation, are built into these business environmental management systems. These systems enable us to define issues and set appropriate targets for the reduction of environmental and climate change impacts and risks. Understanding how the business may be impacted by environmental factors is also a key component of how we seek to mitigate emerging, medium- and longer-term risk. BAE Systems uses analytical tools to apply natural catastrophe classifications to each of its sites worldwide. This has informed our strategy as to where to target a programme of specific flood, windstorm and earthquake assessments of our sites and implement the subsequent risk reduction recommendations. In 2020, we conducted a refresh of this data and during 2021 we will be modelling climate scenarios for 2030, 2050 and 2085.

Additional risks and uncertainties currently unknown to the Group, or which the Group currently deems immaterial, may also have an adverse effect on the business or financial condition of the Group.

Strategic report

The Strategic report was approved by the Board of directors on 24 February 2021.

David Parkes
Company Secretary

Chairman's governance letter



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Dear Shareholders

There is no doubt that the challenges of COVID-19 have tested the fabric and culture of all organisations as they have adjusted operationally, socially and managerially to the demands of the pandemic.

In these circumstances, the quality of leadership, the strength of board membership, and the value of our relationships with employees, customers, suppliers and local communities have never been more important.

I am pleased to confirm that in 2020 the Company responded well to these challenges and I felt it would be helpful to provide some deeper insight into our performance in these areas.

Board leadership

The Board has consistently focused on promoting the long-term sustainable success of the Company, having regard to wider stakeholder interests including in particular the need to contribute to the wider needs of society.

In order to help it discharge its responsibilities and meet its aspirations as a valuable contributor to society at large, the membership of the Board has been drawn from a number of different nationalities, with a diverse mix of gender, skills and backgrounds that bring relevant contributions, robust opinions, quality oversight and collegiate engagement.

To plan for the future and help maintain these qualities, we have announced that two new non-executive directors, Dame Carolyn Fairbairn and Dr Ewan Kirk, will be joining the Board shortly.

During the last six years, the Board has been focused on refreshing the organisation, revising the culture, reinvigorating the performance and underpinning the long-term future by building a substantial order book, a clear strategy and a refreshed and capable leadership team.

The performance of the Company, as outlined in this report, demonstrates the success of this focus and there is no doubt that our Chief Executive, Charles Woodburn, has had a material impact on achieving this in the three years he has held the role.

His success and reputation have, of course, raised his executive profile in the wider corporate community, and during the course of the year he was offered a role outside of the Company with attractive career and reward prospects. As a Board, we were clear that his departure at this critical time in our development would impact the future success of the Company and be damaging for all stakeholders. Consequently, we took decisive action to secure his long-term commitment with a modified reward package.

With the Chief Executive's leadership firmly in place, a refreshed and capable senior executive team assembled and overseen and supported by a group of non-executive directors of considerable quality, I am confident that the Board is well placed to lead the successful growth of the Company in the years ahead.

Shareholders

The relationship with our major shareholders is of critical importance, and we seek to sustain and develop this through regular contact with the Chief Executive, Group Finance Director and Chief Executive Officer of our US business, and supported by a professional Investor Relations team. This is supplemented by direct contact with myself as Chairman and wider engagement through an annual shareholder forum that enables interaction between the non-executive members of the Board and major shareholders on all aspects of the business with an emphasis on non-financial and governance matters.

With the restrictions imposed by the pandemic, much of that contact has been limited to electronic communication, but as all parties have adjusted to the use of technology, the quality of interaction has remained productive and valued by both parties.

Employees

2020 has undoubtedly demonstrated the importance of a transparent, authentic and engaged relationship with all employees. The need for mutual trust and respect has been vital and has enabled safe working to continue, processes and procedures to be quickly revised, on-site working carefully managed where necessary to maintain production and support provided for those required to work from home.

I cannot thank our employees across the world enough for their outstanding response in these most difficult times. There is no doubt that we have drawn on the quality of the relationships built over many years through our engagement with employees, formal trades union interactions, our commitment to training and apprenticeships and our belief in open and transparent communication that is linked to the pride and passion for what we do as a business, in supporting the security and prosperity of the customers we serve.

In a year where physical site visits have not been possible due to the pandemic, we have supplemented our normal communication channels with much increased use of electronic communications, including video messaging from myself, the non-executive directors and the Chief Executive, podcasts and videoconferencing with group gatherings all over the world. The value of these interactions has been substantial and it is our intention to maintain the use of video messaging through the BAE Systems corporate app in a post-COVID-19 environment. Feedback from employees has been extremely positive and it is clear that this type of communication is an important addition to maintain a close link with colleagues across the world.

Customers

The relationships with our customers are strong and I believe we have seen an increased sense of partnership in all parts of the world as we strive to support each other despite the challenges faced. The work that we do in both supplying and servicing the armed forces in the UK, North America, Middle East and Australia is mission-critical and has required continuous operations throughout the pandemic. By working in close harmony, we have maintained a steady drumbeat of production and service provision. We are very appreciative of the support provided by our customers in ensuring we are appropriately paid for our products and services, and we in turn have ensured that the cash has flowed down to support our suppliers.

In periods of adversity, there is no doubt that loyalty, reliability and dependability are valued and remembered by all parties and I believe we will emerge from this period of crisis with stronger and deeper relationships as a result of our joint endeavours.

Suppliers

Through the pandemic, the preservation of strong, dependable supply chains has been critical. We have worked closely with our suppliers, providing advice and practical support, and have consistently sought to build mutually rewarding relationships with our suppliers by sharing knowledge and encouraging best practice in productivity and service.

As a leading member of 'Be the Business', a UK independent body of like-minded companies working in the nation's interest to improve productivity, we have continued to share insights into improved manufacturing techniques and mentoring for management best practice. The combination of practical support and positive communication has served both BAE Systems and its suppliers well in these difficult times.

Community

As a Company, we have a history of supporting the communities in which we work and the needs of people we serve.

This has been amplified this year with our contribution to the production of PPE and ventilators through the tireless commitment of our people who gave their efforts unstintingly around the clock at a time of great need both in the UK and US.

Our contribution to good causes both financially and through employee engagement has continued, including my own as Vice-President of the Royal Navy and Royal Marines Charity.

Our employees, by their actions, have always demonstrated their conviction that BAE Systems is an integral part of the nations and communities we protect and our involvement transcends the supply of products and services to being part of the societies we serve. This was never more evident than in 2020.

Sustainability

The Environmental, Social and Governance agenda has been, and continues to be, a priority for the Board. Our Corporate Responsibility Committee encourages, monitors and oversees our performance in this area with rigour and resolve.

To that end, we have made it a priority to deliver improved, measurable and reportable performance in all these key areas.

In particular, we recognise the environmental impact of our global operations and are committed to the development and implementation of a long-term decarbonisation strategy. In 2020 we accelerated our response in relation to climate change and a proposal for the Company's net zero strategy was put to the Corporate Responsibility Committee. Following a thorough review of the proposal the Company has set a target of achieving net zero greenhouse gas emissions across our operations by 2030.

We cannot do this alone and so we intend to collaborate with our suppliers and customers, and partner with researchers and technologists to innovate for a net zero future.



Sir Roger Carr
Chairman

Board governance

This is the structure through which we manage the Group including the Board division of responsibilities. The structure continues to evolve to meet the needs of the business and our stakeholder responsibilities.

Shareholders

Annual General Meeting

Shareholders vote on key governance matters, including the re-election of directors, their remuneration, the payment of dividends and the appointment of the auditor.

Shareholder relations

The Chief Executive and Group Finance Director meet the Group's principal shareholders on a regular basis. Separately, the Chairman maintains regular contact with the Group's principal shareholders on governance matters and ensures that all directors are aware of their views.

Board

The Board consists of executive and independent non-executive directors, plus a non-executive chairman who was independent in accordance with the UK Corporate Governance Code on his appointment.

Chairman

Leads the Board and is responsible for its overall effectiveness in directing the Company. Also facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information.

Chief Executive

Responsible for the implementation and delivery of the strategy agreed by the Board.

Senior Independent Director

Acts as a sounding board for the Chairman and acts as an intermediary for the other directors as necessary.

Company Secretary

Supports the Board by ensuring that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.

Board committees

The Operational Framework sets out how we do business across BAE Systems, and encapsulates our values, policies and processes, together with clear levels of delegated responsibility aimed at ensuring that all of our employees and businesses act in a clear, accountable and consistent manner. It is reviewed and approved annually by the Board.

Audit Committee

Page 111

Nominations Committee

Page 120

Remuneration Committee

Page 124

Corporate Responsibility Committee

Page 116

Operational governance

Our purpose

The Board has established the Company's Purpose (see page 1) that recognises we have an important role in society. Our Purpose connects with our strategy and culture.

Governance

The UK Corporate Governance Code's (the Code) principles are embedded in the Operational Framework, and its policies and processes underpin all the disclosures made by the Board pursuant to the Code's provisions.

How we conduct our business is fundamental to the success of BAE Systems. The Operational Framework sets out our approach and the standards to which we adhere.

Operational Framework

Our Operational Framework sets out the principles of good governance which, together with our culture, guide our work and behaviour in support of the strategy set in our Group strategic framework (see page 4). Here we set out the values that we ask all our employees to demonstrate in their day-to-day work, wherever they are in the world.

Organisation

From the Board downwards, we set out how we are organised and the responsibilities of the Board, the Chairman, the Chief Executive, the Executive Committee, our Functional Councils (such as Engineering, Human Resources and Procurement) and the senior executives charged with running our businesses.

Code of Conduct

Lays out the standards that are expected of each of us, to support us in doing the right thing. All employees receive annual training designed to stimulate conversations about ethical decision-making.

Responsible Trading Principles

We do not compromise on the way we do business and here we mandate a principles-based approach to our business activity.

Internal controls

Provide assurance regarding:

- the reliability and integrity of information;
- compliance with policies, processes, laws, regulations and contracts;
- the safeguarding of assets and protection against fraud; and
- the economical and efficient use of resources.

Risk framework

This is how we identify, analyse, evaluate and mitigate risk (see page 92).

Workplace and operational environment

This covers how we expect our people to be managed and the obligations placed on us all concerning avoiding conflicts of interest, anti-bribery, and managing the security of our people, information and other assets.

Delegated authorities

As part of a robust system of internal controls, the Board has delegated certain authorities to executive management. Delegation is subject to financial limits and other restrictions, above which matters must be referred to the Board.

Operational Assurance Statement

This key governance process requires that a return is completed every six months by each operational and functional business head, reporting their formal view against such matters as compliance with law and regulation, ethical business conduct, financial controls, risk management, compliance with business planning processes, health and safety, conflicts of interest, delegated authorities, appointment of advisers and product safety.

There is a separate OAS process for our joint ventures. Our Internal Audit function owns the OAS process. It is managed independently from management functions. The Internal Audit Director reports functionally to the Audit Committee and, for day-to-day operations, to the Chief Executive.

Culture

The Board assesses and monitors the Company's culture to ensure that it is aligned with our purpose, values and strategy. Each year, it reviews the nature of the issues reported through our global network of Ethics Officers and our Ethics Helpline (see pages 53 and 54). Directors engage regularly with customers and employees, and the Board uses this and other feedback to monitor Company culture.

Core business processes

These core business processes are mandated by the Operational Framework and designed to ensure consistent planning, reporting and review of business performance across all businesses.

Integrated Business Planning

Creates an agreed five-year business plan and robust strategy against which performance is monitored through our Performance Management Process.

Lifecycle Management Framework

How we plan and manage the execution of all projects above a certain minimum level, providing decision gate reviews at key stages from initial opportunity to final closure.

Mergers, Acquisitions and Disposals process

A structured approach to mergers, acquisitions and disposals.

Leadership Framework

Supports the development of a diverse and inclusive culture that delivers the Group strategy. Provides a principled approach to employee performance, assessment, development and reward.

Page 04
Our strategic framework

Applying the UK Corporate Governance Code Principles

Applying Principles of Good Governance: The Company has applied the Principles in the UK Corporate Governance Code. Using the principal headings in the Code, the following provides details of how it has applied those principles and references other parts of these reports to provide more detail. The statements reference the Code Principles.

Section 1 – Board leadership and Company purpose

Principles	Reference
A. We have an effective and entrepreneurial Board that promotes the long-term sustainable success of the Company, generates value for shareholders and contributes to wider society.	Page 50 Supporting our local communities Page 62 Dividends paid and capital allocation policy objectives Page 122 Annual Board evaluation
B. The Board has established the Company's purpose, values and strategy, and satisfied itself that these and its culture are aligned. All directors are required to act with integrity, lead by example and promote the culture they wish to see for the Company.	Page 01 Our purpose Page 04 Our strategic framework Page 53 Sustainability – Governance Page 102 Board governance Page 116 Corporate Responsibility Committee report
C. Through the Company's integrated strategic planning process the Board has agreed annual and long-term strategic and financial objectives for the Company. The integrated nature of the planning process will help ensure that the necessary resources are in place to meet those objectives. The Board regularly reviews progress against the plan. The Company has a comprehensive controls structure that enables risk to be assessed and managed.	Page 06 Our business model Page 102 Board governance – Operational Assurance Statement – Integrated Business Planning – Lifecycle Management Policy
D. In order for the Company to meet its responsibilities to shareholders and stakeholders, the directors have established a number of means through which it is able to engage with them in order to better understand their views and expectations.	Page 08 Our stakeholders Page 30 The work of the Board Page 116 Corporate Responsibility Committee report
E. The Board looks to ensure that workforce policies and practices are consistent with our values and support our long-term sustainable growth. All members of our workforce are able to raise any matters of concern through our Ethics Helpline or with a local Ethics Officer.	Page 01 Our purpose Page 04 Our strategic framework Page 42 Sustainability – Social

Section 2 – Division of responsibilities

F. The Chairman leads the Board and is responsible for the overall effectiveness of the Board in directing the Company. In doing so he seeks to demonstrate objective judgement and promotes a culture of openness and debate within the boardroom. The directors are provided with accurate, timely and clear information, to facilitate open and constructive board relations.	Page 102 Board governance Page 122 Annual Board evaluation
G. The Board comprises the Chairman, three executive directors and seven non-executive directors. There is a clear division in the roles and responsibilities of the executive and non-executive directors and between the Chairman and Chief Executive which are detailed in our Board Charter (available on the Company's website).	Page 102 Board governance Page 100 Chairman's governance letter
H. The non-executive directors have committed to having sufficient time to meet their responsibilities. The non-executive directors provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.	Page 102 Board governance Page 108 Board information Page 109 Governance disclosures
I. The Company Secretary supports the Board in ensuring the directors have the correct policies, processes, information and time in order to function effectively and efficiently.	Page 102 Board governance Page 123 Board performance evaluation

Section 3 – Composition, succession and evaluation

Principles	Reference
J. The Nominations Committee undertakes a formal, rigorous and transparent approach to succession planning for Board appointments. The Board oversees the development and implementation of succession plans for directors and senior management. Appointments and succession plans are based on merit and objective criteria, whilst also promoting diversity in all forms.	Page 108 Board information Page 120 Nominations Committee report
K. The directors look to maintain a good combination of skills, experience and knowledge on the Board and on its committees. Succession plans take into consideration the lengths of service of directors and the need to regularly refresh Board membership.	Page 100 Chairman's governance letter Page 108 Board information Page 120 Nominations Committee report
L. The Board annual performance evaluation undertaken by the Board in 2020 considered its composition, diversity and how effectively members worked together to achieve objectives. The evaluation included an assessment of the effectiveness of individual members.	Page 120 Nominations Committee report Page 122 Annual Board evaluation

Section 4 – Audit, risk and internal control

M. The Board through its Audit Committee has established formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and the work they undertake assists the Board in satisfying itself as to the integrity of financial and narrative statements.	Page 111 Audit Committee report
N. As detailed in these reports, the directors confirm they consider the 2020 Annual Report and financial statements taken as a whole to be fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy.	Page 176 Directors' responsibility statement
O. The Board has established procedures to manage risks, it also oversees the internal control frameworks and determines the nature and extent of the principal risks the Company is willing to take in order to achieve its long-term strategic objectives.	Page 92 Our risk management framework Page 93 Our principal risks Page 102 Board governance

Section 5 – Remuneration

P. The policies and practices of the Remuneration Committee have been designed to support our strategy and promote the long-term sustainable success of the Company. Executive remuneration is aligned to Company purpose and values and is linked to the successful delivery of our long-term strategy.	Page 124 Remuneration Committee report Page 129 Annual remuneration report
Q. The Remuneration Committee has a formal and transparent procedure for developing policy on executive remuneration and also for determining the remuneration of directors and senior management. Directors are not involved in determining their own remuneration outcome.	Page 124 Remuneration Committee report Page 156 Directors' remuneration policy
R. The Remuneration Committee has the ability to exercise its discretion and independent judgement when agreeing remuneration outcomes. When exercising such discretion it will take into account Company and individual performance, and also wider circumstances.	Page 124 Remuneration Committee report

Board of directors



Sir Roger Carr
Chairman



Dr Charles Woodburn
Chief Executive



Brad Greve
Group Finance Director



Tom Arseneault
President and Chief Executive Officer of BAE Systems, Inc.



Nick Anderson
Non-executive director



Dame Elizabeth Corley
Non-executive director



Dr Jane Griffiths
Non-executive director



Chris Grigg CBE
Non-executive director and Senior Independent Director



Stephen Pearce
Non-executive director



Nicole Piasecki
Non-executive director



Ian Tyler
Non-executive director

- Chairman
- Executive directors
- Non-executive directors

A Sir Roger Carr Chairman

Appointed to the Board: 2013 **Nationality:** UK

Skills, competence and experience
Having joined the Board in 2013, Sir Roger was appointed Chairman in 2014. He is an experienced company chairman with a wealth of knowledge gained across a number of business sectors. With over three decades of boardroom experience, Sir Roger has a deep understanding of corporate governance and what is required to lead an effective board.

Sir Roger is a Senior Advisor to KKR, Chairman of the English National Ballet and Vice President of the Royal Navy and Royal Marines Charity.

He has previously held a number of senior appointments including Chairman of Centrica plc, Vice Chairman of the BBC Trust, Deputy Chairman and Senior Independent Director of the Court of the Bank of England, President of the Confederation of British Industry, Chairman of Cadbury plc, Chairman of Chubb plc, Chairman of Mitchells & Butlers plc, Chairman of Thames Water plc and Chief Executive of Williams plc.

Throughout his career he has served on a number of external committees including the Prime Minister's Business Advisory Group, the Manufacturing Council of the CBI, The Higgs Committee on Corporate Governance and Business for New Europe. He is a Fellow of the Royal Society for the encouragement of Arts, Manufactures and Commerce, a Companion of the Institute of Management, and an Honorary Fellow of the Chartered Governance Institute. He is also a Visiting Fellow of Saïd Business School, University of Oxford and holds an Honorary Doctorate in Business from Nottingham Trent University.

He was knighted for Services to Business in the Queen's New Year's Honours list 2011.

Other non-executive appointments
None.

Committee membership
Chairman of the Nominations Committee.

B Dr Charles Woodburn Chief Executive

Appointed to the Board: 2016 **Nationality:** UK

Skills, competence and experience
Charles joined BAE Systems in May 2016 as Chief Operating Officer and became Chief Executive on 1 July 2017.

Based on strong engineering and technology credentials, Charles is an experienced business leader with over 25 years' experience in the defence and aerospace, and oil and gas industries. Prior to joining the Company in 2016 he was Chief Executive Officer of Expro Group, before which he spent 15 years with Schlumberger Limited holding a number of senior management positions in the Far East, Australia, Europe and the US. He is a Fellow of the Royal Academy of Engineering.

Non-executive appointments
None.

C Brad Greve Group Finance Director

Appointed to the Board: 2020 **Nationality:** US

Skills, competence and experience
Brad joined BAE Systems in 2019 as Group Finance Director Designate and joined the Board on 1 April 2020.

He is a highly experienced executive with deep financial and operational management experience gained over a 30-year career in international engineering and technology businesses. Prior to joining the Company he held a number of senior executive roles in Schlumberger, undertaking roles in Europe, Africa, South America and the United States.

Non-executive appointments
None.

D Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.

Appointed to the Board: 2020 **Nationality:** US

Skills, competence and experience
Tom was appointed to the Board on 1 April 2020, serving as President and Chief Executive Officer of BAE Systems, Inc. Throughout his career, Tom has led complex organisations responsible for fulfilling critical and technologically challenging missions. Most recently he served as President and Chief Operating Officer of BAE Systems, Inc., having held various senior roles within BAE Systems, Inc.

Prior to his senior leadership appointments, Tom managed various organisations and programmes for Sanders, a Lockheed Martin company, until it was acquired by BAE Systems in 2000. Earlier in his career, he held a variety of engineering and programme management positions with General Electric and TASC.

Non-executive appointments
None.

E Nick Anderson Non-executive director

Appointed to the Board: 2020 **Nationality:** UK

Skills, competence and experience
As Group Chief Executive of a FTSE 100 industrial engineering company, Nick has a strong record of leading and growing global businesses. His knowledge and experience, particularly in leading international engineering and manufacturing operations, are a particular asset to the Board.

Since being appointed Group Chief Executive of Spirax-Sarco Engineering plc in January 2014, Nick has overseen the successful global growth of Spirax-Sarco Engineering, which serves customers in 130 countries worldwide. Prior to joining Spirax-Sarco Engineering plc in 2011, Nick worked for Smiths Group plc as Vice-President of John Crane Asia Pacific and previously President of John Crane Latin America.

Other non-executive appointments
None.

Committee membership
Nominations Committee and Corporate Responsibility Committee.

F Dame Elizabeth Corley Non-executive director

Appointed to the Board: 2016 **Nationality:** UK

Skills, competence and experience
Dame Elizabeth brings investor, governance and boardroom experience to the Board. She currently chairs the board of the Impact Investment Institute, having previously chaired the industry Taskforce on Social Impact Investing for the UK government. She served as Chief Executive Officer of Allianz Global Investors, initially for Europe then globally, from 2005 to 2016. Prior to that, she worked for Merrill Lynch Investment Managers. Dame Elizabeth is active in representing the investment industry and developing standards within it.

She is a member of the CFA Future of Finance Advisory Council, the AQR Institute of Asset Management at the London Business School, the Committee of 200 and the 300 Club; and is a former member of the board of the UK Financial Reporting Council.

Dame Elizabeth is also an acclaimed writer, a Fellow of the Royal Society for the encouragement of Arts, Manufactures and Commerce and a trustee of the British Museum.

Other non-executive appointments
Non-executive director of Pearson plc and Morgan Stanley.

Committee membership
Audit Committee, Nominations Committee and Remuneration Committee.

G Dr Jane Griffiths Non-executive director

Appointed to the Board: 2020 **Nationality:** UK

Skills, competence and experience
Appointed to the Board on 1 April 2020, Jane brings experience in leading high technology businesses and international corporate leadership to the Board. During her career with Johnson & Johnson, she held various executive positions and led its Corporate Citizen Trust in EMEA and sponsored its Women's Leadership Initiative.

Jane previously had been Company Group Chair of Janssen EMEA, the group's research-based pharmaceutical arm, where she was sponsor of Janssen's Global Pharmaceuticals Sustainability Council. She is a former Chair of the European Federation of Pharmaceutical Industries and Associations, past Chair of the PhRMA Europe Committee and former member of the Corporate Advisory Board of the UK government-backed 'Your Life' campaign, aimed at encouraging more people to study STEM subjects.

Other non-executive appointments
Non-executive director of Johnson Matthey Plc.

Committee membership
Chair of the Corporate Responsibility Committee and member of the Nominations Committee.

H Chris Grigg CBE Non-executive director and Senior Independent Director

Appointed to the Board: 2013 **Nationality:** UK

Skills, competence and experience
Chris recently retired as Chief Executive of The British Land Company PLC, a position he held for over 11 years. He brings extensive public company business leadership experience to the Board. He is currently a senior adviser to HM Treasury.

He has more than 30 years' experience in the banking and real estate industries. Prior to joining British Land, he was Chief Executive of Barclays Commercial Bank. Before that, he was a partner at Goldman Sachs. Chris is a former member of the executive board of the European Public Real Estate Association and the board of the British Property Federation.

Other non-executive appointments
None.

Committee membership
Corporate Responsibility Committee, Remuneration Committee and Nominations Committee.

I Stephen Pearce Non-executive director

Appointed to the Board: 2019 **Nationality:** AU

Skills, competence and experience
Appointed to the Board on 1 June 2019, Stephen has more than 20 years of public company experience and over 30 years of financial and commercial experience in the mining, oil and gas, and utilities industries. Stephen is currently Finance Director of Anglo American plc, a role he has held since April 2017, and a director of Anglo American Platinum Limited and De Beers plc, both of which are non-wholly-owned subsidiaries of Anglo American plc.

He previously served as CFO and an executive director of Fortescue Metals Group Limited from 2010 to 2016. He is a Fellow of the Institute of Chartered Accountants, a Fellow of the Governance Institute of Australia and a Member of the Australian Institute of Company Directors.

Other non-executive appointments
None.

Committee membership
Chairman of the Audit Committee and member of the Nominations Committee.

J Nicole Piasecki Non-executive director

Appointed to the Board: 2019 **Nationality:** US

Skills, competence and experience
Nicole was appointed to the Board on 1 June 2019 and brings extensive experience gained from executive positions within the aerospace industry and leadership of multi-functional teams. She previously held a number of engineering, sales, marketing and business strategy roles during her 25-year career with the Boeing Company, including Vice President and General Manager of the Propulsion Systems Division and Vice President of Business Development & Strategic Integration for Boeing's commercial aircraft business, and President of Boeing Japan.

She is Chair of the Board of Trustees of Seattle University. Nicole formerly served on the Federal Aviation Authority's Management Advisory Board, the US Department of Transportation's Future of Aviation Advisory Committee and the Federal Reserve Bank of San Francisco's Seattle branch.

Other non-executive appointments
Weyerhaeuser Company and Howmet Aerospace Inc.

Committee membership
Nominations Committee and Corporate Responsibility Committee.

K Ian Tyler Non-executive director

Appointed to the Board: 2013 **Nationality:** UK

Skills, competence and experience
Ian brings considerable financial and long-term international contracting experience to the Board. Having qualified as a chartered accountant, Ian subsequently held a number of senior finance and operational positions within industrial companies before being appointed Finance Director of Balfour Beatty plc in 1996. He was subsequently appointed as Chief Executive in 2005. He is currently Chairman of the UK housebuilding company, Vistry Group PLC.

Ian was formerly Chairman of Cairn Energy PLC and non-executive director of Mediclinic International plc, Cable & Wireless Communications Plc and VT Group plc.

Other non-executive appointments
Chairman and non-executive director of Amey plc, a subsidiary of Ferrovial, S.A., AWE Management Limited and Affinity Water Limited.

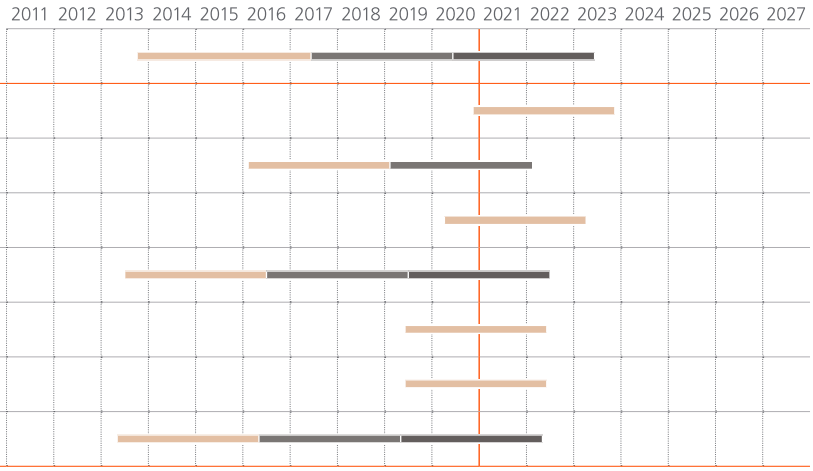
Committee membership
Chairman of the Remuneration Committee, and member of the Audit Committee and Nominations Committee.

Board information

- Chairman
- Non-executive director
- Executive director
- Committee chair
- A Audit Committee
- C Corporate Responsibility Committee
- N Nominations Committee
- R Remuneration Committee
- First term
- Second term
- Third term

Membership

	Committee membership	Nationality
Sir Roger Carr Chairman[1]	N	UK
Nick Anderson Non-executive director	C N	UK
Dame Elizabeth Corley Non-executive director	A N R	UK
Jane Griffiths Non-executive director	C N	UK
Chris Grigg Non-executive director	C N R	UK
Stephen Pearce Non-executive director	A N	AU
Nicole Piasecki Non-executive director	C N	US
Ian Tyler Non-executive director	A N R	UK



The average length of appointment of non-executive members of the Board (as at 31 December 2020) was four years.

		Date of appointment to the Board of executive members
Charles Woodburn Chief Executive	UK	9 May 2016
Brad Greve Group Finance Director	US	1 April 2020
Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.	US	1 April 2020

The average length of appointment of executive members of the Board (as at 31 December 2020) was two years.

1. Sir Roger Carr joined the Board in October 2013 and was appointed as Chairman in February 2014.

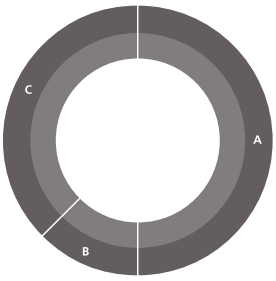
Attendance

Individual directors' attendance at meetings of the Board and its committees in 2020

	Board	Audit Committee	Corporate Responsibility Committee	Nominations Committee	Remuneration Committee
Revathi Advaithi[1]	4/4	–	1/2	1/1	–
Nick Anderson[2]	2/2	–	–	1/1	–
Tom Arseneault[3]	6/6	–	–	–	–
Sir Roger Carr	8/8	–	–	4/4	–
Dame Elizabeth Corley	8/8	5/5	–	4/4	8/8
Jerry DeMuro[4]	1/2	–	–	–	–
Brad Greve[3]	6/6	–	–	–	–
Jane Griffiths[3]	6/6	–	2/2	1/1	–
Chris Grigg	8/8	–	4/4	4/4	8/8
Peter Lynas[4]	1/2	–	–	–	–
Stephen Pearce	8/8	5/5	–	4/4	–
Nicole Piasecki	8/8	–	2/2	3/4	–
Paula Rosput Reynolds[5]	8/8	–	–	4/4	8/8
Nick Rose[5]	8/8	–	–	4/4	–
Ian Tyler	8/8	5/5	4/4	4/4	8/8
Charles Woodburn	8/8	–	–	–	–

1. Retired on 25 June 2020.
2. Appointed on 1 November 2020.
3. Appointed on 1 April 2020.
4. Retired on 31 March 2020.
5. Retired on 31 December 2020.

Tenure – independent non-executive directors



A	Up to three years	4
B	Over three and up to six years	1
C	Over six years	3

Board diversity



Governance disclosures

UK Corporate Governance Code (the Code) compliance: The Company was compliant with the provisions of the Code throughout 2020 with the exception of Provision 38 concerning pension contribution rates for executive directors (see below), and the Board has applied its principles in its governance structure and operations (see page 102). The following statements are made in compliance with the Code.

Code compliance

Provision 38 of the Code states: "the pension contribution rates of executive directors, or payments in lieu, should be aligned with those available to the workforce". The Remuneration Committee has considered this requirement with regard to pension arrangements for Charles Woodburn, the Chief Executive. Recognising the practical issues involved and the Company's existing contractual commitments, it was agreed that his employer pension contribution rate should be fixed at its monetary value as at the beginning of 2020 (at which point it was 19% of his base salary). Consequently, it is anticipated that his contribution rate will, over time, reduce to the weighted average of employer contribution rates for active members across all UK pension schemes (see Remuneration Committee report, page 127). Peter Lynas was Group Finance Director up to 31 March 2020, when he retired. His pension contribution rate did not comply with Code Provision 38 but Brad Greve, who succeeded him in that role, has an employer pension contribution rate in line with that of the wider UK workforce participating in the Company's defined contribution pension arrangements.

Risk management and internal control statement

The Board is responsible for the Company's risk management and internal control systems. It has delegated responsibility for reviewing in detail the effectiveness of these systems to the Audit Committee, which reports to the Board on its findings so that all directors can take a view on the matter.

An overview of the processes used to identify, evaluate and manage the principal risks can be found on pages 90 to 99. These processes are an integral part of our governance framework, the Operational Framework, details of which can be found on page 102. The Operational Framework mandates the Operational Assurance Statement process, which is owned by the Company's Internal Audit function and is one of the principal processes used by the Board in monitoring the effectiveness of control systems.

The risk management and internal control systems detailed in the Operational Framework were in place throughout the year and the Board, having reviewed their effectiveness, believes they accord with the Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

Viability statement

As required by the provisions of the Code, the Board has undertaken an assessment of the future prospects of the Company, taking into account the Company's current position and principal risks. This assessment considered both the Company's long-term prospects and also its ability to continue in operation and meet its liabilities as they fall due over its five-year business planning period.

Analysis of business prospects

The Board has considered the long-term prospects of the Company based on our strategy, markets and business plan as outlined on pages 18 to 55 of this report. In its strategic review of the Company, the Board recognised the importance of certain factors that underpin its long-term prospects and viability. In summary, these are:

- a diverse portfolio of businesses based on well-established market positions, providing both complex, high technology products and programmes, and differentiated technical services and support. In 2020, 36% of Group sales were product/programme related and 64% services and support;
- a geographically diverse business with a high proportion of sales to governments and other major prime defence contractors. In 2020, 36% of sales were to the US Department of Defense, 21% to the UK Ministry of Defence and 13% to the Kingdom of Saudi Arabia Ministry of Defence and Aviation. In recent years, major new business wins in the Middle East, Australia, Canada and Germany provide a strong foundation for further market diversity and growth;
- long-term visibility of sales and future sale prospects through a substantial order backlog and incumbent positions on major defence programmes; and
- market positions underpinned by a highly skilled workforce, intellectual property assets and proprietary know-how, which are safeguarded and developed for the future by customer- and Company-funded investment. Such investment is focused on a well-developed understanding of future technologies and the threat environment shaping the long-term defence and aerospace market.

Assessment

The Board's assessment of the Company's prospects was informed by the following business processes:

Risk management process – the Company has developed a structured approach to the management of risk (see above) and emerging and principal risks identified are considered as part of the Board's annual review of the Integrated Business Plan.

Integrated Business Plan (IBP) – the IBP represents a common process with standard outputs and requirements that produces an integrated strategic and business plan for the Group and also for each of its businesses over the following five years. The use of a five-year period provides a robust planning tool against which long-term decisions can be made concerning, amongst other things, strategic priorities, funding requirements (including commitments to Group pension schemes), returns made to shareholders, capital expenditure and resource planning. Longer-term strategic inputs also form part of the IBP process and, where activity is required to meet such long-term priorities, this is provided for in the plan.

The detailed plan is reviewed each year by the Board as part of its strategy review process. Once approved by the Board, the IBP provides the basis for setting all detailed financial budgets and strategic actions across the businesses, and is subsequently used by the Board to monitor performance.

Liquidity analysis – the Company's liquidity is underpinned by an undrawn committed Revolving Credit Facility of £2bn contracted to April 2025, and is available to meet general corporate funding requirements. The Board regularly reviews an analysis based on the financial output from the IBP, looking at the forecast working capital requirements, cash flow, and committed borrowing and other funding facilities available to the Company over the five-year period covered by the IBP. This analysis includes 'stress testing' of the Company's liquidity under severe, but plausible, scenarios as developed from the IBP, including the following:

- the Company being unable to access debt markets to renew term debt facilities;
- an unfavourable change to the terms of trade the Company enjoys with certain principal customers; and
- the loss of a major export market.

The scenarios tested included the impact of multiple adverse factors.

Conclusion

In undertaking its review of the IBP in 2020, the Board considered the prospects of the Company over the five-year period covered by the process. On the basis of this and other matters considered and reviewed by the Board, the Board has reasonable expectations that the Company will be able to continue in operation and meet its liabilities as they fall due over the following five years. It is recognised that such future assessments are subject to a level of uncertainty that increases with time and, therefore, future outcomes cannot be guaranteed or predicted with certainty. Also, this assessment was made recognising the principal risks that could have an impact on the future performance of the Company (see pages 90 to 99).

Going concern statement

Accounting standards require that directors satisfy themselves that it is reasonable for them to conclude whether it is appropriate to prepare financial statements on a going concern basis and the Code requires that, if appropriate, this report includes a statement to that effect. Following review, the directors have concluded that it is appropriate to adopt the going concern basis for these financial statements and have not identified any material uncertainties concerning the Company's ability to do so in the 12-month period from the date of approving them.

For this reason, they continue to adopt the going concern basis in preparing the accounts.

Directors

In compliance with the Code, all directors are subject to annual re-election by shareholders.

Prior to making Board appointments, the Board considers other demands on an individual's time to ensure that, following appointment, directors have sufficient time to meet their board responsibilities. Non-executive directors are required to seek prior approval before taking on additional external appointments.

In addition to being a non-executive director of the Company, Ian Tyler is chairman of Vistry Group PLC, a listed FTSE 250 company, and three unlisted companies: AWE Management, a private company owned by three joint venture partners; Amey plc, a subsidiary of Ferrovial, S.A., a Spanish listed company; and Affinity Water Limited. His appointment with AWE Management will end in June 2021.

The Chairman has reviewed Ian's commitments and is satisfied that he has sufficient time to meet his responsibilities to BAE Systems. This position will be kept under review.

Dame Elizabeth Corley, a non-executive director, is also a non-executive director of Pearson Plc and of Morgan Stanley, a US-listed company. One of its UK subsidiaries provides broking services to the Company. Consequently an assessment was undertaken to assess whether this relationship has a bearing on her independence for the purpose of Provision 10 of the Code. After review, it was determined that it was not a material business relationship given the relatively low value of the contractual arrangements and the nature of the relationship, i.e. broking services are provided by a UK subsidiary of Morgan Stanley, and her appointment is to the board of the US parent company and non-executive in nature. Should there be any material change in either her role with Morgan Stanley or the services its UK subsidiary provides to the Company, this decision will be reconsidered.

The Board considers all of the non-executive directors shown on pages 106 and 107 of this report to be independent in accordance with Code provisions.

Audit Committee report



Stephen Pearce
Chairman of the
Audit Committee

Members

Stephen Pearce (Chairman)
Dame Elizabeth Corley
Ian Tyler

Dear Shareholders

I am pleased to present the Audit Committee's report for the financial year ended 31 December 2020. It has been an interesting, and indeed challenging, year, set against the backdrop of the global pandemic where corporates have been faced with the challenges of having to address a wide range of unprecedented issues whilst at the same time striving initially to keep employees safe and their businesses on an even keel, and then to operate as closely as possible on a business as usual level – a real live and protracted testbed for sound governance, effective business continuity planning, risk mitigation, decision-making agility and corporate resilience.

The Company's operational response to the global pandemic is set out on page 27. The elements which comprise the Company's system of internal controls – primarily the Operational Framework; mandated reviews that provide visibility of business performance; the Operational Assurance Statement (OAS) process; and independent assessment of the effectiveness of internal controls – continued to operate throughout the year.

The Audit Committee too continued to focus throughout the year on the key areas of its remit whilst also focusing on the COVID-19 impacts. The section on the Audit Committee's year on page 115 provides an overview of the work that we have undertaken in the last 12 months and I will comment below on various aspects of that activity.

The Committee also remains mindful of the changing governance landscape and potential weight of anticipated regulation in the near future, particularly given the number of formal reviews undertaken recently regarding different aspects of the statutory audit sector including, amongst other things, the perceived widening of the 'audit expectation gap'. Whilst UK government focus has necessarily been heavily engaged in steering a way through the pandemic, we expect regulatory attention to gather pace during the year ahead and will be looking to consider the outputs from that process as appropriate.

External audit

Deloitte LLP was originally appointed by the shareholders in 2018 as our external auditor and has just completed the third year of its first five-year cycle.

In June we agreed the scope and level of materiality of the 2020 audit plan of work and discussed with Deloitte the areas that they had identified as key risks and other particular areas of focus, and the specific audit procedures that they would perform to undertake the related audit work. The scope of work took account of the evolution of the Group and programme status as well as rotational scoping requirements under international auditing standards, with four business units coming into scope for the first time.

To take account of the COVID-19 environment, the audit timetabling and resourcing was reassessed; however, there were no major changes to the way in which the audit was executed other than a greater need to work remotely, including developing data sharing solutions. Risk assessments were undertaken to determine potential areas of increased risk as a result of COVID-19, and the audit programme was kept flexible to accommodate any additional impacts. The Company adjusted the date of its annual report approval and preliminary announcement to the market to enable an additional week to be factored into the full-year audit timetable than would otherwise have been the case.

Audit independence

We have reviewed in detail the confirmation and information received from Deloitte on the arrangements that they have in place to safeguard auditor independence and objectivity, which are consistent with the ethical standards published by the Financial Reporting Council (FRC), including specific safeguards in place where they are providing permissible non-audit services to the Group.

Non-audit services policy

The Committee has a formal policy governing the engagement of the auditor to provide non-audit services which we review on an annual basis. The policy prohibits certain activities from being undertaken by the auditor and also places restrictions on the employment of former employees of the auditor.

The policy permits the provision of Audit-Related Services and Permitted Non-Audit Services up to limits that are pre-approved by the Committee, with specific approvals required beyond such limits by the Committee. Such approvals are kept to a minimum and relate to work which, by its nature, is most appropriately carried out by the auditor.

The new UK Ethical Standard came into force in 2020 and changes to policy were made to reflect the new requirements. A copy of the policy is available on the Company's website.

Details of fees payable to the auditor are set out on page 199. In 2020, non-audit fees for Deloitte represented 16% of the audit fee. The principal non-audit services provided by Deloitte related to their review of the Half-yearly report, US benefit plan audits and non-audit work in relation to the two bond issues referred to on page 29.

Audit Committee report
continued

Audit independence and effectiveness

The scope and output of our annual review of the independent effectiveness of the 2020 audit is set out below.

Audit Quality Review (AQR)

The FRC's AQR team monitors the quality of audit work of certain UK audit firms through inspections of a sample of audits and related procedures at individual audit firms. Deloitte has taken us through the findings from its latest AQR report and outlined initiatives being taken in respect of the firm's evolution of its firmwide audit approach and methodology.

Internal control and risk

The Board has delegated to the Committee responsibility for reviewing in detail the effectiveness of the Company's risk management and internal control system.

It is recognised that remote working and social distancing have placed strain on established processes and procedures. As the business responded to COVID-19, reliance on first, second and third line assurance providers to monitor the effectiveness of the control environment was heightened. Focus areas for assurance teams included health, safety and wellbeing, physical and cyber security, financial controls (including procurement), and export controls.

The Committee's review of the effectiveness of internal controls has encompassed a review of the reports relating to the six-monthly OAS, which are submitted by each business or function as a mandated policy under the Group-wide Operational Framework.

Documentation of the governance changes implemented in response to COVID-19 through the half-year OAS process acted as a record of management response and expected control.

Other control reports, and reports from both internal and external auditors, supported the Audit Committee's assessment of the control environment.

We have discussed the outputs of financial, IT and Lifecycle Management (LCM) controls testing, and any required improvement actions, with management, and internal and external audit, with a view to ensuring the ongoing robustness of the financial and operational environment, programme execution and risk mitigation. Areas of specific focus have included the following:

- **LCM** – the bedrock of our programme execution and management, LCM is integral to the successful execution of the Group's projects and programmes, and of particular importance in the early identification of programme risk and the determination of profit recognition or provisioning which tend to be areas where judgement is required to be exercised. At the current time, when the Group has several large programmes in relatively early stages, adherence to LCM methodology is vital to ensure timely delivery, at target or better margins.
- **General IT controls** – the importance of a strong IT control environment is acknowledged and remediation is a key focus where testing has identified that improvement is required.
- **Cyber risk** – remains a key focus for many corporates. The IT assurance and governance programme has been further developed over the year with input and support from the Internal Audit function.
- **Export controls compliance** – the Group General Counsel has kept us up-to-date during the year with ongoing developments in the export control compliance programmes and enhancements to existing procedures.

We have reviewed the ongoing effectiveness of the Company's risk management processes as part of our wider review of internal controls. The Group's principal risks are set out on pages 93 to 99.

The Committee has also met with the Director of Insurable Risk to receive an update on insurance matters and market conditions.

Internal Audit

Internal Audit plays an integral role in the Company's governance structure and provides regular reports to the Committee on its assessment of governance and controls across the Group. These include an overview of the work undertaken in the period under review, individual reports on audits conducted, progress against the agreed internal audit plan and the tracking of remedial action in the case of any control failures. Internal Audit also reports the outputs of the twice-yearly OAS process. Specific attention has been paid during the year to ensure governance and controls have been maintained during the COVID-19 period. As well as financial and export controls, programme execution and operational excellence continue to be areas of focus for assurance work.

A rolling three-year flexible internal audit programme has been developed and mapped against the Group's overall strategic priorities and risks, and those of the businesses. The aim is to enable Internal Audit to take a greater thematic approach to audits at Group level, whilst retaining flexibility aligned to business dynamics and emerging risk.

The three-year programme is prepared by Internal Audit using a risk-based approach. The programme for the year ahead is agreed jointly by the Audit and Corporate Responsibility Committees to ensure that the overarching programme covers not only financial and business risk, but also the assessment of the effectiveness of key areas of ethical and reputational risk. The assurance programme comprises a broad range of audits covering areas such as mandated governance, OAS outputs, risk register findings, change programmes, structural, business and regulatory changes, and areas

How the independence and effectiveness of the external audit process was assessed

Who we surveyed:

- Senior executives, including key finance roles
- Internal Audit Director

Areas we covered:

- Commitment to audit quality
- Technical knowledge
- Professional scepticism and robustness of challenge
- Understanding of industry and business risk
- Understanding of our internal control systems
- Quality of communications
- Level and quality of resourcing
- Commitment to improved standards

as well as interaction with the Committee members.

The output from the review was positive with the external auditor having delivered an effective audit in challenging COVID-19 conditions, providing robust and constructive challenge, and focusing on continual improvement. The benefit of maintaining continuity of audit teams was noted as the external auditor continued to build on its understanding of the Group's business and key risks. Areas for focus in 2021 would include enhancing communications in a small number of businesses.

On the basis of the review following the 2020 year-end audit, the Committee has proposed to the Board that it recommends that shareholders support the re-appointment of Deloitte LLP at the 2021 AGM.

How the Committee assesses the independence and effectiveness of Internal Audit

Who we survey:

- Group-wide heads of Audit Review Boards
- Other business leaders

Audit Committee members have also input into the review.

Areas for feedback include:

- Role of Internal Audit and independence
- Audit planning, processes and execution
- People resources and skilling
- Communications and reporting

Review of the 2020 interim EY report on progress in respect of recommendations made in the last External Quality Assessment conducted by EY was also taken into account.

relating to responsible behaviour and non-financial risk. Internal Audit may also from time to time undertake other work within the context of the risk environment.

The majority of the 2020 internal audit plan has been delivered, of necessity remotely within the COVID-19 environment, with the scope of each audit remaining substantially as planned and some of the timescales to complete being extended. A small number of audits have been postponed. The review of governance and controls has continued virtually through Quarterly Business Reviews and Audit Review Boards (ARBs) and businesses have documented any changes to governance and controls as a result of remote working in their OAS responses. Document retention has been accelerated into electronic format, with increased digitalisation seen on approvals and previously paper-based processes. Internal Audit has tested controls that were affected by or introduced because of COVID-19. Overall, governance and controls have continued to operate effectively. Examples of good practice – be they generic or specifically relating to the COVID-19 environment – have been collated by Internal Audit to be shared by the businesses.

We held a session with the VP, Internal Audit, to discuss the scope, environment and priorities for internal audit work undertaken within the US businesses, the levels of resourcing available to undertake the programme of work and specific challenges stemming from the COVID-19 environment.

During the year under review, and separate from the normal regular sessions we hold with the Internal Audit Director without management present, the Committee held a separate session with him, senior members of his team and the external auditor. The wide-ranging discussion at this year's session focused on progress to date on preparations for the potential UK framework for controls over financial reporting/Sarbanes Oxley, reporting and assurance expectations; preparations for ESG/TCFD[1] reporting and assurance; information management and technology controls; the resilience of Group employees in the current working environment; technology in assurance; and the quality of risk management beyond in-year risks.

Revisions to the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Audit (IIA) came into effect in 2020. The IIA also issued a new Code of Practice for Internal Audit in 2020. Internal and external review of the revised standards evidenced Internal Audit's standards and practice to be broadly aligned.

Internal Audit is running a programme of continuous improvement relating to its purpose, people and processes. The programme was informed by the results of the 2018 External Quality Assessment (EQA) undertaken by Ernst & Young LLP (EY) and also by the subsequent internal annual performance evaluations and the new IIA standards. Progress has been made against the 2018 EQA recommendations and a formal review of progress was undertaken with EY in 2020. The review concluded that 12 out of the 22 recommendations had been implemented with significant progress made on the remaining recommendations. Successes include the clarity of purpose and independence of the Internal Audit function, work undertaken to develop people capability and improvement in the standard and content of audit reports. The introduction of the Climate Assessment Framework considering culture within the business is notable. Further work is required on the adoption of technology and this will be addressed in 2021 through the roll-out of a more comprehensive Data Analytics programme and implementation of a new Audit Management System.

Results from the 2020 internal annual evaluation were positive, with all respondents believing that Internal Audit played an integral role in assuring the governance of the Group. Areas for further development include leveraging knowledge and sharing best practice across the business, and supplementing Internal Audit's resource given the complexity of the business and broad range of audit topics. These will be considered in Internal Audit's functional improvement activity for 2021.

1. Environmental, Social and Governance/Task Force for Climate Related Financial Disclosure.

Financial statements

The Committee reviews all significant issues concerning the financial statements which include the going concern and viability statement.

The Committee agreed the parameters of, and subsequently reviewed the supporting report for, the going concern statement (see page 110) and the statement on the Board's assessment of the prospects of the Company (see the viability statement on page 109) over the five-year period used in the Integrated Business Plan. The Committee considered the period covered by the viability statement, and whilst a number of companies have elected to use a three-year horizon, we continue to be of the view that a five-year period remains the most appropriate timespan for this Group given our business planning cycle and the long-term nature of a number of our programmes.

In assessing going concern and viability, the Committee has considered cash flow projections and timings, which include assumptions, as far as they can be made, of the impact of COVID-19, with related sensitivity analysis and stress testing scenarios, borrowing facilities available to the Company and covenants. Other related issues such as credit ratings are also considered.

The potential impact of COVID-19 on liquidity and cash management have clearly been, and continue to be, a key focus for the Board as a whole during the global pandemic.

In addition to the going concern and viability statement reviews, the principal matters we considered concerning the 2020 financial statements were:

Recognition of revenue, profit and provisioning

The estimation of contract margin and the level of revenue and profit to recognise in a single accounting period requires the exercise of management judgement.

The Committee reviewed key estimates and judgements applied in determining the financial status of the more significant programmes including:

- Type 26 frigate;
- Astute submarine;
- Saudi British Defence Co-operation Programme;
- Saudi Typhoon; and
- US Land Programmes.

In addition the Committee reviewed estimates and judgements associated with the Group's accounting for the impact of the COVID-19 pandemic.

Audit Committee report
continued

Pensions

Accounting for pensions and other post-employment benefits involves making estimates when measuring the Group's retirement benefit obligations. These estimates require assumptions to be made about uncertain events, such as discount rates, inflation rates and longevity.

Recognising the scale of the Group's pension obligation, we reviewed the key assumptions supporting the valuation of the post-employment benefit obligation. This included a comparison of the discount and inflation rates used against externally-derived data. We reviewed the methodology used to allocate a proportion of the post-employment benefit obligation to equity accounted investments and concluded that this was appropriate with reference to agreements between the Company and those companies. We also considered the adequacy of disclosures in respect of the sensitivity of the deficit to changes in these key assumptions (see note 24 to the Group accounts on pages 229 to 239).

As previously reported, a $1.3bn (£1.0bn), ten-year, 3.4% bond was raised in April 2020 in order for the Group to inject £1bn into the UK pension scheme.

The Committee also considered the accounting treatment of a Pension Annuity buy-out of certain US pension benefits which resulted in a non-recurring settlement gain of approximately £64m under IAS 19.

Goodwill

Impairment testing of goodwill on the balance sheet is underpinned by the value of the future prospects of the related business, which have to be estimated.

We considered the level of goodwill held on the Group's balance sheet and whether, given the future prospects of the acquired businesses, the value of goodwill held on the balance sheet remains appropriate.

The Committee noted that at 31 December 2020, the carrying value of the Land Munitions Cash-Generating Unit (CGU) was broadly equal to its recoverable amount and therefore sensitive to movements in the discount rate. No goodwill impairments were made as a result of the review.

The methodology for impairment testing used by the Group is set out in note 8 to the Group accounts on page 206, including disclosures on CGUs and their assumptions.

How we ensure that the Group's Annual Report, taken as a whole, is fair, balanced and understandable and provides information necessary for shareholders to assess the Company's position and performance, business model and strategy

The process is:

- comprehensive guidance issued to all the contributors at operational level;
- a verification process dealing with the factual content of the reports;
- comprehensive reviews undertaken at different levels in the Group that aim to ensure consistency and overall balance; and
- comprehensive review by the directors and the Executive Committee.

Taxation

Computation of the Group's tax expense and liability, the provisioning for potential tax liabilities and the level of deferred tax asset recognition are underpinned by management judgement and estimation of the amounts that could be payable.

Whilst tax policy is ultimately a matter for the Board's determination, we reviewed the Group's tax strategy as set out on page 63. Twice during the year, we reviewed the Group's tax charge and tax provisions, and discussed these with the Group Tax Director. We also reviewed the basis of recoverability of the deferred tax asset relating to the Group's pension deficit. In addition we took the opportunity to meet with the incoming Group Tax Director designate, an external appointee, who succeeded the outgoing Group Tax Director on his retirement at the year-end, to discuss her views and priorities in relation to tax matters.

Acquisitions accounting

The Committee reviewed the accounting treatment under IFRS3 regarding the Group's recent US acquisitions of the Airborne Tactical Radios business and the Military Global Position business, in particular the purchase price allocation methodology to establish the fair value of the goodwill and intangible and other assets acquired.

Alternative Performance Measures (APMs)

The Committee has considered the Company's use of APMs within the 2020 Annual Report.

In the light of recent FRC guidance and a current IASB Exposure Draft on 'General Presentation and Disclosures' which would prohibit presentation of APMs on the face of the income statement, the Committee has considered management's recommendations on use of APMs going forward. After consideration the Committee agreed that the Sales and Underlying EBITA APMs, together with their related reconciliations to statutory measures, should be removed from the 2020 income statement.

The reconciliations continue to be provided in the segmental analysis note on page 194 and the Sales and Underlying EBITA continue to be presented in the Our financial highlights and Group financial review sections on pages 20 and 57 respectively. In terms of other APMs included in the prior year's Annual Report, the Committee further agreed that the IFRS measure 'Order Book' (i.e. Order Backlog less unfunded order backlog and share of order backlog of equity-accounted investments) would be included alongside the APM 'Order Backlog' in the 2020 year-end reporting process, enabling the Group to align more closely the number of IFRS and APMs published in the Annual Report. Finally, it was agreed that at Group level, the APM Operating Business Cash Flow (OBCF) would be replaced by Free Cash Flow (FCF), with OBCF continuing to be used at segment level. At Group level, FCF would provide a fuller illustration of cash available for the Group's discretionary use.

The Committee also agreed that, for its 2021 reporting cycles, the Group would adopt an Underlying EBIT profitability measure in place of the previously reported Underlying EBITA measure, as it reflects a better measure of underlying profitability. The calculation of the Group's Underlying earnings per share measure would also be updated to ensure consistency with the Underlying EBIT measure.

In 2021 and beyond we will be looking to adopt or incorporate the various governance and regulatory initiatives under formulation as the governance landscape continues to evolve.

Stephen Pearce
Chairman of the Audit Committee

The Audit Committee's year

February, London, UK

Committee

- Reviewed the financial statements and specific disclosures, including viability and going concern, for recommendation to the Board.
- Considered the accounting, financial control and audit issues reported by the auditor that flowed from the audit work.
- Reviewed the effectiveness of the external audit process.
- Received a report from the Group Tax Director.
- Considered output from the six-monthly OAS review.
- Reviewed the procedures and outputs for the identification, assessment and reporting of risk.
- Regular quarterly items[1].

Joint session with the Corporate Responsibility Committee:

- Agreed final iteration of the 2020 Internal Audit programme.

Committee composition and evaluation

The composition of the Audit Committee is stated on page 111 and the breadth of experience of the Committee members is set out on page 107. The performance evaluation of the Committee is undertaken as part of the wider Board evaluation and the Board believes the Committee to have the appropriate composition, skills and experience to discharge its responsibilities.

June, Videoconference

Committee

- Agreed external audit strategy and scope.
- Reviewed external auditor independence issues.
- Agreed external audit engagement letter and fee.
- Considered output of the Internal Audit Director's report.
- Received a presentation from VP, Internal Audit, for the US businesses.
- Considered progress made by Internal Audit against its latest External Quality Assessment.
- Reviewed the Non-Audit Services Policy.
- Regular quarterly items[1].

July, Videoconference

Committee

- Reviewed the financial statements and specific disclosures, including going concern, for recommendation to the Board.
- Considered the accounting, financial control and audit issues reported by the auditor that flowed from the half-year review work.
- Received an update on the status of aged debt and receivables.
- Received a report from the Group Tax Director.
- Considered output from the six-monthly OAS review.
- Reviewed the procedures and outputs for the identification, assessment and reporting of risk.
- Regular quarterly items[1].

December, Videoconference

Committee

- Considered any emerging accounting issues prior to the year end.
- Considered the external auditor's controls report.
- Considered output of the Internal Audit Director's report.
- Received a report on export control compliance.
- Set the parameters for work supporting the viability and going concern statements.
- Received an update on the status of aged debt and receivables.
- Received a presentation from the Director, Group Insurable Risk.
- Considered use of Alternative Performance Measures (APMs).
- Discussed the first iteration of the 2021 Internal Audit programme.
- Reviewed the Internal Audit Charter.
- Undertook a review of the effectiveness of the Internal Audit function.
- Reviewed the Committee's Terms of Reference.
- Regular quarterly items[1].

Meeting

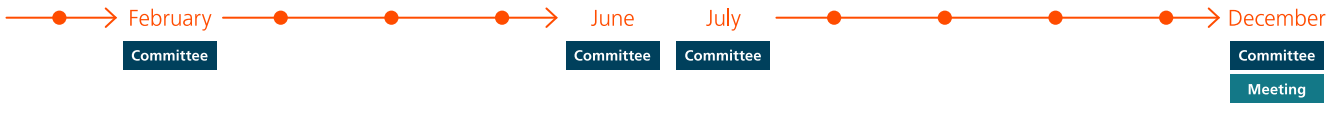
- Informal meeting with the Internal Audit Director and external auditor to discuss a range of issues as detailed on page 113.

1. The Committee reviews the nature and level of non-audit services (including independence safeguards from the incumbent auditor where it provides such services), and holds a separate session with the Internal Audit Director and external auditor without management present. The Audit Committee Chairman also meets with the Group Finance Director, the Internal Audit Director and the external audit on an ad hoc basis.

Competition and Markets Authority Audit Order

The Committee has complied with the provisions of the Competition and Markets Authority Audit Order in respect of committee responsibilities and audit re-tendering disclosures. The last audit tender undertaken concluded with the appointment of Deloitte LLP in May 2018.

Audit Committee timeline



Corporate Responsibility Committee report



Jane Griffiths
Chair of the Corporate Responsibility Committee

Members

Jane Griffiths (Chair)
Nick Anderson
Chris Grigg
Nicole Piasecki

The UK Corporate Governance Code

Provision 5 of the UK Corporate Governance Code (the Code) requires that boards have an effective mechanism to engage with the workforce. In 2019, the Board agreed that the most appropriate and effective method of undertaking employee engagement was for the Corporate Responsibility Committee to take up this responsibility.

This decision was made on the basis that engaging with employees had always been a key part of the Committee's activities since establishment. The non-executive membership of the Committee achieves the same independence characteristics as appointing a single non-executive director (as suggested in the Code). The Company has 89,600 employees across more than 40 countries and in recognition of the geographical spread, size and complexity of the business, there were practical advantages to the role being performed by more than one director.

We will continue to monitor how best practice evolves across UK listed companies and review our approach accordingly.

Dear Shareholders

I am pleased to present my first Corporate Responsibility Committee report that I hope provides an insight into the discussions and the work undertaken by the Committee in 2020, and an overview of our plans for 2021.

During the year there were some changes to the Committee's membership. Revathi Advaithi stepped down from the Board in June, and Nicole Piasecki and I were welcomed to the Committee in September. On 1 January 2021, I succeeded Ian Tyler as Chair of the Committee. I would like to thank Ian for his dedication and stewardship of the Committee over the last seven years.

We view employee engagement as a key method in monitoring and assessing Company culture. This engagement, coupled with employee sentiment surveys and regular discussions with the executive, support the Committee in better understanding Company culture. At the beginning of 2020 we agreed our priorities and the employee engagement programme, which centred on in-person interaction between the Committee and members of the workforce. However, the onset of COVID-19 meant that priority was given to engagement by the executive team and the Chairman, who were at the forefront of the interaction with the workforce.

As such, in 2020, the Committee relied largely on the regular updates from the Chairman, Chief Executive, President & Chief Executive Officer of BAE Systems, Inc., the executive team and business line leaders. In the second half of the year non-executive directors did benefit from limited engagement with a small number of employees by videoconference, during these online meetings, at which executive directors were not present, we had an opportunity to discuss the Group's response to the COVID-19 pandemic and learn more about how the Group was supporting the workforce.

Since the onset of the COVID-19 pandemic, our priorities have been focused on the health, safety and wellbeing of our workforce, supporting our local communities and customers. In light of the unique set of challenges posed by COVID-19, the Committee was pleased with the range and extent of methods used by the Group to support and engage employees, including: videoconferences with senior managers; virtual get together sessions and town hall meetings with the Chief Executive, Chairman and President & Chief Executive Officer of BAE Systems, Inc.; podcasts; and the launch of an employee app. The swift actions put in place to address IT capacity challenges and the enhanced roll-out of the employee app were crucial to ensuring employees remained connected. The employee app also provided a forum for employees to ask questions, raise concerns and for feedback to be gathered and responded to.

To facilitate changing working environments, we were briefed on the managerial and employee guidance which was adapted to support on-site, home-working and hybrid teams. In recognition of the changes and pressures upon personal circumstances, employees were encouraged to utilise the employee assistance programme. The Group also partnered with a learning platform, Percipio, to provide courses on health, safety and wellbeing, and also provided guidance on building personal resilience to cope with the logistical and emotional challenges endured by all.

We were very proud to learn of employee efforts in responding to the various challenges posed by COVID-19, the Group's membership of the VentilatorChallengeUK consortium and community support through the provision of Personal Protective Equipment, and financial support to healthcare providers and local charities.

In addition to working closely with the executive team, navigating workforce wellbeing and through COVID-19, we continued to oversee areas such as safety, environment, diversity and inclusion, anti-bribery and corruption, and the business conduct and supplier conduct programmes.

Workforce engagement by members of the Board

Virtual get together sessions
The Chief Executive and Group Finance Director, members of the executive team and various line leaders hosted interactive forums to provide regular updates on Company matters during the course of the year.

Videoconferences with a global cohort of high-potential employees
Informal engagement with high-potential individuals gave members of the Board a view of employee experiences.

Virtual trades union forum
Meeting with the Chief Executive, trades union representatives and members of the executive team to discuss employee matters.

Site visit to Rochester
An easing of restrictions allowed the Committee Chairman, a non-executive director and the Chief Executive to visit our Electronic Systems site in Rochester. They undertook socially-distanced workplace engagement and informal meetings with employees.

Employee app videos
Reflections of the challenges of 2020, with views from the Chairman and members of the Committee, expressing their thanks for the dedication and hard work of employees during the year.

End-of-year get together
Virtual interactive get together hosted by the Chairman and Chief Executive, discussing the Company outlook and priorities for 2021.

Engagement on workforce matters

COVID-19 response
Business conduct
Executive behaviours
Diversity and inclusion
Safety, Health and Environment

Safety, Health and Environment

The safety of our employees is a key area of focus for the Committee and in 2020 we reviewed both site and programme-specific safety performance, as well as health and safety practices associated with COVID-19 return to work plans.

The Company appointed Safety, Health and Environment (SHE) directors in all principal markets and at the start of the year, we met the SHE Director for the UK business. Over the course of the year, we continued to meet with senior executives within the UK and US businesses who presented the actions being taken to improve safety performance levels across the Group. Although we were pleased to see a reduction in the severity of incidents as a result of various safety cultural initiatives and process improvements, it was disappointing to see an increase in the number of injuries overall during 2020.

The Group's safety performance is a non-financial component of the annual incentive plan for senior executives. The Committee sets, measures and determines the level of performance achieved against the safety objectives and makes a recommendation to the Remuneration Committee. Under the annual incentive plan, 3% of the maximum amount payable to participants is based on the Committee's assessment of performance against safety.

At a Group level, the targeted Recordable Accident Rate reduction of 10% was not met. Although significant strides were made in the UK, Saudi Arabia and Australia businesses, with a 37% improvement in the number of major injuries recorded, we were disappointed in the level of injuries recorded by our US business, BAE Systems, Inc. We also review the number of major injuries, and 37 such incidents were recorded in 2020 (38 in 2019). Accordingly, under this element of the annual incentive plan, only those who achieved the reduction target will be eligible to receive a payout. In order to better understand the safety challenges faced by the US businesses, we asked the President & Chief Executive Officer of BAE Systems, Inc. to attend one of our meetings and provide details of the actions being taken to improve safety performance. The Committee will continue to engage with senior executives to ensure we remain focused on continually improving performance in this area.

Diversity and inclusion

The Group has a clear purpose, a set of values and behaviours that guide the culture, and commitment to ensuring that BAE Systems is an inclusive organisation. The Group strives to ensure a diverse workforce that has a variety of skills and perspectives which reflects the richness of the markets and communities in which we operate.

The Group's performance on diversity and inclusion is a non-financial component of the annual incentive plan for senior executives. The Committee sets, measures and determines the level of performance achieved against these objectives and makes a recommendation to the Remuneration Committee. Under the annual incentive plan, 2% of the maximum amount payable to participants is based on the Committee's assessment of performance against diversity and inclusion.

The executive annual incentive plan includes the following objectives:

- attract and retain a diverse workforce that reflects market availability at all levels of the organisation; and
- advance an inclusive workplace where leaders can retain key talent effectively and employees feel that their differences are valued and intentionally leveraged.

In 2020, the executive annual incentive plan measures were based on:

- increasing the representation of women at senior levels in the Group; and
- driving inclusion through leadership and engagement.

During the year, the Committee reviewed progress against the 2020 diversity and inclusion objectives.

Across the global workforce, female representation had increased by 0.5%. The Saudi Arabian business met targets to increase female representation in the workforce and launched a two-year fast-track senior management development programme for women. In our US business, BAE Systems, Inc. met its goal to increase representation of both women and people of colour at leadership levels.

Corporate Responsibility Committee report
continued

We learned that there had been an improvement in the data provided by a self-identification campaign that encouraged employees to share more information about themselves, to aid our understanding and improve equitable and inclusive decision-making. This data allowed us to recognise that, whilst progress has been made, there is more to do on the journey to a truly representative and inclusive workplace. In order to achieve this goal, we will keep monitoring the progress made toward increasing gender diversity and ethnic minority representation across the Company. The Committee will continue to oversee the efforts to embed diversity and inclusion into processes, practices, policies, systems and training across the Group.

To foster employee engagement and inclusive practices, the Group launched an Employee Resource Group (ERG) framework and we were pleased to hear of the support that employees received from the ERGs in our UK and US businesses and that each ERG was sponsored by a senior leader from across the Group. Senior leaders also took an active and visible approach to fostering workplace conversations and hosted employee panel discussions during the Group's Inclusion Week conference.

Climate change and environmental sustainability

We are committed to meeting the UK government targets of net zero emissions by 2050 and recognise the environmental impact of our global operations. In September, the Committee took an in-depth look at the Group's aspirations to reduce carbon emissions. We received a presentation on proposed decarbonisation targets, which had been developed through a holistic Group-wide process that set out reduction targets and improvement activities to reduce our carbon footprint.

Developing our understanding of the emission scopes and associated activity was crucial to assessing the feasibility of meeting each scope within a certain timeframe, and understanding the required infrastructure to ensure success. Following this work, the Group was able to articulate and set ourselves the target of achieving net zero greenhouse gas emissions across operations by 2030; and working towards a net zero value chain by 2050.

Looking forward

As we look forward to 2021, there will no doubt be continued focus on monitoring the impact of COVID-19 on employees, customers, local communities and our suppliers.

We are committed to engaging with employees first-hand in order to understand matters of importance and provide updates on the Group's performance. Our plan of activities has been adapted to ensure the Committee is able to engage with employees and other stakeholder groups directly in order to continue to monitor and assess Company culture.

Our 2021 plan includes remote forums and various opportunities to enable us to better engage with the workforce, in the face of any COVID-19-related disruptions. Additionally, the Committee will oversee the Company's progress against the net zero target and continue to focus on health and safety performance, diversity and inclusion and our broader sustainability ambitions.

Jane Griffiths
Chair of the Corporate Responsibility Committee

The Corporate Responsibility Committee's year

February, London, UK
Committee

- Received an update on the implementation of the Group Product Trading Policy within the Applied Intelligence business.
- Reviewed 2019 safety performance relative to the objectives and made recommendations to the Remuneration Committee concerning the element of the annual incentive plan.
- Agreed the 2020 annual incentive targets in respect of safety, and diversity and inclusion.
- Began to review sustainability strategy ambitions.
- Received a presentation from the recently-appointed Safety, Health and Environment Director.
- Joint session with the Audit Committee: Agreed final iteration of the 2020 Internal Audit programme.

June, Videoconference
Committee

- Reviewed the employee engagement activities that had been taken across the Group in light of COVID-19 and received presentations from the Group HR Director and Senior Vice President HR, BAE Systems, Inc. to better understand the wellbeing and support initiatives provided to the workforce in the UK, Rest of World and BAE Systems, Inc.
- Reviewed safety performance within the BAE Systems, Inc. business and undertook a year-on review of the safety position within Platforms & Services (US) and, in particular, the Ship Repair business.
- Received an update on Group performance against the 2020 diversity and inclusion objectives.

September, Videoconference
Committee

- Received an update on the continued COVID-19 workforce engagement programme and the preliminary ideas around the future working practices.
- Considered the Group's net zero ambitions and discussed potential timeframes.
- Received a presentation from the Internal Audit Director about the Operational Assurance Statement process and the key challenges posed by COVID-19.

December, Videoconference
Committee

- Received the annual update on responsible procurement and considered supply chain resilience.
- Considered our sustainability social targets and ambitions.
- Reviewed the anti-bribery and corruption policy.
- Agreed the Corporate Responsibility 2021 objectives and agenda.

Schedule of activities in 2021

February

- Review of 2020 performance metrics.
- Environment.
- Social and community.
- Employee engagement.
- Product trading.
- Review and approval of Modern Slavery statement.
- Agree annual Internal Audit programme with Audit Committee.

June

- Review of anti-bribery and corruption processes.
- Environment.
- Social and community.
- Employee engagement.
- Workplace safety and wellbeing (US).
- Diversity and inclusion.

September

- Application of the Product Trading Policy.
- Environment.
- Social and community.
- Employee engagement.
- Workplace safety and wellbeing (UK and Rest of World).
- Sustainability strategy and direction.

December

- Review of Advisers Policy.
- Environment.
- Social and community.
- Employee engagement.
- Workplace and stakeholder engagement plan.
- Corporate Responsibility-related performance objectives.

Corporate Responsibility Committee timeline



Nominations Committee report



Sir Roger Carr
Chairman of the
Nominations Committee

Members

Sir Roger Carr (Chairman)
Nick Anderson
Dame Elizabeth Corley
Jane Griffiths
Chris Grigg
Stephen Pearce
Nicole Piasecki
Ian Tyler

Dear Shareholders

Last year we saw a significant number of changes to membership of the BAE Systems Board, with five directors leaving and four joining. In terms of Board succession planning, a good deal was achieved, particularly with regard to executive directors, where we successfully completed our succession planning for the Group Finance Director and US President & Chief Executive Officer roles. We also accomplished the first part of our planned non-executive director changes in 2020, with the appointment of Jane Griffiths and Nick Anderson. This year, following the retirement of two experienced non-executives, we have announced that Dame Carolyn Fairbairn will be joining the Board on 1 March and Dr Ewan Kirk will join shortly afterwards on 1 June 2021.

At Executive Committee level, our Chief Executive has continued to strengthen his senior management team and we have seen further changes as a result. In recognition that there is more work to be done, we are actively addressing and making progress on our succession plans below Executive Committee level, and also in completing our non-executive director changes, to ensure our Board maintains the right balance of skills, experience, knowledge and diversity. These matters are being actively addressed and progress is being made.

Board succession

In last year's report, we detailed how Brad Greve had been recruited with the intention that he would succeed Peter Lynas as Group Finance Director at the beginning of April 2020. Peter had served in that position since 2011 and had provided Brad with an excellent legacy, including a robust control environment and strong financial discipline. I would like to thank Peter for the professional and collaborative manner in which he managed the handover of responsibilities to Brad, the two having worked together for seven months prior to his appointment to effect a seamless handover on 1 April. Additionally, from that date, Tom Arseneault succeeded Jerry DeMuro as head of our US business and joined the Board. His appointment was the culmination of a succession management process going back a number of years and one which saw Tom developing and showing excellent leadership credentials in a number of roles, initially in leading our US Electronic Systems business and more recently in taking on the operational management of BAE Systems, Inc. as a whole.

Following their new appointments, Brad Greve and Tom Arseneault could not have had a more difficult start, immediately having to deal with the unprecedented impact of the COVID-19 pandemic. It proved to be a good – but unexpected – test of the work the Committee had undertaken in planning executive director succession over the last few years. I am pleased to report that, led by our Chief Executive, Charles Woodburn, they have shown excellent leadership, resourcefulness and adaptability in the management of the Company during 2020 and into the new year.

Having served as a non-executive director for just over nine years, Paula Rosput Reynolds stood down from the Board at the end of the year. In planning for her retirement, Ian Tyler joined the Remuneration Committee from the beginning of 2020 ahead of succeeding Paula as Chair of the Committee, with effect from 1 January 2021. Our longest serving non-executive director, Nick Rose, was due to retire from the Board in April 2020 but I am very grateful that he agreed to stay on until the end of the year to help the Company navigate the challenges of the COVID-19 pandemic. Sadly, in June, Revathi Advaithi stepped down from the Board and retired as a non-executive director for personal reasons.

Using the services of Julia Budd at the search consultants Russell Reynolds Associates, the Committee identified two excellent candidates for appointment as non-executive directors in 2020, with Jane Griffiths joining the Board in April and Nick Anderson in November. Jane has an impressive record of leading research-led high-technology businesses and brings a wealth of international corporate experience to the Board. Nick is the Chief Executive of the FTSE 100 industrial engineering company Spirax-Sarco Engineering plc, and has extensive experience in growing and leading international manufacturing and engineering businesses.

The forthcoming appointments of Dame Carolyn Fairbairn and Dr Ewan Kirk will further strengthen the Board, and the timing of their joining will allow them to develop their understanding and knowledge of the Company ahead of anticipated non-executive retirements in the next year or so. Dame Carolyn, who recently stepped down as Director General of the CBI, brings a deep understanding of business and government. Ewan has extensive experience in identifying and leveraging emergent scientific research, and know-how and insight into the successful commercial exploitation of digital technology.

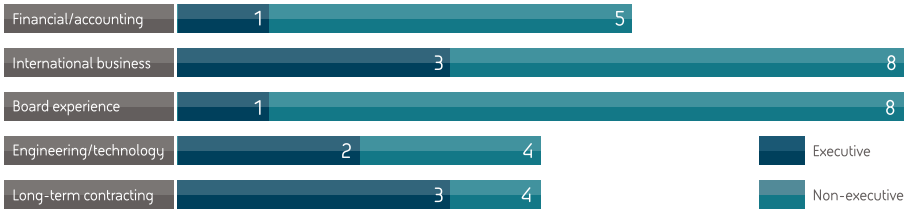
Executive succession planning

The Committee undertook a detailed review of succession plans in July last year, and evaluated our plans for the executive directors and Executive Committee positions, 11 roles in total. The key points from this review were:

- There had been an improvement in the quality of the succession plans with greater diversity in terms of the number of individuals identified and an increase in the number of individuals currently at the lower end of the pipeline. For the 11 Executive Committee positions (which includes the three executive directors), 57 potential successor candidates had been identified and classified in terms of being 'ready now' or were within two job moves away from being ready for one of these roles.
- There had been an increase in the movement of individuals within the succession pipeline during the previous 12 months, with 28% of individuals assessed as having advanced in their 'readiness' to take on an Executive Committee level role.
- Gender diversity had improved a little on the previous year and by over 20% in the last three years, with female employees accounting for 39% of the potential successors identified.
- There was clear evidence of individuals identified as high-potential succession candidates moving more rapidly into senior roles than their peers, and also of more stretching roles being used to develop such individuals and provide them with opportunities to demonstrate their capabilities.

The succession planning review concluded that progress was being made in the quality of the Company's succession and development planning processes. There was also visibility of a more proactive approach to the development of senior managers and progress around greater gender diversity, although it was apparent that further work was required to progress better ethnic diversity.

Skills and experience



The Committee has to take into account national security considerations for certain roles within the Company – particularly those in line management positions, where higher levels of a particular nation's security clearances are likely to be required. Through the Special Share mechanism contained in the Company's Articles of Association, the UK government requires that the Chief Executive of the Company must be a British national. Similarly, the US national security arrangements governing our US defence businesses effectively limit the senior line leadership positions in those companies to US nationals. The Special Share provisions also require that a majority of all directors must be British nationals. Such restrictions are an intrinsic part of being a defence company and being trusted with matters affecting national security, however they do add to the complexity of managing succession planning. For certain senior positions these constraints limit the size of the internal pipeline significantly.

Ultimately, the Committee's principal focus is on the three Board level executive roles. As detailed above, we have been successful in managing transitions in two of these roles within the last 12 months. Not so long ago, we also managed the Chief Executive succession successfully with Charles Woodburn taking on that role in 2017. The national security and UK citizenship requirements mentioned above, plus the usual challenges of leading a large and complex company such as BAE Systems, mean that long-term succession planning for our Chief Executive role is unusually challenging. That said, the Committee recognises the importance of further improving the quality of the succession pipeline to ensure we have robust and quality succession plans – not just for the Chief Executive role, but all for all senior executive positions in the Company.

Board composition

The Nominations Committee is aligned with the Company's diversity values. It aims to create a Board that not only brings individuals together with the right balance of skills, knowledge and experience, but is also reflective of the global markets in which we operate. To help us achieve this, we will continue to work with search consultants to identify a diverse range of potential non-executive director candidates. With regard to executive directors, the Committee specifically monitors the level of gender and ethnic diversity (to the extent it is possible to do so) in its oversight of the executive succession planning process used across the Company. Led by the Corporate Responsibility and Remuneration committees, the Board has set goals and incentivised executives to achieve greater workforce diversity. These actions are having an impact on the level of diversity within our succession plans and driving change in the executive pipeline that ultimately produces candidates for appointment to the Board. At present, there is only one woman on the Executive Committee but women comprise 37% (2019 34%) of the Company's senior management, i.e. Executive Committee members, the Company Secretary and their first reports. Also, as you can see from the analysis above, there is a growing number of women on the Executive Committee succession plans and the Chief Executive and the Board have agreed clear incentivised actions aimed at achieving greater diversity and inclusion at all levels in the Company.

Nominations Committee report
continued

The Board was on course for much of 2020 to meet the target set by the Hampton-Alexander Review, concerning gender diversity, and also the recommendations of the Parker Review, concerning ethnic diversity. Unfortunately, with the loss of Revathi Advaithi part way through the year, we narrowly missed these targets for gender and ethnic diversity at the year-end. We recognise the value of diversity around the Board table and it is our policy to meet the targets set by these two reviews.

At present, following the loss of Revathi Advaithi, the Board lacks ethnic diversity. This is an issue that we are determined to address, and we will meet the Parker Review target in 2021. We will also maintain focus on the diversity and inclusion objectives the Board has set (see pages 46 and 117) and help drive long-term sustainable change.

Board evaluation

At the beginning of 2020 we completed a comprehensive performance evaluation, led by Ffion Hague of Independent Board Evaluation. Following feedback on the evaluation at a Board meeting in February, the directors set themselves a number of objectives and monitored performance against these during the year. Two of these covered executive and non-executive succession planning, details of which are provided elsewhere in this report. Another objective was to engage directly as a Board with shareholders, customers and employees. Unfortunately, the COVID-19 pandemic meant that direct engagement was not possible but virtual meetings were held by individual directors with employees and shareholders. This was useful but did not replicate fully the quality of engagement we had hoped to enjoy in 2020; we will look to achieve this in 2021, COVID-19 restrictions permitting.

One of our key objectives for 2020 was to engage the Board in taking a longer-term review of our strategy. We were able to achieve this at the beginning of November, when we conducted a review of future technologies and how they would likely drive change in defence markets over the next decade and beyond. This is reported more fully in our summary of The work of the Board (on page 30) and we will be revisiting the key themes and tracking the agreed actions during our meetings in 2021.

For a number of years, we have followed the practice of alternating between internally- and externally-facilitated annual performance evaluations. As the 2020 review was facilitated externally, a simpler internal review has just been completed. More details of this process and a summary of the outcomes is shown opposite.

Summary

Board succession planning is always an ongoing process but one where short-term goals have to be achieved. In 2020 we delivered on the appointment of two new executive directors and made two non-executive director appointments. The pace of change has been maintained into 2021 with two further non-executive director appointments being made and we look to make a further appointment during the year to ensure we have a diverse Board with the right skills and experience to provide the highest standards of leadership and oversight in the years ahead. The Committee will continue to drive executive succession planning with energy and determination.

Sir Roger Carr
Chairman of the
Nominations Committee

Board evaluation – 2020/2021

Period of evaluation

Evaluation conducted at the end of 2020 with feedback and review taking place at a Board meeting held on 24 February 2021.

Evaluation process

Internally evaluated using a questionnaire developed by the Company using best practice guidance, including the FRC's Guide on Board effectiveness. Questions covered the performance of the Board, its committees and individual directors.

Facilitator

The Company Secretary, with guidance from the Chairman.

Feedback

The Company Secretary produced a report for the Board analysing the responses to the questionnaire, including any additional comments made by directors. Also, where the same questions had been used for previous surveys, the trend in performance relative to past years was provided.

The report formed the basis of a discussion at a Board meeting, following which it agreed a number of objectives for 2021. Reports were also produced analysing the responses to questions concerning the performance of the Board's committees, which have been provided to committee chairs and will be considered by the individual committees.

Feedback for the survey concerning individual directors has been provided to the Chairman and this will be used as part of an annual review process with each Board member. Feedback on the Chairman's own performance has been provided directly to the Senior Independent Director who, following discussion with his fellow non-executive directors, will discuss this with him.

Resulting actions

The Board has agreed the following actions in response to the evaluation:

Executive succession – we will build on the work undertaken to date to drive executive succession and development activity to ensure that the Company has strong and diverse pipeline of candidates for all senior executive roles.

Sustainability – we will ensure that we remain focused on delivering against our sustainability agenda, including valuing and developing our people, making a positive social and economic contribution to our communities and reducing the environmental impact of our operations and products. We will also oversee the next phase of our carbon net zero plans.

Evolve our strategy – the Board's strategy review activities have identified certain key technologies and long-term growth areas, in 2021 it will undertake further work in evaluating the technology and looking at how to exploit these developing business opportunities successfully.

Efficiency and effectiveness – the Board will be reviewing the actions being taken to improve our competitiveness and drive profitable growth.

Nominations Committee timeline



Remuneration Committee report



Ian Tyler
Chairman of the Remuneration Committee

Members
Ian Tyler (Chairman)
Dame Elizabeth Corley
Chris Grigg

Dear Shareholders

On behalf of the Board, I am pleased to present the Remuneration Committee's report for 2020. I assumed the chairmanship on 1 January 2021, succeeding from Paula Rosput Reynolds who has chaired this Committee for over five years. Together with my colleagues, we have appreciated the quality of shareholder consultation you have provided, which led, among other things, to the strong support we received for the renewal of our Directors' Remuneration Policy at the 2020 Annual General Meeting (97.5% in favour).

Whilst the market for BAE Systems' capabilities has mostly remained strong so far through the COVID-19 pandemic, delivering our customers' needs whilst keeping all our employees safe against such a challenging backdrop has called on all the ingenuity, determination and innovation of our management teams and our workforce. We could not have asked more from them. As a result of their efforts, the Company has not taken advantage of the UK government's funded furlough scheme and we have not borrowed any money under government COVID-19 borrowing facilities. Overall the Company has delivered a year of strong performance. Our employees across the Group have demonstrated fantastic commitment and contribution to delivering our customers' priorities, and the Committee has ensured its continued focus on the wellbeing and remuneration of the wider workforce in its considerations over the year.

The year in review

Impact of COVID-19 pandemic

In making remuneration decisions in relation to 2020, the Committee, whilst mindful of the impact of COVID-19 on the cost of delivering service and product to our customers, chose to make no allowance for these additional challenges when assessing the performance and reward outcomes for the executive directors. The Committee believed that achievements should be assessed against performance hurdles established prior to the pandemic without adjustment, and respecting that the Company has paid all dividends, has not taken advantage of the UK government's funded furlough scheme, nor any government COVID-19 borrowing facilities and has not raised additional equity.

2020 incentives outcome

After the close of 2020, the Committee met and reviewed performance under the short-term annual incentive for all the executive directors and Executive Committee members. The Committee has not made any adjustment to the performance conditions in respect of the vesting outturn of the 2020 annual incentive or 2018 long-term incentive awards to account for the impact of COVID-19. Group financial results for the 2020 annual incentive were achieved at between target and stretch; performance for the non-financial element varied for the executive directors and Executive Committee members and was between target and stretch overall.

As set out on page 205 of our report, the 2020 fully diluted underlying EPS is 46.5p. Pursuant to the strict definition set out in the Annual Incentive Plan and Long-Term Incentive Plan (LTIP) documentation, this figure excludes a non-recurring benefit of 1.7p resulting from the buy-out of certain US defined benefit pension liabilities. During the course of the year, in discussion with the Board, management undertook to re-examine a number of areas, including pensions, to seek additional value enhancement. A market opportunity was identified to reduce a material element of the Company's US defined benefit pension liability through a buy-out, delivering an immediate improvement in earnings and an enduring benefit in cost and cash outflow. Through what the Committee saw as highly effective action taken by the leadership team, after a period of prolonged negotiations, a buy-out was successfully completed in the third quarter of 2020. As a result, the Committee exercised its discretion and agreed that the final incentives' vesting outturn should reflect the 2020 fully diluted underlying EPS result including the 1.7p of earnings associated with this achievement.

The Committee used its judgement in evaluating non-financial performance, including the executives' commitment to safety, diversity and inclusion, as well as overall leadership contributions. A discussion of that evaluation and the bonuses earned by the executive directors are reported on pages 144 to 147.

The Performance Shares granted in 2018 to Tom Arseneault, Peter Lynas and Jerry DeMuro under our long-term incentives will partially vest in early 2021. In addition, the 2018 Restricted Shares granted to our US-based executive directors will vest. The awards due to Peter Lynas and Jerry DeMuro, are subject to time pro-rating as set out on page 154. The vesting of the 2018 Performance Shares award granted to Charles Woodburn is described separately in the section regarding 2021 remuneration. The details of the vesting outcomes and amounts awarded are also described in the following report.

Having thoroughly reviewed annual and three-year performance, and the related remuneration outcomes, the Committee is satisfied that the Policy operated as intended during 2020.

Granting of long-term incentives

Last year, in relation to the grant of the 2020 long-term incentive awards, the Company followed its normal practice of using the closing share price immediately prior to the date of grant to determine the number of shares awarded. However, given the volatility in the market in March 2020, we attached an additional condition to retain the ability to exercise discretion to ensure that the value of the awards in three years' time at vesting is appropriate. Given the continued uncertainty in the broad market, we intend, in the grant of 2021 performance shares, to include the same condition regarding the ultimate vesting of shares.

Executive director changes

Brad Greve was appointed Group Finance Director and joined the BAE Systems plc Board on 1 April 2020, succeeding Peter Lynas who retired after a distinguished career of over 35 years with BAE Systems, including nine years as Group Finance Director. Tom Arseneault joined the BAE Systems plc Board on 1 April 2020, succeeding Jerry DeMuro as President and Chief Executive Officer of BAE Systems, Inc. The retirements of Peter Lynas and Jerry DeMuro were both handled according to our approved Policy and were disclosed previously.

2020 Directors' Remuneration Policy

The Committee has implemented the 2020 Directors' Remuneration Policy (the Policy) that was approved by shareholders at the 2020 AGM, and includes the following key changes. The Policy maintained our three-part construct of base salary, annual incentive and long-term incentives (LTIs), with no changes to the target or maximum annual incentive opportunity or LTI award levels.

- from 2021, safety and diversity and inclusion measures within non-financial annual incentive will apply as a 'downward' underpin if performance is not achieved at the high levels expected;
- from 2021, metrics applicable to award of Performance Shares will include a cash-generation measure and strategic progress measures, in addition to existing EPS growth and relative TSR, all with an equal weighting of 25%;

- any new UK executive directors will be offered employer pension contribution of 8% into a defined contribution scheme, or cash alternative, in line with the wider UK workforce;
- current Chief Executive pension allowance to be fixed in monetary terms at the employer pension contribution level of £186,200 per annum;
- introduction of five-year time period for achieving Minimum Shareholding Requirement with effect from the AGM and confirmation of consequences of not meeting it; and
- establishment of a formal post-cessation shareholding policy:
  - 100% of full MSR to be held for two years by UK executive directors; and
  - 300% of salary to be held for one year applicable to US executive directors.

2021 remuneration

To confirm, for 2021 no revisions are proposed to our executive remuneration framework that would constitute a change to the Policy. In line with our commitment to continued transparency, we have engaged with our major shareholders and informed them of the decisions for 2021 reported here. As part of this, we informed them of the important remuneration decisions made by the Board and Remuneration Committee in relation to our Chief Executive.

Chief Executive remuneration

As set out on pages 30 to 33 of this Annual Report, the directors have detailed some of the decisions they made during 2020, and in doing so, how they looked to promote the success of the Company, having regard to key stakeholder interests. One of the key decisions reported, concerns how the directors acted to secure the continued services of our Chief Executive, Dr Charles Woodburn. Given the exceptional nature of the matter, we have written to our major shareholders to provide a detailed explanation and to ask for their support in this matter.

Background

During the last quarter of 2020, our Chief Executive, Dr Woodburn, received an offer to become chief executive of a major international public company based in the UK. The offer, which resulted from a discussion regarding a potential non-executive role, was unsolicited, attractive, and provided a material opportunity to expand his career horizon and improve his immediate and long-term financial reward. Given his commitment to the Company, prior to accepting the offer, he chose to share the opportunity he had been given with the Board.

The Board valued the significant contribution Dr Woodburn had made since his appointment and recognised the importance of his leadership role at this critical time in the development of the Company. Accordingly, the Board elected to review his remuneration with a view to securing his enthusiastic and enduring commitment to the Company with goodwill on both sides.

Remuneration Committee and Board considerations

The Board carefully reviewed the Company and stakeholder risks of the potential departure of Dr Woodburn and the challenges of replacing him. Given the nature of our business, the UK government has mandated through the Special Share arrangements that the Chief Executive must be a British citizen and they would have the highest level of security clearance. Most importantly, the Chief Executive must have sufficient intellect and experience to occupy a position that is critical to our important role in the defence and security interests of the UK, US, Australia and the Kingdom of Saudi Arabia. These challenges were weighed against the cost of measures that may be required to retain his services for an extended period.

The Board concluded that in the three years he had served as Chief Executive, considerable progress had been made in the strategic development and operational performance of the business and that he was respected and valued by the Board, his executive team, our shareholders, political leaders and customers in the countries we serve. The Board also recognised that the progress he had made in that period through refreshing management, deepening our order book, strengthening our technology and sharpening our competitive edge, had been substantial. Despite a good deal of work having been undertaken on succession planning, given the exacting requirements for the role outlined above, as yet no internal successor for the Chief Executive role had been sufficiently developed to effect a seamless transition of leadership.

In considering Board composition, it was also noted that of the three Executive Directors, Dr Woodburn had the longest tenure as a Board member, with the Group Finance Director and President and Chief Executive Officer, BAE Systems, Inc. being respectively recruited and appointed only in the last 12 months. In light of the above, the Board also reflected on the past challenges faced by the Company in recruiting a Chief Executive some four years ago, the time taken for him to build a comprehensive understanding of a complex international business, the generational change of leadership that is now in process, and the potential damage that the early departure of Dr Woodburn would inflict on the Company, important government customer relationships and shareholders. Based on close examination of both the defence industry and FTSE 50 median reward levels, it had become increasingly clear that Dr Woodburn's current remuneration no longer reflected his value to the Company or standing in the market.

As a defence company of international importance the Board therefore concluded that the benefit of retaining our existing Chief Executive on improved terms with a long-term commitment to stay, materially outweighed the risk to all stakeholders associated with the turbulence of change and the cost and time associated with finding, hiring and introducing a new leader into the Company.

Our Directors' Remuneration Policy and options for discretion

The reasonableness discretion afforded to the Committee under the Directors' Remuneration Policy allows the Committee to increase or decrease the number of Performance Shares vesting in exceptional circumstances in light of important factors in the business. The Remuneration Committee and Board considered the immediate and present danger of the loss of Dr Woodburn to be an exceptional circumstance and elected to exercise its discretion in modifying his salary and increasing the number of shares vesting in his 2018 Performance Shares award.

The basis for the use of Remuneration Committee Policy discretion

The Board and Remuneration Committee considered the potential modification of the reward package by addressing specific criteria:

1. Salary would correspond to the current median level of reward as published for a FTSE 50 chief executive.
2. LTIP award would be paid only if the individual remained in employment as Chief Executive as at December 2023 and market expectations of 2020 performance were achieved.
3. The quantum of the award would align with the now lapsed one-off Performance Shares award allocated at the time of his recruitment, which was intended as buy-out of certain long-term incentives that were forfeited at the time of his departure from his previous company.
4. All of the above adjustments will be made on a one-off basis.

Irrespective of the size of the offer made by the alternative employer, the Board was clear that no further reward adjustment of any kind would be made at any time in relation to such an offer irrespective of circumstance and any future remuneration adjustments would always be subject to the approved remuneration policy at the time and to shareholder approval where required.

The award

The Committee has therefore applied the following two-step adjustment to Dr Woodburn's salary, which is within the Directors' Remuneration Policy: (i) salary increase of 3.21% with effect from 1 December 2020 and (ii) a further salary increase with effect from 1 January 2021 of 9.5%, to deliver a total base salary of £1,107,538. This salary is in line with median market levels for a FTSE 50 Chief Executive and is a fair reflection of his value, competence, skill and performance having now been in post for over three years.

The Committee additionally agreed the need to strengthen his existing long-term incentive arrangements to recognise more fully the critical nature of the role and the importance of retaining him. By exercising its discretion, the Committee determined that a Performance Share award granted to Dr Woodburn in 2018 will vest in full with the shares being receivable in 2023. Such vesting is conditional on his continued employment as Chief Executive through to December 2023, and the delivery of 2020 performance in accordance with current market expectations. Taking into account the 2020 performance outcome, the additional value of this LTIP award as a result of the discretion applied is approximately £2m, as at the share price stated in the table shown in line with the lapsed Performance Share award agreed at the time of his joining.

LTIP award reconciliation

Basis of calculation of 2018 LTIP	
Number of shares	570,454
Share price (three-month average) as at 31 December 2020	£4.844
TSR	Nil vest
EPS	50% vest

LTIP 2018 grant	Total grant	Shares released for TSR (nil vest)	Shares released for EPS (50% vest)
Number of shares	570,454	0	142,613
Value at £4.844 share price	£2,763,393	–	£690,846

Total possible value of 2018 LTIP	£2,763,393
Earned outturn based on EPS performance	£690,846
Additional share value required to equate to full potential value of 2018 LTIP	£2,072,547
Total	**£2,763,393**

Reward conditionality

- Delivery of the 2020 performance in accordance with the Company's November 2020 EPS guidance (achieved).
- Dr Woodburn to be in role as Chief Executive until at least December 2023.
- All standard terms and conditions associated with LTIP to apply.

The decision-making process and conclusions

In considering both the importance of retaining Dr Woodburn as Chief Executive and determining a reward package that was proportionate and appropriate, the Board referenced its duties under Section 172(1) of the Companies Act to act in the way that it considered in good faith would be most likely to promote the success of the company for the benefit of its members as a whole.

All non-executive directors of the Board were engaged in a step-by-step process in making these decisions through assessing alternative options, risks and comparative marketplace reward levels. The decisions on both the principle of retention and determination of the reward package were achieved only after careful thought and discussion, and were reached unanimously and unequivocally by the Board under the rules of the Directors' Remuneration Policy. All parties agreed that a positive outcome had been achieved. The Company has retained a first class leader on fair market value terms. The three-year commitment enables the development of candidates for internal succession to the post of Chief Executive to be successfully executed. Dr Woodburn, appropriately compensated, is pleased to remain and is enthusiastic to complete the job he had started to make BAE Systems a more competitive, agile, and technically advanced company.

Review of other executive director base salaries

The Committee has considered carefully the level of performance of our executive directors, who have been expected to demonstrate exceptional leadership and resilience throughout the COVID-19 crisis. Reflecting the skills, time, performance and experience since appointment in role, the Committee has approved salary increases in line with the wider workforce in the relevant markets, being 2% for our Group Finance Director and 3.5% for our President and Chief Executive Officer of BAE Systems, Inc.

Annual incentive plan metrics

As set out in our approved Policy, the structure of the annual incentive plan for 2021 will be 75% financial performance measures and 25% non-financial measures. The annual financial targets will continue to align with the long-term earnings and cash targets based on the same weightings and metrics that applied in 2020. The 25% non-financial element will continue to be based on a combination of personal performance objectives that provide clear line of sight to our key strategic objectives. As previously disclosed, from 2021 forwards, safety and diversity and inclusion (D&I) will operate as an underpin to the non-financial component of the annual incentive. The Committee will use their discretion to modify the annual incentive outturn downwards if they find that safety and/or D&I are not up to the high standards expected of our leadership.

Long-term incentive plan metrics

In line with our approved Policy, from 2021, Performance Shares will be measured over a three-year period against a cash generation measure and measures reflecting strategic progress, in addition to the existing Earnings per Share (EPS) and relative Total Shareholder Return (TSR) measures; each of these four performance conditions will be equally weighted at 25%.

25% subject to strategic progress metrics

The Committee has previously confirmed that these metrics will be measured against quantifiable targets based on our three key strategic pillars, each with equal weighting. The Committee will disclose the areas of strategic progress applicable in each year, with the specific metrics to be disclosed retrospectively after the end of the relevant financial year due to commercial sensitivity.

(i) Drive operational excellence

The focus of this objective is the adherence to project plans of mission-critical projects over the three-year performance period. This objective will be measured by the metric of On Time Delivery, evaluated against an approved set of customer contracts, in a manner consistent with the normal course of business. The contracts to be measured will be representative of each of our main business sectors, having regard to execution risk, scale and duration, and will be approved by the Committee on an annual basis. For our US executive director, On Time Delivery will be measured against BAE Systems, Inc. contracts only. The Company's robust quality and safety processes will continue to apply.

Measurement of On Time Delivery will be derived from our existing systems, which measures progress compared to the contracted project baseline, as modified by any customer-agreed re-baselining. The overall outturn will be based on the aggregated On Time Delivery three-year average. Target performance will be achieved for equal or better than the aggregated On Time Delivery three-year average, with threshold and stretch levels also applying. The final outturn (between 0% and 100%) will be subject to review by Group Internal Audit and approved by the Committee.

(ii) Continuously improve competitiveness and efficiency

As a company, we strive to continually improve our competitiveness in order to drive profitable growth to benefit all of our stakeholders. The most effective measure of this is three-year Return on Capital Employed (ROCE). ROCE demonstrates our ability to generate profitable business growth, manage our overhead costs through improved efficiency, and strategically deploy capital to enhance future shareholder return.

The Committee has approved the ROCE metrics applicable to the 2021 Performance Share awards, calibrated in line with the approved Integrated Business Plan (IBP) as follows:

- Threshold set as 25bps reduction in 2023 ROCE, and reflecting an improvement across the three-year period;

– On Target set as 2023 ROCE consistent with the IBP; and
– Stretch reflecting a 25bps improvement in 2023 ROCE, thereby ensuring an increase in return and/or improvement in capital employed.

The level of vesting for achieving the Threshold, On Target and Stretch targets shall be 25%, 50% and 100% respectively of the award, with pro-rata vesting for intermediate performance.

(iii) Advance and leverage our technology

This metric is designed to support our strategic focus on making technology investments. Effective delivery of major technology programmes will be used to measure this objective.

Annually, the Committee will approve the significant strategic technology projects to be measured, such that they highlight leveraging digital technology internally within the Company. The IBP process will be used to identify these projects such that they are strategic in nature, above the threshold for Lifecycle Management (LCM), and have clearly articulated and measurable value contributions. Each project will be measured against key milestones within the LCM process which include: (i) project launch/ business case agreed; (ii) go-live; and (iii) benefits delivered, and will be independently assessed via the LCM process. The vesting outcome will be derived from the outturn of each of the projects (between 0% and 100% of this element), with final approval by the Committee.

25% subject to cash generation

UK executive directors will be measured on three-year Free Cash Flow (FCF). The Company regularly publishes three-year FCF guidance, and presents FCF in the financial results. The FCF metric itself will be calibrated to be closely correlated to the Group's approved IBP. Threshold, Target and Stretch levels will be set appropriately to align with the Group's three-year FCF guidance and to incentivise improved cash performance over the three-year period.

To provide focus on cash generation within our BAE Systems, Inc. business, and maintain alignment within the senior BAE Systems, Inc. leadership team, our US executive director will be subject to three-year Operating Cash Flow (OCF) in respect of the BAE Systems, Inc. business.

Due to commercial sensitivity, the Free Cash Flow and BAE Systems, Inc., OCF targets will be disclosed retrospectively after the end of the relevant financial year.

25% measured against Total Shareholder Return

This metric will be measured against a single comparator group being a subset of the companies in the FTSE 100 index, chosen to ensure they reflect the size, sector, nature of operations, level of international exposure and shareholder base of BAE Systems. The same performance requirements will apply as for the 2020 Performance Share awards.

25% subject to earnings per share growth

The Committee has reviewed how the IBP approved by the Board has been translated into EPS targets that are appropriately challenging, aligned with shareholder expectations and still provide a meaningful incentive for executives to drive performance. Therefore the same performance requirements will apply as for the 2020 Performance Share awards.

Other items of note

We recognise that there is an increasing focus on measures relevant to Environmental, Social and Governance (ESG) performance. Our current remuneration framework includes a focus on safety that will apply as a downward underpin in the annual incentive, if the Committee finds that this is not up to the high standards expected. The Committee will continue to monitor the relevance of ESG metrics within the remuneration construct as they relate to our sustainability agenda (see page 34).

In relation to aligning pension contributions for incumbent directors, the Committee recognises the desire to see pension provision for highly-compensated executives brought in line with those available to the wider workforce. Since 2020, the Chief Executive's pension has been fixed at the monetary value of £186,200 per annum. This is equivalent to 16.8% of his 1 January 2021 salary (a reduction from 19%), and represents a move towards the level of employer contributions based on a weighted average of UK active members (approximately 15.5%). It is anticipated that his effective contribution rate will continue to reduce in future years and over time this will align his rate with that of the wider workforce. Recognising the practical issues involved and the Company's existing contractual commitments, the Committee will continue to monitor the matter of pension provision as part of broader market trends and investor expectations.

Context to the Committee's decisions

The business environment in which BAE Systems operates is a challenging one. There are the geopolitical realities of the industry in which we operate and the customers with whom we do business. There is the technical complexity of the work we do and the need for constant invention to make our businesses thrive. There is the competitive environment in which we acquire and retain talent, including the security of our work. All of these factors make us mindful of the importance of a highly skilled and experienced workforce, that it constantly be replenished with next-generation talent, and that the organisation be properly led and given the right performance incentives. While the Committee remains responsible for the full spectrum of senior executive employment matters, we also have a responsibility to ensure that the wider workforce across the globe is being treated equitably. Performance regarding safety, diversity, inclusion, gender pay differences, and pay practices around the world are all factors that are considered as we make our decisions.

In addition to developing the overall Directors' Remuneration Policy and framework, the Committee assesses the level of challenge within our annual and long-term incentive plan targets. Annually, in November, the full Board reviews and adopts the Integrated Business Plan. Thereafter, the Committee reviews the specific business targets/metrics for the one- and three-year periods and engages in a discussion regarding the underlying assumptions, including the degree of 'stretch' contained within them. After setting one- and three-year targets, the Committee periodically reviews progress towards the attainment of the objectives.

After the close of each year, the Committee undertakes a thorough review of annual and three-year performance.

Nevertheless, despite the challenges resulting from the COVID-19 pandemic and those in relation to securing the continued services of our Chief Executive, we believe we have made balanced judgements in respect of 2020. As a Committee, we will continue to look ahead to 2021 as another year in which we strengthen our framework on pay for performance. With the enhancement in individual goals now firmly in place and the changes approved in the 2020 policy review, we have the basis on which to exercise greater judgement in evaluating the performance, contributions and potential of our executives. As well, the Committee is engaged in ensuring the wider workforce remuneration, succession pipeline, and incentives are creating an environment where our most talented employees are being recognised and given greater responsibilities – and differences in individuals are valued.

Concluding comments

The Remuneration Committee remains committed to its policy of paying for performance, with our Directors' Remuneration Policy ensuring that our executive incentive arrangements are meaningful whilst simultaneously aligning them to the Company's strategic goals and to the interests of our shareholders. The Committee is actively engaged in monitoring performance and continuing to ensure that the level of challenge within our annual and long-term incentive plans remains appropriate.

I do hope you find this detailed explanation and transparency of our remuneration changes helpful, and in particular, in relation to the one-off and exceptional remuneration decisions we have made to secure the continued services of Charles Woodburn as Chief Executive of the Company. It is against this background that we ask for your support when voting on our Directors' remuneration report at this year's AGM.

On behalf of the Board

Ian Tyler
Chairman of the Remuneration Committee

The Remuneration Committee's year

January, London, UK
Committee
- Assessed outturn of 2019 strategic objectives for executive directors and Executive Committee members.
- Agreed 2020 key strategic objectives for executive directors and Executive Committee members.

February, London, UK
Committee
- Determined 2019 bonuses against performance for executive directors and Executive Committee members for payment in March 2020.
- Approved 2019 Group All-Employee Free Share Plans payments.
- Determined vesting outcome for 2017 Long-Term Incentive awards.
- Approved grant of 2020 Long-Term Incentive awards and associated performance targets for executive directors and Executive Committee members.
- Reviewed feedback from shareholder consultation on 2020 remuneration policy renewal and remuneration review.
- Approved 2019 Annual remuneration report including renewal of remuneration policy.

March, Videoconference
Committee
- Approved 2020 Long-Term Incentive grant resolutions.

May, Videoconference
Committee
- Reviewed feedback from shareholder consultation and Annual General Meeting in respect of 2020 remuneration policy renewal and remuneration review.
- Considered reward implications as a result of COVID-19 pandemic.
- Received an overview of broader workforce remuneration.

July, Videoconference
Committee
- Considered reward implications as a result of COVID-19 pandemic.
- Reviewed progress against Executive Committee 2020 objectives.
- Approved the vesting outcome of the 2017 Autumn Long-Term Incentive awards.

September, Videoconference
Committee
- Received an executive remuneration update.
- Considered long-term incentive metrics applicable to 2021 awards.
- Approved grant of 2020 Autumn Long-Term Incentive awards.
- Received an overview of broader workforce remuneration.

November, Videoconference
Committee
- Approved the approach to the development of the 2020 Annual remuneration report.
- Reviewed level of executive directors' and Executive Committee members' shareholdings relative to their Minimum Shareholding Requirement.
- Reviewed dilution levels and share usage under Employee Share Plans.
- Approved operation of Group All-Employee Free Share Plans for 2021.
- Approved long-term incentive metrics applicable to 2021 awards.
- Reviewed cascade of approved remuneration policy below executive director level.
- Received key external market trends from the 2020 AGM season, and an internal update ahead of 2021 reward review.
- Received remuneration analysis for individuals on Executive Committee succession plans.

December, Videoconference
Committee
- Considered the recent updates to institutional investor guidance.
- Reviewed and set salaries for executive directors and Executive Committee members.
- Agreed the approach, structure and targets for the 2021 annual incentive plan.
- Reviewed the draft 2021 strategic objectives applicable to the Executive Committee.
- Agreed special remuneration adjustment for the Chief Executive to secure his services.

Remuneration Committee timeline



Annual remuneration report at a glance

for the year ended 31 December 2020

Business performance and incentive outcomes in 2020

		2020 performance	2020 incentive outcome
Group underlying EPS[1]	AIP	48.3p	●
Group net debt[1]	AIP	£(97)m	●
Group order intake[1]	AIP	£20.2bn	●
Recordable Accident Rate (per 100,000 employees)[2]	AIP	485	●
Major injuries recorded	AIP	37	●
Average three-year diluted underlying EPS growth	LTI	5%	●
Three-year TSR	LTI	–4.3%	●

AIP Annual Incentive Plan
LTI Long-Term Incentive

● Below threshold
● Between threshold and target
● At or above target

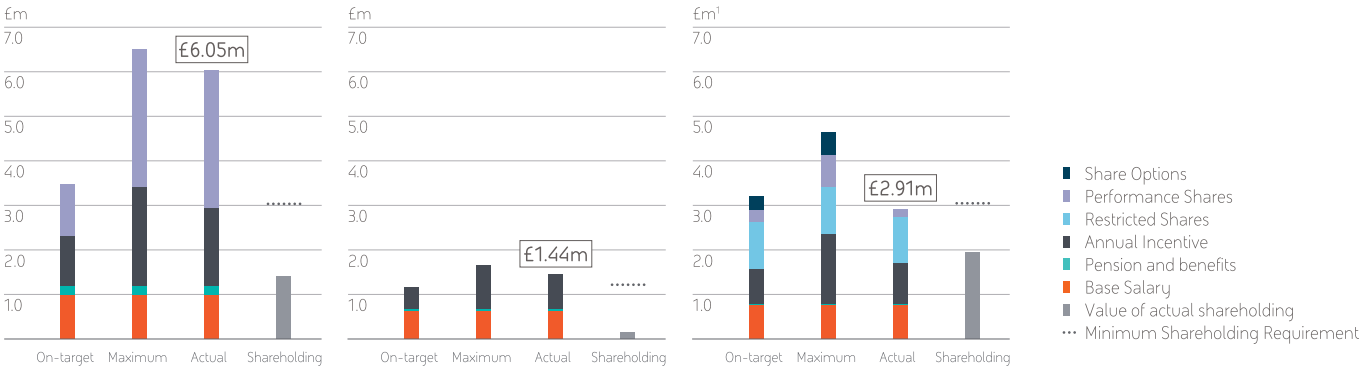
1. Adjusted to be on a like-for-like basis with the targets (see page 144).
2. Safety performance has been assigned at a Group level, with a small portion of the available award made in recognition of the improvement (reduction) in the number of injuries recorded in the UK, Saudi Arabia and Australia businesses. No payout was awarded in respect of BAE Systems, Inc.'s safety performance as a result of the level of major injuries recorded.

This resulted in the following incentive outcomes:

– 2020 annual bonus payouts for the executive directors were between target and 80% of maximum; and
– The outcomes applicable to Tom Arseneault, Peter Lynas and Jerry DeMuro are as follows: Performance Shares (EPS) granted in March 2018 achieved target performance and will vest at 50%. Performance Shares (TSR) granted in March 2018 did not meet their performance condition and will lapse. However, with respect to Charles Woodburn's March 2018 Performance Shares, as detailed in the Remuneration Committee Chairman's letter on page 125, the Committee exercised its discretion to determine the outcome of the award at the maximum level of 100%.

Summary of executive directors' remuneration in 2020

The charts below show the 2020 actual remuneration achieved, as disclosed in the single total figure of remuneration on page 140, compared with the 2020 on-target and maximum opportunity. In respect of Brad Greve and Tom Arseneault who were appointed as executive directors during the year, annualised figures have been provided to include their remuneration prior to their appointment. On-target remuneration assumes target vesting of incentives payable in respect of the performance period with year-end 2020, whilst maximum remuneration assumes maximum vesting of incentives payable. Also included is the value of the actual shareholding for each executive director as at 31 December 2020 compared to their Minimum Shareholding Requirement (as set out on page 152).



Charles Woodburn
Chief Executive

Brad Greve
Group Finance Director

Tom Arseneault[2]
President and Chief Executive Officer of BAE Systems, Inc.

1. The figures for Tom Arseneault have been converted from US dollars to sterling.
2. Long-term incentive figures above are based on the 2018 Performance Shares and Share Options. For Tom Arseneault, the figures include his 2020 Restricted Shares award (as required by regulation in the single total figure of remuneration); his single total figure of remuneration on page 140 includes pro-rating of his 2018 Performance Shares and Share Option awards (the latter is underwater and shown as nil).

Remuneration in the wider context

The Committee has responsibility for reviewing remuneration and related policies applicable to the wider workforce and the alignment of incentives and rewards with culture, ensuring this is taken into account when setting the policy for executive remuneration. As detailed on page 43 our objective is to inspire and enable our people to fulfil their potential. We strive to create an inclusive, agile environment in which everyone does their best work for our customers and feels valued for their contribution. Within this context:

– a consistent remuneration philosophy and strategy is applicable to all employees across the Group;
– we provide our employees with competitive reward packages which reflect their individual responsibilities and contribution to business performance, and we recognise individual and team successes through a variety of financial and non-financial recognition schemes;
– we offer post-employment benefits aligned to competitive practice in each relevant home market;
– we also encourage employees to become shareholders in BAE Systems and, in some markets, offer share schemes to support this;
– we have further embedded our Behaviours in our people processes, to measure, recognise and reward not just what our people achieve but how they achieve it;
– the mean pay difference between men and women across the UK workforce is 9.1% in favour of men; and
– the median pay ratio of Chief Executive remuneration to UK average employee is 102:1.

Annual remuneration report at a glance

for the year ending 31 December 2021

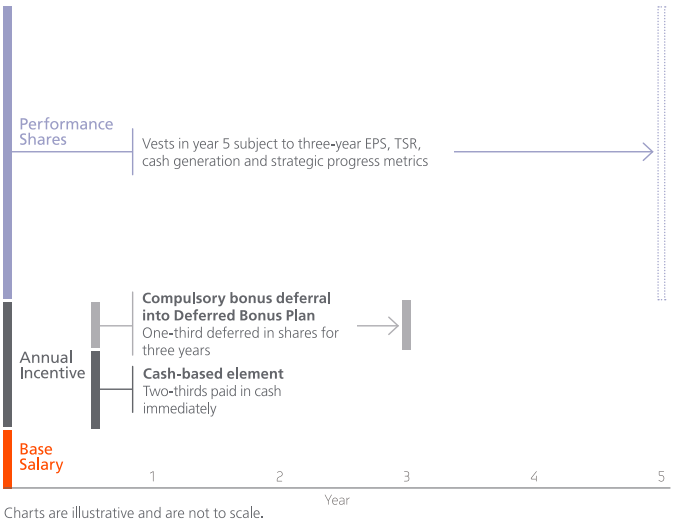
Summary of remuneration framework

The table below sets out the overall remuneration framework applicable to each of the executive directors under the 2020 approved remuneration policy.

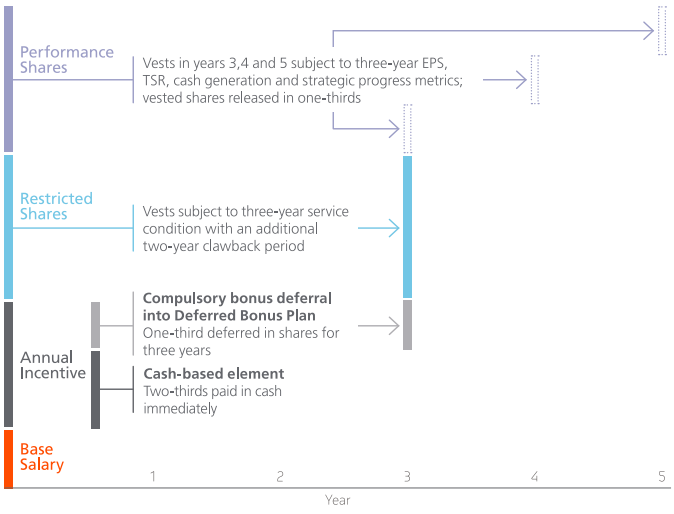
	Purpose and link to strategy		Charles Woodburn CEO	Brad Greve GFD	Tom Arseneault President and CEO Inc.
Base Salary (with effect from 1 January 2021)	Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.		£1,107,538	£622,200	$1,014,000
Pension and benefits	Provide employment benefits and competitive post-retirement benefits to ensure overall package is market competitive.		Defined contribution (£186,200)	Defined contribution (8% salary)	US defined benefit and Section 401(k) defined contribution[1]
Annual Incentive	Drive and reward annual performance of individuals and teams on both financial and non-financial metrics, including leadership behaviours, in order to deliver sustainable growth in shareholder value. Compulsory deferral into shares increases alignment with shareholder interests.	On-target/maximum opportunity (% salary)	112.5%/225%	80%/160%	112.5%/225%
		Performance condition	75% financial (Earnings, cash and order intake)/ 25% non-financial (key strategic objectives)[2]		
		Deferral into Deferred Bonus Plan	One-third compulsory deferral		
Performance Shares	Direct financial measures of long-term earnings and cash generation that drive our financial ambitions for the Company, and external strategic measures including relative TSR performance, aligned to the interests of shareholders.	Grant (% salary)	370%	335%	298%
		Performance condition	25% relative TSR/ 25% three-year diluted underlying EPS growth/ 25% cash generation/ 25% strategic progress		
		Vesting	Three-year performance conditions, vests in year 5		Three-year performance conditions and vested shares released one-third in years 3,4,5
Restricted Shares	Provide long-term reward through time-vesting awards principally in the Company's US market.	Grant (% salary)	n/a		150%
		Vesting	n/a		Three-year service condition and two-year clawback period
Minimum Shareholding Requirement	Provide long-term alignment with shareholder interests.	(% salary)	300%	200%	425%
		Post-cessation shareholding requirement (% salary)	300% for two years	200% for two years	300% for one year

1. Further detail on Tom Arseneault's pension is provided on pages 149 and 164.
2. Safety and diversity and inclusion measures will operate as a downward underpin to non-financial measures.

Application of 2021 package for UK executive directors



Application of 2021 package for US executive director



Charts are illustrative and are not to scale.

Annual remuneration report

for the year ended 31 December 2020

This section details the remuneration of the executive and non-executive directors (including the Chairman) during the financial year ended 31 December 2020 and will be proposed for an advisory vote by shareholders at the 2021 Annual General Meeting (AGM).

It has been prepared on the basis prescribed in Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Response to remuneration reporting provisions in the 2018 UK Corporate Governance Code

In response to the Code requirements, you will find the following detailed in our reporting:

Page 137
Strategic rationale of our remuneration framework

Page 132
Appropriateness of our remuneration

Page 136
How the Committee has addressed the factors of clarity, simplicity, risk, predictability, proportionality and alignment to culture

Page 124
Operation of our policy

Page 138
Engagement with shareholders

Page 133
Engagement with our workforce

Page 124
Exercise of discretion

Statement of voting

Shareholder voting on the resolutions to approve the Annual remuneration report put to the 2020 AGM and the Directors' remuneration policy put to the 2020 AGM was as follows:

Annual remuneration report

Votes for	%	Votes against	%	Total votes cast	Votes withheld (abstentions)
2,228,101,351	92.50	180,570,698	7.50	2,408,672,049	94,920,178

Directors' remuneration policy

Votes for	%	Votes against	%	Total votes cast	Votes withheld (abstentions)
2,423,919,276	97.55	60,821,405	2.45	2,484,740,681	18,848,820

The Directors' remuneration policy approved at the 2020 AGM, which took effect on 7 May 2020, is detailed on pages 157 to 171. It is also available in the Investor Relations section of the Company's website: baesystems.com

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Appropriateness of remuneration and wider context

Our reward philosophy and approach

The Committee has responsibility for reviewing remuneration and related policies applicable to the wider workforce, ensuring that this is taken into account when setting the policy for executive remuneration. Our aim across the Group is to provide a reward package that is aligned to shareholders' interests, supports the achievement of the Company's in-year financial and strategic objectives, is competitive against the appropriate market and is consistent with our focus on performance and our values of Trusted, Innovative and Bold. During 2020, we have further embedded our Behaviours in our people processes as we continue to measure, recognise and reward not just what our people achieve but how they achieve it. This means:

- base salaries are set with reference to median of the relevant market competitive level;
- high performance and exceptional contribution are recognised through in-year incentives;
- packages for leadership roles have an increased emphasis on longer-term share-based reward;
- providing employees with competitive and affordable retirement benefits which reward long-term contribution and loyalty; and
- ensuring access to a competitive and cost-effective package of other benefits as part of our total reward offering.

As set out on page 136, the Committee considered a number of core principles in the renewal of our 2020 remuneration policy for executive directors, including how our reward policy and practice compares across the wider workforce. The table below illustrates this for the different groups of employees within BAE Systems.

	Executive directors	Executive Committee	Senior executives	Middle management	Wider workforce
Base Salary	Base salary is set based on market pay approach recognising the individual's skill, knowledge, experience levels and contribution to role. Normally reviewed annually with increases typically in line with the wider workforce.				Base salary is either subject to negotiation with recognised trades unions and/or is set in line with market and/or performance.
Pension and benefits	Range of employment benefits and competitive post-retirement benefits in line with relevant home market.				
Short-term incentive	Annual incentive based 75% on financial performance of our KPIs and 25% on non-financial metrics of key strategic objectives, with safety and diversity and inclusion applied as downward underpin. Compulsory deferral into shares for three years.	Annual incentive based 75% on financial performance of our KPIs and 25% on non-financial metrics of key strategic objectives, with safety and diversity and inclusion applied as downward underpin. Compulsory deferral into shares for three years (except in the US).		Annual incentive based on business and individual performance.	In UK businesses, incentive typically based on business and/or individual performance.
Long-term incentive	Performance shares are subject to three-year performance conditions (and further holding requirements) designed to drive sustained company financial performance aligned to interests of shareholders. Restricted shares vest subject to service condition (applicable in the US only).	Performance shares are subject to three-year performance conditions (and further holding requirements) designed to drive sustained company financial performance aligned to interests of shareholders. Share options (with no performance conditions) are exercisable after three years. Restricted shares vest subject to three-year service condition (predominantly applicable in the US).		Eligible employees may participate in and receive free matching shares in our Company Share Incentive Plan (SIP) or international equivalent. Company rewards eligible employees with annual award of free shares, or cash equivalent, based on our Group financial performance.	

The Committee regularly undertakes a deep-dive session to build its understanding of reward arrangements applicable to the wider workforce. The Committee has deepened its approach, not only due to the broader governance requirements, but because it believes that well-designed remuneration can be a tool of culture change and progressive improvement in Company performance. Such deep-dive sessions provide assurance that the remuneration for the wider workforce is consistent with market trends, with regulation, and is non-discriminatory with respect to gender, ethnicity and other personal attributes not related to performance.

The Committee is provided with visibility of remuneration practices in the different sectors/markets in which we operate and for the different populations within the wider workforce across the Company globally. These sessions have covered a range of topics including workforce demographics, the outcome of the annual reward review throughout the workforce, reward principles, job sizing, pay philosophy and pay ranges, annual and long-term incentive design, employee share plans and other employee benefits including pension and retirement schemes. During meetings, the Committee is also periodically updated on wider employee matters such as the outcome of our UK gender pay analysis and an analysis of selected key talent such as those individuals on an Executive Committee succession plan.

The Committee, as well as all Board members, meets periodically with the wider workforce and with high-potential employees to engage in candid dialogue.

Whilst the Company does not currently directly engage with employees as part of the process of reviewing executive pay, formulating the Remuneration Policy and its alignment with wider company pay policy, the Company does receive insights from the broader employee population using an engagement survey. Further detail on engagement with employees is given on page 138.

Pay comparisons

Pay ratio of Chief Executive to UK average employee

The Committee is mindful of the relationship between Chief Executive remuneration and the remuneration of the wider BAE Systems employee population. As required by legislation, the table below provides the ratio of the Chief Executive to that of the median, 25th and 75th percentile total remuneration of full-time equivalent UK employees. We voluntarily disclosed the pay ratio on the required basis in 2018:

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2020	**Option B**	**120:1**	**102:1**	**88:1**
2019	Option B	90:1	72:1	59:1
2018	Option B	61:1	48:1	38:1

The reporting regulations offer three calculation approaches for determining the pay ratio – Options A, B and C. The table above has been calculated using the approach determined by Option B which is deemed the most appropriate methodology for BAE Systems. Recognising that BAE Systems has more than 30,000 UK employees, operating on different human resources and payroll systems, it is not feasible to adopt Option A. The calculations for the relevant representative employees were performed as at 31 December 2020.

To ensure Option B provides a sufficiently accurate representation of the UK workforce, we have performed sensitivity analysis around the three quartiles. Our approach has been to consider the total pay and benefits for a number of employees centred around each quartile. This allows any anomalies that may arise when calculating the total pay and benefits for the full financial year (such as if an employee left part way through the year) to be adjusted or excluded. By taking an average of the remaining figures, this provides a robust representation of each quartile.

The total full-time equivalent pay and benefits for the relevant employees has been calculated based on the amount paid or receivable in respect of the financial year. The calculations are on the same basis as required for the Chief Executive's remuneration for single total figure purposes. For pension-related benefits, employer pension costs have been estimated using the employer contribution rates applicable to the member's pension scheme. No other estimates or adjustments have been used in the calculation and no remuneration items have been omitted. A minority of employees in this calculation are employed on a part-time basis and therefore their remuneration has been annualised to reflect the full-time equivalent.

Our reward framework across the Group is based on a consistent set of principles, including managing reward by reference to external competitor benchmarks (see page 132). In the case of our Chief Executive, his total remuneration comprises a significant proportion in variable pay and therefore the single figure will vary considerably depending on the level of performance against the measures which drive the Annual and Long-Term Incentive Plans. The employees in the calculation would not typically participate in any long-term incentive plans and receive a significantly higher proportion of their remuneration in the form of fixed pay. The difference in ratio at the three quartiles is consistent with our market-based approach to reward, with the ratio increasing as the Chief Executive's remuneration is compared with that of more junior employees. The overall picture presented by the ratios is consistent with our pay, reward and progression policies.

£	25th percentile	50th percentile	75th percentile
Total pay and benefits	50,444	59,183	68,487
Salary component	33,254	41,126	51,117

Relative to 2019, the pay ratio in 2020 has increased by approximately 33%, 42% and 50% at 25th, median and 75th percentiles respectively. Whilst there has been a decrease in annual bonus in respect of 2020 (78.7% of maximum in 2020 versus 95.6% in 2019), the pay ratio has been impacted by the full vesting of long-term incentives in respect of performance ending in 2020 for the Chief Executive (compared with partial vesting in respect of 2019).

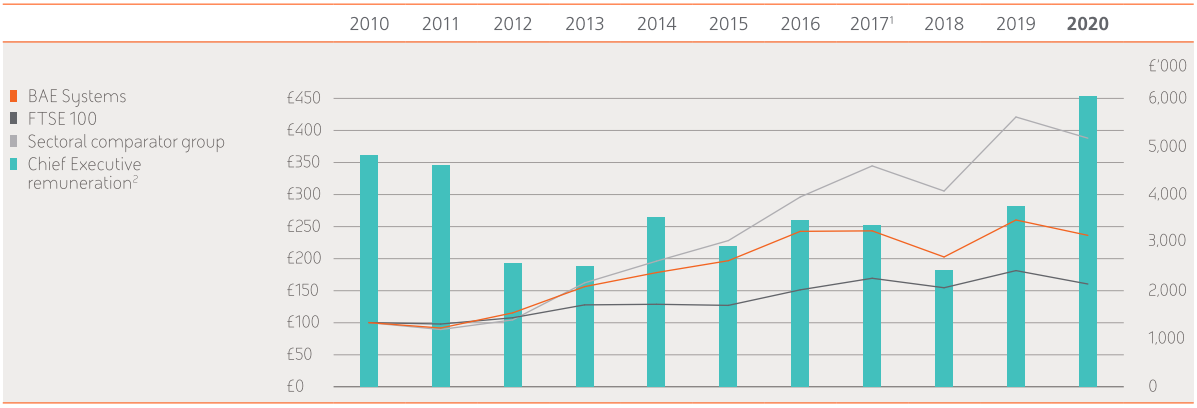
Total Shareholder Return (TSR) performance and Chief Executive pay

The graph below shows the value by 31 December 2020, on a TSR basis, of £100 invested in BAE Systems on 31 December 2010 compared with the value of £100 invested in the FTSE 100 index, including the effect of dividends. The graph additionally shows the remuneration of the Chief Executive, plotted as a bar chart on the secondary y-axis.

The FTSE 100 is considered to be an appropriate comparator for this purpose as it is a broad equity index of which BAE Systems is a constituent member and reflects the investment interests of our UK shareholder base. In addition, it forms 50% of the TSR performance measure for awards made between 2016 and 2020. The equivalent data is shown for the sectoral comparator group which is of relevance to our international shareholder base, and forms the remaining 50% of the TSR performance measures for awards made until 2020.

The chart below demonstrates the strong long-term alignment of our Chief Executive pay and the returns to our shareholders. We achieved this through the Chief Executive receiving a high proportion of his remuneration in shares and with our performance conditions being based on measures which directly support the implementation of our strategy.

Value at 31 December 2020 of £100 investment at 31 December 2010



Change in Chief Executive's remuneration over ten years

	2010	2011	2012	2013	2014	2015	2016	2017[1]	2018	2019	**2020**
Chief Executive's single total figure (£'000)[3]											
Ian King	4,810	4,613	2,574	2,499	3,519	2,929	3,463	2,086	n/a	n/a	**n/a**
Charles Woodburn	–	–	–	–	–	–	–	1,279	2,416	3,747	**6,048**
	4,810	4,613	2,574	2,499	3,519	2,929	3,463	3,365	2,416	3,747	**6,048**
Bonus paid as a percentage of maximum											
Ian King	71.0%	68.6%	55.6%	53.4%	74.3%	72.4%	82.3%	75.9%	n/a	n/a	**n/a**
Charles Woodburn	–	–	–	–	–	–	–	75.8%	65.6%	95.6%	**78.7%**
LTI as a percentage of maximum vesting[3]											
Ian King	57.6%	44.3%	nil	nil	16.8%	nil	nil	11.3%	n/a	n/a	**n/a**
Charles Woodburn	–	–	–	–	–	–	–	n/a	nil	10.9%	**100%**

1. Ian King retired and stepped down as Chief Executive on 30 June 2017 and Charles Woodburn took over the position on 1 July 2017. Ian King's remuneration is shown from the start of the financial year until 30 June 2017. Charles Woodburn's remuneration is shown from 1 July 2017 to the end of that financial year.
2. Plotted as a bar chart on the secondary y-axis.
3. Total remuneration includes the value of share plans vesting that were granted prior to appointment as Chief Executive.

Annual percentage change in directors' remuneration

The table below shows the percentage change over the year ended 31 December 2019 to the year ended 31 December 2020 in respect of directors' remuneration and average employee remuneration. As required by legislation, Directors' remuneration is compared to employees of the BAE Systems plc entity on a full-time equivalent basis. We are voluntarily disclosing this information on the required basis in this year's report. As such, we have excluded any directors who left or joined the Board part way through 2020.

	Salary/fees % change	Benefits % change	Annual bonus % change[1]
Executive directors			
C N Woodburn	+6.9	–3.9	–12.1
Non-executive directors			
Sir Roger Carr	0.0	0.0	n/a
Dame Elizabeth Corley	+4.7	–100.0	n/a
C M Grigg	+28.1	–100.0	n/a
S T Pearce[2]	+133	–4.0	n/a
N W Piasecki[2]	+79.5	–35.5	n/a
P Rosput Reynolds	+3.6	–82.1	n/a
N C Rose	–30.8	–87.4	n/a
I P Tyler	+3.6	–64.7	n/a
Average employee[3]	+2.5	+2.5	–2.0

1. Annual percentage change information is provided on a voluntary basis for 2020. The table includes those individuals employed as a director for the whole of 2020 and with remuneration disclosed in the 2019 single figure table (to determine the percentage change).
2. Remuneration for Stephen Pearce and Nicole Piasecki in respect of 2019 reflects their part-year from joining the Board on 1 June 2019.
3. Figures provided in respect of employees of BAE Systems plc on a full-time equivalent basis, calculated on a median average basis.

Gender pay

BAE Systems has published its annual gender pay gap report in line with the UK regulations. For 2020, the average (mean) gender pay gap for our UK workforce was 9.1% in favour of men (2019 10.3%), which is lower than the current UK national average of 15.5%. We have a gender pay gap because we employ around four times more men than women and a greater proportion of our senior leadership population is male. We rely on employing large numbers of employees with STEM qualifications and we, like other companies, face challenges recruiting females with these qualifications because there are significantly fewer women who study and work in these fields. We continue to work hard to improve our gender balance and remain steadfast in our commitment to delivering the plans we have in place to increase the number of women in BAE Systems and support the progression of women into senior executive positions.

Relative importance of spend on pay

The following charts set out underlying EBITA[1], amounts paid in returns to shareholders, total employee costs and average headcount for the years ended 31 December 2019 and 2020. These charts have been chosen as they are most representative in assisting to understand the relative importance of spend on pay.

Underlying EBITA[1] (£m)

+0.7%



Returns to shareholders[3] (£m)

+3.0%



Total employee costs[2] (£m)

+4.2%



Average headcount[4] ('000)

+1.3%



1. Operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBITA), and non-recurring items (see page 58). This is included as it is the Group's principal measure of operational profitability.
2. After excluding the impact of exchange translation, wages and salaries increased by approximately 3% per employee in 2020.
3. Returns to shareholders comprise dividends to ordinary shareholders paid in the year.
4. Excluding share of equity accounted investments. This is included for year-on-year comparison of employee headcount.

Remuneration principles

The Committee established six core principles which underpin our approach to executive remuneration. The principles are aligned to BAE Systems' strategic objectives, taking account of shareholder expectations and the remuneration factors set out in Provision 40 of the 2018 UK Corporate Governance Code (the Code), as well as reflecting a stronger performance accountability across the enterprise. The Committee considered these principles in the renewal of our 2020 remuneration policy, whilst being mindful of the alignment and fairness of remuneration with the wider workforce. The table below shows this close alignment between the Committee's core principles and the Code's factors, including how the Committee addresses each factor.

Factor within Provision 40	How the Committee addresses the factor
Clarity Remuneration arrangements should be transparent and promote effective engagement with shareholders and the workforce.	In line with our commitment to full transparency and engagement with our shareholders on the topic of executive remuneration, the Remuneration Committee Chairman engages with our major shareholders to set out the changes planned. In a year of significant change, the Remuneration Committee Chairman will consult with our major shareholders to discuss and seek views on potential changes. The Company consults directly with the broader employee population on their remuneration through a variety of methods including Webex, explanatory guides hosted on intranet, human resources or business-led briefings.
Simplicity Remuneration structures should avoid complexity and their rationale and operation should be easy to understand.	Clear direction of travel for changes to our reward framework in recent years has been to reduce the complexity of our long-term incentive arrangements as demonstrated by: – **2014:** Introduction of new single 'umbrella' LTI plan allowing simplicity and flexibility of design; and – **2018:** Simplification of construct by elimination of share options for executive directors.
Risk Remuneration arrangements should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated.	Full range of design features exist within remuneration arrangements to take risks into account as follows: – malus and clawback mechanisms within AIP and LTIs; – Remuneration Committee application of reasonable discretion to override formulaic outcomes; and – safety metric within AIP focuses on recordable accident rate and major injuries recorded.
Predictability The range of possible values of rewards to individual directors and any other limits or discretions should be identified and explained at the time of approving the policy.	Our remuneration policy contains the following: – maximum award levels and vesting outcomes applicable to annual and long-term incentive arrangements; and – as set out above in Risk, the Committee has the ability to apply malus, clawback and reasonableness discretion where appropriate.
Proportionality The link between individual awards, the delivery of strategy and the long-term performance of the Company should be clear. Outcomes should not reward poor performance.	Performance conditions attached to annual and long-term incentive arrangements require a minimum level of performance to be achieved before any payout is made. As set out on page 137, there is a direct link between an individual's reward and their contribution to driving strategy and increasing company performance. No payment is made for poor performance. Any individual's performance that is below expectations is dealt with as part of our performance management process – any individual leaving due to performance issues would not be entitled to any incentive payments.
Alignment to culture Incentive schemes should drive behaviours consistent with Company purpose, values and strategy.	As set out on page 137, there is a direct link between driving BAE Systems' strategy and an individual's reward. As shown opposite, the Committee has established six core principles which underpin the philosophy and approach to executive remuneration to ensure alignment to BAE Systems' strategic objectives.

Remuneration Committee core principles

Simplicity
Clarity and simplicity of design; ease of understanding by executives and external stakeholders.

Motivational
Plans are relevant and meaningful with clear line of sight between actions and reward outcomes; metrics and targets which drive superior performance and value for shareholders.

Aligned with shareholder interests
Close alignment of reward outcomes and shareholder experience; long-term share ownership and 'skin in the game' for executives.

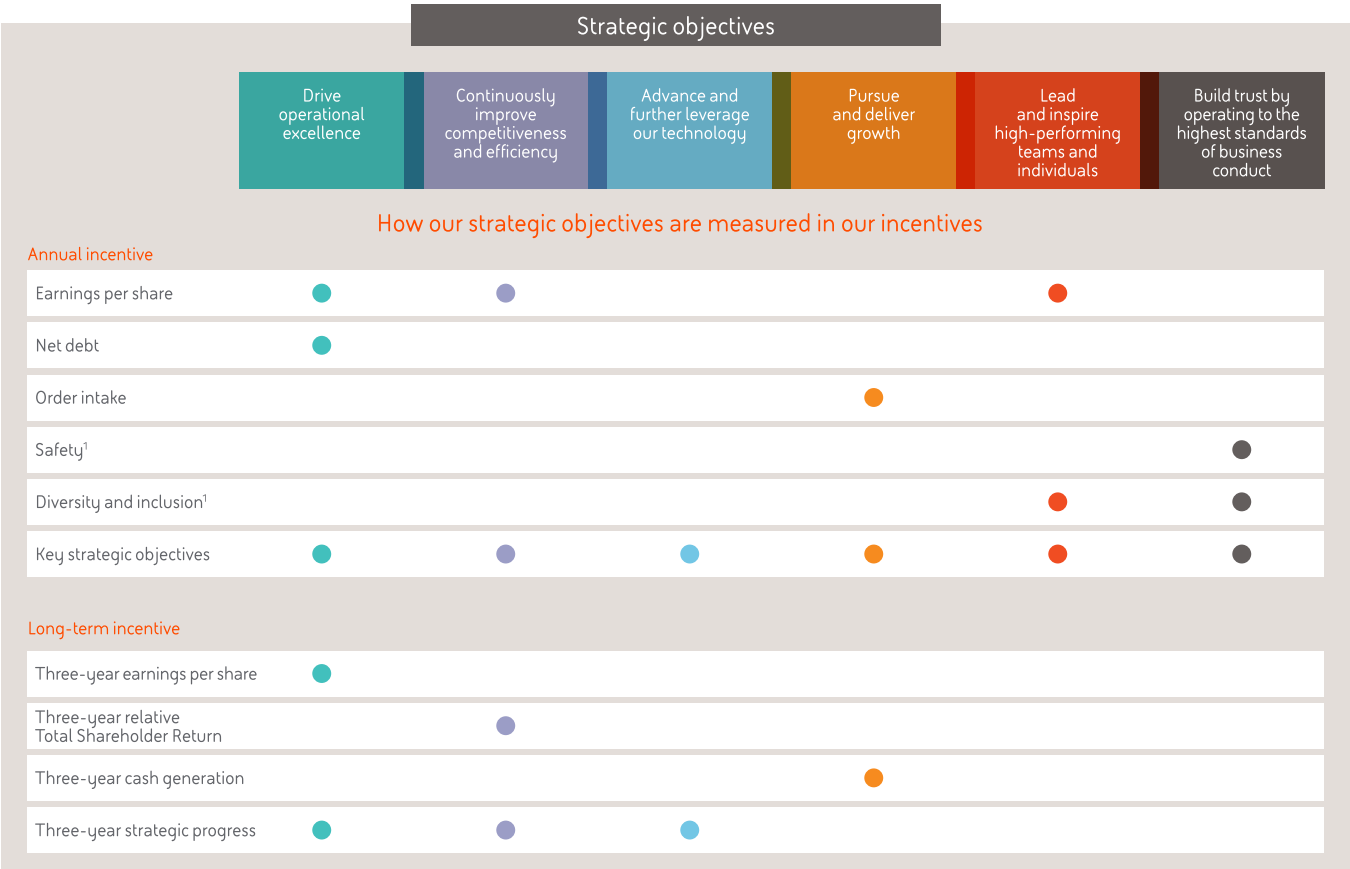
Globally competitive
Reward opportunity aligned to relevant competitive employment market; enabling mobility across different businesses and geographies.

Acceptable to shareholders
Compliance with proxy bodies and corporate governance guidelines; continuing government, investor, media and public scrutiny of executive pay and fairness relative to wider workforce.

Flexibility/adaptability
Transparent and responsible application of discretion to override formulaic outcomes; ability to respond to special/ unforeseen circumstances during life of binding policy.

Strategic rationale for our directors' remuneration

As detailed on page 132, the Committee's aim across the Group is to provide a reward package that is aligned to shareholders' interests, supports the achievement of the Company's in-year financial and strategic objectives, is competitive against the appropriate market and is consistent with our focus on performance and our values of Trusted, Innovative and Bold. In the context of our executive directors and senior executive population, a significant proportion of their remuneration package is performance-related, and the performance conditions applying to incentive arrangements support the delivery of the Company's strategy. The chart below shows the alignment of our incentive measures with our strategic objectives.



1. Safety and diversity and inclusion will be applied as a downward underpin if these are not achieved at high levels expected.

The table below sets out how our executive directors' and senior executives' remuneration framework directly aligns to our strategy.

Element	Purpose and link to strategy
Base salary	Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.
Pension and benefits	Provide employment benefits and competitive post-retirement benefits to ensure overall package is market competitive.
Annual incentive	Drive and reward annual performance of individuals and teams on both financial and non-financial metrics, including leadership behaviours, in order to deliver sustainable growth in shareholder value.
Bonus deferral	Compulsory deferral into shares increases alignment with shareholder interests.
Performance shares	Direct financial measures of long-term earnings and cash generation that drive our financial ambitions for the Company, and external strategic measures including relative TSR performance, aligned to the interests of shareholders.
Restricted shares (predominantly in the US)	Provide long-term reward through time-vesting awards principally in the Company's US market.
Share options (below executive director level)	Drive and reward delivery of sustained improvement in the Company's share price.
Shareholding requirements	Provide long-term alignment with shareholder interests.

Engagement with shareholders

In line with our commitment to full transparency and engagement with our shareholders on the topic of executive remuneration, the Remuneration Committee Chairman annually writes to our major shareholders and also Institutional Shareholder Services, the Investment Association and Glass Lewis, to set out the remuneration changes planned. In a year of significant change, such as the renewal of our Remuneration Policy, the Remuneration Committee Chairman will additionally engage directly with our major shareholders to discuss and seek views on potential changes. The Remuneration Committee Chairman values direct engagement with our shareholders and makes himself available for such meetings throughout the year to hear their perspective on remuneration matters.

Periodically, BAE Systems conducts a Governance Investor event, aimed at encouraging greater transparency and awareness of our governance programmes. The event provides an opportunity for closer contact with non-executives, particularly the committee chairs. As part of the November 2020 event, held virtually, the Remuneration Committee Chairman shared an overview of the Remuneration Committee including their role and remit, the key areas for consideration during 2020 and beyond, and a summary of the changes in our 2020 Remuneration Policy.

Engagement with workforce

The skills, capabilities and commitment of our people are critical to ensuring the long-term sustainability of our business and delivering the innovation needed to solve our customers' complex challenges. Effective engagement enables our employees to contribute to improving business performance and helps us to create an environment in which everyone is valued and can fulfil their potential.

Our Company Behaviours, launched in 2019, build on our organisational strengths and focus us, individually and collectively, on the characteristics that will underpin our success in the future. They define the way we want to work – with each other and with our partners and customers – and are key to creating an inclusive culture in which everyone can thrive. During the pandemic, these Behaviours came to the fore, with qualities like adaptability, creativity, collaboration and integrity enabling us to meet unprecedented challenges. During 2020, we have further embedded our Behaviours in our performance, talent, recruitment and reward processes as we continue to measure, recognise and reward not just what our people achieve but how they achieve it.

As a result of the various global restrictions, the Board was unable to complete its planned programme of site visits and associated face-to-face engagement with employees. Where possible, the programme was adapted to seek employee feedback and engage remotely. The Chairman and non-executive directors held a number of video conferences with a variety of colleagues from across our global employee base. In these conversations, directors sought feedback on the Company's response to the pandemic and heard first-hand accounts of the impact of COVID-19 on the employees. They also shared experiences of how we were adapting to support customers, suppliers and their communities.

We keep employees informed about what is happening across the business using a variety of channels, including our intranet, email and employee app, through podcasts, newsletters, leadership blogs and trade union forums, and also through virtual and face-to-face leadership briefings and team meetings where we seek to listen to employees' views and opinions. Employees are encouraged to share their views through our channels and employee surveys. We also engage with trade unions in Australia and the UK and labour unions in the US.

As shareholders through our all-employee share schemes, eligible employees are encouraged to vote and attend (subject to COVID-19 restrictions) our Annual General Meeting (AGM). In addition to providing an update on our business performance, it also provides the opportunity for them in their capacity as shareholders to ask questions to our Chairman and other members of the Board.

Single total figure of remuneration

Single total figure of remuneration for the Chairman and non-executive directors

	● Fees £'000		● Benefits £'000		● Other £'000		**Total £'000**		● Total fixed remuneration £'000		● Total variable remuneration £'000	
	2020	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Chairman												
Sir Roger Carr	**700**	700	–	–	–	–	**700**	700	**700**	700	–	–
Non-executive directors												
R Advaithi[1]	**40**	80	**2**	7	–	18	**42**	105	**42**	105	–	–
N J Anderson[2]	**14**	n/a	**1**	n/a	–	n/a	**15**	n/a	**15**	n/a	–	n/a
Dame Elizabeth Corley	**84**	80	–	3	–	4	**84**	87	**84**	87	–	–
H Green[3]	**n/a**	68	**n/a**	2	**n/a**	18	**n/a**	88	**n/a**	88	**n/a**	–
J V Griffiths[4]	**64**	n/a	–	n/a	–	n/a	**64**	n/a	**64**	n/a	–	n/a
C M Grigg	**103**	80	–	3	–	4	**103**	87	**103**	87	–	–
S T Pearce[5]	**109**	47	**1**	1	–	4	**110**	52	**110**	52	–	–
N W Piasecki[5]	**84**	47	**7**	11	**4**	13	**95**	71	**95**	71	–	–
P Rosput Reynolds[6]	**109**	105	**2**	8	**4**	27	**115**	140	**115**	140	–	–
N C Rose[6]	**90**	130	–	1	–	4	**90**	135	**90**	135	–	–
I P Tyler	**109**	105	**1**	2	–	5	**110**	112	**110**	112	–	–

1. Retired from the Board on 25 June 2020.
2. Appointed to the Board on 1 November 2020.
3. Retired from the Board on 7 November 2019.
4. Appointed to the Board on 1 April 2020.
5. Appointed to the Board on 1 June 2019.
6. Retired from the Board on 31 December 2020.

● Fixed remuneration element
● Variable remuneration element

Chairman

Sir Roger Carr's fee was set at £700,000 per annum with effect from 1 February 2017 and has remained at that level following a review prior to the commencement of his third three-year term from 1 February 2020.

The Chairman's fee is set by the Remuneration Committee and will not be reviewed again for the remainder of his current three-year term.

Non-executive directors

The non-executive directors' fees are set by the Non-Executive Directors' Fees Committee which comprises Sir Roger Carr (Committee Chairman), Philip Bramwell (Group General Counsel), Charles Woodburn and, from 1 April 2020, Tom Arseneault. Jerry DeMuro was a member of this committee until his retirement from the Board on 31 March 2020.

The fee structure was reviewed in January 2020 and was set from 1 April 2020 on a per annum basis as follows: (i) Chairman, Audit Committee: £110,000 (2019 £105,000); (ii) Chairman, Corporate Responsibility Committee: £110,000 (2019 £105,000); (iii) Chairman, Remuneration Committee: £110,000 (2019 £105,000); (iv) other non-executive directors: £85,000 (2019 £80,000); and (v) additional fee for Senior Independent Director: £25,000 (2019 £25,000). These amounts are shown in the 'Fees' column above. This will be subject to periodic review.

A travel allowance of £4,500 per meeting is also paid on each occasion that a non-executive director's travel necessitates air travel of more than five hours (one way) to the meeting location, subject to a maximum of six travel allowances per year. These amounts are shown in the 'Other' column.

The amounts in the 'Benefits' column relate to travel expenses and subsistence.

The above table has been subject to audit.

Single total figure of remuneration for the executive directors

	Base salary £'000		Taxable benefits[1] £'000		Bonus[2] £'000		LTIP[3] £'000		Pension[4] £'000		Other[5] £'000		**Total £'000**		Total fixed remuneration £'000		Total variable remuneration £'000	
	2020	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
C N Woodburn	**983**	920	**20**	21	**1,740**	1,978	**3,118**	651	**186**	175	**1**	2	**6,048**	3,747	**1,189**	1,116	**4,859**	2,631
B M Greve*	**458**	n/a	**12**	n/a	**573**	n/a	**–**	n/a	**38**	n/a	**1**	n/a	**1,082**	n/a	**508**	n/a	**574**	n/a
T A Arseneault*[6]	**578**	n/a	**18**	n/a	**748**	n/a	**45**	n/a	**12**	n/a	**1,035**	n/a	**2,436**	n/a	**608**	n/a	**1,828**	n/a
P J Lynas**	**165**	658	**6**	19	**206**	1,006	**205**	476	**132**	535	**–**	1	**714**	2,695	**303**	1,212	**411**	1,483
J DeMuro**[6]	**210**	849	**17**	49	**274**	1,805	**493**	766	**13**	13	**252**	1,317	**1,259**	4,799	**240**	911	**1,019**	3,888

* Appointed to the Board on 1 April 2020.
**Retired from the Board on 31 March 2020.
● Fixed remuneration element
● Variable remuneration element

The above table has been subject to audit.

Note: The figures in respect of Brad Greve and Tom Arseneault are in relation to the nine-month period from their appointment as executive directors on 1 April 2020. The total single figure in respect of Brad Greve for the full year 1 January to 31 December 2020 is £1,441k. The respective figure in respect of Tom Arseneault is £2,779k. The figures in respect of Peter Lynas and Jerry DeMuro are in relation to their service as executive directors in the three-month period from 1 January to 31 March 2020.

Details of Brad Greve's and Tom Arseneault's salary arrangements on appointment are detailed on pages 142 and 143 respectively. As disclosed last year this includes for Brad Greve details of the £210,000 cash payment paid to him within 30 days of him commencing employment in 2019 of which 50% of the net amount had to be used to purchase BAE Systems plc shares. This arrangement, whereby the Company bought out certain incentives previously awarded by his previous employer and forfeited as a consequence of joining BAE Systems, was at a level consistent with the fair value at the time of recruitment and in accordance with the Remuneration Policy. This payment is not included in the above table.

1. The benefits received by Charles Woodburn include the provision of a car allowance and the private use of a chauffeur-driven car (2020 £20k; 2019 £21k). The benefits received by Brad Greve include the provision of a car allowance and the private use of a chauffeur-driven car (2020 £12k). The benefits received by Tom Arseneault include private use of a chauffeur-driven car and parking (2020 £327); medical and dental benefits (2020 £11k); and insured life and disability benefits (2020 £6k). The benefits received by Peter Lynas include the provision of a car allowance and the private use of a chauffeur-driven car (2020 £6k; 2019 £19k). Jerry DeMuro's benefits include private use of a chauffeur-driven car and parking (2020 £1k; 2019 £2k); medical and dental benefits (2020 £3k; 2019 £13k); insured life and disability benefits (2020 £2k; 2019 £9k); and the private use of a company aircraft (2020 £11k; 2019 £25k).
2. Further detail on bonus payments is provided on page 144. One-third of the net bonus paid to Charles Woodburn, Brad Greve and Tom Arseneault will be deferred compulsorily into BAE Systems shares for a three-year period, without additional performance conditions. This arrangement also applies to the net bonuses paid to Peter Lynas and Jerry DeMuro in respect of their service as executive directors in 2020. The full year net bonus in respect of Brad Greve is subject to compulsory deferral as set out above. In the case of Tom Arseneault, the net bonus earned since becoming an executive director on 1 April 2020 is subject to compulsory deferral as set out above. Bonuses presented for approval at the Remuneration Committee meeting on 24 February 2021 in relation to Tom Arseneault and Jerry DeMuro included a clerical error, which was subsequently identified, and which in aggregate overstated these bonuses by £258k. The corrected bonuses above, of £748k for Tom Arseneault and £274k for Jerry DeMuro, are both calculated in compliance with the remuneration policy noted in this report.
3. This column relates to the estimated or actual value of Long-Term Incentive Plans for which the performance period ended in the relevant financial year.

   The values in the 2020 column are calculated on the basis of the three-month average share price of £4.8442 as at 31 December 2020 and relate to the vesting portion (50%), including shares deriving from notional reinvested dividends, of the 2018 LTIP PS[EPS] granted to Peter Lynas, Jerry DeMuro and Tom Arseneault for which the performance period ended on 31 December 2020 (see page 147 for further detail). The respective figures for Charles Woodburn's 2018 LTIP PS are based on full 100% vesting as set out on page 147. The values in respect of Tom Arseneault have been apportioned to include amounts in respect of his service as executive director since 1 April 2020. There has been no exercise of discretion as a result of share price appreciation or depreciation.

   An estimate of the amount of 2018 LTIP award attributable to share price appreciation is set out below. As the 2018 LTIP grant price was higher than the 2020 year-end three-month average share price, this has resulted in a negative share price appreciation for the 2018 vested awards.

	2018 LTIP PS £
C N Woodburn	–555,508
T A Arseneault[1]	–8,030
P J Lynas	–36,599
J DeMuro	–87,863

1. The figures in respect of Tom Arseneault have been apportioned to include amounts in respect of his service as an executive director since 1 April 2020.

As required by regulation, the estimated vesting values for the awards shown in the 2019 column (which were calculated in the 2019 Annual Report on the basis of the three-month average share price of £5.64 as at 31 December 2019), have been adjusted to reflect the actual value on the vesting of the performance award in March 2020 based on the then share price of £4.39. The figures reported in the 2019 column in the 2019 Annual Report on the estimated basis were Charles Woodburn: £838k; Peter Lynas: £612k; and Jerry DeMuro: £985k. The respective figures in the 2019 Total column have been recast accordingly.

4. The figures for Charles Woodburn relate to a salary supplement in lieu of Company pension contributions and the added pension value received in the year from his defined contribution scheme in respect of the employer contributions.

   The figures for Brad Greve relate to a salary supplement in lieu of Company pension contributions (in respect of the period from 1 April 2020) and the added pension value received over the full year from his defined contribution scheme in respect of the employer contributions.

   The figures for Tom Arseneault and Jerry DeMuro include company contributions paid into their Section 401(k) defined contribution arrangements in respect of the full year.

   The figures for Peter Lynas in the 2019 column reflect defined benefit arrangements and have been calculated in line with the method set out in Section 229 of the Finance Act 2004 using a capitalisation factor of 20 to assess the increase in the value of the pension promise over the year under review, net of inflation. The figure in the 2020 column has been calculated on the same basis to 31 March 2020, the date of his retirement. Details of his pension payments in 2020 are given on page 149.

   Further detail on pensions is given on page 148.

5. This column includes (i) the value of Free Share awards under the UK all-employee Share Incentive Plan (SIP) of £535 for Charles Woodburn and Brad Greve, and their respective Matching Shares under voluntary investment in the SIP; and (ii) for Tom Arseneault, the value of the 2020 grant of Restricted Shares (£1,035k). This award formed part of Tom Arseneault's 2020 LTIP allocation but is required to be reported under 'Other' as it has no performance conditions attached. This award was granted in March 2020, prior to Tom Arseneault becoming an executive director. Jerry DeMuro's prior year figure relates to his Restricted Shares award in 2019 and the value of the notional reinvested dividends in respect of his 2016 Restricted Share Plan award. Jerry DeMuro's 2020 figure (£252k) relates to the value of the notional reinvested dividends in respect of his 2017 Restricted Share Plan award which vested in March 2020, and his 2018 Restricted Share Plan and 2019 Restricted Share Plan awards, both of which vested on 31 December 2020. The full values of the 2018 and 2019 awards have been included in the table, reflecting his continued employment to 31 December 2020.

6. Tom Arseneault is paid in US dollars (as was Jerry DeMuro) with the disclosed figures above being converted into sterling at the required exchange rate.

The nine-month figure in respect of Jerry DeMuro's role as Executive Vice President since 1 April 2020 is £1,640,989. This amount largely relates to salary, benefits and annual incentive earned as detailed on page 143. There were no other payments to former directors in 2020 other than pension payments made to Peter Lynas as disclosed on page 149.

Implementation of our policy in the year ending 31 December 2021

For the purposes of the Companies Act 2006, the Directors' remuneration policy (the Policy) has been operating in practice since the date of its approval on 7 May 2020 at the 2020 AGM. The remuneration for 2021 will be implemented as follows:

- The salary of the Chief Executive is increased to £1,107,538 with effect from 1 January 2021.
- The salary of the Group Finance Director is increased to £622,200 with effect from 1 January 2021.
- The salary of the President and Chief Executive Officer of BAE Systems, Inc. is increased to $1,014,000 with effect from 1 January 2021.
- Annual and Long-Term Incentive opportunity levels are in line with 2020 approved Policy (as set out on pages 155 to 159).
- Long-Term Incentive awards of Performance Shares only for UK executive directors, and Performance Shares and Restricted Shares for US executive director.
- The performance measures and weightings for 2021 for the Annual Incentive and Long-Term Incentives are set out on pages 160 to 163 with additional information on pages 126 and 127.
- The Committee is of the view that bonus targets for the Annual Incentive are commercially sensitive and that it would be detrimental to the Company to disclose them in advance. The targets will be disclosed retrospectively after the end of the relevant financial year.

Executive director changes in 2020

Group Finance Director

As announced by the Company on 8 August 2019, the following arrangements applied in relation to Peter Lynas when he retired as a director and ceased employment on 31 March 2020. The arrangements were in accordance with the Company's 2017 Remuneration Policy, approved by shareholders, and the Rules of the Company's 2000 Pension Plan and Executive Pension Scheme:

Peter Lynas' retirement on 31 March 2020 was at his Normal Retirement Date and accordingly:

- he was entitled to receive his accrued pension benefit in accordance with the Rules of the BAE Systems 2000 Pension Plan and the BAE Systems Executive Pension Scheme;
- under the Rules of the BAE Systems Long-Term Incentive Plan, any unvested share awards will vest at the normal vesting date, subject to the relevant performance conditions and time pro-rating. Awards were reduced pro-rata for time based on the period from grant date to 31 March 2020 (calculated on the basis of actual days employed). The applicable performance conditions will be tested at the end of the normal performance period. In the case of any such award vesting after 31 March 2020, the award remains exercisable for a period of six months from the day on which the award vests;
- bonus shares under the BAE Systems Deferred Bonus Plan will continue to be deferred and will be released on the normal release dates;
- any share awards held by him, which had vested on or before 31 March 2020 but had not been exercised at that date lapsed unless exercised in the six-month period from 31 March 2020 or, if earlier, the date on which such award normally lapsed;
- following termination of employment, he will be subject to a reduced minimum shareholding requirement equivalent to 100% of salary for a period of two years from leaving employment;
- he remained eligible to receive an annual incentive payment for 2019 in accordance with the Company's Remuneration Policy. His bonus was subject to compulsory deferral of one-third of the net amount under the BAE Systems Deferred Bonus Plan in the normal way with the balance being paid at the normal bonus payment date in March 2020;
- he remained eligible for an annual incentive payment for 2020, determined by the Remuneration Committee, subject to an assessment of performance and pro-rated for three months of service during 2020. His bonus will be paid at the normal bonus payment date following the end of the 2020 financial year and subject to compulsory deferral of one-third of the net amount under the BAE Systems Deferred Bonus Plan in the normal way;
- he will continue to be covered by the Company's D&O insurance policy and his current director's indemnification arrangements will remain in place;
- he will continue to be bound by the terms of his service contract which continue to apply following cessation of employment including post-termination restrictive covenants and confidentiality provisions;
- his annual salary remained at the 2019 level until his retirement date;
- no payment in lieu of notice or other termination payment was payable; and
- taxable benefits comprising the provision of a car allowance and the private use of a chauffeur-driven car ceased from 31 March 2020.

As also announced on 8 August 2019, the Company appointed Brad Greve as Group Finance Director Designate to succeed Peter Lynas as Group Finance Director and join the BAE Systems plc Board on 1 April 2020. He joined BAE Systems and became a member of the Executive Committee in September 2019. His remuneration arrangements were in line with the Company's 2017 Remuneration Policy approved by shareholders:

- base salary of £610,000;
- eligible for participation in the BAE Systems plc Annual Incentive and Long-Term Incentive Plan;
- Minimum Shareholding Requirement of 200% of base salary; and
- pension – Company contribution of up to 8% of reference salary.

In accordance with the Remuneration Policy, the Company has bought out certain incentives previously awarded by his previous employer and forfeited as a consequence of joining BAE Systems at a level consistent with the fair value at the time of recruitment in the form of a one-off payment for forfeited earnings as follows:

- £210,000 cash payment to be paid within 30 days of commencing employment. 50% of the net amount must be used to purchase BAE Systems plc shares within 120 days following payment.

Chief Executive Officer, BAE Systems, Inc.

It was announced on 17 December 2019 Jerry DeMuro would retire from the Company on 31 December 2020. He stepped down from the BAE Systems plc Board and from his role as Chief Executive Officer of BAE Systems, Inc. on 31 March 2020 and undertook the role of Executive Vice President until the end of the year, remaining on the BAE Systems, Inc. Board. In this capacity he had responsibility for the delivery of a number of strategic assignments across BAE Systems' US and other businesses, including a governance review of global shipbuilding.

The following arrangements applied in relation to Jerry DeMuro when he retired as a director of BAE Systems plc on 31 March 2020 and ceased employment on 31 December 2020. The arrangements are in accordance with the Company's 2017 Remuneration Policy, approved by shareholders:

For retirement benefit and share plan purposes, Jerry DeMuro separated from the Company with the Company's consent on 31 December 2020 and:

- he was entitled to receive his accrued retirement savings plan benefit in accordance with the Rules of the BAE Systems, Inc. 401(k) Plan;
- under the Rules of the BAE Systems Long-Term Incentive Plan, any unvested share awards, subject to the discretion of the Remuneration Committee, vested on 31 December 2020 or, if later, will vest as soon as practicable after the first opportunity when any relevant performance conditions can be determined, and subject to time pro-rating. Awards were reduced pro-rata for time based on the period from grant date to 31 December 2020 (calculated on the basis of actual days employed). The applicable performance conditions will be tested at the end of the normal performance period;
- bonus shares under the BAE Systems Deferred Bonus Plan continued to be deferred and will be released on the normal release dates;
- any share awards held by him, which have vested on or before 31 December 2020 but have not been exercised at that date will lapse unless exercised in the six-month period from 31 December 2020 or, if earlier, the date on which such award normally lapses;
- following termination of employment, he will be subject to a minimum shareholding requirement equivalent to 300% of salary for a period of one year from leaving employment;
- he remained eligible to receive an annual incentive payment for 2019 in accordance with the Company's Remuneration Policy. His bonus was subject to compulsory deferral of one-third of the net amount under the BAE Systems Deferred Bonus Plan in the normal way with the balance being paid at the normal bonus payment date in March 2020;
- he will be eligible for an annual incentive payment for 2020, determined by the Remuneration Committee, subject to an assessment of performance and pro-rated for three months of service during 2020. Any bonus will be paid at the normal bonus payment date following the end of the 2020 financial year and subject to compulsory deferral of one-third of the net amount under the BAE Systems Deferred Bonus Plan in the normal way;
- for the period from 1 April 2020 in his future role as Executive Vice President, his annual salary remained at the 2019 level until his retirement date of 31 December 2020. In addition, he remained eligible to receive an on-target bonus payment equivalent to 112.5% of base salary, pro-rata for the actual number of months worked;
- he was not eligible to receive any future awards under the Company's Long-Term Incentive Plan;
- he will continue to be covered by the Company's D&O insurance policy and his current director's indemnification arrangements will remain in place;
- he will continue to be bound by the terms of his service contract which continue to apply following cessation of employment including post-termination restrictive covenants and confidentiality provisions;
- no payment in lieu of notice or other termination payment was payable; and
- benefits comprising the use of a chauffeur-driven car, medical and dental benefits and insured life and disability benefits ceased from 31 December 2020.

Tom Arseneault succeeded Jerry DeMuro as President and Chief Executive Officer of BAE Systems, Inc. and joined the BAE Systems plc Board on 1 April 2020. Tom Arseneault had been President and Chief Operating Officer of BAE Systems, Inc. since May 2019 and continued as a member of the BAE Systems, Inc. Board and the BAE Systems plc Executive Committee. On appointment his Remuneration arrangements were in line with the Company's 2017 Remuneration Policy approved by shareholders:

- base salary of $980,000 (Note: Tom Arseneault was appointed with a base salary which was approximately 10% below that of his predecessor. It was noted that consideration would be given to close this differential in the first two years, dependent on performance in the new role.);
- eligible for participation in the BAE Systems plc Annual Incentive and Long-Term Incentive Plan; and
- Minimum Shareholding Requirement of 425% of base salary.

Annual bonus

Annual bonuses for the 2020 year are paid in March 2021. Annual bonus is made up of financial metrics, safety, diversity and inclusion, and personal objectives, designed to support the achievement of certain strategic outcomes necessary for the long-term sustainability of the business. The breakdown of bonus measures, achievement and payout for each executive director is shown below. One-third of the net bonus payment is subject to compulsory deferral into BAE Systems shares for a three-year period, for which there is no additional performance condition.

Charles Woodburn Chief Executive

Measures		Weight (as a percentage of target)	Actual performance against targets set	Threshold for 2020	Target for 2020	Stretch for 2020	Actual performance[1]	Percentage of maximum opportunity
Financial	Group underlying EPS	45.0		46.6p	48.0p	49.4p	48.3p	60.7%
	Group net debt	22.5		£(1,044)m	£(871)m	£(569)m	£(97)m	100%
	Group order intake	7.5		n/a	£17.1bn	£18.0bn	£20.2bn	100%
Personal	Safety[2]	3.0		See note 2 below				40%
	Diversity and inclusion[2]	2.0		See note 2 below				100%
	Key strategic objectives	20.0		See Key strategic objectives section on page 146				90.8%
							Total bonus (as a percentage of maximum)	**78.7%**
							Amount of bonus	**£1,739,713**

Brad Greve Group Finance Director

Measures		Weight (as a percentage of target)	Actual performance against targets set	Threshold for 2020	Target for 2020	Stretch for 2020	Actual performance[1]	Percentage of maximum opportunity
Financial	Group underlying EPS	45.0		46.6p	48.0p	49.4p	48.3p	60.7%
	Group net debt	22.5		£(1,044)m	£(871)m	£(569)m	£(97)m	100%
	Group order intake	7.5		n/a	£17.1bn	£18.0bn	£20.2bn	100%
Personal	Safety[2]	3.0		See note 2 below				40%
	Diversity and inclusion[2]	2.0		See note 2 below				100%
	Key strategic objectives	20.0		See Key strategic objectives section on page 146				89%
							Total bonus (as a percentage of maximum)	**78.3%**
							Amount of bonus	**£573,313**

Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.

Measures		Weight (as a percentage of target)	Actual performance against targets set	Threshold for 2020	Target for 2020	Stretch for 2020	Actual performance[1]	Percentage of maximum opportunity
Financial	Group underlying EPS	15.0		46.6p	48.0p	49.4p	48.3p	60.7%
	Group net debt	7.5		£(1,044)m	£(871)m	£(569)m	£(97)m	100%
	Group order intake	2.5		n/a	£17.1bn	£18.0bn	£20.2bn	100%
	BAE Systems, Inc. underlying EBITA	30.0		$1,395.9m	$1,437.0m	$1,482.2m	$1,281.4m	0%
	BAE Systems, Inc. debt	15.0		$3,629m	$3,679m	$3,779m	$4,372m	100%
	BAE Systems, Inc. order intake	5.0		n/a	$11.7bn	$12.2bn	$13.4bn	100%
Personal	Safety[2]	3.0		See note 2 below				0%
	Diversity and inclusion[2]	2.0		See note 2 below				100%
	Key strategic objectives	20.0		See Key strategic objectives section on page 146				84.6%
							Total bonus (as a percentage of maximum)	**58%**
							Amount of bonus	**$959,675**

The above table has been subject to audit.

1. Adjusted to be on a like-for-like basis with the targets.
2. Performance against the safety and diversity and inclusion elements of the bonus was determined by the Corporate Responsibility Committee (whose composition is stated on page 116). In respect of safety, at a Group level, the targeted Recordable Accident Rate reduction of 10% was not met. However, as significant progress was made in the UK, Saudi Arabia and Australia businesses, with a 37% improvement (reduction) in the number of injuries recorded, a partial payout was awarded, as denoted by the amber performance rating above. In respect of our US business, BAE Systems, Inc., the target level of performance was not achieved in respect of key safety performance indicators including the number of major injuries recorded, and recordable accident rate, as denoted by the red performance rating above.

In relation to diversity and inclusion, the Company met stretch targets in respect of increasing representation of women at senior levels in the Group, and achieved a 0.5% increase in female representation across the Group. Stretch target was also achieved against the objective of driving inclusion through leadership and engagement. Our US business, BAE Systems, Inc., met its goal to increase representation of both women and people of colour at leadership levels.

As set out on page 205 of the Annual Report, the 2020 fully diluted underlying EPS is 46.5p. This figure excludes a non-recurring benefit of 1.7p resulting from the buy-out of certain US Defined Benefit pension liabilities. During the course of the year, in discussion with the Board, management undertook to re-examine a number of areas, including pensions, to seek additional value enhancement. A market opportunity was identified to reduce a material element of the Company's US Defined Benefit pension liability through a buy-out, thereby delivering an immediate improvement in earnings and an enduring benefit in cost and cash outflow. Through what the Committee saw as highly effective action taken by the leadership team, after a period of prolonged negotiations, the buy-out was successfully completed in the third quarter of 2020. As a result, the Committee exercised its discretion and determined that the final vesting outcome of the EPS should include the 1.7p of earnings associated with this achievement and the Committee will ensure the continuing benefit will be reflected in the ongoing incentive targets. Taking into consideration the overall business performance during the year, the Committee believes the bonus outturns are appropriate.

As set out on page 142, Peter Lynas remained eligible to receive an annual incentive payment for 2020, determined by the Remuneration Committee, subject to an assessment of performance and pro-rated for three months' service during 2020, and is subject to compulsory deferral of one-third of the net amount under the BAE Systems Deferred Bonus Plan. The annual bonus applicable to Peter Lynas is subject to the same metrics and weightings as set out above for the Group Finance Director. The payout due in respect of the financial, safety and diversity and inclusion elements are as set out above, being (as percentage of maximum opportunity) 76%, 40% and 100% respectively. Peter Lynas' achievement of 89% against the key strategic objectives element is set out on page 147. His overall total bonus (as percentage of maximum) is 78%.

Brad Greve was appointed as Group Finance Director and joined the BAE Systems plc Board on 1 April 2020. The relevant table above relates to the period from his appointment to the Board on 1 April 2020 to 31 December 2020.

As set out on page 143, Jerry DeMuro remained eligible to receive an annual incentive payment for 2020, determined by the Remuneration Committee, subject to an assessment of performance and pro-rated for three months' service during 2020, and is subject to compulsory deferral of one-third of the net amount under the BAE Systems Deferred Bonus Plan. The annual bonus applicable to Jerry DeMuro is subject to the same metrics and weightings as set out above for the President and Chief Executive Officer of BAE Systems, Inc. The payout due in respect of the financial, safety and diversity and inclusion elements are as set out above, being (as percentage of maximum opportunity) 52%, 0% and 100% respectively. Jerry DeMuro's achievement of 85% against the key strategic objectives element is set out on page 147. His overall total bonus (as percentage of maximum) is 58%.

Tom Arseneault was appointed as President and Chief Executive Officer of BAE Systems, Inc. and joined the BAE Systems plc Board on 1 April 2020. The relevant table above relates to the period from his appointment to the Board on 1 April 2020 to 31 December 2020.

Key strategic objectives

Achievement against key strategic objectives represents 20% of the annual bonus opportunity applicable to each of the executive directors. These objectives relate to the delivery of the Group's strategic objectives and demonstration of leadership behaviours. Executive directors and Executive Committee members are assigned primary responsibility for, or required to support, a set of shared common strategic objectives. The objectives are both technical and organisational, grouped under the three key strategic priorities of drive operational excellence, continuously improve competitiveness and efficiency, and advance and further leverage our technology. To support these priorities, there are six shared strategic objectives.

Key achievements in the year included:

Charles Woodburn Chief Executive	Brad Greve Group Finance Director	Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.
Drive operational excellence **Key successes in 2020 –** Astute Boat 4 delivered under lockdown conditions. Offshore Patrol Vessel programme completed. Amphibious Combat Vehicle initial operating capability achieved.		
– Successful implementation of framework for Quality measurement across the Group. – Achieved improved Group supplier delivery quality metric.	– Successful implementation of framework for Quality measurement across the Group. – Achieved improved Group supplier delivery quality metric.	– Achieved improved BAE Systems, Inc. supplier delivery quality metric.
Continuously improve competitiveness and efficiency **Key successes in 2020 –** Focused on supply chain resilience in response to COVID-19 and preparation for Brexit transition, ensuring critical programmes remained on track. Development of our Factory of the Future. Savings and efficiencies achieved in COVID-19 conditions to help maintain productivity. Process improvements and robotic welding machines installed in US Combat vehicles.		
– Exceeded Group supply chain savings targets. – Reduced general and administration costs. – Development of enterprise plan for automation of commercial and procurement functions. – Enhanced customer relationships internationally and collaboration across the Group.	– Exceeded Group supply chain savings targets. – Reduced general and administration costs. – Development of enterprise plan for automation of commercial and procurement functions. – Delivered £1bn one-off cash injection into UK pension scheme, accelerating deficit reduction.	– Exceeded BAE Systems, Inc. supply chain savings targets. – Reduced general and administration costs at BAE Systems, Inc. – Developed enterprise plan for automation of commercial and procurement functions. – Enhanced customer relationships internationally and collaboration across the Group.
Advance and further leverage our technology **Key successes in 2020 –** Increased year-on-year self-funded research and development spend. Military GPS and Airborne Tactical Radios US acquisitions. Techmodal acquisition integrated in Maritime. Tempest programme advancement. PHASA-35 successfully completed critical endurance flight trials.		
– Delivered progress on Group-wide integrated technology plans. – Increased self-funded R&D spend. – Completed two US acquisitions of $2.2bn.	– Increased self-funded R&D spend. – Completed two US acquisitions of $2.2bn.	– Delivered progress on Group-wide integrated technology plans. – Achieved integrated development and cross-sector technology transitions. – Completed two US acquisitions of $2.2bn.
Pursue and deliver growth **Key successes in 2020 –** US defence electronics business delivered another record order backlog supplemented by the acquisitions. Secured German order for 38 Typhoons. Munitions business announced a 15-year partnership with the UK Ministry of Defence. Number of major programmes ramping up in Electronic Systems, US Combat Vehicles, Air and Maritime.		
– Secured Eurofighter Typhoon contract. – Progress in awards of MK45 LOA in India and FMSP.	– Continued improvement in cost management and data to support successful bids, ongoing management of programmes and cash generation.	– Orders exceeded expectations, underpinned by contract awards across all three business sectors, including additional F-35 EW orders, wins in Aegis Recompete and international wins for CV90 upgrades and refurbishments. – Key programme milestones delivered despite COVID-19 conditions, including cumulative delivery milestone of over 800 F-35 electronic warfare systems, and full-rate production decision on M109A7, and on the ACV programme.
Lead and inspire high-performance teams and individuals (see note 2 on page 144 as separately assessed within diversity and inclusion target) **Key successes in 2020 –** Management continued to be strengthened with a blend of internal promotions and external hires. Engineering leaders development programme roll-out. Implementation of behaviour-based approach to performance management, and investment to drive skills development and talent management. Increase in women in engineering roles, including leadership, by 3%.		
– Improvements in talent management to support delivery of robust succession planning. – Developments in recruitment to ensure strategic workforce plans are met. – Increased mobility across executive population.	– Improvements in talent management to support delivery of robust succession planning. – Developments in recruitment to ensure strategic workforce plans are met. – Increased mobility across executive population.	– Improved succession planning and talent management.
Build trust by operating to the highest standards of business conduct **Key successes in 2020 –** Increased level of classified work, including in Applied Intelligence's cyber security domain.		
– Reduced overall significant Group risk rating.	– Successfully stepped into new role with smooth transition from predecessor. – Reduced overall significant Group risk rating. – Achieved high level of internal and external audit results and strong financial controls. – Continued transparency in investor relations and positive feedback from annual investor survey.	– Reduced overall significant Group risk rating. – Received superior ratings for BAE Systems, Inc. system security plan. – Successfully stepped into new role with smooth transition from predecessor.
Achievements were offset by need to drive further improvements in safety and the impact of COVID-19 work interruptions, delays and costs.	Achievements were offset by need to drive further improvements in safety and the impact of COVID-19.	Achievements were offset by ongoing challenges in safety, impact of COVID-19 on US Commercial Avionics business and project performance margin issues.
Payout (% of maximum): 90.8%	**Payout (% of maximum): 89.0%**	**Payout (% of maximum): 84.6%**

The outturn of 89% in respect of Peter Lynas' key strategic objectives for the three-month period to 31 March 2020, has been based on the following key achievements:

- achieving a high level of internal and external audit results in respect of 2019 financial year end;
- securing a new deficit recovery plan in relation to our UK pension schemes including the one-off payment of £1bn;
- maintaining the Group's investor proposition; and
- ensuring a smooth handover and transition to his successor, Brad Greve.

The outturn of 85% in respect of Jerry DeMuro's key strategic objectives for the three-month period to 31 March 2020, has been based on the following key achievements:

- securing Military GPS and Airborne Tactical Radios US acquisitions;
- maintaining strength of the BAE Systems, Inc. business with portfolios being well aligned to customer priorities and growth areas outlined in the National Defense Strategy; and
- ensuring a smooth handover and transition to his successor, Tom Arseneault.

Long-Term Incentive Plan (LTIP) performance

Annual average diluted underlying EPS growth

Outperformance of performance conditions ending on 31 December 2020	Threshold	Maximum	Actual	Percentage of maximum achieved
2020 EPS requirement	45.7p	50.7p	48.2p	
Annual average EPS growth	3%	7%	5%	50%

Relative TSR against comparator groups

Outperformance of performance conditions ending on 31 December 2020	Threshold	Maximum	Actual	Percentage of maximum achieved
TSR against sectoral comparator group	3.2%	31.6%	(4.3)%	0%
TSR against FTSE 100 comparator group	(1.2)%	31.9%	(4.3)%	0%
Overall vesting against TSR				0%

2018 Performance Shares (LTIP PS)

Performance conditions: half on relative TSR against two comparator groups (with equal weighting), half on EPS growth of 3% to 7% per annum. The three-year performance period ended on 31 December 2020. The outcomes in relation to the TSR and EPS conditions set out below are applicable to Tom Arseneault, Peter Lynas and Jerry DeMuro. However, with respect to Charles Woodburn's 2018 LTIP PS, as detailed in the Remuneration Committee Chairman's letter on pages 125 and 126, the Committee exercised its discretion to determine the outcome of the award at the maximum level of 100%. The value of the shares vesting was £3,117,834 as included in the table on page 140.

With respect to the 2018 LTIP PS TSR award, the threshold TSR performance was not met and therefore the TSR portion of the award will lapse.

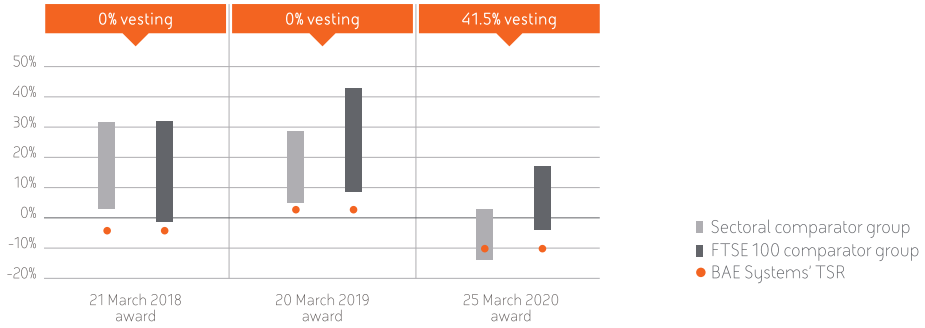
With respect to the 2018 LTIP PS^{EPS} award, the vesting outturn has been determined as follows. As set out on page 205 of the Annual Report, the 2020 fully diluted underlying EPS is 46.5p. This figure excludes a non-recurring benefit of 1.7p resulting from the buy-out of certain US Defined Benefit pension liabilities. During the course of the year, in discussion with the Board, management undertook to re-examine a number of areas, including pensions, to seek additional value enhancement. A market opportunity was identified to reduce a material element of the Company's US Defined Benefit pension liability, thereby delivering an immediate improvement in earnings and an enduring benefit in cost and cash outflow. Through what the Committee saw as highly effective action taken by the leadership team, after a period of prolonged negotiations, the buy-out was successfully completed in the third quarter of 2020. As a result, the Committee exercised its discretion and determined that the final vesting outcome of the EPS should include the 1.7p of earnings associated with this achievement. The Committee was therefore satisfied that the performance condition was partially met and that it was appropriate for vesting at 50.0% of the EPS portion. Taking into consideration the overall business performance over the three-year performance period, the Committee believes the vesting outturns are appropriate.

The value of the shares vesting for Peter Lynas and Jerry DeMuro was £205,343 and £492,856 respectively, as included in the table on page 140, being 50% of the 2018 LTIP PS EPS portion of the award, and 25% of the overall 2018 LTIP PS award (their 2018 LTIP PS awards having been pro-rated on their respective retirements on 31 March 2020 and 31 December 2020). The value of shares vesting for Tom Arseneault was £180,224, being 50% of the 2018 LTIP PS EPS portion of the award, and 25% of the overall 2018 LTIP PS award. The amount included in the table on page 140 has been apportioned to reflect his service as an executive director since 1 April 2020.

A summary of TSR performance to 31 December 2020 on outstanding TSR-related LTIP awards is illustrated in the chart below. The vesting percentage for the 21 March 2018 award is the actual vesting outturn referred to above for Tom Arseneault, Peter Lynas and Jerry DeMuro.

The grey boxes show the range of TSR required for 25% vesting to full vesting in respect of the sectoral international defence and FTSE 100 comparator groups, as appropriate, and the orange circles show BAE Systems' TSR. The proportion that would vest is shown in the boxes at the top of the chart.

TSR performance under the TSR-related awards as at 31 December 2020



Pension entitlements

Total pension entitlements

					Figures included in the remuneration table on page 140		
Director	Age	Normal retirement age	Accrued benefit at 1 January 2020[1,2] £ per annum	Accrued benefit at 31 December 2020[1] £ per annum	Added pension value received in the year from defined benefit scheme £	Added pension value received in the year from defined contribution scheme £	Total £
Charles Woodburn	49	65	43,809	51,457	n/a	3,000	3,000
Brad Greve*	53	65	11,873	18,411	n/a	5,500	5,500[3]
Tom Arseneault*	57	65	See notes below		–	11,940	11,940[3]
Peter Lynas**	62	62	357,303	366,343[2]	132,201	n/a	132,201
Jerry DeMuro**	65	65	226,737	282,511	n/a	12,511	12,511

* Appointed to the Board on 1 April 2020.
**Retired from the Board on 31 March 2020.

1. Accrued benefit for Charles Woodburn and Brad Greve is the total value of their defined contribution account, including employee contributions and investment returns. Accrued benefit for Jerry DeMuro is the total value of his Section 401(k) account, including both employee and company contributions as well as investment returns.
2. The figure includes both funded and unfunded defined benefit arrangements for Peter Lynas. Accrued benefit for Peter Lynas is annual pension payable on retirement prior to any reduction for early payment or exchanging pension for cash. In addition, a longevity adjustment factor is applied to pension accrued after 5 April 2006 to mitigate against life expectancy changes. The figures allow for the factors in force at the effective date of the calculation. As Peter Lynas retired from the Board on 31 March 2020, the closing accrued benefit figure is as at that date, his date of retirement.
3. Whilst Brad Greve and Tom Arseneault were appointed to the Board on 1 April 2020, the added pension values received cover the whole year.

The above table has been subject to audit.

Charles Woodburn participates in the BAE Systems Executive Pension Scheme Defined Contribution Retirement Plan (EPS DCRP), which is a defined contribution arrangement for senior executives. A salary supplement of £186,200 per annum is paid in lieu of the Company contributions in excess of those permitted by the Annual Allowance (£4,000 per annum from 6 April 2020), which are paid into the EPS DCRP. Up to 5 April 2020 Charles Woodburn contributed the maximum £10,000 per annum into the EPS DCRP arrangement as permitted by the Annual Allowance at that time.

Brad Greve also participates in the BAE Systems EPS DCRP. The Company contributes the maximum into the EPS DCRP arrangement as permitted by the Annual Allowance (£10,000 per annum to 5 April 2020, £4,000 per annum from 6 April 2020). An 8% salary supplement is paid in lieu of the Company contributions in excess of those permitted by the Annual Allowance which are paid into the EPS DCRP.

Tom Arseneault participates in US defined benefit and Section 401(k) arrangements as follows:

Arrangement	Accrued benefit at 1 January 2020	Accrued benefit at 31 December 2020
BAE Systems ERP Qualified Plan – life pension	$39,348 per annum	$39,348 per annum
BAE Systems ERP 2006 Qualified Plan – lump sum	$81,000 per annum	$82,000 per annum
12/31/2004 BRP Restoration Plan – life pension	$5,283 per annum	$5,283 per annum
2007 BRP – 10-year pension	$106,313 per annum	$108,868 per annum
Section 401(k)	$1,110,166	$1,352,745

Accrued defined benefit for Tom Arseneault is annual pension payable at retirement prior to any reduction for early retirement. The added pension value received in 2020 from defined benefit schemes is a negative figure (and thus floored at zero) largely due to using prescribed UK methodology to calculate US pension benefits. Tom Arseneault also participates in a Section 401(k) defined contribution arrangement set up for US employees in which the company will match his contributions up to a maximum contribution of 6% of salary, up to US regulatory limits (2021 and 2020 $19,500). In 2020, the company paid contributions of $16,319 into this arrangement. Accrued Section 401(k) benefit for Tom Arseneault is the total value of his Section 401(k) account including both employee and company contributions as well as investment returns.

Jerry DeMuro participates in a Section 401(k) defined contribution arrangement set up for US employees in which the company matched his contributions up to a maximum contribution of 6% of salary, up to US regulatory limits (2020 $19,500). In 2020, the company paid contributions of $17,100 into this arrangement.

Peter Lynas is a member of the BAE Systems Executive Pension Scheme (ExPS) and the BAE Systems Pension Scheme – 2000 Plan Benefits (2000 Plan) which together provide a pension for executive directors payable at 62 of 1/30th of three-year average final salary for each year of service subject to the payment of members' contributions (currently 8%). Benefits paid prior to age 62 for ExPS and age 65 for 2000 Plan are subject to actuarial reduction. Peter Lynas retired at 31 March 2020 aged 62 with a pension of £350,395 per annum (with his pension payments totalling £263,309 for the nine months from retirement to 31 December 2020) and a cash lump sum of £150,296 (excluding Additional Voluntary Contributions). As disclosed and described in prior years, bonuses up to 10% of base salary are pensionable for all members of the 2000 Plan.

Share interests

Scheme interests awarded during the financial year

Scheme	Type of interest	Date of grant	Number of shares	Basis of award	Face value of award[1] £	Exercise price £	Date to which performance is measured	Performance condition	Percentage of interests receivable if minimum performance achieved
Charles Woodburn									
LTIP PS^{TSR}	Performance Shares/nil cost option	25.03.20	373,737	185% of salary	1,812,998	nil	Three years to 31.12.22	TSR/secondary financial measure	25%
LTIP PS^{EPS}	Performance Shares/nil cost option	25.03.20	373,737	185% of salary	1,812,998	nil	Three years to 31.12.22	EPS	25%
Brad Greve									
LTIP PS^{TSR}	Performance Shares/nil cost option	25.03.20	210,626	167.5% of salary	1,021,747	nil	Three years to 31.12.22	TSR/secondary financial measure	25%
LTIP PS^{EPS}	Performance Shares/nil cost option	25.03.20	210,627	167.5% of salary	1,021,752	nil	Three years to 31.12.22	EPS	25%
Tom Arseneault									
LTIP PS^{TSR}	Performance Shares	25.03.20	211,994	149% of salary[2]	1,028,383	n/a	Three years to 31.12.22	TSR/secondary financial measure	25%
LTIP PS^{EPS}	Performance Shares	25.03.20	211,994	149% of salary[2]	1,028,383	n/a	Three years to 31.12.22	EPS	25%
LTIP RS	Retention	25.03.20	213,416	150% of salary[2]	1,035,281	n/a	n/a	n/a	n/a

1. The value of the award is calculated on the date of grant by reference to the middle market quotation at the close of the preceding day.
2. Calculated on the previous salary of the President & Chief Operating Officer of BAE Systems, Inc. in line with the usual timetable of granting awards to senior executives prior to assuming the role of President and Chief Executive Officer of BAE Systems, Inc. on 1 April 2020.

Key: LTIP – Long-Term Incentive Plan. PS – Performance Shares. RS – Restricted Shares.

Note: As set out in the Remuneration Committee Chairman's letter on page 124, in light of the volatility in the market during March 2020, the Committee attached an additional condition to retain the ability to exercise discretion to ensure that the value of awards in three years' time at vesting is appropriate.

Note: Performance Shares and Restricted Shares – Shares under award attract notional reinvested dividends prior to vesting. Performance Shares are intended to be free share awards and are structured as a nil cost option to give the participant more flexibility as to the timing of the benefit. For the US executive director, awards of Performance Shares are classified as conditional share awards (rather than share options) and are deliverable on the third, fourth and fifth anniversary of grant, subject to attainment of the performance condition. For the UK executive directors, shares vest on the fifth anniversary of grant.

The table above has been subject to audit.

Description of share plans and summary of performance conditions

Long-term incentives operate under the BAE Systems Long-Term Incentive Plan (LTIP) approved by shareholders at the 2014 AGM. The three main vehicles in use are Performance Shares, Share Options and Restricted Shares.

LTIP Performance Shares

Up to 2017, shares under award vest after satisfaction of the three-year performance condition. Awards that vest are capable of being exercised in three equal tranches on a phased basis from the third, fourth and fifth anniversary of grant. Any unexercised awards will lapse on the seventh anniversary of grant. From 2018, awards to UK executive directors remain subject to the three-year performance period but will not vest until the fifth anniversary of grant and will be exercisable until the seventh anniversary of grant. For US participants, the awards are automatically delivered in three equal tranches at the end of years three, four and five, subject to the performance condition being achieved. Shares under award attract notional reinvested dividends prior to tranche vesting.

Existing awards granted up to 2020 are weighted 50% on the EPS performance condition and 50% on the TSR performance condition as set out below. The TSR sectoral comparator group is shown below.

Plan	Performance condition
LTIP PS^{EPS}	Rate of average annual diluted underlying EPS growth over the three-year performance period, with 25% vesting at 3% average growth per annum, 50% vesting at 5% average growth per annum and 100% vesting at 7% average growth per annum, with vesting on a straight-line basis between these parameters.
LTIP PS^{TSR}	The proportion of the award capable of exercise is determined by: (i) 50% of the TSR measure is on the sectoral comparator group of other international defence companies and 50% is on a TSR percentile ranking against the companies in the FTSE 100 index. Under both the sectoral and FTSE 100 comparator groups, no shares vest if the Company's TSR is less than median TSRs achieved by the comparator group, with 25% vesting at median, 100% vesting if the Company's TSR is in the top quintile and vesting on a straight-line basis between these two parameters; and (ii) whether there has been a sustained improvement in the Company's underlying financial performance. In taking such a view, the Committee may consider (but not exclusively) the following financial metrics: net cash/debt; EBITA[1]; order book; turnover; risk; and project performance.

1. Operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments.

The TSR sectoral comparator group for awards from 2016–2019 comprises:

Cobham	Leonardo	SAIC
General Dynamics	Lockheed Martin	Thales
Harris Corporation	Meggitt	United Technologies
L3 Technologies	Northrop Grumman	
Leidos	Raytheon	

The TSR sectoral comparator group for awards made in 2020 comprises:

General Dynamics	Lockheed Martin	SAIC
L3 Harris Technologies	Meggitt	Thales
Leidos	Northrop Grumman	
Leonardo	Raytheon Technologies	

The TSR comparator group for awards from 2021 will be a subset of the companies in the FTSE 100 index, chosen to ensure the peer group of companies better reflects the size, sector, nature of operations, level of international exposure and shareholder base of BAE Systems.

For awards granted from 2021 onwards, the EPS and TSR measures referred to below will be supplemented by a cash generation measure and measures reflecting strategic progress; each of these four performance conditions will be equally weighted at 25%.

Plan	Performance condition
LTIP PS^{EPS}	Rate of average annual diluted underlying EPS growth over the three-year performance period, with 25% vesting at 3% average growth per annum, 50% vesting at 5% average growth per annum and 100% vesting at 7% average growth per annum, with vesting on a straight-line basis between these parameters.
LTIP PS^{TSR}	The proportion of the award capable of vesting is determined by: (i) The Company's TSR measured against a single comparator group being a defined subset of companies in the FTSE 100 index. No shares vest if the Company's TSR is less than the median TSRs achieved by the comparator group, with 25% vesting at median, 100% vesting if the Company's TSR is in the top quintile and vesting on a straight-line basis between these two parameters; and (ii) whether there has been a sustained improvement in the Company's underlying financial performance. In taking such a view, the Committee may consider (but not exclusively) the following financial metrics: net cash/debt; EBIT (as set out on page 65); order book; turnover; risk; and project performance.
LTIP PS^{FCF} Applicable to UK directors only	Three-year cumulative Free Cash Flow (FCF) at a Group level, with 25% vesting at threshold, 50% vesting at target and 100% vesting at stretch, with vesting on a straight-line basis between these parameters. Due to commercial sensitivity, the targets will be disclosed retrospectively after the end of the relevant financial year.
LTIP PS^{OCF} Applicable to US director only	Three-year Operating Cash Flow (OCF) in respect of the BAE Systems, Inc. business, with 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance, with vesting on a straight-line basis between these targets. Due to commercial sensitivity, the targets will be disclosed retrospectively after the end of the relevant financial year.
LTIP PS^{SP}	The proportion of the award capable of vesting is determined by the following three key strategic objectives, each with equal weighting. Due to commercial sensitivity, the targets will be disclosed retrospectively after the end of the relevant financial year. (i) **Drive operational excellence.** Focuses on the adherence to project plans of mission-critical projects. Measured by the metric of On Time Delivery, evaluated against an approved set of customer contracts, in a manner consistent with the normal course of business. Contracts are representative of each main business sector, having regard to execution risk, scale and duration. For our US executive director, On Time Delivery will be measured against BAE Systems, Inc. contracts only. The Company's robust quality and safety processes will continue to apply. Target performance achieved for equal or better than aggregated On Time Delivery three-year average. Threshold and stretch performance levels will also apply, with final vesting outturn between 0% and 100% of this element. (ii) **Continuously improve competitiveness and efficiency.** Measured by three-year Return on Capital Employed (ROCE) to support continually improving our competitiveness in order to drive profitable growth benefiting all of our stakeholders. 25% vesting for 25bps reduction in 2023 ROCE, 50% vesting for 2023 ROCE consistent with the Integrated Business Plan (IBP) and 100% vesting for 25bps improvement in 2023 ROCE, with vesting on a straight-line basis between these parameters. (iii) **Advance and leverage our technology.** Effective programme delivery for major technology programmes will be used to measure our effectiveness at driving technology adoption. Measurement based on milestone achievement over three-year performance period. The selected projects will be measured against the key milestones including: (i) project launch/business case agreed; (ii) go-live; and (iii) benefits delivered. The vesting outcome will be derived from the outturn of each of the projects (between 0% and 100% of this element) with final approval by the Committee.

Note that in accordance with the Directors' remuneration policy: (a) Performance Share awards granted to executive directors are subject to application of reasonableness discretion in light of other important factors in the business; and (b) the Committee can adjust the weighting of the performance conditions, and, if considered appropriate, may introduce an alternate performance condition aligned to the Company's strategy, or remove a performance condition set out above.

LTIP Share Options

Options are normally exercisable between the third and tenth anniversary of their grant, subject to the performance condition set out below being achieved. Awards are subject to a further two-year clawback period after the initial three-year vesting period. From 2018 executive directors no longer receive share option awards.

Plan	Performance condition
LTIP SO	50% of the TSR measure is on the current sectoral comparator group of other international defence companies and 50% is on a TSR percentile ranking against the companies in the FTSE 100 index. Under both the sectoral and FTSE 100 comparator groups, no shares vest if the Company's TSR is less than median TSRs achieved by the comparator group, with 25% vesting at median, 100% vesting if the Company's TSR is in the top quintile and vesting on a straight-line basis between these two parameters.

Note: The share options granted to Tom Arseneault between 2013–2019 as set out on page 154 were granted prior to him being appointed as an executive director and do not have performance conditions attached to them. Share options granted to him from 2015 onwards are subject to a two-year clawback period after the initial three-year vesting period.

LTIP Restricted Shares

Restricted Shares are not subject to a performance condition as they are designed to address retention issues principally in the US. The shares are subject only to the condition that the participant remains employed by the Group at the end of the vesting date (three years after the award date). Shares under award attract notional reinvested dividends prior to vesting. Awards made to the US executive director are subject to a further two-year clawback period after the initial three-year vesting period.

Statement of directors' shareholdings and share interests

Minimum Shareholding Requirement (MSR)

Executive directors are required to establish and maintain a minimum personal shareholding equal to a set percentage of base salary as set out in the table below. Executive directors are required to achieve their Initial Value as quickly as possible, and achieve their Subsequent Value within a five-year time period. Where an executive director has not achieved their MSR, the consequence is a restriction on the number of shares that can be sold on exercise or release, until their MSR Subsequent Value is met. Where an executive director has met less than the Initial Value (50% of their MSR), they must retain 50% of the net value (i.e. the value after the deduction of exercise/sale costs and tax) of shares acquired through the various share schemes; if they have met the Initial Value but not the Subsequent Value (i.e. between 50% and 100% of their MSR), they must retain 25% of the net value. In the event that the executive director has not met the Subsequent Value at the end of the five-year period, the Committee will set out their proposed remedial actions at that time. The Committee has discretion to increase the Initial Value and/or Subsequent Value. Shares owned beneficially by the director and his/her spouse count towards the MSR.

With effect from adoption of the 2020 Remuneration Policy at the AGM on 7 May 2020, where an executive director leaves employment for any reason, a post-cessation shareholding policy will apply. For UK executive directors, the policy is based on the full MSR continuing to apply for a period of two years. For US executive directors, the policy is based on 300% MSR applying for a period of one year. Executive directors will be required to sign a contract on leaving employment to ensure compliance with this policy. Any case of non-compliance would be dealt with by the Committee.

The following table sets out MSR Initial Value and Subsequent Value and actuals as at 31 December 2020:

	Initial Value	Subsequent Value	Actual
Charles Woodburn	150%	300%	139%
Brad Greve	100%	200%	23%
Tom Arseneault	212.5%	425%	271%

The actual MSR figures in the table are provided as at 31 December 2020, based on the year-end share price of £4.88.

The higher MSR values applicable to Tom Arseneault recognise the higher LTI opportunity and broader US market practice.

There are MSR requirements in place for all of the employee population who receive LTIPs.

There are no shareholding requirements for the Chairman or the non-executive directors.

Prior to the 2020 Remuneration Policy coming into effect on 7 May 2020, the MSR policy did not apply after the individual ceased to be a director. However, as disclosed last year, the Committee agreed specific arrangements for post-cessation shareholding levels for Peter Lynas and Jerry DeMuro. On his retirement on 31 March 2020, Peter Lynas became subject to a reduced MSR of 100% of salary for a period of two years. Following cessation of employment on 31 December 2020, Jerry DeMuro became subject to a MSR of 300% of salary for a period of one year. Peter Lynas' and Jerry DeMuro's post-cessation MSR as at 31 December 2020 are shown below.

	Post-cessation MSR	Actual
Peter Lynas	100%	310%
Jerry DeMuro	300%	420%

Share interests as at 31 December 2020 (or date of cessation as a director)

The interests of the directors who served during the year ended 31 December 2020 in the shares of BAE Systems plc, or scheme interests in relation to those shares, were as follows:

	Shares	Scheme interests: Options and awards over shares					
		Share awards with performance conditions	Share awards without performance conditions	Share options with performance conditions	Share options with performance conditions, vested but unexercised	Share options without performance conditions	Total scheme interests
Sir Roger Carr	166,549	–	–	–	–	–	–
R Advaithi[1]	–	–	–	–	–	–	–
N J Anderson[2]	14,000	–	–	–	–	–	–
T A Arseneault[3]	398,777	777,255	365,958	–	–	2,028,576	3,171,789
Dame Elizabeth Corley	19,000	–	–	–	–	–	–
J DeMuro[4]	680,758	1,013,034	452,227	–	102,004	–	1,567,265
B M Greve[3]	29,020	421,253	–	–	–	–	421,253
J V Griffiths[3]	–	–	–	–	–	–	–
C M Grigg	24,555	–	–	–	–	–	–
P J Lynas[4]	341,003	–	–	373,960	64,615	–	438,575
S T Pearce	10,000	–	–	–	–	–	–
N W Piasecki	–	–	–	–	–	–	–
P Rosput Reynolds[5]	25,200	–	–	–	–	–	–
N C Rose[5]	55,000	–	–	–	–	–	–
I P Tyler	–	–	–	–	–	–	–
C N Woodburn	288,003	–	–	2,108,001	–	–	2,108,001

1. Retired from the Board on 25 June 2020.
2. Appointed to the Board on 1 November 2020.
3. Appointed to the Board on 1 April 2020.
4. Retired from the Board on 31 March 2020.
5. Retired from the Board on 31 December 2020.

Note: The share options without performance conditions were granted to Tom Arseneault prior to him being appointed as an executive director. Of these options, 1,407,511 are vested but unexercised. The related breakdown of these options is shown on page 154.

The above table has been subject to audit.

The interests of directors include those of their connected persons. The shares held by Paula Rosput Reynolds were represented by 6,300 American Depositary Shares.

Details of the share interests in options and awards held by the executive directors as at 31 December 2020 (or date of cessation as a director) are given on page 154 together with details of nil-cost options exercised in 2020, and the pro-rating of outstanding awards held by Jerry DeMuro when he ceased to be an employee on 31 December 2020.

Performance Shares granted under the LTIP are classified as share awards with performance conditions for the US executive director and as nil-cost options with performance conditions for the UK executive directors.

The interests of Peter Lynas and Jerry DeMuro are shown in the table as at 31 March 2020, the date they retired as directors. Their interests as at 31 December 2020 were as follows:

- Peter Lynas: Beneficial interest in shares: 418,283; Share options with performance conditions: 244,324; Total scheme interests: 244,324.
- Jerry DeMuro: Beneficial interest in shares: 680,758; Share awards with performance conditions: 779,294; Share awards without performance conditions: 334,572; Share options with performance conditions, vested but unexercised: 102,004; Total scheme interests: 1,215,870.

Since 31 December 2020, both Charles Woodburn and Brad Greve have each acquired an additional 91 shares under the Partnership and Matching Shares elements of the Share Incentive Plan so that their beneficial shareholdings at the date of this report stood at 288,094 and 29,111 respectively.

There have been no changes in the interests of the remaining directors in the shares of BAE Systems plc between 31 December 2020 and the date of this report.

Breakdown of scheme interests

Charles Woodburn

Options and awards held as at 31 December 2020

	31 December 2020	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS[EPS]	**88,599**[1]	21.03.17	nil	21.03.21
LTIP PS[TSR]	**285,227**[2]	20.03.18	nil	20.03.23
LTIP PS[EPS]	**285,227**[2]	20.03.18	nil	20.03.23
LTIP PS[TSR]	**350,737**[3]	20.03.19	nil	20.03.24
LTIP PS[EPS]	**350,737**[3]	20.03.19	nil	20.03.24
LTIP PS[TSR]	**373,737**[3]	25.03.20	nil	25.03.25
LTIP PS[EPS]	**373,737**[3]	25.03.20	nil	25.03.25
	2,108,001			

Performance Shares – nil cost options exercised during 2020

	Exercised during the year	Exercise price £	Date of grant	Date of exercise	Market price on exercise £
LTIP PS[EPS]	44,298	nil	21.03.17	03.08.20	4.88

The Performance Shares nil-cost options exercised by Charles Woodburn attracted notional reinvested dividends which equated to an additional 5,227 shares on exercise of these options.

Brad Greve

Options and awards held as at 31 December 2020

	31 December 2020	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS[TSR]	**210,626**[3]	25.03.20	nil	25.03.25
LTIP PS[EPS]	**210,627**[3]	25.03.20	nil	25.03.25
	421,253			

Tom Arseneault

Options and awards held as at 31 December 2020

	31 December 2020	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS[TSR]	**4,457**[1]	23.03.16	n/a	23.03.21
LTIP PS[EPS]	**43,725**[1]	21.03.17	n/a	21.03.21
LTIP PS[TSR]	**65,970**[4]	20.03.18	n/a	20.03.21
LTIP PS[EPS]	**65,971**[5]	20.03.18	n/a	20.03.21
LTIP PS[TSR]	**86,572**[3]	20.03.19	n/a	20.03.22
LTIP PS[EPS]	**86,572**[3]	20.03.19	n/a	20.03.22
LTIP PS[TSR]	**211,994**[3]	25.03.20	n/a	25.03.23
LTIP PS[EPS]	**211,994**[3]	25.03.20	n/a	25.03.23
	777,255			
LTIP SO	**288,602**	25.03.13	3.89	25.03.16
LTIP SO	**304,245**	26.03.14	4.12	26.03.17
LTIP SO	**258,380**	25.03.15	5.43	25.03.18
LTIP SO	**289,258**	23.03.16	4.99	23.03.19
LTIP SO	**267,026**	21.03.17	6.49	21.03.20
LTIP SO	**268,594**	20.03.18	5.82	20.03.21
LTIP SO	**352,471**	20.03.19	4.85	20.03.22
	2,028,576			
LTIP RS	**65,970**	20.03.18	n/a	20.03.21
LTIP RS	**86,572**	20.03.19	n/a	20.03.22
LTIP RS	**213,416**	25.03.20	n/a	25.03.23
	365,958			

Peter Lynas

Options and awards held as at 31 March 2020

	31 March 2020	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS[EPS]	**17,255**[1]	25.03.15	nil	25.03.20
LTIP PS[TSR]	**15,436**[1]	23.03.16	nil	23.03.20
LTIP PS[EPS]	**96,945**[1]	21.03.17	nil	21.03.20
LTIP PS[TSR]	**75,167**[4]	23.03.18	nil	20.03.23
LTIP PS[EPS]	**75,167**[5]	20.03.18	nil	20.03.23
LTIP PS[TSR]	**46,995**[3]	20.03.19	nil	20.03.24
LTIP PS[EPS]	**46,995**[3]	20.03.19	nil	20.03.24
	373,960			
LTIP SO	**64,615**[1]	23.03.16	4.99	23.03.19

Note: The breakdown for Peter Lynas is shown as at 31 March 2020, the date he retired as a director, and includes pro-rating of his awards on retirement. The subsequent exercise of nil cost options (Performance Shares) during 2020 is shown below. His 2016 Share Option lapsed on 30 September 2020.

Performance Shares – nil cost options exercised during 2020

	Exercised during the year	Exercise price £	Date of grant	Date of exercise	Market price on exercise £
LTIP PS[EPS]	17,255	nil	25.03.15	14.04.20	5.29
LTIP PS[TSR]	7,718	nil	23.03.16	14.04.20	5.29
LTIP PS[EPS]	32,314	nil	21.03.17	14.04.20	5.29
LTIP PS[TSR]	7,718	nil	23.03.16	29.04.20	5.19
LTIP PS[EPS]	64,631	nil	21.03.17	29.04.20	5.19

The Performance Shares nil-cost options exercised by Peter Lynas attracted notional reinvested dividends which equated to an additional 17,294 shares on exercise of these options (9,666 on 14 April 2020 and 7,628 on 29 April 2020).

Jerry DeMuro

Options and awards held as at 31 March 2020

	31 March 2020	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS[TSR]	**10,549**[1]	23.03.16	n/a	23.03.21
LTIP PS[EPS]	**104,062**[1]	21.03.17	n/a	23.03.21
LTIP PS[TSR]	**194,279**[4]	20.03.18	n/a	20.03.21
LTIP PS[EPS]	**194,280**[5]	20.03.18	n/a	20.03.21
LTIP PS[TSR]	**254,932**[3]	20.03.19	n/a	20.03.22
LTIP PS[EPS]	**254,932**[3]	20.03.19	n/a	20.03.22
	1,013,034			
LTIP SO	**102,004**[1]	23.03.16	4.99	23.03.19
LTIP RS	**195,584**	20.03.18	n/a	20.03.21
LTIP RS	**256,643**	20.03.19	n/a	20.03.22
	452,227			

Note: The breakdown for Jerry DeMuro is shown as at 31 March 2020, the date he retired as a director. As at 31 December 2020, the date he ceased to be an employee, his outstanding awards were pro-rated as follows: the 2018 Performance Share awards were pro-rated to 180,452 (TSR portion) and 180,453 (EPS portion); each of the TSR and EPS portions of the 2019 Performance Share awards were pro-rated to 151,889; and the 2018 and 2019 Restricted Shares awards were pro-rated respectively to 181,664 and 152,908 with both of the Restricted Share awards vesting on 31 December 2020. The outstanding 2016 and 2017 Performance Share awards, which had previously met their performance conditions, became available for release on 31 December 2020.

The tables above have been subject to audit.

Performance conditions for the LTIP are detailed on page 150.

1. Subject to a performance condition that has been met.
2. All shares due to vest subject to agreed terms.
3. Subject to a performance condition that is yet to be tested.
4. The outstanding award or option will lapse after the end of the financial year having not met the performance condition.
5. The outstanding award or option will partially lapse after the end of the financial year having not met the full performance condition.

Remuneration Committee composition and advisers

The Committee members comprise Ian Tyler (Chairman), Dame Elizabeth Corley and Chris Grigg. Paula Rosput Reynolds and Nick Rose also served on the Committee throughout 2020 as Committee Chair and Committee member respectively prior to their retirement from the Board on 31 December 2020. Advisers to the Remuneration Committee are shown below.

During the year, the Committee received material assistance and advice on remuneration policy from the Group Human Resources Director, Karin Hoeing; the Human Resources Director, Reward, Paul Farley; and his successor, Claudia Terry. Charles Woodburn in his role as Chief Executive also provided advice that was of material assistance to the Committee.

Adviser	Services provided	Appointment	Governance	Fees (in respect of services provided to the Committee)
PricewaterhouseCoopers (PwC)	Independent adviser to the Committee, including attendance at Remuneration Committee meetings. Also provided information on market practice in relation to different aspects of remuneration, market trends and benchmarking of the remuneration packages for the executive population.	Committee appointment. By the Company at the request of the Committee.	The Committee is aware that PwC provides a variety of other services to the Company, including tax and pensions advice. PwC also provides a range of consultancy services. The Committee is satisfied that the PwC LLP engagement partner and team, who provide remuneration advice to the Committee, do not have connections with the Group, or the individual directors, that may impair their independence and objectivity. PwC is a member of the Remuneration Consultants Group (RCG) and is a signatory to the RCG's code of conduct.	£67,824 Fee basis: Hourly
Linklaters	Provided legal services, principally advice regarding remuneration reporting and remuneration awards.	By the Company with the approval of the Committee.	Only provides legal compliance, legal drafting and review services, and does not advise the Committee. The Committee is aware that Linklaters is one of a number of legal firms that provide legal advice and services to the Company on a range of matters. Linklaters is regulated by the Law Society.	£20,067 Fee basis: Hourly
Aon	Advises on the TSR outcomes as required for assessing the performance condition under the BAE Systems Long-Term Incentive Plan 2014.	By the Company.	The Committee is aware that Aon provides a variety of other human resources-related services to the Company. The nature of the advice provided to the Committee is limited to factual information concerning the performance of the Company's shares.	£20,550 Fee basis: Fixed fee

Preface to the

Directors' remuneration policy

The Directors' remuneration policy (the Policy) set out on pages 157 to 171 was agreed by shareholders at the Annual General Meeting on 7 May 2020 and took legal effect on that date. The approved policy has been printed verbatim from the 2019 Annual Report, updated only so that the page numbers, where appropriate, refer to the 2020 Annual Report in order to aid readability, and to report subsequent Board membership changes.

Directors' remuneration for 2021

For 2021, it remains our intention to operate the Policy that was agreed by shareholders at the 2020 AGM. This section sets out how the Policy will apply in 2021.

Metrics and weightings applicable in 2021

- The performance metrics and weightings applicable to the 2021 annual incentive are 75% on financial metrics relating to earnings, cash and order intake at a Group level and additionally, in the case of the US executive director, at a BAE Systems, Inc. level, and 25% personal objectives designed to support the Group's strategy. From 2021, safety and diversity and inclusion measures will operate as a downward underpin to the non-financial annual incentive, if performance is not achieved at the high level expected. The following metrics and weightings will apply for 2021:

Financial metrics			Non-financial metrics
75%			25%
Earnings	Cash	Order intake	Key strategic objectives
45%	22.5%	7.5%	25%

- There are no changes proposed to the quantum applicable to the executive directors, and one-third of the net annual incentive will continue to be deferred into shares for three years on a compulsory basis.
- As set out in the Chairman's letter, from 2021, Performance Shares will be measured over a three-year period against a cash generation measure and a metric reflecting strategic progress, in addition to the existing EPS and relative Total Shareholder Return (TSR) metrics, each with equal weighting of 25% as follows:
  - Cash generation metric will be measured as cumulative free cash flow at a Group level for UK executive directors, and operating cash flow of the US business for the US executive director.
  - Strategic progress metric will be measured against quantifiable targets based on our three key strategic pillars of drive operational excellence, continuously improve competitiveness and efficiency, and advance and leverage our technology.
  - TSR condition measured against a subset of companies from the FTSE 100 index, chosen to ensure the peer group better reflects our Company, with no change to the performance requirements.
  - EPS condition has a performance range of 3% to 7% average annual EPS growth requirement.
- There is no change in 2021 to the criteria and weightings applying to Restricted Shares.
- UK executive directors will continue to receive Performance Shares only. The US executive director will continue to receive an equal weight in expected value in Performance Shares and Restricted Shares.

Below executive director level for 2021:

- UK and Rest of World participants will be measured against the free cash flow, strategic progress and EPS metrics set out above, each with equal weighting.
- US participants will be measured equally against the operating cash flow of BAE Systems, Inc., and EPS metrics set out above.

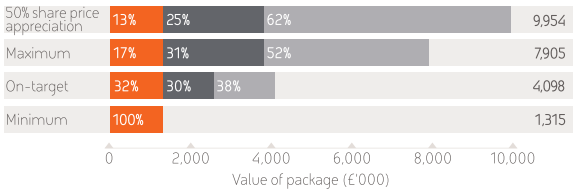
Illustration of application of policy for 2021

The following charts show the value of the package each of the executive directors would receive based on 2021 base salaries, remuneration and 2021 LTI awards assuming the following scenarios:

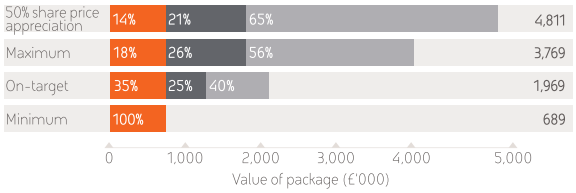
1. minimum fixed pay (including salary, benefits and pension as provided in the single total figure table on page 140), and the Restricted Shares award for the US executive director;
2. pay receivable assuming on-target performance is met;
3. maximum pay assuming all variable elements pay out in full; and
4. 50% share price appreciation on maximum payout.

The minimum, on-target and maximum scenarios exclude any share price appreciation and dividends. 50% share price appreciation assumes all variable elements pay out in full and there is 50% gain in share price in respect of Performance Shares and Restricted Shares awards received. UK legislation requires that these charts are given in relation to the first year in which the remuneration policy takes legal effect (see page 166). The charts below are reporting the actual levels for 2021.

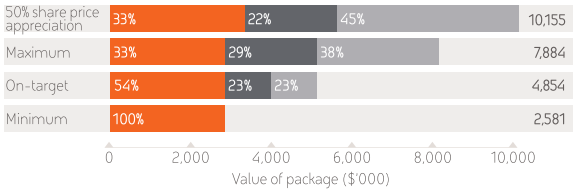
Chief Executive (£'000)



Group Finance Director (£'000)



President and Chief Executive Officer of BAE Systems, Inc. ($'000)



Fixed elements of remuneration
Annual bonus
Performance Shares

Directors' remuneration policy

This Directors' remuneration policy (the Policy) will take legal effect from the conclusion of the 2020 Annual General Meeting (AGM) subject to shareholder approval at the 2020 AGM.

The Remuneration Committee (the Committee) considers the remuneration policy annually to ensure that it remains aligned with business needs and is appropriately positioned relative to the market. However, in the absence of exceptional or unexpected circumstances which may necessitate a change to the Policy, there is currently no intention to revise the Policy more frequently than every three years.

The Policy is to set base salary with reference to the relevant market-competitive level. We use target performance to estimate and benchmark the total potential reward against reward packages paid by BAE Systems' competitors. Actual total direct reward reflects the performance of the individual and the Company as a whole. The aim is to deliver an overall remuneration package for executive directors which provides an appropriate balance between short-term and long-term reward and between fixed and variable reward as described more fully below.

The Committee is governed by Terms of Reference which set out their roles and responsibilities including how the Committee will be conducted and operate. These are reviewed at least annually to ensure they remain appropriate and include relevant corporate governance and other guidance. The Terms of Reference are available on the Company's external website. Our Long-Term Incentive Plan provides the Committee with discretion with respect of vesting outcomes that affect the actual level of reward payable to individuals; as explained on page 161, such discretion would only be used in exceptional circumstances and, if exercised, disclosed at the latest in the report on implementation of the Policy (i.e. the Annual remuneration report) for the year in question.

The Committee has appointed independent external advisers to receive material independent assistance and advice. In addition, to avoid any conflicts of interest or appearance thereof, no director is involved in deciding their own remuneration outcome with such items being discussed without their presence in the meeting.

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Note

References in this Policy to 'UK executive directors' are to UK-based executive directors and references to 'US executive directors' are to US-based executive directors.

Directors' remuneration policy
continued

Revisions compared to the policy approved at the 2017 AGM

The Policy contains no components which were not in the remuneration policy approved at the 2017 AGM. A description and explanation of all significant changes from the policy approved in 2017 are summarised below.

Annual incentive

- Confirmation that non-financial metrics will continue to be based on a combination of personal performance objectives linked to our strategic objectives, safety measures, and diversity and inclusion targets. However, from 2021, safety, diversity and inclusion targets will be reflected in the ultimate reward on the basis of being an 'underpin'. In other words, the Board expects safety, diversity and inclusion targets to be met in all circumstances; the Committee will, as a general matter, use its discretion to adjust the overall annual incentive in the event of below-target performance.

Long-Term Incentives (LTI)

- To continue the simplification of our LTI framework, since 2018, share options have not been granted to any executive directors. As a result, UK executive directors receive Performance Shares only and US executive directors receive a mix of Performance Shares and Restricted Shares, to maintain current Expected Value.
- Introduction of a cash generation measure and a metric reflecting strategic progress in addition to existing Earnings per Share (EPS) and relative Total Shareholder Return (TSR) conditions to apply to Performance Shares. Each metric will be equally weighted at 25%. Introduction of these additional measures is designed to capture the financial ambitions for the Company and provide focus on objectives that reflect our strategic priorities. Confirmation that we intend to disclose the areas of strategic progress in each year, but the specific metrics of measure will be disclosed prospectively only to the extent that they are not commercially sensitive.
- Maintain ability to adjust the weightings of the performance conditions and if considered appropriate, the Committee may introduce an alternate performance condition aligned to the Company's strategy, or remove a performance condition set out above, but with a minimum of 20% weighting always applying to the Total Shareholder Return (TSR) metric.
- Confirmation of the range of values possible for Performance Shares and Restricted Shares.

Pension

- Participation in executive defined contribution retirement plan (or cash equivalent) as default pension vehicle with 8% employer contribution for newly externally-appointed UK executive directors or internally-appointed UK executive directors, consistent with that available to the wider UK workforce in the Company's UK defined contribution arrangements.
- The annual value of the current Chief Executive's contributions will be fixed at the monetary value of his 2020 employer pension contribution of £186,200 per annum as a salary supplement. Assuming average salary increases in the region of 2.5% per annum, fixing the monetary value at this level will align the employer contribution rate applicable to the Chief Executive to the weighted average employer rate of 17% over a period of around four years.

Remuneration policy for other employees

- Confirmation that LTI grants will continue to be made in line with 2020 policy with the following differences:
  - for US participants below Executive Committee level, performance conditions and targets for performance share grants are tailored to reflect the strategic context and focus for the US business; and
  - share options may continue to be granted below executive director level without performance conditions attached and vest and are exercisable after three years.

Minimum Shareholding Requirement (MSR)

Acknowledging the relevant provisions of the Corporate Governance Code as well as broader expectations of investors in relation to MSR, the following have been introduced:

- Introduction of five-year time period achieving Minimum Shareholding Requirement (MSR) applicable to all executive directors.
- Continue to apply restriction on number of shares that can be sold on exercise or release, until the MSR is met. If less than 50% of MSR has been met, 50% of the net value (i.e. the value after deduction of exercise/sale costs and tax) of shares acquired through the various share schemes must be retained; if between 50% and 100% of MSR has been met, 25% of the net value must be retained. In the event that the executive director is still not compliant with their MSR at the end of the five-year period, the Committee will set out their proposed remedial actions at that time.
- Introduction of post-cessation shareholding policy applicable to all executive directors. For UK executive directors, the policy is based on the full MSR continuing to apply for a period of two years. For US executive directors, the policy is based on 300% MSR applying for a period of one year. Executive directors will be required to sign a contract on leaving employment to ensure compliance with this policy.

Non-executive directors' fees maximum opportunity

- Confirmation that the current Chairman's fee has been fixed at £700,000 from 1 February 2020 and is fixed at this level through the duration of his final term of office ending at the AGM in 2023.

Consideration of employment conditions elsewhere in the Company

Further details provided in relation to building the Committee's understanding of reward arrangements applicable to the wider workforce.

Stakeholder considerations

Further details provided in relation to the Committee's engagement with shareholders on the topic of executive remuneration.

Executive directors' policy table

Base salary

Purpose and link to strategy
Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.

Operation
Salaries are reviewed annually. Business and individual performance, skills, the scope of the role and the individual's time in the role are taken into account when setting and assessing salaries, as is market data for similar roles in the relevant market comparator group.

The comparator group for UK executive directors is comprised of selected companies from the FTSE 100 and is constructed to position BAE Systems around the median in terms of market capitalisation. For the Chief Executive Officer of BAE Systems, Inc., the comparator group is drawn from companies in the US aerospace and defence sectors, together with similar organisations in the general industry sector where BAE Systems, Inc. is positioned at the median of the comparator group by reference to revenue size.

Maximum opportunity
When considering salary increases for the executive directors in their current roles, the Committee considers the general level of salary increase across the Group and in the relevant external market.

Actual increases for the executive directors in their current roles will generally not exceed the average percentage increase for employees as a whole, taking account of the level of movement within the relevant UK/US comparator group.

As a maximum, in exceptional circumstances (such as a material increase in job size or complexity while performing the same role, or a recently appointed executive director where the salary is positioned low against the market), the increase will not exceed 10% in any single year for executive directors performing the same role. If an individual's role changes then a salary increase above 10% may be awarded in any single year to position their salary appropriately in accordance with the base salary principles described under 'Operation' above. As a matter of policy, no new executive director role will have a salary greater than the Chief Executive at that time.

Performance metrics used, weighting and time period applicable
None.

Annual incentive

Purpose and link to strategy
Drive and reward annual performance of individuals and teams on both financial and non-financial metrics, including leadership behaviours in order to deliver sustainable growth in shareholder value.

Compulsory deferral into shares increases alignment with shareholder interests.

Operation
The annual incentive is driven off in-year financial performance, corporate responsibility and other non-financial objectives measured at the Group and individual level.

One-third of the total net annual incentive amount is subject to compulsory deferral for three years in BAE Systems shares without any matching.

A malus mechanism may be applied to any bonus, and a clawback mechanism may be applied to the deferred bonus shares until up to the end of the three-year deferral period, where:

- the Company is entitled to terminate employment for cause or the participant has engaged in misconduct (including breach of policy) which gives rise to other disciplinary sanction;
- the results of the Company and/or relevant business or businesses for any period have been restated or subsequently appear materially inaccurate or misleading; and/or
- any Group company or business unit has made a material financial loss.

Cash dividends are payable to the participants on the shares during this three-year deferral period.

Executive directors' policy table continued

Annual incentive continued

Maximum opportunity
Chief Executive: 225% of salary

Chief Executive Officer of BAE Systems, Inc.: 225% of salary

Chief Operating Officer: 200% of salary

Group Finance Director: 160% of salary

Where a new executive director role is established, the maximum opportunity will not exceed that of the Chief Operating Officer role as set out above.

The payout for maximum performance is double the payout for on-target performance where maximum performance is shown as the respective maximum percentages above. The payout for achieving a threshold performance is 40% of the payout for on-target performance (i.e. 20% of maximum), with no payout for achieving less than this. Payout for performance between targets is calculated on a straight-line basis.

Performance metrics used, weighting and time period applicable
Performance is assessed on an annual basis, using a combination of the Group's main performance indicators for the year and other objectives designed to support the Group's strategy. Metrics, which will include financial and non-financial metrics as well as the achievement of personal objectives, will be determined and weighted each year according to business priorities. 75–80% will relate to financial metrics aligned with long-term earnings and cash targets. The non-financial element will be based on a combination of personal performance objectives that provide a clear line of sight to our strategic objectives, safety measures, and diversity and inclusion targets*.

Metrics and weightings to be determined annually. Proposed metrics and weightings applicable in 2020:

Group EPS – 45%

Group cash – 22.5%

Order intake – 7.5%

Safety, and diversity and inclusion – 5%**

Key strategic objectives designed to support the Group's strategy – 20%

*See notes 4 and 5 on page 165 regarding the selection and weighting of performance metrics.

**Beginning in 2021, safety, and diversity and inclusion will be an underpin to the annual plan. At that point, Key strategic objectives will increase from 20% to 25% of the total weighting.

All bonus payments are at the discretion of the Committee, which will be based on an assessment of the individual's personal contribution to business performance over the relevant year and leadership behaviours demonstrated in making that contribution, relative to others.

Long-Term Incentives (LTI)

Operation
Long-term incentives will operate under the BAE Systems Long-Term Incentive Plan approved by shareholders at the 2014 AGM.

The size of awards granted is based on a percentage of salary, which is divided by the share price to determine the number of shares subject to the award.

Dividend equivalents in respect of vested shares may be paid at the time of vesting (or exercise, in the case of options) and are not taken into account when determining individual limits.

A malus and clawback mechanism may be applied, until two years after vesting, or if sooner, the fifth anniversary of grant, or the occurrence of certain corporate events, to all awards granted on or after 25 March 2015 where:

- the Company is entitled to terminate employment for cause or the participant has engaged in misconduct (including breach of policy) which gives rise to other disciplinary sanction;
- the results of the Company and/or relevant business or businesses for any period have been restated or subsequently appear materially inaccurate or misleading;
- any Group company or business unit has made a material financial loss; and/or
- the measurement of any performance condition does not reflect the actual performance of the Company over the performance period.

The Committee will establish the targets for each measure at the start of each performance period based on Group projections and market expectations for the business. The performance conditions for previous awards are described in the Annual remuneration report.

Awards and performance conditions can be adjusted to take account of variations of share capital and other transactions or events.

On a change of control or similar transaction, awards generally will vest to the extent performance conditions are then satisfied (if applicable) and then be pro-rated to reflect the acceleration of vesting unless the Committee decides otherwise. Alternatively, awards may be exchanged for equivalent awards over shares in the acquiring company.

The share plan rules may be amended from time-to-time by the Committee in certain circumstances including minor changes for administrative, tax or other regulatory purposes.

Subject to this Policy, performance conditions of awards already granted may be amended in accordance with their terms or if anything happens which causes the Committee reasonably to consider it appropriate to do so.

Performance metrics used, weighting and time period applicable
See notes 4 and 5 on page 165 regarding the selection and weighting of performance metrics.

Maximum opportunity
Over the lifetime of this Policy, the Committee will have discretion to vary the weighting of different types of awards within the framework set out below, but the overall LTI Expected Value (EV) will remain the same (assuming the LTI EV is calculated as 50% of face value for Performance Shares and 100% of face value for Restricted Shares):

- UK executive directors' awards will consist of Performance Shares only.
- US executive directors' awards will consist of a mix of Performance Shares and Restricted Shares (with Restricted Shares comprising no more than 50% of overall LTI EV), ensuring competitiveness of overall LTI opportunity in line with US market practice.

Performance metrics used, weighting and time period applicable
See below in relation to Performance Shares.

In addition to the primary performance tests set out below, the Committee confirms and recognises its obligation to judge the overall reasonableness of the rewards received relative to the overall business actions and results achieved. When determining the final performance condition outcome under Performance Share awards granted since the 2017 AGM, the Committee will have discretion over the number of awards vesting in light of other important factors in the business (reasonableness discretion). The discretion may result in vesting of awards going upwards (subject to maximum 100% vesting of awards) as well as downwards. Any factors will be properly considered as they arise and any discretion to the calculated results will be applied in a highly disciplined manner and the rationale and impact will be reported transparently.

See notes 4 and 5 on page 165.

Executive directors' policy table continued

Long-Term Incentives – Performance Shares

Purpose and link to strategy
Direct financial measures of long-term earnings and cash generation that drive our financial ambitions for the Company, and external strategic measures including relative TSR performance, aligned to the interests of shareholders.

Operation
For UK executive directors, awards, typically in the form of nil-cost options, will vest subject to performance and service conditions on the fifth anniversary of grant. These will be exercisable between the fifth and tenth anniversary of grant or such shorter period as may be specified by the Committee.

For US executive directors, awards are delivered as conditional share awards (RSUs). To maintain the competitiveness of the LTI offering in the US, awards will vest automatically in three equal tranches on the third, fourth and fifth anniversary of grant, subject to performance conditions.

Policy maximum opportunity
Award levels applicable to UK executive directors for normal annual grants (assuming award of Performance Shares only) are as follows:

Chief Executive: 370% of salary

Chief Operating Officer: 350% of salary

Group Finance Director: 335% of salary

Award levels applicable to US executive directors for normal annual grants (assuming the current LTI EV weightings in Performance Shares and Restricted Shares) are as follows:

Chief Executive Officer of BAE Systems, Inc.: 298% of salary

Note the percentages above could be exceeded if the LTI EV weightings were to be varied (see above).

Where a new executive director role is established, the maximum opportunity will not exceed that of the Chief Operating Officer role as set out above.

Range of values: the size of awards granted is based on a percentage of salary, which is divided by the share price to determine the number of shares subject to the award. The maximum value that an executive director can receive is based on this number of shares subject to the award multiplied by maximum vesting of 100%, multiplied by any share price growth between grant date and vesting date and including any dividend equivalents received in respect of vested shares. The minimum value that an executive director can receive is zero on the basis of nil vesting, for example either due to the performance conditions not being achieved, or as a result of the application of reasonableness discretion that determines nil vesting of the awards.

Performance metrics used, weighting and time period applicable
Metrics and weightings will be as follows (subject to the Committee's ability to adjust as set out below):

- 25% of award based on TSR relative to one or more appropriate comparator groups over the three-year performance period as selected by the Committee at the time of grant:
  - Vesting of each comparator group is determined as: nil vesting if TSR ranked below median in the comparator group; 25% vesting if TSR ranked at the median; 100% vesting if TSR ranked in the upper quintile; pro-rata vesting for performance between median and upper quintile.
  - If more than one comparator group is used, vesting of the TSR portion of the award will be determined by the average of the vesting outcomes from each comparator group.
  - Award subject to a secondary financial measure as set out on pages 150 and 151.
- 25% of award based on average annual EPS growth over the three financial years starting with that in which the award is granted, with 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance. Pro-rata vesting for intermediate performance.
- 25% of award based on three-year cumulative cash generation metric over the three financial years starting with that in which the award is granted, with 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance. Pro-rata vesting for intermediate performance.
- 25% of award based on specific and quantifiable strategic goals, reflecting strategic progress, that are directly aligned to our company strategic goals of driving operational excellence, continuously improving competitiveness and efficiency and advancing and further leveraging our technology.

The metrics and weightings applicable in 2020 are as follows:

- 50% of award based on TSR relative to the following two comparator groups over the three-year performance period:
  - An appropriately sized group of international defence companies selected by the Committee at the time of grant.
  - All companies in the FTSE 100 index.
- 50% of award based on average annual EPS growth over the three financial years starting with that in which the award is granted, with threshold performance requirement as average annual EPS growth of 3%, target performance requirement as average annual EPS growth of 5% and stretch performance requirement as average annual EPS growth of 7%.

Note that awards granted to executive directors are subject to application of reasonableness discretion in light of other important factors in the business as described earlier.

The Committee can adjust the weighting of the performance conditions, and, if considered appropriate, may introduce an alternate performance condition aligned to the Company's strategy, or remove a performance condition set out above, but with a minimum of 20% weighting always applying to the Total Shareholder Return (TSR) metric.

See notes 4 and 5 on page 165.

Long-Term Incentives – Restricted Shares

Purpose and link to strategy
Provide long-term reward through time-vesting awards principally in the Company's US market.

Operation
The shares are subject only to the condition that the participant remains employed by the Group on the vesting date (three years after the award date). Directors are required to retain their shares for a further two-year period, except for any shares that need to be sold to cover tax liabilities due in respect of the shares. During that time, they are subject to clawback as described above. However, this holding requirement will not apply following a change of control. These awards are not subject to a performance condition as they are designed to address competitive market practice and retention issues principally in the US. Non-US-based executive directors are not eligible.

Policy maximum opportunity
Award levels applicable to US executive directors for normal annual grants (assuming the current LTI EV weightings in Performance Shares and Restricted Shares) are as follows:

Chief Executive Officer of BAE Systems, Inc.: 150% of salary

Range of values: the size of awards granted is based on a percentage of salary, which is divided by the share price to determine the number of shares subject to the award. The value that a US executive director will receive is based on this number of shares subject to the award multiplied by the change in share price between grant date and vesting date and including any dividend equivalents received in respect of vested shares.

Performance metrics used, weighting and time period applicable
None.

See notes 4 and 5 on page 165.

Benefits

Purpose and link to strategy
Provide employment benefits which ensure that the overall package is market competitive when these elements are taken into account.

Operation
Benefits include provision of a company car (or cash equivalent), life assurance and ill-health benefit cover which are provided directly or through membership of the Company's pension schemes. The main benefits in the UK include a car allowance (currently £16,000 per annum), private use of a chauffeur-driven car and annual medical screening, plus life assurance and ill-health benefit cover provided through membership of the Company's pension schemes.

Opportunity for UK executive directors to participate in the Share Incentive Plan, a tax approved all-employee plan.

In the US, benefits include parking and private use of a chauffeur-driven car and company aircraft, medical and dental benefits, and insured life and disability benefits.

Additional benefits, such as relocation assistance, may also be provided in certain circumstances if considered reasonable and appropriate by the Committee. Relocation assistance comprises reimbursement for direct items of expenditure, such as legal, estate agency, removals and temporary accommodation.

Directors' and Officers' insurance cover is also provided for all executive directors.

Maximum opportunity
Benefits are set at a level which the Committee considers to be appropriate against comparable roles in companies of similar size in the relevant market. Benefits are as reported and itemised within the single total figure shown as part of the Annual remuneration report on page 140. The maximum cost of such benefits will reflect the associated market-competitive cost of provision. Relocation assistance is based on actual costs incurred which are linked to the size and value of the property, plus a maximum relocation allowance of £2,500.

Participation limits for the Share Incentive Plan are those set by the UK tax authorities from time-to-time.

Performance metrics used, weighting and time period applicable
None.

Directors' remuneration policy
continued

Executive directors' policy table continued

Pension

Purpose and link to strategy
Provide competitive post-retirement benefits or cash allowance equivalent.

Operation
The current Chief Executive as at 19 February 2020 is a member of the defined contribution section of the BAE Systems Executive Pension Scheme (EPS DCRP). In line with our policy at the time of his appointment, Company contributions are 19% of salary and UK member contributions are 6% of salary. In the UK, the Company has a number of defined benefit (DB) plans which are closed to new entrants, with new hires being offered membership of a defined contribution (DC) pension scheme. Employer contribution rates for the different schemes range from 8% to approximately 50% salary. The level of employer contribution based on a weighted average of UK active members across all schemes is approximately 17%. From 2020, the annual value of the current Chief Executive's contributions will be fixed at the monetary value of his 2020 employer pension contribution of £186,200 per annum. Assuming broad average salary increases in the region of 2.5% per annum, fixing the monetary value at this level will align the employer contribution rate applicable to the Chief Executive to the weighted average employer rate of 17% over a period of around four years. The Committee will continue to monitor the matter of pension provision as part of a broader mix of total remuneration.

For any new externally-appointed UK executive directors, or internally-appointed UK executive directors, membership of the BAE Systems EPS DCRP is offered as the default pension vehicle. Company contributions are set at 8% of base salary for those members contributing 6% of salary, in line with that available to the wider UK workforce participating in the Company's UK defined contribution arrangements. In certain circumstances, individuals may elect instead to receive some or all of their Company contributions as a cash allowance. Consistent with the above, the Group Finance Director designate as at 19 February 2020[1] is a member of the BAE Systems EPS DCRP with Company contributions of 8% salary.

Where the Annual Allowance (AA) is breached, as is the case with the Chief Executive and the Group Finance Director designate, each individual will pay member contributions up to the AA limit and the Company contributions will be paid as a salary supplement. Where UK executive directors' pension entitlement or accrual is restricted to the Lifetime Allowance (LTA) and/or the AA, the Company may offer a salary supplement to offset the impact of these restrictions.

The current Group Finance Director as at 19 February 2020[1] is due to retire on 31 March 2020, before this Policy takes legal effect. He is a member of the BAE Systems Executive Pension Scheme and member of an underlying employee pension plan, which together provide a target benefit for executive directors payable at normal retirement age (62) of 1/30th of final pensionable earnings (FPE) for each year of service up to a maximum of two-thirds of FPE. His contributions are currently 8% of salary in line with other members in the equivalent part of the scheme. This part of the scheme is a legacy arrangement and has not been open to new joiners for many years. Further detail is provided on page 125 as part of the Annual remuneration report in the 2019 Annual Report.

The current Chief Executive Officer of BAE Systems, Inc. as at 19 February 2020[2] is due to step down from the Board on 31 March 2020, before this Policy takes legal effect. He participates in a Section 401(k) defined contribution arrangement in which the Company matches his contributions up to a maximum of 6% of salary, subject to US regulatory limits. The same provisions and features of the plan apply to the majority of participating active employees.

Any new US executive directors, whether externally-appointed or internally-appointed, would be offered participation in the US Section 401(k) defined contribution plan. The same provisions and features of the plan currently apply to the majority of participating active employees, with the Company matching contributions up to a maximum of 6% of salary, subject to US regulatory limits. For any internally-appointed US executive directors who are also participants in the BAE Systems Employees' Retirement Plan (ERP, a qualified pension plan) and the BAE Systems 2007 Benefit Restoration Plan (BRP 2007, a non-qualified pension plan), these plans provide for either a lump sum or annuitised payments based on the accrued values at the time of separation from employment. Annual additional accruals are currently limited to $1,000 in the ERP and $500 in the BRP 2007.

The current President and Chief Operating Officer of BAE Systems, Inc. as at 19 February 2020 participates in a Section 401(k) defined contribution arrangement as described above, and is also a participant in the ERP and BRP 2007, as described above.

Maximum opportunity
The BAE Systems EPS DCRP provides a maximum Company contribution of 19% (in addition to employee contribution of 6%) of base salary in respect of the current Chief Executive. From 2020, the maximum Company contribution has been fixed at £186,200 per annum for the current Chief Executive.

The maximum Company contribution for any new externally-appointed UK executive directors, or internally-appointed UK executive directors is 8% (in addition to employee contribution of 6%) of base salary.

Under the existing executive defined benefit scheme, a maximum of two-thirds of FPE is accrued at 1/30th for each year of service.

Where UK executive directors' pension entitlement or accrual is restricted to the LTA and/or the AA, the Company may offer a salary supplement to offset the impact of these restrictions.

With limited exceptions, the US Section 401(k) defined contribution plan currently provides company matching contributions up to a maximum of 6% of base salary, subject to US statutory limits. For US executive directors who are eligible to participate in the ERP and the BRP 2007, these plans provide a cash sum or annuity at retirement equal to the present value of all prior annual accruals and credits from the initial year of service eligibility through to the present. Since the start of 2013, annual additional accruals have been set at $1,000 from the ERP and $500 from the BRP 2007.

1. Peter Lynas, Group Finance Director as at 19 February 2020, is to retire on 31 March 2020. Brad Greve, Group Finance Director designate as at 19 February 2020, is to be appointed as Group Finance Director and a director of BAE Systems plc with effect from 1 April 2020.
2. Jerry DeMuro, Chief Executive Officer of BAE Systems, Inc. as at 19 February 2020, is to step down from the Board on 31 March 2020. Tom Arseneault, President and Chief Operating Officer of BAE Systems, Inc. as at 19 February 2020, will succeed Jerry DeMuro as President and Chief Executive Officer of BAE Systems, Inc. and director of BAE Systems plc with effect from 1 April 2020.

Notes to the executive directors' policy table

Remuneration policy for other employees

1. The Company's approach to annual salary reviews is consistent across the Group, with consideration given to the scope of the role, level of experience, performance and market data for similar roles in other companies.
2. All leaders may participate in an annual bonus scheme with similar metrics to those used for the executive directors. Other employees may participate in performance-based incentive plans which vary by organisational level and with relevant metrics for the particular area of the business.
3. LTI grants may be made to the most senior managers in the business (approximately 400 individuals globally). The nature of the awards depends on the individual's location, roles and responsibilities, in particular:
   - performance conditions and targets for Performance Share grants made to UK and Rest of World participants are made in line with those applying to executive directors;
   - for US participants below Executive Committee level, performance conditions and targets for Performance Share grants are tailored to reflect the strategic context and focus of the US business;
   - Performance Shares applicable to participants below executive director level vest on the third anniversary subject to performance conditions and are exercisable (or released in the case of US participants) in equal tranches on the third, fourth and fifth anniversary of grant;
   - Share Options are granted to participants below executive director level; there are no performance conditions attached and they vest and are exercisable after three years;
   - Restricted Share grants are currently made to the most senior managers in the US businesses reflecting competitive market practice and vest after three years. Targeted awards may also be made with Remuneration Committee approval to selected individuals outside the US below executive director level;
   - one quarter of the total annual incentive amount is subject to compulsory deferral for three years in BAE Systems shares without any matching for UK and Rest of World participants that receive LTI grants; and
   - Minimum Shareholding Requirements are in place for all of the approximately 400 individuals globally that receive LTI grants.

Performance measures and targets

4. The Committee selected the performance conditions because these are central to the Company's overall strategy and are the key metrics used by the executive directors to oversee the operation of the business. Any non-financial performance targets are determined by the Committee in consultation with the Corporate Responsibility Committee as appropriate.
5. The performance conditions and targets are determined annually by the Committee (within the parameters set out above), taking account of the Group's strategic objectives, the internal business plan and budgets, as well as external market expectations and general economic conditions. The Committee is of the view that the performance targets for the annual bonus are commercially sensitive and that it would be detrimental to the interests of the Company to disclose them before the start of the financial year. The targets will be disclosed retrospectively after the end of the relevant financial year.

Minimum Shareholding Requirement (MSR)

6. The Committee has agreed a policy whereby the executive directors are required to establish and maintain a minimum personal shareholding equal to a set percentage of base salary as set out in the table below. Executive directors are required to achieve their Initial Value as quickly as possible, and achieve their Subsequent Value within a five-year time period. Where an executive director has not achieved their MSR, the consequence is a restriction on the number of shares that can be sold on exercise or release, until their MSR Subsequent Value is met. Where an executive director has met less than the Initial Value (50% of their MSR), they must retain 50% of the net value (i.e. the value after deduction of exercise/sale costs and tax) of shares acquired through the various share schemes; if they have met the Initial Value but not the Subsequent Value (i.e. between 50% and 100% of their MSR), they must retain 25% of the net value. In the event that the executive director has not met the Subsequent Value at the end of the five-year period, the Committee will set out their proposed remedial actions at that time. The Committee has discretion to increase the Initial Value and/or Subsequent Value (see below). Shares owned beneficially by the director and his/her spouse count towards the MSR.

   With effect from the 2020 AGM, where an executive director leaves employment for any reason, a post-cessation shareholding policy will apply. For UK executive directors, the policy is based on the full MSR continuing to apply for a period of two years. For US executive directors, the policy is based on 300% MSR applying for a period of one year. Executive directors will be required to sign a contract on leaving employment to ensure compliance with this policy. Any case of non-compliance would be dealt with by the Committee.

   The following table sets out MSR Initial Value and Subsequent Value:

	Initial Value	Subsequent Value
Chief Executive	150%	300%
Chief Operating Officer	100%	200%
Group Finance Director	100%	200%
Chief Executive Officer of BAE Systems, Inc.	212.5%	425%

Directors' remuneration policy continued

Executive directors' policy table continued

Illustration of application of remuneration policy

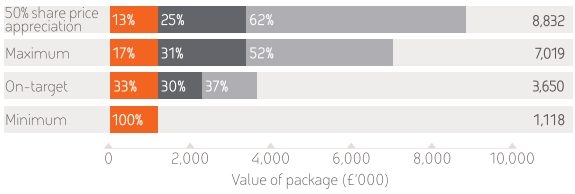
The charts below show the value of the package each of the executive directors would receive in the first year of operation of the Policy. No illustration of Remuneration Policy is shown for Peter Lynas (current Group Finance Director) and Jerry DeMuro (current Chief Executive Officer of BAE Systems, Inc.) who are stepping down from the Board in advance of the 2020 AGM at which the proposed Remuneration Policy is being put to shareholders, as set out in the executive director changes below.

The values are based on 2020 levels for base salaries, benefits and pension and assume that the office-holders at the date of this Policy coming into effect are employed throughout the first year of operation of the Policy. Annual and long-term incentives are based on awards applying in 2021. The charts assume the following scenarios:

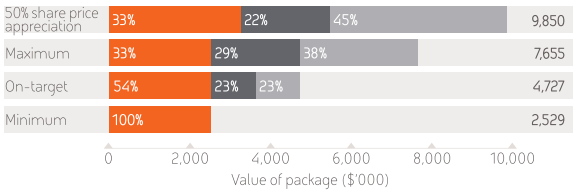
- minimum fixed pay includes salary, benefits and pension as provided in the single figure table on page 118 of the 2019 Annual Report and Restricted Shares award for the US executive director awarded at 150% salary (excluding share price growth);
- on-target pay assumes on-target performance is met in respect of variable elements (annual and long-term incentives);
- maximum pay assumes variable elements pay out in full; and
- 50% share price appreciation assumes all variable elements pay out in full and there is 50% gain in share price over the relevant vesting period in respect of Performance Shares and Restricted Shares awards received, and excludes dividends.

The minimum, on-target and maximum scenarios below exclude any share price appreciation and dividends.

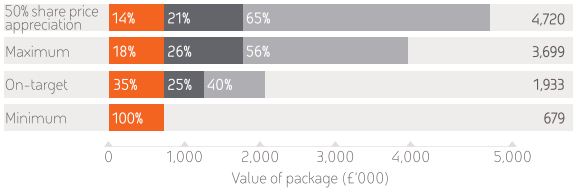
Chief Executive (£'000)



President and Chief Executive Officer of BAE Systems, Inc. ($'000)



Group Finance Director (£'000)



- Fixed elements of remuneration
- Annual bonus
- Performance Shares

Executive directorship changes

As announced on 8 August 2019, Peter Lynas is to retire as Group Finance Director on 31 March 2020 and Brad Greve, Group Finance Director designate, is to be appointed as Group Finance Director and a director of BAE Systems plc on 1 April 2020. As announced on 17 December 2019, Jerry DeMuro is to retire on 31 December 2020, stepping down from his role as executive director on 31 March 2020. Tom Arseneault will succeed him as President and Chief Executive Officer of BAE Systems, Inc. and a director of BAE Systems plc on 1 April 2020.

Non-executive directors' (NEDs) policy table

Fees

Purpose and link to strategy
To attract NEDs who have a broad range of experience and skills to provide independent judgement on issues of strategy, performance, resources and standards of conduct.

Operation
NEDs' fees are set by the Non-Executive Directors' Fees Committee.

NEDs receive a basic fee with an additional fee for those who are chairmen of committees and/or undertake the role of Senior Independent Director.

NEDs also receive a travel allowance per meeting on each occasion that a scheduled Board meeting necessitates air travel of more than five hours (one way) to the meeting location, subject to a maximum of six travel allowances per year.

Fees are typically reviewed annually, taking into account time commitment requirements and responsibility of the individual roles, and after reviewing practice in other comparable companies.

The Chairman's fees are set by the Committee on a three-year basis and not normally subject to review during that period.

Maximum opportunity
Actual fee levels are disclosed in the Annual remuneration report for the relevant financial year.

The current Chairman's fee has been set at £700,000 from 1 February 2020 and is fixed at this level for three years.

The aggregate cost of fees and benefits paid to NEDs (including the Chairman) will not exceed an annual limit of £2.5m and the cost of fees and benefits paid to the Chairman will not exceed £1.25m annually.

Performance metrics used, weighting and time period applicable
None.

Benefits

Purpose and link to strategy
Reimbursement for reasonable and documented expenses incurred in the performance of duties.

Operation
NEDs are not eligible to participate in any pension benefits provided by the Company, nor do they participate in any performance-related incentives.

The Chairman is provided with a chauffeur-driven car. This may be used for non-Company business, but the cost of the benefit of such usage shall be paid by the Chairman.

The Company reimburses travel and subsistence costs (including payment of the associated tax cost) incurred by the director or his/her spouse whilst undertaking duties on behalf of the Company that may be assessed as a benefit for tax purposes. Directors' and Officers' insurance cover is also provided for all directors.

Maximum opportunity
See the aggregate limit under 'Fees' above.

Prior commitments
For the duration of this Policy, the Company will honour any commitments made in respect of executive director and non-executive director remuneration and benefits before the date on which either: (i) the Directors' remuneration policy becomes effective; or (ii) an individual becomes a director, even where such commitments are not consistent with the policy set out in this report or prevailing at the time any such commitment is fulfilled. This includes (without limitation) all existing share awards as detailed on page 102 of the 2013 Annual Report under the LTIP SO and ExSOP[2012] that remain outstanding. Any commitments entered into (such as grants of share awards) consistent with a previously approved Directors' remuneration policy that was applicable at the relevant time.

Directors' remuneration policy
continued

Recruitment

Approach to recruitment remuneration

The recruitment policy provides an appropriate framework within which to attract individuals of the required calibre to lead a company of BAE Systems' size, scale and complexity. The Committee determines the remuneration package for any appointment to an executive director position, either from within or outside BAE Systems.

Operation
The Committee will take into consideration all relevant factors, including overall total remuneration, the type of remuneration being offered and the jurisdiction from which the candidate was recruited, and will operate in order to ensure that arrangements are in the best interests of the Company and its shareholders without paying more than is necessary to secure the individual of the required calibre.

The fees and benefits applicable to the appointment of any new non-executive directors will be in accordance with the policy table on page 167.

Opportunity
The Committee seeks to align the remuneration package offered with the policy set out in the executive directors' policy table above recognising that participation under the policy above varies by geography.

- For UK executive director appointments, participation in annual incentive plans will not exceed 225% of annual salary and long-term awards under this Policy will not exceed 550% of annual salary.
- For US executive director appointments, participation in annual incentive plans will not exceed 225% of annual salary and long-term awards under this Policy will not exceed 500% of annual salary.

The Committee may make awards on hiring an external candidate to 'buy-out' existing equity or, in exceptional circumstances, other elements of remuneration forfeited on leaving the previous employer. In doing so, the Committee will take account of relevant factors including any performance conditions attached to these awards, the form in which they were granted (e.g. cash or shares) and the time over which they would have vested. Buy-out awards would be capped to be no higher, on recruitment, than the fair value of those forfeited. Full details will be disclosed in the next Annual remuneration report following recruitment which will include details of the need to grant a buy-out award.

Fixed elements (base salary, retirement and other benefits)
The salary level will be set in accordance with the principles for setting base salary described in the executive directors' policy table above.

The executive director shall be eligible to participate in applicable BAE Systems' employee benefit plans, including coverage under applicable executive and employee pension and benefit programmes in accordance with the terms and conditions of such plans, as may be amended by the Company in its sole discretion from time-to-time.

In the case of promotion of an existing Group employee to an executive directorship on the Board, commitments made before such promotion will continue to be honoured whether or not they are consistent with the remainder of this Policy. In the case of pensions however, any previous arrangement will cease and the individual will be offered provision in line with the agreed policy on page 164.

Annual Incentive Plan
The appointed executive director will be eligible to earn a discretionary annual bonus in accordance with the annual incentive framework as described in the executive directors' policy table above.

The level of opportunity will be consistent with the policy disclosed in the executive directors' policy table in this report and subject to the maximums referred to therein and under 'Opportunity' above.

Long-Term Incentive Plan
The executive director will be eligible for equity awards in such amounts as the Committee may determine in its sole discretion, subject to this Policy and the rules of the Long-Term Incentive Plan.

The level of opportunity will be subject to the maximums referred to under 'Opportunity' above.

Other
For internal and external appointments, the Committee may agree that the Company will meet certain relocation expenses in accordance with the provisions described under the Benefits section of the policy table on page 163.

Service contracts and letters of appointment

Executive directors

Operation
In accordance with long-established policy, all executive directors have rolling service agreements which may be terminated in accordance with the terms of these agreements.

Dates of appointment for executive directors

Name	Date of appointment	Notice period
Charles Woodburn[1]	1 July 2017	12 months either party
Peter Lynas[2]	1 April 2011	12 months either party
Jerry DeMuro[3]	1 February 2014	90 days either party
Brad Greve[4]	1 April 2020	12 months either party
Tom Arseneault[5]	1 April 2020	60 days either party

1. Appointed to the Board as Chief Operating Officer on 9 May 2016; appointed as Chief Executive with effect from 1 July 2017.
2. Retired from the Board and the Company on 31 March 2020 as announced on 8 August 2019.
3. Retired from the Board and as Chief Executive Officer of BAE Systems, Inc. on 31 March 2020 as announced on 17 December 2019. Jerry DeMuro's contract of employment automatically renewed for one-year periods from 31 December each year, unless one party gave at least 90 days' notice of non-renewal.
4. Appointed as Group Finance Director designate with effect from 1 September 2019 and joined the Board on 1 April 2020 as announced on 8 August 2019.
5. President and Chief Operating Officer of BAE Systems, Inc., he joined the Board and became Chief Executive Officer of BAE Systems, Inc. on 1 April 2020 as announced on 17 December 2019. His contract of employment automatically renews for one-year periods from 31 December each year, unless one party gives the other at least 60 days' notice.

Notice period
The Committee's policy is that the service contracts of executive directors will not exceed 12 months. In exceptional circumstances, in relation to newly recruiting an executive director operating in a US environment, the notice period may be extended to a maximum of 24 months and structured such that it reduces to no more than 12 months by no later than the end of the first complete year of service.

Change of control
No executive director has provisions in his service contract that relate to a change of control of the Company.

Chairman

The Chairman's appointment is documented in a letter of appointment and he is required to devote no fewer than two days a week to his duties as Chairman. His appointment as Chairman (which commenced on 1 February 2014) will automatically terminate if he ceases to be a director of the Company. The Chairman's appointment was reviewed by the Nominations Committee prior to the end of his second three-year term and has been extended until the conclusion of the Company's Annual General Meeting in May 2023, unless it is terminated earlier in accordance with the Company's Articles of Association or by the Company or the Chairman giving not less than six months' notice.

Non-executive directors

The non-executive directors do not have service contracts but do have letters of appointment detailing the basis of their appointment. The dates of their original appointment are shown below:

Name	Date of appointment	Expiry of current term
Revathi Advaithi[1]	01.01.2018	25.06.2020
Nick Anderson[2]	01.11.2020	31.10.2023
Dame Elizabeth Corley	01.02.2016	01.02.2022
Jane Griffiths[3]	01.04.2020	31.03.2023
Chris Grigg	01.07.2013	30.06.2022
Stephen Pearce	01.06.2019	31.05.2022
Nicole Piasecki	01.06.2019	31.05.2022
Paula Rosput Reynolds[4]	01.04.2011	31.12.2020
Nick Rose[4]	08.02.2010	31.12.2020
Ian Tyler	08.05.2013	07.05.2022

1. Retired from the Board on 25 June 2020.
2. Appointed to the Board on 1 November 2020.
3. Appointed to the Board on 1 April 2020.
4. Retired from the Board on 31 December 2020.

The Company announced on 11 February 2021 the appointments of Dame Carolyn Fairbairn and Dr Ewan Kirk as non-executive directors, with effect from 1 March 2021 and 1 June 2021, respectively. Their first terms will expire on 29 February 2024 and 31 May 2024, respectively.

The non-executive directors are normally appointed for an initial three-year term that, subject to review, may be extended subsequently for further such terms. Any third term of three years is subject to rigorous review, taking into account the need progressively to refresh the Board. Non-executive directors do not have periods of notice.

In accordance with the UK Corporate Governance Code, all directors are subject to annual election or re-election at the Company's AGM.

Service contracts and letters of appointment continued

Policy on payment for loss of office

Operation
The policy on payment for loss of office provides a clear set of principles that govern the payments that will be made for loss of office, and take account of the need to ensure a smooth transition for leadership roles during times of change. The policy that will apply for a specific executive director's payments for loss of office will be the policy that was in place at the point when the payments for loss of office were agreed for the executive director in question.

Any termination payment made in connection with the departure of an executive director will be subject to approval by the Committee, having regard to the terms of the service contract or other legal obligations and the specific circumstances surrounding the termination, including whether the scenario aligns to an example under the approved leaver criteria, performance, service and health or other circumstances that may be relevant.

In addition to payments described below, the Committee may pay such amounts as are necessary to settle or compromise any claim or by way of damages, where the Committee views it as in the best interests of the Company to do so. In the event of the termination of an executive director's contract, it is the Committee's policy to seek to limit any payment to not more than one year's base salary. Where appropriate the Company may also meet a director's reasonable legal expenses in connection with their termination of their appointment.

Notice and pay in lieu of notice
For executive directors, employment contracts will generally be on terms that allow them to be terminated on up to 12 months' notice from either party or by way of payment of base salary in lieu of notice, at the Company's discretion. Neither notice nor a payment in lieu of notice will be given in the event of gross misconduct.

For US-based executive directors, employment contracts are typically for one-year periods and renew automatically unless one party gives at least 60 days' notice of non-renewal. If the employment is (a) terminated by the Company (other than for cause as defined in the contract) or (b) the executive director resigns for a 'Good Reason' (as defined in the contract), the executive director is entitled to a termination payment equal to (i) one year's base salary and (ii) a bonus payable at target level pro-rated for service for the relevant financial year. They will also be entitled to a continuation of medical benefits for 18 months (or a cash payment in lieu).

In all cases, the Committee seeks to include provisions in directors' employment contracts to allow the Company to pay any notice or severance payments on a phased basis and apply mitigation if the executive director secures alternative employment, to the extent that this is reasonably practicable taking into account local labour law, tax and other relevant considerations.

Other than notice payments, the Company has no obligation to make any termination payments when the Chairman's appointment terminates. Non-executive directors do not have periods of notice and the Company has no obligation to make any termination payments when their appointment terminates, other than to pay fees in accordance with the appointment letters.

Retirement benefits
As governed by the rules of the relevant pension plan. No enhancement for leavers will be made.

Annual Incentive Plan
Where an executive director's employment is terminated after the end of a performance year but before the payment is made, the executive director will remain eligible for an annual incentive award for that performance year subject to an assessment based on performance achieved over the period. No award will be made in the event of gross misconduct.

The Committee may, as set out below, exercise its discretion to allow an annual incentive payment for the year of cessation as part of the termination package for executive directors. Where it does so, the exercise of the discretion and reason why the Committee considered such action appropriate will be disclosed.

Where an executive director leaves during the relevant performance year by reason of death, ill-health, disability, retirement, a transfer of business or redundancy, the Committee may use its discretion to determine that an executive director will remain entitled to receive a bonus (subject to an assessment based on performance over the performance year and pro-rated for time) in respect of the financial year in which the individual ceased employment. In all cases, one-third of the bonus will be subject to compulsory deferral as set out previously, unless the Committee decides otherwise.

The Committee's policy is not to award an annual incentive for any portion of the notice period not served.

The treatment set out above does not apply to the Chief Executive Officer of BAE Systems, Inc. and the applicable treatment is provided in the section on notice and pay in lieu of notice.

Long-Term Incentive Plans
The treatment of outstanding share awards in the event that an executive director leaves is governed by the relevant share plan rules.

Under the Long-Term Incentive Plan, where an executive director leaves the Group by reason of ill-health, injury, disability, retirement with the agreement of the Company, sale of a business or employing company, redundancy or leaving in such circumstances as the Committee determines (each an 'approved leaver'), unvested awards and options generally continue and vest on the normal vesting date (or, in the case of Performance Shares held by US executive directors, the first normal vesting date or, if later, cessation), unless the Committee determines that the awards should vest on cessation. Any performance conditions will be applied at the time of vesting.

On vesting, the number of shares under award will, unless the Committee decides otherwise, be reduced pro-rata to reflect the period in which the executive director was in employment as a proportion of the relevant vesting period (or in the case of Performance Shares held by US executive directors or Performance Shares granted prior to the 2017 AGM, as a proportion of the initial three-year vesting period).

In the event of death, awards generally vest at the time of death subject to the satisfaction of any performance conditions at that time. Awards are then pro-rated as set out above.

Where an executive director's employment is terminated for any other reason, his unvested awards and options will lapse. Options normally remain exercisable for six months after cessation (or vesting, if later) and 12 months after death.

If the Committee exercises its discretion to treat a director as an approved leaver as permissible under the leaver provisions of the share plan rules, the exercise of the discretion and reason why the Committee considered such action appropriate will be disclosed.

Where an executive director's employment is terminated or an executive director is under notice of termination for any reason at the date of award of any Long-Term Incentive awards, no Long-Term Incentive awards will be made.

Consideration of employment conditions elsewhere in the Company

The Committee has responsibility for reviewing remuneration and related policies applicable to the wider workforce. To support this, the Committee is provided with periodic deep dive sessions on a range of wider workforce remuneration topics that are designed to provide the Committee with visibility of remuneration practices in the different sectors/markets in which we operate and for the different populations within the wider workforce across the Company globally. This enables the Committee to take the wider workforce into account when setting the policy for executive remuneration. Whilst the Committee does not consult directly with employees as part of the process for reviewing executive pay, the Committee does receive insights from the broader employee population via an engagement survey. When considering salary increases for the executive directors, the Committee considers the general level of salary increase across the Group and in the external market.

Stakeholder considerations

In line with our commitment to full transparency and engagement with our shareholders on the topic of executive remuneration, the Remuneration Committee Chairman conducts an annual programme of consultation with major shareholders. This typically involves setting out the changes planned for the following year, including seeking shareholder input and views to various executive remuneration matters including the development of, or potential changes to, remuneration policy or arrangements.

Statutory and other information

Company registration

BAE Systems plc is a public company limited by shares registered in England and Wales with the registered number 1470151.

Directors

The current directors who served during the 2020 financial year are listed on pages 106 and 107. 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 Advaithi 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.

Dividend

An interim dividend of 9.4p per share was paid on 30 November 2020. Prior to that, an interim dividend of 13.8p per share was paid on 14 September 2020 being the value of the dividend proposed but subsequently deferred earlier in the year. The directors propose a final dividend of 14.3p per ordinary share. Subject to shareholder approval, the final dividend will be paid on 1 June 2021 to shareholders on the share register on 23 April 2021.

Annual General Meeting (AGM)

The Company's AGM will be held on 6 May 2021. The Notice of Annual General Meeting is enclosed with this Annual Report and details the resolutions to be proposed at the meeting.

Certain information in the Strategic report

The following items are set out in the Strategic report on pages 1 to 99:

- disclosures in relation to the use of financial instruments;
- particulars of important events affecting the Group which have occurred since 31 December 2020;
- an indication of likely future developments in the business of the Group;
- an indication of the activities of the Group in the field of research and development;
- actions taken to introduce, maintain or develop arrangements aimed at employees;
- greenhouse gas emissions;
- employee engagement (including regard to employee interests and encouraging employees to be shareholders); and
- fostering business relationships with suppliers, customers and others.

Office of Fair Trading undertakings

As a consequence of the merger between British Aerospace and the former Marconi Electronic Systems businesses in 1999, the Company gave certain undertakings to the Secretary of State for Trade and Industry (now the Secretary of State for Business, Energy and Industrial Strategy). In February 2007, the Company was released from the majority of these undertakings and the remainder have been superseded and varied by a new set of undertakings. Compliance with the undertakings is monitored by a compliance officer. Further information regarding the undertakings and the contact details of the compliance officer may be obtained through the Company Secretary at the Company's registered office or through the Company's website.

Profit forecast

In its half-year results announcement on 30 July 2020, the Group made the following statement in respect of the year ending 2020, which is regarded as a profit forecast for the purposes of the Financial Conduct Authority's Listing Rule 9.2.18 (and which replaced the profit forecast made in the Group's full-year results announcement on 20 February 2020 and in the Annual Report 2019, such forecast being cancelled by the Company in its announcement on 3 April 2020 due to the COVID-19 pandemic):

"Whilst the Group is subject to geopolitical uncertainties and there remains considerable uncertainty in respect of COVID-19, the following guidance is provided on current expected operational performance under new working practices introduced in recent months. We expect the Group's underlying earnings per share to be a mid-single digit lower than last year's 45.8p, assuming a $1.25 to sterling exchange rate and a tax rate now expected to be 19%, in line with last year. The final rate is dependent on the geographic mix of profits."

In the Group's Trading Update on 11 November 2020, the Group made the following statement:

"Underlying earnings per share are now expected to be slightly higher than previously guided with good operational performance and an expected lower tax rate offsetting the negative foreign exchange impact."

Underlying earnings per share was 46.8p in 2020.

Employees

The Group is committed to giving open, full and fair consideration to applications for employment from disabled people and people with health conditions or impairments who meet the requirements for roles, and making available training opportunities and appropriate accommodation to everyone employed by the Group, because we firmly believe that inclusion of all of our people, enabling them to contribute to the best of their ability, is vital to our business. Our commitment to disability inclusion and accessibility in the workplace can also be recognised through our pledge to support The Valuable 500 campaign.

Political donations

No political donations were made in 2020.

Issued share capital

As at 31 December 2020, BAE Systems' issued share capital of £86,686,002 comprised 3,467,440,044 ordinary shares of 2.5p each and one Special Share of £1.

Treasury shares

As at 1 January 2020, the number of shares held in treasury totalled 261,897,751 (having a total nominal value of £6,547,444 and representing 7.6% of the Company's called up share capital at 31 December 2019). During 2020, the Company used 12,902,202 treasury shares (having a total nominal value of £322,555 and representing 0.4% of the Company's called up share capital at 31 December 2020) to satisfy awards under the Free and Matching elements of the Share Incentive Plan (7,886,468 shares in aggregate), awards under the Free and Matching elements of the International Share Incentive Plan (1,043,439 shares in aggregate), awards vested under the Performance Shares element of the Long-Term Incentive Plan (2,005,460 shares), awards vested under the Restricted Shares element of the Long-Term Incentive Plan (1,416,709 shares), and options exercised under the Executive Share Option Plan (550,126 shares). The treasury shares utilised in respect of the Share Incentive Plan, the International Share Incentive Plan, and the Performance and Restricted Shares elements of the Long-Term Incentive Plan were disposed of by the Company for nil consideration. The 550,126 shares disposed of by the Company in respect of the Executive Share Option Plan were disposed of by the Company for an aggregate consideration of £8,712,009. As at 31 December 2020, the number of shares held in treasury totalled 248,995,549 (having a total nominal value of £6,224,889 and representing 7.2% of

the Company's called up share capital at 31 December 2020).

The rights to treasury shares are restricted in accordance with the Companies Act and, in particular, the voting and dividend rights attaching to these shares are automatically suspended.

Rights and obligations of ordinary shares

On a show of hands at a general meeting every holder of ordinary shares present in person and entitled to vote shall have one vote, and every proxy entitled to vote shall have one vote (unless the proxy is appointed by more than one member in which case the proxy has one vote for and one vote against if the proxy has been instructed by one or more members to vote for the resolution and by one or more members to vote against the resolution; or if the proxy has been instructed by one or more shareholders to vote either for or against a resolution and by one or more of those shareholders to use his discretion how to vote). On a poll, every member present in person or by proxy and entitled to vote shall have one vote for every ordinary share held. Subject to the relevant statutory provisions and the Company's Articles of Association, holders of ordinary shares are entitled to a dividend where declared or paid out of profits available for such purposes. Subject to the relevant statutory provisions and the Company's Articles of Association, on a return of capital on a winding-up, holders of ordinary shares are entitled, after repayment of the £1 Special Share, to participate in such a return. There are no redemption rights in relation to the ordinary shares.

Rights and obligations of the Special Share

The Special Share is held on behalf of the Secretary of State for Business, Energy and Industrial Strategy (the 'Special Shareholder'). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British.

The holder of the Special Share is entitled to attend a general meeting, but the Special Share carries no right to vote or any other rights at any such meeting, other than to speak in relation to any business in respect of the Special Share. Subject to the relevant statutory provisions and the Company's Articles of Association, on a return of capital on a winding-up, the holder of the Special Share shall be entitled to repayment of the £1 capital paid up on the Special Share in priority to any repayment of capital to any other members.

The holder of the Special Share has the right to require the Company to redeem the Special Share at par or convert the Special Share into one ordinary share at any time.

Restrictions on transfer of securities

The restrictions on the transfer of shares in the Company are as follows:

- the Special Share may only be issued to, held by and transferred to the Special Shareholder or his successor or nominee;
- the directors shall not register any allotment or transfer of any shares to a foreign person, or foreign persons acting in concert, who at the time have more than a 15% voting interest in the Company, or who would, following such allotment or transfer, have such an interest;
- the directors shall not register any person as a holder of any shares unless they have received: (i) a declaration stating that upon registration, the share(s) will not be held by foreign persons or that upon registration the share(s) will be held by a foreign person or persons; (ii) such evidence (if any) as the directors may require of the authority of the signatory of the declaration; and (iii) such evidence or information (if any) as to the matters referred to in the declaration as the directors consider appropriate;
- the directors may also refuse to register any instrument of transfer of shares unless the instrument of transfer is in respect of only one class of share and it is lodged at the place where the register of members is kept, accompanied by a relevant certificate or such other evidence as the directors may reasonably require to show the right of the transferor to make the transfer;
- the directors may refuse to register an allotment or transfer of shares in favour of more than four persons jointly;
- where a shareholder has failed to provide the Company with certain information relating to their interest in shares, the directors can, in certain circumstances, refuse to register a transfer of such shares;
- certain restrictions may from time-to-time be imposed by laws and regulations (for example, insider trading laws);
- restrictions may be imposed pursuant to the Listing Rules of the Financial Conduct Authority whereby certain of the Group's employees require the Company's approval to deal in shares; and
- awards of shares made under the Company's Long-Term Incentive Plan 2014, Deferred Bonus Plan, Share Incentive Plan, International Share Incentive Plan, Group All-Employee Free Shares Plan and International Profit Sharing Scheme are subject to restrictions on the transfer of shares prior to vesting and/or release.

The Company is not aware of any arrangements between its shareholders that may result in restrictions on the transfer of shares and/or voting rights.

Significant direct and indirect holders of securities

As at 31 December 2020, the Company had been advised of the following significant direct and indirect interests in the issued ordinary share capital of the Company:

Name of shareholder	Percentage notified
AXA S.A. and its group of companies	5.00%
Barclays PLC	3.98%
BlackRock, Inc.[1]	11.00%
The Capital Group Companies, Inc.	5.02%
Franklin Resources Inc., and affiliates	4.92%
Invesco Limited	4.97%
Silchester International Investors LLP	3.01%

1. The Company was notified on 15 February 2021 that BlackRock, Inc.'s percentage had reduced to 10.97%.

Exercise of rights of shares in employee share schemes

The trustees of the employee trusts do not seek to exercise voting rights on shares held in the employee trusts other than on the direction of the underlying beneficiaries. No voting rights are exercised in relation to shares unallocated to individual beneficiaries.

Restrictions on voting deadlines

The notice of any general meeting shall specify the deadline for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be proposed at the general meeting. The number of proxy votes for, against or withheld in respect of each resolution are publicised on the Company's website after the meeting.

Appointment and replacement of directors

Subject to certain nationality requirements mentioned below, the Company may by ordinary resolution appoint any person to be a director.

The directors also have the power to make appointments to the Board at any time. Any individual so appointed will hold office until the next AGM and shall then be eligible for re-election.

The majority of directors holding office must be British. Otherwise, the directors who are not British shall vacate office in such order that those who have been in office for the shortest period since their appointment shall vacate their office first, unless all of the directors otherwise agree among themselves. Any director who holds the office of either Chairman (in an executive capacity) or Chief Executive shall also be British.

The Company must have not less than six directors holding office at all times. If the number is reduced to below six, then such number of persons shall be appointed as directors as soon as is reasonably practicable to reinstate the number of directors to six. The Company may by ordinary resolution from time-to-time vary the minimum number of directors.

All directors will stand for election or re-election in 2021 as required by the Company's Articles of Association and in compliance with the UK Corporate Governance Code.

Amendment of the Company's Articles of Association

The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders. Where class rights are varied, such amendments must be approved by the members of each class of shares separately.

In addition, certain provisions of the Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British.

Powers of the directors

The directors are responsible for the management of the business of the Company and may exercise all powers of the Company subject to applicable legislation and regulation, and the Articles of Association.

At the 2020 AGM, the directors were given the power to buy back a maximum number of 320,673,347 ordinary shares at a minimum price of 2.5p each. The maximum price was the higher of (i) an amount equal to 105% of the average of the middle market quotations of the Company's ordinary shares as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which such ordinary shares are contracted to be purchased, and (ii) the higher of the price of the last independent trade and the highest current independent bid on the London Stock Exchange as stipulated by Regulatory Technical Standards adopted by the European Commission pursuant to article 5(6) of the Market Abuse Regulation.

This power will expire at the earlier of the conclusion of the 2021 AGM or 30 June 2021. A special resolution will be proposed at the 2021 AGM to renew the Company's authority to acquire its own shares.

At the 2020 AGM, the directors were given the power to issue new shares up to a nominal amount of £26,720,106. This power will expire on the earlier of the conclusion of the 2021 AGM or 30 June 2021. Accordingly, a resolution will be proposed at the 2021 AGM to renew the Company's authority to issue further new shares.

Conflicts of interest

As permitted under the Companies Act 2006, the Company's Articles of Association contain provisions which enable the Board to authorise conflicts or potential conflicts that individual directors may have.

To avoid potential conflicts of interest the Board requires the Nominations Committee to check that any individuals it nominates for appointment to the Board are free of potential conflicts. In addition, the Board's procedures and the induction programme for new directors emphasise a director's personal responsibility for complying with the duties relating to conflicts of interest. The procedure adopted by the Board for the authorisation of conflicts reminds directors of the need to consider their duties as directors and not grant an authorisation unless they believe, in good faith, that this would be likely to promote the success of the Company. As required by law, the potentially conflicted director cannot vote on an authorisation resolution or be counted in the quorum. Any authorisation granted may be terminated at any time and the director is informed of the obligation to inform the Company without delay should there be any material change in the nature of the conflict or potential conflict so authorised.

Directors' indemnities

The Company has entered into deeds of indemnity with all its current directors and those persons who were directors for any part of 2020 which are qualifying indemnity provisions for the purpose of the Companies Act 2006.

The directors of BAE Systems Pension Funds Trustees Limited, BAE Systems 2000 Pension Plan Trustees Limited, BAE Systems Executive Pension Scheme Trustees Limited and Alvis Pension Scheme Trustees Limited benefit from indemnities in the governing documentation of the BAE Systems Pension Scheme, the BAE Systems 2000 Pension Plan, the BAE Systems Executive Pension Scheme and the Alvis Pension Scheme, respectively, which are qualifying indemnity provisions for the purpose of the Companies Act 2006.

All such indemnity provisions are in force as at the date of this Directors' report.

Change of control – significant agreements

The following significant agreements contain provisions entitling the counterparties to exercise termination, alteration or other similar rights in the event of a change of control of the Company:

- The Group entered into a £2bn Revolving Credit Facility dated 12 December 2013 which was amended and restated on 30 April 2018. The facility provides that, in the event of a change of control of the Company, the lenders are entitled to renegotiate terms, or if no agreement is reached on negotiated terms within a certain period, to call for the repayment or cancellation of the facility. The Revolving Credit Facility was undrawn as at 31 December 2020.
- The Company has entered into a Restated and Amended Shareholders Agreement with European Aeronautic Defence and Space Company EADS N.V. (EADS) and Finmeccanica S.p.A. (Finmeccanica) relating to MBDA S.A.S. dated 18 December 2001 (as amended). In the event that control of the Company passes to certain specified third-party acquirors, the agreement allows EADS and Finmeccanica to exercise an option to terminate certain executive management level nomination and voting rights, and certain shareholder information rights of the Company in relation to the MBDA joint venture. Following the exercise of this option, the Company would have the right to require the other shareholders to purchase its interest in MBDA at fair market value.

- The Company and EADS have agreed that if Finmeccanica acquires a controlling interest in the Company, EADS will increase its shareholding in MBDA to 50% by purchasing the appropriate number of shares in MBDA at fair market value.
- The Company, BAE Systems, Inc., BAE Systems (Holdings) Limited and BAE Systems Holdings Inc. entered into a Special Security Agreement dated 23 October 2015 with the US Department of Defense regarding the management of BAE Systems, Inc. in order to comply with the US government's national security requirements. In the event of a change of control of the Company, the Agreement may be terminated or altered by the US Department of Defense.
- In June 2017, BAE Systems Surface Ships Limited entered into a contract with the UK Ministry of Defence (MoD) for the manufacture of the first batch of three Type 26 frigates. Where the MoD considers that a proposed change of control of BAE Systems Surface Ships Limited would be contrary to the defence, national security or national interest of the UK or where the change of control would result in increased costs to the MoD under the contract, then the change of control shall not proceed until agreement with the MoD is established. If there is a change of control without notice or notwithstanding the objection of the MoD on such grounds, then the MoD may terminate the contract with immediate effect.
- The MSDF agreement between BAE Systems Surface Ships Limited and the MoD became effective on 1 October 2014 and establishes a framework for the provision of surface ship support work and services relating to HM Naval Base Portsmouth. Where the MoD considers that a proposed change of control of BAE Systems Surface Ships Limited would be contrary to the defence, national security or national interest of the UK, then the change of control shall not proceed until agreement with the MoD is established. If there is a change of control without notice or notwithstanding the objection of the MoD, the MoD shall be entitled to terminate the MSDF.
- In August 2008, BAE Systems Land Systems (Munitions & Ordnance) Limited (now BAE Systems Global Combat Systems Munitions Limited) and the MoD entered into a 15-year partnering agreement for the provision of ammunition to UK Forces (the Munitions Acquisition Supply Solution (MASS) partnering agreement). Where the MoD considers that a proposed change of control of BAE Systems Global Combat Systems Munitions Limited would be contrary to the defence, national security or national interest of the UK, then the change of control shall not proceed until agreement with the MoD is established. In the event that there is a change of control of BAE Systems Global Combat Systems Munitions Limited, notwithstanding the objection of the MoD on such grounds, the MoD may, having followed the dispute resolution process, terminate the MASS agreement for default.
- In November 2020, BAE Systems Global Combat Systems Munitions Limited and the MoD entered into a 15-year agreement for the provision of ammunition to UK forces (the Next Generation Munitions Solution (NGMS) agreement) from 2023 to 2037. Where the MoD has any concerns regarding a proposed change of control of BAE Systems Global Combat Systems Munitions Limited and such concerns are not resolved, then if the change of control proceeds, the MoD may terminate the contract.
- In November 2012, BAE Systems Marine Limited entered into a contract with the MoD for the design, construction, testing and commissioning of Boat 4 of the Astute Class programme. In November 2015, BAE Systems Marine Limited entered into a contract with the MoD for the design, construction, testing and commissioning of Boat 5 of the Astute Class programme. In March 2016, BAE Systems Marine Limited entered into a contract with the MoD for the design, construction, testing and commissioning of Boat 6 of the Astute Class Programme. In March 2018, BAE Systems Marine Limited entered into a contract with the MoD for the design, construction, testing and commissioning of Boat 7 of the Astute Class Programme. Where the MoD considers that a proposed change of control of BAE Systems Marine Limited would be contrary to the defence, national security or national interest of the UK, then the change of control shall not proceed until agreement is established with the MoD. In the event that there is a change of control of BAE Systems Marine Limited, notwithstanding the objection of the MoD on such grounds, the MoD shall be entitled to terminate the agreements immediately.
- In December 2011, BAE Systems Marine Limited entered into a contract with the MoD for the design of the Dreadnought submarines. Where the MoD considers that a change of control of BAE Systems Marine Limited would be contrary to the defence, national interest or national security of the UK, then the change of control shall not take place until agreement is reached with the MoD on how to proceed. In the event that there is a change of control notwithstanding the objection of the MoD on such grounds, the MoD shall be entitled to terminate the contract with immediate effect.
- In September 2016, BAE Systems Marine Limited entered into a contract with the MoD for the initial phase of manufacturing activities for the Dreadnought Class programme. This contract was extended and amended to include additional manufacturing activities in March 2018. Where the MoD considers that a proposed change of control of BAE Systems Marine Limited would be contrary to the defence, national security or national interest of the UK, then the change of control shall not proceed until agreement is established with the MoD. In the event that there is a change of control of BAE Systems Marine Limited, notwithstanding the objection of the MoD on such grounds, the MoD shall be entitled to terminate the agreements immediately.
- In December 2018, BAE Systems' subsidiary, ASC Shipbuilding Pty Limited, entered into a contract providing the framework for the design and manufacture of Hunter Class Frigates for the Royal Australian Navy (Head Contract). As part of the acquisition of ASC Shipbuilding Pty Limited from the Australian Commonwealth, BAE Systems Australia Limited entered into a Sovereign Capability and Option Deed (SCOD). Under the Head Contract and the SCOD, if there is a change of control of ASC Shipbuilding Pty Limited, BAE Systems Australia Limited or BAE Systems plc, consent is required from the Australian Commonwealth Government prior to any change of control occurring. If there is a change of control without notice or notwithstanding an objection, the Commonwealth may terminate the Head Contract, take any action to mitigate an actual or potential threat to Australia's national security interests, or exercise its call option under the SCOD and regain ownership of ASC Shipbuilding Pty Limited.

In addition, the Company's share plans contain provisions as a result of which options and awards may vest and become exercisable on a change of control of the Company in accordance with the rules of the plans.

Auditor

Deloitte LLP have indicated their willingness to be re-appointed as the Company's auditor and a resolution proposing their re-appointment will be put to the 2021 AGM.

Statement of directors' responsibilities in respect of the Annual Report and the financial statements

The directors are responsible for preparing the Annual Report, and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law, they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law, and have elected to prepare the parent company financial statements in accordance with UK accounting standards, including Financial Reporting Standard (FRS) 101, Reduced Disclosure Framework.

Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company, and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements;
- assess the Group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a strategic report, directors' report, directors' remuneration report and corporate governance statement that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement of disclosure of information to auditor

The directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that he/she ought to have taken to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Responsibility statement of the directors in respect of the Annual Report and financial statements

Each of the directors listed below confirms that to the best of their knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company, and the undertakings included in the consolidation taken as a whole; and
- the Strategic report and Directors' report, taken together, include a fair review of the development and performance of the business, and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

In addition, each of the directors considers that the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Sir Roger Carr	Chairman
Charles Woodburn	Chief Executive
Tom Arseneault	President & Chief Executive Officer of BAE Systems, Inc.
Brad Greve	Group Finance Director
Nick Anderson	Non-executive director
Dame Elizabeth Corley	Non-executive director
Jane Griffiths	Non-executive director
Chris Grigg	Non-executive director
Stephen Pearce	Non-executive director
Nicole Piasecki	Non-executive director
Ian Tyler	Non-executive director

On behalf of the Board

Sir Roger Carr
Chairman
24 February 2021

Directors' report

The Directors' report was approved by the Board of directors on 24 February 2021.

David Parkes
Company Secretary

Independent Auditor's report

to the members of BAE Systems plc only

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of BAE Systems plc (the Parent Company) and its subsidiaries (the Group) give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2020 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 and International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the consolidated income statement;
- the consolidated and Parent Company statement of comprehensive income;
- the consolidated and Parent Company statements of changes in equity;
- the consolidated and Parent Company balance sheets;
- the consolidated cash flow statement; and
- the related notes 1 to 36 and 1 to 12, including the associated accounting policies.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and international accounting standards in conformity with the requirements of the Companies Act 2006 and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 Reduced Disclosure Framework (United Kingdom Generally Accepted Accounting Practice).

2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the FRC's) Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the Group and Parent Company for the year are disclosed in Note 2 to the financial statements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Summary of our audit approach

Key audit matters

The key audit matters that we identified in the current year were:

- revenue and margin recognition on long-term contracts;
- carrying value of goodwill; and
- valuation of post-employment benefit obligations.

Within this report, key audit matters are identified as follows:

Λ Increased level of risk

≈ Similar level of risk

V Decreased level of risk

Materiality

The materiality that we used for the Group financial statements was £72.5m which was determined on the basis of forecast adjusted profit before tax, adjusted for non-recurring items and fair value and foreign exchange adjustments on financial instruments as described further on page 181 below.

Scoping

Twenty-seven components were subject to audit procedures. Of these, six components were subject to a full-scope audit. Of the remaining twenty-one components, nineteen were subject to an audit of specified account balances and two were subject to specified audit procedures.

The components, which were either full or specified balance scope in the current year, contribute 85% of revenue, 85% of profit before tax and 90% of net assets.

Significant changes in our approach

Our audit has been responsive to the impact of COVID-19, for example in relation to the key audit matters as described further below, but otherwise there have been no significant changes to our audit approach in comparison to the prior period.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the Group's and Parent Company's ability to continue to adopt the going concern basis of accounting included the following audit procedures:

- obtained an understanding of relevant controls over management's going concern models, including the review of the inputs and assumptions used in those models;
- tested the accuracy of management's models, including agreement to the most recent board approved budgets and forecasts which included the impact of COVID-19 and Brexit;
- we challenged the key assumptions of these forecasts by:
  - reading analyst reports, industry data and other external information and comparing these with management's estimates;
  - comparing forecast revenue with the Group's order book and historical performance, including the impact of COVID-19 on operations in FY20;
  - evaluating the historical accuracy of forecasts prepared by management;
  - assessing the sensitivity of the headroom and management's forecasts; and
- assessed the sufficiency of the Group's disclosure concerning the going concern basis.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group's and Parent Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In relation to the reporting on how the Group has applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

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

5.1. Revenue and margin recognition on long-term contracts ≈

Refer to page 111 (Audit Committee Report) and Note 1 (accounting policy and financial disclosures)

Revenue:
£19,277m (2019 £18,305m)

Key audit matter description

The estimation of both overall lifetime contract margin and the appropriate level of revenue and profit to recognise in any single accounting period require the exercise of management judgement. Within BAE Systems' contract portfolio there are a number of programmes where the estimates required in reaching these judgements are complex and could lead to a material error within the financial statements if reached incorrectly. Consequently, we consider that revenue and margin recognition represents a significant risk to our audit and a key audit matter.

We focus a greater proportion of audit effort on a number of contracts where we consider there to be the highest degree of management judgement required, and design contract-specific procedures to mitigate the associated risks.

In order to identify the key contracts where there is a significant risk of material misstatement, we undertook a contract risk assessment process at each component, utilising data analytics, the latest contract information, our understanding of the business and review of external information about market and geopolitical conditions which might impact certain contracts, including where relevant consideration of the effect of COVID-19. We held meetings with key finance and contract managers, attended Quarterly Business Reviews and other key management meetings, read and understood underlying contract documentation and reviewed management support for key contract judgements. In addition, we looked for contracts that might have higher levels of judgement associated with the risk of schedule delivery or technical complexity, fixed price contracts which increase the risk of contract losses and other indicators that could increase the risk of a material impact on the financial statements.

As a result of our risk assessment we identified five contracts where we consider there to be the highest degree of management judgement required. These are:

- Astute Class submarines;
- Type 26 frigates;
- Armored Multi-Purpose Vehicles (AMPV);
- Saudi Salam Typhoon (Salam); and
- Saudi British Defence Co-operation Programme (SBDCP).

The AMPV contract has been added as a new significant risk contract in the current year.

We consider the level of risk associated with this key audit matter has remained consistent with the prior year.

How the scope of our audit responded to the key audit matter

Our contract testing approach included:

Testing the relevant controls on significant risk contracts

- We obtained an understanding of and, where deemed appropriate, tested relevant manual and IT controls within management's Lifecycle Management (LCM) Framework and project accounting processes which management have established to ensure that contracts are appropriately forecast, managed, challenged and accounted for.
- As part of this, we observed the controls in operation by attending a sample of project contract status review meetings, Quarterly Business Review meetings and Group-level meetings to validate the various levels of challenge applied to the forecasts.

Challenging management's assumptions and estimates on significant risk contracts

To gain assurance over the contract judgements and estimates made, our work included:

- making inquiries of contract project teams and other personnel to obtain an understanding of the performance of the project throughout the year and at year-end, including where relevant the impact of COVID-19;
- analysing historical contract performance and understanding the reason for in-year movements or changes;
- testing the underlying calculations used in the contract assessments for accuracy and completeness, including the estimated costs to complete the contract alongside associated contingencies, and assumptions made regarding COVID-19. As part of this we considered historical forecasting accuracy of costs, including on similar programmes, and challenged future cost expectations with reference to those data points;
- examining external correspondence to support the timeframe for delivery of the product or service and any judgements made in respect of these;
- examining external evidence to support contract status and estimation of variable consideration (including associated recoverability of contract balances), such as customer correspondence and for certain contracts, meeting with the customer directly;
- enquiring with in-house and external legal counsel regarding contract-related litigation and claims; and
- considering whether there were any indicators of management override of controls or bias in arriving at their reported position.

Key observations

The results of our testing were satisfactory.

Through our testing of significant risk contracts we did not identify any audit adjustments and consider the judgements made by management in recognising revenue and profit to be reasonable. We have concluded overall that the judgements made by management are reasonable.

5.2. Carrying value of goodwill

Refer to page 111 (Audit Committee Report) and Note 8 (accounting policy and financial disclosures)

Goodwill:
£10,846m (2019 £9,984m)

Key audit matter description

The Group holds material goodwill balances relating to UK and overseas acquisitions, the majority of which are in the US. Management performs an impairment review of the carrying value of each Cash-Generating Unit (CGU) on an annual basis in line with the requirements of IAS 36.

The impairment assessment involves management judgement in considering whether the carrying value of the CGU is recoverable. Determining the recoverable amount involves significant estimation including:

- forecasting future cash flows;
- determining the discount rate; and
- determining future growth rates.

In planning our audit, we determined there to be a heightened level of impairment risk in relation to the carrying value of goodwill associated with the Platforms & Services (US) (P&S), Applied Intelligence (AI) and Land Munitions (Munitions) CGUs. These CGUs have goodwill of £3,428m, £206m and £427m respectively. Our assessment over the level of risk at each CGU included consideration of the impact of COVID-19 on each business and its respective forecast.

Through our risk assessment, we determined that the key drivers of future cash flows in each CGU were as follows:

- **P&S:** future demand, long-term contract margin and operating cash flow assumptions, predominantly within the Combat Vehicles business;
- **AI:** ability to achieve the revenue growth and cost reduction forecast following prior and current year restructuring and business disposals; and
- **Munitions:** long-term business growth driven by future demand and financial performance under revised contract terms.

As a result, we have performed additional procedures over the key cash flow assumptions for each of these CGUs.

Specifically, in relation to Munitions, the recoverable amount is now equal to its carrying value and as such we have identified a significant risk in relation to the long-term growth assumptions. In addition, for P&S the headroom between recoverable and carrying amount has reduced since the previous year. As a result, we consider the level of risk associated with this key audit matter to have increased compared to the prior year.

The size of the balance, level of management judgement and audit effort involved in assessing the carrying value of goodwill means we consider this to be a key audit matter.

How the scope of our audit responded to the key audit matter

We have performed a series of specific audit procedures to address the key audit matter identified in relation to these CGUs. This included the following:

- we obtained a detailed understanding of management's process and key controls for performing the CGU impairment assessment. Specific focus was given to understanding management's process and controls over forecasting future cash flows and determination of the key assumptions as detailed above;
- we challenged forecast performance with reference to the recent and historical performance of each CGU, historical forecasting accuracy, external industry benchmarks, the impact to date of COVID-19 and specific forecast events. This included performing sensitivity analysis to evaluate the impact of changing a range of assumptions including suppressed growth, lower margin assumptions and changes in the discount rate;
- we critically assessed the risks and opportunities identified by management in their forecasts and modelled different scenarios to understand the impact of both adverse and positive changes to the future forecasts and the level of associated headroom;
- specifically in relation to Munitions we have challenged the long-term growth rate assumption with reference to market, industry and economic data combined with an evaluation of the underlying key contracts that underpin the future growth assumptions;
- where management's forecasts have assumed significant contract renewals or an extension to existing contracts (i.e. moving from initial to full rate of production) we challenged those judgements with operational management and, where relevant, correspondence with the customer over contract renewal. Our assessment also considered the potential longer-term impact of COVID-19 on defence spending and government budgets;
- operating cash flow and working capital assumptions were challenged with reference to our revenue contract audit work for key programmes, as well as historical trends for each line of business;
- we tested the integrity of management's impairment model used to derive the recoverable amount; and
- we involved Deloitte valuation specialists to support our challenge of the applicable discount rate.

Key observations

We completed our audit of the forecasts of the P&S, AI and Munitions businesses and are satisfied that management's assumptions are reasonable and supportable based on available evidence, both internal and external.

Management has included disclosure in the financial statements indicating that the recoverable value of the Munitions CGU is equal to its carrying amount and the impact on significant CGUs of a reasonably possible change in key assumptions. We concur with management's assessment that no reasonably possible change in a key assumption would lead to a material impairment.

5.3. Valuation of post-employment benefit obligations

Refer to page 111 (Audit Committee Report) and Note 24 (accounting policy and financial disclosures)

Group's share of the net IAS 19 deficit after allocation to equity accounted investments:
£4,485m (2019 £4,455m)

Valuation of post-employment benefit obligation assets before allocation to equity accounted investments:
£29,729m (2019 £27,687m)

Valuation of post-employment benefit obligation liabilities before allocation to equity accounted investments:
£34,574m (2019 £32,466m)

Key audit matter description

The principal post-employment benefit schemes are held in the UK and US and are funded defined benefit schemes, with assets held in separate trustee-administered funds.

We identified the following areas which were the focus of our procedures in auditing the Group's net post-employment benefit obligations as a key audit matter:

Liabilities
The key judgements relating to the post-employment benefit obligations include:

- inflation assumptions, including the basis for determining the inflation risk premium;
- discount rates; and
- mortality assumptions, including consideration of the impact of COVID-19.

Given the significant size of the post-employment benefit obligations at year-end, small changes to these input assumptions can lead to material changes in the net IAS 19 deficit. Assumptions are also made in the determination of the Group's share of assets and liabilities of multi-employer schemes in which it participates and the corresponding amounts attributed to other participating employers.

Assets
Given the size and nature of the scheme assets there is significant audit effort required in ensuring the valuation of assets is supportable.

Certain asset classes are inherently more judgemental to value and have a higher level of associated valuation risk, namely:

- private equity investments;
- pooled investment vehicles without published market prices;
- private placements;
- longevity swaps; and
- property assets.

We consider the level of risk associated with this key audit matter is consistent with the prior year. However, in the current year property assets have been included as a higher risk asset category in response to the impact of COVID-19.

How the scope of our audit responded to the key audit matter

Liabilities
In relation to post-employment benefit obligations we have performed the following procedures:

- we obtained a detailed understanding and performed walkthroughs of management's process, with specific focus on understanding key controls relating to the valuation of the post-employment benefit obligation including maintenance of membership data;
- in conjunction with Deloitte actuarial specialists, we challenged the assumptions used in the IAS 19 valuation, including assessing and challenging the reasonableness of the assumptions against available market data and benchmarking against their peers;
- specific focus was given to challenging the basis on which the Group determined its inflation risk premium in relation to RPI following the government announcement in November 2020, with reference to our own independent modelling and other market data sources;
- we have considered the adjustment made by management to the CMI 2019 mortality tables to normalise for the impact that COVID-19 has had on excess deaths in 2020 versus the base CMI 2019 assumptions, with reference to interim CMI data points and advice the company has received from its actuaries;
- we have assessed the competence, capabilities and objectivity of the third party administrators who maintain membership data on behalf of the Group. This included considering and responding to the matters raised in the report on controls at one of the Group's third party administrators;
- we performed analytical procedures to challenge key changes in membership data since the last triennial valuation, the most recent pension scheme accounts and that used in the IAS 19 valuation;
- we agreed a sample of cash contributions made into the pension funds, including the £1bn accelerated deficit contribution made in April 2020;
- in conjunction with Deloitte actuarial specialists, we evaluated the US insurance buy-out agreement and challenged the assumptions used to value the liability at the point it was transferred to the insurer in order to ensure the accounting treatment adopted by the company and the recognition of the net gain was appropriate; and
- we assessed the competence, capabilities and objectivity of the actuaries engaged by management to perform the valuations of the schemes.

Assets
In relation to asset valuations we have performed the following procedures with increased focus on those assets with a higher valuation risk as noted above:

- we tested the pension asset valuation controls for certain asset classes;
- we performed audit procedures relating to the assets held within the pension schemes through seeking third party confirmation from asset managers and/or custodians or other supporting evidence as appropriate;
- in conjunction with our Deloitte actuarial specialists, we challenged the fair value assumptions used to value the longevity swaps including the updates made to the mortality base tables in the year as well as the future projected mortality rates and discount rate;
- we assessed publicly available information on the assets, comparing to internal benchmarks and reconciling inputs used by management to determine the asset values; and
- in the case of specialist asset classes, such as properties, involved relevant specialists to challenge the third party valuations performed with reference to recent market transactions, rental yields and movements in the MSCI Real Estate index.

Key observations

Overall, we consider the discount rate and other key pension assumptions used by management in calculating the post-employment benefit obligation to be within our independently developed reasonable range.

We consider that the insurance buy-out in the US has been appropriately recorded as a gain in the income statement in the current year and the basis on which that gain has been determined lies within our independently determined reasonable range.

We concluded our testing of the assets and are satisfied they are appropriately valued.

6. Our application of materiality

6.1. Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent Company financial statements
Materiality	£72.5m (2019 £75m)	£44m (2019 £46m)
Basis for determining materiality	4.5% of adjusted profit before tax of £1,618m (2019 4.8% of adjusted profit before tax of £1,575m). This includes adjustment for non-recurring items of £19m and fair value adjustments and foreign exchange movements on financial instruments of £41m, detailed in notes 1 and 5 of the financial statements respectively.	Materiality has been set with reference to the net assets of the Parent Company.
Rationale for the benchmark applied	Adjusted profit before tax was considered to be the most relevant benchmark as it is considered the most stable and comparable profit metric. The adjustments excluded relate to items that are considered one-off in nature or relate to complex financial instrument valuations, which are volatile and not reflective of the underlying performance of the business. We consider the measure suitable having also considered the other relevant benchmark of profit before taxation, where our materiality also equates to 4.5%.	This represents 1% of the Parent Company net assets. In addition, we consider the materiality of the Parent Company in the context of the Group materiality and have capped this at 45% of that of the Group. We consider net assets the key benchmark used by members of the Parent Company in assessing financial performance.
Component materiality	The work performed on components identified in our Group audit scope (excluding the Parent Company) was completed to a component materiality level between £15m and £30.6m (2019 £21m and £34m).	

6.2. Performance materiality

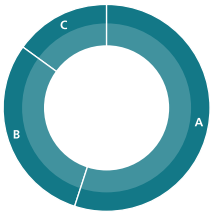
We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	Group financial statements	Parent Company financial statements
Performance materiality	65% (2019 70%)	70% (2019 70%)
Basis and rationale for determining performance materiality	In determining performance materiality for the Group, we considered the following factors: – the quantum and nature of the uncorrected misstatements identified in the prior year audit; – our assessment of the potential for uncorrected misstatements in the current year; – the size and nature of the contract-based significant risks of material misstatement identified; and – the heightened uncertainty of forecasting and maintaining the control environment in a COVID-19 environment in comparison to the prior period.	In determining performance materiality for the Parent Company, we considered the following factors: – the low value of profit impacting misstatements identified in prior periods; and – our risk assessment, including our assessment of the overall control environment. Given the nature of the Parent Company operations, the consistency of audit risks identified in comparison to the prior year and reduced sensitivity to forecasting uncertainty on Parent Company balances in comparison to the Group, we considered a further reduction to performance materiality as a result of COVID-19 was not required for the Parent Company.

6.3. Error reporting threshold

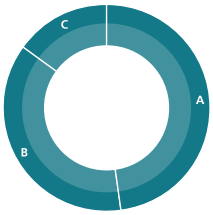
We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £3.625m (2019 £3.75m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

Revenue



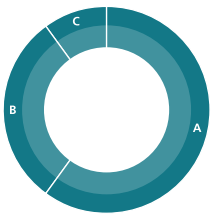
A	Full audit scope	55%
B	Specified audit procedures	30%
C	Review at Group level	15%

Profit before tax



A	Full audit scope	48%
B	Specified audit procedures	37%
C	Review at Group level	15%

Net assets



A	Full audit scope	60%
B	Specified audit procedures	30%
C	Review at Group level	10%

7. An overview of the scope of our audit

7.1. Identification and scoping of components

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the audit risks. This exercise has considered the relative size of each reporting unit's contribution to revenue, profit before tax and adjusted profit before tax, alongside further financial or contractual risks, which we consider to be present.

We have considered units that contribute more than 10% of the Group's revenue or adjusted profit before tax to be 'financially significant', and requiring a full scope audit. In addition, as part of our risk assessment procedures and using our knowledge of the business, we assess where else we consider it appropriate to perform a full scope audit. This resulted in full scope audits for six components located in the UK, Saudi Arabia and the US, and included the Group's largest joint venture, MBDA.

Additionally our audit planning identified twenty-one non-financially significant components, located in the UK, Saudi Arabia, Australia and the US, where we consider there to be a reasonable possibility of material misstatement in specific balances within the financial statements. As a result of our risk assessment procedures and the detailed scoping exercise performed at the planning stage of our audit we determined that it was appropriate to rotate certain non-financially significant components in and out of our Group audit scope in the current year. We have directed component auditors to perform an audit of specified account balances or specified audit procedures on the respective income statements and balance sheets for these components.

For all components designated financially significant or subject to an audit of specified account balances, revenue was determined to be in scope for the audit.

For all other reporting units not included in full-scope, specified account balance scope or specified audit procedure scope, we performed centrally-directed analytical review procedures to confirm our conclusion that there was no significant material misstatement in the residual population.

As each of the business units maintains separate financial records, we have engaged component auditors from the Deloitte member firms in the US, UK, Saudi Arabia and Australia to perform procedures at all the wholly owned components under our direction and supervision. This approach also allows us to engage local auditors who have appropriate knowledge of local regulations to perform the audit work, under a common Deloitte audit approach.

In respect of MBDA, we have engaged with the entity's non-Deloitte auditors to perform a full-scope audit under our direction and supervision.

The twenty-five components within either full or specified account balance scope contribute the proportions of Group totals shown to the left.

7.2. Our consideration of the control environment

The Group operates a range of IT systems which underpin the financial reporting process. These can vary by business and/or by geography. For all of the components that were subject to either a full scope or audit of specified balances, we identified relevant IT systems for the purpose of our audit work. These were typically the principal Enterprise Resource Planning (ERP) systems for each business that govern the general ledger and contract accounting balances, and in some cases also included ancillary/feeder systems into the main ERP.

Our approach was principally designed to inform our risk assessment and, as such, we assessed relevant general IT controls. The Group continues to invest in its IT systems and this includes seeking to remediate control findings where they are identified through its own assurance framework, including Internal Audit, or through the external audit. As part of our controls work in the prior and current year, we identified a number of control deficiencies that management is in the process of remediating as disclosed in the Audit Committee report on page 112. Where deficiencies have been identified and the remediation activity remained ongoing during the current year we did not seek to place reliance on those relevant IT systems for the purpose of our audit.

The majority of the focus of our significant account balance controls assessment is in relation to the Group's contract accounting processes, the Lifecycle Management Framework (LCM). For each component where revenue is in scope, we obtained an understanding of key contract controls, such as with respect to the estimation of contract costs and the amount of contract revenue to recognise in the period. At each business unit we also consider key controls relevant to other income statement and balance sheet items where they are considered relevant to our audit.

We have also considered head office controls relating to central balances and processes such as pension accounting, consolidation and financial reporting, treasury and the Group's planning and budgeting process.

During the course of our audit, we placed reliance on a number of relevant contract accounting controls and certain valuation controls in relation to pension assets.

7.3. Working with other auditors

Our oversight of component auditors focused on the planning of their audit work and understanding of their risk assessment process to identify key areas of estimates and judgement, as well as the execution of their audit work. We issued detailed instructions to the component auditors, reviewed and challenged the related component inter-office reporting and findings from their work, reviewed underlying audit files, attended component audit closing conference calls and held regular remote communication to interact on any related audit and accounting matters which arose. Additionally, all teams were involved in our annual planning workshop, which was overseen and directed by the Group audit team. We mitigated our inability to visit overseas

components due to COVID-19 travel restrictions through increased remote communication and remote review of audit working papers.

The BAE Systems, Inc. business units in the US are subject to a Department of Defense Special Security Arrangement (SSA), which is a government requirement setting out specific protocol that foreign controlled companies must comply with in order to be able to undertake government defence contracts. As part of this there is restriction on the flow of information outside of the US. Therefore, for the US components there are restrictions around access to the audit file and specific workpapers for non-US nationals. As such we have designed alternative procedures, including involvement of an additional independent US national partner, to ensure that appropriate oversight of the US component team is obtained.

In addition to the work performed at a component level, at Group level we have audited the consolidation process and carried out analytical procedures over the residual financial information of the remaining components not subject to audit or audit of specified account balances. At a Group level we also perform audit procedures on centrally held balances including treasury, post-employment benefit obligations, goodwill, tax, head office costs and litigation and claims.

We are satisfied that the level of involvement of the Group audit partner and team in the component audits has been extensive and has enabled us to conclude that sufficient appropriate audit evidence has been obtained in support of our opinion on the Group Financial Statements as a whole.

The Parent Company is located in the United Kingdom and audited directly by the Group audit team.

8. Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

9. Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

10. Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

11.1. Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Group's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- the Group's own assessment of the risks that irregularities may occur either as a result of fraud or error;
- results of our enquiries of management, internal legal counsel, internal audit and the Audit Committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the Group's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations, including obtaining an understanding of the Group's bribery and corruption and whistleblowing policies; and
- the matters discussed among the audit engagement team including significant component audit teams and involving relevant internal specialists, including tax, valuations, pensions and IT specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the level of judgement involved in estimating costs to complete on long-term contracts and the subsequent impact on revenue and margin recognition. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the Group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules, pension legislation and taxation legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Group's ability to operate or to avoid a material penalty, including in respect of export controls, defence contracting and anti-bribery and corruption legislation.

11.2. Audit response to risks identified

As a result of performing the above, we identified revenue and margin recognition on long-term contracts as a key audit matter related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the Audit Committee, in-house legal counsel and where necessary, circularising external legal counsel, concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with relevant regulatory authorities;
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business; and
- as part of assessing relevant controls as outlined above in Section 7, we sought to gain an understanding of the impact COVID-19 and remote working had on the nature and operation of those controls, to inform our risk assessment and conclusions on their effectiveness.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and significant component audit teams, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and the Parent Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

13. Corporate Governance Statement

The Listing Rules require us to review the directors' statement in relation to going concern, longer-term viability and that part of the Corporate Governance Statement relating to the Group's compliance with the provisions of the UK Corporate Governance Code specified for our review.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the Corporate Governance Statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- the directors' statement with regards the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on page 110;
- the directors' explanation as to its assessment of the Group's prospects, the period this assessment covers and why the period is appropriate set out on page 109;
- the directors' statement on fair, balanced and understandable set out on page 114;
- the board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 109;
- the section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on page 109; and
- the section describing the work of the Audit Committee set out on page 111.

14. Matters on which we are required to report by exception

14.1. Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

14.2. Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

15. Other matters which we are required to address

15.1. Auditor tenure

Following the recommendation of the Audit Committee, we were appointed by the members on 10 May 2018 to audit the financial statements for the year ending 31 December 2018 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is three years, covering the years ending 31 December 2018 to 31 December 2020.

15.2. Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

16. Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

John Adam
Senior Statutory Auditor

For and on behalf of
Deloitte LLP Statutory Auditor

London, United Kingdom
24 February 2021

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Group accounting policies

Accounting policies are included within the relevant note to the Group accounts.

Preparation of the consolidated financial statements

Basis of preparation

The consolidated financial statements of BAE Systems plc have been prepared on a going concern basis, as discussed in the Directors' report on page 110, and in accordance with EU-endorsed International Financial Reporting Standards (IFRS) and the Companies Act 2006 applicable to companies reporting under IFRS.

Following the ending of the transition period of the UK leaving the EU, the FRC has confirmed that an equivalent UK Endorsement Board to the European Financial Reporting Advisory Group (EFRAG) will be established, which is expected to be operational later in 2021. For the year ended 31 December 2020, the Group continued to apply EU-endorsed IFRS. From 1 January 2021, the Group will prepare consolidated financial statements in accordance with UK-endorsed IFRS. It is not expected at this stage that the UK-endorsed IFRS will differ significantly from EU-endorsed 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).

Transactions in foreign currencies are translated at the exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the balance sheet date, with the resulting exchange differences recognised in the income statement.

Significant accounting policies

The significant accounting policies applied in the preparation of these consolidated financial statements are set out in the relevant notes. These policies have been applied consistently to all the years presented, unless otherwise stated. The directors believe that the consolidated financial statements reflect appropriate judgements and estimates, and provide a true and fair view of the Group's financial performance and position.

Critical accounting policies

Certain of the Group's significant accounting policies are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the consolidated financial statements. The critical accounting policies are listed below and explained in more detail in the relevant notes to the Group accounts:

Critical accounting policy	Description	Notes
Revenue and profit recognition	The Group accounts for revenue in accordance with IFRS 15 Revenue from Contracts with Customers. For most of the Group's contracts, revenue and associated margin are recognised progressively over time as costs are incurred, and as risks have been mitigated or retired. The ultimate profitability of contracts is based on estimates of revenue and costs, including allowances for technical and other risks including the impacts of COVID-19 and climate change, which are reliant on the knowledge and experience of the Group's project managers, engineers and finance and commercial professionals. Material changes in these estimates could affect the profitability of individual contracts. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events or circumstances.	1
Carrying value of goodwill	Goodwill is not amortised, but is tested annually for impairment and carried at cost less accumulated impairment losses. For the purposes of impairment testing, goodwill is allocated to Cash-Generating Units on a consistent basis. The impairment review calculations require the use of estimates of the future profitability and cash-generating ability of the acquired businesses based on the Group's five-year Integrated Business Plan and the pre-tax discount rate used in discounting these projected cash flows.	8
Deferred tax asset on post-employment benefit obligations	The Group has recognised a deferred tax asset in respect of the deficits in its pension/post-employment schemes. It is management's judgement that the Group will generate sufficient taxable profits to recover the net deferred tax asset recognised. This judgement requires the use of estimates of future taxable profits based on the Group's Integrated Business Plan.	15
Tax provisions	Provision is made for known issues based on management's interpretation of country-specific legislation and management's assessment of the likely outcome of negotiations or litigation. The Group's approach is to consider each uncertain tax position separately. Where management considers it is probable that there will be a future outflow of funds to a tax authority, a provision is recognised. The position is reviewed on an ongoing basis. Provisions are measured using management's best estimate of the most likely amount, being the single most likely amount in a range of possible outcomes. The Group discloses any significant uncertainties in relation to tax matters to the relevant tax authority. The resolution of tax positions taken by the Group can take a considerable period of time to conclude and, in some cases, it is difficult to predict the outcome.	17
Valuation of post-employment benefit obligations	Defined benefit pension scheme accounting valuations are prepared by independent actuaries. The liabilities of the pension schemes are valued based on a number of actuarial assumptions. For each of the actuarial assumptions used there is a range of possible values and management estimates the point within that range that most appropriately reflects the Group's circumstances. Small changes in these assumptions can have a significant impact on the size of the deficit.	24

Sources of estimation uncertainty

The application of the Group's accounting policies requires the use of estimates. The impact of the COVID-19 pandemic on economic activity has been, and is expected to continue to be, significant. While the Group has addressed the impact on its business effectively to date, it continues to conduct ongoing risk assessments and scenario planning in order that it can respond to potential rapid changes in circumstances, given the continuing uncertainty relating to the impact of the pandemic. While this uncertainty continues, the Group will need to consider a range of estimates and assumptions in the application of its accounting policies and management's assessment of the carrying values of assets and liabilities. In the event that these estimates or assumptions prove to be incorrect, there may be an adjustment to the carrying values of assets and liabilities within the next year. Potential areas of the Group's financial statements which could be materially impacted may include, but are not limited to:

- revenue and margin recognition on contracts, which is based on constraints on variable consideration, estimates of future costs and an assessment of technical and other risks. The long-term nature of many of the Group's contracts means that judgements are made in estimating future costs on a contract as well as when risks will be mitigated or retired. The impact of the COVID-19 pandemic has increased uncertainty in relation to these judgements and estimates. The Group continues to work closely and collaboratively with its key customers to continue to deliver effectively on its contracts and commitments. However, the volume, scale, complexity and long-term nature of its programmes mean that a range of calculated potential sensitivities would be wide-ranging and not practicable to calculate. Owing to the ongoing uncertainty regarding the future impact of the COVID-19 pandemic, the Group's estimates and assumptions relating to revenue could be impacted by issues such as reduced productivity as a result of altered working practices to comply with safety and social distancing requirements, production delays and increased costs as a result of disruption to the supply chain or where there is uncertainty as to the recovery from customers of programme costs incurred. As shown in note 1, the Group has recognised £0.3bn of revenue in respect of performance obligations satisfied or partially satisfied in previous periods (2019 £0.3bn). This continues to provide an approximation of the potential revenue sensitivity arising as a result of management's estimates and assumptions for variable consideration, future costs, and technical and other risks, although given its inherent uncertainty, it may not reflect the full potential impact of the pandemic;
- the valuation of post-employment benefit obligations and related deferred tax balances, if estimates relating to actuarial assumptions (including discount rate, inflation rate, and mortality assumptions) are no longer valid or change significantly as the impact of the pandemic develops. Discount and inflation rates could change significantly as a result of a prolonged economic downturn, monetary policy decisions and interventions or other macro-economic issues resulting from the pandemic. The impact of estimates made with regard to mortality projections may also change significantly, given the uncertainty in this area resulting from the pandemic. Note 24 provides information on the key assumptions and analysis of their sensitivities. Pension asset values could also be impacted by the economic uncertainty, for example if there is a longer-term impact on the valuation of assets for which there is no observable market value; and
- the provisional values attributed to assets and liabilities acquired through business combinations during the year, including intangible assets and goodwill arising, if estimates relating to the expected performance of those businesses are no longer valid or change significantly. This may arise if the performance of the acquired businesses was materially adverse to the acquisition business case assumptions, or if there are longer-term changes in customer demand as a result of potential reductions in defence budgets. These may impact upon estimated future cash flows for value-in-use assessments and therefore potentially lead to the impairment of acquired assets, including intangible assets and goodwill arising. The two US acquisitions which completed in the year form part of the Electronic Systems Cash-Generating Unit (CGU), and note 8 provides information for the CGU on the sensitivity of goodwill impairment to changes in assumptions.

Judgements made in applying accounting policies

In the course of preparing the financial statements and when applying its accounting policies, the Group has been required to make judgements with regard to the actions required to enable the business to continue to meet customers' requirements, in an operating environment still dominated by uncertainties arising from the COVID-19 pandemic. No judgements have been made in the process of applying the Group's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

Separate from accounting policy judgements, assessments have been made by each business sector to consider how to effectively manage and ensure continued delivery of their commitments to customers amid the ongoing impact of the pandemic. These judgements are based on considerations such as, but not limited to: local operational restrictions and the ability of sites and facilities to ensure safe and socially distanced working practices; customer instructions, requirements and guidance on progression of essential programmes; potential disruption to elements of the Group's supply chain; and possible changes in customer demand in commercial lines of business. While the Group's actions and decisions during 2020 have effectively addressed many of these issues, the ongoing nature of the pandemic and its continuing future uncertainty mean that these remain under constant review and adaptation where necessary.

It should be noted that these assessments are part of a broader range of scenario planning undertaken by the business in the face of the COVID-19 pandemic, rather than as a formal forecasting process. The pandemic continues to be an inherently uncertain event with future developments which cannot be predicted with certainty, and the Group will therefore continue to monitor its impact on the business, undertake risk assessments, and amend these judgements as required.

Preparation of the consolidated financial statements
continued

Changes in accounting policies

The following standards, interpretations and amendments to existing standards became effective on 1 January 2020 and have not had a material impact on the Group:

- Amendments to References to the Conceptual Framework in IFRS Standards, effective 1 January 2020;
- Amendments to IAS 1 and IAS 8: Definition of Material, effective from 1 January 2020;
- Amendments to IFRS 9, IAS 39 and IFRS 7: Interest Rate Benchmark Reform (Phase 1), effective from 1 January 2020; and
- Amendments to IFRS 3: Definition of a Business, effective from 1 January 2020.

The following amendments to existing standards have been issued and became effective in the year as a response to the COVID-19 pandemic, but did not have a material impact on the Group:

- Amendment to IFRS 16 Leases: Covid-19-Related Rent Concessions, effective from 1 June 2020 and endorsed by the EU on 9 October 2020.

The following other standards, interpretations and amendments to existing standards have been issued but were not mandatory for accounting periods beginning on 1 January 2020:

- Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16: Interest Rate Benchmark Reform (Phase 2), effective from 1 January 2021 (endorsed by the UK); and
- Amendments to IFRS 4 Insurance Contracts: deferral of IFRS 9, effective from 1 January 2021 (endorsed by the UK).

The Amendments were adopted in the EU by Commission Regulation (EU) 2020/2097 of 15 December 2020. However, the Regulation does not come into force until 20 days after publication in the Official Journal, which was after the end of the Transition Period. Consequently, it was necessary for the Amendments to be adopted in the UK. They were therefore adopted by the Secretary of State on 5 January 2021.

The following other standards, interpretations and amendments to existing standards have been issued but were not mandatory for accounting periods beginning on 1 January 2020. These are expected to be endorsed by the new UK Endorsement Board after it becomes operational later in 2021, and are not expected to have a material impact on the Group:

- IFRS 17 Insurance Contracts, effective from 1 January 2023 (not yet endorsed by the UK);
- Amendments to IAS 1: Presentation of Financial Statements, effective from 1 January 2023 (not yet endorsed by the UK);
- Amendments to IFRS 3: Business Combinations, effective from 1 January 2022 (not yet endorsed by the UK);
- Amendments to IAS 16: Property, Plant and Equipment, effective from 1 January 2022 (not yet endorsed by the UK);
- Amendments to IAS 37: Provisions, Contingent Liabilities and Contingent Assets, effective from 1 January 2022 (not yet endorsed by the UK); and
- Annual Improvements to IFRS Standards 2018-2020 Cycle, effective from 1 January 2022 (not yet endorsed by the UK).

Consolidation

The financial statements of the Group consolidate the results of the Company and its subsidiary entities, and include its share of its joint ventures' results accounted for under the equity method.

A subsidiary is an entity controlled by the Group. The Group controls a subsidiary when it is exposed, or has the rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary. The results of subsidiaries are included in the income statement from the date of acquisition.

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Joint ventures are accounted for under the equity method where the Consolidated income statement includes the Group's share of their profits and losses, and the Consolidated balance sheet includes its share of their net assets within equity accounted investments.

The assets and liabilities of overseas subsidiaries and equity accounted investments are translated at the exchange rates ruling at the balance sheet date. The income statements of such entities are translated at average rates of exchange during the year. All resulting exchange differences are recognised directly in a separate component of equity. Translation differences that arose before the transition date to IFRS (1 January 2004) are presented in equity, but not as a separate component. When a foreign operation is sold, the cumulative exchange differences recognised in equity since 1 January 2004 are recognised in the income statement as part of the profit or loss on sale.

Consolidated income statement for the year ended 31 December

	Notes	2020 £m	2020 Total £m	2019 £m	2019 Total £m
Continuing operations					
Revenue	1		**19,277**		18,305
Operating costs	2		**(17,686)**		(16,724)
Other income	4		**270**		150
Share of results of equity accounted investments	1		**69**		168
Operating profit	1		**1,930**		1,899
Financial income		**17**		27	
Financial expense		**(351)**		(300)	
Net finance costs	5		**(334)**		(273)
Profit before taxation			**1,596**		1,626
Taxation expense	6		**(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	7				
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

	Notes	2020 Other reserves[1] £m	2020 Retained earnings £m	2020 Total £m	2019 Other reserves[1] £m	2019 Retained earnings £m	2019 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	6	**–**	**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	19	**(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	6	**(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

1. An analysis of other reserves is provided in note 26.

Consolidated statement of changes in equity for the year ended 31 December

	Notes	Attributable to equity holders of BAE Systems plc						
		Issued share capital £m	Share premium £m	Other reserves[1] £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
Profit for the year		–	–	–	1,299	1,299	72	1,371
Total other comprehensive income for the year		–	–	(176)	(1,086)	(1,262)	(14)	(1,276)
Total comprehensive income for the year		–	–	(176)	213	37	58	95
Share-based payments (inclusive of tax)	31	–	–	–	73	73	–	73
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)		–	–	(35)	–	(35)	–	(35)
Ordinary share dividends	26	–	–	–	(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
Profit for the year		–	–	–	1,476	1,476	56	1,532
Total other comprehensive income for the year		–	–	(320)	(536)	(856)	(6)	(862)
Total comprehensive income for the year		–	–	(320)	940	620	50	670
Share-based payments (inclusive of tax)	31	–	–	–	75	75	–	75
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)		–	–	(5)	–	(5)	–	(5)
Ordinary share dividends	26	–	–	–	(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

1. An analysis of other reserves is provided in note 26.

Consolidated balance sheet as at 31 December

	Notes	2020 £m	2019 £m
Non-current assets			
Intangible assets	8	**11,745**	10,371
Property, plant and equipment	9	**2,655**	2,437
Right-of-use assets	10	**1,053**	1,138
Investment property	11	**128**	137
Equity accounted investments	12	**409**	428
Other investments		**–**	13
Other receivables	13	**506**	484
Post-employment benefit surpluses	24	**408**	302
Other financial assets	14	**248**	350
Deferred tax assets	15	**972**	726
		18,124	16,386
Current assets			
Inventories	16	**858**	835
Trade, other and contract receivables	13	**5,491**	5,458
Current tax	17	**6**	19
Other financial assets	14	**189**	210
Cash and cash equivalents	18	**2,768**	2,587
Assets held for sale	19	**94**	135
		9,406	9,244
Total assets	20	**27,530**	25,630
Non-current liabilities			
Loans	21	**(4,957)**	(3,020)
Lease liabilities	10	**(1,020)**	(1,116)
Contract liabilities	22	**(524)**	(527)
Other payables	23	**(1,164)**	(954)
Post-employment benefit obligations	24	**(4,893)**	(4,757)
Other financial liabilities	14	**(282)**	(227)
Provisions	25	**(386)**	(385)
		(13,226)	(10,986)
Current liabilities			
Loans and overdrafts	21	**(467)**	(377)
Lease liabilities	10	**(236)**	(238)
Contract liabilities	22	**(3,238)**	(3,536)
Trade and other payables	23	**(4,898)**	(4,390)
Other financial liabilities	14	**(181)**	(232)
Current tax	17	**(72)**	(55)
Provisions	25	**(291)**	(300)
Liabilities held for sale	19	**–**	(5)
		(9,383)	(9,133)
Total liabilities		**(22,609)**	(20,119)
Net assets		**4,921**	5,511
Capital and reserves			
Issued share capital	26	**87**	87
Share premium		**1,249**	1,249
Other reserves	26	**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	6	**225**	94
Research and development expenditure credits	4	**(28)**	(12)
Share of results of equity accounted investments	1	**(69)**	(168)
Net finance costs	5	**334**	273
Depreciation, amortisation, impairment and derecognition	2	**675**	660
Gain on investment revaluation	4	**(6)**	–
Profit on disposal of property, plant and equipment, and investment property	2,4	**(25)**	(9)
Profit on sale and leaseback	4	**(21)**	–
Loss/(gain) in respect of held for sale assets and business disposals	2,4	**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	12	**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	12	**(2)**	(6)
Purchase of subsidiary undertakings, net of cash and cash equivalents acquired	34	**(1,706)**	(12)
Cash flow in respect of held for sale assets and business disposals, net of cash and cash equivalents disposed	19	**5**	55
Net cash flow from investing activities		**(2,037)**	(232)
Interest paid		**(227)**	(233)
Equity dividends paid	26	**(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	28	**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 Group accounts

1. Segmental analysis and revenue recognition

Revenue and profit recognition

Revenue represents income derived from contracts for the provision of goods and services, over time or at a point in time, by the Group to customers in exchange for consideration in the ordinary course of the Group's activities.

Performance obligations

Upon approval by the parties to a contract, the contract is assessed to identify each promise to transfer either a distinct good or service or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Goods and services are distinct and accounted for as separate performance obligations in the contract if the customer can benefit from them either on their own or together with other resources that are readily available to the customer and they are separately identifiable in the contract.

The Group provides warranties to its customers to give them assurance that its products and services will function in line with agreed-upon specifications. Warranties are not provided separately and, therefore, do not represent separate performance obligations. A provision for warranties is recognised when the underlying products and services are sold (see note 25 for further detail).

Transaction price

At the start of the contract, the total transaction price is estimated as the amount of consideration to which the Group expects to be entitled in exchange for transferring the promised goods and services to the customer, excluding sales taxes. Variable consideration, such as variable price mechanisms, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Group's products and services, which are designed and/or manufactured under contract to the customer's individual specifications, there are typically no observable stand-alone selling prices. Instead, stand-alone selling prices are typically estimated based on expected costs plus contract margin consistent with the Group's pricing principles.

Whilst payment terms vary from contract to contract, on many of the Group's contracts, an element of the transaction price is received in advance of delivery. The Group therefore has significant contract liabilities (note 22). The Group's contracts are not considered to include significant financing components on the basis that there is no difference between the consideration and the cash selling price. UK Ministry of Defence contracting rules prohibit the inclusion of financing in the sales price. Negotiations on competitive international export contracts do not make allowance for the cash payment profile.

Revenue and profit recognition

Revenue is recognised as performance obligations are satisfied as control of the goods and services is transferred to the customer.

For each performance obligation within a contract, the Group determines whether it is satisfied over time or at a point in time. Performance obligations are satisfied over time if one of the following criteria is satisfied:

- the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs;
- the Group's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date.

The Group has determined that most of its contracts satisfy the over time criteria, either because the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs (typically services or support contracts, for example in the case of ongoing maintenance and support of aircraft and flying capability), or the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date (typically development or production contracts, such as in the production of ships or aircraft to customers' unique specifications).

For each performance obligation to be recognised over time, the Group recognises revenue using an input method, based on costs incurred in the period. Revenue and attributable margin are calculated by reference to reliable estimates of transaction price and total expected costs, after making suitable allowances for technical and other risks including the impact of COVID-19 and climate change. Revenue and associated margin are therefore recognised progressively as costs are incurred, and as risks have been mitigated or retired. The Group has determined that this method appropriately depicts the Group's performance in transferring control of the goods and services to the customer.

If the over time criteria for revenue recognition are not met, revenue is recognised at the point in time that control is transferred to the customer, which is usually when legal title passes to the customer and the business has the right to payment, for example, on delivery.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

1. Segmental analysis and revenue recognition continued

Software licences

The Group sells software licences either separately or together with other goods and services, including computer hardware and implementation, hosting and support. Revenue recognition in respect of software licences sold as part of a bundle of goods and services is considered separately when the licence is determined to be a separate performance obligation. Software licences either represent a right to access the Group's intellectual property as it exists throughout the licence period or a right to use the Group's intellectual property as it exists at the point in time at which the licence is granted. Revenue in respect of right to access licences is recognised over the licence term or, in relation to perpetual licences, over the related customer relationship and revenue in respect of right to use licences is recognised upfront on delivery to the customer. A software licence is considered to be a right to access the Group's intellectual property as it exists throughout the licence period if all of the following criteria are satisfied:

- the contract requires, or the customer reasonably expects, that the Group will undertake activities that significantly affect the intellectual property; and
- the licence directly exposes the customer to the effects of those activities; and
- those activities do not result in the transfer of a good or service to the customer.

Contract modifications

The Group's contracts are often amended for changes in customers' requirements and specifications. A contract modification exists when the parties to the contract approve a modification that either changes existing or creates new enforceable rights and obligations. The effect of a contract modification on the transaction price and the Group's measure of progress towards the satisfaction of the performance obligation to which it relates is recognised in one of the following ways:

1. prospectively, as an additional, separate contract;
2. prospectively, as a termination of the existing contract and creation of a new contract; or
3. as part of the original contract using a cumulative catch-up.

The majority of the Group's contract modifications are treated under either 1 (for example, the requirement for additional distinct goods or services) or 3 (for example, a change in the specification of the distinct goods or services for a partially completed contract), although the facts and circumstances of any contract modification are considered individually as the types of modifications will vary contract-by-contract and may result in different accounting outcomes.

Costs to obtain a contract

The Group expenses pre-contract bidding costs which are incurred regardless of whether a contract is awarded. The Group does not typically incur costs to obtain contracts that it would not have incurred had the contracts not been awarded, such as sales commission.

Costs to fulfil a contract

Contract fulfilment costs in respect of over time contracts are expensed as incurred. Contract fulfilment costs in respect of point in time contracts are accounted for under IAS 2 Inventories.

Reporting segments

The Group has the following six reporting segments:

- **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;
- **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;
- **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;
- **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;
- **Maritime** comprises the Group's UK-based maritime and land activities; and
- **HQ** comprises the Group's head office and UK-based shared services activities, together with a 49% interest in Air Astana.

The Board (the chief operating decision maker as defined by IFRS 8 Operating Segments) monitors the results of these reporting segments to assess performance and make decisions about the allocation of resources. Segmental performance is evaluated based on Key Performance Indicators – sales (see page 196) and underlying EBITA (see page 197). Finance costs and taxation expense are managed on a Group basis.

Notes to the Group accounts
continued

1. Segmental analysis and revenue recognition continued

Alternative performance measure – Sales

Definition: Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments.

Purpose: Allows management to monitor the sales performance of subsidiaries and equity accounted investments.

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

	Intra-group revenue		Revenue from external customers	
	2020 £m	2019 £m	**2020 £m**	2019 £m
Electronic Systems	**95**	89	**4,462**	4,350
Cyber & Intelligence	**81**	102	**1,731**	1,630
Platforms & Services (US)	**32**	43	**3,367**	3,142
Air	**13**	12	**6,580**	6,141
Maritime	**89**	62	**3,106**	3,009
HQ	**9**	10	**31**	33
	319	318	**19,277**	18,305

Sales and revenue by customer location

	Sales		Revenue	
	2020 £m	2019 £m	**2020 £m**	2019 £m
UK	**3,965**	3,850	**3,751**	3,681
Rest of Europe	**2,017**	2,095	**1,235**	1,156
US	**9,315**	8,642	**9,309**	8,635
Canada	**114**	129	**114**	129
Saudi Arabia	**2,716**	2,693	**2,631**	2,593
Qatar	**1,104**	698	**913**	581
Rest of Middle East	**335**	482	**309**	410
Australia	**665**	667	**664**	667
Rest of Asia and Pacific	**578**	564	**332**	424
Africa, and Central and South America	**53**	289	**19**	29
	20,862	20,109	**19,277**	18,305

1. Segmental analysis and revenue recognition continued

Revenue from external customers by domain

	2020					2019				
	Air £m	**Maritime £m**	**Land £m**	**Cyber £m**	**Total £m**	Air £m	Maritime £m	Land £m	Cyber £m	Total £m
Electronic Systems	**3,884**	**105**	**473**	**–**	**4,462**	3,502	109	739	–	4,350
Cyber & Intelligence	**240**	**414**	**77**	**1,000**	**1,731**	219	412	93	906	1,630
Platforms & Services (US)	**43**	**1,180**	**2,144**	**–**	**3,367**	42	1,196	1,904	–	3,142
Air	**6,007**	**396**	**177**	**–**	**6,580**	5,557	413	171	–	6,141
Maritime	**–**	**2,879**	**227**	**–**	**3,106**	–	2,774	235	–	3,009
HQ	**31**	**–**	**–**	**–**	**31**	33	–	–	–	33
	10,205	**4,974**	**3,098**	**1,000**	**19,277**	9,353	4,904	3,142	906	18,305

Revenue by major customer

Revenue from the Group's three principal customers, which individually represent over 10% of total revenue, is as follows:

	2020 £m	2019 £m
US Department of Defense	**6,899**	6,547
UK Ministry of Defence	**4,030**	3,868
Kingdom of Saudi Arabia Ministry of Defence and Aviation	**2,559**	2,541

Revenue from the UK Ministry of Defence and the US Department of Defense was generated by the five principal reporting segments. Revenue from the Kingdom of Saudi Arabia Ministry of Defence and Aviation was generated by the Air and Maritime reporting segments.

Alternative performance measure – Underlying EBITA

Definition: Operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBITA), and non-recurring items.

Purpose: Provides a measure of operating profitability that is comparable over time.

Amortisation and impairment of intangible assets are excluded because they are not related to the in-year operational performance of the business, being driven by the timing and amount of investment in acquired businesses and software.

Finance costs and taxation expense of equity accounted investments are excluded for consistency with pre-interest, pre-tax business performance.

Non-recurring items are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying business performance. The Group's definition of non-recurring items includes profit or loss on business transactions, and costs incurred which are one-off in nature, for example non-routine costs or income relating to post-employment benefit schemes, and other exceptional items which management has determined as not being relevant to an understanding of the Group's underlying business performance.

2020

The non-recurring credit of £19m in 2020 comprises a settlement gain on the US pension annuity buy-out of £64m, partly offset by acquisition-related costs of £20m, a £13m impairment charge relating to Platforms & Services (US)'s legacy Commercial Shipbuilding business which the business exited in 2018, a Guaranteed Minimum Pension equalisation charge of £7m, and a loss on business disposals of £5m.

2019

The non-recurring charge of £27m comprised a £36m charge relating to the derecognition of Enterprise Resource Planning software intangible assets in the Air sector, charges of £13m relating to legal disputes arising from historical disposals, a gain of £14m on the sale of the Group's 55% shareholding in BAE Systems Global Combat Systems Limited upon formation of the Rheinmetall BAE Systems Land joint venture, and a gain of £8m relating to the disposal of Aircraft Accessories and Components Company.

1. Segmental analysis and revenue recognition continued

Operating profit/(loss) by reporting segment

	Underlying EBITA		Non-recurring items		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

Share of results of equity accounted investments within reporting segments

	Underlying EBITA		Non-recurring items		Amortisation of intangible assets		Financial and taxation expense		Share of results of equity accounted investments	
	2020 £m	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
Electronic Systems	**2**	5	**–**	–	**–**	–	**–**	–	**2**	5
Platforms & Services (US)	**16**	21	**–**	–	**(1)**	(1)	**(13)**	(4)	**2**	16
Air	**157**	188	**–**	–	**(8)**	(7)	**(48)**	(50)	**101**	131
Maritime	**10**	8	**–**	–	**–**	–	**(3)**	(4)	**7**	4
HQ	**(27)**	30	**–**	–	**–**	–	**(16)**	(18)	**(43)**	12
	158	252	**–**	–	**(9)**	(8)	**(80)**	(76)	**69**	168

Alternative performance measure – Order backlog

Definition: 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.

Purpose: Supports future years' sales performance of subsidiaries and equity accounted investments.

Performance obligations

The Group's order book[1], reconciled to order backlog as defined by the Group, is shown below.

	2020 £bn	2019 £bn
Order backlog as defined by the Group	**45.2**	45.4
Deduct Unfunded order backlog	**(2.2)**	(2.2)
Deduct Share of order backlog of equity accounted investments	**(10.9)**	(9.2)
Add Order backlog in respect of orders from equity accounted investments	**4.2**	3.2
Order book[1]	**36.3**	37.2

1. Order book represents the transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.

The Group expects that approximately 44% (2019 40%) of the order book will be recognised as revenue during the next year, with the remainder largely recognised over the following four (2019 four) years.

For each performance obligation to be recognised over time, the Group recognises revenue using an input method, based on costs incurred in the period. Revenue and attributable margin are calculated by reference to reliable estimates of transaction price and total expected costs, after making suitable allowances for technical and other risks. Revenue and associated margin are therefore recognised progressively as costs are incurred, and as risks have been mitigated or retired. The Group has determined that this method appropriately depicts the Group's performance in transferring control of the goods and services to the customer. Accordingly, revenue of £0.3bn (2019 £0.3bn) was recognised during the year in respect of performance obligations satisfied or partially satisfied in previous periods.

2. Operating costs

Research and development

The Group undertakes research and development activities either on its own behalf or on behalf of customers.

Group-funded expenditure on research, and on development activities not meeting the conditions for capitalisation, is written off as incurred and charged to the income statement.

Customer-funded expenditure on research and development activities is recognised in the income statement in accordance with the Group's revenue recognition policy.

	2020 £m	2019 £m
Raw materials, subcontracts and other bought-in items used	**6,689**	6,448
Change in inventories of finished goods and work-in-progress	**88**	(20)
Staff costs (note 3)	**6,687**	6,417
Guaranteed Minimum Pension equalisation charge	**7**	–
Depreciation	**543**	511
Amortisation	**128**	101
Impairment – property, plant and equipment (note 9), and right-of-use assets (note 10)	**–**	6
Impairment – intangible assets (note 8)	**4**	6
Impairment – inventory write down	**13**	–
Acquisition-related costs	**20**	–
Derecognition of intangible assets (note 8)	**–**	36
Loss on disposal of property, plant and equipment, and investment property	**–**	1
Loss in respect of held for sale assets and business disposals	**5**	13
Other operating charges	**3,502**	3,205
Operating costs	**17,686**	16,724

Operating costs includes research and development expenditure of £228m (2019 £224m) funded by the Group. Development investment of £8m (2019 £13m) was capitalised during the year (see note 8).

Fees payable to the Company's auditor and its associates included in operating costs

	2020			2019		
	UK £'000	**Overseas £'000**	**Total £'000**	UK £'000	Overseas £'000	Total £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**2,555**	**–**	**2,555**	2,032	–	2,032
Fees payable to the Company's auditor and its associates for other services to the Group:						
The audit of the Company's subsidiaries	**3,393**	**5,772**	**9,165**	3,082	4,624	7,706
Total audit fees	**5,948**	**5,772**	**11,720**	5,114	4,624	9,738
Audit-related assurance services[1]	**1,137**	**716**	**1,853**	655	422	1,077
Other non-audit services	**25**	**7**	**32**	–	–	–
Total non-audit fees	**1,162**	**723**	**1,885**	655	422	1,077
Total fees payable to the Company's auditor and its associates	**7,110**	**6,495**	**13,605**	5,769	5,046	10,815

1. Audit-related assurance services principally comprises fees in respect of the review of the Group's Half-yearly Report, the audit of BAE Systems pension schemes and comfort letter procedures performed related to the bonds issued to fund the £1bn pension deficit contribution advancement (note 24) and the US acquisitions (note 34).

3. Employees

The weekly average and year-end numbers of employees, excluding those in equity accounted investments, were as follows:

	Weekly average		At year end	
	2020 Number '000	2019 Number '000	**2020 Number '000**	2019 Number '000
Electronic Systems	**16**	16	**16**	16
Cyber & Intelligence	**10**	10	**10**	10
Platforms & Services (US)	**12**	12	**12**	12
Air	**24**	23	**24**	23
Maritime	**16**	16	**17**	16
HQ	**2**	2	**2**	2
	80	79	**81**	79

The aggregate staff costs of Group employees, excluding employees of equity accounted investments, were as follows:

	2020 £m	2019 £m
Wages and salaries[1]	**5,727**	5,505
Social security costs	**426**	402
Share-based payments (note 31)	**74**	74
Pension costs – defined contribution plans (note 24)	**242**	226
Pension costs – defined benefit plans (note 24)	**206**	192
Other post-employment benefit costs (note 24)	**12**	18
	6,687	6,417

1. After excluding the impact of exchange translation, wages and salaries increased by approximately 3% per employee in 2020.

4. Other income

Leases

Lease income under operating leases is recognised in the income statement on a straight-line basis over the lease term.

	2020 £m	2019 £m
Research and development expenditure credits	**28**	12
Operating lease income from investment property (note 10)	**30**	28
Operating lease income from subleasing right-of-use assets (note 10)	**–**	1
Profit on disposal of businesses	**–**	22
Profit on disposal of property, plant and equipment	**12**	–
Profit on disposal of investment property	**13**	10
Gain on sale and leaseback	**21**	–
Gain on revaluation of other investments	**6**	–
Management recharges to equity accounted investments (note 32)	**19**	19
Royalties	**20**	11
Settlement gain on transfer of US pension liabilities (note 24)	**64**	–
Other[1]	**57**	47
Other income	**270**	150

1. Includes £15m (2019 £15m) for capital spend recovery in respect of Saudi Arabia Industrial Participation investments and a £9m (2019 £7m) recovery of site development costs for the Dreadnought programme in Barrow.

5. Net finance costs

Interest income and borrowing costs

Interest income and borrowing costs are recognised in the income statement in the period in which they are incurred.

	2020 £m	2019 £m
Interest income on cash and other financial instruments	**16**	26
Interest income on finance lease receivables (note 10)	**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 (note 10)	**(44)**	(48)
Net present value adjustments on provisions and other payables	**(8)**	(28)
Net interest expense on post-employment benefit obligations (note 24)	**(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.

6. Taxation expense

Income tax expense comprises current and deferred tax. Current and deferred tax is recognised in profit or loss except to the extent that it relates to a business combination or items recognised directly in equity or other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences:

- on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- related to investments in subsidiaries and equity accounted investments to the extent that it is probable that they will not reverse in the foreseeable future; and
- arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Taxation expense

	2020 £m	2019 £m
Current taxation		
UK:		
Current year	**(115)**	(91)
Adjustments in respect of prior years	**–**	(89)
	(115)	(180)
Overseas:		
Current year	**(171)**	(208)
Adjustments in respect of prior years	**53**	297
	(118)	89
Total current taxation	**(233)**	(91)
Deferred taxation		
UK:		
Origination and reversal of temporary differences	**(1)**	3
Adjustments in respect of prior years	**1**	(3)
Tax rate adjustment	**4**	(1)
	4	(1)
Overseas:		
Origination and reversal of temporary differences	**(2)**	11
Adjustments in respect of prior years	**(10)**	(13)
Tax rate adjustment	**16**	–
	4	(2)
Total deferred taxation	**8**	(3)
Taxation expense	**(225)**	(94)
UK	**(111)**	(181)
Overseas	**(114)**	87
Taxation expense	**(225)**	(94)

6. Taxation expense continued

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	**–**	(161)
Adjusted taxation expense (including equity accounted investments)	**(273)**	(308)
Underlying effective tax rate	**17%**	19%

The one-off tax benefit in 2019 related to two items. Firstly, following agreements reached in respect of overseas tax matters, a benefit was recognised. Secondly, 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.

6. Taxation expense continued

Tax recognised in other comprehensive income

	2020			2019		
	Before tax £m	Tax benefit/ (expense) £m	Net of tax £m	Before tax £m	Tax benefit/ (expense) £m	Net of tax £m
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on post-employment benefit schemes	**(1,361)**	**256**	**(1,105)**	(556)	76	(480)
Tax rate adjustment	**–**	**74**	**74**	–	(19)	(19)
Equity accounted investments	**(71)**	**16**	**(55)**	(52)	14	(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	**(35)**	**–**	**(35)**	(8)	–	(8)
Fair value gain arising on hedging instruments during the period	**46**	**(9)**	**37**	11	(2)	9
Cumulative fair value loss/(gain) on hedging instruments reclassified to the income statement	**42**	**(7)**	**35**	(7)	2	(5)
Equity accounted investments	**(2)**	**(1)**	**(3)**	12	(6)	6
	(1,605)	**329**	**(1,276)**	(927)	65	(862)

	2020			2019		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings £m	Total £m
Current tax						
Subsidiaries:						
Remeasurements on post-employment benefit schemes	**–**	**83**	**83**	–	28	28
	–	**83**	**83**	–	28	28
Deferred tax						
Subsidiaries:						
Remeasurements on post-employment benefit schemes	**–**	**173**	**173**	–	48	48
Tax rate adjustment	**–**	**74**	**74**	–	(19)	(19)
Fair value gain arising on hedging instruments during the period	**(9)**	**–**	**(9)**	(2)	–	(2)
Cumulative fair value loss/(gain) on hedging instruments reclassified to the income statement	**(7)**	**–**	**(7)**	2	–	2
Equity accounted investments	**(1)**	**16**	**15**	(6)	14	8
	(17)	**263**	**246**	(6)	43	37
Tax on other comprehensive income	**(17)**	**346**	**329**	(6)	71	65

7. Earnings per share

Alternative performance measure – Underlying earnings per share

Definition: Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives and non-recurring items.

Purpose: Provides a measure of underlying performance that is comparable over time.

Amortisation and impairment of intangible assets are excluded because they are not related to the in-year operational performance of the business, being driven by the timing and quantum of investment in acquired businesses and software.

Non-cash finance movements on pensions are excluded because they are driven by external factors, such as corporate bond yields and inflation.

Non-cash finance movements on financial derivatives are excluded because they are driven by external factors, such as foreign exchange rates and interest rates.

Non-recurring items (as defined in note 1) are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying performance.

	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 6.

8. Intangible assets

Intangible assets are carried at cost or valuation, less accumulated amortisation and impairment losses.

Cost or valuation

Goodwill

Under the acquisition method for business combinations, goodwill is the acquisition-date fair value of the consideration transferred, less the net of the acquisition-date fair values of the identifiable assets acquired and liabilities assumed. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of joint ventures and associates is included in the carrying value of equity accounted investments. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Software

Software includes:

- **Computer software licences acquired** for use within the Group are capitalised as an intangible asset on the basis of the costs incurred to acquire and bring to use the specific software; and
- **Software development costs** that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Group-funded expenditure associated with enhancing or maintaining computer software programs for sale is recognised as an expense as incurred.

Development costs

Development costs funded by the Group on activities applied to a plan or design for the production of new or substantially improved products are capitalised as an internally-generated intangible asset if certain conditions are met. The costs capitalised include materials, direct labour and related overheads.

Programme and customer-related

Intangible assets recognised by the Group include those relating to ongoing programmes within businesses acquired, mainly in respect of customer relationships and order backlog. These assets are initially recognised at their fair value at the acquisition date.

Other

Other intangible assets includes patents, trademarks and licences.

Amortisation

Goodwill is not amortised. Amortisation on intangible assets, excluding goodwill, is charged to the income statement on a straight-line basis over their estimated useful lives.

For programme-related intangibles, amortisation is set on a programme-by-programme basis over the life of the individual programme. Amortisation for customer-related intangibles is also set on an individual basis.

The estimated useful lives are as follows:

Software	up to 5 years
Development costs	up to 10 years
Programme and customer-related	up to 15 years
Other	up to 20 years

The Group has no indefinite-life intangible assets other than goodwill.

Impairment of intangible assets, property, plant and equipment, right-of-use assets, investment property and equity accounted investments

The carrying amounts of the Group's intangible assets (excluding goodwill), property, plant and equipment, right-of-use assets, investment property and equity accounted investments are reviewed at each balance sheet date to determine whether there is any indication of impairment as required by IAS 36 Impairment of Assets. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangible assets that are not yet available for use, impairment testing is performed annually.

An impairment loss is recognised whenever the carrying amount of an asset or its Cash-Generating Unit (CGU) exceeds its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an appropriate pre-tax discount rate. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs.

Impairment losses are recognised in the income statement.

An impairment loss in respect of goodwill is not reversed. An impairment loss in respect of other intangible assets, property, plant and equipment, investment property and equity accounted investments is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised or if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

8. Intangible assets continued

	Goodwill £m	Software £m	Development costs £m	Programme and customer-related £m	Other £m	Total £m
Cost or valuation						
At 1 January 2019	15,078	775	105	236	93	16,287
Additions:						
Acquired separately	–	67	–	–	9	76
Internally developed	–	18	13	–	–	31
Business acquisitions (note 34)	30	–	–	1	3	34
Derecognition	–	(36)	–	–	–	(36)
Disposals[1]	–	(79)	(7)	(1)	(65)	(152)
Reclassification as held for sale	(48)	(8)	–	(60)	–	(116)
Net transfer from property, plant and equipment	–	19	–	–	–	19
Foreign exchange adjustments	(320)	(13)	(5)	(9)	(2)	(349)
At 31 December 2019	14,740	743	106	167	38	15,794
Additions:						
Acquired separately	–	62	–	–	–	62
Internally developed	–	22	8	–	–	30
Business acquisitions (note 34)	1,062	–	–	500	66	1,628
Disposals[1]	–	(6)	–	(109)	–	(115)
Transfer from property, plant and equipment	–	16	–	–	–	16
Foreign exchange adjustments	(247)	–	(3)	(16)	(5)	(271)
At 31 December 2020	**15,555**	**837**	**111**	**542**	**99**	**17,144**
Amortisation and impairment						
At 1 January 2019	4,839	400	73	227	90	5,629
Amortisation[2]	–	87	10	5	5	107
Impairment charge	–	6	–	–	–	6
Disposals[1]	–	(78)	(7)	(1)	(65)	(151)
Reclassification as held for sale	–	(8)	–	(60)	–	(68)
Transfer from property, plant and equipment	–	9	–	–	–	9
Foreign exchange adjustments	(83)	(12)	(4)	(8)	(2)	(109)
At 31 December 2019	4,756	404	72	163	28	5,423
Amortisation[2]	–	86	5	36	6	133
Impairment charge	–	4	–	–	–	4
Disposals[1]	–	(6)	–	(109)	–	(115)
Foreign exchange adjustments	(47)	(1)	(2)	4	–	(46)
At 31 December 2020	**4,709**	**487**	**75**	**94**	**34**	**5,399**
Net book value						
At 31 December 2020	**10,846**	**350**	**36**	**448**	**65**	**11,745**
At 31 December 2019	9,984	339	34	4	10	10,371
At 1 January 2019	10,239	375	32	9	3	10,658

1. Includes intangible assets with nil net book value no longer used by the Group.
2. Amortisation of £133m (2019 £107m) includes £128m (2019 £101m) charged to the income statement as an amortisation expense and £5m (2019 £6m) recoverable on customer contracts.

8. Intangible assets continued

Impairment testing

The recoverable amount of the Group's goodwill is based on value in use estimated using risk-adjusted future cash flow projections from the five-year Integrated Business Plan (IBP) and a terminal value based on the projections for the final year of that plan, with growth rate assumptions of 2% applied for each significant Cash-Generating Unit (CGU). The IBP process includes the use of historical experience, available government spending data and the Group's order backlog, as well as the impact of evolving issues such as COVID-19, climate change and Brexit. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital of 6.13% (2019 6.62%) (adjusted for risks specific to the market in which the CGU operates), have been used in discounting these projected risk-adjusted cash flows. The Airborne Tactical Radios and Military GPS businesses acquired during the year have been included in the Electronic Systems CGU.

Significant CGUs

Goodwill allocated to CGUs which are largely dependent on US government spending on defence, aerospace and security represents £8.8bn (2019 £8.0bn) of the Group's total goodwill balance. The Group monitors changes in defence budgets on an ongoing basis.

		Allocated goodwill		Pre-tax discount rate	
Cash-Generating Unit	Key assumptions	**2020 £bn**	2019 £bn	**2020 %**	2019 %
Electronic Systems	Continued demand from the US government for electronic warfare systems (where the business has a leadership position), other technology-based solutions and growth in the commercial avionics market	**4.8**	3.9	**9**	8
Intelligence & Security (within Cyber & Intelligence)	Continued demand in the US for the Group's services in the areas of homeland security, law enforcement and counter-intelligence	**0.7**	0.7	**9**	8
Platforms & Services (US)	Continued demand in the Group's principal markets for existing and successor military tracked vehicles, naval guns, missile launchers, artillery systems, munitions, upgrade programmes and support, and in the US for complex infrastructure, maritime and aviation services	**3.3**	3.4	**9**	8

The headroom, calculated as the difference between net assets including allocated goodwill as at 31 December 2020 and the value in use calculations, for the CGUs listed above, is shown below. The table also shows the headroom assuming a 1% reduction in the terminal value growth rate assumption, a 1% increase in the discount rate and a 1% reduction in the operating margin used in the value in use calculations.

	Headroom as at 31 December		Headroom assuming a 1% reduction in the terminal value growth rate assumption		Headroom assuming a 1% increase in the discount rate		Headroom assuming a 1% reduction in operating margin	
Cash-Generating Unit	**2020 £bn**	2019 £bn	**2020 £bn**	2019 £bn	**2020 £bn**	2019 £bn	**2020 £bn**	2019 £bn
Electronic Systems	**4.7**	5.7	**3.2**	4.1	**2.9**	3.8	**4.0**	4.9
Intelligence & Security	**0.7**	0.9	**0.5**	0.7	**0.4**	0.6	**0.5**	0.7
Platforms & Services (US)	**1.2**	2.2	**0.5**	1.3	**0.3**	1.1	**0.7**	1.6

Other CGUs

The remaining goodwill balance of £2.0bn (2019 £2.0bn) is allocated across multiple CGUs, including £0.4bn allocated to the Land Munitions CGU. No individual CGU exceeds 10% of the Group's total goodwill balance. The majority of the projected cash flows within these CGUs are underpinned by expected levels of primarily UK government spending on defence, aerospace and security, and the Group's ability to capture a broadly consistent market share. In the case of the Land Munitions CGU, its future cash flows are underpinned by the Next Generation Munitions Solution contract secured in 2020. At 31 December 2020, the carrying value of this CGU is broadly equal to its recoverable amount and therefore sensitive to movements in the key assumptions.

Capital commitments

At 31 December 2020, capital expenditure of £20m (2019 £16m) in respect of intangible assets was contracted for but not provided for in the accounts.

9. Property, plant and equipment

Cost

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. The cost of demonstration assets is written off as incurred. The reimbursement of the cost of an item of property, plant and equipment by way of a government grant is presented as deferred income and recognised in the income statement on a basis consistent with the depreciation of the asset over its estimated useful life.

Assets held for leasing out under operating leases are included in property, plant and equipment at cost less accumulated depreciation and impairment losses.

Depreciation

Depreciation is provided, normally on a straight-line basis, to write off the cost of items of property, plant and equipment over their estimated useful lives to any estimated residual value, using the following rates:

Buildings	up to 50 years, or the lease term if shorter
Plant and machinery:	
Computing equipment and motor vehicles	4 to 5 years
Other equipment	10 to 20 years, or the project life if shorter

No depreciation is provided on freehold land and assets in the course of construction.

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment

The carrying amounts of the Group's property, plant and equipment are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

9. Property, plant and equipment continued

	Land and buildings £m	Plant and machinery £m	Total £m
Cost			
At 1 January 2019	2,315	3,398	5,713
Additions[1]	199	238	437
Reclassification as held for sale	(37)	(25)	(62)
Transfer to intangible assets	–	(19)	(19)
Reclassification between categories	(14)	23	9
Disposals	(21)	(108)	(129)
Foreign exchange adjustments	(48)	(72)	(120)
At 31 December 2019	2,394	3,435	5,829
Additions[1]	268	279	547
Business acquisitions (note 34)	–	28	28
Transfer to intangible assets	(9)	(7)	(16)
Reclassification between categories	30	(30)	–
Disposals	(131)	(50)	(181)
Foreign exchange adjustments	(21)	(45)	(66)
At 31 December 2020	**2,531**	**3,610**	**6,141**
Depreciation and impairment			
At 1 January 2019	1,145	2,203	3,348
Depreciation charge for the year	87	199	286
Impairment charge for the year	2	1	3
Reclassification as held for sale	(21)	(22)	(43)
Transfer from intangible assets	–	(9)	(9)
Reclassification between categories	(13)	22	9
Disposals	(19)	(105)	(124)
Foreign exchange adjustments	(28)	(50)	(78)
At 31 December 2019	1,153	2,239	3,392
Depreciation charge for the year	88	213	301
Reversal of impairment charge	(2)	–	(2)
Reclassification between categories	2	(2)	–
Disposals	(116)	(48)	(164)
Foreign exchange adjustments	(12)	(29)	(41)
At 31 December 2020	**1,113**	**2,373**	**3,486**
Net book value			
At 31 December 2020	**1,418**	**1,237**	**2,655**
At 31 December 2019	1,241	1,196	2,437
At 1 January 2019	1,170	1,195	2,365

1. Includes £170m (2019 £93m) of land and buildings at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

9. Property, plant and equipment continued

Net impairment

	2020 £m	2019 £m
Electronic Systems	**(2)**	2
Platforms & Services (US)	**–**	1
	(2)	3

2020

The impairment charge raised in Electronic Systems in 2019 was written back in 2020 due to the sale of the property in Austin, Texas.

2019

The impairment charge in Electronic Systems related to building structural issues in Austin, Texas.

Assets in the course of construction

	Land and buildings[1] £m	Plant and machinery £m	Total £m
At 31 December 2020	**470**	**260**	**730**
At 31 December 2019	313	214	527

1. Includes £350m (2019 £210m) at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

Capital commitments

At 31 December 2020, capital expenditure of £134m (2019 £205m) in respect of property, plant and equipment was contracted for but not provided for in the accounts.

10. Leases

The Group as lessee

All leases in which the Group is lessee (except as noted below) are recognised as a right-of-use asset and a corresponding lease liability at the date at which the leased asset is available for use by the Group. Each lease payment is allocated between repayment of the lease liability and finance cost. The finance cost is charged to the income statement over the lease term to produce a constant periodic rate of interest on the lease liability. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

The lease liability is initially measured as the present value of future lease payments, discounted using the interest rate implicit in the lease. Where this rate is not determinable, the Group's incremental borrowing rate is used, which is the interest rate the Group would have to pay to borrow the amount necessary to obtain an asset of similar value, in a similar economic environment with similar terms and conditions.

The right-of-use asset is initially measured at cost, comprising the initial value of the lease liability, any lease payments made (net of any incentives received from the lessor) before the commencement of the lease, any initial direct costs and any restoration costs.

The carrying amounts of the Group's right-of-use assets are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

Payments in respect of short-term leases, low-value leases and leases of intangible assets are charged to the income statement on a straight-line basis over the lease term.

The Group as lessor

Leases in which the Group is lessor are classified as finance leases or operating leases. If the lease transfers substantially all of the risks and rewards of ownership to the lessee, the lease is classified as a finance lease. All other leases are classified as operating leases.

A sublease where the Group is an intermediate lessor is classified as a finance lease when it transfers substantially all of the risks and rewards of the right-of-use asset arising from the head lease.

Lease income under operating leases is recognised in the income statement on a straight-line basis over the lease term.

Amounts due from lessees under finance leases are recognised as a receivable discounted at the interest rate implicit in the lease. Finance lease income is recognised in the income statement over the lease term to produce a constant periodic rate of interest on the receivable.

The Group leases land, buildings, vehicles and equipment under non-cancellable lease arrangements. The leases have varying terms, including escalation clauses, renewal rights and purchase options. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

10. Leases continued

Right-of-use assets

	31 December 2020			31 December 2019		
	Land and buildings £m	**Plant and machinery £m**	**Total £m**	Land and buildings £m	Plant and machinery £m	Total £m
Additions during the year	**142**	**11**	**153**	129	9	138
Business acquisitions (note 34)	**12**	**–**	**12**	–	–	–
Depreciation expense for the year	**222**	**10**	**232**	207	10	217
Impairment charge for the year	**–**	**2**	**2**	3	–	3
Net book value	**1,037**	**16**	**1,053**	1,120	18	1,138

Lease liabilities

A maturity analysis of the future undiscounted lease payments in respect of the Group's lease liabilities is presented in the table below:

	2020 £m	2019 £m
Payments due:		
Within one year	**270**	297
Between one and five years	**633**	710
Later than five years	**551**	566
Total undiscounted gross payments	**1,454**	1,573
Deduct Impact of discounting	**(198)**	(219)
Lease liabilities	**1,256**	1,354

The Group is also committed to future undiscounted lease payments of £95m in respect of leases which had not yet commenced at 31 December 2020 (2019 £84m).

The total cash outflow for leases in the year ended 31 December 2020, including short-term leases and low-value leases, amounted to £304m (2019 £317m).

Amounts recognised in the income statement

	2020 £m	2019 £m
Included in operating costs:		
Depreciation on right-of-use assets	**(232)**	(217)
Impairment of right-of-use assets	**(2)**	(3)
Short-term lease expense	**(23)**	(30)
Low-value lease expense	**(3)**	(5)
	(260)	(255)
Included in other income:		
Operating lease income from investment property	**30**	28
Operating lease income from subleasing right-of-use assets	**–**	1
	30	29
Included in net finance costs:		
Interest income on finance lease receivables	**1**	1
Interest expense on lease liabilities	**(44)**	(48)
	(43)	(47)

10. Leases continued

Operating leases

The Group is party to operating leases in which it is the lessor, primarily relating to investment property. Under the terms of the lease agreements, no contingent rents are receivable. The leases have varying terms including escalation clauses and renewal rights. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

A maturity analysis of the future undiscounted lease receipts from operating leases in which the Group is lessor is presented in the table below:

	2020 £m	2019 £m
Receipts due:		
Within one year	**30**	28
Between one and two years	**29**	25
Between two and three years	**27**	24
Between three and four years	**26**	23
Between four and five years	**–**	22
Later than five years	**4**	3
	116	125

Finance lease receivables

A sublease is classified as a finance lease when it transfers substantially all of the risks and rewards of the right-of-use asset arising from the head lease.

A maturity analysis of the future undiscounted lease receipts from finance leases in which the Group is lessor is presented in the table below:

	2020 £m	2019 £m
Receipts due:		
Within one year	**11**	11
Between one and two years	**10**	11
Between two and three years	**11**	11
Between three and four years	**9**	10
Between four and five years	**5**	10
Later than five years	**11**	15
Total undiscounted gross receipts	**57**	68
Deduct: Impact of discounting	**(4)**	(5)
Finance lease receivables (note 13)	**53**	63

11. Investment property

Cost

Land and buildings that are leased to non-Group entities are classified as investment property. The Group measures investment property at its cost less accumulated depreciation and impairment losses.

Depreciation

Depreciation is provided, on a straight-line basis, to write off the cost of investment property over its estimated useful life of up to 50 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment

The carrying amounts of the Group's investment property are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

	£m
Cost	
At 1 January 2019	160
Cost recognised on transition to IFRS 16	45
Additions	15
Disposals	(11)
At 31 December 2019	209
Additions	8
Disposals	(17)
At 31 December 2020	**200**
Depreciation and impairment	
At 1 January 2019	62
Impairment recognised on transition to IFRS 16	2
Depreciation charge for the year	8
At 31 December 2019	72
Depreciation charge for the year	10
Disposals	(10)
At 31 December 2020	**72**
Net book value	
At 31 December 2020	**128**
At 31 December 2019	137
At 1 January 2019	98

Fair value	
At 31 December 2020	**322**
At 31 December 2019	222

The fair values above are based on and reflect current market values as prepared by in-house professionals who have the appropriate professional qualifications and recent experience of valuing properties in the location and of the type being valued.

Capital commitments

At 31 December 2020, capital expenditure of £34m (2019 £45m) in respect of investment property was contracted for but not provided for in the accounts.

12. Equity accounted investments

Equity accounted investments comprises joint ventures and associates. A joint venture is a joint arrangement whereby the parties that have joint control have rights to the net assets of the arrangement. An associate is an entity over which the Group has significant influence.

The Group recognises its share of the profit or loss and other comprehensive income of equity accounted investments as a separate line in the Consolidated income statement and Consolidated statement of comprehensive income, respectively.

The carrying value of an equity accounted investment comprises the Group's share of net assets and purchased goodwill, and is assessed for impairment as a single asset. The carrying amounts of the Group's equity accounted investments are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

Principal equity accounted investments

Joint venture	Principal activities	Shareholding	Principally operates in
Eurofighter Jagdflugzeug	Management and control of the European Typhoon programme	33%	Germany
MBDA	Development and manufacture of guided weapons	37.5%	Europe

The following tables summarise the financial information of the Group's principal equity accounted investments included in their own financial statements, as adjusted for fair value adjustments at acquisition and differences in accounting policies, and reconcile this to the Group's interest in those equity accounted investments.

	2020		2019	
	Eurofighter Jagdflugzeug £m	**MBDA £m**	Eurofighter Jagdflugzeug £m	MBDA £m
Revenue (100%)	**2,715**	**3,193**	2,558	3,246
Underlying EBITA[1] excluding depreciation	**12**	**479**	28	454
Depreciation and amortisation	**–**	**(114)**	–	(101)
Financial income	**1**	**7**	1	64
Financial expense	**–**	**(18)**	–	(72)
Taxation expense	**(4)**	**(106)**	(4)	(110)
Profit for the year (100%)	**9**	**248**	25	235
Remeasurements on post-employment benefit schemes, net of tax	**–**	**(148)**	–	(103)
Amounts credited to hedging reserve, net of tax	**–**	**4**	–	36
Foreign exchange adjustments	**–**	**(6)**	–	8
Total comprehensive income for the year (100%)	**9**	**98**	25	176
Group's share of total comprehensive income for the year	**3**	**37**	8	66
Non-current assets	**16**	**2,440**	14	2,297
Cash and cash equivalents	**9**	**2,552**	24	2,343
Current assets excluding cash and cash equivalents	**1,143**	**4,410**	823	4,102
Current assets	**1,152**	**6,962**	847	6,445
Non-current financial liabilities excluding trade and other payables, and provisions	**–**	**(3)**	–	(5)
Other non-current liabilities	**(68)**	**(866)**	(65)	(805)
Non-current liabilities	**(68)**	**(869)**	(65)	(810)
Current financial liabilities excluding trade and other payables, and provisions	**–**	**–**	–	(20)
Other current liabilities	**(1,065)**	**(7,964)**	(753)	(7,446)
Current liabilities	**(1,065)**	**(7,964)**	(753)	(7,466)
Net assets (100%)	**35**	**569**	43	466

1. Operating profit excluding amortisation and impairment of intangible assets (EBITA), and non-recurring items.

12. Equity accounted investments continued

	2020			2019		
	Eurofighter Jagdflugzeug £m	**MBDA £m**	**Total £m**	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Group's share of net assets	**12**	**213**	**225**	14	175	189
Goodwill adjustment	**–**	**6**	**6**	–	5	5
Carrying value	**12**	**219**	**231**	14	180	194

	2020			2019		
	Eurofighter Jagdflugzeug £m	**MBDA £m**	**Total £m**	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Dividends received	**6**	**–**	**6**	3	73	76

Group summary

The Group also has a number of individually immaterial joint ventures and associates, the carrying values of the most significant of which at 31 December 2020 are as follows: Rheinmetall BAE Systems Land (RBSL) (£78m), FADEC International (£43m), FNSS (£24m) and Panavia Aircraft (£17m). The following table shows a reconciliation of opening to closing carrying value for both the Group's principal and immaterial joint ventures in aggregate.

	Principal equity accounted investments £m	Other £m	Total £m
At 1 January 2019	207	211	418
Group's share of profit for the year	96	72	168
Group's share of remeasurements on post-employment benefit schemes	(52)	–	(52)
Tax on items that will not be reclassified to the income statement	14	–	14
Foreign exchange adjustments	3	–	3
Amounts credited to hedging reserve	16	15	31
Tax on items that may be reclassified to the income statement	(3)	(3)	(6)
Group's share of total comprehensive income for the year	74	84	158
Equity accounted investment reclassified as held for sale (note 19)	–	(66)	(66)
Fair value of 45% investment retained in RBSL (note 19)	–	76	76
Equity accounted investment funding	–	6	6
Dividends received from equity accounted investments	(76)	(66)	(142)
Foreign exchange adjustments	(11)	(11)	(22)
At 31 December 2019	194	234	428
Group's share of profit for the year	95	(26)	69
Group's share of remeasurements on post-employment benefit schemes	(71)	–	(71)
Tax on items that will not be reclassified to the income statement	16	–	16
Foreign exchange adjustments	(2)	–	(2)
Amounts credited/(charged) to hedging reserve	2	(6)	(4)
Tax on items that may be reclassified to the income statement	–	(1)	(1)
Group's share of total comprehensive income for the year	40	(33)	7
Equity accounted investment reclassified as held for sale (note 19)	–	(5)	(5)
Equity accounted investment funding	–	2	2
Dividends received from equity accounted investments	(6)	(21)	(27)
Foreign exchange adjustments	3	1	4
At 31 December 2020	**231**	**178**	**409**

Contingent liabilities

The Group is not aware of any material contingent liabilities in respect of its equity accounted investments.

13. Trade, other and contract receivables

Trade receivables are measured at amortised cost under IFRS 9 Financial Instruments as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest on the principal amount outstanding.

Contract receivables represent amounts for which the Group has an unconditional right to consideration in respect of unbilled revenue recognised at the balance sheet date and comprise costs incurred plus attributable margin.

Trade receivables, contract receivables, amounts owed by equity accounted investments and finance lease receivables include a provision for expected credit losses. The Group measures the provision at an amount equal to lifetime expected credit losses, estimated by reference to past experience and relevant forward-looking factors.

The Group writes off a receivable when there is objective evidence that the debtor is in significant financial difficulty and there is no realistic prospect of recovery, for example, when a debtor enters bankruptcy or financial reorganisation.

US deferred compensation plan assets are measured at fair value in accordance with IAS 19 Employee Benefits.

	2020 £m	2019 £m
Non-current		
Contract receivables	**27**	38
Prepayments	**68**	61
Accrued income	**1**	1
US deferred compensation plan assets	**344**	322
Finance lease receivables (note 10)	**43**	53
Other receivables	**23**	9
	506	484
Current		
Contract receivables	**2,579**	2,649
Trade receivables	**1,611**	1,405
Amounts owed by equity accounted investments (note 32)	**69**	53
Prepayments	**646**	855
Accrued income	**89**	82
Finance lease receivables (note 10)	**10**	10
Other receivables[1]	**487**	404
	5,491	5,458

1. Includes £234m (2019 £129m) in relation to VAT receivable in Saudi Arabia.

Trade receivables are stated net of a provision for expected credit losses. Disclosures relating to the ageing of trade receivables and movements in the provision for expected credit losses are provided in note 14.

14. Other financial assets and liabilities and financial risk management

Derivative financial instruments and hedging activities

The international nature of the Group's business means it is exposed to volatility in currency exchange rates. In order to protect itself against currency fluctuations, the Group's policy is to hedge all material firm transactional exposures.

The Group uses interest rate derivative instruments to manage the Group's exposure to interest rate fluctuations on its borrowings and deposits by varying the proportion of fixed rate debt relative to floating rate debt over the forward time horizon.

The Group uses foreign exchange derivative instruments to manage the Group's exposure to currency fluctuations on its borrowings and deposits with the Group's subsidiaries and equity accounted investments.

In accordance with its treasury policy, the Group does not hold derivative financial instruments for trading purposes.

The Group aims to achieve hedge accounting treatment for all derivatives that hedge material foreign currency exposures.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, such instruments are stated at fair value at the balance sheet date. The fair values are estimated by discounting expected future cash flows.

Fair value through profit or loss

Gains and losses on derivative financial instruments that are not designated as cash flow hedges are recognised within finance costs in the income statement for the period.

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the exposure to variability in cash flows relating to a highly probable forecast transaction (income or expense) or recognised asset or liability, the effective portion of any change in the fair value of the instrument is recognised in other comprehensive income and presented in the hedging reserve in equity. Amounts recognised in equity are removed from the hedging reserve and included in the cost of the underlying transaction or reclassified to the income statement when the underlying transaction affects profit or loss. These amounts are presented within the same line item in the income statement as the underlying transaction, typically revenue or operating costs. The ineffective portion of any change in the fair value of the instrument is recognised in the income statement within finance costs immediately. The Group treats the foreign currency basis element of the designated foreign exchange derivative hedging instruments as a cost of hedging and as such it is excluded from the hedge designation.

	2020		2019	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	**111**	**(96)**	233	(221)
Other foreign exchange/interest rate contracts	**–**	**(4)**	14	–
Debt-related derivative financial instruments	**137**	**(182)**	103	(6)
	248	**(282)**	350	(227)
Current				
Cash flow hedges – foreign exchange contracts	**180**	**(136)**	203	(174)
Other foreign exchange/interest rate contracts	**9**	**(28)**	7	(28)
Debt-related derivative financial instruments	**–**	**(17)**	–	(30)
	189	**(181)**	210	(232)

Debt-related derivative financial instruments

The debt-related derivative financial instruments represent the fair value of cross-currency, interest rate and foreign exchange derivatives relating to the US$500m 4.75% bond, repayable 2021, the US$800m 3.8% bond, repayable 2024, the US$500m 7.5% bond, repayable 2027, the US$1,300m 3.4% bond, repayable 2030, and the US$400m 5.8% bond, repayable 2041 (see note 21). These derivatives have been entered into specifically to manage the Group's exposure to foreign exchange or interest rate risk.

14. Other financial assets and liabilities and financial risk management continued

Interest rate risk

The Group's objective is to manage its exposure to interest rate fluctuations on borrowings through varying the proportion of fixed rate debt relative to floating rate debt with derivative instruments, including interest rate and cross-currency swaps.

The Group's interest rate management policy is that a minimum of 50% (2019 50%) and a maximum of 90% (2019 90%) of gross debt is maintained at fixed interest rates. At 31 December 2020, the Group had 88% (2019 80%) of fixed rate debt and 12% (2019 20%) of floating rate debt based on a gross debt of £5.5bn (2019 £3.3bn), including debt-related derivative financial assets.

Based on contracted maturities and/or repricing dates, the following amounts are exposed to interest rate risk over the future as shown below:

	Less than one year £m	Between one and two years £m	More than two years £m
Cash and cash equivalents	2,768	–	–
Loans and overdrafts	655	655	655

The floating rate debt has been predominantly achieved by entering into interest rate swaps which swap the fixed rate US dollar interest payable on debt into either floating rate sterling or US dollars. At the end of 2020, the Group had a total of $0.9bn (2019 $0.9bn) of this type of swap outstanding with a weighted average duration of 3.8 years (2019 4.8 years). In respect of the fixed rate debt, the weighted average period in respect of which interest is fixed was 12.1 years (2019 7.1 years). Given the level of short-term interest rates during the year, the average cost of the floating rate debt was 3.4% (2019 5.3%) on US dollars. The cost of the fixed rate debt was 4.1% (2019 4.7%).

Sensitivity analysis

A change of 100 basis points in short-term rates applied to the average fixed/floating mix and level of borrowings would vary the interest cost to the Group by approximately £7m (2019 £7m).

In respect of cash deposits, given the fluctuation in the Group's working capital requirements, cash is generally invested for short-term periods based at floating interest rates. A change of 100 basis points in the average interest rates during the year applied to the average cash deposits would vary the interest receivable by approximately £22m (2019 £15m).

Liquidity risk

Contractual cash outflows on financial liabilities

The contracted cash outflows on loans and overdrafts, and derivative financial instruments at the reporting date are shown below, classified by maturity. The cash outflows are shown on a gross basis, are not discounted, are translated at the spot rate and include estimated interest payments where applicable. Contracted cash outflows reflects the gross cash outflow on derivative financial instruments and excludes the broadly offsetting cash inflows for the receive leg of derivatives that are settled separately to the pay leg.

	31 December 2020					31 December 2019				
		Contracted cash outflow					Contracted cash outflow			
	Carrying amount £m	**Less than one year £m**	**Between one and five years £m**	**More than five years £m**	**Total £m**	Carrying amount £m	Less than one year £m	Between one and five years £m	More than five years £m	Total £m
Loans and overdrafts	**(5,424)**	**(676)**	**(2,240)**	**(5,013)**	**(7,929)**	(3,397)	(533)	(1,874)	(2,460)	(4,867)
Cash flow hedges – financial assets	**291**	**(6,190)**	**(4,241)**	**(343)**	**(10,774)**	436	(5,098)	(5,006)	(438)	(10,542)
Cash flow hedges – financial liabilities	**(232)**	**(6,228)**	**(4,582)**	**(431)**	**(11,241)**	(395)	(5,078)	(5,933)	(602)	(11,613)
Other foreign exchange/interest rate contracts – financial assets	**9**	**(516)**	**–**	**–**	**(516)**	21	(351)	–	–	(351)
Other foreign exchange/interest rate contracts – financial liabilities	**(32)**	**(1,515)**	**–**	**–**	**(1,515)**	(28)	(1,679)	–	–	(1,679)
Debt-related derivatives – financial assets	**137**	**(40)**	**(144)**	**(47)**	**(231)**	103	(53)	(213)	(370)	(636)
Debt-related derivatives – financial liabilities	**(199)**	**(457)**	**(141)**	**(158)**	**(756)**	(36)	(442)	(248)	–	(690)
Other financial assets and liabilities	**(26)**					101				

A maturity analysis of the contracted cash outflows on lease liabilities is provided in note 10.

Contractual cash outflows in respect of all other financial liabilities are materially equivalent to the balance sheet carrying amount. Contractual amounts relating to other non-derivative financial liabilities, such as trade payables, are settled within the normal operating cycle of the business (within one year for current liabilities and within two years for the majority of non-current liabilities).

14. Other financial assets and liabilities and financial risk management continued

Borrowing facilities

The Group's objective is to maintain adequate undrawn committed borrowing facilities.

At 31 December 2020, the Group had a committed Revolving Credit Facility (RCF) of £2bn (2019 £2bn). The RCF was undrawn throughout the year. The RCF also acts as a backstop to Commercial Paper issued by the Group. At 31 December 2020, the Group had no Commercial Paper in issue (2019 £nil).

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 currency and notional amount of the designated hedging instruments match the currency and principal amounts of the forecast transactions being hedged, therefore the hedging instruments and hedged items have values which will generally move in opposite directions because of the same hedged risk. As the critical terms of the hedging instruments match those of the hedged items, an economic relationship can be demonstrated on an ongoing basis.

The hedge ratio is 1:1 on the basis that the notional amount of the designated hedging instruments matches the principal amount of the forecast foreign currency sales/purchases designated as the hedged items.

The Group considers the potential sources of hedge ineffectiveness to be:

– valuation adjustments for credit risk made to derivative hedging instruments at each hedge effectiveness measurement date;
– changes to the timing and amount of forecast transactions; and
– non-occurrence of the designated hedged items.

The effect of cash flow hedges on the Group's financial position and performance for the year is as follows:

	31 December 2020					31 December 2019				
	Maturity date	**Weighted average hedged rate**	**Change in the value of hedging instruments since 1 January £m**	**Change in the value of hedged items since 1 January £m**	**Notional amount £m**	Maturity date	Weighted average hedged rate	Change in the value of hedging instruments since 1 January £m	Change in the value of hedged items since 1 January £m	Notional amount £m
Purchase/(sale) contracts:										
Sterling/US dollar	**to 2029**	**1.33**	**8**	**(8)**	**(137)**	to 2029	1.32	71	(71)	(83)
Sterling/euro	**to 2031**	**1.09**	**81**	**(81)**	**(356)**	to 2029	1.11	(34)	34	(640)
Other	**to 2026**	**n/a**	**(43)**	**43**	**(4)**	to 2026	n/a	(26)	26	(46)
Cash flow hedges			**46**	**(46)**	**(497)**			11	(11)	(769)

The notional amount is the sterling equivalent of the net currency amount purchased or sold. For designated sterling/US dollar cash flow hedges, the Group has purchased $4,420m at a cost of £3,284m and sold $4,150m for £3,147m, resulting in a net purchase of $270m at a cost of £137m. For designated sterling/euro cash flow hedges, the Group has purchased €8,174m at a cost of £7,469m and sold €7,773m for £7,113m, resulting in a net purchase of €401m at a cost of £356m. The Group also hedges purchases and sales in multiple other currency pairs, with £1,594m (2019 £2,288m) of currencies purchased at a cost of £1,598m (2019 £2,333m).

Sensitivity analysis

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.

Excluding the UK, US, Saudi Arabian and Qatari governments where credit risk is not considered an issue, no one counterparty constitutes more than 4% of the trade receivables balance (2019 4%).

14. Other financial assets and liabilities and financial risk management continued

The carrying amount of the Group's financial assets represents the maximum exposure to credit risk.

Movements on the provision for expected credit losses are as follows:

	2020 £m	2019 £m
At 1 January	**20**	30
Net remeasurement of loss allowance	**19**	(9)
Amounts written off	**(3)**	(1)
At 31 December	**36**	20

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.

The Group writes off a receivable when there is evidence that the debtor is in significant financial difficulty and there is no realistic prospect of recovery, for example, when a debtor enters bankruptcy or financial reorganisation. None of the trade receivables that were written off during the year are still subject to enforcement activity. The ageing of trade receivables is detailed below:

	2020			2019		
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Not past due	**1,029**	**–**	**1,029**	750	–	750
Up to 180 days overdue	**544**	**–**	**544**	388	–	388
Past 180 days overdue	**74**	**(36)**	**38**	287	(20)	267
	1,647	**(36)**	**1,611**	1,425	(20)	1,405

Trade receivables past 180 days overdue primarily include amounts which relate to contracts in Saudi Arabia. The Group has assessed the risk of default and recoverability of these receivables at the balance sheet date and the expected credit losses in respect of these balances are not considered to be material.

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.

Surplus cash held by the businesses over and above balances required for working capital management is loaned to the Group's centralised treasury department. Surplus cash is invested in instant-access current accounts, short-term deposits and money market funds, choosing instruments with appropriate maturities or sufficient liquidity to provide adequate headroom as determined by cash forecasts.

The Group's objective is to monitor and control counterparty credit risk and credit limit utilisation. The Group adopts a conservative approach to the investment of its surplus cash which is deposited with financial institutions with investment-grade (BBB- and above) credit ratings for short periods. The cash and cash equivalents balance at 31 December 2020 of £2,768m (2019 £2,587m) was invested with 38 (2019 28) financial institutions. A credit limit is allocated to each institution taking account of its market capitalisation, credit rating and credit default swap price. The cash and cash equivalents of the Group are invested in non-speculative financial instruments which are usually highly liquid, such as short-term deposits. The Group therefore believes it has reduced its exposure to counterparty credit risk through this process. The cash and cash equivalents balance is subject to review for impairment under IFRS 9 as set out below:

Counterparty credit rating at 31 December	2020	2019
AAA to AA-	**59%**	41%
A+ to A-	**40%**	51%
BBB+ to BBB-	**1%**	8%

Offsetting financial assets and liabilities

		2020					2019				
	Notes	Gross balances[1] £m	Amounts offset[2] £m	Balance sheet[3] £m	Amounts not offset[4] £m	Net balances[5] £m	Gross balances[1] £m	Amounts offset[2] £m	Balance sheet[3] £m	Amounts not offset[4] £m	Net balances[5] £m
Assets											
Cash and cash equivalents	18	**2,768**	**–**	**2,768**	**–**	**2,768**	2,593	(6)	2,587	–	2,587
Other financial assets		**437**	**–**	**437**	**(303)**	**134**	560	–	560	(432)	128
Liabilities											
Overdrafts	21	**(101)**	**–**	**(101)**	**–**	**(101)**	(6)	6	–	–	–
Other financial liabilities		**(463)**	**–**	**(463)**	**285**	**(178)**	(459)	–	(459)	412	(47)

1. The gross amounts of the recognised financial assets and liabilities.
2. The amounts offset in accordance with paragraph 42 of IAS 32.
3. The net balances presented in the Consolidated balance sheet.
4. The amounts subject to a master netting arrangement not offset in the Consolidated balance sheet in accordance with paragraph 42 of IAS 32. Includes £285m (2019 £412m) in respect of recognised financial instruments and £18m (2019 £20m) in respect of cash collateral.
5. The net balances after deducting the amounts in (4) from (3).

15. Deferred tax

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

The most significant recognised deferred tax assets relate to the deficits on the Group's pension/post-employment schemes (see below). This is because post-employment benefit costs are deducted in determining accounting profit as service is provided by employees, but deducted in determining taxable profit either when contributions are paid to the pension/post-employment schemes or when post-employment benefits are paid.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different taxable entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

Deferred tax assets/(liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2020 £m	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
Property, plant and equipment	**33**	36	**(103)**	(85)	**(70)**	(49)
Intangible assets	**4**	–	**–**	(1)	**4**	(1)
Provisions and accruals	**199**	194	**–**	–	**199**	194
Goodwill	**–**	–	**(279)**	(278)	**(279)**	(278)
Pension/post-employment schemes:						
Deficits	**845**	759	**–**	–	**845**	759
Additional contributions and other[1]	**251**	98	**–**	(1)	**251**	97
Share-based payments	**19**	20	**–**	–	**19**	20
Financial instruments	**–**	–	**(18)**	(7)	**(18)**	(7)
Other items	**17**	10	**(3)**	(27)	**14**	(17)
Rolled over capital gains	**–**	–	**(11)**	(10)	**(11)**	(10)
Capital losses carried forward	**11**	10	**–**	–	**11**	10
Trading losses carried forward	**7**	8	**–**	–	**7**	8
Deferred tax assets/(liabilities)	**1,386**	1,135	**(414)**	(409)	**972**	726
Set off of tax	**(414)**	(409)	**414**	409	**–**	–
Net deferred tax assets	**972**	726	**–**	–	**972**	726

1. Includes deferred tax assets on US deferred compensation plans and, for 2020, relief to be claimed in future periods on UK pension contributions.

15. Deferred tax continued

Movement in temporary differences during the year

	At 1 January 2020 £m	Foreign exchange adjustments £m	Acquisitions and disposals £m	Recognised in income £m	Recognised in equity £m	**At 31 December 2020 £m**
Property, plant and equipment	(49)	5	–	(26)	–	**(70)**
Intangible assets	(1)	–	(3)	8	–	**4**
Provisions and accruals	194	(5)	–	10	–	**199**
Goodwill	(278)	9	–	(10)	–	**(279)**
Pension/post-employment schemes:						
Deficits	759	(1)	–	(11)	98	**845**
Additional contributions and other[1]	97	(3)	–	8	149	**251**
Share-based payments	20	–	–	–	(1)	**19**
Financial instruments	(7)	–	–	(2)	(9)	**(18)**
Other items	(17)	(1)	–	32	–	**14**
Rolled over capital gains	(10)	–	–	(1)	–	**(11)**
Capital losses carried forward	10	–	–	1	–	**11**
Trading losses carried forward	8	–	–	(1)	–	**7**
	726	4	(3)	8	237	**972**

	At 1 January 2019 £m	Foreign exchange adjustments £m	Acquisitions and disposals £m	Recognised in income £m	Recognised in equity £m	At 31 December 2019 £m
Property, plant and equipment	(57)	3	–	5	–	(49)
Intangible assets	(1)	1	(1)	–	–	(1)
Provisions and accruals	202	(8)	–	–	–	194
Goodwill	(283)	10	–	(5)	–	(278)
Pension/post-employment schemes:						
Deficits	722	(4)	–	12	29	759
Additional contributions and other[1]	96	(3)	–	4	–	97
Share-based payments	12	1	–	6	1	20
Financial instruments	(12)	1	–	4	–	(7)
Other items	8	1	–	(26)	–	(17)
Rolled over capital gains	(10)	–	–	–	–	(10)
Capital losses carried forward	10	–	–	–	–	10
Trading losses carried forward	17	(2)	(4)	(3)	–	8
	704	–	(5)	(3)	30	726

1. Includes deferred tax assets on US deferred compensation plans and, for 2020, relief to be claimed in future periods on UK pension contributions.

15. Deferred tax continued

Unrecognised deferred tax assets and liabilities

Deferred tax assets have not been recognised in respect of the following items:

	2020		2019	
	Gross amount £m	**Unrecognised deferred tax asset £m**	Gross amount £m	Unrecognised deferred tax asset £m
Deductible temporary differences, including tax credits	**2**	**2**	3	2
Capital losses carried forward	**215**	**41**	221	38
Trading and other losses carried forward	**289**	**43**	202	24
	506	**86**	426	64

These assets have not been recognised as the incidence of future profits in the relevant countries and legal entities cannot be accurately predicted at this time.

The Group has not recognised any deferred tax liability on temporary differences totalling £467m (2019 £191m) relating to potentially taxable unremitted earnings of overseas subsidiaries and equity accounted investments because the Group is in a position to control the timing of the reversal of the temporary differences and none are expected to reverse in the foreseeable future.

Changes in tax rates

Both recognised and unrecognised UK deferred tax balances as at 31 December 2020 have been calculated at a rate of 19% (2019 17%). As at 31 December 2019, legislation was in place for the UK current tax rate to be reduced from 19% to 17% with effect from 1 April 2020. However, under the Finance Act 2020, the rate was retained at 19%. The impact of the increase in rate at which UK deferred tax balances are calculated by 2% has been recorded partly in the Consolidated income statement but mainly in the Consolidated statement of comprehensive income.

16. Inventories

Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value.

	2020 £m	2019 £m
Raw materials and consumables	**459**	375
Work-in-progress	**320**	348
Finished goods and goods for resale	**79**	112
	858	835

The Group recognised £21m (2019 £14m) as a write down of inventories to net realisable value.

17. Current tax

Current tax for the current and prior periods is recognised as a liability to the extent that it has not yet been settled, and as an asset to the extent that the amounts already paid exceed the amount due or the benefit of a tax loss can be carried back to recover current tax of a prior period. Current tax assets and liabilities are measured at the amount expected to be paid to or recovered from taxation authorities, using the rates that have been enacted or substantively enacted by the balance sheet date.

	2020 £m	2019 £m
Tax provisions	**(185)**	(180)
Research and development expenditure credits receivable	**56**	187
Other	**63**	(43)
	(66)	(36)
Represented by:		
Current tax assets	**6**	19
Current tax liabilities	**(72)**	(55)
	(66)	(36)

Tax provisions of £185m (2019 £180m) are in respect of known tax issues, of which £146m (2019 £142m) relates to the UK. Whilst there is inherent uncertainty regarding the timing of any resolution of tax positions, the Group considers there to be a possibility of a material change in tax positions in the next financial year.

Following review of the April 2019 EU Commission decision that concluded that the UK's Controlled Foreign Company regime partially represents State Aid, a provision has been recognised in the UK for the estimated exposure.

18. Cash and cash equivalents

Cash and cash equivalents includes cash in hand, call and term deposits, investments in money market funds and other short-term liquid investments with original maturities of three months or less and which are subject to an insignificant risk of change in value. For the purpose of the cash flow statement, cash and cash equivalents also includes bank overdrafts that are repayable on demand and which form an integral part of the Group's cash management.

	2020 £m	2019 £m
Cash	**919**	1,039
Money market funds	**966**	680
Short-term deposits	**883**	868
	2,768	2,587

Cash and cash equivalents includes £109m (2019 £283m) which is subject to regulatory restrictions and is therefore not available for general use by other entities within the Group.

19. 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 (note 2).

19. Assets and liabilities held for sale and business disposals continued

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)

20. Geographical analysis of assets

Analysis of non-current assets by geographical location

Asset location	Notes	**2020 £m**	2019 £m
UK		**4,219**	4,119
Rest of Europe		**1,065**	935
US		**10,202**	8,830
Saudi Arabia		**538**	679
Australia		**471**	435
Rest of Asia and Pacific		**1**	10
Non-current segment assets		**16,496**	15,008
Post-employment benefit surpluses	24	**408**	302
Other financial assets	14	**437**	560
Tax	15,17	**978**	745
Inventories	16	**858**	835
Current trade, other and contract receivables	13	**5,491**	5,458
Cash and cash equivalents	18	**2,768**	2,587
Assets held for sale	19	**94**	135
Consolidated total assets		**27,530**	25,630

21. Loans and overdrafts

Loans and overdrafts are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, loans and overdrafts are stated at amortised cost. Any difference between the amount initially recognised and the redemption value is recognised in the income statement over the period of the borrowings.

	2020 £m	2019 £m
Non-current		
US$500m 4.75% bond, repayable 2021	**–**	377
£400m 4.125% bond, repayable 2022	**399**	399
US$800m 3.8% bond, repayable 2024	**584**	602
US$750m 3.85% bond, repayable 2025	**545**	561
US$500m 7.5% bond, repayable 2027	**364**	376
US$1,300m 3.4% bond, repayable 2030	**942**	–
US$1,000m 1.9% bond, repayable 2031	**724**	–
US$400m 5.8% bond, repayable 2041	**290**	299
US$550m 4.75% bond, repayable 2044	**393**	406
US$1,000m 3% bond, repayable 2050	**716**	–
	4,957	3,020
Current		
Overdrafts	**101**	–
US$500m 2.85% bond, repayable 2020	**–**	377
US$500m 4.75% bond, repayable 2021	**366**	–
	467	377

In April, BAE Systems issued $1.3bn (£1.0bn) of ten-year bonds in the US capital market maturing in 2030 at a 3.4% coupon. The proceeds were used to fund the £1.0bn contribution into the BAE Systems Pension Scheme. In September, BAE Systems issued $2.0bn (£1.5bn) of bonds in the US capital market comprising a $1.0bn (£0.8bn) ten-year bond maturing in 2031 at a 1.9% coupon and a $1.0bn (£0.8bn) 30-year bond maturing in 2050 at a 3.0% coupon. The proceeds 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 from Raytheon Technologies Corporation.

The US$500m 4.75% bond, repayable 2021, has been converted to a sterling fixed rate bond by utilising foreign exchange swaps that mature in October 2021 and give an effective rate during 2020 of 4.3%.

US$500m of the US$800m 3.8% bond, repayable 2024, has been converted to a floating rate bond by utilising interest rate swaps that mature in October 2024 and give an effective rate during 2020 of 2.9%.

The US$500m 7.5% bond, repayable 2027, was converted at issue to a sterling fixed rate bond by utilising cross-currency swaps and has an effective rate during 2020 of 7.7%.

The US$400m 5.8% bond, repayable 2041, has been converted to a floating rate bond by utilising interest rate swaps that mature in October 2024 and give an effective rate during 2020 of 4.5%.

US$1,237m of the US$1,300m 3.4% bond, repayable 2030, was converted at issue to a sterling fixed rate bond by utilising cross-currency swaps and has an effective rate during 2020 of 3.5%.

22. Contract liabilities

Contract liabilities represent the obligation to transfer goods or services to a customer for which consideration has been received, or consideration is due, from the customer.

	2020 £m	2019 £m
Non-current		
Contract liabilities	**524**	527
Current		
Contract liabilities	**3,238**	3,536
	3,762	4,063

Revenue recognised in the year includes £3,150m (2019 £3,422m) that was included in the opening contract liabilities balance.

Non-current and current contract liabilities as at 1 January 2019 were £560m and £3,496m, respectively.

The reduction in contract liabilities since 2019 is primarily due to utilisation of customer advances during the year.

23. Trade and other payables

Trade and other payables are stated at amortised cost.

US deferred compensation plan liabilities represent the present value of expected future payments required to settle the obligation to employees in accordance with IAS 19 Employee Benefits.

	2020 £m	2019 £m
Non-current		
Accruals	**53**	48
Amounts owed to equity accounted investments (note 32)	**11**	–
Other taxes and social security costs	**36**	–
Deferred income[1]	**687**	536
US deferred compensation plan liabilities	**350**	339
Other payables	**27**	31
	1,164	954
Current		
Trade payables	**697**	675
Amounts owed to equity accounted investments (note 32)	**1,156**	1,134
Other taxes and social security costs	**536**	123
Accruals	**2,128**	2,094
Deferred income	**131**	135
Other payables	**250**	229
	4,898	4,390

1. Includes £678m (2019 £524m) of funding received from the UK government for property, plant and equipment at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme.

24. Post-employment benefits

Pension schemes

Defined contribution

Obligations for contributions are recognised as an expense in the income statement as incurred.

Defined benefit

The cost of providing benefits is determined periodically by independent actuaries and charged to the income statement in the period in which those benefits are earned by the employees. Remeasurements, including actuarial gains and losses, are recognised in the Consolidated statement of comprehensive income in the period in which they occur. Past service costs resulting from a plan amendment or curtailment are recognised immediately in the income statement.

The post-employment benefit surpluses and obligations recognised in the Group's balance sheet represent the fair value of scheme assets, less the present value of the defined benefit obligations calculated using a number of actuarial assumptions as set out on page 233. The bid values of scheme assets are not intended to be realised in the short term and may be subject to significant change before they are realised. The present values of scheme liabilities are derived from cash flow projections over long periods and are, therefore, inherently uncertain.

IAS 19 Employee Benefits, limits the measurement of a defined benefit surplus to the lower of the surplus in the defined benefit scheme and the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the scheme or reductions in future contributions to the scheme. IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, issued in 2007, provides an interpretation of the requirements of IAS 19, clarifying that a refund is available if the entity has an unconditional right to a refund in certain circumstances. The Group has applied IFRIC 14 and has determined that there is no limit on the recognition of the surpluses in its defined benefit pension schemes as at 31 December 2020.

MBDA participates in the Group's defined benefit schemes and, as these are multi-employer schemes, the Group has allocated a share of the IAS 19 pension surpluses and deficits to MBDA based on the relative payroll contributions of active members or actual obligations where known. Whilst this methodology is intended to reflect a reasonable estimate of the share of the deficit, it may not accurately reflect the obligations of the participating employers.

In the event that an employer who participates in the Group's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Group considers the likelihood of this event arising as remote.

The Group's share of the IAS 19 pension deficit allocated to equity accounted investments is included in the balance sheet within equity accounted investments.

Background

Pension schemes

BAE Systems plc operates pension schemes for the Group's qualifying employees in the UK, US and other countries. The principal schemes in the UK and US are funded defined benefit schemes, and the assets are held in separate trustee-administered funds. The largest funded defined benefit scheme is the Main Scheme which represents 93% (2019 93%) of the UK IAS 19 defined benefit obligation at 31 December 2020. The schemes in other countries are primarily defined contribution schemes.

At 31 December 2020, the weighted average durations of the UK and US defined benefit pension obligations were 18 years (2019 17 years) and 12 years (2019 11 years), respectively.

The split of the defined benefit pension liability on a funding basis between active, deferred and pensioner members for the Main Scheme and US schemes in aggregate is set out below:

	Active %	Deferred %	Pensioner %
Main Scheme (merged)[1]	31	21	48
US schemes[2]	28	16	56

1. Source: 31 October 2019 actuarial valuation reports.
2. Source: Annual updates of the US schemes as at 1 January 2020.

24. Post-employment benefits continued

Background continued

Regulatory framework

The funded UK schemes are registered and subject to the statutory scheme specific-funding requirements outlined in UK legislation, including the payment of levies to the Pension Protection Fund as set out in the Pension Act 2004. These schemes were established under trust and the responsibility for their governance lies jointly with the trustees and the Group.

The funded US schemes are tax-qualified pension schemes regulated by the Pension Protection Act 2006 and insured by the Pension Benefit Guaranty Corporation (PBGC) up to certain limits. These schemes were established under, and are governed by, the US Employee Retirement Income Security Act 1974 and the BAE Systems Administrative Committee is a named fiduciary with the authority to manage their operation.

Benefits

The UK defined benefit schemes provide benefits to members in the form of a set level of pension payable for life based on members' final salaries. The benefits attract inflation-related increases both in deferment and payment. All UK defined benefit schemes are closed to new entrants, with benefits for new employees being provided through a defined contribution scheme. The Normal Retirement Age for the majority of active members of the Main Scheme is 65. Specific benefits applicable to members differ between schemes. Further details on the benefits provided by each scheme are provided on the BAE Systems Pensions website: baesystemspensions.com.

A UK High Court judgment was delivered on 26 October 2018 concerning gender equalisation for the effect of Guaranteed Minimum Pensions (GMPs) for occupational pension schemes. In 2018, a non-recurring past service cost was included in the income statement to reflect the expectation that the impact of GMP equalisation would increase the pension deficit in the balance sheet. In 2020, an allowance of £145m (2019 £132m, 2018 £121m) was included within the pension deficit (before allocation to equity accounted investments). This is a consistent proportion of the UK liabilities as applied in 2018 and 2019, and reflects the updated UK IAS 19 valuations as at 31 December 2020.

A further UK High Court judgment was delivered on 20 November 2020 which ruled that past cash-equivalent transfer values needed to account for gender equalisation for the effect of GMPs. The additional liability resulting from this is estimated to be £7m. This has been included within the 2020 pension deficit (before allocation to equity accounted investments) and recognised as a non-recurring past service cost.

The US defined benefit schemes ceased to be final salary schemes in January 2013. The benefits accrued based on the final salaries of members at that point will become payable on retirement. The Normal Retirement Age for the largest scheme in the US is 65.

Other post-employment benefits

The Group operates a number of non-pension retirement benefit schemes, under which certain employees are eligible to receive benefits after retirement, the majority of which relate to the provision of medical benefits to retired employees of the Group's subsidiaries in the US.

Funding

Introduction

Disclosures in respect of pension funding are provided below. Disclosures in respect of pension accounting under IAS 19 are provided on pages 233 to 239.

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 233. 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.

24. Post-employment benefits continued

Funding continued

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.

24. Post-employment benefits continued

Funding continued

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.

Risk management

The defined benefit pension schemes expose the Group to actuarial risks, including market (investment) risk, interest rate risk, inflation risk and longevity risk.

Risk	Mitigation
Market (investment) risk Asset returns may not move in line with the liabilities and may be subject to volatility.	The investment portfolios are highly diversified, investing in a wide range of assets, in order to reduce the exposure of the total portfolio to a materially adverse impact from a single security or type of security. To reduce volatility, certain assets are held in a matching portfolio, which largely consists of index-linked bonds, gilts and swaps, designed to mirror movements in corresponding liabilities. Some 42% (2019 45%) of the Group's pension scheme assets are held in equities and pooled investment vehicles due to the higher expected level of return over the long term. Some of the Group's pension schemes use derivative financial instruments as part of their investment strategy to manage the level of market risk. The Main Scheme has an equity option strategy protecting £2.9bn of assets against a significant fall in equity markets, in line with the prior year. The strategy also caps the upside if equity markets increase more than an agreed percentage.
Interest rate risk Liabilities are sensitive to movements in interest rates, with lower interest rates leading to an increase in the valuation of liabilities.	In addition to investing in bonds as part of the matching portfolio, the UK schemes invest in interest rate swaps to reduce the exposure to movements in interest rates. The swaps are held with several banks to reduce counterparty risk. The current level of interest rate protection is expressed as a hedge ratio of 72.4%. The discount rate assumptions set as part of the UK funding valuations directly reflect the expected returns on assets held by the schemes and provide a natural hedge against interest rate risk. The planned investment strategy, which is reflected in the discount rate and liability calculation, is for the schemes to increase their investments in bonds or other assets which match the liabilities as the schemes mature. Under the UK funding valuations, the Group expects the schemes to be fully hedged against interest rate movements following a five-year transition period to the planned investment strategy.
Inflation risk Liabilities are sensitive to movements in inflation, with higher inflation leading to an increase in the valuation of liabilities.	In addition to investing in index-linked bonds as part of the matching portfolio, the UK schemes invest in long-term inflation swaps to reduce the exposure to movements in inflation. The swaps are held with several banks to reduce counterparty risk. The current level of inflation protection is expressed as a hedge ratio of 100.2%. The Group's US schemes are not indexed with inflation. The UK funding valuations provide a natural hedge against inflation movements within the discount rate. The Group is already fully hedged against inflation movements and, under the planned investment strategy, the Group aims to maintain a fully hedged position. In 2014, the Main Scheme implemented a pension increase exchange to allow retired members to elect for a higher current pension in exchange for foregoing certain rights to future pension increases.
Longevity risk Liabilities are sensitive to life expectancy, with increases in life expectancies leading to an increase in the valuation of liabilities.	Longevity adjustment factors are used in the majority of the UK pension schemes in order to adjust the pension benefits payable so as to share the cost of people living longer with employees. In 2013, with the agreement of the Company, the trustees of the 2000 Plan, Royal Ordnance Pension Scheme and Shipbuilding Industries Pension Scheme entered into arrangements with Legal & General to insure against longevity risk for the current pensioner population, covering a total of £4.4bn of pension scheme liabilities. These arrangements reduce the funding volatility relating to increasing life expectancy. This longevity risk cover with Legal & General remains in place following the merger of the 2000 Plan and SIPS into the Main Scheme.

24. Post-employment benefits continued

IAS 19 accounting

The disclosures below relate to post-retirement benefit schemes in the UK, US and other countries which are accounted for as defined benefit schemes in accordance with IAS 19.

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

Discount rate

The discount rate assumptions are derived through discounting the projected benefit payments using a third-party AA corporate bond yield curve to produce a single equivalent discount rate for the UK and US territories. This inherently captures the maturity profile of the expected benefit payments. For the UK territory, the discount rate used for future service differs from that used for past service as it only uses the cash flows relating to active members, which have a different duration. Further information on the duration of the schemes is detailed on page 229.

Retail Prices Index (RPI) and Consumer Prices Index (CPI) inflation

In the UK, the inflation assumptions are derived by reference to the difference between the yields on index-linked and fixed-interest long-term government bonds, or advice from the local actuary depending on the available information. Index-linked government bonds contain a premium that investors are willing to pay to mitigate the risk that RPI inflation is higher than expected. To account for this, the RPI assumption includes an inflation risk premium deduction.

As a consequence of RPI reform announcements during 2019 and the outcome of the RPI consultation in November 2020, the Company has reviewed its approach to setting inflation assumptions. The inflation risk premium deduction has been set at 0.5% per annum (2019 0.35%) and the CPI assumption has been set at 0.7% per annum (2019 0.8%) lower than RPI. The resulting RPI assumption is 2.7% per annum and the CPI assumption is 2.0% per annum. The 0.7% per annum RPI-CPI differential is a weighted average of a 1% per annum differential pre-2030 and 0.1% per annum differential post-2030; this reflects the anticipated change to the RPI index from 2030. In the US, inflation assumptions are not relevant as the Group's US pension schemes are not indexed with inflation.

Rate of increase in salaries

The rate of increase in salaries for the UK schemes is assumed to be RPI inflation of 2.7% (2019 RPI inflation of 2.8%), plus a promotional scale. From 1 January 2013, employees in the US schemes no longer accrue salary-related benefits.

Rate of increase in deferred pensions

The rate of increase in deferred pensions for the UK schemes is based on CPI inflation of 2.0% (2019 CPI inflation of 2.0%), with the exception of the legacy 2000 Plan, which is based on RPI inflation of 2.7% (2019 RPI inflation of 2.8%). For all UK schemes, the rate of increase in deferred pensions is subject to inflation caps.

Rate of increase in pensions in payment

The rate of increase in pensions in payment differs between UK schemes. Different tranches of the schemes' benefits increase at rates based on either RPI or CPI inflation, and some are subject to an inflation cap. With the exception of two smaller schemes, the rate of increase in pensions in payment is based on RPI inflation.

Life expectancy

For its UK pension schemes, the Group has used the Self-Administered Pension Schemes S2 mortality tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of scheme members and information on the demographic profile of the scheme's membership.

In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2019 tables (published by the Institute of Actuaries) have been used (in 2019, the Continuous Mortality Investigation 2018 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% per annum (2019 1.0%), an initial rate adjustment parameter ('A') of 0.25% (2019 0.25%) in conjunction with a smoothing parameter ('S_K') of 7 for all members (2019 7). A refinement has been made to the standard 2019 model for the purpose of the IAS 19 valuation, resulting in no weighting being given to the assumed life expectancy improvement in 2020. This is in recognition of the excess deaths in 2020 due to COVID-19; however, the assumption is that future years will return to more 'normal' life expectancy improvements. The CMI is considering changing its methodology and more data may emerge on the long-term impact of COVID-19 which could impact this set of assumptions going forward, given the uncertainty that exists.

24. Post-employment benefits continued

IAS 19 accounting continued

Over 2020, the Society of Actuaries in the US released updated mortality assumptions reflecting the results of its comprehensive mortality study. For the majority of the US schemes, the mortality tables used at 31 December 2020 are a blend of the fully generational PRI-2012 White Collar table and the PRI-2012 Blue Collar table, both projected using Scale MP-2020.

US healthcare schemes

The latest valuations of the principal schemes, covering retiree medical and life insurance schemes in certain US subsidiaries, were performed by independent actuaries as at 1 January 2020. These valuations were rolled forward to reflect the information at 31 December 2020. The method of accounting for these is similar to that used for defined benefit pension schemes.

Long-term healthcare cost is assumed to increase at 4.8% per annum (2019 4.8%). This is based on an assumed increase in 2020 of 7.0% for pre-retirement and 7.5% for post-retirement, with both rates then reducing to 4.5% by 2027 and remaining at 4.5% per annum each year thereafter.

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.

Amounts recognised on the balance sheet

The table below shows a reconciliation between the gross assets and liabilities of the Group's UK, US and other post-employment benefit schemes and the amounts recognised on the Group's balance sheet after allocation to equity accounted investments.

	2020				
	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Saudi Arabia end of service benefit £m	Total £m
Present value of unfunded obligations	**(152)**	**(146)**	**–**	**(132)**	**(430)**
Present value of funded obligations	**(29,239)**	**(4,748)**	**(157)**	**–**	**(34,144)**
Fair value of scheme assets	**25,029**	**4,482**	**218**	**–**	**29,729**
Total net IAS 19 (deficit)/surplus	**(4,362)**	**(412)**	**61**	**(132)**	**(4,845)**
Allocated to equity accounted investments	**360**	**–**	**–**	**–**	**360**
Group's share of net IAS 19 (deficit)/surplus	**(4,002)**	**(412)**	**61**	**(132)**	**(4,485)**
Represented by:					
Post-employment benefit surpluses	**308**	**36**	**64**	**–**	**408**
Post-employment benefit obligations	**(4,310)**	**(448)**	**(3)**	**(132)**	**(4,893)**
	(4,002)	**(412)**	**61**	**(132)**	**(4,485)**
Group's share of net IAS 19 deficit of equity accounted investments	**(143)**	**–**	**–**	**–**	**(143)**

24. Post-employment benefits continued

IAS 19 accounting continued

	2019				
	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Saudi Arabia end of service benefit £m	Total £m
Present value of unfunded obligations	(118)	(143)	–	(105)	(366)
Present value of funded obligations	(26,758)	(5,174)	(168)	–	(32,100)
Fair value of scheme assets	22,765	4,703	219	–	27,687
Total net IAS 19 (deficit)/surplus	(4,111)	(614)	51	(105)	(4,779)
Allocated to equity accounted investments	324	–	–	–	324
Group's share of net IAS 19 (deficit)/surplus	(3,787)	(614)	51	(105)	(4,455)
Represented by:					
Post-employment benefit surpluses	234	11	57	–	302
Post-employment benefit obligations	(4,021)	(625)	(6)	(105)	(4,757)
	(3,787)	(614)	51	(105)	(4,455)
Group's share of net IAS 19 deficit of equity accounted investments	(129)	–	–	–	(129)

Total cumulative actuarial losses recognised in equity since the transition to IFRS are £6.5bn (2019 £5.2bn).

Changes in the fair value of scheme assets before allocation to equity accounted investments

	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Saudi Arabia end of service benefit £m	Total £m
Value of scheme assets at 1 January 2019	21,246	4,213	194	–	25,653
Interest income	609	173	8	–	790
Actual return on assets excluding amounts included in interest income	1,491	766	32	–	2,289
Actual return on assets	2,100	939	40	–	3,079
Contributions by employer	451	10	2	37	500
Contributions by employer in respect of employee salary sacrifice arrangements	78	–	–	–	78
Total contributions by employer	529	10	2	37	578
Members' contributions	7	–	–	–	7
Administrative expenses	(15)	(21)	(1)	–	(37)
Foreign exchange translation	–	(185)	(9)	–	(194)
Benefits paid	(1,102)	(253)	(7)	(37)	(1,399)
Value of scheme assets at 31 December 2019	22,765	4,703	219	–	27,687
Interest income	487	156	7	–	650
Actual return on assets excluding amounts included in interest income	1,146	572	8	–	1,726
Actual return on assets	1,633	728	15	–	2,376
Contributions by employer	1,621	80	1	14	1,716
Contributions by employer in respect of employee salary sacrifice arrangements	72	–	–	–	72
Total contributions by employer	1,693	80	1	14	1,788
Members' contributions	6	–	–	–	6
Administrative expenses	(14)	(7)	(1)	–	(22)
Settlements	–	(615)	–	–	(615)
Business acquisitions	–	7	–	–	7
Foreign exchange translation	–	(144)	(7)	–	(151)
Benefits paid	(1,054)	(270)	(9)	(14)	(1,347)
Value of scheme assets at 31 December 2020	**25,029**	**4,482**	**218**	**–**	**29,729**

24. Post-employment benefits continued

IAS 19 accounting continued

Assets of defined benefit pension schemes

	2020								
	UK[1]			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[2]	**1,037**	**–**	**1,037**	**–**	**–**	**–**	**1,037**	**–**	**1,037**
Overseas	**2,763**	**–**	**2,763**	**–**	**–**	**–**	**2,763**	**–**	**2,763**
Pooled investment vehicles[3]	**835**	**6,582**	**7,417**	**1,132**	**2**	**1,134**	**1,967**	**6,584**	**8,551**
Fixed interest securities:									
UK gilts	**1,294**	**–**	**1,294**	**–**	**–**	**–**	**1,294**	**–**	**1,294**
UK corporates	**1,900**	**3,176**	**5,076**	**–**	**–**	**–**	**1,900**	**3,176**	**5,076**
Overseas government	**49**	**–**	**49**	**32**	**–**	**32**	**81**	**–**	**81**
Overseas corporates	**1,931**	**–**	**1,931**	**3,135**	**–**	**3,135**	**5,066**	**–**	**5,066**
Index-linked securities:									
UK gilts	**2,734**	**456**	**3,190**	**–**	**–**	**–**	**2,734**	**456**	**3,190**
UK corporates	**–**	**1,047**	**1,047**	**–**	**–**	**–**	**–**	**1,047**	**1,047**
Property[4]	**–**	**1,858**	**1,858**	**–**	**102**	**102**	**–**	**1,960**	**1,960**
Derivatives[5]	**–**	**(1,602)**	**(1,602)**	**–**	**–**	**–**	**–**	**(1,602)**	**(1,602)**
Cash:									
Sterling	**792**	**34**	**826**	**–**	**–**	**–**	**792**	**34**	**826**
Foreign currency	**22**	**6**	**28**	**79**	**–**	**79**	**101**	**6**	**107**
Other	**–**	**115**	**115**	**–**	**–**	**–**	**–**	**115**	**115**
Total	**13,357**	**11,672**	**25,029**	**4,378**	**104**	**4,482**	**17,735**	**11,776**	**29,511**

	2019								
	UK[1]			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[2]	2,214	1	2,215	–	–	–	2,214	1	2,215
Overseas	1,935	1	1,936	–	–	–	1,935	1	1,936
Pooled investment vehicles[3]	1,931	5,161	7,092	1,178	1	1,179	3,109	5,162	8,271
Fixed interest securities:									
UK gilts	1,280	–	1,280	–	–	–	1,280	–	1,280
UK corporates	1,476	2,359	3,835	–	–	–	1,476	2,359	3,835
Overseas government	41	–	41	34	–	34	75	–	75
Overseas corporates	1,480	16	1,496	3,304	–	3,304	4,784	16	4,800
Index-linked securities:									
UK gilts	2,105	297	2,402	–	–	–	2,105	297	2,402
UK corporates	268	994	1,262	–	–	–	268	994	1,262
Property[4]	–	1,778	1,778	–	113	113	–	1,891	1,891
Derivatives[5]	–	(1,405)	(1,405)	–	–	–	–	(1,405)	(1,405)
Cash:									
Sterling	619	29	648	–	–	–	619	29	648
Foreign currency	31	5	36	72	–	72	103	5	108
Other	13	136	149	–	1	1	13	137	150
Total	13,393	9,372	22,765	4,588	115	4,703	17,981	9,487	27,468

1. The Main Scheme and one of the Group's smaller UK defined benefit pension schemes participate in a Combined Investment Fund (CIF), covering £2.7bn (2019 £10.1bn) of assets. The purpose of the CIF is to provide economies of scale for the CIF schemes' investment administration.
2. Includes £6m (2019 £15m) of the Company's own ordinary shares.
3. Primarily invested in private markets and exchange traded funds. The amounts classified as unquoted primarily comprise investments in private markets, with the majority held in infrastructure, alternatives and direct funds, valued in accordance with International Private Equity and Venture Capital Valuation Guidelines.
4. Valued on the basis of open market value at the end of the year determined in accordance with the Royal Institution of Chartered Surveyors' Appraisal and Valuation Standards and the Practice Note contained therein. Includes £257m (2019 £233m) of property occupied by Group companies.
5. Includes equity protection options, forward foreign exchange contracts, futures, and interest rate, inflation and longevity swaps. In addition, the total derivative figures shown are net of £393m (2019 £358m) of repurchase agreements. The valuations are based on valuation techniques using underlying market data and discounted cash flows.

24. Post-employment benefits continued

IAS 19 accounting continued

Longevity swap

The Group holds longevity insurance contracts for some of its UK defined benefit pension schemes. These provide long-term protection and income to the underlying pension scheme in the event that insured members live longer than expected.

The value of the longevity insurance contracts held by the Group are calculated by an actuary. At a high level, they are measured by discounting the difference between the projected fixed and floating cash flows payable under the contracts, excluding the value of future projected fees. The significant assumptions used for this valuation are the discount rate and mortality assumptions; fair values for these assumptions are advised by an actuary based on external data and characteristics of the insured member population.

As at 31 December 2020, the longevity swap valuation leads to a negative adjustment to the assets which reflects that experience to date on the contracts has been higher than expected deaths.

Changes in the present value of the defined benefit obligations before allocation to equity accounted investments

	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Saudi Arabia end of service benefit £m	Total £m
Defined benefit obligations at 1 January 2019	(24,800)	(4,924)	(165)	(97)	(29,986)
Current service cost	(193)	(11)	(1)	(17)	(222)
Contributions by employer in respect of employee salary sacrifice arrangements	(78)	–	–	–	(78)
Total current service cost	(271)	(11)	(1)	(17)	(300)
Members' contributions	(7)	–	–	–	(7)
Past service cost – plan amendments	(4)	–	–	–	(4)
Actuarial loss due to changes in financial assumptions	(2,547)	(638)	(19)	(26)	(3,230)
Actuarial gain due to changes in demographic assumptions	448	19	1	–	468
Experience (losses)/gains	(96)	(28)	8	(2)	(118)
Interest expense	(701)	(201)	(6)	(5)	(913)
Foreign exchange translation	–	213	7	5	225
Benefits paid	1,102	253	7	37	1,399
Defined benefit obligations at 31 December 2019	(26,876)	(5,317)	(168)	(105)	(32,466)
Current service cost	(209)	(13)	(1)	(19)	(242)
Contributions by employer in respect of employee salary sacrifice arrangements	(72)	–	–	–	(72)
Total current service cost	(281)	(13)	(1)	(19)	(314)
Members' contributions	(6)	–	–	–	(6)
Past service cost – plan amendments	(9)	(1)	8	–	(2)
Actuarial loss due to changes in financial assumptions	(3,067)	(474)	(13)	(11)	(3,565)
Actuarial gain/(loss) due to changes in demographic assumptions	–	7	8	(4)	11
Experience gains/(losses)	344	(12)	–	(7)	325
Interest expense	(550)	(165)	(5)	(4)	(724)
Settlements	–	679	–	–	679
Business acquisitions	–	(7)	–	–	(7)
Foreign exchange translation	–	139	5	4	148
Benefits paid	1,054	270	9	14	1,347
Defined benefit obligations at 31 December 2020	**(29,391)**	**(4,894)**	**(157)**	**(132)**	**(34,574)**

24. Post-employment benefits continued

IAS 19 accounting continued

Amounts recognised in the income statement after allocation to equity accounted investments

	2020			
	UK defined benefit pension schemes £m	**US and other pension schemes £m**	**Other schemes £m**	**Total £m**
Included in operating costs:				
Current service cost	**(191)**	**(13)**	**(20)**	**(224)**
Past service cost – plan amendments	**(1)**	**(1)**	**8**	**6**
	(192)	**(14)**	**(12)**	**(218)**
Settlements	**–**	**64**	**–**	**64**
Guaranteed Minimum Pension equalisation charge	**(7)**	**–**	**–**	**(7)**
Administrative expenses	**(13)**	**(7)**	**(1)**	**(21)**
	(212)	**43**	**(13)**	**(182)**
Included in net finance costs:				
Net interest expense on post-employment benefit obligations	**(57)**	**(9)**	**(2)**	**(68)**
Group defined benefit schemes included in share of results of equity accounted investments:				
Group's share of equity accounted investments' operating costs	**(9)**	**–**	**–**	**(9)**
Group's share of equity accounted investments' finance costs	**(2)**	**–**	**–**	**(2)**

	2019			
	UK defined benefit pension schemes £m	US and other pension schemes £m	Other schemes £m	Total £m
Included in operating costs:				
Current service cost	(177)	(11)	(18)	(206)
Past service cost – plan amendments	(4)	–	–	(4)
	(181)	(11)	(18)	(210)
Administrative expenses	(14)	(21)	(1)	(36)
	(195)	(32)	(19)	(246)
Included in net finance costs:				
Net interest expense on post-employment benefit obligations	(83)	(28)	(3)	(114)
Group defined benefit schemes included in share of results of equity accounted investments:				
Group's share of equity accounted investments' operating costs	(9)	–	–	(9)
Group's share of equity accounted investments' finance costs	(3)	–	–	(3)

The Group incurred a charge of £242m (2019 £226m) in relation to defined contribution schemes for employees.

24. Post-employment benefits continued

IAS 19 accounting continued

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 on page 233.

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 (see longevity risk on page 232), 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.

25. Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and the amount has been reliably estimated. If the effect is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax discount rate.

Warranties and after-sales service

Warranties and after-sales service are provided in the normal course of business with provisions for associated costs being made based on an assessment of future claims with reference to past experience. A provision for warranties is recognised when the underlying products and services are sold. The provision is based on historical warranty data and a weighting of possible outcomes against their associated probabilities.

Reorganisations

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced to those affected. The costs associated with the reorganisation programmes are supported by detailed plans and based on previous experience as well as other known factors. Future operating costs are not provided for.

Legal, contractual and environmental

The Group holds provisions for expected legal, contractual and environmental costs that it expects to incur over an extended period. Management exercises judgement to determine the amount of these provisions. Provision is made for known issues based on past experience of similar items and other known factors. Each provision is considered separately and the amount provided reflects the best estimate of the most likely amount, being the single most likely amount in a range of possible outcomes.

	Warranties and after-sales service £m	Reorganisations £m	Legal, contractual and environmental £m	Other £m	Total £m
Non-current	54	18	266	47	385
Current	56	34	186	24	300
At 1 January 2020	110	52	452	71	685
Created	38	13	105	16	172
Utilised	(34)	(14)	(54)	(10)	(112)
Business acquisitions (note 34)	4	–	–	15	19
Transfer to other balance sheet categories	–	–	(5)	–	(5)
Released	(12)	(13)	(53)	(7)	(85)
Net present value adjustments	–	–	7	2	9
Foreign exchange adjustments	–	–	(4)	(2)	(6)
At 31 December 2020	**106**	**38**	**448**	**85**	**677**
Represented by:					
Non-current	51	2	275	58	386
Current	55	36	173	27	291
	106	**38**	**448**	**85**	**677**

25. Provisions continued

Warranties and after-sales service

Warranty and after-sales service provisions are generally utilised within three years post-delivery. Whilst actual events could result in potentially significant differences to the quantum, but not the timing, of the outflows in relation to the provisions, management has reflected current knowledge in assessing the provision levels.

Reorganisations

Reorganisation provisions are generally utilised within one to three years. There is limited volatility around the timing and amount of the ultimate outflows related to these provisions.

Other debtors includes £9m (2019 £18m) which is reimbursable in respect of reorganisation costs.

Legal, contractual and environmental

Reflecting the inherent uncertainty within many legal proceedings, the amount of the outflows could differ significantly from the amount provided. While the timing of the outflows is also uncertain, the Group expects these provisions to be utilised over a period of approximately 25 years.

Other

There are no individually significant provisions included within other provisions.

26. Share capital and other reserves

Share capital

	Equity		Non-equity		Total
	Ordinary shares of 2.5p each		Special Share of £1		
	Number of shares m	Nominal value £m	Number of shares	Nominal value £	Nominal value £m
Issued and fully paid					
At 1 January 2019, 31 December 2019 and 31 December 2020	**3,467**	**87**	**1**	**1**	**87**

Special Share

One Special Share of £1 in the Company is held on behalf of the Secretary of State for Business, Energy and Industrial Strategy (the Special Shareholder). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British citizens. The effect of these requirements can also be amended by regulations made by the directors and approved by the Special Shareholder.

The Special Shareholder may require the Company at any time to redeem the Special Share at par or to convert the Special Share into one ordinary voting share. The Special Shareholder is entitled to receive notice of and to attend general meetings and class meetings of the Company's shareholders, but has no voting right, nor other rights, other than to speak in relation to any business in respect of the Special Share.

Treasury shares

As at 31 December 2020, 248,995,549 (2019 261,897,751) ordinary shares of 2.5p each with an aggregate nominal value of £6,224,889 (2019 £6,547,444) were held in treasury. During 2020, 12,902,202 (2019 9,752,386) treasury shares were used to satisfy awards and options under the Share Incentive Plan, International Share Incentive Plan, Performance Share Plan, the Performance Shares and Restricted Shares elements of the Long-Term Incentive Plan, and the Executive Share Option Plan.

BAE Systems ESOP Trust

The Group has an ESOP discretionary trust to administer the share plans and to acquire Company shares, using funds loaned by the Group, to meet commitments to Group employees. Dividend waivers were in operation for shares within the ESOP Trust, other than those owned beneficially by the participants, for the dividends paid in the year.

At 31 December 2020, the ESOP held 5,946,770 (2019 2,887,846) ordinary shares of 2.5p each, with a market value of £29m (2019 £16m). The shares held by the ESOP are recorded at cost and deducted from retained earnings until such time as the shares vest unconditionally to employees.

A dividend waiver was also in operation for the dividends paid in the year over shares within the Company's share incentive plan trusts other than those shares owned beneficially by the participants.

Own shares held

Own shares held, including treasury shares and shares held by BAE Systems Employee Share Option Plan (ESOP) Trust, are recognised as a deduction from retained earnings.

26. Share capital and other reserves continued

Equity dividends

Equity dividends on ordinary share capital are recognised as a liability on the date that the shareholder's right to receive payment is established. This is generally the date that the dividend is declared.

	2020 £m	2019 £m
Final 13.2p dividend per ordinary share paid in the year in respect of the year ended 31 December 2018	–	423
Interim 13.8p dividend per ordinary share paid in the year in respect of the 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.

Other reserves

	Merger reserve £m	Statutory reserve £m	Revaluation reserve £m	Capital redemption reserve £m	Hedging reserve £m	Translation reserve £m	Total £m
At 1 January 2019	4,589	202	10	3	38	1,639	6,481
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	(322)	(322)
Reclassification of cumulative currency translation reserve on disposal of subsidiary	–	–	–	–	–	(8)	(8)
Net amounts charged to hedging reserve	–	–	–	–	(1)	–	(1)
Equity accounted investments, net of tax	–	–	–	–	25	(19)	6
At 1 January 2020	4,589	202	10	3	62	1,290	6,156
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	(210)	(210)
Reclassification of cumulative currency translation reserve on disposal of subsidiary	–	–	–	–	–	(35)	(35)
Reclassification of cumulative currency translation reserve on partial disposal of subsidiary	–	–	–	–	–	(22)	(22)
Net amounts credited to hedging reserve	–	–	–	–	37	–	37
Equity accounted investments, net of tax	–	–	–	–	(5)	2	(3)
At 31 December 2020	**4,589**	**202**	**10**	**3**	**94**	**1,025**	**5,923**

26. Share capital and other reserves continued

Merger reserve

The merger reserve arose on the acquisition of the Marconi Electronic Systems (MES) business by British Aerospace in 1999 to form BAE Systems, and represents the amount by which the fair value of the shares issued by British Aerospace as consideration exceeded their nominal value.

Statutory reserve

Under Section 4 of the British Aerospace Act 1980, this reserve may only be applied in paying up unissued shares of the Company to be allotted to members of the Company as fully paid bonus shares.

Revaluation reserve

The revaluation reserve relates to the revaluation at fair value of the net assets of the BVT joint venture previously held as an equity accounted investment on the acquisition of the remaining 45% interest in 2009.

Capital redemption reserve

The capital redemption reserve represents the cumulative nominal value of the Company's ordinary shares repurchased and subsequently cancelled.

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

Capital

The Group funds its operations through a mixture of equity funding and debt financing, including bank and capital market borrowings.

At 31 December 2020, the Group's capital was £4,827m (2019 £5,449m), which comprises total equity of £4,921m (2019 £5,511m), excluding amounts accumulated in equity relating to cash flow hedges of £94m (2019 £62m). Net debt was £2,718m (2019 £743m).

The capital structure of the Group reflects the judgement of the directors of an appropriate balance of funding required. The Group's policy is to maintain an investment grade credit rating and ensure operating flexibility, whilst:

- meeting its pension obligations;
- investing in research and technology and pursuing other organic investment opportunities;
- paying dividends in line with the Group's policy of long-term sustainable cover of around two times underlying earnings (see note 7);
- making accelerated returns of capital to shareholders when the balance sheet allows and when the return from doing so is in excess of the Group's Weighted Average Cost of Capital; and
- investing in value-enhancing acquisitions, where market conditions are right and where they deliver on the Group's strategy.

27. Operating business cash flow

Alternative performance measure – Free cash flow

Definition Operating business cash flow for the Group less interest paid (net) and taxation.

Purpose Allows management to monitor utilisation of cash in line with the Group's capital allocation policy.

Alternative performance measure – Operating business cash flow

Definition 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.

Purpose Allows management to monitor the operational cash generation of the Group.

Taxation is excluded because it is not relevant to the pre-tax operational cash generation of the Group.

Net capital expenditure, lease principal amounts and financial investment are included as a measure of the investment in the business to support the operational performance of the Group.

Dividends received from equity accounted investments are included as a measure of the operating cash generation of the Group's equity accounted investments.

Reconciliation of net cash flow from operating activities to free cash flow

	2020 £m	2019 £m
Net cash flow from operating activities	**1,166**	1,597
Add back Taxation paid	**251**	252
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)
Principal element of lease payments and receipts	**(226)**	(230)
Net capital expenditure, lease principal amounts and financial investment	**(618)**	(684)
Dividends received from equity accounted investments	**27**	142
Operating business cash flow	**826**	1,307
Taxation paid	**(251)**	(252)
Interest paid, net of interest received	**(208)**	(205)
Free cash flow	**367**	850

Reconciliation of operating business cash flow to net cash flow from operating activities by reporting segment

	Operating business cash flow		Deduct Dividends received from equity accounted investments		Add back Net capital expenditure, lease principal amounts and financial investment		Net cash flow from operating activities	
	2020 £m	2019 £m	2020 £m	2019 £m	2020 £m	2019 £m	2020 £m	2019 £m
Electronic Systems	**580**	672	**(2)**	(5)	**189**	166	**767**	833
Cyber & Intelligence	**221**	68	**–**	–	**30**	31	**251**	99
Platforms & Services (US)	**382**	241	**(13)**	(17)	**89**	81	**458**	305
Air	**718**	408	**(8)**	(117)	**207**	206	**917**	497
Maritime	**243**	150	**(4)**	(3)	**78**	142	**317**	289
HQ	**(1,318)**	(232)	**–**	–	**25**	58	**(1,293)**	(174)
	826	1,307	**(27)**	(142)	**618**	684	**1,417**	1,849
Taxation paid[1]							**(251)**	(252)
Net cash flow from operating activities							**1,166**	1,597

1. Taxation is managed on a Group-wide basis.

28. Movement in assets and liabilities arising from financing activities

	As at 1 January 2019 £m	Cash (inflow)/ outflow £m	Non-cash movements: Foreign exchange movements £m	Non-cash movements: Fair value and other movements £m	As at 31 December 2019 £m	Cash (inflow)/ outflow £m	Non-cash movements: Foreign exchange movements £m	Non-cash movements: Fair value and other movements £m	As at 31 December 2020 £m
Non-current assets									
Other financial assets[1]	**120**	–	–	(3)	**117**	–	–	20	**137**
Current assets									
Other financial assets[1]	**87**	(167)	–	87	**7**	(59)	–	61	**9**
	207	(167)	–	84	**124**	(59)	–	81	**146**
Non-current liabilities									
Loans	**(3,514)**	–	117	377	**(3,020)**	(2,666)	254	475	**(4,957)**
Lease liabilities	**(1,270)**	–	17	137	**(1,116)**	–	15	81	**(1,020)**
Other financial liabilities[1]	**(9)**	–	–	3	**(6)**	–	–	(180)	**(186)**
Cash collateral[3]	**(19)**	(1)	–	–	**(20)**	2	–	–	**(18)**
Current liabilities									
Loans[2]	**(785)**	782	3	(377)	**(377)**	506	(12)	(483)	**(366)**
Lease liabilities	**(216)**	239	1	(262)	**(238)**	236	(5)	(229)	**(236)**
Other financial liabilities[1]	**(11)**	127	–	(174)	**(58)**	43	(2)	(28)	**(45)**
	(5,824)	1,147	138	(296)	**(4,835)**	(1,879)	250	(364)	**(6,828)**
		980				**(1,938)**			
Interest paid		233				227			
Equity dividends paid		724				746			
Dividends paid to non-controlling interests		56				19			
Partial disposal of shareholding in subsidiary undertaking		(31)				(27)			
Net cash flow from financing activities		**1,962**				**(973)**			

1. Excluding cash flow hedges, for which the cash flow is reported within cash flow from operating activities. See note 14 for an analysis of other financial assets and liabilities.
2. Movements in loans exclude overdrafts.
3. Reported in other payables.

29. Net debt

Key Performance Indicator – Net debt

Definition Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments).

Purpose Allows management to monitor the indebtedness of the Group.

Components of net debt

	Notes	2020 £m	2019 £m
Cash and cash equivalents	18	**2,768**	2,587
Debt-related derivative financial instrument assets – non-current	14	**137**	103
Loans – non-current	21	**(4,957)**	(3,020)
Loans and overdrafts – current	21	**(467)**	(377)
Debt-related derivative financial instrument liabilities – non-current	14	**(182)**	(6)
Debt-related derivative financial instrument liabilities – current	14	**(17)**	(30)
Net debt		**(2,718)**	(743)

30. 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).

30. Fair value measurement continued

Carrying amounts and fair values of certain financial instruments

	Notes	2020 Carrying amount £m	2020 Fair value £m	2019 Carrying amount £m	2019 Fair value £m
Financial instruments measured at fair value:					
Non-current					
Equity investments at fair value through profit and loss		**–**	**–**	13	13
Other financial assets	14	**248**	**248**	350	350
Other financial liabilities	14	**(282)**	**(282)**	(227)	(227)
Current					
Other financial assets	14	**189**	**189**	210	210
Money market funds	18	**966**	**966**	680	680
Other financial liabilities	14	**(181)**	**(181)**	(232)	(232)
Financial instruments not measured at fair value:					
Non-current					
Loans	21	**(4,957)**	**(5,737)**	(3,020)	(3,315)
Current					
Cash and cash equivalents (excluding money market funds)	18	**1,802**	**1,802**	1,907	1,907
Loans and overdrafts	21	**(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.

31. Share-based payments

The Group has granted equity-settled share options and Long-Term Incentive Plan arrangements which are measured at fair value at the date of grant using an option pricing model. The fair value is expensed on a straight-line basis over the vesting period, based on the Group's estimate of the number of shares that will actually vest.

Details of the terms and conditions of each share-based payment plan are given in the Annual remuneration report on pages 131 to 155.

Expense in year

	2020 £m	2019 £m
Executive Share Option Plan	**6**	6
Performance Share Plan	**20**	21
Restricted Share Plan	**8**	7
	34	34

The Group also incurred a charge of £40m (2019 £40m) in respect of the equity-settled all-employee Free Shares and Matching Partnership Shares elements of the Share Incentive Plan.

Executive Share Option Plan

	2020		2019	
	Number of shares '000	**Weighted average exercise price £**	Number of shares '000	Weighted average exercise price £
Outstanding at the beginning of the year	**38,979**	**5.36**	36,164	5.44
Granted during the year	**11,402**	**4.86**	11,610	4.89
Exercised during the year	**(2,368)**	**4.77**	(4,077)	4.62
Expired during the year	**(4,452)**	**5.91**	(4,718)	5.46
Outstanding at the end of the year	**43,561**	**5.20**	38,979	5.36
Exercisable at the end of the year	**15,297**	**5.36**	12,476	4.74

	2020	2019
Range of exercise price of outstanding options (£)	**3.01 – 6.49**	3.01 – 6.49
Weighted average remaining contracted life (years)	**7**	7
Weighted average fair value of options granted (£)	**0.96**	0.64

Performance Share Plan and Restricted Share Plan

	Performance Share Plan		Restricted Share Plan	
	2020 Number of shares '000	2019 Number of shares '000	**2020 Number of shares '000**	2019 Number of shares '000
Outstanding at the beginning of the year	**22,495**	22,380	**4,406**	4,100
Granted during the year	**9,525**	9,653	**2,222**	2,084
Exercised during the year	**(1,767)**	(964)	**(1,270)**	(1,305)
Expired during the year	**(4,375)**	(8,574)	**(384)**	(473)
Outstanding at the end of the year	**25,878**	22,495	**4,974**	4,406
Exercisable at the end of the year	**471**	223	**–**	8

	2020	2019	**2020**	2019
Weighted average remaining contracted life (years)	**5**	5	**5**	5
Weighted average fair value of awards granted (£)	**4.38**	3.89	**4.86**	4.90

The exercise price for the Performance Share Plan and Restricted Share Plan is £nil (2019 £nil).

31. Share-based payments continued

Details of options/awards granted in the year

The fair value of equity-settled options/awards granted in the year has been measured using the weighted average inputs below and the following valuation models:

Executive Share Option Plan – Binomial
Performance Share Plan – Monte Carlo
Restricted Share Plan – Dividend valuation

	2020	2019
Range of share price at date of grant (£)	**4.85 – 5.14**	4.85 – 5.63
Expected option/award life (years)	**3 – 10**	3 – 10
Volatility (%)	**27 – 28**	19
Risk free interest rate (%)	**(0.1) – 0.1**	0.3

Volatility was calculated with reference to the Group's weekly share price volatility, after allowing for dividends, for the greater of 30 weeks or for the period until vest date.

The average share price in the year was £5.24 (2019 £5.21).

32. Related party transactions

The Group has a related party relationship with its directors and key management personnel (see below), equity accounted investments (note 12) and pension schemes (note 24).

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:

	Sales to related parties		Purchases from related parties		Amounts owed by related parties		Amounts owed to related parties[1]		Management recharges[1]	
Related party	**2020 £m**	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
Advanced Electronics Company Limited	**49**	41	**142**	215	**–**	–	**43**	35	**–**	–
CTA International SAS	**1**	2	**–**	–	**–**	1	**13**	13	**–**	–
Eurofighter Jagdflugzeug GmbH	**897**	854	**439**	248	**58**	41	**83**	42	**–**	–
FADEC International LLC	**45**	114	**–**	–	**–**	–	**–**	–	**–**	–
FAST Training Services Limited	**2**	2	**–**	–	**–**	–	**–**	–	**–**	–
MBDA SAS	**24**	28	**188**	164	**8**	8	**1,024**	1,041	**19**	19
Panavia Aircraft GmbH	**35**	27	**42**	16	**1**	1	**1**	–	**–**	–
Rheinmetall BAE Systems Land Limited	**5**	4	**–**	–	**1**	–	**–**	–	**–**	–
BAE Systems Pension Funds Trustees Limited	**–**	–	**20**	20	**–**	–	**212**	225	**–**	–
Other	**9**	2	**–**	1	**1**	2	**3**	3	**–**	–
	1,067	1,074	**831**	664	**69**	53	**1,379**	1,359	**19**	19

1. Also relates to disclosures under IAS 24 Related Party Disclosures, for the parent company, BAE Systems plc. At 31 December 2020, £967m (2019 £862m) was owed by BAE Systems plc and £412m (2019 £497m) by other Group subsidiaries.

The Group considers key management personnel, as defined under IAS 24 Related Party Disclosures, to be the members of the Group's Executive Committee and the Company's non-executive directors. Fuller disclosures on directors' remuneration are set out in the Annual remuneration report on pages 131 to 155. Total emoluments for directors and key management personnel charged to the Consolidated income statement were:

	2020 £'000	2019 £'000
Short-term employee benefits	**15,518**	18,163
Post-employment benefits	**1,072**	1,275
Share-based payments	**5,877**	8,538
	22,467	27,976

33. Contingent liabilities

Contingent liabilities are potential future cash outflows which are either not probable or cannot be measured reliably.

The Group has entered into a number of guarantee and performance bond arrangements in the normal course of business and regards these as insurance contracts. Various Group undertakings are parties to legal actions and claims which arise in the normal course of business. Provision is made for any amounts that the directors consider may become payable (see note 25).

The Group believes that any significant liability in respect of its guarantees and performance bond arrangements, and legal actions and claims not already provided for, is remote.

34. Acquisition of businesses

Businesses 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.

34. Acquisition of businesses continued

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 ended 31 December 2020.

The acquisitions contributed £181m to the Group's revenue and £53m to the Group's underlying EBITA[1] 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 EBITA[1] would have been £2,207m for the year ended 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 ended 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. Further detail on alternative performance measures can be found on page 20.

Businesses acquired during 2019

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

35. 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), realising a small profit on disposal.

Notes to the Group accounts
continued

36. Information about related undertakings

In accordance with Section 409 of the Companies Act 2006, a full list of subsidiaries and equity accounted investments as at 31 December 2020 is disclosed below. Unless otherwise stated, the Group's shareholding represents ordinary shares held indirectly by BAE Systems plc, the year end is 31 December and the address of the registered office is Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU, United Kingdom. For companies incorporated outside of the United Kingdom, the country of incorporation is shown in the address. No subsidiary undertakings have been excluded from the consolidation.

Subsidiaries – wholly-owned

4219 Lafayette, LLC[1]
4219 Lafayette Center Drive, Chantilly VA 20151, United States

Aerosystems International Limited[2]
15 Canada Square, London E14 5GL, United Kingdom

Alvis Limited

Alvis Pension Scheme Trustees Limited[3]

Alvis Vickers Limited

Armstrong Whitworth Aircraft Limited[3]

ASC Shipbuilding Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Australian Marine Engineering Corporation (Finance) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Avro International Aerospace Limited[3]

BAE Systems (Al Diriyah C4i) Limited[3]

BAE Systems (Aviation Services) Limited

BAE Systems (Canada) Inc.
220 Laurier Avenue West, Suite 1200, Ottawa ON K1P 5Z9, Canada

BAE Systems (Combat and Radar Systems) Limited
Charter Place, 23/27 Seaton Place, St. Helier, Jersey JE1 1JY

BAE Systems (Consultancy Services) Limited[2]
15 Canada Square, London E14 5GL, United Kingdom

BAE Systems (Corporate Air Travel) Limited

BAE Systems (CS&SI – Qatar) Limited[3]

BAE Systems (Defence Systems) Limited

BAE Systems (Dynamics) Limited

BAE Systems (Farnborough 1) Limited

BAE Systems (Farnborough 2) Limited

BAE Systems (Farnborough 3) Limited

BAE Systems (Finance) Limited

BAE Systems (Funding Four) Unlimited Company
Riverside One, Sir John Rogerson's Quay, Dublin 2, Ireland

BAE Systems (Funding Three) Limited

BAE Systems (Funding Two) Limited

BAE Systems (Gripen Overseas) Limited

BAE Systems (Hawk Synthetic Training) Limited

BAE Systems (Holdings) Limited[3]

BAE Systems (Insurance) Limited[2]
15 Canada Square, London E14 5GL, United Kingdom

BAE Systems (International) Limited

BAE Systems (Kazakhstan) Limited

BAE Systems (Kuwait) Limited

BAE Systems (Land and Sea Systems) Limited[4]

BAE Systems (Malaysia) Sdn Bhd
Level 25 Menara Hong Leong, No. 6 Jalan Damanlela, Bukit Damansara, 50490 Kuala Lumpur, Malaysia

BAE Systems (MEH) Limited

BAE Systems (Military Air) Overseas Limited

BAE Systems (Nominees) Limited[3]

BAE Systems (Oman) Limited

BAE Systems (Operations) Limited[5]

BAE Systems (Operations) Singapore Pte Limited
One Marina Boulevard #28-00, Singapore 018989, Singapore

BAE Systems (Overseas Holdings) Limited

BAE Systems (Poland) Sp. z o.o.
ul. Abp. A. Baraniaka 88, 61-131 Poznan, Poland

BAE Systems (Projects) Limited

BAE Systems (Property Investments) Limited

BAE Systems (Vehicles and Equipment) Limited

BAE Systems 2000 Pension Plan Trustees Limited[3]

BAE Systems AB[6]
Box 5676, SE-114 86 Stockholm, Sweden

BAE Systems Al Diriyah Programme Limited[3]

BAE Systems Applied Intelligence (Asia Pacific) Pte Limited
United Square, 101 Thomson Road, #25-03/04, 307591, Singapore

BAE Systems Applied Intelligence (Australia) Pty Limited
Level 12, 16-20 Bridge Street, Sydney NSW 2000, Australia

BAE Systems Applied Intelligence (Belgium) NV
Geldenaaksebaan 329, B-3001, Heverlee, Leuven, Belgium

BAE Systems Applied Intelligence (Connect) A/S
c/o Kromann Reumert, Sundkrogsgade 5, Copenhagen East, 2100, Denmark

BAE Systems Applied Intelligence (GCS) Limited
Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (Germany) GmbH
Mainzer Landstrasse 50, 60325 Frankfurt am Main, Germany

BAE Systems Applied Intelligence (Integration) Limited
Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (International) Limited
Priestley Road, Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (Ireland) Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

BAE Systems Applied Intelligence (Japan) KK
12/F Ark Mori Building, 1-12-32 Akasaka, Minato-ku, Tokyo, 107-6024, Japan

BAE Systems Applied Intelligence (Spain) S.A.
Paseo de la Castellana, 141, Cuzco IV, 28046 Madrid, Spain

BAE Systems Applied Intelligence (UK) Limited

BAE Systems Applied Intelligence A/S
c/o Kromann Reumert, Sundkrogsgade 5, Copenhagen East, 2100, Denmark

BAE Systems Applied Intelligence Canada Inc.
1959 Upper Water Street, Suite 900, Halifax NS B3J 2X2, Canada

BAE Systems Applied Intelligence France SAS
19 Boulevard Malesherbes, 75008, Paris, France

BAE Systems Applied Intelligence GCS Inc.[7]
CSC, 100 Shockoe Slip, 2nd Floor Richmond VA 23219, United States

BAE Systems Applied Intelligence Inc.[8]
CSC, 2711 Centerville Road, Suite 400, Wilmington DE 19808, United States

BAE Systems Applied Intelligence Limited
Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence LLC[1]
5th Floor, Suite 1920, 256 Franklin Street, Boston MA 02110, United States

BAE Systems Applied Intelligence Malaysia Sdn Bhd
Level 25, Menara Hong Leong, No. 6 Jalan Damanlela, Bukit Damansara, 50490 Kuala Lumpur, Malaysia

BAE Systems Applied Intelligence New Zealand Limited
c/o Russell McVeagh, Vero Centre, 48 Shortland Street, Auckland Central, 1140, New Zealand

BAE Systems Applied Intelligence Pty Limited
Level 12, 16-20 Bridge Street, Sydney NSW 2000, Australia

BAE Systems Australia (Electronic Systems) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (NSW) Holdings Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (NSW) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (Singapore) Pte Limited[9]
9 Raffles Place #26-01, Republic Plaza, Singapore 048619

BAE Systems Australia Datagate Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Defence Holdings Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Defence Pty Limited[10]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Holdings Limited[3]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Logistics Pty Limited[5]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Sea Sentinel Project Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Avionics Singapore Pte Limited
One Marina Boulevard, #28-00, Singapore 018989, Singapore

BAE Systems Bofors AB
SE-691 80 Karlskoga, Sweden

BAE Systems Bofors Holdings Sdn Bhd
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia

BAE Systems C-ITS AB
Box 5676, SE-114 86 Stockholm, Sweden

BAE Systems China (Exports) Limited

BAE Systems Communications Limited[2,3]
15 Canada Square, London E14 5GL, United Kingdom

BAE Systems Communications Solutions, LLC[1]
Knowledge Oasis, Building 4, Second Floor, 0402-Z427, Knowledge Oasis Muscat, PO Box 16, Postal Code 135, Muscat, Oman

BAE Systems Controls Inc.[8]
1098 Clark Street, Endicott NY 13760, United States

BAE Systems Creole Inc.[11]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474, United States

BAE Systems Datagate Holdings Limited

BAE Systems Datagate Limited

BAE Systems Deployed Systems Limited[12]

BAE Systems Display Technologies Limited[2]
15 Canada Square, London E14 5GL, United Kingdom

36. Information about related undertakings continued

Subsidiaries – wholly-owned continued

BAE Systems do Brasil Ltda
SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil

BAE Systems Electronic Systems (Overseas) Limited

BAE Systems Electronics Limited

BAE Systems Enterprises Limited

BAE Systems Executive Pension Scheme Trustees Limited[3]

BAE Systems Finance B.V.
c/o IQ-EQ, Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

BAE Systems Finance Inc.[7]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Flight Training (Australia) Pty Limited[5]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Funds Management[3,13]

BAE Systems GCS International Limited

BAE Systems Global Combat Systems Bridging Limited

BAE Systems Global Combat Systems Munitions Limited

BAE Systems Global LLC[1]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Hägglunds AB
SE-691 80, Karlskoga, Sweden

BAE Systems Hawaii Shipyards Inc.[7]
3049 Ualena Street, Suite 915, Honolulu HI 96819, United States

BAE Systems Holding GmbH
Hauptstrasse 48, 82433 Bad Kohlgrub, Germany

BAE Systems Holdings (South Africa) (Pty) Limited
Central Office Park No. 5, 257 Jean Avenue, Centurion, Gauteng, 0157, South Africa

BAE Systems Holdings B.V.
c/o IQ-EQ, Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

BAE Systems Holdings Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Holdings International LLC[1]
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

BAE Systems Imaging Solutions Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems India (Homeland Security) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Services) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Technology) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Ventures) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems Information and Electronic Systems Integration Inc.[3]
65 Spit Brook Road, Nashua NH 03061, United States

BAE Systems Insurance (Isle of Man) Limited
Tower House, Loch Promenade, Douglas, IM1 2LZ, Isle of Man, United Kingdom

BAE Systems Integrated System Technologies (KSA) Limited

BAE Systems Integrated System Technologies (Overseas) Limited

BAE Systems Integrated System Technologies GmbH[2]
Hans-Stießberger-Str. 2b, 85540 Haar, Germany

BAE Systems Integrated System Technologies Limited

BAE Systems International Inc.[8]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems Jacksonville Ship Repair LLC[1]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Land & Armaments Holdings LLC[1,7]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Land & Armaments Inc.[7]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Land & Armaments L.P.[1]
2000 North 15th Street, 11th Floor, Arlington VA 22201, United States

BAE Systems Land Systems (Finance) Limited

BAE Systems Land Systems (Investments South Africa) Limited

BAE Systems Land Systems (Investments) Limited

BAE Systems Land Systems (Logistics) Limited[2]
15 Canada Square, London E14 5GL, United Kingdom

BAE Systems Land Systems (Ranges) Limited

BAE Systems Land Systems (Singapore Investments) Limited

BAE Systems Land Systems ATF Limited

BAE Systems Land Systems FMTV International Inc.[11]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems Land Systems Pinzgauer (Holdings) Limited

BAE Systems Land Systems Pinzgauer Limited

BAE Systems Logistica Ltda
SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil

BAE Systems MAI Turkey Hava Sistemleri A.Ş
Üniversiteler Mahallesi, Beytepe Lodumlu Köy Yolu Cad. No: 5/348 Çankaya, Ankara, Turkey

BAE Systems Marine (Holdings) Limited

BAE Systems Marine (YSL) Limited

BAE Systems Marine Limited

BAE Systems Norfolk Ship Repair Inc.[7]
750 West Berkley Avenue, Norfolk VA 23523, United States

BAE Systems Oman LLC[1]
PO Box 74, Postal Code 111, Seeb, Oman

BAE Systems Ordnance Systems Inc.[7]
4509 West Stone Drive, Kingsport TN 37660-9982, United States

BAE Systems Overseas Inc.[7]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Pension Funds CIF Trustees Limited[3]

BAE Systems Pension Funds Investment Management Limited[3,15]

BAE Systems Pension Funds Trustees Limited[3]

BAE Systems Project Services Limited

BAE Systems Projects (Canada) Limited

BAE Systems Properties Limited

BAE Systems Quest Limited[3]

BAE Systems Regional Aircraft (Japan) KK[7]
Minami Azabu T&F Building 8th Floor, 4-11-22 Minami Azabu, Minato-ku, Tokyo, Japan

BAE Systems Regional Aircraft Colombia SAS[16]
c/o Brigard & Urrutia, Calle 70 A No. 4-41, Bogotá, Colombia

BAE Systems Resolution Inc.[11]
1999 Bryan Street, Suite 900, Dallas TX 75201, United States

BAE Systems Rokar International Limited
PO Box 45059, 11 Hartom Street, Mount Hotzvim, 91450 Jerusalem, Israel

BAE Systems S&S Operations Inc.[7]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems San Diego Ship Repair Inc.[6]
2205 East Belt Street, Foot of Sampson Street, San Diego CA 92113, United States

BAE Systems Saudi America Limited
Business Gate Building 7, Floor 1, Riyadh 11482, Saudi Arabia

BAE Systems Saudi Arabia (Maintenance and Equipment Services) Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

BAE Systems Saudi Arabia (Vehicles and Equipment Holdings) Limited[3]

BAE Systems Saudi Arabia (Vehicles and Equipment Nominees) Limited[3]

BAE Systems Saudi Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

BAE Systems Serviços de Aviônicos Ltda.
Rua Boa Vista, No. 254, 13th Floor, Suite 15, Centro, São Paulo, São Paulo 01014-907, Brazil

BAE Systems Share Plans Trustee Limited[3]

BAE Systems Shared Services (Overseas) Limited

BAE Systems Shared Services Inc.[7]
11215 Rushmore Drive, Charlotte NC 28277, United States

BAE Systems Ship Repair Inc.[7]
750 West Berkley Ave., Norfolk VA 23523, United States

BAE Systems Southeast Shipyards AMHC Inc.[7]
8500 Heckscher Drive, Jacksonville FL 32226, United States

BAE Systems Surface Ships (Holdings) Limited

BAE Systems Surface Ships (Overseas) Limited

BAE Systems Surface Ships (Projects) Limited

BAE Systems Surface Ships Integrated Support Limited

BAE Systems Surface Ships Intermediate Holdings Limited

BAE Systems Surface Ships International Limited[6]

BAE Systems Surface Ships Limited

BAE Systems Surface Ships Maritime Limited

BAE Systems Surface Ships Portsmouth Limited[6]

BAE Systems Surface Ships Projects (Malaysia) Sdn Bhd
Level 29 Menara Binjai, No 2 Jalan Binjai, Off Jalan Ampang, 50450 Kuala Lumpur, Malaysia

BAE Systems Surface Ships Property Services Limited

BAE Systems Surface Ships Support Limited[5]

BAE Systems SWS Defence AB
SE-691 80 Karlskoga, Sweden

BAE Systems Tactical Vehicle Systems LP[1]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Technology Solutions & Services Inc.[7]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Training Services Limited

BAE Systems TVS Holdings LLC[1]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Zephyr Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Fifth Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Fourth Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Second Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Third Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems, Inc.[7]
1209 Orange Street, Wilmington DE 19801, United States

36. Information about related undertakings continued

Subsidiaries – wholly-owned continued

Brabazon Limited

British Aerospace (Far East) Limited[17]
Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong

British Aerospace (Malaysia) Sdn Bhd[17]
Unit 30-01, Level 30, Tower A, Vertical Business Suite, Avenue 3, Bangsar South, No.8, Jalan Kerinchi, 59200 Kuala Lumpur, Malaysia

British Aircraft Corporation (Pension Fund Trustees) Limited[3]

British Aircraft Corporation Limited[3]

Buckfield Properties Limited

Cashhold Limited[2,3,5]
15 Canada Square, London E14 5GL, United Kingdom

CPS International, Inc.[11]
c/o Benedetti & Benedetti, Comosa Building, 21st Floor, Ave. Samuel Lewis, PO Box 850120, Panama 5, Panama

Creole (Nigeria) Limited[5]
Tapa House (2nd Floor), 45, Imman Dauda St (Abosede Kuboye Crescent Entrance) Surulere, Lagos, Nigeria

Detica B.V.
Luna ArenA, Herikerbergweg 238, 1101 CM Amsterdam, Netherlands

Detica Group Holdings (Ireland) Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Group Limited

Detica Ireland Limited[6]
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Mexico S. de R.L. de C.V.
Torre Esmeralda II, Blvd Manuel Avila Camacho No. 36 Piso 18, Lomas de Chapultepec, 11000 D.F., Mexico

Detica Patent Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Services, Inc.
5th Floor, Suite 1920, 256 Franklin Street, Boston MA 02110, United States

Dividend Training Limited

ETI Engineering, Inc.[7]
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

Gloster Aircraft Limited[3]

H-B Utveckling, H-B Development AB
Nybrogatan 7, SE-114 34 Stockholm, Sweden

Hadrian Holdings, Inc.[14]
521 Fifth Avenue, New York NY 101075, United States

Hadrian Trustees Limited[3,14,18]

Hägglunds Vehicle GmbH
Ernst-Grote Strasse 13, 30916 Isernhagen, Germany

Hawker Siddeley Aviation Limited[3]

Hawker Siddeley Dynamics Limited[3]

Hertfordshire Estates Limited[5]

HSA/HSD Pension Fund Trustees Limited[3]

Hunter Aerospace Corporation Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

International Military Sales Limited

Jetstream Aircraft Limited[3]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Lemacrown Limited[19]

MES Holdco Limited
Charter Place, 23/27 Seaton Place, St. Helier, Jersey JE1 1JY

MES Interco[13]

Meslink Limited

Newcombe Properties Limited

Piper Group plc[2]
15 Canada Square, London E14 5GL, United Kingdom

Pitch Technologies AB
Repslagaregatan 25, SE-582 22 Linköping, Sweden

Pitch Technologies Limited
Sweden House, 5 Upper Montagu Street, London W1H 2AG, United Kingdom

PT. BAE Systems Services[7]
Wisma 46, Kota BNI, 34th Floor, Suite 34.01.A, Jl. Jenderal Sudirman Kavling 71, Jakarta 10220, Indonesia

Representaciones SSTS, CA[11]
Ave Francisco de Miranda, Centro Lido El Rosal Oficina 71B, Caracas, Venezuela

Riptide Autonomous Solutions Canada Company
1300-1969 Upper Water Street, Purdy's Wharf Tower II, Halifax, NS, BJ3 3R7, Canada

Royal Ordnance (Crown Service) Pension Scheme Trustees Limited

Royal Ordnance B.V.[2]
c/o IQ-EQ, Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

Royal Ordnance Senior Staff Pension Scheme Trustees Limited

Royal Ordnance Speciality Metals Limited[3]

RWT Limited[3]

Salford Electrical Instruments Limited

Scentcivil Limited

Scottish Aviation Limited[3]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Sepia, LLC[1]
4219 Lafayette Center Drive, Chantilly VA 20151, United States

Shipbuilding (MSF) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Shipbuilding (VIC) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Stewart & Stevenson Operations (Nigeria) Limited[11]
Tapa House (2nd Floor), 45, Imman Dauda St (Abosede Kuboye Crescent Entrance), Surulere, Lagos, Nigeria

Stewart & Stevenson TVS UK Limited

Stratsec.net Sdn Bhd
Unit F-3-1, Blok F, Third Floor, CBD Perdana 3, Jalan Perdana, Cyber 12, 63000 Cyberjaya, Selangor Darul Ehsan, Malaysia

Support Solutions General Services and Contracting Company/Limited Liability company[1,16]
House No. 145, Street No. 1, Qtr. 611, Al Andulous Area, Al Mansour, Baghdad, Iraq

TDS International Holdings Pty Limited[20]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

TDS International Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Techmodal Limited

Techmodal Ventures Limited

The Blackburn Aeroplane & Motor Co Limited[3]

The Bristol Aviation Company Limited[3]

The British & Colonial Aeroplane Co. Limited[3]

The Leeds Partnership Limited[5]

The Supermarine Aviation Works Limited[3,4]

Thomas Sopwith Aviation Company Limited[3]

VSEL Birkenhead Limited

Warship Design Services Limited

Westover Controls Incorporated[7]
1098 Clark Street, Endicott NY 13760, United States

36. Information about related undertakings continued

Subsidiaries – not wholly-owned

Advanced National Company for Aircraft Maintenance Limited (51%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Aircraft Research Association Limited (92.8%)[3,18]
Manton Lane, Bedford MK41 7PF, United Kingdom

BAE Systems Saudi Development and Training Company Limited (51%)[21]
PO Box 67775, Riyadh 11517, Saudi Arabia

BAE Systems SDT (UK) Limited (51%)

Flight Control System Management GmbH (66.6%)[22]
PO Box 801109, 81663 Munich, Germany

Granada Enterprises Limited (51%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Hadrian Properties, Inc. (95%)[14]
521 Fifth Avenue, New York NY 101075, United States

International Systems Engineering Company Limited (46.2%)
PO Box 54002, Riyadh 11514, Saudi Arabia

Overhaul and Maintenance Company Holding (51%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Prismatic Limited (76%)
2 Omega Park, Alton GU34 2QE, United Kingdom

Saudi Maintenance & Supply Chain Management Company Limited (51%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Saudi Technology & Logistics Services Limited (65%)[3]
PO Box 1732, Riyadh 11441, Saudi Arabia

SMSCMC (UK) Limited (51%)

Equity accounted investments

Abercromby Property International (20.42%)
521 Fifth Avenue, New York NY 101075, United States

Advanced Electronics Company Limited (25.5%)
PO Box 90916, Riyadh 11623, Saudi Arabia

Air Astana (49%)[8]
121 Kabanbay Batyr Avenue, Yessil District, Astana 010000, Kazakhstan

AMSH B.V. (50%)[23]
Weena 210-212, 3012 NJ Rotterdam, Netherlands

BAE Systems Strategic Aerospace Services WLL (49%)
Building 58, Street 850, Area 23, Qatari Bin Al Fajaa, Doha, Qatar

BAeHAL Software Limited (40%)[3,14]
Airport Lane, HAL Estate, Bangalore 560010, India

BHIC Bofors Defense Asia Sdn Bhd (49%)
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia

Canadian Naval Support Limited (50%)[24]
3099 Barrington Street, Halifax NS B3K 5M7, Canada

CTA International SAS (50%)
13 Route De La Miniere, 78034 Versailles Cedex, France

Data Link Solutions L.L.C. (50%)[1,17]
350 Collins Road, Northeast Cedar Rapids IA 52498, United States

Eurofighter Jagdflugzeug GmbH (33%)[3]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

European Aerosystems Limited (50%)[3,20]

FADEC International LLC (50%)[1]
1098 Clark Street, Endicott NY 13760, United States

FAST Holdings Limited (50%)[14,20]

FAST Training Services Limited (50%)[14]

FNSS Savunma Sistemleri A.S (49%)[20]
Oğulbey Mahallesi, Oğulbey Kumeevleri, No. 441/A, 441/B, Gölbaşı, Ankara, Turkey

MBDA Holdings SAS (25%)
1 Avenue Réaumur, 92350 Le Plessis-Robinson, France

Nobeli Business Support AB (34%)
SE-691 80 Karlskoga, Sweden

Nurol BAE Systems Hava Sistemleri Anonim Şirketi (49%)[23]
Universiteler Mah, 1605.Cad, No:3/1-3, 06800, Ankara, Turkey

Panavia Aircraft GmbH (42.5%)[3]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

Rheinmetall BAE Systems Land Limited (45%)
Hadley Castle Works, PO Box 106, Telford TF1 6QW, United Kingdom

Saab Bofors Test Center AB (30%)
SE-691 80 Karlskoga, Sweden

Saab-BAe Systems Gripen AB (50%)[2,3]
SE-581 88 Linköping, Sweden

Sealand Support Services Limited (33.3%)[10]
MoD Sealand, Welsh Road, Sealand, Deeside, Flintshire CH5 2LS, United Kingdom

Spectrum Technologies Limited (20%)[3,14]
Western Avenue, Bridgend Industrial Estate, Bridgend, Mid Glamorgan CF31 3RT, United Kingdom

Winner Developments Limited (33.3%)

Notes

1. Unincorporated entity for which the address given is the principal place of business.
2. In members' voluntary liquidation.
3. Directly owned by BAE Systems plc.
4. Ownership held in class of A shares, B shares and preference shares.
5. Ownership held in class of A shares and B shares.
6. Ownership held in ordinary shares and preference shares.
7. Ownership held in common shares.
8. Ownership held in common stock.
9. Year end 30 June.
10. Ownership held in ordinary shares and redeemable preference shares.
11. Ownership held in authorized shares.
12. 40% owned by BAE Systems plc.
13. Unlimited company.
14. Year end 31 March.
15. Year end 5 April.
16. In liquidation.
17. Year end 30 September.
18. Limited by Guarantee.
19. Ownership held in ordinary shares and class of A shares.
20. Ownership held in class of A shares.
21. 1% owned by BAE Systems plc.
22. 33.3% owned by BAE Systems plc.
23. Ownership held in class of B shares.
24. Ownership held in common shares and B Preferred shares.

Company statement of comprehensive income for the year ended 31 December

	2020 £m	2019 £m
Profit for the year	**600**	874
Other comprehensive income		
Items that will not be reclassified to the income statement:		
Remeasurements on post-employment benefit schemes	**(137)**	(99)
Items that may be reclassified to the income statement:		
Amounts (debited)/credited to hedging reserve	**(2)**	1
Total other comprehensive income for the year (net of tax)	**(139)**	(98)
Total comprehensive income for the year	**461**	776

Company statement of changes in equity for the year ended 31 December

	Notes	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings[1] £m	Total equity £m
At 1 January 2019		87	1,249	205	2,830	4,371
Profit for the year		–	–	–	874	874
Total other comprehensive income for the year		–	–	1	(99)	(98)
Total comprehensive income for the year		–	–	1	775	776
Share-based payments	10	–	–	–	75	75
Ordinary share dividends[2]		–	–	–	(724)	(724)
At 31 December 2019		87	1,249	206	2,956	4,498
Profit for the year		–	–	–	600	600
Total other comprehensive income for the year		–	–	(2)	(137)	(139)
Total comprehensive income for the year		–	–	(2)	463	461
Share-based payments	10	–	–	–	74	74
Ordinary share dividends[2]		–	–	–	(746)	(746)
At 31 December 2020		**87**	**1,249**	**204**	**2,747**	**4,287**

1. The non-distributable portion of retained earnings is £827m (2019 £767m).
2. Details of ordinary share dividends are provided in note 26 to the Group accounts.

Company balance sheet as at 31 December

	Notes	2020 £m	2019 £m
Non-current assets			
Intangible assets		**53**	61
Property, plant and equipment		**7**	10
Right-of-use assets		**25**	27
Investments in subsidiary undertakings and participating interests	2	**9,047**	8,987
Amounts owed by subsidiary undertakings[1]	3	**4,173**	3,092
Other receivables		**10**	3
Post-employment benefit surpluses	8	**121**	49
Other financial assets	4	**301**	496
		13,737	12,725
Current assets			
Trade and other receivables	3	**69**	70
Current tax		**14**	14
Other financial assets	4	**274**	307
Cash and cash equivalents		**2,149**	1,763
		2,506	2,154
Total assets		**16,243**	14,879
Non-current liabilities			
Loans	5	**(3,071)**	(1,075)
Lease liabilities		**(30)**	(29)
Other payables		**(21)**	(21)
Post-employment benefit obligations	8	**(469)**	(361)
Other financial liabilities	4	**(350)**	(385)
Provisions	7	**(120)**	(126)
		(4,061)	(1,997)
Current liabilities			
Loans	5	**(467)**	–
Lease liabilities		**(4)**	(1)
Trade and other payables	6	**(7,086)**	(8,007)
Other financial liabilities	4	**(312)**	(356)
Provisions	7	**(26)**	(20)
		(7,895)	(8,384)
Total liabilities		**(11,956)**	(10,381)
Net assets		**4,287**	4,498
Capital and reserves			
Issued share capital		**87**	87
Share premium		**1,249**	1,249
Other reserves	9	**204**	206
Retained earnings[2]		**2,747**	2,956
Total equity		**4,287**	4,498

1. Amounts due from subsidiary undertakings for the year ended 31 December 2019 have been reclassified from current to non-current trade and other receivables. See note 3 for details.
2. The Company's profit for the year is £600m (2019 £874m).

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

Registered number: 1470151

Notes to the Company accounts

1. Preparation

Basis of preparation

The financial statements of BAE Systems plc have been prepared on a going concern basis, as discussed in the Directors' report on page 110, and in accordance with Financial Reporting Standard (FRS) 101, Reduced Disclosure Framework.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the EU (EU-adopted IFRS), but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken:

- the requirements of paragraphs 45(b) and 46 to 52 of IFRS 2 Share-based Payment;
- the requirements of paragraphs 62, B64(d), B64(e), B64(g), B64(h), B64(j) to B64(m), B64(n)(ii), B64(o)(ii), B64(p), B64(q)(ii), B66 and B67 of IFRS 3 Business Combinations;
- the requirements of paragraph 33(c) of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;
- the requirements of IFRS 7 Financial Instruments: Disclosures;
- the requirements of paragraphs 91 to 99 of IFRS 13 Fair Value Measurement;
- the requirements of the second sentence of paragraph 110 and paragraphs 113(a), 114, 115, 118, 119(a) to (c), 120 to 127 and 129 of IFRS 15 Revenue from Contracts with Customers;
- the requirement in paragraph 38 of IAS 1 Presentation of Financial Statements, to present comparative information in respect of: paragraph 79(a)(iv) of IAS 1; paragraph 73(e) of IAS 16 Property, Plant and Equipment; paragraph 118(e) of IAS 38 Intangible Assets; and paragraphs 76 and 79(d) of IAS 40 Investment Property;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 to 136 of IAS 1 Presentation of Financial Statements;
- the requirements of IAS 7 Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraphs 17 and 18A of IAS 24 Related Party Disclosures;
- the requirements in IAS 24 Related Party Disclosures, to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and
- the requirements of paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) of IAS 36 Impairment of Assets.

The Company intends to continue to prepare its financial statements in accordance with FRS 101.

In accordance with Section 408(3) of the Companies Act 2006, the Company is exempt from the requirement to present its own income statement. The amount of profit for the year of the Company is disclosed in the Company statement of comprehensive income and Company balance sheet.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments).

Significant accounting policies

The significant accounting policies applied in the preparation of these individual financial statements are set out below. These policies have been applied consistently to all the years presented, unless otherwise stated.

Investments in subsidiary undertakings and participating interests

Fixed asset investments in shares in subsidiary undertakings and participating interests are stated at cost less provision for impairment.

The Company recognises an increase in its investments in subsidiary undertakings in respect of the cost of share-based payment awards issued by the Company to employees of the Company's operating subsidiaries, with a corresponding entry to equity.

Amounts owed by subsidiary undertakings

Amounts owed by subsidiary undertakings are stated at amortised cost including a provision for expected credit losses. The Company measures the provision at an amount equal to 12-month expected credit losses, but this is not material to the financial statements as the probability of default is insignificant.

Other significant accounting policies

Other significant accounting policies are consistent with the Group accounts.

Judgements and sources of estimation uncertainty

In the course of preparing the financial statements, no judgements have been made in the process of applying the Company's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

There are no major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Changes in accounting policies

Several standards, interpretations and amendments to existing standards became effective on 1 January 2020, as detailed on page 188 of the Group accounts, none of which had a material impact on the Company.

2. Investments in subsidiary undertakings and participating interests

	£m
Cost	
At 1 January 2020	9,006
Additions	60
At 31 December 2020	**9,066**
Impairment provisions	
At 1 January and 31 December 2020	**19**
Net carrying value	
At 31 December 2020	**9,047**
At 31 December 2019	8,987

3. Trade and other receivables

	2020 £m	2019 £m
Non-current		
Amounts owed by subsidiary undertakings[1,2]	**4,173**	3,092
Current		
Amounts owed by Group joint ventures	**6**	6
Prepayments	**14**	18
Accrued income	**23**	21
Other receivables	**26**	25
	69	70

1. Amounts owed by subsidiary undertakings are repayable on demand. Whilst the majority of these receivables are interest free, certain balances bear interest priced on an arm's-length basis.
2. Amounts owed by subsidiary undertakings of £3,092m were previously presented within current receivables in 2019. The Group believes it is more representative to present these items within non-current receivables as they are not expected to be settled within the Group's normal operating cycle. Accordingly amounts presented in current receivables in 2019 have been reclassified to non-current receivables.

4. Other financial assets and liabilities

	2020		2019	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Non-current				
Other foreign exchange/interest rate contracts	**164**	**(168)**	393	(379)
Debt-related derivative financial instruments	**137**	**(182)**	103	(6)
	301	**(350)**	496	(385)
Current				
Cash flow hedges – foreign exchange contracts	**–**	**(1)**	1	–
Other foreign exchange/interest rate contracts	**274**	**(294)**	306	(326)
Debt-related derivative financial instruments	**–**	**(17)**	–	(30)
	274	**(312)**	307	(356)

Disclosures in respect of the fair value of other financial assets and liabilities are provided in note 30 to the Group accounts.

Notes to the Company accounts
continued

5. Loans

	2020 £m	2019 £m
Non-current		
US$500m 4.75% bond, repayable 2021	**–**	377
£400m 4.125% bond, repayable 2022	**399**	399
US$1,300m 3.4% bond, repayable 2030	**942**	–
US$1,000m 1.90% bond, repayable 2031	**724**	–
US$400m 5.8% bond, repayable 2041	**290**	299
US$1,000m 3.0% bond, repayable 2050	**716**	–
	3,071	1,075
Current		
Overdrafts	**101**	–
US$500m 4.75% bond, repayable 2021	**366**	–
	467	–

6. Trade and other payables

	2020 £m	2019 £m
Current		
Amounts owed to subsidiary undertakings[1]	**5,869**	6,909
Amounts owed to Group joint ventures	**967**	862
Accruals	**105**	121
Deferred income	**49**	35
Other payables	**96**	80
	7,086	8,007

1. Amounts owed to subsidiary undertakings are repayable on demand. Whilst the majority of these payables are interest free, certain balances bear interest priced on an arm's-length basis.

7. Provisions

	Contractual and other £m
Non-current	126
Current	20
At 1 January 2020	146
Created	3
Utilised	(3)
At 31 December 2020	**146**
Represented by:	
Non-current	120
Current	26
	146

The Company holds provisions for contractual costs that it expects to incur over an extended period. These costs are based on past experience of similar items and represent management's best estimate of the likely outcome, but the timing and amount of the outflows could differ significantly from management's estimates. The Company expects these provisions to be utilised over a period of approximately 25 years.

8. Post-employment benefits

The Company participates in all of the Group's UK pension schemes. Regular contributions to the schemes are made in line with the schedule of contributions and a share of deficit funding is allocated to participating employers. The deficit allocation methodology is based on the relative payroll contributions of active members. Full disclosures relating to these schemes are given in note 24 to the Group accounts.

Amounts recognised on the balance sheet

The table below shows the Company's share of the Group's UK pension schemes after allocation to other participating employers.

	2020 £m	2019 £m
Present value of unfunded obligations	**(87)**	(79)
Present value of funded obligations	**(2,837)**	(1,965)
Fair value of scheme assets	**2,576**	1,732
Company's share of net IAS 19 deficit	**(348)**	(312)
Represented by:		
Post-employment benefit surpluses	**121**	49
Post-employment benefit obligations	**(469)**	(361)
	(348)	(312)

Notes to the Company accounts
continued

9. Share capital and other reserves

Share capital

Disclosures in respect of the Company's share capital are provided in note 26 to the Group accounts.

Other reserves

	Statutory reserve £m	Capital redemption reserve £m	Hedging reserve £m	Total £m
At 1 January 2019	202	3	–	205
Amounts credited to hedging reserve	–	–	1	1
At 31 December 2019	202	3	1	206
Amounts credited to hedging reserve	–	–	(2)	(2)
At 31 December 2020	**202**	**3**	**(1)**	**204**

Statutory reserve

Under Section 4 of the British Aerospace Act 1980, this reserve may only be applied in paying up unissued shares of the Company to be allotted to members of the Company as fully paid bonus shares.

Capital redemption reserve

The capital redemption reserve represents the cumulative nominal value of the Company's ordinary shares repurchased and subsequently cancelled.

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

10. Share-based payments

Options over shares of the Company have been granted to employees of the Company under various plans. Details of the terms and conditions of each share-based payment plan are given in the Annual remuneration report on pages 131 to 155.

	2020		2019	
	Range of exercise price of outstanding options £	**Weighted average remaining contracted life Years**	Range of exercise price of outstanding options £	Weighted average remaining contracted life Years
Executive Share Option Plan	**3.01 – 6.49**	**7**	3.01 – 6.49	8
Performance Share Plan	**–**	**5**	–	5

The average share price in the year was £5.24 (2019 £5.21).

11. Employees

The total number of employees of the Company at 31 December 2020 was 1,743 (2019 1,729). All of the Company's employees work within the Group's HQ segment.

Total staff costs, excluding charges for share-based payments, were as follows:

	2020 £m	2019 £m
Wages and salaries	**109**	113
Social security costs	**12**	13
Pension costs – defined contribution plans	**4**	5
Pension costs – defined benefit plans	**27**	21
	152	152

12. Other information

Company audit fee

Fees payable to the Company's auditor for the audit of the Company's annual accounts totalled £2,555,000 (2019 £2,032,000). Fees payable to Deloitte LLP and its associates for non-audit services to the Company are not required to be disclosed because the Group accounts disclose such fees on a consolidated basis (see note 2 to the Group accounts).

Related party transactions

Disclosures in respect of related party transactions are provided in note 32 to the Group accounts.

The Company also has amounts receivable from Aircraft Research Association Limited of £nil (2019 £3m) which is a partially-owned subsidiary.

Directors' emoluments

Under Schedule 5 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (Schedule 5), total directors' emoluments, excluding Company pension contributions, were £6,267,009 (2019 £9,059,747); these amounts are calculated on a different basis to emoluments in the Annual remuneration report which are calculated under Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (Schedule 8). These emoluments were paid for their services on behalf of the BAE Systems Group. No emoluments related specifically to their work for the Company. Under Schedule 5, the aggregate gains made by the directors from the exercise of share options in 2020 as at the date of exercise was £1,010,527 (2019 £140,961) and the net aggregate value of assets received by directors in 2020 from Long-Term Incentive Plans as calculated at the date of vesting was £1,753,203 (2019 £891,314); these amounts are calculated on a different basis from the valuation of share plan benefits under Schedule 8 in the Annual remuneration report. Retirement benefits are accruing to one director in respect of defined benefit schemes and to three directors in respect of defined contribution schemes.

Company guaranteed borrowings

Borrowings by subsidiary undertakings totalling £1,886m (2019 £2,322m), which are included in the Group's borrowings, have been guaranteed by the Company, with the guarantees measured initially at their fair values, and subsequently measured at the higher of the expected credit loss determined under IFRS 9 Financial Instruments and the amount initially recognised less cumulative amortisation.

Information about related undertakings

In accordance with Section 409 of the Companies Act 2006, a full list of the Company's subsidiaries and significant holdings is included in note 36 to the Group accounts.

Shareholder information

Registered office

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London
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United Kingdom

Telephone: +44 (0)1252 373232

Company website: **baesystems.com**

Registered in England and Wales, No. 1470151

Registrars

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Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
United Kingdom

If you have any queries regarding your shareholding or need to notify any changes to your personal details, please contact Equiniti.

Equiniti's website (**help.shareview.co.uk**) includes a comprehensive set of answers to many frequently asked questions relating to managing a shareholding. If you cannot find the answer to your question, there is an online email form, which will help to ensure your question is directed to the most appropriate team for a response. Alternatively, you can call the BAE Systems Helpline on 0371 384 2044 or, from outside the UK, +44 121 415 7058. Lines are open from 8.30am to 5.30pm Monday to Friday, excluding UK bank holidays.

In addition, the following services are offered to shareholders:

- **Shareview** – online access to your shareholding, including balance movements, indicative share prices and information on recent payments
- **Dividend mandates** – have your dividends paid directly into either your UK bank/building society account or an overseas bank account
- **Dividend reinvestment plan (DRIP)** – have your dividend reinvested in shares purchased on the stock market

More information on all these services can be found on Equiniti's website (**shareview.co.uk**).

American Depositary Receipts

BAE Systems plc American Depositary Receipts (ADRs) are traded on the Over The Counter market (OTC) under the symbol BAESY. One ADR represents four BAE Systems plc ordinary shares.

JP Morgan Chase Bank N.A. is the depositary. If you should have any queries please contact:

JP Morgan Chase Bank N.A.
PO Box 64504
St Paul
MN 55164-0504, USA

Email: **jpmorgan.adr@eq-us.com**

Telephone (toll free from within US and Canada): +1 800 990 1135

Telephone from outside US and Canada: +1 651 453 2128

ShareGift

ShareGift, the share donation charity (registered charity number 1052686), accepts donations of small parcels of shares which may be uneconomic to sell. Details of the scheme are available from ShareGift at **sharegift.org**, by telephone on 020 7930 3737 or by email: **help@sharegift.org**

Share price information

The middle market price of the Company's ordinary shares on 31 December 2020 was 488.8p and the range during the year was 397p to 669p.

For more information

Visit the Shareholder information section of our website: **investors.baesystems.com**

Financial calendar

Financial year end	31 December
Annual General Meeting	6 May 2021
2020 final ordinary dividend payable	1 June 2021
2021 half-yearly results announcement	29 July 2021
2021 interim ordinary dividend payable	30 November 2021
2021 full-year results:	
– preliminary announcement	February 2022
– Annual Report	March 2022
2021 final ordinary dividend payable	June 2022

Beware of share fraud

Investment scams are often sophisticated and difficult to spot.

Spot the warning signs

Fraudsters will often:

- contact you out of the blue;
- apply pressure to invest quickly;
- downplay the risks to your money;
- promise tempting returns that sound too good to be true; and
- say that they're only making the offer available to you or even ask you to not tell anyone else about it.

If you're suspicious, report it

You can report the firm or scam to the FCA by contacting their **Consumer Helpline** on **0800 111 6768** or using the reporting form using the link shown below.

If you've lost money in a scam, contact Action Fraud on **0300 123 2040** or **www.actionfraud.police.uk**

How to avoid investment scams

Reject unexpected offers

Scammers usually cold call, but contact can also come by email, post, word of mouth or at a seminar. If you've been offered an investment out of the blue, chances are it's a high risk investment or a scam.

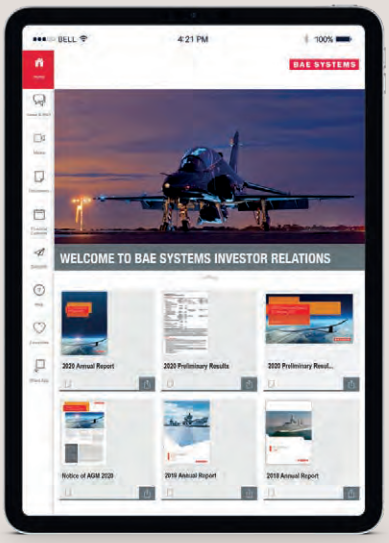
Check the FCA Warning List

Use the FCA Warning List to check the risks of a potential investment – you can also search to see if the firm is known to be operating without their authorisation.

Get impartial advice

Get impartial advice before investing – don't use an adviser from the firm that contacted you.

Be ScamSmart and visit
www.fca.org.uk/scamsmart



Download the BAE Systems Investor App

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Designed and produced by Radley Yeldar.

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