BAE SYSTEMS

Annual Report 2021
BAE Systems plc

baesystems.com

Navigating our Annual Report

Strategic report

Governance

Financial statements

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 14
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.

– We have a deep commitment to supporting the communities in which we work and to reducing the environmental impacts of our activities.

– At the heart of our business we are performance driven and values led.

Page 18
Our stakeholders

Our financial highlights

We monitor the underlying financial performance of the Group using the alternative performance measures defined in the Financial glossary on page 78. 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.

Financial performance measures as defined by the Group[3]

Sales

KPI

£21,310m 5% growth[4]

2021	21,310
2020	20,862

Net debt (excluding lease liabilities)

BONUS KPI

£(2,160)m £558m decrease

2021	(2,160)
2020	(2,718)

Underlying EBIT[5]

KPI

£2,205m 13% growth[4]

2021	2,205
2020	2,037

Order intake[8]

BONUS KPI

£21,458m £543m increase

2021	21,458
2020	20,915

Underlying earnings per share excluding one-off tax benefit[5,6]

BONUS KPI

47.8p Including 2021 one-off tax benefit 50.7p 12% growth[4]

2021	47.8 50.7
2020	44.3

Order backlog[8]

£44.0bn £1.2bn decrease

2021	44.0
2020	45.2

Free cash flow[7]

KPI

£1,864m £497m higher

2021	1,864
2020	1,367

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

BONUS 75% of the UK executive directors' annual bonuses are based on the achievement of financial KPIs (see page 157).

Financial performance measures derived from IFRS[1]

Revenue

£19,521m 1% growth

Order book[9]

£35.5bn £0.8bn decrease

Operating profit

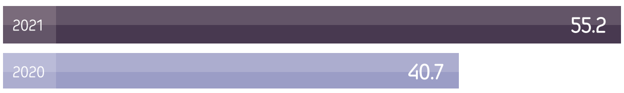
£2,389m 24% growth

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

£(2.1)bn £2.4bn decrease

Basic earnings per share

55.2p 36% growth

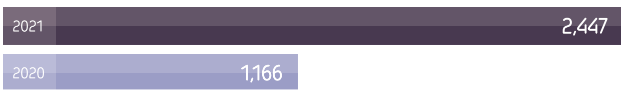


Dividend per share[10]

25.1p 6% growth

Net cash flow from operating activities

£2,447m £1,281m higher

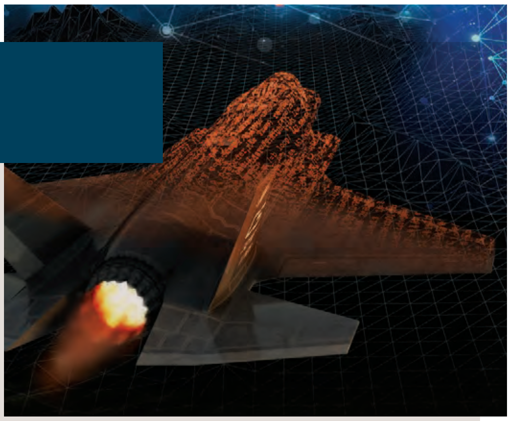


1. International Financial Reporting Standards.
2. Generally Accepted Accounting Principles.
3. The purposes and definitions of non-GAAP measures are provided in the Financial glossary on page 78.
4. Growth rates for Sales, Underlying EBIT and Underlying EPS are on a constant currency basis (i.e. current year compared with prior year translated at current year exchange rates). All other growth rates and year-on-year movements are on a reported currency basis.
5. With effect from 2021, the Group adopted the underlying EBIT profitability measure in place of the underlying EBITA measure. Further details are provided in the Financial glossary on page 78.
6. The one-off tax benefit in 2021 is described on page 71. Growth rate disclosed excludes the impact of the 2021 one-off tax benefit.
7. 2020 Free cash flow of £1,367m is before a £1bn UK pension scheme contribution.
8. Including share of equity accounted investments.
9. Order book represents the transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.
10. The 2020 dividend per share of 23.7p is in respect of the year ended 31 December 2020. An interim dividend of 13.8p per share was paid in 2020, in respect of the year ended 31 December 2019, having been proposed as a 2019 final dividend but deferred in light of the pandemic.

Our business at a glance

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

Air

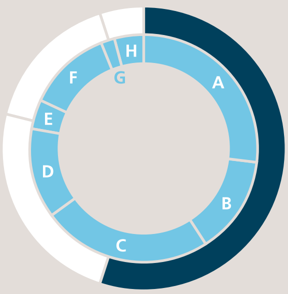


Sales[1] by domain

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 advanced defence electronics equipment for military aircraft, which enable next-generation threat detection, countermeasure and attack, a global leader in electronic warfare systems
- Design, manufacture and support of advanced electronics for commercial aircraft
- Development of next-generation unmanned and future air system capabilities under the Tempest programme, and defence information systems
- In-service support of Tornado combat aircraft
- Manufacture, upgrade and in-service support of Hawk trainer aircraft
- Design and manufacture of missiles and missile systems through a 37.5% interest in MBDA

Sales[1] by line of business (%)



A	Typhoon	27%
B	F-35 Lightning II	14%
C	Defence electronics	24%
D	Tornado	13%
E	Commercial avionics	4%
F	Weapon systems	12%
G	Hawk	2%
H	Other	4%

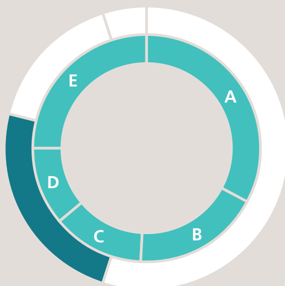
Maritime

Sales[1] by domain

24%

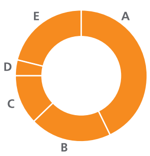
- Design and manufacture of submarines
- Design and manufacture of complex warships
- Provision of naval ship repair and modernisation services in the US
- Provision of in-service support to surface ships and facilities management in the UK
- Design, manufacture and support of naval gun systems, torpedoes,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

Sales[1] by line of business (%)



A	Submarines	33%
B	Complex warships	18%
C	US naval ship repair	13%
D	UK naval support	11%
E	Other	25%

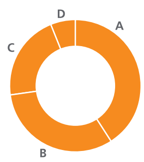
Sales[1] by destination



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	43%
B	UK	20%
C	Saudi Arabia	12%
D	Australia	4%
E	Other international markets	21%

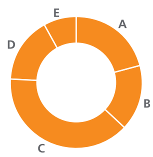
Sales[1] by activity



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	41%
B	Military and technical services and support	32%
C	Electronic systems	21%
D	Cyber	6%

Sales[1] by reporting segment



BAE Systems reports its performance through five principal reporting segments.

A	Electronic Systems	21%
B	Platforms & Services (US)	16%
C	Air	39%
D	Maritime	16%
E	Cyber & Intelligence	8%

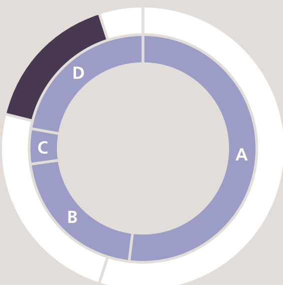
Land

Sales[1] by domain

16%

- 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 line of business (%)



A	Combat vehicles	52%
B	Munitions	21%
C	Commercial	5%
D	Weapon systems/other	22%

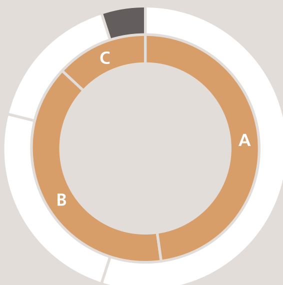
Cyber

Sales[1] by domain

5%

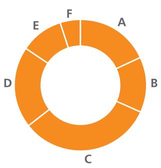
- Supply of cyber, intelligence and security capabilities to US government agencies
- Supply of cyber, intelligence and security capabilities to UK and other government agencies
- Supply of defence-grade cyber solutions for the commercial market

Sales[1] by line of business (%)



A	US government	48%
B	UK and other governments	39%
C	Commercial	13%

Employees by reporting segment



BAE Systems employs a skilled workforce of 90,500 people[2] in more than 40 countries.

A	Electronic Systems	16,400
B	Platforms & Services (US)	12,300
C	Air	29,700
D	Maritime	18,200
E	Cyber & Intelligence	9,600
F	HQ/other	4,300
Total employees[2]		**90,500**

2021 sales[1]

£21,310m

2021 revenue

£19,521m

Page 26 Our markets

Page 68 Group financial review

Page 30 Our key programmes and franchises

Page 81 Segmental review

Page 36 Sustainability – Environmental, Social and Governance

1. Sales is an Alternative Performance Measure as defined by the Group, being Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments. Note 1 to the financial statements on page 208 provides a reconciliation to the IFRS Revenue measure.
2. Including share of equity accounted investments.

Chairman's letter

Whilst the pandemic continued to challenge all businesses, I am pleased to confirm that BAE Systems proved to be robust and resilient in rewarding our stakeholders through strong operational performance delivering attractive financial outcomes.

First and foremost, we help governments fulfil their prime responsibility to provide security and safety for their countries and citizens.

Sir Roger Carr
Chairman

I cannot thank enough our people across the globe, who, under the leadership of Charles Woodburn, Tom Arseneault and Brad Greve, continued to work with enthusiasm and determination in the face of ongoing adversity to ensure we supported our stakeholders the world over.

My hope is that in 2022, vaccine programmes which protect so many, will enable us all to return to more normal conditions, remembering the lessons learned, but energised by the opportunities of the better days to come.

It is also clear, that the pandemic has emphasised the importance of business in advancing the Environmental, Social and Governance (ESG) agenda that is vital to all our sustainable futures. For that reason, I felt it would be helpful for me to summarise what I believe to be the important role that BAE Systems has in delivering security, prosperity and a fairer society in the communities we serve.

Our commitment to national security

First and foremost, we help governments fulfil their prime responsibility to provide security and safety for their countries and citizens. We are proud of the work we do to serve and equip those that serve and protect us, and we do so by being performance driven and values led.

In discharging our responsibilities, we adhere to the rules and laws of one of the most tightly regulated industries in the world.

Our government work is with governments who are partners and allies of the UK and the US, notably in the Gulf and Australia. We build advanced warships, submarines, land vehicles and military aircraft in addition to supporting our customers with first-class service and cyber capabilities.

In all cases we have a multi-dimensional relationship. A competitive supplier, a partner in projects, toe-to-toe in competitive bids, arm-in-arm in new product development, hand-in-glove in trade missions, always conducting our business with ethics at the top of our own agenda.

Our commitment to education and training

We are closely aligned with government priorities in the markets where we operate, on education, skills training, a fairer distribution of opportunity and a focus on an environmental agenda that preserves the planet for us all.

We are leading advocates in correcting the false perception that apprenticeships are somehow a second-class achievement when compared with a university degree – emphasising that skilled apprenticeship qualifications are invaluable, opportunity enriching, economically important, and a key driver of social mobility.

I see this every day in our business, where in the UK in recent years we have hired around 800 apprentices per year and in 2021 over a quarter of these were selected from the more socially disadvantaged parts of the community. We see them grow into accomplished and confident people, who become valued and immediate contributors to the economy.

In this regard, our investment of around £90m in education and skills last year alone, continues to provide us with a pipeline of talent for the future and a remarkable return on our investment in human capital.

There is little doubt that education and training is the first step on the road to international competitiveness, but it is also an unquestionably important driver of social change.

Levelling up is a UK government objective, and fairness is a driving force in all our communities. Talent is not the exclusive preserve of one particular region and we recognise that it is a resource that we nurture to ensure that as a company we are comfortable in our own skin, and as a business we are a competitive entity with a sustainable future.

Our commitment to economic prosperity

Our engineering and manufacturing capabilities in the UK are concentrated in the north west of England with more than 20,000 highly skilled people, totally committed to designing, developing and building for some of the world's most advanced military aircraft, the Typhoon and F-35, based in Warton and Samlesbury, and in parallel, nuclear submarines in Barrow-in-Furness.

Indeed, at BAE Systems alone we made an annual contribution to UK 2020 GDP of over £10bn, delivering just under £4bn in exports and resulting in the employment of 143,000 people directly and indirectly through a network of 5,000 suppliers.

Our manufacturing capabilities are across the UK. In Scotland we are building the Type 26 frigate, a design developed in the UK and now adopted by Australia and Canada, reflecting the quality of British skills and engineering.

Internationally, the US represents 46% of our revenues, employing 31,000 people coast to coast, in advanced electronics, military vehicle production, ship repair and cyber.

In Australia, we are building Hunter Class frigates – an advanced anti-submarine warship made by Australians for Australians, in a world-class shipyard funded by the Australian government.

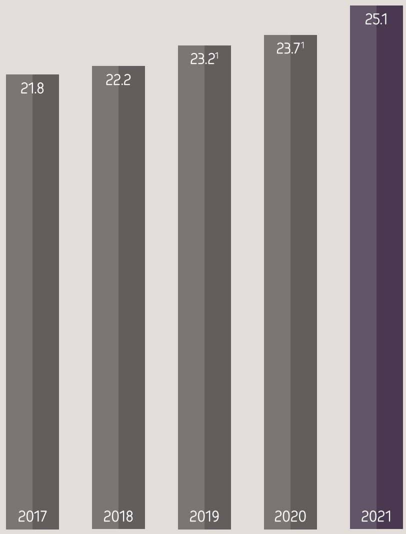
To these major centres of production, we add military jet assembly in the Gulf and a partnership in India, all delivering high-quality jobs and state-of-the-art products and services to provide our customers with military capabilities that are second to none, and to contribute to their economies as a result of our long-term relationship.

Sir Roger Carr with employees during a visit at Portsmouth Naval Base.

Dividend per share

25.1p

6% growth



1. 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.

Chairman's letter continued

Our commitment to sustainability

We recognise that if we wish to win the support of our stakeholders we know we must show leadership, not simply in the products we deliver, but the values we demonstrate.

We supported COP26 and have set ourselves a 2030 net zero greenhouse gas emissions target. Within BAE Systems, Charles Woodburn, as Chief Executive Officer, is the thought leader and prime driver of this important target and the Group has responded to his direction with energy and enthusiasm.

For us all, ESG is not an optional extra in the way we do business. Protecting the environment is mission-critical and engaging with our communities an essential part of our business model, with diversity and inclusion firmly baked into the DNA of the Group.

As I reflect on the last 12 months, there is no doubt that COVID-19 has reinforced our commitment to the societies in which we operate and the importance of relationships with colleagues and communities on which we depend.

Internally we have revised our communication methods using technology to connect with greater informality and increased regularity across the organisation. This has supplemented the traditional interaction the Board has with our colleagues through town halls, site visits and trades union gatherings which were limited through the pandemic, but are now returning as restrictions are lifted.

Whatever challenges COVID-19 may have brought to our business, adversity has undoubtedly brought us all much closer together – a lasting benefit from a difficult period which we are determined will not fade as better times return.

Our commitment to good governance

All of this work is overseen by a first-class Board which I am privileged to chair. We are currently 14 in number with a healthy mix of age, gender, experience, ethnicity and nationality.

In compliance with the UK government's Special Share requirements a majority of the Board and our Chief Executive are British nationals. We also meet the targets set by the Hampton-Alexander and Parker reports with regard to gender and ethnic diversity.

The skillset is a broad mix of finance, operations, HR, strategy and AI. All have earned their place on merit. Four have been recruited in the last 12 months as part of normal succession planning with one further appointment to be made in 2022.

In recognition of our unique position in the US, where we are a top ten prime contractor to the US Department of Defense, our governance structure is augmented by the BAE Systems, Inc. board, which is populated by leading figures formerly from the US government and military and intelligence communities who ensure all that we do in the US is aligned with the needs and requirements of the nation.

It is against this background of multi-layer oversight, high quality board membership, and importantly, total commitment to best practice, that I am confident our business is genuinely performance driven and values led.

Summary

As a company our collective mindset is of immense pride in what we do, rigour in how we do it, people above profit, ethics above outcomes, and safety above everything. We care deeply about how we make money and not simply how much money we make.

It is with these firm beliefs and considerable endeavours that we have delivered sales of £21.3bn, underlying earnings of 47.8p per share, underpinned by an order backlog of £44.0bn and free cash flow of £1,864m.

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

Sir Roger Carr
Chairman

Work inside our Factory of the Future, in Warton, UK, which is being designed to enable a radically different approach to the design and manufacture of complex combat air systems.

Our social and economic impact in Barrow-in-Furness

The challenge

Barrow-in-Furness is a town in Cumbria, North West England and home to our Submarines shipyard. It is a small, densely populated and relatively deprived area with some of the poorest health outcomes in Cumbria. Approximately 29% of Barrow's working age population is employed at our shipyard.

Our business requires the local area to provide people with the right skills and behaviours to deliver our business plan and a supply chain that is efficient, effective, responsive and flexible. In order to achieve this, the right social, economic and environmental conditions must be present. The health and prosperity of the local area is a unique strategic imperative and crucial to our business success.

To support this we collaborate with partners and create a strategic and proactive approach to help overcome local challenges.

Our commitment

The challenges faced in the local area are, and will remain, significant. They will require a long-term, evidence-based, collaborative and well-resourced response, but the initial indicators of the effectiveness of Submarines' involvement are encouraging. Please also see details of the unclaimed asset programme on pages 62 and 63.

Our contribution

- Through the Movement to Work programme, we have offered in excess of 170 placements to young unemployed people in Barrow, approximately two-thirds of whom have transitioned onto apprenticeship programmes.
- We work with local partners to deliver a wide range of activities across different stages of education. This has included supporting the Furness Education Trust since its inception in 2009, with £400,000 in funding as well as ongoing in-kind support, which have contributed to the Trust moving from OFSTED 'Special Measures' to 'Good' and increasing student entry numbers by 184% over that period.
- As a key stakeholder in the 'Town Deal' partnership, we have worked with a number of local partners to develop a town investment plan, which resulted in a successful application for £25m of government funding to improve the local area. The plan includes the creation of a £10.4m Barrow Learning Quarter, consisting of a new university campus and the establishment of a number of Community Resilience Hubs.
- We have supported the local Barrow Dock Museum project which helped attract £900,000 of further investment. We funded a counselling service with the Cumbria Alcohol and Drugs Advisory Service to provide support to those who signal they may have a drug or alcohol problem.

Chief Executive's review

During 2021, we delivered a strong set of financial results, progressed our strategic objectives and accelerated our Environmental, Social and Governance (ESG) ambitions, all against a continuing challenging backdrop.

> 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

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

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

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

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

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

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

Safety and wellbeing

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

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

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

> 2021 has been about evolving, accelerating and integrating our sustainability agenda.

ESG

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

We recognise that the way we do business and the actions and behaviours we demonstrate are vital for the future strength of our business and we want to continue to increase our ambitions and accelerate our progress. We made some real strides in 2021 as laid out in detail in the Sustainability – Environmental, Social and Governance section on pages 36 to 67, with some notable highlights being: setting ourselves the target of achieving net zero greenhouse gas emissions across our operations by 2030 and joining the United Nations 'Race to Zero' campaign; driving a bolder set of diversity ambitions to be recognised as a leading employer in defence and security for valuing diversity and inclusion; committing to cease handling white phosphorus; and gaining accreditation as a real living wage UK employer. All are examples of accelerated progress achieved through stakeholder engagement underpinned by a strategic rationale.

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

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

2021 operational performance

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

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

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

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

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

Chief Executive's review continued

Charles Woodburn hosting a visit for our non-executive directors to the Factory of the Future, Warton.

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

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

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

Driving competitiveness and efficiency

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

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

Portfolio

We continue to evaluate and increase value creation from our portfolio through acquisitions and disposals as we align to our customer needs and priorities in addressing the evolving threat environment. The US acquisitions completed in 2020 are performing well and construction is progressing on the new facility for the GPS business to maintain delivery of market-leading technologies. In respect of disposals, we sold the Filton and Broughton sites generating a good cash result, the BAE Systems Rokar International business, and our stake in Advanced Electronics Company, one of our Saudi Arabian portfolio companies.

We completed two new acquisitions in 2021, both in the UK, firstly a small technology bolt-on which enhances our data and digital capabilities, and secondly In-Space Missions, a company that designs, builds and operates satellites and satellite systems, enabling us to combine BAE Systems' experience in highly secure satellite communications with In-Space Missions' full lifecycle satellite capability. We also announced we had entered into a definitive agreement to acquire Bohemia Interactive Simulations, a leading developer of advanced military simulation and training software, headquartered in the US.

Advancing and further leveraging our technology

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

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

Demand outlook

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

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

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

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

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

Our portfolio is well positioned to benefit from increased defence spending in Asia-Pacific through our Australia business, which is already set to grow significantly due to our contracted positions, and through export opportunities from our UK, US and Australian business to the region. The AUKUS announcement in September 2021 is strategically significant.

As the largest defence provider in the UK and Australia and a top ten prime contractor to the US Department of Defense we are well positioned to support our government customers in these nations as discussions progress. This is a clear example of how nations are looking to coordinate capabilities in multi-domain operations to address the threat environment.

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

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

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

Balance sheet and capital allocation

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

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

Post-employment benefits schemes

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

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

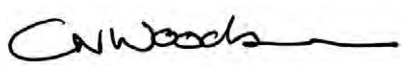
Executive Committee changes

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

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

Summary

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



Charles Woodburn
Chief Executive

Our strategic framework

Our strategy is comprised of six 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
1 Sustain and grow our defence business	– Defence sales grew by 3% – 2021 orders ahead of expectation – Number of major long-term programmes continued to grow – Increased self-funded R&D	– Strong order backlog and long-term programme positions – Defence spending increasing in many of our major markets – Good opportunity pipeline in all our sectors – Geopolitical and macro risks still remain
2 Continue to grow our business in adjacent markets	– Work continued on key controls and avionics development programmes including 777X – BAE Systems' clean propulsion systems continued to expand its product offerings and markets – Hydrogen Fuel cell partnerships and EVTOL investments announced – Acquisition of In-Space Missions	– Our clean propulsion systems technology is well placed as demand for low and zero emission technology grows – Commercial aerospace recovery is expected in the coming years – Cyber security and digital technology opportunities with allied governments – Investment in space capabilities to drive revenue growth in this domain
3 Develop and expand our international business	– Qatar programme moving into aircraft delivery and support – A number of significant export awards for MBDA – CV90 awards in several markets – Continued to widen reach and relationships in targeted markets especially in Asia-Pacific	– Strong bid pipeline in Europe, Asia-Pacific and Middle East supported by increasing defence budgets in many key markets – Opportunities to develop in new markets driven by threat environment and ability to export from UK, US, Australia and Sweden – MBDA remains well positioned across Air, Land and Sea
4 Inspire and develop a diverse workforce to drive success	– Progression of employee value proposition to drive recruitment marketing strategy – Recruited a record 1,373 apprentices and graduates in the UK – Established new gender diversity metrics, embedded our ambitions into process, practices, policies, systems and training – Implemented talent management framework across all levels and relaunched leadership and learning programmes online	– Build stronger employee experience aligned to organisation culture and sustainability ambitions – Progress gender diversity goals and develop stronger ethnicity ambitions – Evolve recruitment transformation programme to focus on critical skills of the future – Develop workplace climate to build stronger culture of agility and inclusiveness, strengthening our commitment to mental health, safety and wellbeing
5 Enhance financial performance and deliver sustainable growth in shareholder value	– Strong set of financial results delivering order intake, sales, EBIT, EPS and free cash flow growth – Dividend increased for 17th year in a row – £500m share buyback announced in July 2021 and completed in February 2022	– 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 – Delivery on rolling three-year cash targets enables strategic flexibility to deliver a broad and balanced capital allocation policy and enhanced shareholder returns
6 Advance and integrate our sustainability agenda	– UN Race to Zero and 2030 net zero ambitions – Record UK apprentice hiring programme and continued investment in STEM and early careers – SASB submission and the introduction of disclosures in line with TCFD recommendations – Ongoing focus on safety and wellbeing and accredited as real living wage UK employer	– Develop 2030 net zero roadmap and mature TCFD disclosures – Progress ESG agenda and increase our visibility and impact – Use external benchmarks to set targets and metrics and drive improvements and ambitions – Engage employees and key stakeholders to set ESG priorities and drive integrated approach

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 2021

- Continued effective response to situations arising from the pandemic and supply chain disruptions
- Astute Boat 5, Anson launched
- F-35 aft fuselage production ramped to full rate quantities
- US Combat Vehicle production ramp
- Carrier Strike Group successfully supported on first operational deployments
- Increased profits year-on-year in all US sectors, Maritime, Applied Intelligence and at a Group level
- Acceleration of sustainability agenda

Our priorities for 2022

- Type 26/Hunter Class programme
- Initial deliveries of Typhoon for Qatar
- Continued multi-programme delivery on US Combat Vehicles
- Increased profitability in Platforms & Services (US)
- Further leverage strategic workforce planning
- Deliver against our ESG commitments
- Supplier quality and delivery
- Improve competitiveness

Continuously improve competitiveness and efficiency

Successes in 2021

- Focused on supply chain resilience in response to pandemic-driven challenges ensuring critical programmes remained on track
- Continued to drive value from our external spend and worked to further relationships with our strategic suppliers
- Savings and efficiencies achieved in continued COVID-19 conditions to help maintain productivity
- Data analytics and benchmarking implemented to drive cost saving programmes

Our priorities for 2022

- Increased collaboration across the Group and with industry partners to mitigate inflationary and supply chain challenges
- Continue to drive supply chain savings and ‘Partner to Win’ programme
- 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 core supply chain processes to maximise productivity and efficiency
- Aggregate our supply chain risk and illuminate lower levels of our supply chain to manage risk and support programme delivery
- Continued focus on efficient business and cost structures with lessons learned through COVID-19
- Investment in new technology and production techniques to drive efficiency

Advance and further leverage our technology

Successes in 2021

- £250m initial order for next phase of Tempest Future Combat Air System
- In-Space Missions UK acquisition
- DARPA contract for revolutionary Active Flow Control flight demonstrator vehicle
- Successful demonstration of autonomous armoured vehicle for Australian Army
- Our autonomous system used in successful test flights of Boeing’s Loyal Wingman for the Royal Australian Air Force
- University of Nottingham became our sixth UK strategic academic partner

Our priorities for 2022

- Grow our presence in space, especially Low Earth Orbit satellite market and use of space to integrate military domains with secure communication technology
- Develop our digital offer, including analysing large data sets to aid decision making on the battlefield
- Further develop products for All Domain Operations, including networking, battlefield situational awareness and resilient communications
- Continue electrification of platforms on land, sea and air, both for military and commercial customers
- Develop sustainable solutions for our customers and across our own operations, supporting our net zero targets

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.

Identifying customer needs

- We have established positions on long-term programmes
- Strong and collaborative relationships with our customers
- Our position as a trusted supplier allows us to identify emerging trends and opportunities for growth

Research and development

- Technology and innovation underpin our strategy and the development of products and services
- We partner with academic and industrial leaders to develop new technologies that support our future product strategies
- Clear focus for our research and development spend and that of our customers aligned to future product and services strategies

Bidding and contracting

- Focus on value for our customers while effectively managing risk
- Record of delivery on complex projects
- Partnerships with a network of suppliers supporting economic prosperity and development

Designing and developing

- Engineering expertise in developing cutting-edge products and services
- Product safety embedded in our designs to maximise safety in the manufacture and use of our products
- Products are designed and developed in a way that provides for future flexibility with the ability to upgrade in an agile manner

Advanced manufacturing, commissioning and integration

- Investment in advanced manufacturing techniques and facilities
- Focus on operational excellence with safety as a priority
- Management of complex projects and collaboration across global supply chains

Services, sustainment and upgrade

- Provide competitive services that add value for our customers
- Technical expertise acquired through product design and development
- Flexibility and responsiveness to maximise availability of our customers' products

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 14
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 50
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 34
Our investment in technology

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 67
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 38
Climate change and the 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 118
Governance framework

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 are the users of our products and services 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.

Supporting our communities

We contribute to the economic prosperity of the places where our people live and work through high value jobs and caring for and supporting our local communities. Supporting causes that have meaning to our business and the communities in which we operate is vitally important to us and our employees.

Climate change

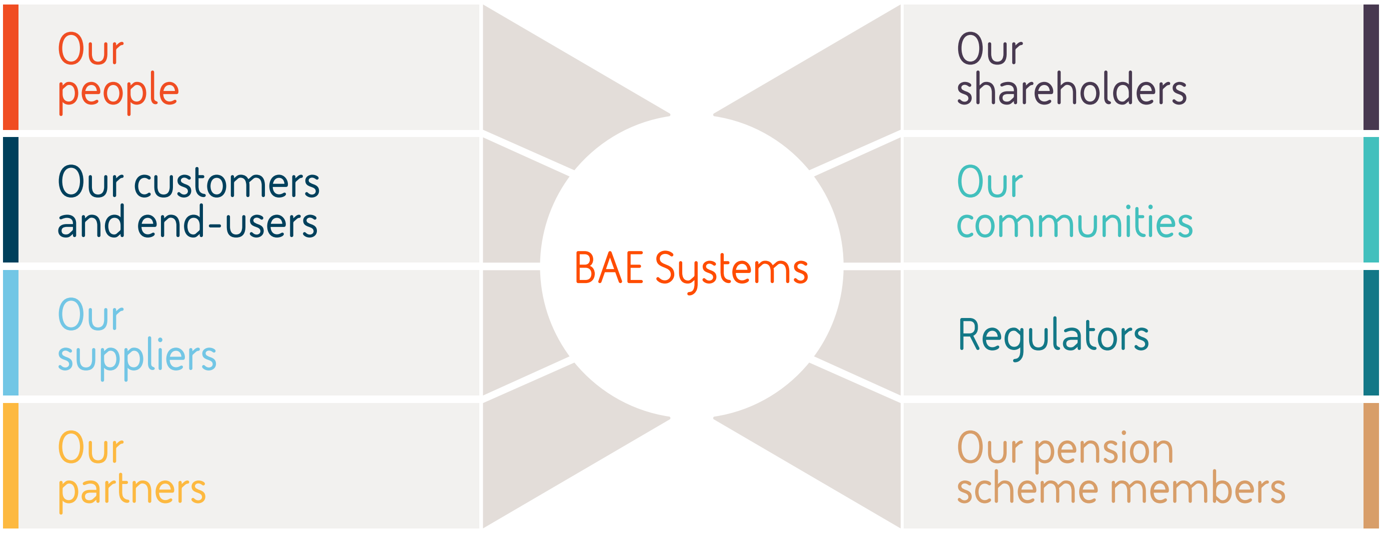
We acknowledge the significant and lasting impacts of climate change. Our goal is to develop and implement a long-term strategy that reduces the impact of our activities, supply chain and products on the climate by using our world-class engineering capabilities and cutting-edge technologies. We will also progress our ambition of net zero greenhouse gas emissions.

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 engaged in 2021
Our people Page 51 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 used a range of channels to engage with employees across the Group, including in-person and virtual meetings, briefings, conferences, toolbox talks, stand-downs and listening forums at all levels. Leaders provided regular updates through videos and podcasts. We also used digital channels including our Employee App, intranet, email and TV systems. Employees were encouraged to share feedback and get involved in Company activities. We ran surveys to measure employee sentiment in the year. Engagement has continued with trades unions in Australia and the UK and labour unions in the US.
Our customers and end-users Page 65 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.	Despite international travel restrictions and the cancellation of some events, we were able to meet customers at a number of exhibitions. At these events, we ensured virtual and hybrid channels were in place to engage with customers not able to attend. We used the Carrier Strike Group deployment to meet customers on board Royal Navy vessels as part of dedicated International Industry Days. We continued to hold regular face-to-face meetings, virtual sessions and programme reviews where possible. We worked closely with end-users at customer facilities, bases and sites, always ensuring we complied with local restrictions.

Stakeholders	Description	Areas of interest	Why we engage	How we engaged in 2021
Our suppliers Page 67 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.	We worked hard to engage directly with our suppliers early and maintained close relationships to ensure continuity of supply and to proactively manage risks arising from supply chain disruptions as a result of global events. This enabled us to support our suppliers through this challenging time, for example by providing extended demand visibility, ensuring timely payment and where appropriate having a flexible approach to terms of trade.
Our partners Page 53 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.	We engaged with our partners at physical and virtual events, including organising our own virtual conference to present PhD research we have co-sponsored with UK Research and Innovation. We maintained regular dialogue with industry partners around specific customer challenges that require a multi-partner approach, such as sustainability and multi-domain integration.
Our shareholders Page 24 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 – ESG 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.	A full investor programme was possible but given pandemic related restrictions engagement was largely virtual. This took the form of management and Investor Relations meetings and an increased number of conferences and bank-led Q&A sessions. We conducted a live broadcast from the DSEI trade show and held two capital markets events, one focused on technology and our US operations, the other on ESG.
Our communities Page 58 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.	Our volunteering and fundraising programme focused on virtual and online initiatives where possible. Employees volunteered their time and expertise through virtual mentoring and coaching, and we used online fundraising tools to encourage employees to participate in virtual activities whilst still being able to fundraise away from site.
Regulators Page 64 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.	We liaised openly and constructively with various regulators, including conducting ongoing discussions with UK and US regulators in support of efforts to reduce regulatory burdens, improve bilateral defence trade cooperation and support Company licensing strategy.
Our pension scheme members Page 24 More information	Members and trustees of our pension schemes	– Company performance – Member benefits – Pension fund investment strategy – Deficit recovery	To make sure current and former employees in our pension schemes are informed about how we continue to meet our commitments to them and ensure they have access to all the information they need to manage their pension arrangement.	We enhanced our UK pensions website for members, ensuring they have access to key scheme documents and a range of pension guides on key topics. All members received a newsletter to keep them updated and engaged in their pension planning; for members of our Defined Benefit pension schemes, this included an annual report on the financial health of their scheme. We continued to work with our Consultative Committees, to ensure ongoing dialogue between the Company, Trustee and members.

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 investment proposition

At BAE Systems we serve, supply and protect those who serve and protect us.

BAE Systems plc is one of the world's largest aerospace and defence companies, employing a highly-skilled global workforce of approximately 90,000 people located in over 40 countries. The geographic diversity of our business is a major strength and differentiator among our peers in the defence sector. We are the largest defence contractor in both the UK and Australia, and a top ten defence prime contractor in the US. Our business spans all domains of the global security market, from Air and Space, to Land, Sea, Subsurface and Cyber domains.

Our investment proposition

is driven by our consistent strategy and strategic priorities of…

Drive operational excellence

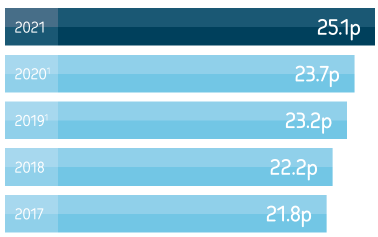
Continuously improve competitiveness and efficiency

Advance and further leverage our technology

The strategic actions, an accelerated and increasingly embedded ESG agenda and culture of the business are focused on long-term sustainable management and governance of our business and creating and delivering value for our stakeholders.

We are well positioned to successfully build on our track record of…

Shareholder returns



18 years of dividend increases

1. 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.

Clear, consistent and careful capital allocation

Pension – UK lump sum deficit funding completed[1]
Investment in business – included in earnings and cash outlook

Free cash flow

Dividend | M&A | Buyback

Maintain investment-grade credit rating and balance sheet flexibility

1. Per current funding plan. Next triennial review will be in 2022.

ESG agenda

Well-positioned portfolio | Sustainability agenda | Long-term programme visibility

Environment
- Goal to reduce environmental impact of our activities
- Committed to TCFD recommendations
- Target net zero greenhouse gas emissions across our operations by 2030

Governance
- Governance and business conduct
- Responsible supply chain

Social
- Our people and values – developing talent
- Positive social and economic impacts
- Technology investment
- Safety and wellbeing
- Human rights

Further embedding sustainability into business through strategic objectives → Benefit to all stakeholders

Accelerating our ambitions

Our outlook and investment proposition is supported by our five key competitive advantages

1 Multi-year programmes – visibility on value generators

- £44bn order backlog – we expect good order intake in 2022, further underpinning positive outlook.
- Incumbent positions on key long-term programmes in all sectors.
- Backlog in many cases is a subset of the expected through-life programme values for the following programmes:
  - F-35;
  - Dreadnought submarines;
  - Type 26 and Hunter Class frigates;
  - Typhoon support;
  - Saudi Arabia support;
  - US combat vehicle production; and
  - Electronic warfare technology.
- Provides visibility on value generators for years to come.
- All sectors positioned to grow from backlog and known programmes with a good opportunity pipeline.
- Projections are based on internal management estimates and reflect management's current assumptions, including assumed receipt of future orders.

2 World-class defence capabilities

Electronic Warfare
A leader in full-spectrum electronic warfare technology and solutions – customers increasing focus and growth expectation.

Combat Air
Consortium positions on F-35 and Typhoon – Leading availability model for combat aircraft support – Leading development of next-generation combat air systems and technologies.

Combat Vehicles
Build 4 of 5 vehicles in US Heavy Brigade Combat Team; CV90/BvS10 manufactured in Sweden.

Undersea Warfare
Design, build, combat management systems, weapons and autonomous systems capabilities.

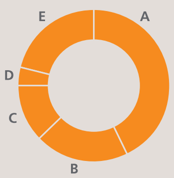
Cyber
Trusted partner for allied nations.

Combat Ships
Design, build, support and integrate complex combat ships.

Multi-Domain Capabilities
Well positioned to offer differentiated solutions in autonomous, networking and data exploitation – augments and differentiates our platform businesses.

3 Diverse geographic footprint – deep customer relationships

- Largest defence contractor in UK, Australia and top ten prime contractor in the US.



Sales[1] by destination

A	US	43%
B	UK	20%
C	Saudi Arabia	12%
D	Australia	4%
E	Other international markets	21%

4 Differentiated technology

- We have differentiated technology incumbent positions and are fostering a high-performance, innovative culture.
- More than 2,500 inventions protected by patents or patent applications.
- We are positioning for future growth aligned to customer priorities as threats in the grey zone mean defence needs to adapt.
- R&D is increasing as we look to build on existing world-leading technologies and generate new differentiating capabilities.

R&D investment increasing

Multi-domain	Autonomy	Advanced electronics	Sustainable technology	Electronic warfare	Cyber	Sensors and processing

- We are accelerating the pace of innovation through collaboration and partnerships with leading defence laboratories and educational institutions.

5 Value creating operating model

Balanced mix of production, aftermarket	Efficient R&D model – customer, self and collaboration funded	CAPEX – self and customer funded – franchise specific	Advance payments

Strong operating model – negative working capital

In summary, these competitive advantages and pushing our strategic actions deliver a compelling investment proposition for our shareholders.

What we look to achieve in the coming years...

- Strong consistent programme performance
- Technology investment
- Efficiency and simplification in working
- Portfolio shaping for value creation
- Secure further opportunities and widen market base
- Accelerate our sustainability agenda

- Top line growth
- Margin expansion
- Strong cash conversion
- Focused capital allocation
- Higher ROCE

Attractive shareholder returns

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, on pages 22 to 25, we highlight some of the key decisions and discussions undertaken by the Board in 2021.

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."

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 18 Our stakeholders
- Page 51 People
- Page 58 Supporting our communities
- Page 134 Environmental, Social and Governance Committee report

Overview of the year

After the unusual demands of the COVID-19 pandemic in 2020, last year saw the Board engaged in a more normal pattern of activity – all ultimately aimed at promoting the long-term success of the Company. The easing of COVID-19 restrictions as the year progressed allowed the directors to meet collectively in person and also for a number of non-executive Board members to join senior executives on visits to our sites, to engage directly with employees. Led by the Chief Executive and the President & Chief Executive Officer of our US business, high-level customer engagement and meetings with business partners and major suppliers was also maintained, providing essential feedback on performance and other matters – details of which were relayed to the Board.

The Board was alert to the ongoing impact of the pandemic, particularly with regard to how our employees were affected. Regular updates were received on this matter, which included the work that was being undertaken across the Company to promote awareness of mental health issues. The Board welcomed the increased levels of communication and the steps taken to support employees during the pandemic. The Board received feedback direct from employees, with the opinion survey conducted across the UK and Rest of World businesses specifically asking about mental wellbeing and how the Company had supported them during the pandemic – the questions referring directly to these matters received favourable response rates of 70% and 79% respectively.

Looking beyond the pandemic, it also had initial discussions on future ways of working and considered potential structural changes to the workplace. The personal tone and increased levels of communication fostered at the peak of the pandemic were maintained, and the Board was pleased to see the positive feedback from employees with regard to the authenticity and more conversational style of communications.

Our Company purpose is the starting point for our strategy. At the heart of that is a recognition of the fundamental importance of defence and security to society, and our core purpose of serving, supplying and protecting those who serve and protect us. The Board has discussed the Company's purpose at length and has identified the need to engage more widely with all stakeholders to communicate the vital role played by companies such as BAE Systems. Only the defence industry can bring together the technology, know-how and resources needed to provide our government customers with the means to fulfil their primary responsibility – ultimately, to provide security and safety for their country and citizens.

Key matters considered and decisions made in 2021

Company culture and employee engagement

During the year the Board considered the Company's culture, and the results of recent employee engagement surveys were used to help inform the Board's deliberations.

Members of the workforce in the UK, Australia and the Kingdom of Saudi Arabia undertook a comprehensive employee engagement survey. Additionally, a random sample of 20% of the workforce of the US business undertook a pulse survey that reviewed employee perceptions. For our non-US businesses (comprising 43,000 employees), the survey was similar to one undertaken in 2018, which was used as a baseline to compare and identify changes. The three principal objectives of the survey were: to assess employee engagement; to understand progress in achieving alignment with certain behaviours adopted and promoted by the Company; and, to hear about employee experiences during the COVID-19 pandemic.

In reviewing the results from the UK, Australia and the Kingdom of Saudi Arabia, the Board noted that there had been an increase in favourable scores across all questions, compared to the 2018 survey. The biggest increases related to questions focused on Company behaviours, speaking up, collaboration and embracing new ways of working. The survey also highlighted the need to continue our focus on how we engage with certain areas of the workforce and on completing the work initiated on early careers development. One of the highest scores received was in response to a question regarding how proud employees were to work for our Company. This, and other questions designed to benchmark employee engagement, all showed increases in the level of favourable responses.

In its review of culture, the Board endorsed the Behavioural Framework that is central to the work being undertaken by the Chief Executive to accelerate performance, it being based on the following behaviours: inspiration; courage; integrity; people development; collaboration; adaptability; creativity; and strategic vision. It also welcomed the tone set by senior leaders in continuing to advance an inclusive workplace and one where employees feel their differences are valued.

On the basis of the work undertaken by the Board in considering feedback from employees and in reviewing the Company's culture, it agreed the following objectives:

- drive greater focus on engagement with the manual workforce and on millennial career development;
- undertake further work on refining our behaviours to reflect the feedback and recent learning;
- build on our engagement with employees and the positive sentiments evident regarding Company purpose;
- ensure that we drive forward on the work underway looking at the Future of Work; and
- maintain focus on workforce health and wellbeing.

The Board will continue to monitor our corporate culture and ensure it remains aligned with our values and purpose.

Strategic development and investing for the future

In his opening remarks to the Board at the start of its annual Strategy Review in November last year, the Chairman reminded directors of the long-term nature of the business. He highlighted the importance of making sound strategic decisions and judgements that would be the foundation of the business in future decades. For example, the current Typhoon programme is based on customer and Company decisions made in the early 1980s and we are likely to benefit from those decisions for another two decades.

Digital technology is having a major impact on the nature of the defence and security challenges faced by our government customers. Against that background, the Board spent time in 2021 looking at the future of defence, drawing on engagement with customers and developing the strategic understanding and outlook against which we can make decisions today, to promote the success of the Company in the decades to come. The Board continues to exercise oversight over the development and performance of today's business, while at the same time planning for the long term, in strategically important areas such as autonomous systems for multi-domain operations, digital infrastructure for the future battlefield and sustainable solutions for defence and commercial customers.

To help the Board develop a more detailed understanding of the technologies that will determine the long-term performance of the Company and in developing strategically important capabilities, it created a new board committee last year, the Innovation and Technology Committee. This Committee is chaired by Dr Ewan Kirk, who has a deep understanding of digital technology and innovation. As part of this role (and always respecting national security requirements) he has been engaging with employees to help understand the technologies and capabilities we have at present and how we can develop these to meet the long-term needs of our customers. This year, the members of the Committee have a programme of meetings that will see it holding meetings at our sites and taking the opportunity to meet employees that are innovating for the future.

The work of the Board continued

AGM vote and succession planning

As reported to shareholders last year, following an unsolicited offer made to the Chief Executive, Charles Woodburn, the Board agreed to take steps to secure his continued leadership of the Company. It did so having agreed the significant contribution that he had made since his appointment and the importance of his role in leading the Company at a critical time in its development. Based on feedback received from customers and other stakeholders, the directors believed that continuity in leadership was crucial to maintaining customer relationships and in sustaining the progress made in the execution of major defence programmes, which are vital to the long-term success of the Company.

With the support of the Board, the Remuneration Committee agreed certain changes to the Chief Executive's salary and incentives and achieved the objective of securing his continued service. Those changes were an important part of the Directors' Remuneration Report as put to shareholders at the Company's AGM in 2021. The resolution was passed with over three-quarters of votes cast in favour and the directors were very appreciative of the support the resolution received. The Board acknowledges the importance of shareholder views and feedback. We continue to engage with investors to maintain open dialogue and to ensure we understand their views. We recognise that from time to time, the views and priorities of shareholders may differ and we have to consider how best to balance these views when decision making. Prior to the meeting, largely facilitated by the Chairman, the Board engaged with shareholders accounting for nearly 70% of the Company's share capital. The depth of engagement was positively received as was the exceptional level of transparency in both the dialogue and also in the reporting provided by the directors in the 2020 Annual Report. This engagement provided the Board with a clear understanding of the ongoing support for the current senior executive team, but also feedback that the Board should ensure robust succession plans.

Executive director succession planning, therefore, was a key focus for the Board in 2021. It completed an in-depth review of succession plans for all Executive Committee level roles including the Chief Executive. This included a rigorous analysis of key executives identified as possible 'ready now' successors for each of these roles. More details of the review have been provided in the Nominations Committee Report (see page 126).

Similarly, non-executive succession remained an important topic for the Board as seasoned and valued members drew towards the end of their terms of office as independent directors, in accordance with the provisions of the UK Corporate Governance Code.

Capital allocation – share buyback decision

Having completed the Integrated Business Planning (IBP) process in November 2020, the Board recognised the long-term strength of the Company based on its programmes, technologies and customer relationships. The strong foundations of the business were evident in its performance, particularly with regard to cash. The long-term nature of many of the Company's key programmes and franchises provides a firm basis from which to forecast performance, and subject to risks and uncertainties, invest for the future. Against this background of improving performance and the outlook for the business, the Board undertook a review of capital allocation, and accelerated returns to shareholders.

The starting point for the Board in these discussions was its funding obligations to Company pension schemes – the basis of an important stakeholder relationship with employees past and present. With regard to its principal funding obligations to the main UK scheme, it was recognised that the Company had agreed a funding plan in 2020 that reduced the level of deficit significantly through deficit contributions totalling £1.4bn.

The Board also considered the long-term needs of the business and the investment required to help ensure it is well placed to continue to provide the capabilities required by our customers in the long term. Notably, during the previous year, the Board had agreed a £1.7bn investment in two new US businesses to help us access complementary technologies and accelerate profitable growth. In addition, the Company continues to benefit from considerable capital investment across all of its principal operations, much of which is funded by our customers as part of long-term commercial agreements and programmes. The Board has also agreed major capital expenditure investments to be funded by the Company, most notably in our US Electronic Systems business and the FCAS programme in the UK.

Against a background of continued investment in the Company and meeting its wider stakeholder obligations, the Board considered a proposal to initiate a share buyback programme that would have the effect of enhancing returns to shareholders.

In order to ensure the necessary operational flexibility in managing the Company's operations, the Board agreed the need to continue to manage the balance sheet conservatively and maintain its objective of paying dividends, in line with its policy of long-term sustainable cover of around two times underlying earnings.

A share buyback programme of up to £500m was agreed in July, noting that the return from this would be in excess of the Company's weighted average cost of capital. It also agreed in principle with the trustees of the main UK pension scheme as to the deficit recovery implications of a buyback, pursuant to which it was subsequently agreed that additional deficit funding would be provided to the value of 10% of the value of the buyback programme.

Climate change

At the end of 2020, the Company set a target of achieving net zero greenhouse gas emissions across our operations by 2030. The directors previously reviewed the proposed strategy for achieving this and considered the infrastructure and activity required to achieve the goal. Further work was undertaken by the Board during 2021 to continue to develop directors' knowledge and understanding of the Company's climate transition strategy and the associated risks and opportunities. In particular, it looked at how customer requirements were likely to change, in order to address the climate policies being adopted by government customers. Consideration was also given to the possible impact that climate change will have on the Company's supply chain and the Company's ability to react and innovate in delivering a sustainable future that addresses the challenges posed by climate change.

The Board has developed an initial understanding of the Company's climate transition priorities and risk profile, and this will continue to mature over time with the availability of more refined data.

As part of its Strategy Review the Board was provided with feedback on the results of customer engagement and the need to adopt more environmentally friendly solutions to reduce greenhouse gas emissions. The Board also considered the initial results of the work undertaken to identify key technologies required to address our customers' sustainability requirements. These have focused on step-changes in fuel efficiency and options to use non-fossil fuels to power land and maritime platforms. Based on our power management expertise derived from our US-based digital aero-engine controls business, the Company has been at the forefront in providing sustainable transit bus solutions for some time. As part of the 2021 Strategy Review, the Board agreed the importance of continuing to identify and invest in sustainable solutions for defence and commercial customers.

Ethical business conduct

The success of the Group is underpinned by our ability to uphold high standards of governance and ethical business conduct.

The Board sets the ethical standards and values that guide all that we do as a Company. It also regularly reviews the activities that ensure we have a robust and effective ethics programme. At the end of 2020 the directors approved a refreshed Code of Conduct (the Code), after it had been reviewed, updated and externally benchmarked as part of a triennial review process.

The Code is an important part of how we embed our ethical standards and values into the organisational culture of the Company, which is facilitated by:

- leadership and role modelling;
- workforce communication and engagement;
- training and reinforcement; and
- encouraging the right behaviours, and the need to speak up.

During 2021, the Board reviewed ethical business conduct across the Company. It was informed that the roll-out of the refreshed Code of Conduct was ongoing and supported by our annual all-employee training programme based on discussions within teams. The Board was also provided with details of the contacts made to the Company's Ethics Helpline, analysing (on an anonymised basis) the reports made, including the nature of the matters reported.

The Board spent time considering how we maintain a robust, positive ethical culture that continues to reflect the changing needs of society, and is responsive to changes in the workplace – particularly one changed by the COVID-19 pandemic. The directors recognised our comprehensive approach to business conduct matters, welcoming the increasing use of data to provide greater insight into the workplace. They also appreciated the focus on employee engagement and communication aimed at bolstering a corporate culture that aligns with our values and behaviours.

Supply chain and customers

The Board was very aware of the supply chain challenges that many companies encountered during 2021, and received regular updates on the performance of our suppliers. Also, the Group's head of procurement briefed the Board on the actions that were being taken to manage any potential issues. It was informed that a proactive approach was being taken to manage supplier relationships with the Group working closely with suppliers to anticipate any issues and take action where possible to ensure continuity of supply. The value of long-term supplier partnerships was clearly shown during 2021, with our long-term global supply agreements – put in place prior to the pandemic – being of particular assistance in maintaining supply of certain critical commodities. In the UK alone, the Group supports over 5,000 suppliers and we are signatories to the UK government's Prompt Payments Code, through which we commit to assist those suppliers by paying promptly within the agreed payment terms. The Board is informed of any significant issues concerning our commitments under the Code.

Throughout 2021 the Board was briefed regularly on the status of our relationships with key customers. The Chief Executive and the President & CEO of our US business maintained a similar level of close contact with customers during 2021 as had been the case in 2020, despite the ongoing challenges of dealing with the pandemic. The decisions taken to support our employees during these difficulties fed through to our relationships with customers. For example, in the UK and Saudi Arabia, at the height of the pandemic, our employees continued to support Typhoon aircraft availability in very difficult circumstances, and our Maritime Services business successfully supported the Royal Navy in its first major Carrier Strike Group deployment. In the US, the decisions taken in past years to invest in new production capability and processes were critical to our ability to deliver an increased volume of combat vehicles to US military customers.

This year, provided there is a continued easing of pandemic restrictions, the Board will be looking to engage more directly with customers.

Community investment

In 2019 the Board sought shareholder approval to amend the Company's Articles of Association, in order to facilitate a programme that would unlock the value represented by unclaimed assets on our share register. Having received that approval, the Board agreed to a programme whereby unclaimed share assets were sold and the proceeds used to fund good causes benefiting the local communities in which we operate (with a proportion of funds retained to be used, should it be possible to locate the former owners of the assets at a future date). Importantly, it was also agreed that this would be in addition to our regular funding for community initiatives.

During 2021 a total of £1.8m raised through the programme has been committed to six community projects, further details of which can be found on pages 62 and 63. Further commitments will be made to community projects this year.

ESG engagement

ESG matters were discussed on a regular basis by directors throughout 2021 – be that through the Environmental, Social and Governance Committee or in the Board itself. Our core purpose connects us to our stakeholders and during the year the Board continued to engage in communicating our ambitions for ESG matters.

The directors have continued to stress the importance of maintaining our focus on ethical business conduct, the safety of our workforce and promoting a diverse and inclusive workplace. It is also taking action to ensure that we play our part in tackling climate change, and engage more deeply in explaining the important societal role played by our industry in helping government customers fulfil their defence and security obligations.

In October last year, the Company held an ESG event and the directors engaged with more than 130 investors and other stakeholders. The topics discussed at the event centred largely on our environmental responsibilities and the robust governance processes we apply to our products and services – all of which is in addition to the legal and regulatory controls applied by governments. The event was well received, and we have committed to holding further such events in future, aimed at increasing the level of transparency and accountability we provide to stakeholders.

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 world's largest 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 and Australia, provides us with unique capabilities that can be leveraged across the Group to support our customers. The AUKUS announcement in September is a clear example of how nations are looking to coordinate capabilities in multi-domain operations to address the threat environment.

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.

Our market positions and discriminating capabilities are aligned with enduring defence priorities, to include our customers' requirements to operate in joint all-domain environments.

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 30).

Responding to changes in defence and security requirements

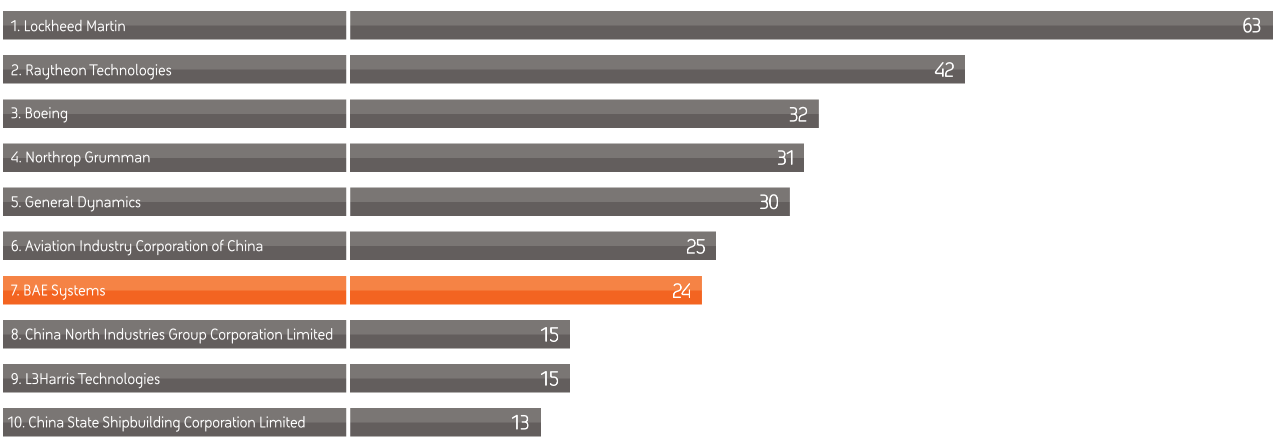
Our business continues to respond to geopolitical and technology trends that will influence and shape our customers' defence and security requirements now and in the future. Our excellence in complex engineering, developing cutting-edge technology and seeking innovative solutions enables us to respond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

Growth aspirations

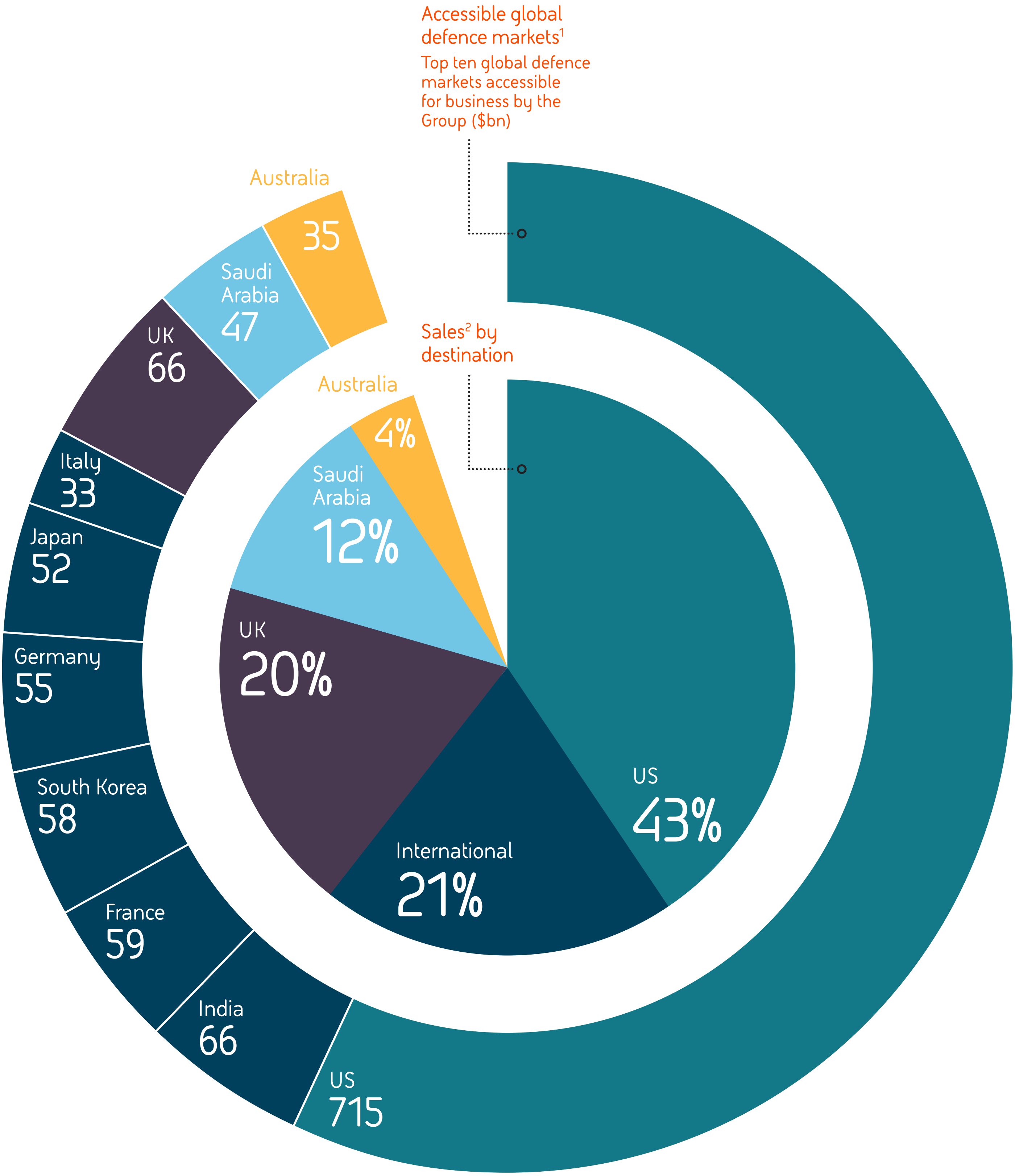
Budgetary growth and contract wins in a number of our principal markets in recent years has provided a growth platform for the Group in the coming years. Through long-standing customer relationships and the development of new ones, combined with the ability to leverage our range of capabilities around 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 2021 (based on 2020 numbers). Exchange rate applied to BAE Systems is $1.283/£1.



1. Markets inaccessible for business by BAE Systems are excluded.
2. Sales is defined in the Financial glossary on page 78.

Source: US budget figure is shown as President's defence budget request for the Department of Defense made in May 2021 for fiscal year 2022 and, outside the US, Jane's Defence Budgets (based on 2021 total defence budgets and constant 2021 US dollars).

Our markets continued

US

Sales[1]

£9,109m

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

Through a range of innovative technologies and proven capabilities, the US business continues to sustain its diverse portfolio of long-term defence programmes for the US Armed Forces and international allies. This US-based portfolio is well aligned to enduring customer priority areas. These include electronic warfare, precision-guided munitions, space security, naval ship repair and modernisation and combat vehicles. The business continues to work under Continuing Resolutions which is not without risk, however the threat environment is driving continued support for defence spending, which is aligned with our expectations for a relatively stable US market outlook.

The backlog for the US-based business remains robust and provides good visibility. 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 and capabilities we are leveraging to advance sustainable technologies across multiple domains.

Opportunities: Budget increases or prioritisation towards our capabilities; increased Foreign Military Sales; civil aerospace recovery earlier than expected; technology investments to market and synergy with existing capabilities; expanded workscope platform positions; and commercial operation expansion especially in sustainable technologies and space.

Risks: Defence budget constraints driven by US debt levels or spend priorities; slower civil aerospace recovery cycle post-pandemic.

UK

Sales[1]

£4,201m

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 at least 2% of Gross Domestic Product on defence. The Defence Command Paper issued in 2021 renewed commitments to our major long-term programmes in complex warship, submarine and combat aircraft design and build, allowing for long-term investment in these key sovereign capabilities, as well as strong support for cyber.

As a result, we have long-term visibility for our major UK operations in build and support and the Defence Command paper identified a number of new capability requirements which will create opportunities in the coming years. 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.

Cyber security and information advantage is increasingly important and the UK cyber budget is increasing, and we are well positioned to benefit from this increased focus.

Opportunities: Leveraging our expertise and capabilities into new domestic and export prospects and partnerships.

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

Saudi Arabia

Sales[1]

£2,497m

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.

We provide 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.

Saudi Arabia has a strong commitment to defence and security spending driven by regional security instability. Saudi Arabia's Vision 2030 strategy to transform its socio-economic landscape by encouraging private sector investment, unlocking non-oil related economic opportunities, achieving greater regional and global integration and promoting in-Kingdom industrialisation continues to shape our activities, in support of Saudi Arabia's national objectives of inward technology transfer and investment, economic diversification, local knowledge and skills transfer, and the development of an indigenous defence industry and capability. We continue to work with key local partners, including Saudi Arabian Military Industries to explore how we can collaborate to deliver further In-Kingdom Industrial Participation opportunities 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.

Australia

Sales[1]

£763m

International

Sales[1]

£4,740m

We have strong geographical diversity across our business

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.

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.

The AUKUS announcement in September is strategically significant and we will support our Australian customer as discussions progress. 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 and the AUKUS agreement.

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

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.

The build contracts for 24 Typhoons and nine Hawks for the Qatar Emiri Air Force are progressing well and our relationships are strengthening as we implement our support and training commitments with the Qatar 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, the Eurofighter consortium and our Hägglunds business 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. Germany and Spain are considering future Typhoon orders, and further Typhoon production 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. The UK, Italy and Sweden signed a Memorandum of Understanding to collaborate on the Tempest project at the end of 2020 which is progressing well. We also welcome the news issued in December 2021 outlining deepening sub-system collaboration between the UK and Japan on the Tempest programme and we continue to support the UK government in this positive, ongoing process.

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 also working on other prospects in Canada.

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

Our US-managed 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 the Asia-Pacific region, we are a supplier to a number of armed forces, both directly and through joint ventures.

Opportunities: Recapitalisation of ageing equipment and the threat environment mean there are export prospects in existing and new markets.

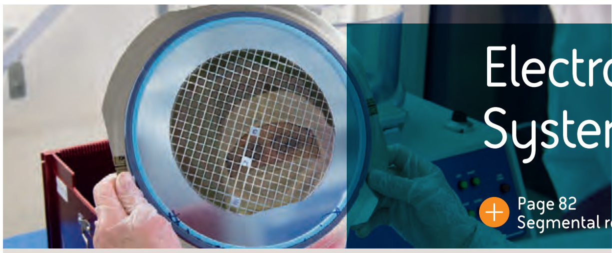
Risks: Threat environment and political priorities change and economic pressures mean defence spending reduces or is deferred.

1. Sales is defined in the Financial glossary on page 78.

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. We also have adjacent commercial positions, including in the sustainable technology and space markets, which we aim to expand pursuant to our strategy.

The programmes and franchises underpinning these positions are primarily long term in nature giving us high visibility of our order backlog. This allows for long-term planning to ensure we have the right people, processes and facilities to enable delivery.



Electronic Systems

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Segmental review

Platforms & Services (US)

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Segmental review

Air

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Segmental review

Maritime

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Segmental review

Cyber & Intelligence

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Segmental review

We have strong technological and programme diversity

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 reduced due to COVID-19 impacts on the civil aerospace sector and we 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 manufacturing

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 levels were achieved in 2021 with production now 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 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 four Astute Class submarines are in operational service with the Royal Navy, while the fifth boat is continuing final commissioning in preparation for sea trials later in 2022. The remaining two 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 underway, with production on the programme to continue into the 2030s.

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 be delivered 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, and we received an initial Concept and Assessment Phase contract.

Combat vehicles

Upgrade of tracked vehicles, including: Bradley Fighting Vehicles and M88 recovery vehicles; design and manufacture of M109 self-propelled howitzers and Armored Multi-Purpose Vehicles; and development of next-generation combat vehicles. Manufacture of amphibious vehicles for the US Marine Corps and international customers. The franchise offers good visibility with a robust backlog of combat vehicles to be delivered in the coming years by US Combat Mission Systems, together with upgrade, production and support awards for CV90 and BvS10 combat vehicles by the Hägglunds business in Sweden. Vehicle upgrade, build and support to the British Army through a joint venture with Rheinmetall.

Cyber security and intelligence

Delivery of a broad range of intelligence and security 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 anti-financial crime solutions for the financial services sector. The increasingly sophisticated technology and 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.

Space

World leader in radiation-hardened electronics for spacecraft and satellites with more than 10,000 cumulative years in orbit. Our orbital expertise combined with next-generation ground resiliency and data analytics solutions help to keep assets performing effectively in the harsh environments of space. The acquisition of In-Space Missions has added the capability to design, build and operate satellites and satellite systems.

Sustainable technology

Global leader in electric drive systems for low and zero emission bus propulsion systems with an extensive installed base of these systems. We are leveraging our existing product portfolio and advancing sustainable vehicle mobility, efficiency and capability for a range of applications in urban transit, maritime and military markets.

Our operational highlights

In 2021, we delivered on our customer-critical key programmes in a challenging global environment.

Advancing and further leveraging our technology

Technology investments increasing across the business, positioning the Group towards future growth areas.

F-35 full-rate production achieved in 2021

F-35 rear fuselage assemblies reached full-rate production in 2021, with 151 assemblies completed in the year.

Qatar contract milestones continue to be achieved

Qatar Typhoon and Hawk programme progressing well, with first five Qatari Hawks having entered into service at RAF Leeming, and first Typhoon flight completed prior to entry into service.

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Continued effective response to COVID-19

Ongoing focus on employee safety and adapting to evolving environment to deliver on customers' critical programmes.

F-35 electronic warfare systems

Electronic Systems surpassed a cumulative delivery milestone of more than 1,000 F-35 electronic warfare systems by year-end, and continues to support Block 4 modernisation efforts under contracts worth more than $870m (£642m).

Electronic Systems acquisitions performing as integration continues

Integration continues to progress for our 2020 acquisitions, and the Precision Strike & Sensing business received more than $600m (£443m) in new 2021 contracts from the Defense Logistics Agency.

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Maritime Services support to Royal Navy

UK Carrier Support Group 2021 was supported from Portsmouth and in various locations on its deployment by our Maritime Services business.

Fifth Astute Class submarine launched

Astute Boat 5, Anson, launched in April and is preparing for sea trials.

Construction of Dreadnought Class submarines

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

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

Type 26 City Class frigate construction for the Royal Navy continues. Australia Hunter Class frigate is progressing through prototyping, and Canadian Surface Combatant entered a key design stage in December.

Acquisition of In-Space Missions

The acquisition combines the Group's experience in highly secure satellite communications with In-Space Missions' full lifecycle satellite capability.

Continued increases in US combat vehicles production

Process and automation improvements continued to support increased combat vehicle production levels, notably on M109, Armored Multi-Purpose Vehicle and Amphibious Combat Vehicle programmes.

Multiple new international combat vehicle contract wins

BAE Systems Hägglunds secured multiple contracts for CV90 and BvS10 work, and RBSL won the Challenger 3 Main Battle Tank contract.

Our investment in technology

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 and inspire our employees.

The global defence environment is changing rapidly and is characterised by constant competition, from sub-threshold cyber activities, the deployment of autonomous platforms and the testing of advanced high-speed weapons with global reach. Our customers across NATO are seeking to address these threats and we are developing cutting-edge technology to support them. At the same time, both our defence and civilian customers are seeking more sustainable products, which is central to our future product development and the evolution of our own operations.

One of the most important steps we are taking is to help our customers in the integration of air, land, sea, space and cyber domains, in order to combine data into a single view to improve battlefield coordination and speed. As well as developing multi-domain digital battle management solutions, we are also working on the next-generation hardware needed for securely sharing the enormous volumes of data required.

We are using this unparalleled breadth of experience across every domain and our systems experience to create multi-domain digital technologies. Together with our partner Sierra Nevada Corporation, the US Air Force awarded us a contract to develop its next-generation signals intelligence technology. The team will provide a sensor prototype that collects and analyses adversaries' electronic signals to provide actionable insights. Our open architecture design means that our customer can easily add new capabilities in the future to counter evolving threats.

In the US we are investing in the development of a virtual System of Systems Testbed, a digital engineering platform that models, simulates and evaluates both emerging capabilities as well as advanced data management processes, before they are deployed into multi-domain operational environments. The US Marine Corps selected BAE Systems' PIONEER™ prototype to move to the second phase in the development and integration of a new, digitally advanced Wargaming and Analysis Center. Our team is demonstrating its innovative modelling and simulation for the digital transformation of wargaming across multiple domains using cutting-edge, explainable artificial intelligence, machine learning, and predictive analytics to support timely and effective decision-making at all levels.

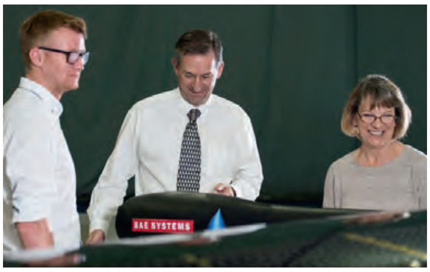
Space has been recognised by many of our customers as a key enabler of multi-domain integration, by allowing communications over global distances and providing real-time intelligence and reconnaissance data. We have acquired In-Space Missions, a specialist Low Earth Orbit company in the UK that gives us the ability to design, manufacture and operate satellites in space.

This acquisition adds to the considerable space capability already present in the UK and US businesses. In the US, our radiation-hardened electronics have been at the heart of every NASA mission from Apollo 11 to four generations of Mars Rovers/Landers, including the Perseverance Rover that landed in February 2021. In the UK we have specialist space technologies in waveforms, electronics, antennae and digital signal processing and analytics. We are currently developing a new suite of software-defined radios that could provide both global positioning and command and control services from Low Earth Orbit, helping our customers to be more resilient and connected.

The growth of autonomous platforms fielded around the world presents a challenge for western militaries, including how these systems can be effectively countered while maintaining human oversight and decision-making over the use of force. This is a challenge we are committed to helping them meet by contributing to a more resilient global digital infrastructure, as well as autonomous systems that complement humans rather than replace them.

In the UK we continue to develop our PAC-24 autonomous boat, which has been extensively trialled with the Royal Navy, while we have also worked with the Australian Defence Force to retrofit the M113 armoured vehicle with our platform-agnostic autonomy module. Both platforms have shown promising results and are acting as testbeds to integrate autonomy into existing operations. We are also working closely between the UK and Australia to use secure open architectures for these platforms, so that they can be integrated into our customers' existing platforms without limiting their choice of provider. The same Australian-developed autonomous system is being provided in Boeing's Loyal Wingman for the Royal Australian Air Force.

Collaboration



Collaborative working is core to how we will help solve tomorrow's technology challenges. In the UK, the University of Nottingham has become our sixth strategic university partner in fields such as advanced manufacturing and electrification of aircraft. Together we are re-writing the rules of manufacturing high value, low production rate products, which is vital in creating Tempest, the future combat air system.

Our Australian business has a similar partnership with Flinders University and the University of New South Wales, who are helping create what we aim to be the world's most sustainable shipyard, which will build the Hunter Class frigates. The US business partners with an extensive number of colleges and universities to not only collaborate on building our STEM talent pipeline, but also to solve technology challenges. For example, in 2021 the Electronic Systems FAST Labs™ team supported students at Rochester Institute of Technology in a capstone project to develop a search-and-rescue system in which multiple drones, equipped with on-board, autonomous mission software, could collaborate to quickly and efficiently search an area and find an object.

As well as academic partners, we collaborate with businesses in other industries such as Williams Advanced Engineering, a key player in motorsport. They are helping us bring electrification technology to some of our most critical products, replacing highly volatile fuel with batteries and improving the efficiency of electric motors.

We also apply technology from one domain into others. Our US business has brought its decades of flight control expertise to the UK's Dreadnought Class submarines. The team is developing electronics that control the heading, pitch, depth and buoyancy of the submarines to the highest levels of safety and reliability, adapting controls usually used in fly-by-wire aircraft to a maritime environment.

Sustainability

Technology will be at the heart of meeting our net zero targets. The work we are doing now on new digital manufacturing techniques is finding new ways to save energy, while the improvements we are making to operational bases is already saving energy. As an example of this, working with the Royal Navy, estate CO_2 emissions from Portsmouth Naval Base in the UK have fallen by more than 40% since 2004, even though energy demand has almost doubled recently due to the needs of the aircraft carriers at the base.

In the US we are bringing our proven expertise in electrification – with more than 14,000 electric drive propulsion systems installed worldwide today – into an area of potential global significance, electric flight. We are progressing technologies that will enable lighter weight, cost-competitive energy storage solutions for hybrid aircraft engines including our collaborative work with Jaunt Air Mobility and others.

We are working with Malloy Aeronautics, a UK-based SME specialising in electric uncrewed air vehicles, to create a new all-electric heavy lift quadcopter. This has the potential to deliver cost-effective, sustainable rapid response capability to military, security and civilian customers, without putting human pilots at risk when used in hazardous locations.

We have secured funding from the UK Department of Transport to design, develop and demonstrate new power and propulsion technologies for London, with the potential to reduce emissions across global waterways. In addition to electric propulsion and power management, we are exploring the use of autonomous maritime capabilities to transport people and goods around the city.

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 2021, we spent £1.6bn (2020 £1.6bn) on R&D, of which £255m (2020 £236m) was funded by BAE Systems. In addition, the Group's share of the R&D expenditure of its equity accounted investments in 2021 was £0.4bn (2020 £0.4bn).

We continue to protect our investments in technologies and have a portfolio of patents and patent applications covering more than 2,500 inventions internationally. Combined with a clear strategy for managing our intellectual property (including technology and know-how), we seek to create value in different ways through, for example, collaboration, licences and sales of rights to others.

2022 priorities

BAE Systems already offers data and digital services across all the domains it operates in, including sub-sea, sea, land, air, cyber and space. In 2022 we will focus on creating an information advantage for our customers by working with them to better integrate digital services across these domains.

Our acquisitions in 2021 help to underpin this approach, enhancing our space-based secure communication services and satellite design and operation through In-Space Missions, and our electromagnetic hardware services through Pulse Power and Measurement Limited (PPM).

Electronic Warfare continues to be a focus in our US business, as full-spectrum awareness and the ability to respond give our customers a distinct competitive advantage. As a world leader with six decades of proven experience in electronic warfare capabilities, we will continue to grow this area of the business to address emerging requirements, to include developing interoperability in the joint environment across all domains, which is a critical element of current and next-generation programme requirements and force modernisation.

We are also continuing our development of autonomy to complement humans, both in crewed vehicles such as Typhoon and in new uncrewed platforms such as PAC-24 and the Loyal Wingman in Australia. The future battlefield will become increasingly autonomous, so it is essential that we help our customers fight at the speed of machine-warfare and maintain command and control of their assets.

Sustainability remains an important area of focus for our business and our customers. We continue to offer low and zero emissions solutions, to include electric, battery electric, fuel-cell electric, and hydrogen options, supporting clean air and net zero initiatives, while also advancing vehicle mobility, efficiency and capability in urban transit, maritime and military markets.

As well as making our sites more energy efficient we are developing Industry 4.0 technologies to make manufacturing more sustainable. We are working with several university partners in the UK and Australia on sustainability with digital design, additive manufacture, novel materials and new power generation systems. These continue to play an important role on the Tempest combat air programme. In the US, we are applying innovative modelling, simulation and digital engineering across multiple business programmes, such as combat vehicle design, the US Marine Corps Wargaming and Analysis Center work, and our modernisation support of the US Navy's Strategic Systems Program.

See examples of how we are using our technologies to reduce the environmental impact of our activities on pages 48 and 49.

Sustainability – Environmental, Social and Governance

Our agenda and governance

We are a business that operates responsibly and sustainably, addressing our material Environmental, Social and Governance (ESG) risks and opportunities via our sustainability agenda.

Introduction

Our sustainability agenda supports our purpose (see page 1) and aligns stakeholder priorities with the Group's ESG risks and opportunities. Our objectives go hand in hand with our focus on improved performance and we continue to increase our ambitions and accelerate our progress across this area.

We are working towards a consistent, aligned framework and strategy from the Board through to the shop floor. A well-understood and clear programme is critical as we progress towards our targets and look to retain and recruit the very best talent to drive strong operational performance and value for our customers and shareholders.

While ever-evolving, ESG themes are not new to us, as we have been addressing them for many years with a robust operational framework (see page 118) and review process in place.

ESG in the defence sector

We all recognise the ESG agenda is broad, with many criteria and changing priorities. Through engagement with our stakeholders, we focus on the ESG areas which are most material to our sector, our communities and our business. We then apply a collective focus in addressing and managing the associated risks with our customers and supply chain.

From a materiality perspective, during 2021 we engaged with internal and external stakeholders regarding material sustainable issues for the Group. This materiality process confirmed that the Group is addressing and managing, via its sustainability agenda, the material ESG issues.

Integrating ESG into our operations

Our sustainability agenda 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 ESG, Culture and Business Transformation Director who advises on our strategy with input from a wide range of stakeholders.

Our Board Environmental, Social and Governance Committee provides oversight of the Company's agenda and progress, including approving ESG-related objectives and targets which form part of executive incentives. To support this, they hear from both senior management and the Company's subject matter experts. The Environmental, Social and Governance Committee routinely reviews data and participates in site visits and virtual meetings to engage with employees and hear their views. This feedback is an important element as it gives the Committee the chance to reflect employee perspectives into boardroom discussions.

During 2021, both safety and diversity were set as qualifiers to the overall award of the non-financial element of the executive bonus. In other words, good performance in both of these areas is expected rather than rewarded. Other elements specifically set within the non-financial element of the executive objectives are related to employee engagement, delivery of the next phase of the net zero plan and driving an inclusive culture.

The sectors address customer requirements taking into account our ESG principles and uphold our Code of Conduct with employees, partners and suppliers. Sector progress against our sustainability agenda is regularly reviewed via our Quarterly Business Reviews and CEO Business Reviews.

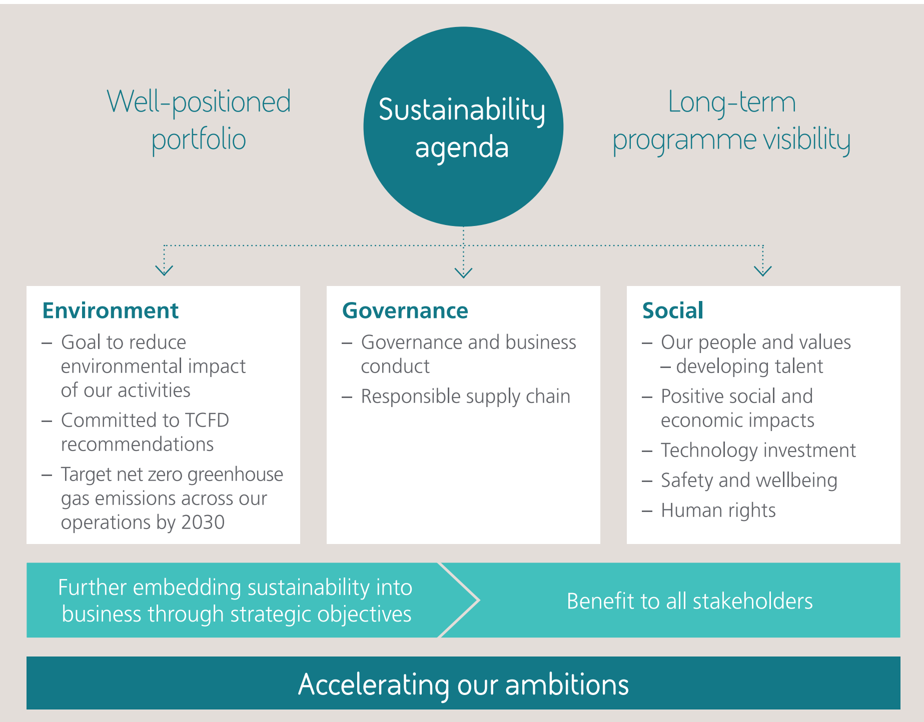
Cross-functional and cross-sector steering groups provide oversight and assurance and our operational assurance framework and Internal Audit confirm compliance with policies and processes.

Our approach to UN Sustainable Development Goals

We continue to 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.

We continually review the SDGs to which the Group can contribute directly. The launch of our net zero ambition in 2021 means we have added SDG 13 – Climate Action, to the list of SDGs we directly contribute to. We have also added SDG 16 – Peace, justice and strong institutions, which reflects our Company purpose, in particular our role in helping our customers provide security and safety, and our commitment to governance, ethics and responsible behaviour.

The Group contributes to the six SDGs on the following page, by leveraging the individual elements of our sustainability agenda which will drive change for the Group and its wider stakeholders and communities. The global and wide-ranging nature of our business means that our programmes influence other SDGs.



Non-financial information statement

This section and the following sections of the Strategic report entitled 'Sustainability – Environmental, Social and Governance' (pages 36 to 67) constitute the Non-Financial Information Statement as required by the Companies Act 2006 as amended, together with the sections 'Our business model' (pages 16 to 17), 'Our stakeholders' (pages 18 to 19) and 'The work of the Board' (pages 22 to 25) which are incorporated in this non-financial information statement by reference.

Our sustainability agenda contributes to the following UN Sustainable Development Goals:

Quality education

We work closely with schools, colleges, training providers 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.

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.

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.

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.

Climate action

We are targeting the achievement of net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030 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 will collaborate with our suppliers and customers, and partner with researchers and technologists to innovate for a net zero future.

Peace, justice and strong institutions

We play a significant role in protecting nations and keeping people safe. Our products and services enable governments to defend the lives and freedoms of people around the world, support international stability, and keep people safe, both at home and overseas. Our technologies and people also support policing and law enforcement.

Our success depends on us being trusted to uphold high standards of governance and business conduct and we have an unwavering commitment to ethics and responsible behaviour, from anti-bribery to anti-corruption.

Our programmes influence these Sustainable Development Goals:

Our progress on Sustainable Development Goals:

Our UN Race to Zero target on the back of our bold 2030 target.

Increasing our gender diversity ambition to greater than 30% in the UK by 2030 and 50% of the Executive Committee by the same date.

Our commitment to cease handling white phosphorus.

Our accreditation as a real living wage UK employer.

Sustainability – Environmental, Social and Governance

Climate change and the environment

Climate change is one of society's greatest challenges. There is growing recognition of the impact of climate change on the future success of businesses. This includes, for our business, the physical impacts of climate change and the impacts of transitioning to a low carbon economy.

Solving the challenge of climate change requires all of us to act together, with urgency. One of the focus areas of our sustainability agenda is to play our part in addressing the significant and lasting impact of climate change. As a defence and security company, technology is at the core of our business and we must leverage this while progressing our ambition of net zero greenhouse gas emissions. Our goal is to develop and implement a long-term strategy that reduces the impact of our activities, supply chain and products on the environment.

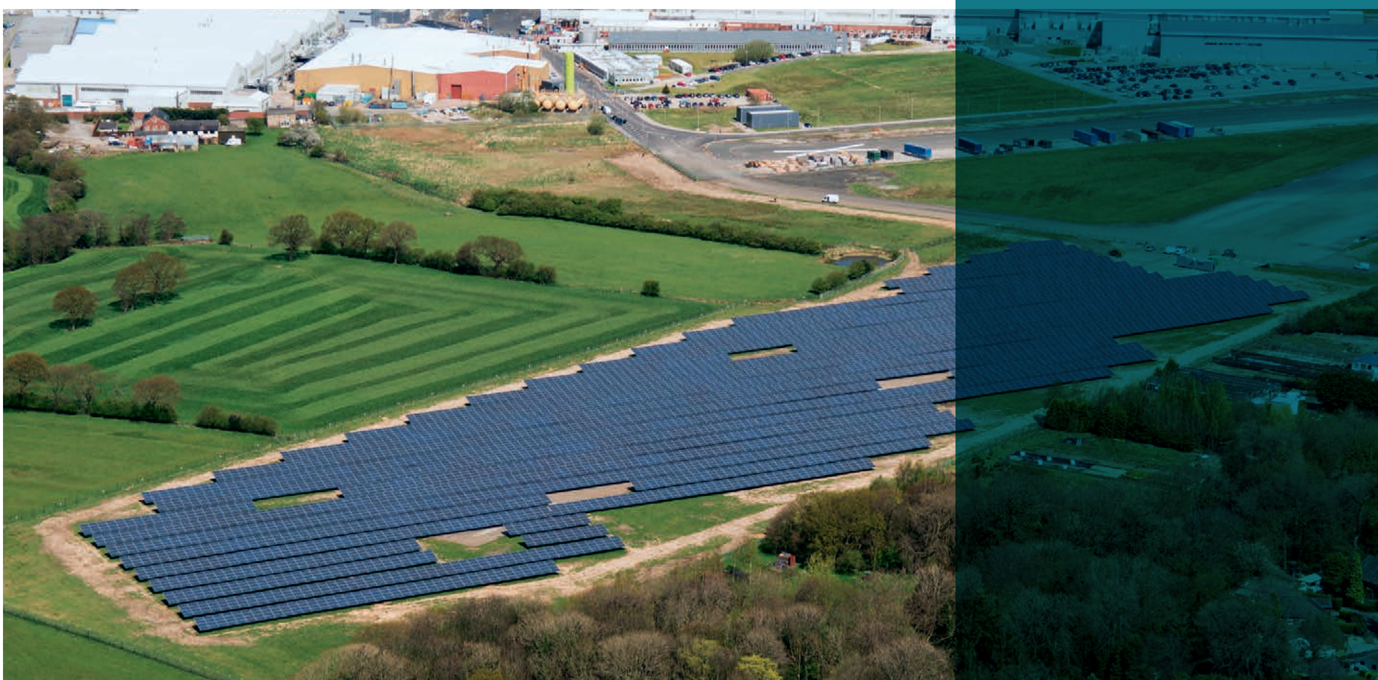
We are progressing our net zero ambition and are developing milestones in line with the UN Race to Zero via the Business Ambition for 1.5°C pathway. Part of our strategy is to reduce our energy consumption, purchase renewable energy and develop on-site renewable electricity supplies where practicable. As well as innovating for a net zero future for ourselves, we are also working with governments and commercial customers to design sustainable solutions to help reduce greenhouse gas emissions and assist them with their transition towards net zero. We also intend to work with our supply chain to reduce emissions.

We know that innovation is key to delivering a sustainable future and managing the challenges posed by climate change. We have a responsibility to use our expertise to pioneer new ways to tackle the very real threats of climate change, learn from others, collaborate and share best practice to achieve this common goal. We are already using technology to transform our operations. It is important for us as a defence company, to understand the challenges that climate change will bring so that we continue to design systems fit for operation in these future environments.

We are also managing our other environmental impacts too, supporting responsible consumption and managing environmental impacts across our operations. 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 continue to look for ways to reduce energy use, water consumption and waste, emissions and other discharges, as well as to reduce the impacts of our products and supply chain.

Climate change and the environment

Climate risk and opportunity scenario planning



We welcome the development of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations and recognise climate change as one of the biggest threats the world faces, and one which poses particular challenges to our business. Supporting a low carbon transition will enhance our business resilience by providing new opportunities.

Climate change and nature-related risks and opportunities extend beyond normal business strategic planning cycles. Climate change and nature-related risks have the potential to impact BAE Systems over short- (less than two years), medium- (three to ten years) and long-term (beyond ten years) time horizons.

To better understand how the potential long-term impacts of climate change could impact our business, in line with the TCFD recommendations, this year we have begun the process of climate change scenario analysis. We have conducted **qualitative climate change risk and opportunity hotspot mapping** with representatives from across our business to obtain a better understanding of the climate issues that could impact the business in the future.

We identified the climate-related risks and opportunities with the potential to impact BAE Systems' business model and strategy by developing high level impact pathways to demonstrate the causal links between the risk and opportunity drivers and the expected impacts based on likelihood of occurrence and the potential to impact the Group in terms of costs, revenue and asset value.

We are exposed to a number of **risks associated with a shift to a low carbon economy**, the most material of these risks over the medium to long term being the cost of substituting existing products and services with lower emissions options and disposal of legacy assets. Associated with this are potential risks around our ability to attract and retain future talent.

While we recognise these risks, **the opportunity around the transition** is also significant for BAE Systems over the medium to long term. There is an opportunity for us to play a key role in enabling the low carbon transition through our development of innovative new technologies. There is growing demand, and therefore revenue streams, for low emissions products and services from new and existing customers, including in adjacent sectors.

Beyond transition aspects, we also recognise the risks arising from **physical changes in climate**, in particular the potential impacts of extreme weather events impacting our operational sites and equipment where we operate around the world, as well as risks to our suppliers. We are already taking action around extreme weather events using analytical tools to apply natural catastrophe classifications to our main operational sites worldwide. In 2020, we conducted a refresh of this data and during 2021 we modelled climate scenarios for 2030, 2050 and 2085, which gives us a portfolio-level understanding of the Group's exposure to natural hazards, both current and future.

We have prioritised sites requiring hazard-specific surveys, which will lead to the identification and implementation of risk improvement recommendations, which may include investment to improve facilities, for locations not previously assessed. We are also modelling climate scenarios for Tier 1 critical suppliers.

We have conducted a qualitative review into the scenario attributes of orderly (below 2°C), disorderly (approximately 2°C) transition scenarios and a business as usual (greater than 4°C) scenario considering peer-reviewed, publicly available third party scenarios, including the International Energy Agency (IEA), Network for Greening the Financial System (NGFS) and the IPCC's Representative Concentration Pathways.

We have reviewed these qualitative scenarios along with the material risks and opportunities identified. We have significant experience in managing our exposure to physical risks and our strategy to manage those risks already takes into account different climate change scenarios. From the data we already have available we have a good view as to which of our assets are at most risk thereby enabling us to address those risks.

In relation to the transition risks we have incorporated the future sustainability of our operations and the further development of our net zero roadmap into our strategy. Our work to date in relation to net zero has focused on a 1.5°C pathway and based on current information we believe our strategy is sufficiently resilient to respond to transition risks associated with that scenario. We have started to progress quantitative climate change scenario analysis which will enable us to enhance the maturity of our views in this regard.

Sustainability – Environmental, Social and Governance

Climate change and the environment continued

We have included in this report climate-related disclosures consistent with the TCFD Recommendations and Recommended Disclosures pursuant to Listing Rule 9.8.6(R)(8). The following table summarises our disclosures and refers to where further detail on climate-related financial disclosures is located:

Governance

Our Board oversees, through the Environmental, Social and Governance Committee, our approach to sustainability, including climate change. The Committee ensures that appropriate climate change and environmental programmes are in place and incentives are set as required to reduce the Group's environmental impact.

Our Executive Committee receives regular updates and briefings on our net zero agenda and during 2021 were set bonus-related objectives (see page 152 of the Annual remuneration report) to support our progress in net zero, including supporting development of sector net zero roadmaps.

Day-to-day responsibility for environmental issues including climate-related issues sits with our Group ESG, Culture and Business Transformation Director.

Our Operational Framework provides a robust governance structure, policies and processes that manage climate-related issues wherever we operate.

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Remuneration Committee report

Strategy

During 2021, the Group revised its strategic framework to include 'advance and integrate our sustainability agenda', which includes our response to climate change and our net zero programme to reflect our commitment to sustainability.

In response to climate change we are developing and implementing a long-term strategy to progress our ambition of net zero greenhouse gas emissions across our operations and value chain. This strategy, which is aligned to the Paris Agreement, is intended to ensure that our business is resilient to climate-related risks and opportunities.

During 2021, we further developed our understanding of the climate-related risks and opportunities with the potential to impact BAE Systems' business model and strategy. We are now progressing quantification of material risk and opportunities against identified scenarios. Further work is planned for 2022 to enable us to develop our views in relation to the resilience of our strategy.

Our strategy starts with emissions reductions, for example improving energy efficiency and introducing cleaner technologies, and also includes purchasing renewable energy and collaborating across our value chain.

We also intend to continue to take into account opportunities associated with climate change, including the ways in which we can use our advanced engineering capabilities and world-class technologies to develop new products and services that support low carbon or reduced emissions requirements.

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Risk management

Our approach to identifying, assessing and managing environmental risks, including climate-related risk, is embedded within our approach to risk management. 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.

Climate change and environment is a principal risk for the Group.

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Environmental, Social and Governance Committee report

Metrics and targets

Many of the climate-related risks and opportunities we face are related to the transition to a low carbon economy. The adoption of our net zero action plan is a key part of addressing these risks. Accordingly the key metric we are currently using to assess these risks is our greenhouse gas emissions data.

We report greenhouse gas Scope 1, 2 and 3 (employee business travel only) emissions in line with the Streamlined Energy and Carbon Reporting (SECR) regulations. We also report data on electricity, waste and water.

Businesses set objectives to improve the performance of their operations such as reducing energy used and the generation of waste, emissions and other discharges, such as effluents. Some of our businesses also set targets to reduce water consumption.

We aim to reduce our emissions as a minimum in line with the 1.5°C pathway by achieving net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030 and by implementing the actions set out in our net zero roadmaps for the relevant businesses, and working towards a net zero value chain by 2050.

We have joined the UN Race to Zero via the Business Ambition for 1.5°C campaign.

Our UK business intends to submit net zero milestones for the Science Based Targets initiative during 2022. We will look to extend this to other parts of the Group as we mature the development of our net zero roadmap and our related internal processes.

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Sustainability – Environmental, Social and Governance

Climate change and the environment continued

Embedding climate considerations into how we do business

Our Board oversees, through the Environmental, Social and Governance (ESG) Committee, that appropriate climate change and environmental programmes are in place and incentives are set as required to reduce the Group's impact on climate change in the immediate and long term, to enable the Group to deliver against its climate change and environmental commitments, and its response to the potential impacts of climate change on the Group's future and current operations.

The ESG Committee is comprised of non-executive directors of the Company appointed by the Board (see ESG Committee report page 134) and met three times during 2021. The ESG Committee invites the Chairman, Chief Executive and a number of other senior executives to attend its meetings to discuss and monitor progress on the ESG issues including objectives and targets. Progress of the Company's net zero programme is a standing agenda item (see page 43 and ESG Committee report). The ESG Committee reports in writing to the Board about Company progress on ESG on a quarterly basis. The ESG Committee supports the Board in overseeing the progress of the executive in ensuring that the Company takes an integrated, strategic approach to addressing climate transition risks and opportunities.

During 2021, the ESG Committee's terms of reference were revised to include climate transition to reflect our focus on moving towards net zero. During 2021, the Board received a briefing from an external expert on carbon and climate-related issues and our intention is that such sessions will be repeated going forward in order to ensure the Board remains fully informed about these issues.

Another key role of the ESG Committee is to approve ESG-related objectives and targets which form part of the executive directors' incentives – see page 152. In 2021, delivery of the next phase of the net zero plan was included within the non-financial element of the executive directors' objectives.

The Board is informed by climate change-related issues when setting its overall strategy. During 2022, the ESG Committee will agree net zero milestones with the Company to sustain and accelerate progress.

During 2021 the members of our Executive Committee (EC) were set bonus-related objectives in support of our net zero initiative including supporting the development of business sector-specific net zero roadmaps.

The Company has robust processes in place to identify, evaluate and manage risks including those arising as a result of climate-related issues (see page 112). Risk, including climate-related risk, is a regular agenda item at Board meetings and the Board reviews risk as part of its annual review process. This, together with regular reports from the ESG Committee, provides the Board with an appreciation of the key risks (and potential opportunities) as a result of climate-related issues and oversight as to how those risks are being managed.

Environmental performance including climate-related risks and opportunities are monitored via the Risk Management Framework which includes our Operational Assurance Statement, Lifecycle Management Performance Review, Integrated Business Plan, Quarterly Business Review and Chief Executive Business Review processes (see page 106). Our Operational Framework provides a robust governance structure, policies and processes that manage climate-related risks and opportunities across the Group. Risk is reviewed by both the EC, Audit Committee and the ESG Committee.

Our EC receives regular updates and briefings on our net zero agenda. During 2021, to reflect our commitment to sustainability and climate change, the EC approved changes to the Group strategic framework (see page 14) and operational governance system. The purpose of these changes is to embed climate change into our Group strategy such that it becomes fundamental to how we do business.

Day-to-day responsibility for environmental issues, including those related to climate, and our net zero programme, sits with our Group ESG, Culture and Business Transformation Director. She is part of the EC and attends the ESG Committee meetings and gives regular updates on our environmental and net zero programme. She is also the owner of our Environmental Policy, which details our commitment to addressing environmental impacts related to our products and activities including climate-related issues. The net zero working group and SHE team report to her and she monitors and receives regular reports on progress. During 2021 we incorporated climate transition into our Group-level Environmental Policy and created a governance, reporting and planning roadmap to achieve net zero. During 2022, this roadmap is being embedded across the Group to help further support a focus on climate-related issues in decision making across the business. We will also establish a Sustainability Council, reporting to the Group ESG, Culture and Business Transformation Director, to support the Company's strategy, recommending to the EC areas of sustainability to be given priority and focus for the forthcoming year and supporting Line and Functional leaders in the implementation of the Company's sustainability programme.

We have also established a cross-functional, net zero working group made up of functional representatives, business leads and environmental specialists. This group reports into the Group ESG, Culture and Business Transformation Director and coordinates the progression of our net zero ambitions for the Group.

As required by our Environmental Policy we have an environmental management system (EMS) in place for all of our businesses. Short- and long-term environmental risks, including those relating to climate, such as those outlined below are built into the businesses' EMS. Part of the EMS process is to define issues and set appropriate targets for the reduction of environmental and climate change impacts and risks.

Climate and environmental risk management

Our approach to identifying and assessing environmental risks is embedded within our approach to risk management (see page 112). Material climate-related operational physical risk, focused on extreme weather events, alongside risks associated with the delivery of the net zero project by 2030 and risks identified in the EMS are already addressed in our business risk registers. During 2021, businesses have started to incorporate wider climate risk within risk registers, including probability, speed and mitigation impact. This activity will progress and be supported by the development and ongoing management of sector net zero roadmaps and physical risk climate scenarios for Tier 1 critical suppliers during 2022. Climate change and environment is a principal risk for the Group (see page 112). 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 relevant 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.

Our direct environmental risks include:

- breaches of environmental requirements resulting in fines and/or the termination of permits;
- transition to a low carbon economy;
- physical risk related to extreme weather events;
- advancing technology and innovation including attracting talent;
- changes in regulatory requirements;
- social and political change, differing legislation and policy in our various markets; and
- risks associated with climate-related physical and transition risks (see page 112).

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

Our ambition to achieve net zero

To play our role in solving the challenge of climate change, we launched our ambition for net zero during 2021 setting 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 also strengthened our net zero pathway by signing up to the UN Race to Zero via the Business Ambition for 1.5°C campaigns. Our UK business intends to submit net zero milestones for the Science Based Targets initiative during 2022. We will look to extend this to other parts of the Group as we mature the development of our net zero roadmap and our related internal processes.

Our net zero programme

During 2021, we progressed our net zero programme by developing a net zero roadmap for the Group and scoping the change management, governance, planning requirements and assessed the level of investment which we will need to transition to a net zero organisation. This overarching roadmap outlines a transformation programme and supporting activities to coordinate delivery of net zero across the Group.

We understand that we need to change our operating model to transition to a net zero organisation. During 2021, we reviewed our governance model to identify changes to key policies and processes to embed our net zero targets/climate risks and opportunities within the business. We have scoped the changes required within our governance model and we are going to integrate net zero considerations into our core policies and processes. We have also reviewed the capability we need to have in place to deliver the net zero transformation programme including the skills to develop low carbon products. Work continues on identifying key performance metrics.

The Group-level net zero roadmap focuses on Scope 1 and 2 emissions and defines how we will reduce our emissions in the next decade and beyond. Emissions reductions are focused on reducing our energy demands and operational emissions. This will be delivered through managing our infrastructure, including investment in our facilities and buildings, energy efficiency improvements including fuel switching, on-site energy installations and purchase of green energy. We have also started our journey to understand the impacts of our value chain, including understanding in-life emissions of products and customer requirements for low carbon products and supply chain emissions.

We recognise the need for a resilient energy supply, and in line with our net zero roadmap for the UK we will focus on maximising energy efficiency, reducing emissions where feasible and focusing on natural renewable power. We will also consider opportunities to enter into long-term power purchase agreements. Our transition to net zero will be conducted in line with our ethical standards, Code of Conduct and Supplier Principles – Guidance for Responsible Business, to ensure we play our part in a just transition.

The sectors are now working to progress roadmaps which will support the Group's overall net zero ambition, outlining short-, medium- and long-term activities, including an understanding of the level of investment required. Sectors will complete this activity in 2022.

Our net zero programme

- Phase 1 Define net zero target
- Phase 2 Develop net zero roadmap
- Phase 3 Develop net zero operating model
- Phase 4 Implement change

Sustainability – Environmental, Social and Governance

Climate change and the environment continued

Collaborating with our customers and suppliers

We have set an ambition for a net zero future that will drive efficiency, innovation and collaboration across our value chain. We recognise that our value chain emissions are many times those of our Scope 1 and 2 emissions and it is critical that we partner and collaborate with our customers and suppliers to reduce emissions by 2050.

Our customers are setting targets and looking for low carbon, sustainable products. We need to continue to work with customers to understand their future requirements to help inform and shape product innovation and development, for example, transitioning products to low or zero carbon fuels.

We are reviewing our current products to understand in-life emissions so that we can transfer this knowledge to drive change and innovate. This will also help us over the short term to maintain existing products by embedding emission considerations at key parts of the design stage and identifying new disposal methods.

We will focus on innovation and technology development to progress products compatible with zero emissions by advancing our capabilities and solutions to improve the sustainability of our products with better performance. We will continue to build on our portfolio of low carbon products and services in partnership with customers, whilst investing in self-funded R&D into low and zero carbon solutions. Our current programmes include: electrification technologies including electric drive propulsion systems; full electric drives; and hydrogen fuel cell systems for ground, air, and maritime applications, as well as synthetic training.

Our major suppliers include multi-nationals in the sector driving their own ESG strategies. We expect and encourage all our suppliers to measure, manage and wherever practicable reduce their greenhouse gas emissions. We intend to work with our suppliers to understand where they are on their own net zero journey, while undertaking projects relating to sustainable procurement, for example green energy and facilities management and to support development of low emission products, for example, electric vehicles.

To support supplier understanding of our ESG expectations, including climate transition, we will be updating our Supplier Principles – Guidance for Responsible Business to expand our expectations on suppliers in relation to sustainability (see page 67).

Responsible consumption

Understanding and managing the environmental impacts of our business supports our long-term strategy of reducing the impact of our activities, supply chain and products on the environment and ensures responsible consumption of resources. Consumption of resources and materials can be different year-on-year, due to the differences in geography and stage of manufacture of platforms and programmes. We are taking a business-led approach to setting reduction targets and driving improvement programmes and activities to support responsible consumption. Businesses set objectives to improve the performance of their operations such as reducing energy used and the generation of waste, emissions and other discharges, such as effluents. Some of our businesses also set targets to reduce water consumption.

Climate change and the environment

Our two major **customers are setting** targets and looking for a growing number of sustainable products.

- US Department of Defense pledged to help the nation achieve net zero emissions by 2050.
- US Administration has committed to a 50% reduction in national carbon emissions by 2030.
- US federal R&D budget set to include a considerable portion to sustainable technologies.
- Defence and commercial opportunities are emerging – integrated HED on Bradley already being trialled.
- UK Ministry of Defence pledged to help the nation achieve net zero emissions by 2050.
- RAF bases net zero by 2040.
- Defence and commercial opportunities will arise from existing and developing technologies.

Electricity consumption

During 2020 and 2021 we have implemented energy efficiency measures at a number of sites across multiple business units and geographies. Examples of measures taken at different sites include installing solar panels, LED lighting replacements, ESOS[1] and ISO[2] 15001 surveys, metering and efficiency improvements in production processes, improvements in steam distribution and improvement to HVAC controls; and in the US, a partnership with the US Environmental Protection Agency's ENERGY STAR® programme, which gives us access to resources, tools and benchmarking across our industry peers. Furthermore, during 2021 we purchased 282,519MWh (2020 173,502MWh) of renewable energy attributes under the Renewable Energy Guarantees of Origin scheme for 26 sites in the UK.

All businesses are developing plans for increasing renewable energy generation in line with our net zero roadmaps.

Waste

Activities to reduce waste are in place at business level to address the specific production and non-production waste streams of programmes and facilities. Business activities include reducing the amount of waste going to landfill via recycling, treatment and incineration and adapting manufacturing techniques, for example, 3D printing (additive manufacturing) utilises more than 95% of the material used, minimising waste.

Examples of initiatives to reduce waste include removing single use plastics and diverting waste cured carbon fibre from landfill. We also announced the extension of our partnership with Keep Scotland Beautiful, investing £100,000 to roll out the third phase of the campaign to expand education and outreach programmes to tackle marine litter. During COP26 we showcased our 'Go With The Flow' project which encouraged engineers to take part in a challenge to design and build a river cleaning vessel. We also took part in UK Recycling Week which encouraged employees to increase recycling both at home and in the workplace. In terms of hazardous waste there was a significant reduction largely driven by a decrease in waste produced in our US business.

Water

Operationally, our environmental management system helps manage and minimise the water we use across our facilities and manufacturing processes and we protect and support the water ecosystems which our facilities and communities depend on. Businesses set initiatives and targets to reduce water consumption annually as appropriate. Initiatives are specific to how businesses consume water operationally and incorporate stages of manufacture, for example, flooding of dry docks. At multiple sites, leak detection and repair programmes are ongoing with further investments planned for 2022. We continue to evaluate climate-related scenarios across our global portfolio of sites to monitor for flooding and drought, to ensure we manage the risk to our people and operations.

Mains water consumption has increased by 11% compared to 2020, mainly due to an increase in water consumption at one of our US sites. Abstracted water volumes have increased compared to 2020 consumption due to three-yearly fluctuations in production/operational activities at one of our UK locations. Without these variations abstracted water consumption remains in line with 2020. Single locations can have a significant effect on consumption and we continue to apply targets to measure, monitor, report and reduce consumption.

1. Energy Savings Opportunity Scheme.
2. International Organization for Standardization.

2021 key environment data

Water consumption

	2021 cubic metres	2020 cubic metres
Mains	**2,270,390**	2,039,777
Abstracted	**14,186,391**	3,584,015
Total	**16,456,781**	5,623,792
Recycled	**951,847**	1,082,603

Waste production

	2021 tonnes	2020 tonnes
Non-hazardous	**41,747**	39,211
Hazardous	**8,690**	15,922
Total	**50,437**	55,133
Recycled[1]	**42,103**	44,354

Electricity consumption[2,3]

	2021 kWh	2020 kWh
Grid	**754,143,257**	752,188,305
Renewable	**2,486,109[4]**	2,304,663[5]
Total	**756,629,366**	754,492,968

1. Includes non-hazardous, hazardous and construction waste recycling.
2. Includes only those facilities that record their electricity consumption via the Group's environmental database.
3. Ramboll US Consulting, Inc. has provided independent third-party verification of BAE Systems' 2021 greenhouse gas (GHG) emissions, in order to provide limited assurance that based on the verification process and procedures conducted there is no evidence that the Company's reporting is not complete, not accurate, not consistent, not transparent and free of material discrepancies. BAE Systems' management is responsible for preparing the GHG inventory and for the collection and presentation of information within it. Ramboll's responsibility is to express conclusions on the agreed verification work and to determine based on the verification process and procedures conducted that there is no evidence that the work has not been prepared in accordance with the outlined methodology statement on page 46. The reliability of the reported information and data is subject to inherent uncertainties given the available methods for determining, calculating or estimating the GHG emissions. It is important to understand our conclusions in this context.
4. Includes only directly-produced renewable electricity.
5. Restated to include only directly-produced renewable electricity.

Sustainability – Environmental, Social and Governance

Climate change and the environment continued

Greenhouse gas emissions data[1]

Absolute energy consumption[2]

	2021		2020	
	Global kWh	**UK kWh**	Global kWh	UK kWh
Energy consumption Scope 1 and 2[2]	**1,624,601,505**	**725,396,538**	1,700,834,942	669,133,482

Greenhouse gas emissions data

	2021		2020	
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)[2]	**142,241**	**76,133**	151,190	69,948
2 Emissions from the electricity and steam purchased for BAE Systems' use (Scope 2 – location-based)[2]	**268,735**	**71,602**	336,207	73,221
Total gross Scope 1 and 2 emissions[2]	**410,976**	**147,735**	487,397	143,169
3 Emissions from employee business travel (Scope 3)[3]	**24,094**	**4,145**	54,769	11,941

Greenhouse gas emissions per employee[4]

	2021		2020	
	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**	5	4

1. Ramboll US Consulting, Inc. has provided independent third-party verification of BAE Systems' 2021 greenhouse gas (GHG) emissions, in order to provide limited assurance that based on the verification process and procedures conducted there is no evidence that the Company's reporting is not complete, not accurate, not consistent, not transparent and free of material discrepancies. BAE Systems' management is responsible for preparing the GHG inventory and for the collection and presentation of information within it. Ramboll's responsibility is to express conclusions on the agreed verification work and to determine based on the verification process and procedures conducted that there is no evidence that the work has not been prepared in accordance with the outlined methodology statement below. The reliability of the reported information and data is subject to inherent uncertainties given the available methods for determining, calculating or estimating the GHG emissions. It is important to understand our conclusions in this context.
2. Relevant reporting period 1 November 2020 to 31 October 2021.
3. Relevant reporting period 1 January 2021 to 31 December 2021.
4. Including subsidiaries.

Methodology

The greenhouse gas emissions data is reported in line with the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard 'Operational Control' method. Our reporting boundary for Streamlined Energy and Carbon Reporting (SECR) is the same as our reporting boundary for the purposes of our financial statements. Emission factors for fuels and UK electricity are published at www.gov.uk/government/collections/government-conversion-factors-for-company-reporting. Emission factors for US electricity are published at www.epa.gov/energy/emissions-generation-resource-integrated-database-egrid. Electricity emission factors for Sweden, Saudi Arabia, Australia and Rest of World are published at www.iea.org/data-and-statistics/data-product/emissions-factors-2021.

For the 2021 reporting cycle, the 2021 UK government emissions factors published by the Department for Business, Energy and Industrial Strategy have been used. The most up-to-date Emissions and Generation Resource Integrated Database factors published by the US Environmental Protection Agency (EPA) are used for US electricity. For the 2021 reporting cycle, the most recent US factors are from the year 2019. The US EPA is due to release the updated 2020 figures in the first quarter of 2022, however they have not been released in time to be used for the current calculations.

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

Greenhouse gas emissions are primarily calculated from energy consumption records reported via the Group's global environmental database. Where actual usage data is not available for facilities and residences within the Global Property Database, an estimated consumption is used based on the type of building or previous consumption data.

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 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. If a business or facility has closed during the reporting year, the site will be excluded from the boundary in the next full reporting year after the change. Emissions from subsidiaries are included in the data set.

The Scope 2 Greenhouse Gas Emissions associated with the Greenhouse Gas Protocol 'Market-Based' Method have been calculated as 232,856 tCO_2e. 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. If sites consume grid electricity backed by REGOs, this has been taken into consideration within the calculations.

The GHG emissions data generated in line with this methodology is used for preparing the SECR report.

Scope 1 emissions from refrigerant gases have been excluded from the SECR disclosure. These emissions have historically been excluded from the GHG inventory on the basis of technical feasibility. An annual strategic and risk review of refrigerant gas used in 2021 did not indicate that any change in this exclusion was required.

Biodiversity

We are developing our understanding of how our facilities and operations impact our surrounding natural habitat. Operationally, significant aspects of biodiversity are addressed via our environmental management system which includes protecting natural habitats, conserving protected species and the management of invasive species in and around our sites. Our businesses have established a number of local initiatives to support their local ecosystems from installing bat roosts, removing invasive species, planting wildflowers to attract bees and cleaning up water courses.

We also undertake a full lifecycle environmental assessment for our ships and submarines, to identify any potential impact on the marine environment, and to minimise these as far as possible. Our sea trials activities undergo a full environmental impact assessment which looks at what needs to happen, where the trials will take place, and the time of year to minimise impact on marine flora and fauna and habitats.

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.

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.

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.

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 20%. While the implementation of energy efficiency projects has contributed to this decrease, the most significant factor in the Group-wide reduction is the reduction in Scope 2 location-based emissions which is mainly due to the decarbonisation of electricity grids and therefore the reduction in carbon conversion factors. The reduction in Scope 1 emissions is due to the slight reduction in all Scope 1 fuels except heavy fuel oil. Reported Scope 3 emissions have reduced as a result of a decrease in business travel due to COVID-19 and a reduction in long-haul flights.

2022 priorities

During 2022, we aim to:

- create sector roadmaps to support our net zero ambition by Q2; and
- develop our net zero milestones for the Science Based Targets initiative.

1. International Organization for Standardization.

Sustainability – Environmental, Social and Governance

Technology

We are committed to using our world-class engineering capabilities and cutting-edge technologies to reduce the environmental impact of our activities.

We know that climate change will continue to affect temperatures and create extreme weather conditions, and it is important that we understand these challenges so that the systems we design are fit for operation in future environments. Part of this is about optimising our products – maintaining operational performance whilst reducing the emissions.

We continue to work with our customers to help them with product innovations that support their strong positions on climate change targets as well as looking at how we can reduce emissions from our own operations and products.

Please also see 'Our investment in technology' section on pages 34 and 35 which gives more detail on the importance of technology and innovation to our business and our customers.

Technology

Reducing the environmental impact of our activities

Energy efficiencies on Portsmouth Naval Base

Since 2004, working with the Royal Navy, BAE Systems has reduced estate CO_2 emissions at Portsmouth Naval Base by more than 40%. This is despite energy demand almost doubling recently due to the needs of the aircraft carriers at the base.

This has been achieved with activities such as the installation of approximately 500kW of photo-voltaic roofing and 13.5MW combined heat and power generation, alongside a number of targeted energy reduction projects and initiatives.

The reductions in energy usage at Portsmouth Naval Base are seen as good practice across both our own company and with our customers, as we have hosted several groups of UK Ministry of Defence visitors, including from outside the Royal Navy, to share our experiences.

We have been working to improve the way data is used to control and monitor estate operations and inform decision-making. We overlaid three-dimensional geospatial models of the dockyard with various sources of estate and asset information to provide powerful visualisation tools, easy access to information and analytics dashboards. Commercial off-the-shelf sensors have been integrated to tag and monitor on-site assets like cranes, buses and pumps. This data provides a single point of truth from which we can track electrical performance, maintenance requirements and power usage across a site and so allows us to better locate charging stations and optimise operations for maximum efficiency.

Energy efficiency in the Future Combat Air System

How do you power a future combat aircraft, when energy demands of the systems aboard are constantly increasing, but the need for efficiency and sustainability has become a global priority?

This is the challenge facing Team Tempest, whose members have a once-in-a-generation opportunity to design a future combat air capability from the ground up, utilising not only today's technologies but those we expect to see decades from now.

Some of the technologies used to power Typhoon today, such as the use of bleed-off air from the engine, may be insufficient to supply all of the future needs of Tempest.

The power requirement necessitates new thinking about power generation and energy management, from energy harvesting to on-board storage and near-instantaneous availability.

Working with Rolls-Royce on propulsion and energy management, we are exploring embedded electrical generation, taking current directly from the main engine shaft. Historically, gearboxes would have been used to do this, but these are less efficient and for Tempest every watt counts.

Alongside our partners, we are investigating systems that can be maintained in a ready or standby state and then powered to hundreds of kilowatts instantly, providing a 'power when you need it' capability.

Advancing our proven electric drive technology to the maritime domain

With 25 years of proven experience with electric drive technology across global transit operations, our sustainable systems are equipping and powering a range of marine vessels, from research and passenger vessels, to superyachts and river tows.

In alignment with operators' current and future environmental goals, our eco-friendly systems include electric hybrid, battery electric, and now fuel cell electric propulsion, with our systems powering SWITCH Maritime's Sea Change, the first hydrogen fuel cell powered passenger vessel in the US.

We have dozens of zero emission fuel cell electric buses in operation and our systems also power Enhydra, the largest hybrid electric passenger ferry in the US. Using this expertise, we continue to facilitate the transition to sustainable energy by making zero carbon technology accessible, leading the way with green propulsion for fleet operators including the University of Vermont's research vessel.

With funding from Innovate UK, we are also working with both Uber Boat by Thames Clippers and Cory Riverside Energy to develop a zero emissions strategy with solutions based on our next-generation electric drive system to ensure air and waterways on the River Thames are preserved for the future.

Electric heavy-lift uncrewed air system

BAE Systems and Malloy Aeronautics are exploring the development of an all-electric 'heavy-lift' uncrewed air system as a potential new solution to deliver cost-effective, sustainable rapid response capability to military, security and civilian customers.

The all-electric powered concept vehicle will be designed with a top speed of 140 kilometres per hour and the ability to carry a class-leading 300 kilogram payload.

The cutting-edge technology could be used for a range of applications such as performing ship-to-ship and ship-to-shore movements to support military and security operations and logistics. Emitting zero carbon, the uncrewed system could help revolutionise military operations where there is a requirement to carry heavy loads, helping to keep military personnel out of harm's way in dangerous situations or disaster zones, whilst reducing the environmental impact of our armed forces.

Sustainability – Environmental, Social and Governance

Social

We are focused on valuing and developing our people and making a positive social and economic contribution to our communities.

Safety and wellbeing

The safety and wellbeing of our people is paramount. The global COVID-19 pandemic continued to drive many of our safety and wellbeing initiatives in 2021. While we have made progress with some of our long-term metrics improving, especially around major injuries rates and a reduction in severity levels, our overall recordable injury rate increased slightly over 2020.

The first quarter of this year was challenging at a number of our major sites around the world, with ongoing pandemic related challenges, including significant changes to working practices, taking a significant amount of bandwidth from our well-established safe systems of work and training programmes. We saw significant improvements in safety during the remaining quarters.

Our safety programme

Our manufacturing activities present a range of risks. These include slips, trips and falls, work in confined spaces, machinery operation and working at height, among 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 104).

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 or 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 demonstrate our commitment to safety and drive performance the Board continued to prioritise safety through the inclusion of a safety objective in executive remuneration.

Safety is set as a qualifier to the overall non-financial element of the executive bonus (see page 157).

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

We use Recordable Accident Rate[1] as a key performance indicator to assess workplace safety improvements and this is used to determine an element of executive bonus.

During 2021, we did not meet the overall Recordable Accident Rate reduction target of 10% against the 2020 baseline. Handling, lifting and carrying, and slips, trips and falls continue to be responsible for more than 50% of recordable injuries.

Our major injury rate decreased by 11%.

The health and safety of our employees continues to be our highest priority. We remain focused on safety across our business, and are targeting our most challenged sites through a comprehensive performance improvement plan. Businesses are conducting safety campaigns to deliver a sustained programme of critical safety themes across employee groups, implementing virtual reality safety training, and implementing new and improved assurance programmes to reduce risk related to safety, health, and environmental impacts.

In 2021, improvements in safety and diversity were underpins to the non-financial element of the executive bonus. The requirements for diversity improvements were met but those for safety improvements were not achieved. While progress was made with some of the long-term metrics improving, especially around major injuries rates and a reduction in severity levels, the overall recordable injury rate increased slightly over 2020. The analysis of this showed a significant increase in hours worked in several of our larger sites throughout 2021 while the staff headcount remained consistent. Given the importance of safety to our Company, it was agreed that there should be no exception and a reduction be applied to the non-financial element of the bonus.

Employee wellbeing

The importance of our employees' wellbeing has been enhanced in COVID-19 times as we have all had challenges balancing work and personal commitments. Our wellbeing programmes support employees in both their work and personal responsibilities. Our Employee Assistance Programme provides assistance to employees across a range of issues, including mental and financial wellbeing. Assistance comes in the form of 'in the moment' telephone support and counselling where required.

To support employees working remotely or in a hybrid model, our businesses have implemented a number of resources and programmes, including 'Work Safe at Home', 'Embracing Hybrid Working' and Working Adjustment Passports.

We continue to promote mental health awareness programmes across the organisation and have worked diligently this year to increase our communications and engagement channels along with introducing training for employees to raise awareness of the importance of mental wellbeing. We have also leveraged technology to launch a digital platform to empower employees to take a proactive and preventative approach to mental health and wellbeing.

2022 priorities

During 2022, we aim to:

- progress our safety performance improvement plans;
- implement a new safety, health and environmental data platform to enhance analytics capabilities and provide enhanced safety, health and environmental process support; and
- expand our functional assurance and audit programme.

Recordable Accident Rate (per 100,000 employees)[2]

BONUS KPI

Major injuries recorded[2]

BONUS

BONUS

The award of the executive directors' bonuses is dependent upon achievement of improvements in both safety and diversity (see page 157).

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

People

Inspiring, leading and empowering high-performing teams

Our people are critical to building a sustainable business for the future, including ensuring we have the right skills to meet our customers' challenges and deliver on our Company purpose.

Recognising the world around us has changed at pace over the past two years, it is important we evolve our employee experience to attract, retain and develop the very best talent. This reflects a culture that is inclusive, supportive and allows everyone to be their best at work and feel valued for their contribution.

To achieve this we are focused on maintaining our position as a leading employer of choice, particularly in engineering, manufacturing, science and technology. This includes having the right skills and capabilities that are essential to helping our customers to provide safety and security. More broadly, our employees are actively involved in the local communities across our sites, delivering wider social and economic contribution in the areas where they work.

Our ambition is to amplify our strengths and adapt to deliver a more modern, fit for purpose organisation, with a stronger emphasis on value, efficiency and agility.

Our People strategy

Our People strategy is delivered through five key pillars: robust succession planning; targeted recruitment; focused talent management; a culture of inclusivity, learning and development; and an incentive structure aligned to delivery. This is underpinned by our People Policy, guidance and support tools.

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.

This commitment is embedded through our governance structure. The Group Human Resources (HR) Director reports directly to the Chief Executive and chairs a Global HR Council, ensuring alignment between our strategy, policy and delivery. This has allowed the organisation to deliver a range of commitments in 2021, recognising 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 111) and we continue to take a range of actions to mitigate the risk.

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. We have structures in place to work with trades union representatives in our local markets, where it is appropriate and legally acceptable. Of our UK workforce, 69% are covered by collective bargaining agreements and approximately 55% of the UK workforce are trade union members. In the US approximately 10% of the workforce is covered by a collective bargaining agreement.

In the UK, participation and engagement is open and constructive from the Chief Executive to local business levels, governed through our Corporate Trade Union Constitution. These strong relationships enable us to work swiftly and effectively with employee representatives, both reactively and proactively, and are most recently evidenced through our approach to the COVID-19 pandemic in order to maintain productivity on our critical programmes.

Our progress in 2021

Talent and critical skills

Maintaining a diverse pipeline of talent and critical skills is key to fulfilling our future customer requirements. In 2021, we sustained our focus on delivering the skills for tomorrow, harnessing them across the business to develop a breadth and depth of knowledge.

In the UK, our award-winning early career and skills programmes have supported around 3,500 young people in training in 2021:

- 851 new apprentices started in 2021 and 939 are forecast for 2022;
- 522 graduates and undergraduates started in 2021 and 751 are forecast for 2022; and
- around 120 young people in the UK government's Movement to Work and Kickstart programmes, and around 100 are forecast for 2022.

In Australia, 93 apprentices and 104 graduates are in training (2020/2021 cohorts), and in Saudi Arabia, 113 trainees, students and graduates joined our early years careers programmes during 2021.

More broadly, we are investing in the capability of our line manager population, equipping them with the right skills and tools to be inspirational leaders of the future. Around 800 UK managers have participated in our inaugural line manager programme and we successfully piloted new programmes from supervisor to mid-level managers, delivered virtually but with a strong emphasis on engagement, including peer learning and coaching.

We have also developed a stronger talent management framework that governs the Group's high-potential talent programme, succession planning and career management process. This year we expanded this, ensuring a pipeline of talent is created across all levels of the organisation and provides the skills for the future. New Talent Dashboards are providing insights on succession plan risks, pipeline diversity and our high-potential talent, enabling decisions on priority actions required.

Our global Emerging Leaders and Advanced Leaders programmes have been launched virtually, both in response to the pandemic and in support of our inclusivity goals. By shifting our learning portfolio online, we have been able to expand access to executive coaching, as well as our core programme.

We also launched a new UK digital learning platform – the first phase in our global implementation ambitions. This provides on-demand access to more than 27,000 courses, including world-class LinkedIn learning opportunities, strategic and functional skill development and online academies.

Social continued

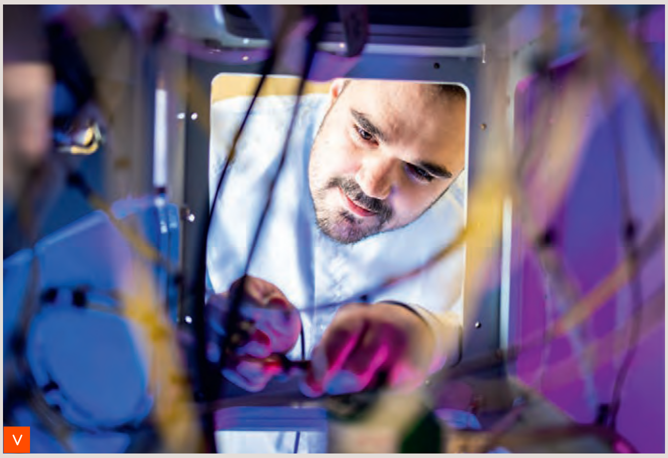
People

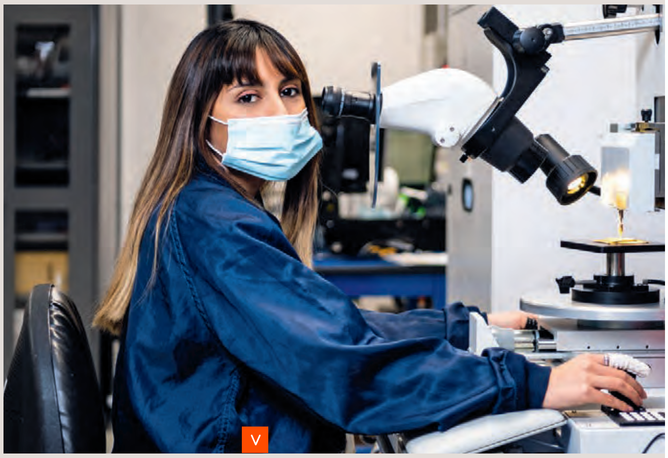
Developing our people, with a specific focus on STEM skills, is vital to the longevity of our business

Developing young people in STEM careers

The availability of specialist skills in engineering and manufacturing is critical for our business. In 2021 we spent £72m on apprenticeships. As a founding member of the UK's Movement to Work (MTW) programme, we are committed to delivering social mobility which provides quality work experience for disadvantaged young people. Working with The Prince's Trust's Get Into Engineering programme, we provide around 100 work placements for young unemployed people each year. This programme had 32 positive outcomes in 2021, of which nine were roles in BAE Systems. We also support the UK government's Kickstart Scheme, which provides six-month job opportunities for unemployed young people to gain work experience. In 2021, we had 28 Kickstart placements on our first cohort (80% of which translated into jobs with the Group) and we had a second cohort of 15 starting in November 2021.

We also make significant investments in outreach activities to school children and university students. In 2021 and in the wake of the pandemic, our education activities were delivered virtually and together with the Smallpeice Trust, the Royal Air Force and Royal Navy we launched 'Coding for Success', an initiative for 600 schools that helps educators and students develop confidence with coding and robotics.





Developing digital and systems engineering skills in Australia

The Diploma of Digital Technologies, initially developed in partnership with Flinders University and TAFE SA for workers at risk of redundancy, evolved in 2021 to support our employees seeking to upskill in areas relevant to the future of shipbuilding – including cyber security, automation, innovation and Industry 4.0.

This year, the programme expanded to include supply chain partners and STEM schoolteachers with more than 90 students starting the diploma in 2021. All students are full-time workers, with lectures and workshops taking place after hours. The programme has achieved 50% female participation and was nominated as a finalist for a national Australian Training Award. The 2021 Australian Training Awards winners were announced on 18 November 2021. While we were not a winner at these awards, we did secure the Industry Collaboration Award at the 2021 South Australia Training Awards.

In 2021, BAE Systems Australia partnered with Australian Industry Group, one of the nation's leading business associations, and a number of employers to develop employment and course specifications for an Australian-first degree apprenticeship in systems engineering. In December, Victoria University was selected to partner on this pilot programme. The programme will build from our UK experience and offers a more flexible approach to practical learning outcomes, and the ability to customise courses to suit employer needs.

Developing new skills to support the drive to net zero

BAE Systems is ensuring it is developing the new skills required that will help drive progress towards net zero. In November 2021 we announced a new programme of Masters-level sustainability apprenticeships to be delivered in partnership with Cranfield University to start in March 2022. Over the next two years, students will undertake a range of modules including sustainability principles, leading a sustainable business, performance management and reporting. In addition to their academic study, the apprentices will apply their academic learning in the workplace as they play a key role in delivering our roadmap to net zero.

Students completing the programme will achieve a Sustainability Business Specialist Apprenticeship, including a Master's degree in Sustainability and supporting progression towards professional recognition with the Institute of Environmental Management and Assessment.

The first ten apprentices to undertake the programme are employees from across our UK businesses, including Scotland, the North West and South East of England, as well as one from the Kingdom of Saudi Arabia. We aim to continue the commitment to sustainability apprenticeships and to explore at a later date the possibility of a new sustainability apprenticeship for new starters.

Partnering to launch advanced manufacturing careers

The Electronic Systems Tech Power programme is improving lives and advancing careers through the power of innovation. Our business is proud to partner with MY TURN, a non-profit organisation in New Hampshire helping under-represented youth launch careers in advanced manufacturing through financial assistance, coaching and support services.

Since 2016, more than 40 MY TURN participants have graduated from the Microelectronics Boot Camp at Nashua Community College, a ten-week course that prepares students for entry-level advanced manufacturing roles. On completing the programme, BAE Systems offers job interviews to graduates, and 14 MY TURN participants have since started their careers with Electronic Systems.

Together, these powerful partnerships are making a difference for our business and our community, not only opening doors to meaningful employment opportunities, but also changing lives by developing high calibre, motivated talent in our local communities.

Social continued

People

We are committed to providing an inclusive environment in which all our employees can develop their skills and reach their full potential.

A decade of progress

BAE Systems, Inc. published a report entitled 'A Decade of Progress' to detail progress made over the past ten years toward increasing diversity, equity and inclusion (DEI) in the workplace and to outline a strategic path forward to further advance our culture of inclusion. We are committed to making our company a more equitable place for all employees, and we are taking active steps that are substantive and enduring to deliver on this commitment at all levels of our organisation through education and experience-based programmes.

In publishing our first ever DEI Impact Report we have shared details about the makeup of our US workforce, what our ambitions are, and what we are doing to meet them. It was an important opportunity to share some of our progress and give employees and stakeholders a tool to help hold us accountable to meet our goals.

Supporting disabled colleagues in the Kingdom of Saudi Arabia

In Saudi Arabia we have striven to create a work environment that caters for all types of disability, empowering and enabling employees to perform their work to the fullest and without obstacles. The ABLE committee was created several years ago and holds awareness and education events for all BAE Systems employees in the Kingdom. In 2020, BAE Systems was awarded a Gold Category certification from the Ministry of Human Resources and Social Development in recognition of our inclusive and supportive work environment for employees with disabilities. The team has also supported the global #Purplelightup initiative lighting up Company buildings and turning social media accounts purple in support of the International Day of Persons with Disabilities.

National Security Academy for cyber talent

BAE Systems' National Security Academy is a UK-based initiative through which Applied Intelligence works with QA Learning to develop individuals with specialist software engineering skills to begin a career in the security sector with BAE Systems. As individuals progress through the Academy, they gain UK Security clearance, allowing them to work on sensitive projects in support of the UK government. The Academy offers an integrated and hands-on four-month training programme building interpersonal skills and developing capabilities in Javascript, Java SE, Web Development and Agile methodologies.

Applied Intelligence aims to fill 50% of the places with talented females who are starting in their careers, have some experience or are returning to work. In the last cohort, 46% of places were filled by women.

Pause for Thought

Part of **GEN**, our Gender Equality Network

Menopause support

As part of our ambition to create an inclusive workplace in which everyone feels able to be themselves, on World Menopause Day in October 2021, we announced our commitment to being a menopause friendly employer. In addition to promoting its accreditation on www.baesystems.com and in recruiting forums, an online menopause hub was launched for employees with expert information from Henpicked – a specialist agency working with menopause-friendly employers. New guidelines for employees and managers have also been developed which include offering working adjustments if required. Online training is available for all employees and Pause for Thought, an Employee Resource Group has been developed for employees in the UK business.

Sustainability – Environmental, Social and Governance

Social continued

High-performing culture

As we continue to build a high-performing culture that delivers our shared strategic objectives, our Values and Behaviours have become integral to this success. Since the Group launched its eight Behaviours in 2019, these have been integrated into all our people processes, including performance, talent, reward, recruitment and learning.

Across the enterprise, our Behaviours have been added in to the Performance Development Reviews (PDRs) for all people managers, alongside key Future Talent Programmes. The feedback from PDRs allows employees to drive their own personal development, while the Group increases efforts to foster cross-business collaboration and agility.

A number of cross-Group working groups have been launched to align our approach, share learning and collaborate across the business. This includes UK workplace climate, which is delivering 17 different projects in 2021/22 focused on career development, inclusive and hybrid working, flexible benefits and our sustainable future. A global Sustainability Steering Group is setting the strategy and direction for our environmental, social and governance priorities, while our Future of Work teams in the UK and US are driving new ways of working.

We have also strengthened our engagement events, including a fully virtual conference for mid-level management in the UK, Australia and Saudi Arabia. Sponsored by our Executive Committee, it was attended by approximately 900 employees, providing an opportunity to listen and contribute to our key strategic priorities, alongside employee-led workshops that will inform our work on workplace climate and culture. These themes also featured in the 2021 Graduate conference.

New ways of working

In a year where adaptability has been integral to our success, adopting an increased flexible and hybrid approach has been key.

In response to the pandemic, we have maintained flexible working across the business. This includes a long-term hybrid working framework that balances the need of individual business, site, team and employee needs.

In the UK, we developed a new policy framework and line management guidance, equipping line leaders to support their teams. Locally-led, experimental 'pathfinders' are helping to test and inform an enduring hybrid proposition including new workplaces for hybrid and on-site workers. A range of technology support was also delivered, from hotdesk booking through to hybrid-friendly video-conferencing and collaboration tools.

For our on-site population, in discussion with trades union leaders, we are launching a review of the worksite experience, working patterns and any broader flexibility that can be offered in order to maintain parity across all employees.

In the US, we launched a workshop series on leading hybrid teams. This featured the fundamentals of hybrid leadership, insights on leading virtually with a people-first approach, and sustaining successful hybrid teams. In addition, the US team built a 'Return to the Workplace' eLearning module focused on the top priorities for leaders engaging with employees in the new hybrid environment.

Keeping our people connected, informed and engaged has never been more important as employees in all of our markets continued to experience major impacts 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.

Leveraging technology

Irrespective of job, role or location, technology remains a key enabler, empowering greater access to information, benefits and career opportunities. We have continued to invest in our employee app for more than 40,000 employees in the UK, Australia and Saudi Arabia, providing access to the latest news, guidance, tools and more.

In the UK we launched a new online benefits platform, called FLEX. It provides employees with access and flexibility to proactively manage their own portfolio of benefits, including private medical insurance, health benefits and broader guidance (financial, health, wellbeing). The US team consolidated several self-service systems, launching an expanded ServiceNow platform for employees to obtain IT, HR and Finance support.

From a career perspective, a new internal mobility team was launched to enhance cross-company progression within the Group. A recruitment transformation programme is also underway for the UK, Australia and Saudi Arabia, including a centralised recruitment hub that will support the recruitment of nearly 7,000 recruits (permanent and fixed) each year and support our strategic workforce planning.

Organisation efficiency and effectiveness

In order to deliver great efficiency, effectiveness and collaboration, we are evolving our People organisation. We recognise that employee expectations continue to evolve and we must adapt in order to attract and retain the very best talent.

In the UK, Australia and Saudi Arabia, we are evolving our People organisation to support our ambitions and strengthen our capabilities:

- new Geographies function that will integrate our strategy, policies and projects across markets;
- Centres of Expertise will provide the tools, policies and governance to ensure a common employee experience;
- business-facing teams will be freed up to focus on business and people performance; and
- People Services will deliver our transactional solutions and services.

We have five workstreams underway, led by a cross-company team dedicated to shaping our vision for 2022 and beyond.

This aligns with our US team, which has also recently launched a review of its People Services, to ensure it is optimally structured to efficiently and effectively support our evolving business.

Diversity and inclusion

These ambitions will rely on a diversity of talent, and illustrate why diversity and inclusion remains a key business priority. In 2021 we established clear ambitions and metrics, embedding these within our process, practices, policies, systems and training.

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. We also ensure training opportunities and appropriate accommodation are available to all. We firmly believe that the 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.

Globally, we have now set an ambition to be recognised as the leading employer in defence and security for valuing diversity and inclusion. We also want to be representative of gender and ethnicity in the localities in which we operate.

These ambitions will be supported by a range of targets:

- **Globally:** 50% of Executive Committee members to be women by 2030.
- **UK:** 30% of the organisation's workforce to be women by 2030 at the latest.
- **BAE Systems, Inc.:** progress towards greater gender and racial diversity at all levels of the organisation.
- **Other countries:** targeted ambitions for other countries in which we operate.

We also need more women in senior grades, including science, technology, engineering and maths (STEM) roles. In the past three years our gender diversity for senior managers has increased from 17.4% to 22.4%, with gains seen in our Engineering, Manufacturing and Operations, and Project Management functions. In 2021 we launched the Emerging Female Leaders programme to enable the progression of women at the mid-point in their careers.

However we are also looking at the broader pipeline of talent, and we have focused our efforts on those starting their career. In 2021, 23% of our 2,000 UK apprentices were female and our overall female population and those working in STEM roles also continued to grow.

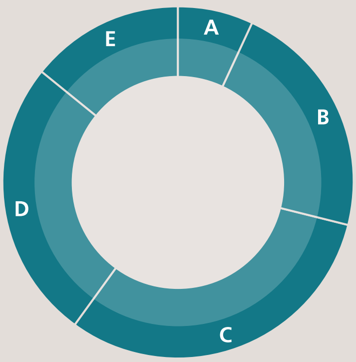
Recognising gender diversity is just one area of our focus. In 2021 we launched a major focus on self-identification, to support our aim to achieve broader diversity and inclusion in our workplace. To accelerate this we launched a UK campaign for employees to complete their characteristics and we established a plan of activity to improve our representation within the business. Examples include:

- early career and education outreach work to increase representation of females and ethnic minorities;
- inclusive hiring guidelines to adapt our language, recruitment process and experience;
- initiated and tested new talent management programmes for emerging female leaders and ethnic minorities;
- launched inclusive buddying and leadership development programmes to support those joining or advancing through the business; and
- initiated targeted support such as menopause awareness, support and training.

Gender diversity

	Male		Female	
Board	9	64%	5	36%
Senior managers[1,2]	256	78%	74	22%
Total employees[3,4]	64,000	78%	18,000	22%

Age diversity[3,4]



A	24 years and younger	7%
B	25–34 years	22%
C	35–49 years	31%
D	50–59 years	26%
E	60 years and older	14%

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. Executive Committee (excluding executive directors) and their direct reports.
3. Excluding share of equity accounted investments.
4. BAE Systems Internal Audit has reviewed and confirmed effective systems, processes and controls are in place to collate and validate this data.

Gender pay gap

We have published our fifth annual gender pay gap report in line with UK regulations. For 2021, the average gender pay gap for our UK workforce was 8.7% (2020 9.1%) which is 7.4% lower than the current UK national average of 16.1%. 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.

Sustainability – Environmental, Social and Governance

Social continued

This has all been strengthened through our Employee Resource Groups (ERGs), which are sponsored by our Executive Committee. They provide visible leadership and direct engagement with a range of groups, to ensure employees feel that their differences are valued and represented.

In the UK, this is supported by 15 different pledges and commitments to external charters, including veterans, LGBTQ+, mental health, disability, social mobility and inclusion. Also in the UK, we have five core ERGs: Enabled (disability); GEN (gender); Mindset (wellbeing); VetNet (veterans); and Outlink UK (LGBTQ+). In BAE Systems, Inc. we have continued our support through the broader Multicultural Network and its eight US ERGs. In addition, an executive-level DEI Council was formed to drive execution of Inc.-wide actions.

In 2021, BAE Systems, Inc. also published a report entitled 'A Decade of Progress' to detail progress made over the past ten years towards increasing diversity, equity and inclusion in the workplace and to share a strategic plan to further advance our culture of inclusion. A number of actions are being taken across all levels of the organisation, from a range of education and experience-based programmes to the assignment of an Inclusive Leader Goal, which clearly defined diversity, equity and inclusion requirements for people managers throughout the year.

Communication, engagement and insights

Data insights and employee sentiment are key to informing our agenda, which is why we held a second employee survey this year. Following our first enterprise-wide 'How We Work' survey in 2018, nearly 43,000 employees were invited to participate in a further survey in the UK and Rest of World.

This allowed us to evaluate the impact of our Behaviours, which were launched in 2019, and to establish employee sentiment, particularly during the pandemic.

In total our response rate was 64% compared to 57% in 2018, with positive sentiment increasing across all areas. It also demonstrated that our Behaviours are upholding the way we work, including an increase in trust and different ways of working.

This benchmarked well against our manufacturing peers, placing us close to or in the top quartile. In particular, the most positive responses focused on the Group's support and response during the pandemic, including adoption of hybrid working.

However some opportunities for improvement were highlighted around the need for greater parity for on-site workers, notably in relation to flexible working. Technology enablement, health and wellbeing, and career progression remained a priority for employees, in particular for millennials.

Based on rising attrition metrics and 2021 industry data, the US team also conducted employee focus groups on retention in an effort to develop strategies to retain our talent in the dynamic job market. The focus groups gathered employee sentiment around returning to the workplace and to understand their views on flexible work practices.

To measure progress on inclusion, BAE Systems, Inc. relaunched the Inclusion Index survey. Results showed improvement in three of four areas and that more than 70% of respondents feel the Company has an inclusive culture. BAE Systems, Inc. also completed an ethics survey focused on assessing three key areas: awareness of our ethics programmes; our culture of ethical business conduct; and outcomes. Overall, compared to the Global Business Ethics Survey benchmark, most of our employees believed they are working in a strong ethics culture, and nearly all respondents were familiar with our policy, training programmes, and the Ethics Helpline for reporting any potential ethical concerns.

In line with our evolving HR model, we are now developing a central employee experience approach that will align and set the direction for this in 2022.

This will be supported by new data-driven approaches to help us better understand key trends and insights, including how we measure change. This will provide a line of sight between improvements in our workplace climate and culture, and our strategic priorities and delivery.

We continue to 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.

Supporting our communities

The work done by our people helps to build stronger nations and enables growth in economies and local communities – through employment and national and local supply chains. We play a vital role in many of the communities where we operate, a significant responsibility in which we take great pride. We aim to build and nurture mutually beneficial relationships between our business, our people and local stakeholders to benefit the local communities. Engaging with our communities as well as supporting and caring for them is an essential part of our business model.

It continues to be important to us to support the local communities in which we operate through charitable donations and sponsorships. During 2021 the Group contributed more than £11m[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.

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 2021 we worked with our partner charities and organisations to continue our support in response to the COVID-19 pandemic, working within the communities where we are based to enable greater social impact. Our employees volunteered, fundraised and donated throughout the year, adapting from face-to-face to virtual initiatives in many instances, in support of our established and new emerging charity partners, alongside the donations and support provided by the Company. We listened to our charity partners about the challenges they continued to face, and where possible, we continued to provide greater flexibility as they navigated the continuing difficulties of the pandemic.

We use the Business for Societal Impact (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. The total value of our community investment programme donations is externally assured every year. All community investment-related expenditure and any associated employee fundraising is reported through an online system which is subject to annual validation checks.

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

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 Australia we have worked on establishing our education ambassador programme, learning from the success of the programmes in the UK and Saudi Arabia where our education ambassadors offer their time to encourage school-age children to pursue STEM subjects and careers. In the UK in 2021 we supported Recruit for Spouses when they saw a 287% increase in demand for their services. Our employees stepped up to support and we saw an increase in the number of employees volunteering time as coaches to the organisation, helping them respond to the demand.

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 have continued to support Team Invictus UK on their journey to the Invictus Games The Hague 2020 (subsequently postponed due to COVID-19), and provided additional funding in 2021 for the delivery of a virtual training programme for the competitors whilst they were unable to meet in person. 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.

We have focused on making a difference within the local communities in which we are based, and in the UK for the second year running we have made significant donations to more than 40 foodbanks local to our sites. We have also, where possible, linked our community support to the wider ESG agenda, donating around 3,000 trees to be planted in the UK and other markets. In the US, Electronic Systems has continued the successful implementation of its local community grants process providing direct support to smaller, community-focused organisations. Additionally, in response to India battling one of the worst waves of the COVID-19 pandemic so far, we supported relief efforts with a company donation and employee fundraising.

In addition to our regular community investment funding, we worked with organisations in a number of our markets to identify community-based projects eligible for the share forfeiture funding, made available following the unclaimed assets programme in 2020. Please see page 62 for details of the progress we have made in 2021.

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 teams also support our community investment efforts by raising awareness and promoting projects in our communities and we have continued to see increased employee engagement as a result.

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 communities. 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:

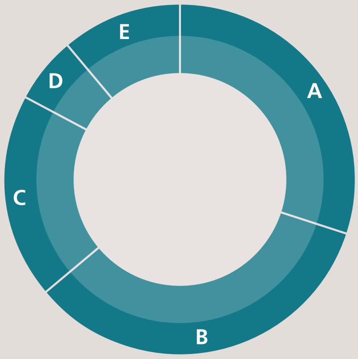
- Armed forces – supporting active service personnel, veterans and their families;
- Education and skills – inspiring young people to consider STEM subjects and careers; and
- Local community – working to support the communities in which we operate.

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, while 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.

Community investment by type[1]



A	Armed forces	30%
B	Education	34%
C	Community	19%
D	Heritage	6%
E	Other	11%

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

We have a Global Community Investment Committee, chaired by our Chief Executive, 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.

2022 priorities

During 2022, 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 local community initiatives we supported during 2021, and recognising the continued demands and challenges many face as a result of the pandemic, we will focus on identifying initiatives with greater social impact in our local communities and those which can demonstrate that our support will make a difference. In response to the success we have seen from employee involvement, we will continue to seek opportunities to provide more in-kind support with knowledge, skills and expertise to our partners and demonstrate greater value to the wider community.

Social continued

Supporting our communities

We have a long and proud history of supporting **our armed forces** – it lies at the very heart of what we do.

Re-committing to the Covenant

We value the unique relationship we have with both serving members of the Armed Forces and veterans and recognise the contribution that serving personnel, reservists and military families bring to our businesses.

In 2013, we were the first defence company to sign the UK Armed Forces Covenant. We were also one of the first six winners of the Ministry of Defence Employer Recognition Scheme Gold Award, which recognises an organisation's commitment to the Armed Forces Covenant. We are proud to have held this status continuously since the Scheme began in July 2014.

In 2021 we re-signed the Armed Forces Covenant, increasing our number of commitments and enhancing some of our existing pledges. This re-commitment recognises the work of our employee resource group VetNet, our increased support to our employee reservists, and our focus on developing skills and employment opportunities for veterans.

Offering new career opportunities for veterans

Around 10% of our workforce in Australia are veterans and recently we were announced as the winner of the Prime Minister's Veterans' Employment awards – large employer category.

Recognising the transferable skills veterans can bring to our business we were proud to announce in 2021 that we are working with the technology training company WithYouWithMe (WYWM) to re-train and upskill a squad of ten veterans into information technology roles within the business.

As part of the WYWM partnership, veterans register their interest via a jobs accelerator event and applicants are selected by their character traits, skills and potential rather than previous work experience. Successful applicants will complete a 12-week programme and will then be deployed to BAE Systems for 12 months in early 2022, where they will continue to learn on the job.

We are also a Platinum signatory to the Soldier On Employment Pledge which cements our commitment to the provision of enhanced employment opportunity and understanding to veterans and their families.

Supporting veterans and drawing on their valuable skills is important to us, and our Veterans Advisory Committee, which is made up of veteran members from the business, provides advice, guidance and support to our workforce. Their passion and commitment is helping to support partnerships like the WYWM and provide a supportive and inclusive workplace.

Helping heroes embrace life-changing scholarships

Since it began in 2018, we have supported The Open University's Disabled Veterans' Scholarships Fund to help further the education of those who have become disabled as a result of military service. BAE Systems was the first corporate partner of the programme and we have already sponsored 24 veterans through their studies.

Students receive practical support for their disability, as well as careers guidance to help them adjust to a civilian work environment. The programme also helps to source work placements and mentors for the students.

The transferable skills of veterans can make a huge contribution, both socially and economically, and higher education can be a valuable tool in identifying and harnessing those skills, helping them to thrive in a post-service career.

Defending 22 – supporting our veterans and military community

For the sixth year, BAE Systems, Inc. employees accepted the Defending 22 (D22) Challenge to demonstrate support and raise awareness of the daily suicide rate and mental health issues our veterans and active duty service members face. For the 22-day challenge, more than 4,200 employees pledged and completed a personal health and wellness goal as a daily reminder of those lost to suicide. In honour of each employee who registered, a donation was made to an organisation whose mission supported improved mental health and wellness for our veterans and those serving in our armed forces.

D22 engages employees in alignment with our company values and mission, and the campaign helps to raise awareness of mental health both in our military veteran community and among our employees by encouraging those who participate to focus on their own wellbeing.

Through employee participation in the 2021 D22 Challenge, we raised more than $170,000 of vital funding for our charity partners. The five US charity partners were: Headstrong; Home Base; GallantFew; Team Red, White & Blue; and Wounded Warrior Project. The 2021 campaign was international, whereby the company made donations to Combat Stress in the UK and Sveriges Veteranförbund Fredsbaskrarna in Sweden for those employees participating outside of the US.

Social continued

Supporting our communities

Supporting our communities

In 2020, the Board approved a proposal for an unclaimed asset programme, with the net proceeds (£3.6m) from any shares sold to be used to support the local communities in which we operate. This funding was in addition to our regular funding for community initiatives.

During 2021 a number of potential projects suitable for the funding were identified and the following projects were approved via the community investment governance process. So far £1.8m has been approved for projects, and more initiatives are being identified for 2022.

Nurturing digital skills in the community

In Lancashire, up to 7,500 young people will benefit from a £300,000 initiative to enhance their digital skills and employability prospects.

The initiative has been developed in collaboration with the Lancashire Enterprise Partnership, CREATE Education and InnovateHer, providing a pathway to build Lancashire's future digital workforce through online education, 3D printers and practical training for up to 70 schools located across the region.

Recognising the long-term impact of the COVID-19 pandemic on young people, these programmes will play a role in inspiring students aged 12 to 16 to pursue fulfilling careers and develop skills that are in high demand from employers in the digital and technology sectors and set to increase significantly over the coming years.

The funding supports our commitment to increasing opportunities for young people from diverse backgrounds and addressing the disproportionate number of females who go on to choose a career in Science, Technology, Engineering and Maths.

Supporting community regeneration in Barrow-in-Furness

Making a difference to the communities in which we have a presence is important, and we are proud to be involved in two projects which will bring significant benefits to Barrow-in-Furness: the development of a university campus (The Learning Quarter), in partnership with the University of Cumbria and Furness College; and the establishment of Community Resilience Hubs in the most disadvantaged areas of the town. Together, these projects have been approved for up to £1m in support from BAE Systems in total over the next three years.

The Learning Quarter will provide an integrated further education and higher education presence, with a focus on enhancing the employability of secondary school students and increasing their potential to go to university. It will not only enhance progression into higher education for local people, but will support the retention and attraction of talent to the area, and enhance the reputation of the town. It will provide new jobs for Barrow both directly and indirectly, and additionally it will generate spend in the local economy.

The Community Resilience Hubs will provide an opportunity for local people to develop skills, access services and come together to build thriving communities. The project will also support access to and use of digital technology, and address health inequalities across Barrow. A social enterprise project will be set up and delivered from the Hubs once these are in place.

The HIVE Portsmouth

We are currently in discussions with a local charity, The HIVE Portsmouth, as we are keen to support their project to set up a collaboration space for the voluntary sector in Portsmouth. Having worked with The HIVE Portsmouth previously, we understand the impact their services can have on the local community. Charities and organisations registered with The Hive Portsmouth will have the opportunity to benefit from the space, allowing them to share costs, operate more efficiently, collaborate on shared projects and provide a more effective service to those most in need.

There are further potential opportunities for our employees to volunteer with time and key skills, enabling a greater sense of pride in being able to give back to the local community.

Rochester Royal British Legion Industries (RBLI) veterans village expansion

Supporting the armed forces is at the heart of what we do, and being able to demonstrate that with a specific community of veterans instils a real sense of pride for our employees. We are pleased to be doing this in Kent, close to our site in Rochester. Funding and volunteers are being proposed to enable the RBLI to expand their Centenary Village which is the largest veterans project in the UK and provides housing, community facilities and employment support.

The unique model of the village allows residents to work on mental health, mobility and physical health, at the same time as employability and skills. This means that veterans are supported throughout their stay so that they can move onwards and eventually out of the village.

Our proposal will contribute to the new Move-On accommodation for the veterans currently living in RBLI's emergency accommodation, providing veterans with a fresh start at independent living.

Community education programmes in Australia

Supporting disadvantaged young people to attend and remain in school is important to us, and we are pleased to commit our support to two programmes in our Australian communities that will do just that.

Both programmes will target young disadvantaged people who are at risk of disengaging with education and provide them with inspiring projects, mentoring and support. The programmes will focus on breaking down barriers, creating social cohesion and building aspirations whilst improving the educational and wellbeing outcomes for young people.

We are proud to be able to support programmes that will make a difference and help break the cycle of poverty, disadvantage and disengagement from education and help to navigate positive future pathways.

STEM lab at Al-Majmaah University

Developing the future of the next generation and inspiring young people to consider careers in science, technology, engineering and maths (STEM) is important to us, and so we are delighted to be able to support the proposed establishment of a new STEM facility at Al-Majmaah University in the Kingdom of Saudi Arabia.

Once operational, the laboratory at the university will provide facilities for up to 12,000 STEM students each year. The funding is intended to support the furnishing and equipping of the laboratory, and in addition we will collaborate with the university on the development of long-term initiatives. These will be similar to the support we provide on the successful University Collaboration Programme and will include training and educational initiatives, research studies, community activities and the provision of support for technical and professional lectures.

MiSK Foundation Fellowship competition

Working with the MiSK Foundation on the Fellowship programme competition, we are able to support opportunities for young people in Saudi Arabia to make a difference to real challenges. Focused on cultivating and encouraging learning and leadership in youth for a better future, the 2021 competition will focus on areas related to six of the UN Sustainable Development Goals which have been identified as national priorities: Good Health and Wellbeing; Quality Education; Affordable and Clean Energy; Decent Work and Economic Growth; Industry, Innovation and Infrastructure; and Sustainable Cities and Communities. Fellows will design and develop a solution to specific challenges, and winners will be awarded funding and a toolkit to support the implementation of the solution.

Sustainability – Environmental, Social and Governance

Governance

Governance and business conduct

Our success depends on us being trusted by our stakeholders to uphold high standards of governance and business conduct. Robust governance remains at the core of our business and underpins the sustainability of the business. This is enhanced by an unwavering commitment to ethical and responsible behaviour, in all aspects of what we do. Our industry is amongst the most highly regulated of any sector, and we always strive to comply with – and often exceed – applicable laws and regulations.

The effective governance of our business is fundamental to us. Our Operational Framework sets out our approach and the policies, processes and standards to which we adhere and apply everywhere we operate. Together with our Code of Conduct and Supplier Principles – Guidance for Responsible Business, these outline expectations for all our employees and business partners in support of our business, including our sustainability agenda.

Anti-corruption programme

To maintain the high standards of ethical conduct that our stakeholders expect, every employee must understand the vital role they have to play and conduct business in an ethical and responsible way. We have a zero tolerance policy regarding corruption in all its forms.

Our anti-corruption programme is designed to ensure adherence to legal and regulatory requirements recognising the bribery and corruption risks that are faced by the Company (see the Laws and regulations principal risk on page 113). The programme also provides our employees with practical guidance, helps them to understand what is expected of them and creates an environment in which they 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. During 2021, we revised our online Gifts and Hospitality Register and refreshed job-specific anti-corruption training. Our anti-corruption programme also includes our Code of Conduct and ethics training.

Employee ethics programme

Our ethics programme is continually being enhanced to ensure we drive the right behaviours and that our employees are trained in ethical decision-making and we are embedding responsible business practices, supported by our corporate values.

Our updated Code of Conduct was rolled out globally during 2021 and incorporates changes to internal policies and processes and external best practice. An employee engagement programme and manager-led scenario training supported awareness and understanding of the revised Code. Our training actively encourages all employees to speak up if they have a concern or talk to a colleague, their manager, HR or a legal contact if they need guidance. The conversation-based training offers everyone in our business an opportunity to consider some of the challenges we face in our workplace, focusing on those that are particularly relevant to each team and encouraging an inclusive and respectful workplace where all employees can be their best.

Training and engagement

We train and educate our employees to empower them to make ethical decisions. All employees are required to complete ethics training annually, alongside an e-learning programme of role-specific training, for example, export controls.

We engage employees throughout the year on ethics and responsible business. In the US, we produce monthly 'Ethics Minute' messages to communicate directly with employees on a range of topics, including workplace respect, creating a culture that speaks up to address issues, reinforcing anti-retaliation, handling gifts and hospitalities, among others. In the UK, we produce quarterly ethics and compliance communications to spotlight particular areas including, gifts and hospitality, security and export controls. We also actively promote our Ethics Officers and Ethics Helpline across our business, to help ensure employees feel they can raise issues and seek guidance in person and in confidence.

Raising an ethics concern

Employees can raise a concern in four ways: via our Ethics Officers; by email; on the telephone; and online reporting to our externally-run Ethics Helpline service. Our Ethics Officers receive regular role-specific training to ensure that they are equipped with the skills to give guidance to employees seeking to raise an issue.

96% of our employees completed our ethics 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 training in due course on their return to the business.

Pages 118 to 119
Governance framework

Anti-corruption programme

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

- **Code of Conduct** – which explicitly prohibits the giving or receiving of bribes by BAE Systems employees;
- **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 relevant policies include: Community Investment Policy; Finance Policy; Fraud Prevention Policy; Export Control Policy; Pursuit of Export Opportunities 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.

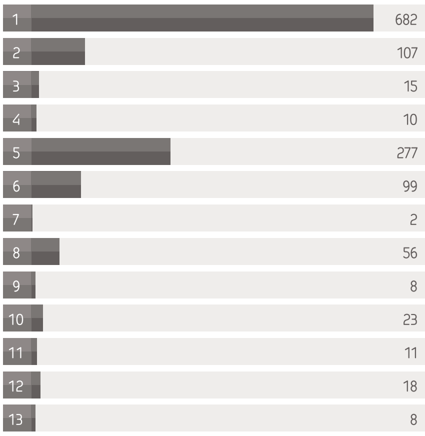
Total ethics enquiries[1]

Anonymity rate

35%

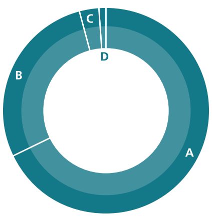
(2020 32%)

2021 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

2021 ethics enquiries by region



A	US	**892**
B	UK	**371**
C	Saudi Arabia	**40**
D	Australia	**13**

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

During 2021, we received 1,316 enquiries, an increase of 18% compared to 2020. We attribute this upward trend to a drop in enquiries in 2020 due to the onset of COVID-19 and the associated change in working patterns seen around that (for example, working from home means employees are less likely to observe poor behaviour). 2021 has seen more of a return to 2019 levels of enquiries (2019 1,432).

Of the 1,316 enquiries received, 634 (48%) required investigation, 30% of which were substantiated. The top five categories for investigation were: employee conduct, accounting charge practices, employee relations, management practices, and safety, health and environment. Of the 634 investigations for 2021, 548 were closed and 86 remain open. These will be closed out during 2022.

Seven ethics enquiries were received about our suppliers. One enquiry required investigation but was not substantiated.

68% 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. Our main metric is the number of enquiries made, and more specifically the number of enquiries per 1,000 employees. We also measure the proportion of requests for guidance compared to reports requiring investigation, anonymity rate and contacts made directly to one of our 206 Ethics Officers (one for every 400 employees) across our business. In 2021 our anonymity rate was 35% compared to 32% from 2020, and 35% in 2019, still well below the benchmark rate of 58%[3].

42% of reports were made directly to Ethics Officers in 2021 – we encourage this route for making reports, as it allows for an immediate response by someone familiar with the local situation. However, we are pleased that employees are using the options available to report issues or obtain guidance, whether they choose to do so anonymously or otherwise.

Dismissals for reasons relating to unethical behaviour[1]

In 2021, 281 employees were dismissed due to misconduct, which may include breaches of the Code. The majority of this 19% increase from 2020 occurred in our US business and generally related to non-compliance with established COVID-19 protocols and requirements.

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. To identify responsible trading risks our Product Trading Policy, requires an evaluation on all products and services and trading activities. The process ensures that in addition to a commercial assessment, consideration is always given to wider ESG concerns.

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.

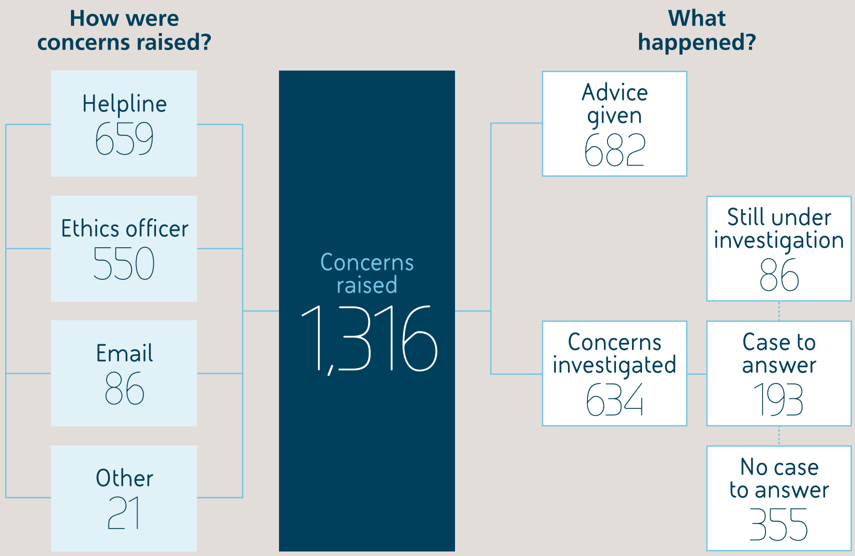
Export of controlled goods and technology must be authorised in advance by governments. Failure to comply with all applicable laws and regulations could result in serious penalties for BAE Systems and the individuals concerned and could harm national security and foreign policy interests. Our Export 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, disclosures and appropriate remedial actions.

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 2021 anonymity benchmark.

Sustainability – Environmental, Social and Governance

Governance continued

How our Ethics Helpline has been used



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. During 2021, we conducted a human rights desktop review of our directly controlled operations and policies to ensure they incorporate best practice.

Our Supplier Principles – Guidance for Responsible Business communicate the human rights principles we expect of our suppliers (see page 67). Our Supplier Principles are embedded within risk-based due diligence during the supplier evaluation stage against non-financial risks and are also considered during ongoing supplier management assessments.

We publish our annual responses to the UK and Australian Modern Slavery Acts, and a statement in response to the California Transparency in Supply Chains Act on our website. During 2021, our UK and Australian businesses established working groups to review and strengthen how modern slavery and human trafficking risk is identified, assessed and managed across our business. In 2022 mandatory training will be introduced for relevant employees, including those within procurement, with key performance indicators being introduced to monitor our progress.

Our approach to identifying and assessing human rights risks is embedded within our approach to risk management (see page 104).

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

Improving industry standards

We continue to play our part in supporting others by setting an example for business partners and seeking to help improve standards across our industry.

We take a proactive leadership role in our engagement with the defence industry, governments, NGOs and other interested parties to develop initiatives that will address the key ethical issues affecting our business environment. For example, we take leadership positions with industry ethics groups such as the International Forum on Business Ethical Conduct (IFBEC) and the US 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 of Europe and the Aerospace, Defence, Security and Space trade associations.

In the US, Tom Arseneault and the Inc. Chief Ethics Officer have been appointed vice-chairs of the DII Executive Steering Committee and the DII Working Group respectively, and the 2021 Best Practice Forum featured Tom Arseneault's participation on the CEO/COO panel providing insights on the view of ethical culture from the C-Suite. Globally, we have collaborated with the NATO Building Integrity programme, including providing speakers for NATO events and giving access to IFBEC's guidance materials. We have also supported IFBEC's programme for members to benchmark employee ethics programmes and share best practice.

2022 priorities

During 2022, we aim to:

- continue promotion of our Speak-Up culture utilising annual ethics training and regular communications which will include anonymised case studies to promote transparency and accountability.

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

Responsible supply chain

We collaborate with suppliers to deliver customer capability, spending £10.5bn with more than 20,000 directly-contracted suppliers worldwide. These relationships are often long-lasting due to the complexity of our products and their long lifecycles, so it is critical that our suppliers share our values. To ensure we work with suppliers who share our approach to responsible business, we monitor and manage them throughout the business relationship.

Governance of supply chain

Our ambition in procurement is to be responsible and sustainable across the life of the contracts we have in place. We cannot achieve this alone, therefore it is important that we collaborate and partner with suppliers to make a positive business difference over the long term.

Our supply chain management starts with our Global Procurement Policy which defines the requirements to be implemented by each of our businesses for the establishment of procurement control and the management of supplier-related risk.

Our Global Procurement Policy requires our businesses to communicate our 'Supplier Principles – Guidance for Responsible Business' to our suppliers. The Supplier Principles are based on our Code of Conduct and Group policies. They set out what we expect from our suppliers and their supply chains and outline best practice guidance for suppliers, in relation to matters such as anti-corruption, how employees are to be treated, international trade compliance, environment, counterfeit components and the BAE Systems Code of Conduct.

Our Supplier Principles and our standard terms and conditions require suppliers to comply with all applicable laws and regulations, including those related to human rights, anti-slavery and the environment.

We periodically update our Supplier Principles and our standard terms and conditions to reflect changes in laws and regulations and to incorporate and progress issues that are important to the Group. For example, we will be updating our Supplier Principles in 2022 to expand our expectations of suppliers in relation to human rights and sustainability and we will be including anti-human trafficking (US) clauses and modern slavery (UK and Australia) clauses within our updated standard terms and conditions.

As part of continuous improvement and to support the Group's sustainability agenda, during 2021 we worked with our suppliers to understand where they are on their own net zero journey, while seeking to identify opportunities relating to sustainable procurement (see page 67). In the UK and Australia, we established working groups to review how modern slavery and human trafficking risk is identified, assessed and managed across our business as part of our overall compliance programme (see page 66).

During 2022 we will develop a strategy and roadmap, which will outline our approach to integrating ESG principles across how we work with suppliers.

Supplier due diligence

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 stipulate our expectation that suppliers embrace our standards on ethical behaviour, including those set out in our Supplier Principles.

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 undertaking ongoing risk-based due diligence.

Supplier assurance

During 2021, we undertook supply chain assurance activity to assess compliance with our Supplier Principles. This activity supports us in identifying and mitigating risks across our supply chain. Our assessments covered 25% of global spend. This activity will continue in 2022.

2022 priorities

During 2022, we aim to:

- launch updated Supplier Principles;
- continue to assess suppliers on the adoption of our Supplier Principles; and
- develop our Supply Chain Sustainability Strategy.

Our UK Modern Slavery Act, Australian 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 in the Financial glossary on page 78. 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.
3. The purposes and definitions of non-GAAP measures are provided in the Financial glossary on page 78.
4. Growth rates for Sales, Underlying EBIT and Underlying EPS are on a constant currency basis (i.e. current year compared with prior year translated at current year exchange rates). All other growth rates and year-on-year movements are on a reported currency basis.
5. With effect from 2021, the Group adopted the underlying EBIT profitability measure in place of the underlying EBITA measure. Further details are provided in the Financial glossary on page 78.
6. The one-off tax benefit in 2021 is described on page 71. Growth rate disclosed excludes the impact of the 2021 one-off tax benefit.
7. 2020 Free cash flow of £1,367m is before a £1bn UK pension scheme contribution.
8. Including share of equity accounted investments.
9. Order book represents the transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.
10. The 2020 dividend per share of 23.7p is in respect of the year ended 31 December 2020. An interim dividend of 13.8p per share was paid in 2020, in respect of the year ended 31 December 2019, having been proposed as a 2019 final dividend but deferred in light of the pandemic.

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

BONUS 75% of the UK executive directors' annual bonuses are based on the achievement of financial KPIs (see page 157).

Financial performance

Financial performance measures as defined by the Group[3]

Sales

KPI

£21,310m 5% growth[4]

2021	21,310
2020	20,862

Underlying EBIT[5]

KPI

£2,205m 13% growth[4]

2021	2,205
2020	2,037

Underlying earnings per share excluding one-off tax benefit[5,6]

BONUS KPI

47.8p

Including 2021 one-off tax benefit 50.7p

12% growth[4]

2021	47.8 (50.7)
2020	44.3

Free cash flow[7]

KPI

£1,864m £497m higher

2021	1,864
2020	1,367

Net debt (excluding lease liabilities)

BONUS KPI

£(2,160)m £558m decrease

2021	(2,160)
2020	(2,718)

Order intake[8]

BONUS KPI

£21,458m £543m increase

2021	21,458
2020	20,915

Order backlog[8]

£44.0bn £1.2bn decrease

2021	44.0
2020	45.2

Financial performance measures derived from IFRS[1]

Revenue

£19,521m 1% growth

2021	19,521
2020	19,277

Operating profit

£2,389m 24% growth

2021	2,389
2020	1,930

Basic earnings per share

55.2p 36% growth

2021	55.2
2020	40.7

Net cash flow from operating activities

£2,447m £1,281m higher

2021	2,447
2020	1,166

Order book[9]

£35.5bn £0.8bn decrease

2021	35.5
2020	36.3

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

£(2.1)bn £2.4bn decrease

2021	(2.1)
2020	(4.5)

Dividend per share[10]

25.1p 6% growth

2021	25.1
2020	23.7

Group financial review continued

Income statement

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

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

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

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

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

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

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

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

Income statement

Financial performance measures as defined by the Group[3]		2021 £m	2020 £m
Sales	KPI	**21,310**	20,862
Underlying EBIT[2]	KPI	**2,205**	2,037
Return on sales		**10.3%**	9.8%

Financial performance measures derived from IFRS[4]	£m	£m
Revenue	**19,521**	19,277
Operating profit	**2,389**	1,930
Return on revenue	**12.2%**	10.0%

Reconciliation of sales to revenue		£m	£m
Sales	KPI	**21,310**	20,862
Deduct Group's share of revenue of equity accounted investments		**(2,979)**	(2,652)
Add Subsidiaries' revenue from equity accounted investments		**1,190**	1,067
Revenue		**19,521**	19,277

Reconciliation of underlying EBIT[2] to operating profit		£m	£m
Underlying EBIT[2]	KPI	**2,205**	2,037
Non-recurring items		**350**	19
Amortisation of programme, customer-related and other intangible assets		**(86)**	(42)
Impairment of intangible assets		**(15)**	(4)
Financial expense of equity accounted investments		**(27)**	(32)
Taxation expense of equity accounted investments		**(38)**	(48)
Operating profit		**2,389**	1,930
Net finance costs		**(279)**	(334)
Taxation expense		**(198)**	(225)
Profit for the year		**1,912**	1,371
Underlying interest expense		**(241)**	(255)
Net interest expense on post-employment benefit obligations		**(67)**	(70)
Fair value and foreign exchange adjustments on financial instruments and investments		**2**	(41)
Net finance costs (including equity accounted investments)		**(306)**	(366)

Exchange rates

Average	2021	2020
£/$	**1.376**	1.283
£/€	**1.163**	1.125
£/A$	**1.832**	1.862

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

1. Current year compared with prior year translated at current year exchange rates.
2. With effect from 2021, the Group adopted the underlying EBIT profitability measure (see Financial glossary on page 78), to include charges relating to software and development intangible amortisation, in place of the previously reported underlying EBITA measure. It reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business. Underlying earnings per share has also been recalculated to ensure consistency with the updated operational profitability measure. The underlying performance for 2020 of segments and the Group has been re-presented on this new basis. During 2020 the Group determined that Free cash flow was its key performance measure for utilisation of cash at a Group level. The Group continues to use Operating business cash flow as its key segment metric, to monitor operational cash generation.
3. The purposes and definitions of non-GAAP measures are provided in the Financial glossary on page 78.
4. International Financial Reporting Standards.

Taxation expense, including equity accounted investments, of £236m reflects the Group's underlying effective tax rate for the year of 18%, plus the tax charge on non-recurring items, less a one-off tax benefit of £94m in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime and the impact of the UK tax rate adjustment (see note 6). The 2020 charge of £273m reflected the Group's underlying effective tax rate for the year of 17%.

The calculation of the underlying effective tax rate is shown in note 6 to the Group accounts on page 215.

Earnings per share

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

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

Orders

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

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

Order book[5] decreased by £0.8bn to £35.5bn.

Earnings per share

Financial performance measures as defined by the Group[1]		2021	2020
Underlying earnings (excluding the 2021 one-off tax benefit)		**£1,523m**	£1,414m
Underlying earnings per share (excluding the 2021 one-off tax benefit)	KPI	**47.8p**	44.3p
Underlying earnings (including the 2021 one-off tax benefit)		**£1,617m**	£1,414m
Underlying earnings per share (including the 2021 one-off tax benefit)		**50.7p**	44.3p

Financial performance measures derived from IFRS[2]		
Profit for the year attributable to equity shareholders	**£1,758m**	£1,299m
Basic earnings per share	**55.2p**	40.7p

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

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

Orders

Financial performance measures as defined by the Group[1]		2021	2020
Order intake[3]	KPI	**£21,458m**	£20,915m
Order backlog[3]		**£44.0bn**	£45.2bn

Financial performance measures derived from IFRS[2]		
Order book[5]	**£35.5bn**	£36.3bn

1. The purposes and definitions of non-GAAP measures are provided in the Financial glossary on page 78.
2. International Financial Reporting Standards.
3. Including share of equity accounted investments.
4. Ratio of Order intake to Sales.
5. Order book represents the transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.

Group financial review continued

Cash flow

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

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

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

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

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

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

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

Interest paid was £247m (2020 £227m).

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

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

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

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

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

Cash flow

Financial performance measures as defined by the Group		2021 £m	2020 £m
Free cash flow[1]	KPI	**1,864**	367

Financial performance measures derived from IFRS[2]		£m	£m
Net cash flow from operating activities		**2,447**	1,166

Reconciliation from free cash flow to net cash flow from operating activities		£m	£m
Free cash flow	KPI	**1,864**	367
Add back Interest paid, net of interest received		**224**	208
Add back Taxation		**234**	251
Operating business cash flow[3]	KPI	**2,322**	826
Add back Net capital expenditure and financial investment		**209**	392
Add back Principal element of lease payments and receipts		**207**	226
Deduct Dividends received from equity accounted investments		**(57)**	(27)
Deduct Taxation		**(234)**	(251)
Net cash flow from operating activities		**2,447**	1,166
Net capital expenditure and financial investment		**(209)**	(392)
Principal element of finance lease receipts		**10**	10
Dividends received from equity accounted investments		**57**	27
Interest received		**23**	19
Acquisitions and disposals		**185**	(1,701)
Net cash flow from investing activities		**66**	(2,037)
Interest paid		**(247)**	(227)
Equity dividends paid		**(777)**	(746)
Purchase of own shares		**(368)**	–
Partial disposal of shareholding in subsidiary undertaking		**28**	27
Dividends paid to non-controlling interests		**(202)**	(19)
Principal element of lease payments		**(217)**	(236)
Cash flow from derivative financial instruments (excluding cash flow hedges)		**(88)**	16
Movement in cash collateral		**(18)**	(2)
Net cash flow from loans		**(367)**	2,160
Net cash flow from financing activities		**(2,256)**	973
Net increase in cash and cash equivalents		**257**	102
Add back/(deduct) Net cash flow from loans		**367**	(2,160)
Foreign exchange translation		**(50)**	220
Other non-cash movements		**(16)**	(137)
Decrease/(increase) in net debt (excluding lease liabilities)		**558**	(1,975)
Opening net debt (excluding lease liabilities)		**(2,718)**	(743)
Net debt (excluding lease liabilities)	KPI	**(2,160)**	(2,718)

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Notes 27 and 29 to the Group accounts

1. During 2020 the Group 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 in the Financial glossary on page 78.

Balance sheet

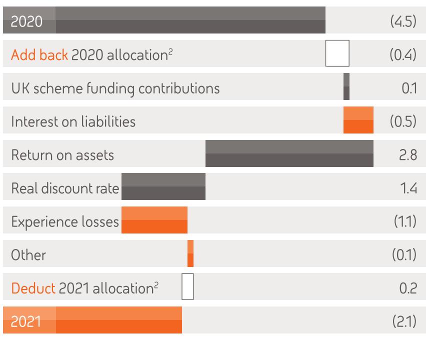
Summarised balance sheet		2021 £m	2020 £m
Intangible assets		**11,716**	11,745
Property, plant and equipment, right-of-use assets and investment property[1]		**3,204**	3,158
Equity accounted investments and other investments		**630**	409
Working capital[1]		**(2,934)**	(3,021)
Lease liabilities		**(1,252)**	(1,203)
Group's share of net IAS 19 post-employment benefits deficit		**(2,124)**	(4,485)
Net tax assets and liabilities		**589**	906
Net other financial assets and liabilities		**(1)**	36
Net debt (excluding lease liabilities)	KPI	**(2,160)**	(2,718)
Net assets held for sale		**–**	94
Net assets		**7,668**	4,921

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

Exchange rates

Year end	2021	2020
£/$	**1.354**	1.367
£/€	**1.191**	1.117
£/A$	**1.863**	1.770

Accounting net pension deficit – bridge (£bn)



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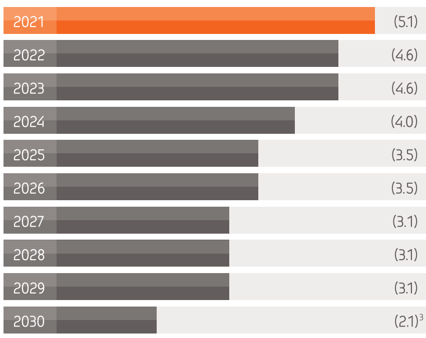
Note 24 to the Group accounts

Maturity of the Group's borrowings (£bn)



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Note 21 to the Group accounts

1. Funding received of £806m (2020 £678m) 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 2031 (£0.7bn), 2041 (£0.3bn), 2044 (£0.4bn) and 2050 (£0.7bn).

Balance sheet

Intangible assets of £11.7bn are in line with the prior year.

Property, plant and equipment, right-of-use assets and investment property is £3.2bn (2020 £3.2bn).

Equity accounted investments and other investments is £630m (2020 £409m).

The **Group's share of the net IAS 19 post-employment benefits deficit** was £2.1bn (2020 £4.5bn). The decrease was driven by higher discount rates and strong asset performance. 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 241.

A net deferred tax asset of £0.4bn (2020 £0.8bn) relating to the Group's pension deficit is included within **net tax assets and liabilities**.

In aggregate, there was a £0.1bn increase in **working capital**.

Lease liabilities are £1.3bn (2020 £1.2bn).

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

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

Group financial review continued

Accounting policies

Key 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 significant, and its uncertain nature means this may continue as governments continue to respond. While the Group has addressed the impact on its business effectively to date, given the ongoing risks and uncertainties, it continues to conduct ongoing risk assessments and scenario planning in order that it can respond to potential rapid changes in circumstances. The Group will therefore 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 profit recognition
Revenue £19,521m (year ended 31 December 2021)
See note 1 to the Group accounts

Post-employment benefit obligations
Group's share of the net IAS 19 post-employment scheme deficit £2.1bn (at 31 December 2021)
See note 24 to the Group accounts

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Key sources of estimation uncertainty

Changes in accounting policies

No new or amended standards which became applicable for the year ended 31 December 2021 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, where they deliver on the Group's strategy and where they offer greater long-term value than repurchasing the Company's own shares.

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 and share buyback

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 15.2p per share making a total of 25.1p per share in respect of the year ended 31 December 2021. At this level, the annual dividend is covered approximately two times by underlying earnings. Subject to shareholder approval at the 2022 Annual General Meeting, the dividend will be paid on 1 June 2022 to holders of ordinary shares registered on 22 April 2022. The ex-dividend date is 21 April 2022.

At 31 December 2021, the Company had retained earnings of £2.8bn (2020 £2.7bn), the non-distributable portion of which is £875m (2020 £827m) (see page 268). Total external dividends relating to the year ended 31 December 2021 are £797m (2020 £762m). The 2021 dividends consist of the interim dividend paid during the year in respect of the first half of 2021 of £316m (2020 £302m) and the final dividend proposed of approximately £481m (2020 £460m). 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 122 and 123).

The £500m share buyback programme announced on 29 July 2021 was completed in February 2022.

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 (excluding lease liabilities)

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 cooperative 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 2022

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

The guidance is based on the measures used to monitor the underlying financial performance of the Group. Reconciliations from these measures to the financial performance measures defined in International Financial Reporting Standards for 2021 are provided in the Group financial review on pages 68 to 75.

Group guidance

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

Sales

Growth expected to be in the 2% to 4% range over 2021.

- Growth expected in the Electronic Systems, Air, Maritime and Cyber & Intelligence segments, whilst Platforms & Services (US) is expected to be stable.
- Approximately 75% of the expected sales are already in the order backlog.

Underlying EBIT

expected to increase in the range of

4% to 6%

2021: £2,205m

Underlying EPS

expected to increase in the range of

4% to 6%

2021: 47.8p

Free cash flow target for 2022

in excess of

£1bn

Three-year free cash flow target

(2022 to 2024) in excess of

£4bn

The three-year free cash flow target for the period 2020 to 2022, originally set at £3.5bn to £3.8bn, has been upgraded to be in excess of £4bn.

Exchange rate assumption of $1.38:£1

Sensitivity to **EPS** is around one pence for every five cent movement

Finance costs expected to be around £240m

Group effective tax rate expected to be around 20%

Non-controlling interest expected to be around £70m

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

Segmental guidance

Year ended 31 December 2022	Expected sales	Expected underlying EBIT margin[1]
Electronic Systems	Up 2% to 4%	16% to 17%
Platforms & Services (US)	Stable	8% to 9%
Air	Up 2% to 4%	10% to 11%
Maritime	Up 3% to 5%	8% to 9%
Cyber & Intelligence	Up 3% to 5%	8% to 9%

1. Underlying EBIT as percentage of Sales.

In 2022, HQ underlying EBIT is expected to be broadly similar to 2021 (expense of £120m).

Sales for the year ended 31 December 2021 – segmental reclassification

With effect from 2022, the Group has established a new Digital Intelligence business, bringing together our non-US digital and data capabilities to further strengthen how we deliver these services and capabilities for our customers. The new Digital Intelligence business will be reporting within the Cyber & Intelligence segment. In addition, our BAE Systems Australia business is transitioning from the Air segment to the Maritime segment.

Sales performance for 2021 is re-presented below to reflect the new business structures, along with reconciliations from the reported 2021 Sales by segment. The re-presented Sales information forms the new basis for Guidance for 2022. The Guidance ranges above are maintained following this segmental re-presentation.

Year ended 31 December 2021	As reported £m	Reclassification £m	Re-presented £m
Electronic Systems	4,491	–	4,491
Platforms & Services (US)	3,395	–	3,395
Air	8,321	(872)	7,449
Maritime	3,416	753	4,169
Cyber & Intelligence	1,752	171	1,923
HQ/intra-group	(65)	(52)	(117)
Group	**21,310**	**–**	**21,310**

Financial glossary

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

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

Measure	Definition	Purpose	Closest IFRS measure and reconciliation
Financial performance measures as defined by the Group			
Sales	Revenue plus the Group's share of revenue of equity accounted investments, excluding subsidiaries' revenue from equity accounted investments.	Enables management to monitor the revenue of both the Group's own subsidiaries as well as its strategically important equity accounted investments, to ensure programme performance is understood and in line with expectations.	Page 70 Revenue
Underlying EBIT[1]	Operating profit excluding amortisation of programme, customer-related and other intangible assets (see note 8), impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBIT) and non-recurring items[2]. The exclusion of amortisation of acquisition-related intangible assets is to allow consistent comparability internally and externally between our businesses, regardless of whether they have been grown organically or via acquisition.	Provides a measure of operating profitability, excluding one-off events, to enable management to monitor the performance of recurring operations over time, and which is comparable across the Group.	Page 70 Operating profit
Return on sales	Underlying EBIT as a percentage of sales.	Provides a measure of operating profitability, excluding one-off events, to enable management to monitor the performance of recurring operations over time, and which is comparable across the Group.	Page 70 Return on revenue
Underlying earnings per share	Profit for the period attributable to shareholders, excluding post-tax impact of amortisation of programme, customer-related and other intangible assets, impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items[2] attributable to shareholders, being underlying earnings, divided by number of shares as defined for Basic EPS in accordance with IAS 33 Earnings per Share.	Provides a measure of the Group's underlying performance, which enables management to compare the profitability of the Group's recurring operations over time.	Page 71 Basic earnings per share
Underlying interest	Net finance costs for the Group and its share of equity accounted investments, excluding net interest expense on post-employment benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.	Provides a measure of finance costs associated with the operational borrowings of the Group that is comparable over time.	Page 70 Net finance costs
Underlying effective tax rate	Taxation expense for the Group and its share of equity accounted investments, excluding any one-off tax benefit/expense, as a percentage of adjusted profit before taxation, being Profit before tax plus taxation expense of equity accounted investments, adjusted for non-recurring items[2].	Provides a measure of taxation for the Group, excluding one-off items, that is comparable over time.	Page 215 Taxation expense
Operating business cash flow	Net cash flow from operating activities excluding taxation and including net capital expenditure and lease principal amounts, financial investment and dividends from equity accounted investments.	Provides a measure of cash generated by the Group's operations, to service debt and meet tax obligations, and in turn available for use in line with the Group's capital allocation policy.	Page 72 Net cash flow from operating activities

Measure	Definition	Purpose	Closest IFRS measure and reconciliation
Financial performance measures as defined by the Group continued			
Free cash flow[1]	Operating business cash flow less interest paid (net) and taxation.	Provides a measure of cash generated by the Group's operations after servicing debt and tax obligations, available for use in line with the Group's capital allocation policy.	Page 72 Net cash flow from operating activities
Net debt (excluding lease liabilities)	Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments). Net debt does not include lease liabilities.	Allows management to monitor indebtedness of the Group, to ensure the Group's capital structure is appropriate and capital allocation policy decisions are suitably informed.	n/a
Order intake	Funded orders received from customers including the Group's share of order intake of equity accounted investments.	Allows management to monitor the order intake of the Group's own subsidiaries as well as its strategically important equity accounted investments, providing insight into future years' sales performance.	n/a
Order backlog	Funded and unfunded unexecuted customer orders including the Group's share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.	Supports future years' sales performance of subsidiaries and equity accounted investments.	Page 210 Order book

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

1. With effect from 2021, the Group adopted the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the previously reported underlying EBITA measure, as it reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business. Underlying earnings per share has also been recalculated to ensure consistency with the updated operational profitability measure. The underlying performance for 2020 of segments and the Group has been re-presented on this new basis. During 2020 the Group determined that Free cash flow was its key performance measure for utilisation of cash at a Group level. The Group continues to use Operating business cash flow as its key segment measure, to monitor operational cash generation.
2. 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, the impact of substantively enacted tax rate changes, and costs incurred which are one-off in nature, for example non-routine costs or income relating to post-retirement benefit schemes, and other exceptional items which management has determined as not being relevant to an understanding of the Group's underlying business performance. The Group does not recognise any non-recurring adjustments which look to normalise business performance by excluding the estimated impact of the COVID-19 pandemic. Note 1 Segmental analysis and revenue recognition includes more information on those items reported as non-recurring in the period.

A Typhoon jet operated by 12 Squadron, the joint Qatar-UK squadron, at RAF Coningsby. We continue to deliver on our commitments for these important customers.

Segmental review

The Group reports its performance through six reporting segments.

Financial performance measures

Year ended 31 December 2021	As defined by the Group: Sales £m (KPI)	Underlying EBIT £m (KPI)	Return on sales %	Operating business cash flow £m (KPI)	Order intake[2] £m (KPI)	Order backlog[2] £bn	Derived from IFRS[1]: Revenue £m	Operating profit £m	Return on revenue %	Net cash flow from operating activities £m	Order book £bn
Page 82 Electronic Systems	4,491	766	17.1	774	4,923	7.2	4,491	715	15.9	951	5.7
Page 86 Platforms & Services (US)	3,395	259	7.6	287	3,236	5.6	3,318	252	7.6	351	5.3
Page 90 Air	8,321	856	10.3	628	7,186	20.3	6,913	930	13.5	743	14.7
Page 94 Maritime	3,416	288	8.4	321	4,336	9.9	3,340	289	8.7	457	9.4
Page 98 Cyber & Intelligence	1,752	156	8.9	173	1,817	1.6	1,752	152	8.7	202	1.0
HQ[3]	307	(120)		139	320	–	36	51		(23)	–
Deduct Intra-group	(372)				(360)	(0.6)	(329)				(0.6)
Deduct Taxation[4]										(234)	
Total	**21,310**	**2,205**	**10.3**	**2,322[5]**	**21,458**	**44.0**	**19,521**	**2,389**	**12.2**	**2,447**	**35.5**

We use financial performance measures as defined by the Group to monitor the underlying financial performance of the Group's reporting segments, and the definitions and purposes of these alternative performance measures are provided in the Financial glossary on page 78. Reconciliations from these measures to the financial performance measures derived from IFRS[1] are provided in the Group financial review on pages 68 to 75. Reconciliations by reporting segment for revenue and operating profit are included in note 1 to the Group accounts (see page 206) and for net cash flow from operating activities in note 27 to the Group accounts (see page 257).

1. International Financial Reporting Standards.
2. Including share of equity accounted investments.
3. HQ comprises the Group's head office activities, together with a 49% interest in Air Astana.
4. Taxation is managed on a Group-wide basis.
5. At a Group level, the key cash flow metric is Free cash flow (see Financial glossary on page 78). In 2021 Free cash flow was £1,864m (2020 £367m).

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 trusted 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.

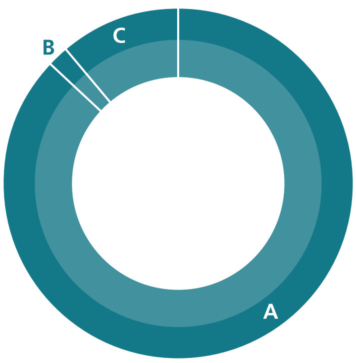
Precision Strike & Sensing Solutions designs and manufactures state-of-the-art systems and technology that enable our customers to execute their precision strike missions.

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.

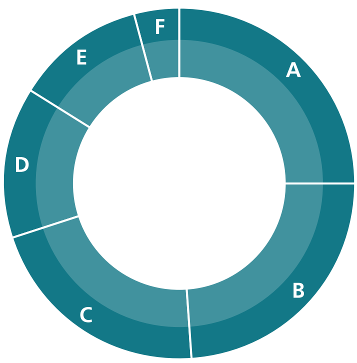
Power & Propulsion Solutions delivers propulsion and power management performance with innovative electrification products and solutions that advance vehicle mobility, efficiency and capability.

Sales by domain (%)



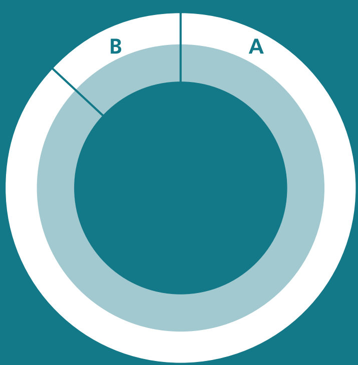
A	Air	87%
B	Maritime	2%
C	Land	11%

Sales by line of business (%)



A	Electronic Combat	25%
B	C4ISR Systems	24%
C	Precision Strike & Sensing	21%
D	Countermeasure & Electromagnetic Attack	14%
E	Controls & Avionics	12%
F	Power & Propulsion	4%

Sales analysis: Defence and commercial (%)



A	Defence	87%
B	Commercial	13%

16,400
Employees[1]

£4,491m
Sales

Page 78
Alternative performance measure definitions

In our Electrification Lab, we are advancing sustainable vehicle mobility, efficiency and capabilities across urban transit, maritime and military markets.

Our adaptive Signals Intelligence, or SIGINT, products are open architecture and software defined, allowing the warfighter to rapidly address emerging and dynamic threats.

Operational and strategic key points

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

Financial performance

Financial performance measures as defined by the Group

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

Financial performance measures derived from IFRS[2]

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

- Sales grew by 5%[3] with growth from the Electronic Combat Solutions and Precision Strike & Sensing Solutions businesses.
- Commercial revenues were flat as the pandemic continued to impact.
- Return on sales of 17.1% on strong operational performance and significant contribution from 2020 acquisitions.
- Increase in operating business cash flow reflected good working capital management and programme execution.
- Key orders secured on F-35, Precision Strike and C4ISR programmes.

1. Including share of equity accounted investments.
2. International Financial Reporting Standards.
3. Constant currency basis.

Electronic Systems

Segmental review continued

Operational performance

Electronic Combat Solutions

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

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

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

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

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

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

Countermeasure & Electromagnetic Attack Solutions

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

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

Precision Strike & Sensing Solutions

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

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

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

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

C4ISR Systems

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

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

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

Controls & Avionics Solutions

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

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

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

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

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

Power & Propulsion Solutions

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

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

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

Looking forward

Forward-looking information for the Electronic Systems reporting segment is provided later in this report.

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Segmental looking forward

Our 2-Color Advanced Warning System developed under the Limited Interim Missile Warning System programme builds upon our experience in fielding systems for the complex rotary-wing environment.

More online
baesystems.com

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.

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 three operational sites in the US located on the Atlantic and Pacific coasts.

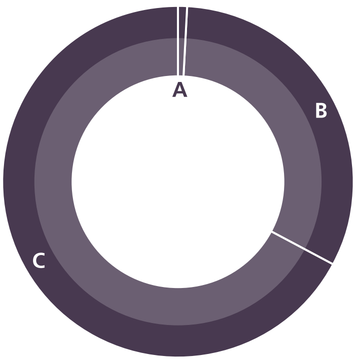
BAE Systems Hägglunds focuses on the tracked vehicle market for Swedish and international customers.

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

Weapon Systems UK is a provider of land-based artillery systems sustainment and services, primarily for the M777 towed ultra-lightweight howitzer.

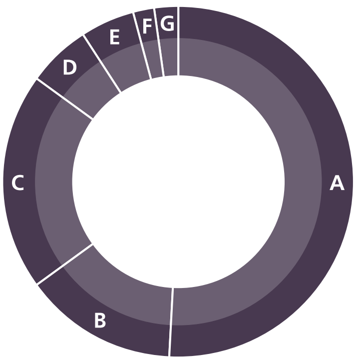
FNSS, the Turkish land systems business in which BAE Systems holds a 49% interest, produces and upgrades tracked and wheeled military vehicles for Turkish and international customers.

Sales by domain
(%)



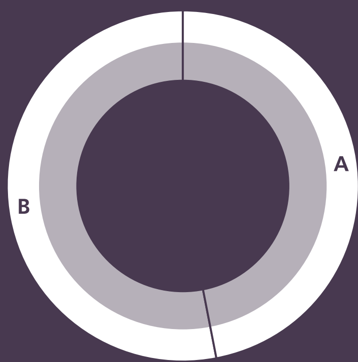
A	Air	1%
B	Maritime	32%
C	Land	67%

Sales by line of business
(%)



A	Combat Mission Systems	51%
B	Ordnance Systems	14%
C	US Ship Repair	20%
D	BAE Systems Hägglunds	6%
E	BAE Systems Bofors	5%
F	Weapon Systems UK	2%
G	FNSS	2%

Sales analysis: Platforms and services
(%)



A	Platforms	47%
B	Services	53%

12,300
Employees[1]

£3,395m
Sales

Page 78
Alternative performance measure definitions

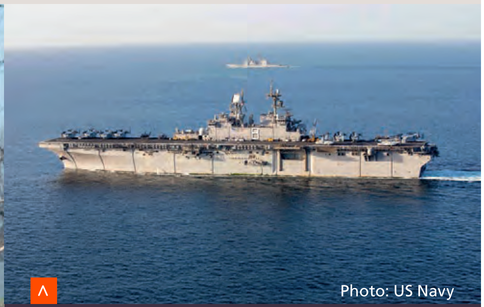


Photo: US Navy

Our Ship Repair team received a contract during the year for work on the USS Makin Island in our San Diego shipyard.

The Combat Mission Systems team delivered the 300th vehicle set of M109A7 self-propelled howitzers in 2021.

Operational and strategic key points

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

Financial performance

Financial performance measures as defined by the Group

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

Financial performance measures derived from IFRS[2]

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

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

1. Including share of equity accounted investments.
2. International Financial Reporting Standards.
3. Constant currency basis.

Platforms & Services (US)

Segmental review continued

Operational performance

Combat Mission Systems

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

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

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

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

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

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

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

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

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

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

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

Ordnance Systems

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

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

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

US Ship Repair

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

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

BAE Systems Hägglunds

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

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

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

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

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

BAE Systems Bofors

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

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

Weapon Systems UK

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

FNSS

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

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

Looking forward

Forward-looking information for the Platforms & Services (US) reporting segment is provided later in this report.

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Segmental looking forward

Beowulf demonstrated its capabilities to the US Army under its Cold Weather All-Terrain Vehicle programme.

More online
baesystems.com

Air

Segmental review continued

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

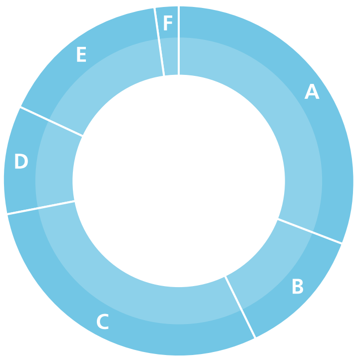
Our **UK-based** business includes UK and international programmes for the production of Typhoon combat and Hawk trainer aircraft, support, training and upgrades for Typhoon and Hawk, support and upgrades for Tornado, and development of next-generation combat air technologies and defence information 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 building the Hunter Class nine-ship Future Frigate programme. Services contracts include the provision of sustainment, training solutions and upgrades.

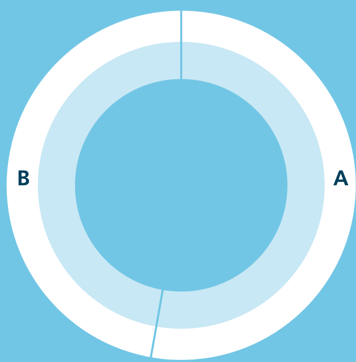
MBDA is a leading global prime contractor of missiles and missile systems across the air, maritime and land domains.

Sales by line of business (%)



A	European and International Markets	31%
B	US Programmes	12%
C	Saudi Arabia	29%
D	Australia	10%
E	MBDA	16%
F	FCAS	2%

Sales analysis: Platforms and services (%)



A	Platforms	53%
B	Services	47%

29,700
Employees[1]

£8,321m
Sales

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Alternative performance measure definitions

An F-35 aircraft on the flight deck of HMS Queen Elizabeth for sea training.

A concept model of Tempest, our Future Combat Air System.

Operational and strategic key points

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

Financial performance

Financial performance measures as defined by the Group

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

Financial performance measures derived from IFRS[2]

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

- Sales growth of nearly 6%[3], driven by F-35, Typhoon support activity, continued ramp in production on Qatar programmes, commencement of German Typhoon programme and MBDA volumes.
- Return on sales of 10.3% delivered by good operational performance, with increased R&D on Tempest programme and maturity mix of projects driving the margin reduction compared to 2020.
- Operating business cash flow reflects some utilisation of advances and timing on supplier spend.
- Orders included initial Tempest Concept & Assessment phase, Typhoon upgrades, further F-35 awards, strong MBDA demand and Hawk support contract renewal in Australia.

1. Including share of equity accounted investments.
2. International Financial Reporting Standards.
3. Constant currency basis.

Air
Segmental review continued

Operational performance

European and International Markets

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

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

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

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

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

Future Combat Air System

The Tempest technology maturation programme is progressing well.

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

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

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

US Programmes

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

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

Saudi Arabia

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

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

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

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

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

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

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

Australia

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

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

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

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

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

MBDA

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

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

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

Looking forward

Forward-looking information for the Air reporting segment is provided later in this report.

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Segmental looking forward

The T-650 concept vehicle, an all-electric 'heavy lift' uncrewed air system designed as a potential new solution to deliver cost-effective, sustainable rapid response capability.

More online
baesystems.com

Maritime

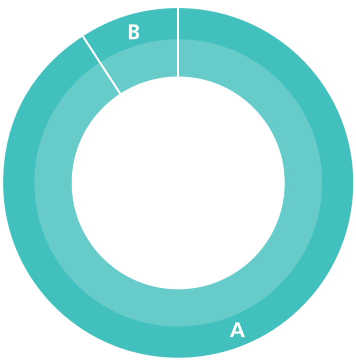
Segmental review continued

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

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.

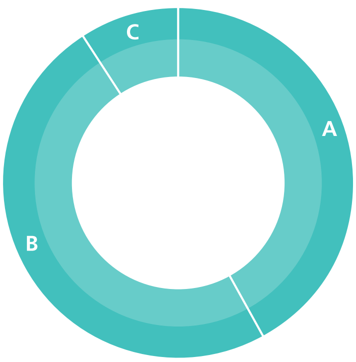
Land UK's munitions business designs, develops and manufactures a comprehensive range of munitions products serving a number of customers including its main customer, the UK Ministry of Defence. Rheinmetall BAE Systems Land (RBSL) – BAE Systems' joint venture with Rheinmetall – is a UK-based business specialising in the design, manufacture and support of military vehicles used by the British Army and international customers. Land UK also develops and manufactures cased-telescoped weapons through its CTA International joint venture.

Sales by domain
(%)



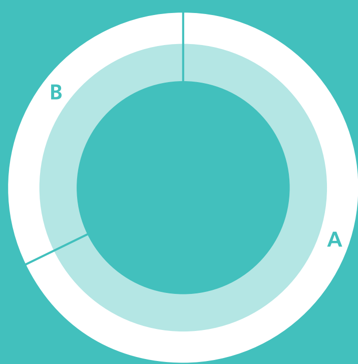
A	Maritime	91%
B	Land	9%

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%

18,200
Employees[1]

£3,416m
Sales

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Alternative performance measure definitions

Early careers colleagues qualify at the Skills Development Centre in Portsmouth, Hampshire, UK.

The first of class Type 26 vessel, Glasgow, rolls out in our Govan shipyard, UK.

Operational and strategic key points

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

Financial performance

Financial performance measures as defined by the Group

		2021	2020
Sales	KPI	**£3,416m**	£3,257m
Underlying EBIT	KPI	**£288m**	£279m
Return on sales		**8.4%**	8.6%
Operating business cash flow	KPI	**£321m**	£243m
Order intake[1]	KPI	**£4,336m**	£3,772m
Order backlog[1]		**£9.9bn**	£9.1bn

Financial performance measures derived from IFRS[2]

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

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

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

Maritime

Segmental review continued

Operational performance

Naval Ships

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

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

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

Submarines

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

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

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

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

Maritime Services

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

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

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

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

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

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

Land UK

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

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

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

The programme is expected to create and sustain more than 200 skilled jobs within RBSL and provide opportunities to more than 60 apprentices over the coming years. The contract will also create and sustain more than 450 jobs across the UK supply chain, helping to protect engineering and manufacturing skills.

The Challenger 3 contract, together with the Mechanised Infantry Vehicle contract, secured at the end of 2020, will provide workload for the business for the next ten years.

Looking forward

Forward-looking information for the Maritime reporting segment is provided later in this report.

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Segmental looking forward

Munitions manufacturing in Glascoed, Monmouthshire, UK.

More online
baesystems.com

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.

Intelligence & Security comprises the three US-based businesses.

Air & Space 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 and US Navy with systems engineering, integration, and sustainment services for critical weapons systems, C5ISR and cyber security that enhance mission effectiveness. Our solutions are deployed across platforms and networks in the air, maritime, land and cyber domains.

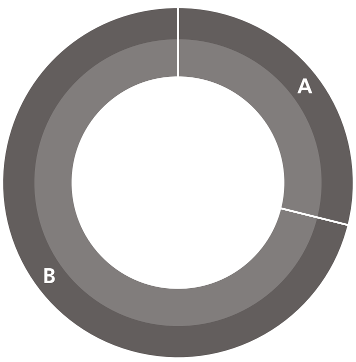
Intelligence Solutions provides innovative mission-enabling solutions and services to intelligence and federal/civilian agencies.

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.

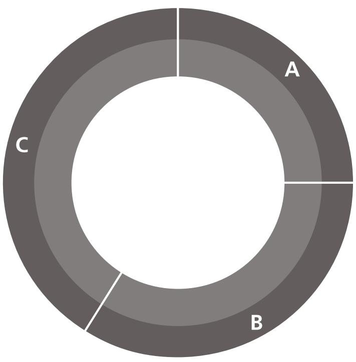
Financial Services delivers anti-fraud and regulatory compliance solutions to banking and insurance customers across Europe, North America, the Middle East, Africa and Asia-Pacific.

Sales by business (%)



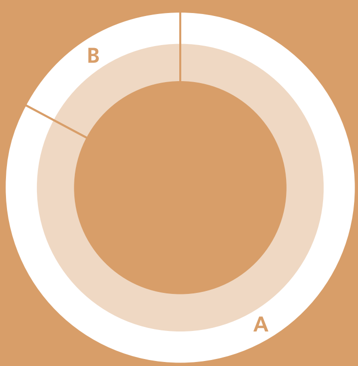
A	Applied Intelligence	29%
B	Intelligence & Security	71%

Sales by line of business Intelligence & Security (%)



A	Air Force Solutions	25%
B	Integrated Defense Solutions	34%
C	Intelligence Solutions	41%

Sales analysis: Applied Intelligence (%)

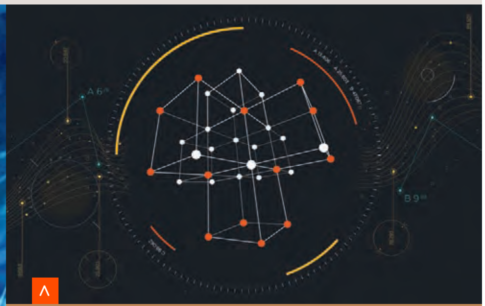


A	Government	83%
B	Financial Services	17%

9,600
Employees[1]

£1,752m
Sales

Page 78
Alternative performance measure definitions



We're one of only a handful of companies certified by GCHQ and CPNI as quality-assured cyber incident response providers. Delivering cyber and intelligence solutions to HMG and allied nations.

Intelligence & Security is conducting integrated prototyping of modelling and simulation tools for the state-of-the-art US Marine Corps Wargaming and Analysis Center.

Operational and strategic key points

Intelligence & Security

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

Applied Intelligence

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

Financial performance

Financial performance measures as defined by the Group

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

Financial performance measures derived from IFRS[2]

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

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

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

Cyber & Intelligence

Segmental review continued

Operational performance

Intelligence & Security

Air & Space Force Solutions

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

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

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

Integrated Defense Solutions

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

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

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

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

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

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

Intelligence Solutions

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

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

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

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

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

Applied Intelligence

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

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

Government

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

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

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

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

Financial Services

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

Looking forward

Forward-looking information for the Cyber & Intelligence reporting segment is provided later in this report.

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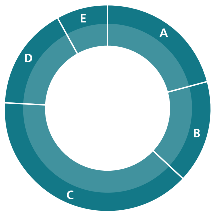
Segmental looking forward

Segmental looking forward

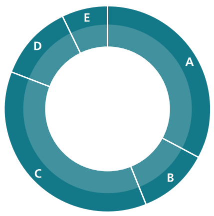
BAE Systems' reporting segments, Electronic Systems, Platforms & Services (US), Air, Maritime and Cyber & Intelligence, align with the strategic direction of the Group.

2021 Sales[1]



A	Electronic Systems	21%
B	Platforms & Services (US)	16%
C	Air	39%
D	Maritime	16%
E	Cyber & Intelligence	8%

2021 Underlying EBIT[1]



A	Electronic Systems	33%
B	Platforms & Services (US)	11%
C	Air	37%
D	Maritime	12%
E	Cyber & Intelligence	7%

1. The purposes and definitions of non-GAAP measures are provided in the Financial glossary on page 78.

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

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

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

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

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

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

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

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Our markets

Page 78
Alternative performance measure definitions

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

Future Typhoon production and support sales are underpinned by existing contracts. Discussions continue in relation to potential further contract awards for Typhoon. Production of rear fuselage assemblies for the F-35 has reached full rate levels and is expected to be sustained at these current levels. The business plays a significant role in the F-35 sustainment programme in support of Lockheed Martin. The UK Combat Air Strategy provides the base to enable long-term planning and investment in a key strategic part of the business.

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

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

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

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

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

Maritime

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

Land UK

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

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

Intelligence & Security

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

Applied Intelligence

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

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

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

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

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 considered on a regular basis at Board and Board committee meetings and the Board reviews risk as part of its business planning and 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 Environmental, Social and Governance 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.

Environmental, Social and Governance Committee

The Environmental, Social and Governance 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 2021 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

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 policy and 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. The 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 principal and emerging risks facing the Group. Principal and emerging risks have been identified, and are managed or mitigated, through the application of the policy 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 107 to 113.

In view of the supply chain issues prevalent across industry generally, including lead-time and availability issues and pricing pressures, the Group has expanded the contract risk and execution risk factor to include the risk that it may be impacted by such issues regarding the delivery of materials by suppliers and the assembly of components and subsystems by subcontractors used in its products in a timely and satisfactory manner, on satisfactory commercial terms and in full compliance with applicable terms and conditions.

The directors have considered the relevance of the risks of climate change and transition risks associated with the Group's net zero greenhouse gas emissions targets when preparing and signing off the Company's accounts.

Page 106
Our risk management framework

Page 107
Our principal risks

Our risk management framework

Board – Overall responsibility for risk management

Risk challenge, monitoring and reporting

Audit Committee
Operational Assurance Statement Risk Register and Non-financial Risk Register

Environmental, Social and Governance Committee
Non-financial Risk Register

Executive Committee
Operational Assurance Statement Risk Register and Non-financial Risk Register

Risk challenge, monitoring and reporting

Chief Executive's Business Review – Core Business Process*
Quarterly top-level review of the key operational, financial and non-financial performance issues within the business, and significant forthcoming bids and events

Quarterly Business Review – Core Business Process*
Quarterly management review of the performance of each of the Group's businesses against their objectives, measures and milestones

Integrated Business Plan – Core Business Process*
Annual long-term strategy review and five-year plan for each business

Strategic objectives and shareholder value

Business Risk
Risk Management Policy – Mandated Policy*

01 Identification
Financial and non-financial risks recorded in risk registers

02 Analysis
Risks analysed for impact and probability to determine gross exposure

03 Evaluation
Risk exposure reviewed and risks prioritised

04 Mitigation
Risk owners identified and action plans implemented. Robust mitigation strategy subject to regular and rigorous review

Operational Assurance Statement – Mandated Process*
Six-monthly management self-assessment of compliance with the Operational Framework and summary of key risks

Project objectives and financial return

Project Risk
Lifecycle Management Framework – Mandated Policy*

01 Identification
Financial and non-financial risks recorded in risk registers

02 Analysis
Risks analysed for impact and probability to determine gross exposure

03 Evaluation
Risk exposure reviewed and risks prioritised

04 Mitigation
Risk owners identified and action plans implemented. Robust mitigation strategy subject to regular and rigorous review

Lifecycle Management Project Performance Review*
Regular management review of project performance and issues to ensure that appropriate decisions and actions are taken

Audit Review Board
Assurance of the Business and Project Risk management processes as mandated in the Audit Charter. Including Operational and Non-financial Risk Management assurance

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*As defined in the Group's Operational Framework

Our principal risks

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

Government customers, defence spending and terms of trade

The Group's largest customers are governments. The Group is dependent on government defence spending, and the timing and terms of trade of government contracts.

Description	Impact	Mitigation
In 2021, 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 the US, UK and international defence markets. The diverse product and services portfolio is marketed across a range of defence markets. Our principal markets – the UK, US, Saudi Arabia and Australia – have a significant and sustained commitment to defence and security – see Our markets on pages 26 and 27 of this Annual Report. BAE Systems benefits from a large order backlog, with established positions on long-term programmes in our principal markets. BAE Systems has a portfolio of commercial businesses, including commercial avionics.
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. Most long-term US government contracts, for example, are funded annually or incrementally and are subject to cancellation if funding appropriations for subsequent periods are not made. 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.
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
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.	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

Contract risk, execution and supply chain

The Group has many contracts, including a small number of large contracts and fixed-price contracts, and is dependent upon component availability, subcontractor performance and key suppliers.

Description	Impact	Mitigation
In 2021, 51% of the Group's sales were generated by its 15 largest programmes. At 31 December 2021, 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, including assumptions on future rates of inflation, 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.
The Group is dependent upon the delivery of materials by suppliers and the assembly of components and subsystems by subcontractors used in its products in a timely and satisfactory manner, on satisfactory commercial terms and in full compliance with applicable terms and conditions. The external supply chain environment is very dynamic at this time, with both lead-time and availability issues, but also pricing pressures, including from inflationary increases in labour, energy and other key materials.	Some of the Group's suppliers or subcontractors may be impacted by the economic environment (including inflationary pressures) which could impair their ability to meet their obligations to the Group and to supply on satisfactory commercial terms. In some instances, the Group is dependent on one or a limited number of suppliers. If any of these suppliers or subcontractors fail to meet the Group's needs, the Group may not, in the short term, have readily available alternatives, thereby impacting its ability to complete its customer obligations satisfactorily and in a timely manner. The above events could have a negative impact on the Group's future results of operations and financial condition.	The Group's procurement function is responsible for establishing and managing end-to-end integrated supplier arrangements. The Executive Committee continues to monitor this risk. In many cases, the Group benefits from long-term programme positions and incumbencies with more stable forward visibility for long-lead items allowing the Group to continue to actively manage supplier lead times against demand requirements. The Group seeks to manage the inflation risk through its contracting arrangements on many of its major programmes, effective cost management and improved efficiency of the Group's own operations and through its long-term supplier agreements.

Our principal risks continued

Description	Impact	Mitigation

Competition in international markets

The Group's business is subject to significant competition in international markets.

Description	Impact	Mitigation
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.

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.

Description	Impact	Mitigation
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 has been an effective roll-out of vaccination programmes in certain countries, it is still not clear how long this pandemic will last or how enduring its long-term impact will be, 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, and the measures taken to control them, 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. The Group continues to build on the experience gained to date in dealing with the pandemic. This includes the use of safe working practices and the effective use of home working. 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.

Description	Impact	Mitigation

Cyber security

The Group could be negatively impacted by threats to the security of its information technology and operational technology systems.

Description	Impact	Mitigation
The cyber security threats faced by the Group include: threats to the operation of its information technology (IT) and operational technology (OT) infrastructure and systems; unlawful attempts to gain access to both the Group's proprietary or classified information and that of its customers, partners and suppliers; and the potential for business disruptions associated with IT and OT failures.	Failure to combat these risks effectively could disrupt business operations, compromise the security of the Group's products and services, erode the Group's competitive advantage, and negatively impact the Group's reputation among its customers and the public, resulting in a negative impact on the Group's future results and financial condition.	The Group has a broad range of measures in place, including use of appropriate tools and techniques to monitor and mitigate the risks. Many of our networks and systems have to be configured and operated to meet government and customer requirements for storing, managing and processing the various different levels of government classified information handled by the Group. We leverage our core specialist internal capabilities in information security, and combine it with our external market and intelligence knowledge, to ensure continued protection, and constant re-evaluation of our security posture against targeted attacks and other evolving threats. To complement the threat and data security risk activity, continual protective monitoring of our networks is undertaken locally and by our Global Security Operations Centre for centralised analysis to protect the enterprise infrastructure. As well as monitoring for signs of external attack, our protective monitoring also operates against Insider Threat activity, where user violations of security policy are detected and investigated. A formal assurance programme, which is audited both internally and externally, is operated to check adherence to company standards and customer requirements. Supplementing these mitigations is a programme of continuous employee education and awareness to help ensure employees understand applicable policies and act appropriately to mitigate the threats.

People

The Group's strategy is dependent on its ability to recruit and retain people with appropriate talent and skills.

Description	Impact	Mitigation
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.

Our principal risks continued

Description	Impact	Mitigation

Pension funding

An aggregate funding deficit could arise in the Group's defined benefit pension schemes.

Description	Impact	Mitigation
The latest estimates show that there is no longer a funding deficit in any of the pension schemes. A funding deficit could arise or be adversely affected by changes in a number of factors, including investment returns and members' anticipated longevity.	An increase in pension scheme liabilities or reduction in pension scheme assets could result in a pension scheme deficit which 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. The investment strategy in place across the UK and US schemes aims to ensure that the pension scheme assets are invested such that they match the cash flows needed to meet the pension liabilities, thereby reducing the risk of a deficit arising. Across the UK schemes there are a number of longevity risk management strategies in place. The US pension plan transferred around $1bn of pension liabilities to an insurance company in 2020. 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 have been finalised and all of the schemes were in surplus requiring no further Company contributions to be made.

Climate change and the environment

The Group may be impacted by environmental factors, including those relating to climate change.

Description	Impact	Mitigation
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 materials and waste, 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 physical risks arising from climate change, such as extreme weather events, for example flooding and storms, and scarcity of water and other resources. The Group may also be impacted by climate change transition risks resulting from the process of adjusting to a low carbon economy. Associated with this are potential risks around our ability to attract and retain future talent.	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. Extreme weather events can impact our operational sites as well of those of our suppliers. The shift to a low carbon economy has the potential to increase the cost of business as the Company transitions to lower emissions technologies and deals with the disposal of its legacy assets.	We have set ourselves the target of achieving net zero greenhouse gas emissions across our operations (Scope 1 and 2) by 2030 and working towards a net zero value chain by 2050. More generally, 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 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 modelled climate scenarios for 2030, 2050 and 2085. We have also begun to assess the natural hazard risks of our critical Tier 1 suppliers' sites. During 2021, we further developed our understanding of the climate-related risk and opportunities with the potential to impact BAE Systems' business model and strategy as a result of the qualitative scenario modelling which has taken place. We are now starting to progress quantification of material risks and opportunities against identified climate scenarios.

Description	Impact	Mitigation
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.
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.

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 23 February 2022.

David Parkes
Company Secretary

Chairman's governance letter

Contents

Dear Shareholders

This year will be the 30th anniversary of the publication of the Cadbury Committee's landmark report on corporate governance, the founding document for today's UK Corporate Governance Code. The report highlighted the importance of an effective board in creating and maintaining good corporate governance. It set out the basic tenets of governance that we recognise today; division of responsibility at the top of a company, a majority of independent directors, board committees to provide oversight on audit and remuneration, and the role of shareholders in satisfying themselves that an appropriate governance framework is in place.

Those core elements have remained. However, as the business environment continues to develop rapidly, corporate governance has broadened, most notably to recognise wider stakeholder responsibilities. This section of our Annual Report reflects that change, and we continue to evolve our reporting to provide best practice levels of disclosure and transparency – in our 1996 annual report (the first to be subject to what was referred to as the Cadbury Code) the section on governance consisted of a mere 12 pages, whereas for 2021 this section runs to 74 pages.

Our statement of Purpose is positioned appropriately at the very beginning of this document – it is at the heart of what we do and how we do it. We recognise the importance of clearly articulating what we do and the value of that to our stakeholders and wider society. Defence and security are of fundamental importance to society. Only defence companies such as BAE Systems can bring together the technology, know-how and resources needed to provide our government customers with the means to fulfil their national defence obligations. That said, we are taking a more active approach in communicating that message to all stakeholders, and it is something on which we will continue to place greater emphasis.

Today, disclosure and transparency is much more than simply 'comply or explain' statements. The Board of BAE Systems recognises its role in monitoring our corporate culture and looking to ensure that, in the words of Our Purpose, we are 'performance driven and values led'. The Board specifically reviewed our corporate culture last year. We used feedback from employees to inform these discussions and also looked at how the values and the behaviours we have set are being used to achieve the desired culture.

The unitary board remains at the heart of the UK's governance model, with directors providing leadership and oversight over a company. Such oversight does involves monitoring in-year financial performance, amongst many other things, and I'm pleased that the Company had another strong year in 2021. However, just as important is the Board's oversight of our performance in investing for the future, such as the significant increases in R&D investment we are making, our use of M&A to augment our technology base and capabilities and investing in our people, including the record number of apprentices and graduates we will be recruiting into our UK businesses this year.

When it comes to performance oversight, the Board is just as much involved in how we do business, as it is in the returns we make for our shareholders. Last October we held a governance event attended by investors at which we provided more insight into how we operate. In our industry, that means applying high standards and robust controls when it comes to how we win new business. It also means mandating a principles-based decision-making process, aimed at ensuring that the risks associated with our possible involvement with new customers, products and services are understood – through this process we can make informed decisions (at Board level, if necessary) and walk away from business opportunities that we believe are not aligned with our ethos.

Following last year's well received governance event, engagement on Environmental, Social and Governance matters remains a high priority and we will host another such event this year.

In conclusion, I believe we have a deep understanding of the governance standards expected of a successful, forward-looking defence and aerospace company, and the leadership and governance standards to give that real substance. For all companies, corporate governance has become broader and more complex. In response, boards are exercising leadership and oversight across a wider and more diverse business agenda. Given that challenge, I'm pleased that we have a diverse group of individuals on our Board that bring the insight, experience and knowledge necessary to take the Company forward.

Sir Roger Carr
Chairman

Board of directors

Sir Roger Carr
Chairman

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

Skills, competence and experience
Sir Roger was appointed Chairman in 2014, having joined the Board in 2013 as Chair Designate. He is an experienced company chairman with a wealth of knowledge gained across a number of business sectors. With over two decades of boardroom experience, Sir Roger has a deep understanding of good stewardship, corporate governance and the enablers of board effectiveness.

Sir Roger is a Senior Advisor to KKR and provides board advisory services for certain of its companies, 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
Chair of Nominations Committee.

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.

He 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 Asia, Australia, Europe and the US. He is a Fellow of the Royal Academy of Engineering.

Non-executive appointments
None.

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 had a 23-year career in 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.

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 during 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 US.

Non-executive appointments
None.

- Chairman
- Executive director

Board of directors continued

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 his roles at Spirax-Sarco Engineering, he was Vice-President of John Crane Asia Pacific and President of John Crane Latin America.

Other non-executive appointments
None.

Committee membership
Environmental, Social and Governance Committee, Innovation and Technology Committee and Nominations Committee.

Dame Elizabeth Corley CBE
Non-executive director

Appointed to the Board: 2016 **Nationality:** UK

Skills, competence and experience
Dame Elizabeth brings a wealth of investor, governance and boardroom experience to the Board. She is a former non-executive director of Pearson plc, and a non-executive director and Chair designate of Schroders plc. She 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.

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.

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. Dame Elizabeth was awarded a DBE in the Queen's Birthday Honours List 2019.

Other non-executive appointments
Non-executive director of Morgan Stanley plc and Non-executive director and Chair designate of Schroders plc.

Committee membership
Audit Committee, Nominations Committee and Remuneration Committee.

Dr Jane Griffiths
Non-executive director

Appointed to the Board: 2020 **Nationality:** UK

Skills, competence and experience
Jane has experience in leading high technology businesses and international corporate leadership. She is Chair of Redx Pharma Plc, an AIM listed company. In a long executive 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, Johnson & Johnson'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
Chair of Redx Pharma Plc and Non-executive director Johnson Matthey Plc.

Committee membership
Chair of Environmental, Social and Governance Committee and member of Nominations Committee.

Crystal E Ashby
Non-executive director

Appointed to the Board: 2021 **Nationality:** US

Skills, competence and experience
Crystal has held various senior leadership roles within the energy and healthcare sectors and has considerable expertise in government affairs, legal and regulatory matters. She is currently the Executive Vice President and Chief People Officer of the US health insurance company, Independence Health Group.

In her executive career, Crystal held various senior leadership roles during a long career with BP America Inc., culminating with her appointment as Executive Vice President of Government and Public Affairs and Strategic University Partnerships and membership of its Americas Leadership Team. She is an Independent Director on the Board of Texas Reliability Entity and serves on the Engineering Dean's Leadership Advisory Board at the University of Michigan. She is a National Association of Corporate Directors Fellow and a member of the International Women's Forum and American Bar Association.

Other non-executive appointments
Non-executive director of Texas Reliability Entity.

Committee membership
Environmental, Social and Governance Committee and Nominations Committee.

Dame Carolyn Fairbairn
Non-executive director

Appointed to the Board: 2021 **Nationality:** UK

Skills, competence and experience
Dame Carolyn is a highly regarded business leader who served as Director-General of the Confederation of British Industry from 2015 to 2020. Carolyn spent her early career as an economist with the World Bank in Washington. She also worked in government as a member of the Number 10 Policy Unit during the 1990s, following which she became a partner at McKinsey specialising in digital and media, and held senior executive roles at the BBC and ITV.

She was previously a non-executive director of Lloyds Banking Group, The Vitec Group plc and Capita plc. She is also a former non-executive director of the UK Competition and Markets Authority, the Financial Services Authority and until 2016, a Trustee of Marie Curie.

Dame Carolyn was awarded a DBE in the Queen's Birthday Honours list 2019.

Other non-executive appointments
Non-executive director of HSBC Holdings plc.

Committee membership
Innovation and Technology Committee, Nominations Committee and Remuneration Committee.

Chris Grigg CBE
Non-executive director and Senior Independent Director

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

Skills, competence and experience
Chris is Chair of the UK Infrastructure Bank and Chair designate of Tilney Smith & Williamson. He has held a range of leadership roles including Chief Executive of Barclays Commercial Bank and, most recently, Chief Executive of The British Land Company PLC, a position he held for over 11 years. He brings extensive public company and business leadership experience to the Board.

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
Chair designate of Tilney Smith & Williamson.

Committee membership
Environmental, Social and Governance Committee, Nominations Committee and Remuneration Committee.

- Non-executive director
- Committee chair
- A Audit Committee
- E Environmental, Social and Governance Committee
- I Innovation and Technology Committee
- N Nominations Committee
- R Remuneration Committee

Dr Ewan Kirk
Non-executive director

Appointed to the Board: 2021 **Nationality:** UK

Skills, competence and experience
Ewan has extensive experience in commercialising data science and quantitative analysis. He has led multiple ventures to identify, apply and leverage technology and mathematics research in both business and philanthropy.

In 2006, he founded Cantab Capital Partners, a science-driven investment management firm, which was acquired by GAM Investments in 2016 and one of the top-performing quantitative investment companies in the UK. Prior to founding Cantab, Ewan was Partner and Head of Quantitative Strategies Group at Goldman Sachs.

He is Chair of the Isaac Newton Institute for Mathematical Sciences, Chairman of DeepTech Labs, a UK-based venture capital fund that invests in deep technology businesses, and Co-Chair of the Turner Kirk Trust.

Other non-executive appointments
None.

Committee membership
Chair of Innovation and Technology Committee and member of Nominations Committee.

Nicole Piasecki
Non-executive director

Appointed to the Board: 2019 **Nationality:** US

Skills, competence and experience
Nicole has 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 and an advisor to Mitsubishi Heavy Industries in Tokyo. 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
Environmental, Social and Governance Committee, Innovation and Technology Committee and Nominations Committee.

Stephen Pearce
Non-executive director

Appointed to the Board: 2019 **Nationality:** AU

Skills, competence and experience
Stephen has 20 years' experience as a director of public companies and more than 30 years of financial and commercial experience in the mining, oil and gas, and utilities industries. He is currently Finance Director of Anglo American plc, a role he has held since April 2017, and a non-executive director of DeBeers.

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
Chair of Audit Committee and member of Nominations Committee.

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 gained across a number of industrial sectors.
In his executive career, Ian held a number of senior finance and operational positions within industrial companies. He was appointed Finance Director of Balfour Beatty plc and subsequently appointed as Chief Executive in 2005. He is currently Chairman of Vistry Group PLC, Amey plc and Affinity Water Limited.

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 of Vistry Group PLC, Amey plc (a subsidiary of Ferrovial, S.A.) and Affinity Water Limited.
Non-executive director of Anglo American plc.

Committee membership
Chair of Remuneration Committee and member of Audit Committee and Nominations Committee.

Governance framework

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.

Role of the Board

The Board shall promote the long-term sustainable success of the Company, generating value for shareholders, while having regard to its other stakeholders and the impact of its operations on the environment and the communities in which we operate. See page 22 for more information on the work of the Board.

The Board agrees Company's purpose, values and standards of behaviour expected of all employees, satisfying itself that these and the culture of the business are aligned. The Board also sets the Group's strategy, oversees and monitors internal controls, risk management and the Company's governance framework. Our robust governance framework sets out how we do business.

Purpose

The Company's purpose (see page 1) recognises that we serve, supply and protect those that protect us, and that we have an important role in society which underpins the Board's decision making. The Board monitors how our strategy, behaviours and culture align with our purpose.

Culture

Much of our strength as a business lies in our corporate culture which is performance driven and values led. The Board is responsible for ensuring that culture is aligned with our purpose, values and strategy.

Strategy

Our strategy (see page 14) is comprised of five key long-term focus areas aligned with our vision and mission. Agreed annually by the Board, it is an important part of how it promotes the long-term sustainable success of the Company.

Board composition

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. 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).

Board engagement with stakeholders

In considering and engaging with stakeholders, the directors act in accordance with Section 172 of the Companies Act. The work of the Board during the year is detailed in pages 22 to 25.

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 development and delivery of the strategy agreed by the Board. Developing for the Board's approval, appropriate values and standards to drive the required behaviours and by leading by personal example with regards to company culture.

Senior Independent Director

Acts as a sounding board for the Chairman and acts as an intermediary for the other directors as necessary. Annually, or on other occasions as necessary, leading the non-executive directors in appraising the Chairman's performance, and providing feedback.

Company Secretary

Ensuring that Board procedures are complied with, advising the Board on all governance matters. Also supports the Board by ensuring that it has the policies, processes, information, time and resources it needs in order to function effectively.

The Board has established principal committees which focus on particular areas, as set out below. The chair of each committee reports to the Board on the committee's activities after each meeting.

Board

- Nominations Committee Page 125
- Audit Committee Page 129
- Environmental, Social and Governance Committee Page 134
- Innovation and Technology Committee Page 138
- Remuneration Committee Page 139

Agreed annually by the Board, the Operational Framework contains a comprehensive statement of mandated governance requirements and delegated responsibilities. The UK Corporate Governance Code's (the Code) principles are embedded within the Operational Framework, and its policies and processes underpin all the disclosures made by the Board pursuant to the Code's provisions.

Internal controls

Operational Framework
Provides a stable foundation from which to deliver our strategy, improve our Company performance and continue to develop our culture.

It is mandatory across all wholly-owned entities and sets out our approach to its organisation, governance framework, core business practices and delegated authorities.

Core Business Processes
This describes the reporting and reviews mandated by the Operational Framework, which provide upwards visibility of project and business performance.

Operational Assurance
A process through which line and functional leaders respectively confirm twice yearly that their businesses and functions are compliant with the Operational Framework.

Internal Audit
Assesses the effectiveness of internal controls through a programme of reviews based on a continuous assessment of business risk across the Company.

We take pride in managing our operations responsibly

Responsible Trading Principles
How we conduct business is fundamental to the success of our Company and we mandate a principles-based approach to our business activity. We do not compromise on the way we conduct business, and consistency of this approach is key in defining our reputation.

Product Safety Policy
We set out principles which describe our approach to product safety to reduce the risk of unintentional harm to people, property and the environment. They apply throughout the life of the Product and throughout the supply chain.

Workplace and Operational Environment
Our people management expectations are clearly communicated to all employees and set out within our People Policy. We have a zero tolerance policy regarding corruption and every member of our workforce is aware of their role in ensuring we maintain high standards of ethical conduct. Pages 64 to 65 provide further detail about our anti-corruption programme.

The safety and wellbeing of our employees is paramount and our high standards for Health and Safety management provide a common framework to guide our workforce and further information can be found on page 50.

We use our expertise to reduce our global environmental impacts and to develop products and services for our customers which reduce their impacts on the environment. Our climate transition strategy and impact on the environment including; greenhouse gas emissions, efficient use of resources, land use and biodiversity, and the environmental impact of the Group's supply chain is overseen by the Environmental, Social and Governance Committee.

We are committed to ensuring that IT systems and services are used in a manner which promotes effective communication and working practices within the organisation and to preventing damage to its business or reputation through misuse of those systems. With the support of our Internal Audit team, our IT assurance and governance programme developed to support the effective management of cyber risks.

Suppliers
The Company depends upon its suppliers to provide fully compliant, cost-effective equipment, goods, services and solutions, which are an integral part of the world-class products required by our customers, and also support the effective operations of our Businesses and the Company's standards of business conduct. Our supply chain management and Supplier Principles – Guidance for Responsible Business (the Supplier Principles) are focused on high achievement of our standards. Our supplier contracts contain 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.

Product Trading Policy
Underpins all of our business activity and is applied to all Company products, trading, and throughout the product lifecycle. The Policy is used to reflect the Company's standards of integrity and help us to thoroughly evaluate the opportunities we pursue.

Risk Management Policy
We set clear requirements for the management and reporting of financial and non-financial risks in support of the delivery of our strategy. Project risks are managed through our Lifecycle Management Framework.

Core Business Processes
Our Integrated Business Plan (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 IBP is reviewed each year by the Board as part of its strategy review process. Once approved, 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.

As mandated by the Operational Framework, Businesses and Group functions complete a bi-annual Operational Assurance Statement (OAS). 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.

Lifecycle Management (LCM) Framework describes our approach to the assurance of Projects. LCM is integral to the successful execution of the Group's projects and programmes. Its application provides progressive risk based assurance throughout the Lifecycle to aid decisions, supporting delivery of Projects to achieve customer satisfaction, schedule and financial requirements.

The purpose of the Mergers, Acquisitions and Disposals process is to provide a structured approach to managing the Acquisitions, strategic Joint Ventures and Disposals. It forms a part of our Strategy and Planning framework in order to support the delivery of the IBP.

National Security Arrangements
The Group is subject to various national security requirements which are an important part of how we operate as a defence company and meet the needs of our customers. Due to the nature of its activities, the UK government holds a Special Share in the Company, ensuring that the Company cannot be non-British controlled. We also have a Special Security Agreement with the US Department of Defense addressing national security matters relating to the ownership and control of our US defence businesses. Similarly, our Australian operations are subject to an Overarching Deed with the Commonwealth of Australia which protects national security and other interests, and allows the Group to own and manage certain Australian defence-related industrial assets. These national security arrangements are an important part of our governance.

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 58 Supporting our communities Page 74 Dividends paid and capital allocation policy objectives Page 127 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 14 Our strategic framework Page 64 Sustainability – Environmental, Social and Governance – Governance Page 118 Governance framework Page 134 Environmental, Social and Governance 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 16 Our business model Page 119 Governance framework – 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 18 Our stakeholders Page 22 The work of the Board Page 134 Environmental, Social and Governance 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 14 Our strategic framework Page 50 Sustainability – Environmental, Social and Governance – Social

Section 2 – Division of responsibilities

Principles	Reference
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 118 Governance framework Page 127 Annual Board evaluation
G. The Board comprises the Chairman, three executive directors and ten 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 114 Chairman's governance letter Page 118 Governance framework
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 118 Governance framework Page 122 Governance disclosures Page 124 Board information
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 118 Governance framework Page 128 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 124 Board information Page 125 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 114 Chairman's governance letter Page 124 Board information Page 125 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 125 Nominations Committee report Page 127 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 129 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 188 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 106 Our risk management framework Page 107 Our principal risks Page 118 Governance framework

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 139 Remuneration Committee report Page 143 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 139 Remuneration Committee report Page 168 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 139 Remuneration Committee report

Governance disclosures

UK Corporate Governance Code (the Code) compliance: The Company was compliant with the provisions of the Code throughout 2021 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 118). 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". Recognising the Company's contractual commitments to the Chief Executive, the Remuneration Committee has taken an equitable approach to this matter. At the beginning of 2020 the Chief Executive's company pension contribution was frozen at the then monetary value (at which point it was equal to 19% of his base salary), recognising that it would thereafter reduce over time to the weighted average of employer contribution rates for active members across all UK pension schemes. As at 1 January 2022, his pension contribution had reduced to 16.4% of his salary, whereas the weighted average of UK active pension scheme members was estimated to be approximately 15.4%. The Remuneration Committee has recently taken additional steps to ensure that the Company will be compliant with Code Provision 38 by December this year (see Remuneration Committee report, page 140).

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 104 to 113. These processes are an integral part of our governance framework, the Operational Framework, details of which can be found on page 118. The Operational Framework mandates the Operational Assurance Statement (OAS) 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 OAS process has been designed to provide assurance with regard to compliance with the policies and processes mandated by the Operational Framework. It is a key element of the Company's governance and is formed of two parts: a self-assessment by businesses and functions of compliance with the Operational Framework; and a report showing their assessment of key risks. Twice a year, the line leaders for our business and the heads of our functions are required to critically analyse compliance relative to a scoring framework, which sets clear standards against which compliance must be assessed. Line and functional leaders are required to assure themselves of the level of compliance for a business, and submit supporting information and data to provide evidence of compliance.

The output from the OAS process is reviewed by (and subject to challenge from) the Internal Audit function relative to its understanding of matters within particular businesses. In addition, the OAS risk management process requires that twice-yearly the risks identified in each of the businesses are reported against a set risk framework. The output from the OAS process is provided to the Board and is reviewed in detail by the Audit and ESG committees. The report to the directors on the output from the OAS process provides granular graphical and narrative analysis of compliance against the requirements of the Operational Framework, and as such is an important part of how the Board monitors and reviews the Company's risk management and internal control systems. Further details of the Board's monitoring and review process can be found in the Audit Committee report on page 130.

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 14 to 34 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 2021, 41% of Group sales were product/programme related and 59% services and support;
- a geographically diverse business with a high proportion of sales to governments and other major prime defence contractors. In 2021, 36% of sales were to the US Department of Defense, 21% to the UK Ministry of Defence and 12% to the Kingdom of Saudi Arabia Ministry of Defence and Aviation. The Company's robust order backlog continues to 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, addressing the Group's stated net zero target and climate-related risks and opportunities, 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 2021, 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 104 to 113).

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. The Board considers all of the non-executive directors named on pages 116 and 117 of this report to be independent for the purposes of the Code.

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. The Board also considers whether there are any potential conflicts of interest that could have a bearing on a non-executive director's independence pursuant to Provision 10 of the Code. The following disclosures are made on these matters:

Ian Tyler

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 two unlisted companies; Amey plc, a subsidiary of Ferrovial, S.A., a Spanish listed company; and Affinity Water Limited. On 1 January 2022, he was appointed a non-executive director of Anglo American plc, a major UK listed company.

The Board has reviewed Mr Tyler's time commitments and is satisfied he has sufficient time to meet his responsibilities to BAE Systems. The Board also considered his cross-directorship with Stephen Pearce, a director of Anglo American plc and a non-executive director of the Company, and agreed that this did not affect their independence. Having served for nine years on the Board, Mr Tyler will stand down with effect from the close of the Company's AGM on 5 May 2022.

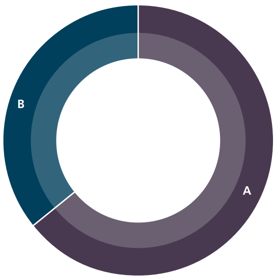
Dame Elizabeth Corley

Dame Elizabeth Corley, a non-executive director, was appointed a non-executive director and Chair designate of Schroders plc on 1 September 2021. Schroders are a shareholder in the Company, holding approximately 1% of the total share voting rights as at the date of this report. Consequently, an assessment was undertaken prior to her appointment to assess whether this relationship could have a bearing on her independence for the purpose of Provision 10 of the Code. It was agreed that the number of shares held by Schroders was not sufficiently material to have a bearing on her independence. The Company was also made aware of steps that would be taken by Schroders to avoid a conflict of interest with regard to any shares they may hold in BAE Systems plc.

Dame Elizabeth Corley is also a non-executive director of Morgan Stanley, a US-listed company, and one of its UK subsidiaries provides broking services to the Company. An assessment was also undertaken to assess whether this relationship would have a bearing on her independence. After review, it was determined that it was not a material business relationship given the relative low value of the contractual arrangements and the nature of the relationship, i.e. broking services as provided by a UK subsidiary of Morgan Stanley, and her appointment being to the board of the US parent company and non-executive in nature. Dame Elizabeth has announced that she will stand down from the Morgan Stanley board this year.

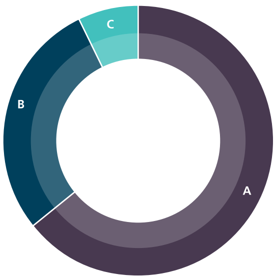
Board information

Gender



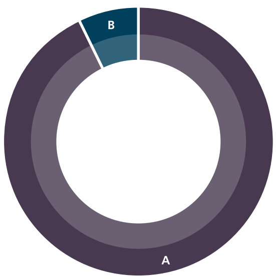
A	Male	9
B	Female	5

Nationality



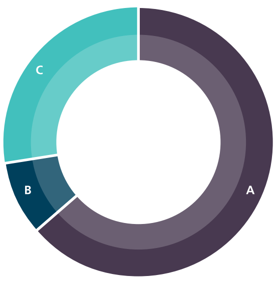
A	UK	9
B	US	4
C	Australia	1

Ethnicity



A	White	13
B	Black	1

Tenure – independent non-executive directors



A	Up to three years	7
B	Over three and up to six years	1
C	Over six years	3

Chairman
Non-executive director
Executive director

Committee chair
A Audit Committee
E Environmental, Social and Governance Committee

I Innovation and Technology Committee
N Nominations Committee
R Remuneration Committee

Membership and attendance

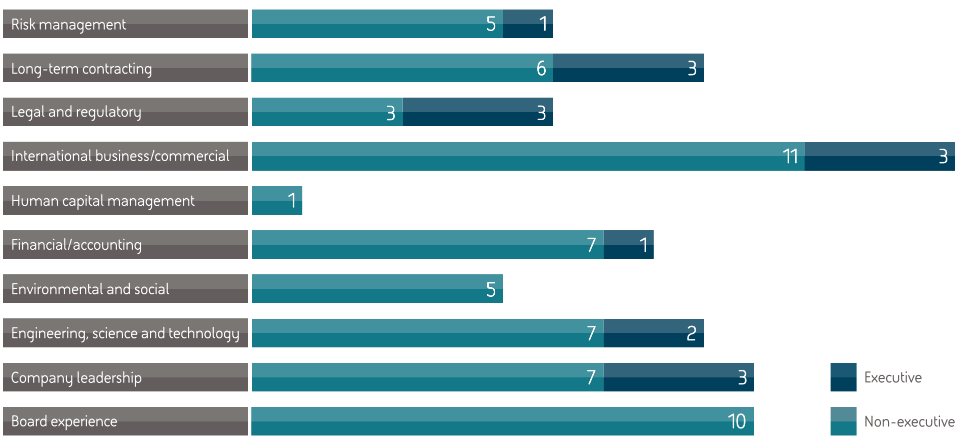
	Board meetings	Committee membership	Audit Committee	Environmental, Social and Governance Committee	Innovation and Technology Committee[1]	Nominations Committee	Remuneration Committee
Sir Roger Carr[2]	9/9	**N**	–	–	–	5/5	–
Nick Anderson	9/9	E I N	–	3/3	1/1	5/5	–
Crystal E Ashby[3]	4/4	E N	–	1/1	–	2/2	–
Dame Elizabeth Corley	9/9	A N R	6/6	–	–	5/5	6/6
Dame Carolyn Fairbairn[4]	8/8	I N R	–	–	1/1	4/4	1/1
Jane Griffiths	9/9	**E** N	–	3/3	–	5/5	–
Chris Grigg	9/9	E N R	–	3/3	–	5/5	6/6
Ewan Kirk[5]	6/6	**I** N	–	–	1/1	3/3	–
Stephen Pearce	9/9	**A** N	6/6	–	–	5/5	–
Nicole Piasecki	9/9	E I N	–	3/3	1/1	5/5	–
Ian Tyler	9/9	A N **R**	6/6	–	–	5/5	6/6
Charles Woodburn Chief Executive	9/9		–	–	–	–	–
Brad Greve Group Finance Director	9/9		–	–	–	–	–
Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.	9/9		–	–	–	–	–

1. The Committee's inaugural meeting was held in October 2021.
2. Sir Roger Carr joined the Board in October 2013 and was appointed as Chairman in February 2014.
3. Appointed on 1 September 2021.
4. Appointed on 1 March 2021.
5. Appointed on 1 June 2021.

The average length of appointment of non-executive members of the Board (as at 31 December 2021) was four years.

The average length of appointment of executive members of the Board (as at 31 December 2021) was three years.

Skills and experience



Nominations Committee report

Sir Roger Carr
Chairman of the
Nominations Committee

Members

Sir Roger Carr (Chairman)
Nick Anderson
Crystal E Ashby
Dame Elizabeth Corley
Jane Griffiths
Chris Grigg
Ewan Kirk
Stephen Pearce
Nicole Piasecki
Ian Tyler

Dear Shareholders

During 2021, the Nominations Committee spent time dealing with both long-term and shorter-term succession planning priorities, all based on a well-developed understanding of the future skills and experience required for both executive and non-executive members of the Board. In particular, all directors appreciate that executive succession planning for the most senior roles in the Company – and that of the Chief Executive in particular – is one of our highest priorities.

Board changes

As detailed in last year's Annual Report, Dame Carolyn Fairbairn and Ewan Kirk joined the Board as non-executive directors on 1 March and 1 June 2021 respectively. I am also delighted that, in the second half of the year we were able to appoint Crystal E Ashby to the Board as a non-executive director, with effect from 1 September.

Dame Carolyn has a deep understanding of business and government, having been Director General of the CBI, prior to joining the Company and having also enjoyed a long business career before that. Dame Carolyn will succeed Ian Tyler shortly as chair of our Remuneration Committee, a role she is well qualified for based on her business and board experience, including chairing and serving on the remuneration committees of other UK listed companies.

As we are a technology company, it is essential that the Board has a good understanding of the key technologies that will be critical to our future success and how workplace culture is critical in supporting the development of new technology and allowing innovation to flourish. Within the senior executive team, we have a deep understanding of the future capabilities our customers will require and the technologies that underpin them, but the Board recognised a particular need to enhance the level of technological awareness within the non-executive members. That led us to appoint Ewan Kirk as a non-executive director. He has extensive experience in identifying and leveraging emergent scientific research and know-how, and insight into the successful commercial exploitation of innovative technologies.

Ewan Kirk will chair a new committee established in 2021, the Innovation and Technology Committee, which will allow non-executives to engage in developing a deeper understanding of the technologies shaping our future and support the Board in making sound decisions in this area.

Given the very significant size and importance of our US business, I am pleased that we were able to increase the number of Americans on the Board with the appointment of Crystal E Ashby as a new non-executive director. She brings a wealth of experience, gained in a complex global business, having had a long career with BP America. Until recently, she spent some time as the interim President and Chief Executive of the Executive Leadership Council – a non-profit organisation that supports inclusive leadership principles and the development and advancement of black executives.

During 2021, the Committee continued to use the services of Julia Budd at the search consultants Russell Reynolds Associates to assist in identifying suitable candidates for appointment to the Board as non-executive directors. They provide other recruitment services to the Company but are not connected to any individual director.

We announced at the end of last year that Ian Tyler would be standing down from the Board as a non-executive director at the close of the Company's AGM in May this year, having served for nine years. Ian has been an excellent non-executive director, chairing both the Corporate Responsibility and Remuneration Committees during his time on the Board. Looking ahead, the Board will also be losing the valuable services of Chris Grigg, a non-executive director and our Senior Independent Director, who is planning to step down at next year's AGM. The Committee will be looking to appoint an additional non-executive director during 2022 to maintain the strength of the non-executive presence on the Board, and we are well advanced in this process.

Nominations Committee report continued

Board Diversity and Inclusion Policy

Diversity and inclusion

We are committed to maintaining a diverse and inclusive Board. As a company we value diversity and are committed to creating a diverse and inclusive working environment for our employees, in which colleagues from any background can fulfil their potential. This is reflected in our clear purpose, values and the behaviours that guide our culture.

The Board understands that diversity is a key attribute to its effectiveness. We aim to maintain a diverse Board, including, among other attributes, an appropriate balance of nationalities, gender, ethnicity, skills, knowledge, experience and personal strengths.

Board composition

The Nominations Committee, on behalf of the Board, undertakes a formal, rigorous and transparent approach to succession planning for director appointments. The Nominations Committee oversees the development and implementation of succession plans for directors and senior managers.

Appointments and succession plans are based on merit and objective criteria, reflecting the skills, knowledge and experience needed to ensure we have a well-rounded, diverse and effective Board. In the case of non-executive directors, other relevant matters are also taken into account, such as independence and the ability to fulfil time commitments.

Due to the nature of its activities, the UK government holds a Special Share in the Company, ensuring that the Company cannot be non-British controlled. The Special Share also includes provisions requiring that a majority of the Directors on the Board are British nationals and the roles of Chairman and Chief Executive are also subject to UK nationality restrictions.

It is the Board's aim to continue to meet the targets set by the Hampton-Alexander and Parker reviews, dealing with gender and ethnic diversity respectively. The Board will maintain oversight of the range of activities the Company is pursuing aimed at increasing the diversity of our workforce – including the executive pipeline that is essential for executive director succession planning. In addition, when we engage search consultants, we will use their services to help identify a diverse range of potential non-executive director candidates and, where necessary, to help with executive director succession requirements.

Reporting

The Nominations Committee will ensure that there is continued appropriate and meaningful disclosure in the Company's Annual Report against the matters set out in this policy.

Succession planning

The Committee has adopted a policy on diversity and inclusion in respect of the Board (it is produced in full above). This is aligned with our Company Purpose and Strategic Objectives, and details specific objectives on Board composition. I am pleased to report that, as at the end of 2021 and at the date of this report, we have met our objectives concerning gender and ethnic diversity – and, consequently, the Board meets the recommendations of both the Parker and the Hampton-Alexander Reviews.

In last year's report I provided details of the actions taken by the directors to retain the services of the Chief Executive, which had a significant impact on the Remuneration Report vote at our 2021 AGM. I and the Remuneration Committee consulted extensively with shareholders prior to and after the 2021 AGM. The Board was very appreciative of the support it received from shareholders in passing the resolution with a majority of more than three-quarters. We do however recognise that some shareholders had particular concerns about the matter. In responding to the outcome of the resolution, the Board committed to undertaking additional work on long-term succession planning across the Company's senior executive population and will continue to engage with our shareholders to maintain a productive and open dialogue on this matter.

While the Nominations Committee is focused principally on appointments to the Board, we appreciate that the quality of the executive pipeline is critical to the long-term success of any succession planning process. The Chief Executive, with the support of our Group HR Director, is responsible for executive development and succession planning across the Group. During the year, the Committee undertook a major review of the output from this company-wide process. Overall, it was clear that we have a good executive succession planning process, and, importantly, succession is being actively managed by the senior executive team, to achieve the desired long-term outcomes.

The key observations from the Committee's review of the succession plans for the 11 members of the Executive Committee at the time of the review (three being executive directors of the Company) were:

- 16 new successor candidates had been added to the plans and nine removed, with improved identification of candidates lower down within the organisation and a larger pool of candidates (55 to 64); and
- the level of gender diversity continues to improve (39% to 41%) and the average age of successors has reduced (44 to 42).

Our Chief Executive announced a number of changes to the Executive Committee recently. These changes are the visible signs of good succession planning in practice and are indicative of the actions being taken to identify, develop and promote high-performing individuals. The Board is also pleased to see the increase in the level of diversity in the Executive Committee, with the position improved in terms of both ethnic and gender diversity – 21% of members are women (8% at the end of 2021 and 2020). Also, women comprise 39% (2020 37%) of the Company's senior management, i.e. Executive Committee members, the Company Secretary and their first reports.

Unlike many companies, nationality and national security restrictions apply to many executive roles in BAE Systems. National security considerations are most likely to apply to line management positions, where the highest levels of national security clearance are often required. Almost uniquely for a major listed company, the nationality of our Chief Executive is specifically mandated by the Company's Articles, which, through the Special Share owned by the UK government, require that the Chief Executive is a British national. Similarly, the US national security arrangements governing our US business effectively limit the senior line leadership positions to US nationals. These national security considerations are an important part of being a defence company but they inevitably restrict the pool of candidates that can be considered for some of the most important line management roles, and therefore form an additional level of complexity for the Committee.

With regard to non-executive succession planning, with Ian Tyler due to retire in May, the Committee will look to recruit an additional director during the year. As we have reported previously, I am planning on stepping down from the Board next year – by which time I will have completed nine years in the role of Chairman. The Committee, led by Chris Grigg, our Senior Independent Director, has taken the first steps in initiating a search for my successor, and appointed the search consultants Spencer Stuart to assist with the task. They provide other search consultancy services to the Company but have no connection with any director.

Board Evaluation

At the beginning of 2021, the Board completed an internally-facilitated performance evaluation, the key findings from which were reported in last year's Annual Report. With regard to what we did last year, having identified these objectives, I can report the following:

Executive succession – as detailed above, this was a key focus last year.

Environment – the Environmental, Social and Governance Committee Report provides more detail on what we did last year as a Board to ensure that we remain focused on delivering against our sustainability agenda. Our 2030 greenhouse gas net zero target is at the heart our environmental strategy and during the year the whole Board took part in an externally facilitated session, to develop the directors' understanding of climate transition risks and opportunities.

Evolution of strategy – as reported elsewhere, progress has been made in developing our strategy which is driving investment in our future, particularly in multi-domain digital technologies, space and sustainability solutions. Last year the Board held in-depth strategy sessions, reviewing progress in these areas and the investments we are making in innovation (see Our investment in technology on page 34).

Efficiency and effectiveness – recognising the importance of continually improving our operational efficiency, last year, the Board through the Remuneration Committee, incentivised this specifically with the addition of a Return on Capital Employed metric. In addition, the Board has been monitoring improvements in profit margin – a key measure of efficiency given the nature of the Company's business.

The Board has just concluded its 2022 evaluation, which was undertaken by an external facilitator, Independent Board Evaluation. Further details of this evaluation are provided on the next page.

Concluding comments

During the last few years, we have been through a period of change with regard to the membership of the Board, both executive and non-executive. Following that, we have a strong, refreshed team that bring a complementary combination of skills, experience and knowledge to the board table. We are also an increasingly diverse team, which adds real value when it comes to the different perspectives we are able to bring to bear in our deliberations.

Sir Roger Carr
Chairman of the Nominations Committee

Nominations Committee report continued

The Nominations Committee's year

January → March → July → October → December

Committee | Committee | Committee | Committee | Committee

Board evaluation 2021/2022

Evaluation provider

The evaluation was undertaken by Independent Board Evaluation (IBE), led by Ffion Hague. IBE is a standalone consultancy of independent practitioners, working solely on board effectiveness reviews. IBE do not provide other services to the Company and have no connections with any of the directors.

Period of evaluation

The evaluation was undertaken in the period between November 2021 and February 2022 with the report being presented by IBE at a meeting of the Board held on 23 February 2022.

Scope

The evaluation comprised a formal and rigorous annual evaluation of the performance of the Board, its committees, the Chairman and individual directors.

Evaluation process

The findings of the evaluation were principally based on information gathered through a series of structured interviews undertaken by Ffion Hague and held with all the directors, Company executives that support the Board and its committees, and also certain individuals from outside the Company that attend Board committee meetings on a regular basis. Also, IBE undertook a data-based benchmarking exercise reviewing the Board relative to similar sized companies in the FTSE 100 and also the companies in the Aerospace & Defence sector.

Ffion Hague was an observer at one of the Board's scheduled meetings and also at meetings of the Audit, ESG and Nominations committees.

The evaluation covered a wide range of matters including the following:

Board

- Shareholders: oversight and relationship
- Strategy: oversight and implementation
- Governance
- Board focus and priorities, use of time
- Risk management
- Succession planning for key board and management roles
- Composition of board – skills, diversity and experience
- Employee engagement
- Selection and induction of new members
- Meetings: frequency, quality, duration
- Quality of papers and presentations
- Resourcing levels: timeliness of papers, support functions

Board committees

- Membership: skills, experience, competence and induction
- Meetings: frequency, quality, duration
- Chairmanship
- Clarity of objectives and terms of reference

Chairman

- Quality of contribution
- Board leadership
- Independence and objectivity
- Understanding of own/others' roles
- Chairing skills
- Agenda setting
- Time commitment

Individual Board members

- Quality of contribution
- Skills, experience, competence
- Time commitment
- Quality of perspective brought to Board discussion

Feedback

A comprehensive report evaluating the Board's performance was produced by IBE, which was provided to Directors ahead of the Board meeting held on 23 February 2022. The principal findings and recommendations from the report were presented to the Board by Ffion Hague. The report provided feedback on the areas covered by the evaluation. Reports were also provided to each of the committees on the findings from the evaluation as they apply to them. The Chairman will provide feedback from the evaluation to individual directors. The Senior Independent Director will provide feedback on the Chairman's own performance after he has met with all the non-executive directors to consider the report provided by IBE.

Key resulting actions

Succession planning – continue to focus on executive development and succession planning and provide the Board with opportunities to engage with high-potential individuals.

Culture – ensure that we continue to evolve the culture of the Company to reflect wider society and drive the pace at which we aim to meet our diversity and inclusion ambitions.

Strategy – engage further in developing our understanding of the key attributes and technologies required for the long-term success of the Company.

Employee engagement – ensure that we maximise opportunities for directors to engage directly with employees and develop further the means by which Board members receive direct feedback from our workforce.

Induction – ensure that the induction process for new non-executive directors is tailored to individual needs and that, post pandemic restrictions, such directors have the opportunity to visit our sites and learn more about the business.

Audit Committee report

Stephen Pearce
Chair of the
Audit Committee

Members

Stephen Pearce (Chair)
Dame Elizabeth Corley
Ian Tyler

Dear Shareholders

I am pleased to present the Audit Committee's report for the financial year ended 31 December 2021. Resilience built into the business in the early stages of the global pandemic in 2020 has stood the Group in good stead throughout the year under review, and to date in the current year. The Group continues to deliver on its customers' critical programmes and to progress strategic priorities against the backdrop of the ongoing global pandemic and associated global macro challenges.

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 – have continued to operate throughout the COVID-19 pandemic.

The section on the Audit Committee's year on page 133 provides an overview of the work that we have undertaken in the last 12 months and I will comment here on various aspects of that activity.

IT security remains a major focus for all corporates with escalating levels of threat on the one hand and increasing regulatory and customer expectations on the other. As well as receiving feedback from internal assurance and external audit on IT security controls during the year, we also held a session with the Chief Information Security Officer for UK and Rest of the World and the Senior Vice President – Chief Information Officer of our US business. At this session, they discussed key cyber risks as well as outlining their roadmaps for protecting the Group and complying with regulation, recognising that the IT security environment is continuously evolving.

Pensions has also been a major area of focus for the Company in the last few years, with the consolidation of six of the Group's nine UK pension schemes having been effected in 2019, followed by a contribution of £1bn into the consolidated pension scheme in 2020. The focus in 2021 has been on enhancing the governance framework around the Group's pension investment management activities on which we have received regular updates on progress from the Group Finance Director.

At the beginning of the year we took a close look at the evolving requirements for disclosure on Environmental, Social and Governance (ESG) issues, particularly in respect of climate change and TCFD[1] reporting requirements, reviewed actions being taken to address this, and agreed in principle the areas for further disclosure in the 2021 Annual Report. This has included enhanced linkage between the Strategic report and the Financial statements. The draft disclosures were subsequently reviewed at a joint session with the ESG Committee. Further detail on climate risk and opportunity scenario planning is set out on page 38. The Internal Audit function has increased its level of assurance activity in the ESG sphere, and plans to build on its existing capability in 2022.

The Internal Audit Charter was reviewed by the Committee during the year and a number of amendments were incorporated, including, amongst other things, more explicit references to risk management, the Three Lines Model of assurance, and ESG-related risk.

Finally, I commented in last year's report that the Committee was mindful of the changing governance landscape and potential weight of anticipated regulation in the near future, given the number of recent formal reviews undertaken regarding different aspects of Corporate Governance and Audit Market Reform.

During the year under review we considered the potential impact on the Company of the various proposals set out in the BEIS White Paper 'Restoring trust in audit and corporate governance'. Preparations are ongoing for the potential introduction of a new regulatory regime and we await to see the output of the government's deliberations so that any relevant action required can be considered.

External audit

Deloitte LLP was originally appointed by the shareholders in 2018 as our external auditor and has just completed the fourth year of its first five-year cycle.

In June we agreed the scope and level of materiality of the 2021 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 agreed was broadly consistent with the prior year but was augmented to take account of the integration into the Group of the Military Global Positioning System business acquired in 2020.

The agreed scope also encompassed consideration of the embedding of controls and risk assessment processes relating to climate change, as well as consideration of the impact of climate change throughout the financial statements and the enhancement of disclosures for TCFD[1] reporting requirements.

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 standard published by the Financial Reporting Council (FRC), including specific safeguards in place where they are providing permissible non-audit services to the Group.

The Committee has been briefed by Deloitte on proposed key partner changes necessitated by regulatory rotational requirements at the end of the fifth year of Deloitte's tenure, subject to Deloitte's audit appointment continuing after that point. A successor has been proposed as lead US partner and selection processes for three other key partner appointments, including that of the lead engagement partner, will be undertaken in the first half of 2022.

1. Task Force for Climate-Related Financial Disclosure.

Audit Committee report continued

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.

A copy of the policy is available on the Company's website.

Details of fees payable to the auditor are set out on page 211. In 2021, non-audit fees for Deloitte represented 5.3% of the audit fee. The principal non-audit service provided by Deloitte related to their review of the Half-yearly report.

Review of audit independence and effectiveness

The scope and output of our annual review of the independent effectiveness of the 2021 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 provided us with the findings from its latest firmwide AQR report, the initiatives being taken in respect of the firm's evolution of its firmwide audit approach and methodology, and how those are transferred into the BAE Systems' audit.

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 businesses responded to the ongoing impact of COVID-19, external assurance providers, the Company's own assurance teams and Internal Audit focused on monitoring the continuing effectiveness of the Company's control environment. In this connection, areas for the various assurance teams included health, safety and wellbeing, 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 originally implemented in response to COVID-19 in 2020 continued throughout the year under review and 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:

- **General financial controls** – the continuing importance of a robust finance control environment, particularly in the light of the Audit and Corporate Governance Reform changes, is recognised with benchmarking of assurance practices underway.
- **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 matured 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. More detail on processes to manage risk, and the Group's principal risks, is set out on pages 104 to 113.

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 of the review was positive with the external auditor having delivered an effective audit, providing robust and constructive challenge, as well as balanced and knowledgeable debate, and demonstrating both its commitment to continuous improvement as well as continuing to build on its knowledge of the Group's business and key risks. Areas for focus in 2022 will be on the criticality of continuity of audit teams to ensure audit quality and, where changes are made to audit personnel, in the provision of effectively managed handovers and briefing, particularly in the approach to the first cycle of partner rotation.

On the basis of the review following the 2021 year-end audit, the Committee has proposed to the Board that it recommends that shareholders support the re-appointment of Deloitte LLP at the 2022 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 capabilities
- Communications and reporting

The Committee has also met with the Director of Insurable Risk to receive an update on work undertaken to review the Group's insurance programmes and to agree the approach to insurance renewal in current 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 continued to be paid during the year to ensure governance and controls have been maintained during the COVID-19 period.

We also hold an annual session with the US Internal Audit lead and this year were pleased to meet with the new Vice President, Internal Audit, to discuss the scope, environment and priorities for internal audit work undertaken within the US businesses, including key business risk, the levels of resourcing available to undertake the programme of work and specific challenges stemming from the ongoing COVID-19 environment. In addition we were briefed on the development of strategic objectives for the US Internal Audit function, and steps being taken to externally benchmark the function against US corporate peers.

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, a senior member of his team and the external auditor. The wide-ranging discussion at this year's session included the direction of the potential changes to UK financial controls; information technology and cyber security controls; safety and its associated culture; and how assurance is being provided against the culture of the Group more broadly.

As well as financial and export controls, safety, IT and IT security, 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 Environmental, Social and Governance Committees to ensure that the overarching programme covers not only financial and business risk, but also the assessment of effectiveness in ESG-related areas including, for example, safety, ethical and reputational risk, product trading, diversity and inclusion, and environment. 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 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 2021 internal audit plan was delivered remotely but with some on-site fieldwork taking place in the second half of the year. On-site fieldwork is likely to gradually increase over the course of 2022. The intangible benefits of meeting face-to-face are without doubt important and Internal Audit is therefore aiming to achieve a balance of remote and on-site audits that continue to be of high quality, whilst responding to the needs of individual businesses.

A small number of audits have been postponed or cancelled, and new audits of higher priority brought into the plan. The review of governance and controls has continued, mostly virtually, through Quarterly Business Reviews and Audit Review Boards (ARBs). Examples of good practice have been collated by Internal Audit and shared with the businesses as appropriate.

The 2022 audit programme will continue to provide assurance over the Group's risks, with an increased focus on IT security and ESG.

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 the progress review undertaken with EY in 2020. Data Analytics has progressed well, with new insights found in the financial controls area, in addition to assurance work in respect of the usual financial controls framework audit.

The workplace climate assessment framework, introduced last year, has been embedded into all audits, enabling Internal Audit to gain insight into the culture of the businesses and the opportunity to assess culture by reference to the Company's purpose, values and Code of Conduct. As well as generating specific recommendations, over time this should allow Internal Audit to identify relevant trends in culture to bring to the attention of the Audit Committee.

The implementation of a new Audit Management System is well underway, allowing Internal Audit not only to manage its own work more efficiently, but also improve how the individual businesses interact with Internal Audit to review relevant recommendations.

The majority of EQA actions are now closed, however Internal Audit has identified other continuous improvement activities to ensure audit services continue to align with best practice. The next EQA is expected to be undertaken in 2023.

Results from the 2021 internal annual evaluation were positive, with all respondents believing that Internal Audit plays an integral role in assuring the governance of the Group. Areas for further development include ensuring that the audit approach continues to adapt to address evolving business risk and opportunity, and optimises the balance between compliance and potential future risk assurance. These will be considered in Internal Audit's functional improvement activity for 2022.

Audit Committee report continued

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 123) and the statement on the Board's assessment of the prospects of the Company (see the viability statement on pages 122 and 123) 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, in respect of COVID-19 and climate change, 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.

In addition to the going concern and viability statement reviews, the principal matters we considered concerning the 2021 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 and US Land Programmes.

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. For the UK deficit, the Group adopted in 2021 the CMI 2020 Mortality Projection tables, with a scheme-specific assessment of the potential impact of COVID-19. 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 241 to 252).

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. No goodwill impairments were made as a result of this review.

The methodology for impairment testing used by the Group is set out in note 8 to the Group accounts on pages 217 to 220, including disclosures on Cash Generating Units and their assumptions.

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 75. 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. As reported at the half-year, a one-off tax benefit of £94m was recognised in the period, in respect of agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime.

Review

Finally, as a Committee we benefit from early sight of the draft Annual Report for our review which gives us an opportunity to consider whether, taken as a whole, it is fair, balanced and understandable. The wider process is set out above.

Alternative Performance Measures (APMs)

As reported last year, the Committee agreed that, for its 2021 reporting cycle, 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.

This year a financial glossary has been included in the Annual Report to provide a composite explanation of APM content, and the respective prominence given to IFRS measures and APMs has been considered.

Looking forward, and as highlighted earlier in this report, a key focus for the Committee in 2022 will be addressing the various regulatory initiatives flowing from the UK government's stated aim to reform the corporate governance and audit regime.

Stephen Pearce
Chair of the Audit Committee

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.

The Audit Committee's year

February	May	June	July	October	November	December
Committee	Committee	Committee	Committee	Committee	Meeting	Committee

Committee composition and evaluation

The composition of the Audit Committee is stated on page 129 and the breadth of experience of the Committee members is set out on pages 116 and 117. The performance evaluation of the Committee is undertaken as part of the wider annual Board evaluation and the Board believes the Committee to have the appropriate composition, skills and experience to discharge its responsibilities.

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.

February
Videoconference
Committee

- Reviewed the financial statements and specific disclosures, including viability and going concern, for recommendation to the Board.
- Received a presentation from the Group Financial Controller and Group Treasurer in respect of work supporting the viability and going concern statements.
- Considered the accounting, financial control and audit issues reported by the external auditor that flowed from the audit work.
- Reviewed the effectiveness of the external audit process.
- Received a report from the Group Tax Director.
- Reviewed external auditor independence and nature and value of non-audit services.

Joint session with the Environmental, Social and Governance Committee:

- Considered output from the six-monthly OAS review.
- Reviewed the procedures and outputs for the identification, assessment and reporting of risk.
- Agreed final iteration of the 2021 Internal Audit programme.
- Considered development of ESG-related disclosures, including climate change and TCFD reporting requirements.

May
Videoconference
Committee

- Reviewed the AGM Trading Statement.
- Considered enhanced governance proposals for the Group's UK pension investment management activities.

June
Videoconference
Committee

- Agreed external audit strategy and scope.
- Reviewed external auditor independence.
- Agreed external audit engagement letter and fee.
- Considered any emerging accounting issues prior to the half-year.
- Considered the potential impacts on the Company of the proposals in the BEIS consultation.
- Considered output of the Internal Audit Director's report.
- Received a presentation from VP, Internal Audit, for the US businesses.
- Reviewed the Non-Audit Services Policy.
- Reviewed nature and value of non-audit services.

July
Videoconference
Committee

- Reviewed the financial statements and specific disclosures, including going concern, for recommendation to the Board.
- Received a presentation from the Group Financial Controller and Group Treasurer in respect of work supporting the going concern statement, together with an update on viability.
- Considered the accounting, financial control and audit issues reported by the external auditor that flowed from the half-year review work.
- Received a report from the Group Tax Director.
- Received a presentation from the Director, Insurable Risk
- Considered output from the six-monthly OAS review.
- Reviewed the procedures and outputs for the identification, assessment and reporting of risk.
- Reviewed external auditor independence and nature and value of non-audit services.

October
London, UK
Committee

- Received presentations from the Chief Security Information Officer, UK and RoW, and the SVP – Chief Information Officer, BAE Systems, Inc. on cyber security evolution and controls.

November
London, UK
Meeting

- Informal meeting with the Internal Audit Director and external auditor to discuss a range of issues as detailed on page 131.

December
Videoconference
Committee

- Considered any emerging accounting issues prior to the year end.
- Considered the external auditor's controls report.
- Discussed the external auditor's proposals for the rotation of key partners.
- Considered output of the Internal Audit Director's report.
- Received a report on export control compliance from the Group General Counsel.
- Set the parameters for work supporting the viability and going concern statements.
- Received technical accounting and financial reporting updates.
- Discussed the first iteration of the 2022 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.
- Reviewed external auditor independence and nature and value of non-audit services.

The Committee holds a quarterly session with the Internal Audit Director and external auditor without management present. The Audit Committee Chair also meets with the Group Finance Director, the Internal Audit Director and the external auditor on an ad hoc basis.

Environmental, Social and Governance Committee report

Jane Griffiths
Chair of the Environmental, Social and Governance Committee

Members

Jane Griffiths (Chair)
Nick Anderson
Crystal E Ashby
Chris Grigg
Nicole Piasecki

Dear Shareholders

When I wrote to you last year, I stated that in addition to keeping the impact of COVID-19 on our stakeholder groups under review, our priorities were to monitor our progress against the net zero target, and continue to focus on health and safety performance, and on diversity and inclusion. In this report, I hope to provide an overview of the workings and discussions of the Committee in 2021.

During the year, we welcomed Nick Anderson and Crystal E Ashby to the Committee. Our refreshed composition provided an opportunity to review the Committee name, Terms of Reference and our employee engagement approach.

At our meeting in February, we reflected on the evolution of activities formally described as Corporate Responsibility, to a more integrated approach, which focused environmental, social and governance (ESG) themes as the building blocks to the creation of long-term sustainable success for the Company. We considered that to truly succeed, these activities must be embedded and confirmed as integral to the Company and the remit of the Committee should reflect this. Accordingly, in July, the Committee changed its name from the Corporate Responsibility Committee, to the Environmental, Social and Governance Committee, to reflect the intrinsic nature of ESG themes to good governance practice.

We also reviewed the Committee's Terms of Reference, and sought to codify our responsibilities in respect of monitoring the Company's progress against its net zero, decarbonisation strategy, and more broadly, to reflect the work of the Committee within recent years. The revised Terms of Reference of the Committee may be found on the Company website[1].

Environment and climate transition

The Board oversees, through the Committee, the Company's ESG performance. We monitor the Company's performance against selected external sustainability indices and review its performance on ESG matters. Climate change is one such matter and the Committee oversees the Company's response in respect of its own impacts on the environment and its response to the potential impacts of climate change on the Company's future and current operations.

The Board has the responsibility to ensure that climate-related risks and opportunities are appropriately addressed. We understand that without effective climate governance structures, it will be difficult to make informed strategic decisions, manage climate transition risks and monitor the associated metrics to achieve our climate-related goals. The Committee supports the Board in overseeing the progress of the executive in ensuring that the Company takes an integrated, strategic approach to addressing climate transition risks and opportunities.

In order to effectively discharge our oversight duties, we regularly engage with, and challenge members of the executive team – the Chief Executive, President and CEO of BAE Systems Inc., Group Finance Director, Group General Counsel and Group Human Resources Director are invited to attend all the meetings of this Committee. Additionally, we receive updates from internal subject matter experts, and training from PwC partners, with climate-related expertise. We do this in order to develop and maintain our collective understanding and awareness of climate change as it pertains to the Company. These insights in turn, allow us to oversee the work of the executive team, who are responsible for the operational management of climate transition risks and opportunities.

In 2020, the Company set a target of achieving net zero greenhouse gas emissions across its operations by 2030 and during 2021, and at our February and July meetings, we received updates on the progress against this target. In September, the Board received training from PwC on sector-specific climate matters which supported the development of our understanding regarding The Financial Stability Board's Task Force on Climate-Related Financial Disclosures. During 2022, we will continue to work with external and internal subject matter experts, to develop our understanding of climate change, emerging climate risks and opportunities.

1. https://investors.baesystems.com/~/media/Files/B/Bae-Systems-Investor-Relations-V3/PDFs/board-committees/esg-committee-terms-of-reference.pdf

Workforce engagement

Following the publication of the Financial Reporting Council's findings on Workforce Engagement, we reviewed contemporary employee engagement practices and effectiveness of the model adopted by the Company.

In accordance with Provision 5 of the UK Corporate Governance Code (the Code), the Board is required to maintain 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 Committee to take up this responsibility.

This decision was made on the basis that engaging with employees had been a part of the Committee's activities since it was established. The non-executive membership of the Committee met the same independence criteria as appointing a single non-executive director, as proposed in the Code. The size and complexity of the business, with 89,600 employees across more than 40 countries, meant that there were practical advantages to the role being performed by more than one director.

The Committee reflected on the changing nature of employee engagement, particularly in light of the COVID-19 pandemic and the efficacy of our employee engagement framework. We agreed that the Committee was still best placed to undertake employee engagement on behalf of the Board, as the reasons outlined above were still applicable.

Through our employee engagement framework, we maintain an overview of the perspectives of the global workforce. The mix of data and engagement with employees, operational and senior management, provide different lenses which in turn are represented at the Board table. This allows us to have meaningful conversation about how strategic decisions may affect members of the global workforce. From 2022, in addition to my Committee report to the Board, I will provide a separate employee engagement update, to ensure the employee voice and their considerations continue to be represented during boardroom discussion.

As a result of COVID-19 restrictions during the year, the Committee was limited on opportunities for physical employee interaction but below are the details of discussions regarding workforce matters and where we were able to meet with employees physically in 2021. In 2022, we will continue to build on our employee engagement programme and will approach our workforce engagement thematically, focusing on elements of environment, social (safety, diversity and inclusion, community engagement etc) and governance, to lead our engagement with the workforce.

Health and safety

The safety and health of our workforce is a priority and in 2021, we regularly reviewed global safety performance. It was disappointing to see that the year began with poor safety performance in Q1 but we were glad to see continued improvement throughout the year. In 2021, the Group had a recordable injury rate of 493 (485 in 2020) and had 32 (37 in 2020) major injuries. We noted that, there were operational initiatives to reverse the recordable injury rate but there was a lack of clarity as to the root cause. Further work was undertaken by the executive team, which subsequently reported that the increase in injuries was largely due to the primary focus of the businesses being on COVID-19 safety and the associated restrictions such as mask wearing. There was also evidence that changes in the workplace may have distracted employees from traditional safety messaging.

The introduction of behaviour-based workplace safety programmes has provided a more consistent framework against which to monitor outcomes, compare sectoral performance and provide better visibility of near-misses and opportunities to develop proactive reporting. During the year, communications were also refreshed to re-emphasise safety practices, and we were pleased to see safety performance improve from Q2.

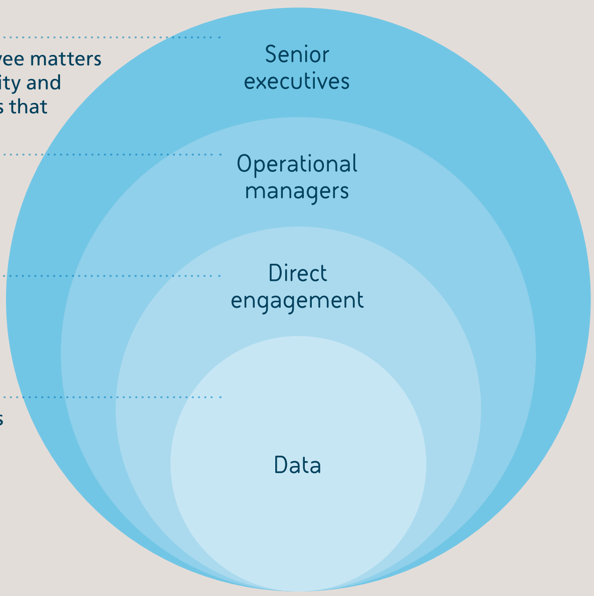
Employee engagement framework

Hear from executives on employee matters such as safety, wellbeing, diversity and inclusion and company decisions that could impact employees.

Review employee sentiment and wellbeing surveys and other data sources evidencing employee views.

Learn from operational management teams on the practical application and impact of workforce policies.

Direct engagement with groups of employees.



Workforce matters

Culture
Business conduct
Diversity and inclusion
Environment
Health and safety

Workforce interaction by members of the Committee

April
Visit to Warton and Samlesbury

May
Visit to Portsmouth

September
Visit to Govan

October
Video messages

November
Visit to Govan to attend COP26

Throughout the year
Attendance at the CEO/TU forums

Environmental, Social and Governance Committee report continued

In respect of mental health and wellbeing, we were pleased to learn that the Company had partnered with a specialist company in the UK, Unmind, to provide employees with access to mental health resources.

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.

In 2021, safety was included as an underpin or gateway to the overall award of the non-financial element of the Executive Bonus.

Diversity and inclusion

The Company values diversity and is committed to creating a diverse and inclusive working environment, in which all colleagues from any background can fulfil their potential and this is reflected in our clear purpose, values and the behaviours that guide our culture.

During the year, we heard from the Group Human Resources Director, who explained that the Company had recently launched a global ambition to be recognised as the leading employer in defence and security sectors for valuing diversity and promoting inclusion. This ambition is underpinned with the following targets:

- increase gender diversity on the Executive Committee (EC) to ensure that women account for 50% of EC membership by 2030;
- continue to progress ethnic diversity in order to be representative of the ethnicities within the localities which the Company operates; and
- continue to progress gender diversity to ensure that women to account for 30% of the UK workforce by 2030.

We learned that in support of this ambition, work was underway to review recruitment practices and provide training to line managers, in order to mitigate against affinity and other unconscious biases and better embed inclusive practices across the Company. The Committee will continue monitoring the Company's efforts to increase diversity across the Group and progress against its global ambition.

The Group's performance on diversity and inclusion is a non-financial component of the annual incentive plan for senior executives. As with the safety component, the diversity and inclusion objectives, operate as a downward underpin to the incentive, if performance is not at the expected levels. We believe this demonstrates that good performance is expected rather than rewarded.

The Committee sets, measures and determines the level of performance achieved against these objectives and makes a recommendation to the Remuneration Committee.

In 2021, the executive annual incentive plan measures were based on:

- increasing the representation of women at senior levels in the Company; and
- driving inclusion through leadership and engagement.

We were pleased to see that the 2021 data highlighted a 0.5% increase in female representation at all levels across core functions, and that there was less female attrition.

The executive annual incentive plan includes the following objectives for 2022:

- 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.

As a Committee, we will continue to challenge the executive team on the pace of change, review the actions and initiatives to drive and deliver a diverse and inclusive workforce.

Product trading and controversial weapons

The Group General Counsel gave a briefing on the application of the Group's Product Trading Policy and the Group's Responsible Trading Principles. The Product Trading Policy requires an evaluation on all BAE Systems' products and trading, and applies throughout the product lifecycle and to all global lines of business where the Group has a controlling interest.

We also discussed the Company's approach to controversial weapons and noted that the Responsible Trading Principles ensure that in addition to commercial assessment, consideration was given to wider ESG concerns. As part of this discussion, we were informed of the Company's commitment to cease handling white phosphorus.

Looking forward

I look forward to 2022, and subject to restrictions, continuing to engage with members of the global workforce, in accordance with our employee engagement programme. The Committee will continue to oversee the Company's climate transition strategy and its progress against its net zero target.

Jane Griffiths
Chair of the Environmental, Social and Governance Committee

The Environmental, Social and Governance Committee's year

February — Committee · July — Committee · September — Committee

February
Videoconference
Committee
- Received an overview of the lobbying activity of the BAE Systems USA Political Action Committee.
- Received an update on the Company's environment and climate transition – net zero programme.
- Reviewed the Company's community and social impact within Barrow.
- Reviewed the 2020 safety and diversity and inclusion performance in respect of the outcomes of the annual incentive plan.
- Agreed the 2021 objectives and annual incentive targets in respect of safety, and diversity and inclusion.
- Joint meeting with the Audit Committee to review non-financial risk register.

July
Videoconference
Committee
- Received an update on the progress against the 2021 diversity and inclusion objectives.
- Performed a deep dive on the Group's safety performance to date.
- Received an update on the Company's environment and climate transition net zero programme.
- Proposed a revision to the Committee title and Terms of Reference.

September
London, UK
Committee
- Reviewed the Operational Assurance Statement process and the audit and assurance landscape during the year.
- Received a briefing on the application of the Group's Product Trading Policy and the Company's Responsible Trading Principles.
- Discussed the Financial Reporting Council's findings on Workforce Engagement and reviewed the evolution of employee engagement practice and effectiveness of the model adopted by the Company.

Schedule of activities in 2022

January
- Review of 2021 performance metrics
- Anti-bribery and corruption
- Diversity and inclusion
- Safety performance
- Annual incentive plan outcomes
- Annual incentive plan objectives

February
- Review of 2021 performance metrics
- Environment
- Society and community
- Employee engagement
- Review of Advisers Policy
- Review and approval of Modern Slavery statement

June
- Review of anti-bribery and corruption processes
- Environment
- Society and community
- Employee engagement
- Safety and wellbeing
- Product trading
- Diversity and inclusion

September
- Application of the Product Trading Policy
- Environment
- Society and community
- Employee engagement
- Safety and wellbeing

December
- Review of Advisers Policy
- Environment
- Society and community
- Employee engagement
- Workplace and stakeholder engagement plan
- Annual incentive plan objectives

Innovation and Technology Committee report

Ewan Kirk
Chair of the Innovation and Technology Committee

Members

Ewan Kirk (Chair)
Nick Anderson
Dame Carolyn Fairbairn
Nicole Piasecki

Dear Shareholders

I am delighted to present the first report of the Innovation and Technology Committee. The Committee was established by the Board in July 2021. We held our inaugural meeting in October wherein we discussed the innovation and technology landscape in the Company's principal markets (excluding the US).

In this report, I will give you an overview of the Committee's remit and in the years to come, I will provide updates on Committee activities and an overview of our discussions.

Role of the Committee

The Committee's purpose is to promote the success of the Company through the effective oversight of the application of science, engineering and technology, and the successful exploitation of its intellectual property and know-how in pursuit of its business and commercial goals.

Through closer engagement with senior executives, we will support and enhance the Company's ability to meet its strategic objectives, and assure ourselves that there are in place; an appropriate culture, infrastructure, collaborative practices and activities that stimulate innovation.

We will do so by:

- reviewing the allocation and prioritisation of R&D funding;
- overseeing of Company processes to identify, develop and exploit technology and intellectual property; and
- maintaining strategic oversight and awareness of STEM developments, as applicable to the Company.

To support us in the developing of our understanding of the Group's technology landscape, we will regularly visit global sites, meeting with employees and managers, and discussing central and sectoral opportunities.

Membership

The Committee is comprised of four non-executive director members; Nick Anderson, Dame Carolyn Fairbairn, Nicole Piasecki and myself. More details of membership and attendance at meetings can be found on page 124. The Committee is supported by members of the senior executive team; the Chief Executive, Group Finance Director, Chief Technology Officer and Group General Counsel are all standing attendees.

National security

In recognition of national security considerations, the Committee focuses principally on the UK business. Much of the intellectual property and know-how owned by the Company is subject to national security laws and regulations, as a result, our site visits and discussions of such technologies are undertaken in accordance with the national security requirements of the UK and other nations.

In particular, the Committee is cognisant of and observes the requirements of BAE Systems, Inc.'s Special Security Agreement.

Ewan Kirk
Chair of the Innovation and Technology Committee

Schedule of activities in 2022

March
- Site visit
- Central themes
- Sectoral focus
- Deep dive

June
- Site visit
- Central themes
- Sectoral focus
- Deep dive

September
- Site visit
- Central themes
- Sectoral focus
- Deep dive

Remuneration Committee report

Ian Tyler
Chair of the
Remuneration Committee

Members

Ian Tyler (Chair)
Dame Elizabeth Corley
Dame Carolyn Fairbairn
Chris Grigg

Dear Shareholders

On behalf of the Board, I am pleased to present the Remuneration Committee's report for 2021.

Before dealing with the Committee's year in more detail, there are a few matters I would like to highlight by way of introduction.

As disclosed in last year's Committee report, with the support of the Board, the Committee agreed certain one-off and exceptional remuneration arrangements to secure the continued services of our Chief Executive. Those changes were an important part of the 2020 Directors' remuneration report as put to shareholders at the Company's AGM in 2021. The resolution was passed with over three-quarters of votes cast in favour and the Committee was very appreciative of the support the resolution received but respects the views of those shareholders that had particular concerns about the matter. The Chairman and the Committee undertook an extensive consultation with investors prior to the AGM on this matter and maintained engagement on governance matters during the remainder of 2021.

Our engagement provided the Board and Committee with a clear understanding of the ongoing support for the current senior executive team, but also, inter alia, focused on the importance of, and challenges around, robust succession plans. This was a key focus for the Remuneration and Nominations committees – and also the whole Board – throughout 2021. The Board completed an in-depth review of the succession plans for all Executive Committee level roles, including the Chief Executive. This included a rigorous analysis of key executives identified as possible 'ready now' successors for each of these roles. Recently, the Chief Executive made a number of changes to the Executive Committee that evidence the focus being applied to succession planning and leadership development. Further details of the work undertaken on succession planning have been provided in the Nominations Committee report on pages 125 to 127.

The ongoing impact of the COVID-19 pandemic on our workforce was at the forefront of directors' minds during the year. When spending time developing its wider understanding of workforce pay and conditions during 2021, the Committee was keen to understand how the Company was maintaining its focus on employee wellbeing. Whilst the remit of the Committee is focused on executive directors and senior executives, we do that in the context of the intrinsic link between Company performance and the contribution of the workforce as a whole. Through the Committee's oversight of share plans, it determines the level of award made to over 47,000 employees that participate in the Group All-Employee Free Shares Plan. This plan has operated for a number of years with the level of annual award determined using the same financial metrics as used for the executive annual incentive plan. Based on last year's strong performance, the Committee has agreed that the participants in the plan will receive an equal share of the overall profit pool of £28.7m, awarded in Company shares – one of the highest levels of award made since the plan was introduced in 2008.

The Company proved to be robust and resilient in 2021, delivering another year of strong performance – thanks to the outstanding efforts of our employees who have continued to work with enthusiasm and determination in the face of ongoing adversity. The safety and wellbeing of our employees remained a primary consideration as the Company continued to address and meet customer requirements, in an ever-evolving environment. The Committee will maintain its overview of wider workforce matters during 2022 and, where applicable, consider these as part of its deliberations on executive pay.

The year in review

Impact of COVID-19 pandemic

Whilst the pandemic has continued to challenge all businesses, BAE Systems has proved to be robust and resilient in rewarding our stakeholders through strong operational performance, delivering good financial outcomes. Last year we continued to pay dividends in line with our usual practice, did not take advantage of the UK government's funded furlough scheme, nor any government COVID-19 borrowing facilities and did not raise additional equity. In making remuneration decisions in relation to 2021, the Committee, whilst mindful of the impact of the ongoing pandemic, will again make no allowance for these additional challenges when assessing the performance and reward outcomes for the executive directors.

2021 incentives outcome

After the close of 2021, 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 2021 annual incentive or 2019 long-term incentive awards to account for the impact of COVID-19. Group financial results for the 2021 annual incentive were achieved at stretch; performance for the non-financial element varied for the executive directors and Executive Committee members and was between target and stretch overall.

The Committee used its judgement in evaluating non-financial performance, including the executives' commitment to the shared strategic objectives, safety, diversity and inclusion, as well as overall leadership contributions. A discussion of that evaluation and the bonuses earned by the executive directors is reported on pages 157 to 159.

The Performance Shares granted in 2019 to two current directors, Charles Woodburn and Tom Arseneault, and also to Peter Lynas and Jerry DeMuro, two former directors, under our long-term incentives will partially vest in early 2022. In addition, the 2019 Restricted Shares granted to our US-based executive director will vest. The awards due to Peter Lynas and Jerry DeMuro were subject to time pro-rating as fully disclosed in last year's Report.

The Performance Share awards made in 2019 were, in equal part, subject to TSR and EPS performance conditions. The Committee confirmed that 15.8% of the award subject to the TSR condition will vest. With regard to the half of the award subject to the EPS performance condition, the Committee considered the principles and practice that should apply in determining the outcome of this award.

Whilst the underlying earnings of the Group were particularly strong in 2021, the Committee nevertheless continued its practice of reviewing all non-recurring items to determine whether they should be included or excluded in determining the outcome of the EPS performance condition.

In summary, the principles the Committee adopts in making such judgements are as follows:

- one-off events are individually assessed to determine whether they impact earnings and performance outturn calculations both positively and negatively;
- inclusion of one-off profits must be linked to genuine management endeavour and demonstrable achievement of value for shareholders and other stakeholders;
- where management recognise risk and consider a provision to be appropriate and supportable, they should not be penalised if subsequent events allow such provisions to be released, and that is not recognised in the underlying numbers;

Remuneration Committee report continued

– windfall profits are not acceptable for, and will not be included in, remuneration outcome calculations and the Committee will assess any one-off profit to determine if it, in full or in part, is considered to arise from a windfall event; and
– any discretion exercised by the Committee must be in keeping with agreed policy and reported fully and transparently in order to secure shareholder support.

In keeping with the principles, the Committee made the following judgements in relation to the outturn of the EPS element of the Performance Share awards:

1. Currency

In line with the terms of the award and the discretion provided to it, the Committee agreed that the principle of constant currency should be used. This will ensure that the calculation of EPS is not affected by currency exchange rate fluctuations, upwards or downwards, from one financial year to the next. In recent years, the impact of currency fluctuations on the outturn of the EPS result has not been sufficiently material to warrant adjustment. However, in respect of 2021 the impact was more material and therefore the Committee determined that constant currency should be used as the basis for calculating EPS over the performance period. Consequently, the baseline target from which performance over the three-year period was measured was 0.6p per share lower than if an actual currency basis had been applied.

2. Discretionary judgement

The Committee chose to exercise its judgement over two items of 'one-off' events. It should be noted, however, that the achievement of the Stretch targets for long-term incentive outcome purposes was only 0.8p short of the Stretch target and, as such, recognition of only an element of one of these items was sufficient to achieve full vesting of the 2019 awards. It should also be noted that if the Committee had not exercised the EPS element of the two discretions detailed below, 84.0% of this element of the award would still have vested.

The two items where the Committee exercised discretion were as follows:

a. EU State Aid – a tax risk was identified in 2019 of £92m when the EU contended that the Group had been in receipt of state aid provided illegally by the UK government. Management made a full provision against profits in 2019 and pursued a challenge to the decision thereafter. Management endeavour achieved a decision that the Group had not been in receipt of state aid and, as a result, the full amount of the provision, together with an additional £2m charged in 2020, was credited to profits in 2021 to offset the charge against profits made in previous years. The Committee considered this decision to be a fair and appropriate adjustment and encouraged provision recognition when appropriate and supportable and rewarded successful outcomes when achieved. The value of this adjustment was 2.9p per share; and

b. Property disposal – during the course of the year, management completed a long and demanding negotiation for the sale of property at Filton and Broughton, delivering a one off profit of £182m. The Committee regarded this disposal as a significant management achievement and exercised its discretion to include the profit achieved in 2021 earnings in determining the performance outcome. This transaction has delivered significant additional liquidity to the Group and thereby increased optionality in terms of future capital allocation. No allowance for this reduction in ongoing profits associated with lost rental income will be made in determining future performance. The value of this adjustment was 4.6p per share.

Having thoroughly reviewed annual and three-year performance, and the related remuneration outcomes, the Committee is satisfied that the Policy operated as intended during 2021.

Granting of long-term incentives

Last year, in relation to the grant of the 2021 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, 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.

2022 remuneration

To confirm, for 2022 no revisions are proposed to our executive remuneration framework that would constitute a change to our approved 2020 Remuneration Policy. In line with our commitment to continued transparency, we have engaged with our major shareholders on the decisions made, changes proposed and matters considered by the Committee.

Looking ahead, the Committee will this year be reviewing the Policy ahead of seeking shareholder approval for its renewal at next year's AGM. As part of that exercise, we will be considering how we can best align executive remuneration with the Company's strategic needs and objectives, and also considering changing dynamics of the current employment market and the need to stay ahead in attracting and retaining talented individuals. We look forward to sharing and engaging with shareholders on any changes we propose making to the Policy in advance of the 2023 AGM.

Review of executive director base salaries

In making salary remuneration decisions, the Committee has considered carefully business and individual performance, skills, the scope of the role and the individual's time in role, as well as relevant market data for similar roles and the salary increase available to the wider workforce. Externally, the current uncertain economic outlook caused by the ongoing pandemic and inflationary pressures – the result of a tightened labour market and war on talent – have been an added focus in our deliberations.

However, the Committee remains sensitive to shareholder and broader societal concerns, and overall believes it is appropriate to adjust executive director salaries in line with the broader workforce in the relevant markets (2.5% in the UK and 3.75% in the US), and at the lower end of wage inflation, with effect from 1 January 2022.

In applying these increases, the Committee is acutely aware that there are clear and significant external challenges in retaining our key talent. Where necessary and appropriate, and in particular where base salary increases are not keeping pace with the external market, we will look to address these challenges. This is something we will be keeping under close scrutiny. We must make sure we are well placed to retain key individuals whose performance has helped drive the strong results we have seen in recent years, and whose retention is critical to delivering the strategic changes that will underpin our long-term success.

CEO pension provision

The Committee recognises the requirements of institutional investors and the UK Corporate Governance Code to align executive director pension contributions with the wider workforce level. Since 2020, the Chief Executive's pension has been fixed at the monetary value of £186,200 per annum. This is equivalent to 16.4% of his 1 January 2022 salary, and represents a continued move towards the level of employer contributions based on a weighted average of UK active pension scheme members which we currently estimate at approximately 15.4%.

The Committee recognises that, on this basis, alignment will take a number of years to achieve but understands that many institutional investors expect to see such alignment by the end of 2022. As such, the Committee has approved, and the Chief Executive has agreed, a reduction to the monetary value of his pension contribution such that with effect from 1 December 2022 he will be aligned with that wider workforce figure. Thereafter, we will review this every three years (in line with the renewal of our remuneration policy) and make any adjustments as may be necessary to maintain alignment.

Environmental, Social and Governance (ESG)

As we have set out in this Annual Report, our sustainability vision has included setting a target of achieving net zero greenhouse gas emissions across our operations by 2030, joining the United Nations 'Race to Zero' campaign, gender diversity ambition of 50% of our Executive Committee members to be women by 2030, commitment to cease handling white phosphorous, and gaining accreditation as a real living wage employer. While ever-evolving, ESG themes are not new to BAE Systems, and the Committee is pleased to be able to confirm our approach to ESG metrics within our remuneration framework.

Annual incentive plan

In respect of 2021, both safety and diversity were set as qualifiers to the overall award of the non-financial element of executive directors' bonus. In other words, good performance is expected in these areas rather than rewarded. Key strategic objectives specifically set within the non-financial element (25% of overall bonus) related to employee engagement, delivery of the next phase of the net zero plan and driving an inclusive culture. Performance against these elements is determined by the ESG Committee with the 2021 outturn reported on page 157.

During 2021, the Company incorporated the management of material ESG risks and opportunities into our long-term strategy. To support the focus on our sustainability agenda, the Committee has approved specific quantifiable and appropriate metrics within the key strategic objectives set for our executive directors in 2022. These metrics relate to establishing plans to deliver our net zero target, demonstrating clear further improvement in our key safety indicators, progress in our employee engagement and culture, and improvements in our governance and ESG ratings. The safety and diversity underpin to the non-financial element of executive directors' bonus will remain in 2022 and requires our executive team to uphold and deliver our commitment to high standards of safety and a diverse and inclusive workforce. Details of these metrics will be disclosed retrospectively in the 2022 Annual Report.

Long-term incentives

Key ESG risks have been integrated into the Company's long-term strategy. Consequently, the Committee has been considering the best approach to incorporating these within our long-term incentive plans. In our discussion on this matter, we agreed the importance of ensuring that any ESG-related performance conditions are clearly aligned with our strategy. In particular, on climate change our clearly stated goal is to develop and implement a long-term strategy that reduces the impact of our activities, supply chain and products on the environment.

A good deal of work is underway to develop a deeper understanding of the climate-related challenges that we, and all, companies face. During the year, the Committee will be following this work and developing proposals on robust and measurable LTIP performance conditions on climate change and other ESG-related matters. It is our intention that we will complete the work in the current year and that these metrics will form part of the changes we will be proposing to our Remuneration Policy when it is put to shareholders for approval next year. We will engage further with shareholders on this matter.

Annual and long-term incentive plans

There are no changes proposed to the annual incentive plan quantum or construct for 2022. Performance shares will continue to be measured over a three-year period against cumulative cash generation, a metric reflecting strategic progress, Earnings per Share (EPS) and relative Total Shareholder Return (TSR).

TSR will be measured against a single comparator group with no change to the performance requirements. During 2021, the Committee further reviewed the TSR comparator group and agreed that, for future awards, the constituent companies of the FTSE 100 would serve as the most appropriate peer group, on the basis that it provides a more stable, relevant and transparent group against which to assess relative performance.

As a point of detail, at the end of March 2021, performance share awards were granted using a TSR comparator group based on a defined subset of the FTSE 100 index. However, having subsequently agreed and recognised the clear benefits of moving to a simple full FTSE 100 comparator group – and also recognising the short period of time (less than two months) that had elapsed since the granting of the 2021 awards – at a meeting held at the beginning of May 2021, the Committee agreed that this simpler comparator should be used for the 2021 performance share awards as well as for future awards.

Benefits review

As part of a broader review of our benefits provision, a new online benefits platform (called FLEX) was launched in the UK during 2021. FLEX provides employees with access and flexibility to proactively manage their own portfolio of benefits, including private medical insurance, health benefits and broader guidance (financial, health and wellbeing). Similarly, in the US, several self-service systems have been consolidated and an expanded ServiceNow platform has been launched.

For our senior executive population, this has resulted in a number of modest changes to ensure our benefits offering is in line with the market in which we compete for talent. These include the introduction of medical benefits, an increase to the car allowance and limited financial and tax advice support.

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. 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.

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.

As a Committee, we will continue to look ahead to 2022 as another year in which we strengthen our framework on pay for performance. As previously stated, our Directors' Remuneration Policy is due for renewal at the 2023 AGM. The Committee has commenced a reassessment of the effectiveness of our current approved Policy and will also use this as an opportunity to include ESG-related performance conditions into our long-term incentives.

As part of this, we recognise and acknowledge the real and significant challenges being presented in the retention and attraction of our key talent. Following a review of potential options of how to address this within our executive remuneration framework, the Committee would very much welcome your thoughts and the opportunity to discuss our proposals at that time.

Concluding comments

The Remuneration Committee remains committed to rewarding performance that is consistent with promoting the long-term success of the Company. Our Directors' Remuneration Policy is designed to ensure that our executive incentive arrangements are competitive and aligned to the Company's strategic goals and 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 explanation and transparency of our remuneration changes helpful. 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
Chair of the Remuneration Committee

Remuneration Committee report continued

The Remuneration Committee's year

January → February → May → September → December

January: Committee, Committee
February: Committee
May: Committee
September: Committee
December: Committee

January
Videoconferences

Committees

- Assessed outturn of 2020 strategic objectives for executive directors and Executive Committee members.
- Agreed 2021 key strategic objectives for executive directors and Executive Committee members.
- Received an update on provisional 2020 financial performance for incentive purposes.

February
London, UK

Committee

- Determined 2020 bonuses against performance for executive directors and Executive Committee members for payment in March 2021.
- Approved 2020 Group All-Employee Free Share Plans payments.
- Determined vesting outcome for 2018 Spring Long-Term Incentive awards.
- Approved grant of 2021 Long-Term Incentive awards and associated performance targets for executive directors and Executive Committee members.
- Reviewed feedback from shareholder consultation.
- Approved 2020 Directors' remuneration report.
- Received remuneration analysis for individuals on Executive Committee succession plans.

May
Videoconference

Committee

- Reviewed feedback from shareholder consultation and May 2021 Annual General Meeting.
- Approved the Total Shareholder Return comparator group.
- Received an update on performance of in-flight LTIP awards.
- Received an overview of broader workforce remuneration.

September
London, UK

Committee

- Received an external environment update on executive remuneration.
- Reviewed progress against Executive Committee 2021 key strategic objectives.
- Approved remuneration package for new or existing Executive Committee members.
- Agreed benchmarking approach for executive directors and Executive Committee members.
- Approved the vesting outcome of the 2018 Autumn Long-Term Incentive awards.
- Approved grant of 2021 Autumn Long-Term Incentive awards.
- Agreed the approach to shareholder engagement following vote on 2020 Directors' remuneration report.

December
Videoconference

Committee

- Reviewed and set salaries for executive directors and Executive Committee members.
- Agreed the approach, structure and targets for the 2022 annual incentive plan.
- Reviewed draft 2022 strategic objectives applicable to executive directors and Executive Committee members.
- Approved approach to aligning the Chief Executive's pension provision with wider UK workforce.
- Received an overview of broader workforce remuneration.
- Agreed approach to development of 2021 Directors' remuneration report.
- Reviewed level of executive directors' and Executive Committee members' shareholdings relative to their Minimum Shareholding Requirement.
- Approved operation of Group All-Employee Free Share Plans for 2022.
- Reviewed dilution levels and share usage under Employee Share Plans.
- Reviewed and approved changes to benefits provision.

Annual remuneration report at a glance

for the year ended 31 December 2021

Business performance and incentive outcomes in 2021

		2021 performance	2021 incentive outcome
Group underlying EPS[1]	AIP	50.2p	●
Group net debt[1]	AIP	£(1,653)m	●
Group order intake[1]	AIP	£21.6bn	●
Average three-year diluted underlying EPS growth	LTI	12.3%	●
Three-year TSR	LTI	24.7%	●

AIP Annual Incentive Plan
LTI Long-Term Incentive

● Below threshold
● Between threshold and target
● At or above target

1. Adjusted to be on a comparable basis with the targets (see page 157).

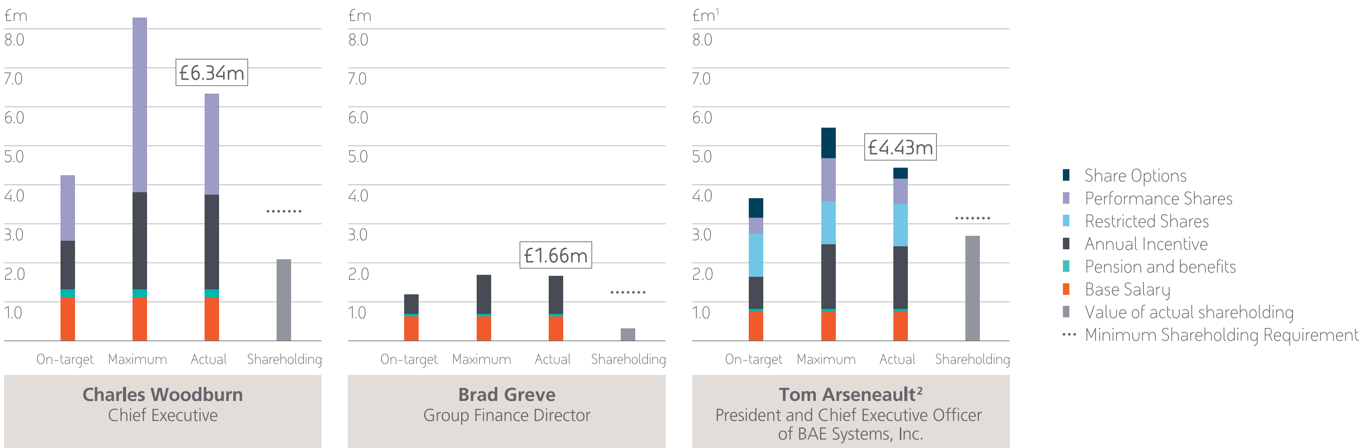
Strong performance achieved against shared key strategic objectives, demonstration of leadership behaviours, and those focused on our sustainability agenda. In 2021, the requirements for diversity improvements were met but those for safety improvements were not achieved. Given the importance of safety to our Company, it was confirmed that a reduction would be applied to the non-financial element of the bonus.

This resulted in the following incentive outcomes:

- 2021 annual bonus payouts for the executive directors were close to maximum; and
- The long-term incentive outcomes applicable to Tom Arseneault and Charles Woodburn are as follows: Performance Shares (EPS) granted in March 2019 achieved maximum performance and will vest at 100%. Performance Shares (TSR) granted in March 2019 achieved above threshold performance and will vest at 15.8%.

Summary of executive directors' remuneration in 2021

The charts below show the 2021 actual remuneration achieved, as disclosed in the single total figure of remuneration on page 155, compared with the 2021 on-target and maximum opportunity. On-target remuneration assumes target vesting of incentives payable in respect of the performance period with year-end 2021, 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 2021 compared to their Minimum Shareholding Requirement (as set out on page 164).



1. The figures for Tom Arseneault have been converted from US dollars to sterling.
2. Long-term incentive figures above are based on the 2019 Performance Shares and Share Options (in respect of Tom Arseneault only). For Tom Arseneault, the figures include his 2021 Restricted Shares award (as required by regulation in the single total figure of remuneration); his single total figure of remuneration on page 155 includes pro-rating of his 2019 Performance Shares and Share Option awards to include amounts in respect of his service as executive director since 1 April 2020.

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. Our people are critical to building a sustainable business for the future, and it is important we evolve our employee experience to attract, retain and develop the very best talent. This reflects a culture that is inclusive, supportive and allows everyone to be their best at work and feel 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;
- we recognise individual and team successes through a variety of financial and non-financial recognition schemes aligned to our financial and strategic objectives;
- 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 integrated our Behaviours (as set out on page 23) into all our people processes, to support a high-performing culture that delivers our shared strategic objectives;
- the mean pay difference between men and women across the UK workforce is 8.7% in favour of men; and
- the median pay ratio of Chief Executive remuneration to UK average employee is 126:1.

Annual remuneration report at a glance

for the year ending 31 December 2022

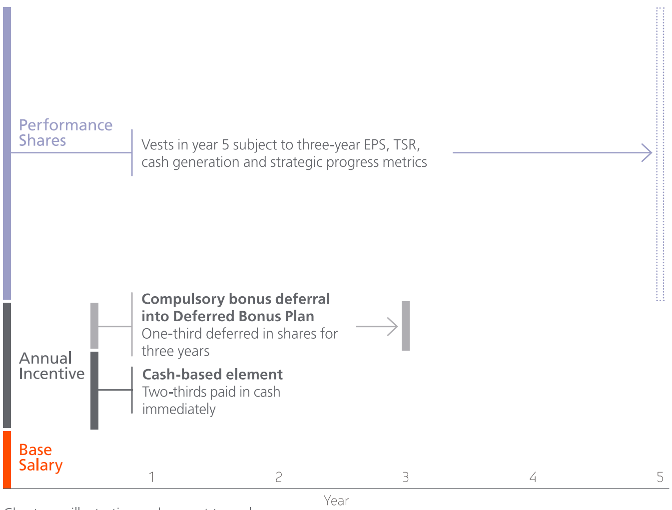
Summary of remuneration framework

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 2022)	Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.		£1,135,226	£637,755	$1,052,000
Pension and benefits	Provide employment benefits and competitive post-retirement benefits to ensure overall package is market competitive.		Defined contribution (£186,200[1])	Defined contribution (8% salary)	US defined benefit and Section 401(k) defined contribution[2]
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)[3]		
		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

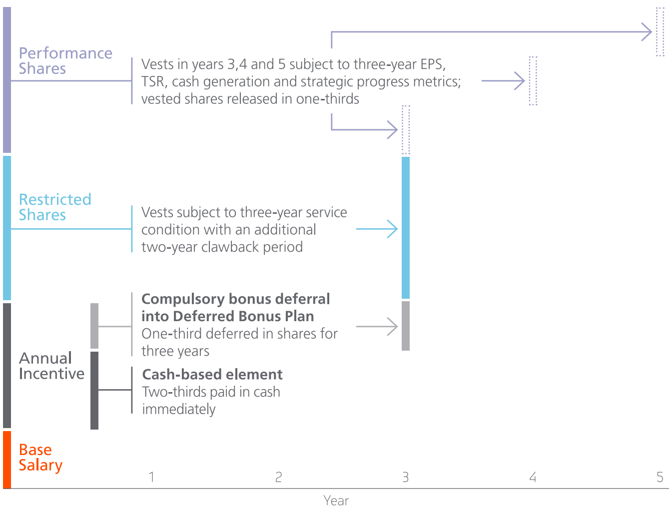
1. Value to be reduced with effect from 1 December 2022 to the monetary level equivalent to the weighted average of UK active pension scheme members.
2. Further detail on Tom Arseneault's pension is provided on pages 160 and 176.
3. Shared key strategic objectives include those focused on supporting our sustainability agenda and those for 2022 are set out on pages 140 and 141. Safety and diversity underpin applies to the non-financial element with the requirement to uphold and deliver our commitment to high standards of safety and a diverse and inclusive workforce.

Application of 2022 package for UK executive directors



Charts are illustrative and are not to scale.

Application of 2022 package for US executive director



Annual remuneration report

for the year ended 31 December 2021

This section details the remuneration of the executive and non-executive directors (including the Chairman) during the financial year ended 31 December 2021 and will be proposed for an advisory vote by shareholders at the 2022 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 152
Strategic rationale for our directors' remuneration

Page 146
Appropriateness of our remuneration

Page 151
How the Committee has addressed the factors of clarity, simplicity, risk, predictability, proportionality and alignment to culture

Page 140
Operation of our policy

Page 153
Engagement with shareholders

Page 153
Engagement with our workforce

Pages 139 and 140
Exercise of discretion

Statement of voting

Shareholder voting on the resolutions to approve the Annual remuneration report put to the 2021 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)
1,735,641,459	76.59	530,398,812	23.41	2,266,040,271	239,395,615

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 169 to 183. It is also available in the Investor Relations section of the Company's website: baesystems.com.

An update to the response to the voting result on the Annual remuneration report resolution put to the 2021 AGM is set out on page 139 in the Remuneration Committee chair's report.

Contents

Annual remuneration report continued

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. Across BAE Systems we continue to accelerate our performance, focusing on both what we do for our customers and how we do it. Since their launch in 2019, our Behaviours have been integral to this success and have been integrated into all our people processes. 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 151, 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 key strategic objectives relating to the delivery of the Group's strategy, including our sustainability agenda, and the demonstration of leadership behaviours, with safety, and diversity and inclusion, applied as downward underpin. Compulsory deferral into shares for three years.		Annual incentive based primarily on organisation performance of our KPIs and remainder on personal objectives and behaviours. Compulsory deferral into shares for three years (except in the US).	Annual incentive based on organisation and individual performance.	In UK businesses, incentive typically based on business and/or individual performance. None in US, Australia and KSA.
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.

The Company also receives insights from the broader employee population using an engagement survey. Further detail on engagement with employees is given on page 153.

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
2021	**Option B**	**154:1**	**126:1**	**89:1**
2020	Option B	121:1	103:1	89:1
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 2021.

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 a similar 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 contributions applicable to the member's pension scheme made through payroll. In respect of annual incentives, the amounts have been estimated based on the expected financial outturn accrued. 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 146). 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	41,286	50,327	71,472
Salary component	34,707	41,415	53,085

Relative to 2020, the pay ratio in 2021 has increased by approximately 28%, 23% and 1% at 25th, 50th and 75th percentiles respectively. The total pay and benefits figures have decreased at 25th and 50th percentiles due to the representative employees being in a relatively less valuable defined contribution pension scheme, whilst the representative employees in 2020 were predominantly in defined benefit pension arrangements. This has caused the Chief Executive pay ratio to increase. The pay ratio has additionally been impacted by the increase in the Chief Executive's remuneration for 2021, primarily as a result of the increase in annual bonus outturn (97.1% in 2021 versus 78.7% in 2020).

Annual remuneration report continued

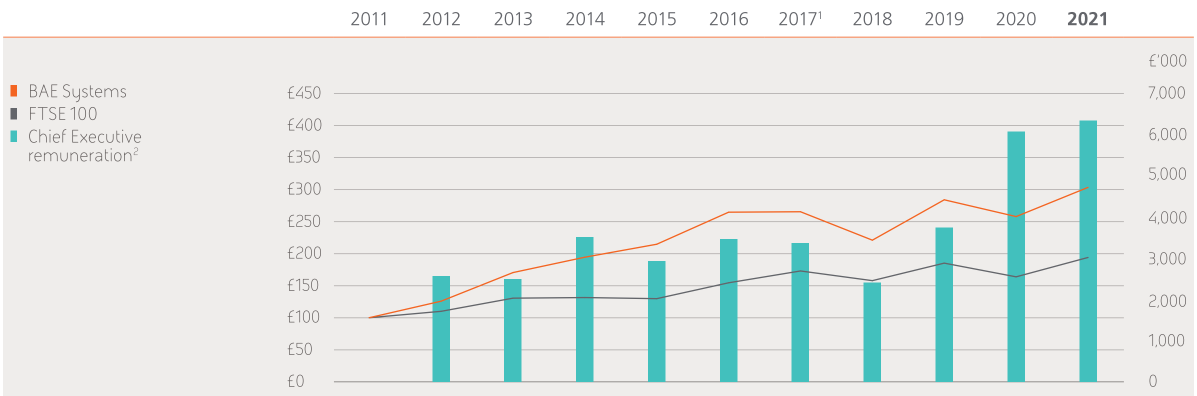
Total Shareholder Return (TSR) performance and Chief Executive pay

The graph below shows the value by 31 December 2021, on a TSR basis, of £100 invested in BAE Systems on 31 December 2011 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 and 100% of the TSR performance measure for awards made in 2021.

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 2021 of £100 investment at 31 December 2011



Change in Chief Executive's remuneration over ten years

	2012	2013	2014	2015	2016	2017[1]	2018	2019	2020	**2021**
Chief Executive's single total figure (£'000)										
Ian King	2,574	2,499	3,519	2,929	3,463	2,086	n/a	n/a	n/a	**n/a**
Charles Woodburn	–	–	–	–	–	1,279	2,416	3,747[3]	6,080	**6,341**
	2,574	2,499	3,519	2,929	3,463	3,365	2,416	3,747[3]	6,080	**6,341**
Bonus paid as a percentage of maximum										
Ian King	55.6%	53.4%	74.3%	72.4%	82.3%	75.9%	n/a	n/a	n/a	**n/a**
Charles Woodburn	–	–	–	–	–	75.8%	65.6%	95.6%	78.7%	**97.1%**
LTI as a percentage of maximum vesting										
Ian King	nil	nil	16.8%	nil	nil	11.3%	n/a	n/a	n/a	**n/a**
Charles Woodburn	–	–	–	–	–	n/a	nil	10.9%[3]	100%	**57.9%**

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 2020 to the year ended 31 December 2021 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.

	2020/2021			2019/2020		
	Salary/fees % change	**Benefits % change**	**Annual bonus % change**	Salary/fees % change	Benefits % change	Annual bonus % change[1]
Executive directors						
C N Woodburn	**+12.7**	**+17.7**	**+39.1%**	+6.9	–3.9	–12.1
B M Greve[2]	**+36.0**	**+44.2**	**+68.7%**	n/a	n/a	n/a
T A Arseneault[2]	**+27.9**	**+156.9**	**+115.4%**	n/a	n/a	n/a
Non-executive directors						
Sir Roger Carr	**0.0**	**0.0**	**n/a**	0.0	0.0	n/a
N J Anderson[2]	**+500.0**	**+81.0**	**n/a**	n/a	n/a	n/a
C E Ashby[3]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a
Dame Elizabeth Corley	**+1.5**	**0.0**	**n/a**	+4.7	–100.0	n/a
Dame Carolyn Fairbairn[3]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a
J V Griffiths[2]	**+72.5**	**0.0**	**n/a**	n/a	n/a	n/a
C M Grigg	**+7.3**	**0.0**	**n/a**	+28.1	–100.0	n/a
E M Kirk[3]	**n/a**	**n/a**	**n/a**	n/a	n/a	n/a
S T Pearce[4]	**+1.1**	**+90.4**	**n/a**	+133.0	–4.0	n/a
N W Piasecki[4]	**+1.5**	**–100.0**	**n/a**	+79.5	–35.5	n/a
I P Tyler	**+1.1**	**+8.9**	**n/a**	+3.6	–64.7	n/a
Average employee[5]	**+1.5**	**+1.5**	**+28.4**	+2.5	+2.5	–2.0

1. Annual percentage change information for the 2019/2020 comparative excludes those directors who joined or retired from the Board part way through 2020, these being Nick Anderson and Jane Griffiths who joined the Board on 1 November 2020 and 1 April 2020 respectively.
2. Remuneration for Brad Greve and Tom Arseneault in respect of 2020 reflects the period from their appointment as executive directors on 1 April 2020. Remuneration for Nick Anderson and Jane Griffiths in respect of 2020 reflects their part-year from joining the Board on 1 November 2020 and 1 April 2020 respectively.
3. Remuneration for Crystal Ashby, Dame Carolyn Fairbairn and Ewan Kirk in respect of 2021 reflects their part-year from joining the Board on 1 September 2021, 1 March 2021 and 1 June 2021 respectively.
4. Remuneration for Stephen Pearce and Nicole Piasecki in respect of 2019 reflects their part-year from joining the Board on 1 June 2019.
5. Figures are provided in respect of the relevant median average employee of BAE Systems plc as determined on a full-time equivalent basis and with annual bonus estimated in respect of 2021.

Annual remuneration report continued

Gender pay

BAE Systems has published its annual gender pay gap report in line with the UK regulations. For 2021, the average (mean) gender pay gap for our UK workforce was 8.7% in favour of men (2020 9.1%), which is lower than the current UK national average of 16.1%. 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.

Relative importance of spend on pay

The following charts set out underlying EBIT[1], amounts paid in returns to shareholders, total employee costs and average headcount for the years ended 31 December 2020 and 2021. These charts have been chosen as they are most representative in assisting to understand the relative importance of spend on pay.

Underlying EBIT[1] (£m)

Returns to shareholders[3] (£m)

Total employee costs[2] (£m)

Average headcount[4] ('000)

1. With effect from 2021, the Group adopted the underlying EBIT profitability measure in place of the previously reported EBITA measure. Further details of this change are provided in the Financial glossary on page 78. 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 2.5% per employee in 2021.
3. Returns to shareholders comprise dividends to ordinary shareholders paid in the year and, in respect of 2021, £368m in share buyback.
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 Chair engages with our major shareholders to set out the changes planned. In a year of significant change, the Remuneration Committee Chair 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 (see also page 153 for engagement on executive pay).
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 prior 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 targets expected to be met in all circumstances, with downward underpin applying within AIP in the event of below-target performance.
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 152, 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 152, 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.

Annual remuneration report continued

Strategic rationale for our directors' remuneration

As detailed on page 146, 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 shared strategic objectives.

Shared strategic objectives

How our strategic objectives are measured in our incentives

	Drive operational excellence	Continuously improve competitiveness and efficiency	Advance and further leverage our technology	Pursue and deliver growth	Lead and inspire high-performing teams and individuals	Advance and integrate our sustainability agenda with progress across each of environment, social and governance
Annual incentive						
Earnings per share	●	●			●	
Net debt	●					
Order intake				●		
Safety and diversity & inclusion[1]					●	●
Key strategic objectives	●	●	●	●	●	●
Long-term incentive						
Three-year earnings per share	●					
Three-year relative Total Shareholder Return		●				
Three-year cash generation				●		
Three-year strategic progress	●	●	●			

1. Safety and diversity & 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 Chair annually writes to our major shareholders and also the 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 Chair will additionally engage directly with our major shareholders to discuss and seek views on potential changes. The Remuneration Committee Chair values direct engagement with our shareholders and makes himself available for such meetings throughout the year to hear their perspective on remuneration matters.

Specific engagement undertaken in 2021 in respect of the 2021 shareholder vote on the Remuneration report is set out on page 139 in the Remuneration Committee report.

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. During 2021, the Remuneration Committee members and other non-executive directors attended the Company's October 2021 ESG event.

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, help us define and develop together a positive, inclusive, future-ready working environment in which everyone can give their best for our customers. As we continue to build a high-performing culture that delivers our shared strategic objectives, our Values and Behaviours have become integral to this success. These Behaviours have been integrated into all our people processes, including performance, talent, reward, recruitment and learning.

Data insights and employee sentiment are key to informing our people agenda. Employees in the UK, Australia and Kingdom of Saudi Arabia undertook a comprehensive employee engagement survey, similar to one run in 2018. The three principal objectives of the survey were: to assess employee engagement; to understand progress in achieving alignment with certain behaviours adopted and promoted by the Company; and, to hear about employee experiences during the COVID-19 pandemic. In our US business, a random sample of 20% of the workforce undertook a pulse survey that reviewed employee perceptions. The Board reviewed the results of these surveys and used these to inform their deliberations on the Company's culture.

In 2021, the easing of COVID-19 restrictions as the year progressed allowed for a number of non-executive Board members to join senior executives on visits to our sites, to engage directly with employees. The personal tone and increased levels of communication fostered at the peak of the pandemic were maintained, and the Board was pleased to see positive feedback from employees with regards to the authenticity and more conversational style of communications.

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. This includes our Employee Resource Groups (ERGs) which are sponsored by our Executive Committee and provide visible leadership and director engagement with a range of groups, to ensure employees feel that their differences are valued and represented. Employees are encouraged to share their views through our channels and employee surveys, including focus groups through to smaller, targeted surveys and polls. We also engage with trade unions in Australia and the UK and labour unions in the US.

This report is the principal means through which we communicate and engage with employees on how executive remuneration aligns with that of the wider workforce. Around 78,000 of the Company's employees who are shareholders in the Company receive email communications with a direct link to this report on the Company's website and an invitation to vote on the resolutions being put to the Annual General Meeting (AGM), including those resolutions on executive remuneration. The results of employee shareholder voting on the AGM resolutions, including those relating to executive remuneration, are subsequently reported to the Board for discussion. This did not impact executive remuneration policy in 2021 as the policy was not due for renewal and is not used to seek feedback on individual outcomes.

Annual remuneration report continued

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	
	2021	2020	**2021**	2020	**2021**	2020	**2021**	2020	**2021**	2020	**2021**	2020
Chairman												
Sir Roger Carr	**700**	700	**–**	–	**–**	–	**700**	700	**700**	700	**–**	–
Non-executive directors												
R Advaithi[1]	**n/a**	40	**n/a**	2	**n/a**	–	**n/a**	42	**n/a**	42	**n/a**	–
N J Anderson[2]	**85**	14	**2**	1	**–**	–	**87**	15	**87**	15	**–**	–
C E Ashby[3]	**28**	n/a	**–**	n/a	**9**	n/a	**37**	n/a	**37**	n/a	**–**	n/a
Dame Elizabeth Corley	**85**	84	**2**	–	**–**	–	**87**	84	**87**	84	**–**	–
Dame Carolyn Fairbairn[4]	**71**	n/a	**–**	n/a	**–**	n/a	**71**	n/a	**71**	n/a	**–**	n/a
J V Griffiths[5]	**110**	64	**5**	–	**–**	–	**115**	64	**115**	64	**–**	–
C M Grigg	**110**	103	**–**	–	**–**	–	**110**	103	**110**	103	**–**	–
E M Kirk[6]	**62**	n/a	**1**	n/a	**–**	n/a	**63**	n/a	**63**	n/a	**–**	n/a
S T Pearce	**110**	109	**2**	1	**–**	–	**112**	110	**112**	110	**–**	–
N W Piasecki	**85**	84	**–**	7	**9**	4	**94**	95	**94**	95	**–**	–
P Rosput Reynolds[7]	**n/a**	109	**n/a**	2	**n/a**	4	**n/a**	115	**n/a**	115	**n/a**	–
N C Rose[7]	**n/a**	90	**n/a**	–	**n/a**	–	**n/a**	90	**n/a**	90	**n/a**	–
I P Tyler	**110**	109	**1**	1	**–**	–	**111**	110	**111**	110	**–**	–

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 September 2021.
4. Appointed to the Board on 1 March 2021.
5. Appointed to the Board on 1 April 2020.
6. Appointed to the Board on 1 June 2021.
7. Retired from the Board on 31 December 2020.

● Fixed remuneration element (Fees, Benefits, Other, Total fixed remuneration)
● Variable remuneration element (Total variable remuneration)

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 Chair), Tom Arseneault, Philip Bramwell (Group General Counsel) and Charles Woodburn.

The fee structure was reviewed in January 2020 and was set from 1 April 2020 on a per annum basis as follows: (i) Committee chairs: £110,000; (ii) other non-executive directors: £85,000; and (iii) additional fee for Senior Independent Director: £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	
	2021	2020	**2021**	2020	**2021**	2020	**2021**	2020	**2021**	2020	**2021**	2020	**2021**	2020	**2021**	2020	**2021**	2020
C N Woodburn	**1,108**	983	**24**	20	**2,420**	1,740	**2,602**	3,150	**186**	186	**1**	1	**6,341**	6,080	**1,318**	1,189	**5,023**	4,891
B M Greve*	**622**	458	**17**	12	**968**	573	**–**	–	**50**	38	**1**	1	**1,658**	1,082	**689**	508	**969**	574
T A Arseneault*[6]	**740**	578	**45**	18	**1,611**	748	**373**	46	**26**	12	**1,109**	1,035	**3,904**	2,437	**811**	608	**3,093**	1,829
P J Lynas**	**n/a**	165	**n/a**	6	**n/a**	206	**n/a**	207	**n/a**	132	**n/a**	–	**n/a**	716	**n/a**	303	**n/a**	413
J DeMuro**[6]	**n/a**	210	**n/a**	17	**n/a**	274	**n/a**	499	**n/a**	13	**n/a**	252	**n/a**	1,265	**n/a**	240	**n/a**	1,025

* Appointed to the Board on 1 April 2020.
**Retired from the Board on 31 March 2020.
● Fixed remuneration element (Base salary, Taxable benefits, Pension, Total fixed remuneration)
● Variable remuneration element (Bonus, LTIP, Other, Total variable remuneration)

The above table has been subject to audit.

Note: The prior year 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 whilst the prior year 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.

1. The benefits received by Charles Woodburn include the provision of a car allowance and private use of a chauffeur-driven car (2021 £22k; 2020 £20k) and private medical insurance (2021 £1k; 2020 £nil). The benefits received by Brad Greve include the provision of a car allowance and private use of a chauffeur-driven car (2021 £16k; 2020 £12k) and private medical insurance (2021 £1k; 2020 £nil). The benefits received by Tom Arseneault include private use of a chauffeur-driven car and parking (2021 £8k; 2020 £327); medical and dental benefits (2021 £15k; 2020 £11k); insured life and disability benefits (2021 £7k; 2020 £6k); and the private use of a company aircraft (2021 £15k; 2020 £nil). The benefits received by Peter Lynas for the prior year included the provision of a car allowance and the private use of a chauffeur-driven car (2020 £6k) whilst the benefits received by Jerry DeMuro in the prior year included private use of a chauffeur-driven car and parking (2020 £1k); medical and dental benefits (2020 £3k); insured life and disability benefits (2020 £2k); and the private use of a company aircraft (2020 £11k).
2. Further detail on bonus payments is provided on page 157. 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 applied to the net bonuses paid to Peter Lynas and Jerry DeMuro in respect of their service as executive directors in 2020 as shown in the prior year figures. With respect to the prior year figures for Brad Greve and Tom Arseneault, the full year net bonus in respect of Brad Greve was subject to compulsory deferral and in the case of Tom Arseneault, the net bonus earned since becoming an executive director on 1 April 2020 was subject to compulsory deferral.
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 2021 column are calculated on the basis of the three-month average share price of £5.6227 as at 31 December 2021 and relate to the vesting portion (57.9% overall; 15.8% TSR and 100% EPS), including shares deriving from notional reinvested dividends, of the 2019 LTIP PS^{EPS}/PS^{TSR} granted to Tom Arseneault and Charles Woodburn for which the performance period ended on 31 December 2021 (see page 159 for further detail). 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 2019 LTIP award attributable to share price appreciation is set out below.

	2019 LTIP PS £
C N Woodburn	+313,834
T A Arseneault[1]	+45,187

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 2020 column (which were calculated in the 2020 Annual Report on the basis of the three-month average share price of £4.84 as at 31 December 2020), have been adjusted to reflect the actual value on the vesting of the performance award in March 2021 based on the then share price of £4.895. The figures reported in the 2020 column in the 2020 Annual Report on the estimated basis were Charles Woodburn: £3,118k; Peter Lynas: £205k; Jerry DeMuro: £493k; and Tom Arseneault: £45k. The respective figures in the 2020 Total and Total variable remuneration columns have been recast accordingly.

Annual remuneration report continued

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 and the added pension value received from his defined contribution scheme in respect of the employer contributions.

   The figures for Tom Arseneault and, in the 2020 column for Jerry DeMuro, include company contributions paid into their Section 401(k) defined contribution arrangements.

   The figures for Tom Arseneault in the 2021 column also reflect defined benefit arrangements calculated in line with the method set out in Section 229 of the Finance Act 2004 using a capitalisation factor of 20 for the life pension, a x10 factor for the 10-year pension and a x1 factor for the lump sum benefit (see page 161).

   The figures for Peter Lynas in the 2020 column reflect defined benefit arrangements calculated to 31 March 2020, the date of his retirement. Details of his pension payments in 2020 were disclosed last year.

   Further detail on pensions is given on page 160.
5. This column includes (i) the value of Free Share awards under the UK all-employee Share Incentive Plan (SIP) of £615 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 2021 grant of Restricted Shares (£1,095k). This award formed part of Tom Arseneault's 2021 LTIP allocation but is required to be reported under 'Other' as it has no performance conditions attached. The balance of the 2021 figure (£14k) relates to the value of notional reinvested dividends in respect of his 2018 Restricted Share Plan award which vested in March 2021, the third anniversary of grant, and have been apportioned to include amounts in respect of his service as an executive director since 1 April 2020. Jerry DeMuro's prior year 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.
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. Tom Arseneault's 2021 salary reflects his 3.5% increase and the exchange rate fluctuations experienced during 2021.

Payments to former directors in respect of the 2021 financial year comprised:

(i) £1,150,791 in respect of Jerry DeMuro, being (a) the value of his 2019 LTIP Performance Shares award (pro-rated for service as disclosed last year, including shares deriving from pro-rated notional reinvested dividends) calculated on the same basis as set out in note 3 to the single figure table on page 155, such value being £1,122,609; and (b) £28,182 relating to reinvested notional dividends accrued prior to the release at the end of 2020 of share awards which releases were reported last year; and

(ii) £347,334 in respect of Peter Lynas, being the value of his 2019 LTIP Performance Shares award (pro-rated for service as disclosed last year, including shares deriving from pro-rated notional reinvested dividends) calculated on the same basis as set out in note 3 to the single figure table on page 155.

Implementation of our policy in the year ending 31 December 2022

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 2022 will be implemented as follows:

- The salary of the Chief Executive is increased to £1,135,226 with effect from 1 January 2022.
- The salary of the Group Finance Director is increased to £637,755 with effect from 1 January 2022.
- The salary of the President and Chief Executive Officer of BAE Systems, Inc. is increased to $1,052,000 with effect from 1 January 2022.
- Modest changes to benefits including the introduction of medical benefits, an increase to the car allowance and limited financial and tax advice support.
- The Chief Executive's pension value will be reduced to the monetary level equivalent to the weighted average UK active members on 1 December 2022.
- Annual and Long-Term Incentive opportunity levels are in line with 2020 approved Policy (as set out on pages 171 to 175).
- 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 2022 for the Annual Incentive and Long-Term Incentives are set out on pages 168 and 171 to 175 with additional information on pages 140 and 141.
- 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.

Annual bonus

Annual bonuses for the 2021 year are paid in March 2022. Annual bonus is made up of financial metrics, shared key strategic objectives relating to the delivery of the Group's strategy including objectives specifically focused on our sustainability agenda, and the demonstration of leadership behaviours. Safety and diversity underpin applies to the non-financial element, with the requirement to uphold and deliver our commitment to high standards of safety and a diverse and inclusive workforce. 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: Below	Threshold	Target	Stretch	Threshold for 2021	Target for 2021	Stretch for 2021	Actual performance[1]	Percentage of maximum opportunity
Financial										
Group underlying EPS	45.0					43.3p	45.7p	46.9p	50.2p	100%
Group net debt	22.5					£(3,283)m	£(3,083)m	£(2,883)m	£(1,653)m	100%
Group order intake	7.5					n/a	£18.7bn	£19.7bn	£21.6bn	100%
Non-financial										
Key strategic objectives	25.0					See Key strategic objectives section on page 158				93%
Safety and diversity & inclusion underpin										95%
									Total bonus (as a percentage of maximum)	**97.1%**
									Amount of bonus	**£2,420,317**

Brad Greve Group Finance Director

Measures	Weight (as a percentage of target)	Actual performance against targets set: Below	Threshold	Target	Stretch	Threshold for 2021	Target for 2021	Stretch for 2021	Actual performance[1]	Percentage of maximum opportunity
Financial										
Group underlying EPS	45.0					43.3p	45.7p	46.9p	50.2p	100%
Group net debt	22.5					£(3,283)m	£(3,083)m	£(2,883)m	£(1,653)m	100%
Group order intake	7.5					n/a	£18.7bn	£19.7bn	£21.6bn	100%
Non-financial										
Key strategic objectives	25.0					See Key strategic objectives section on page 158				93%
Safety and diversity & inclusion underpin										95%
									Total bonus (as a percentage of maximum)	**97.1%**
									Amount of bonus	**£966,899**

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

Measures	Weight (as a percentage of target)	Actual performance against targets set: Below	Threshold	Target	Stretch	Threshold for 2021	Target for 2021	Stretch for 2021	Actual performance[1]	Percentage of maximum opportunity
Financial										
Group underlying EPS	15.0					43.3p	45.7p	46.9p	50.2p	100%
Group net debt	7.5					£(3,283)m	£(3,083)m	£(2,883)m	£(1,653)m	100%
Group order intake	2.5					n/a	£18.7bn	£19.7bn	£21.6bn	100%
BAE Systems, Inc. underlying EBIT	30.0					$1,436.8m	$1,513.8m	$1,559.8m	$1,581.4m	100%
BAE Systems, Inc. debt	15.0					$1,449m	$1,599m	$1,749m	$2,357m	100%
BAE Systems, Inc. order intake	5.0					n/a	$11.8bn	$12.4bn	$12.5bn	100%
Non-financial										
Key strategic objectives	25.0					See Key strategic objectives section on page 158				93%
Safety and diversity & inclusion underpin										95%
									Total bonus (as a percentage of maximum)	**97.1%**
									Amount of bonus	**$2,215,907**

The above table has been subject to audit.

1. Adjusted to be on a comparable basis with the targets.
2. Performance in respect of the safety and diversity & inclusion underpin to the bonus was determined by the Environmental, Social and Governance Committee (whose composition is stated on page 134). In 2021, improvements in safety and diversity were underpins to the non-financial element of the executive bonus. The requirements for diversity improvements were met but those for safety improvements were not achieved. While progress was made with some of the long-term metrics improving, especially around major injuries rates and a reduction in severity levels, the overall recordable injury rate increased slightly over 2020. The analysis into this showed a significant increase in hours worked in several of our larger sites throughout 2021 while the staff headcount remained consistent. Given the importance of safety to our Company, it was confirmed a reduction be applied to the non-financial element of the bonus.

Taking into consideration the overall business performance during the year, the Committee believes the bonus outturns are appropriate.

Annual remuneration report continued

Key strategic objectives

Achievement against key strategic objectives represents 25% of the annual bonus opportunity applicable to each of the executive directors. These objectives relate to the delivery of the Group's strategy including objectives specifically focused on our sustainability agenda, and the demonstration of leadership behaviours. Safety and diversity underpin applies to the non-financial element, with the requirement to uphold and deliver our commitment to high standards of safety and a diverse and inclusive workforce. Executive directors and Executive Committee members are collectively responsible for, or required to support, a set of shared common strategic objectives. The objectives are aligned to our strategy, centred on maintaining and growing our core franchises and securing growth opportunities through advancing our three strategic priorities and demonstrating Company Behaviours.

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 2021 –** Astute Boat 5, HMS Anson launched; US Combat vehicle production ramped to full rate; UK Carrier Strike Group successfully supported on first operational deployments; Global Combat Ship continues to progress in the UK, Australia and Canada.		
– Delivered stretch net improved project performance margins per Group Salients. – Established and implemented Line of Business Quality Scorecard, with improvements achieved against the KPIs.	– Delivered stretch net improved project performance margins per Group Salients. – Established and implemented Line of Business Quality Scorecard, with improvements achieved against the KPIs.	– Delivered stretch net improved project performance margins per Group Salients. – Established and implemented Line of Business Quality Scorecard, with improvements achieved against the KPIs.
Continuously improve competitiveness and efficiency **Key successes in 2021 –** Achieved supply chain resilience in response to pandemic-driven challenges ensuring critical programmes remained on track; process and automation improvements in US combat vehicles production; data analytics and benchmarking implemented to drive cost saving programmes.		
– Enhanced customer relationships across key international markets and 'home' markets, increasing collaboration across the Group. – Established and delivered supply chain risk management system against clear milestones.	– Enhanced customer relationships across key international markets and 'home' markets, increasing collaboration across the Group. – Established and delivered supply chain risk management system against clear milestones.	– Enhanced customer relationships across key international markets and 'home' markets, increasing collaboration across the Group. – Reduced general and administration costs at BAE Systems, Inc. – Established and delivered supply chain risk management system against clear milestones.
Advance and further leverage our technology **Key successes in 2021 –** In-Space Missions UK acquisition; contract signed for next phase of Tempest Future Combat Air System; successful integration of 2020 acquisitions (Military GPS and Airborne Tactical Radios) with winning orders and growing the business.		
– Significant year with significant progress against our Group integrated technology plans. – Acquisition of In-Space Missions to accelerate our Space capabilities. – Successful launch of our global multi-domain autonomous systems programme.	– Significant year with significant progress against our Group integrated technology plans. – Acquisition of In-Space Missions to accelerate our Space capabilities. – Successful launch of our global multi-domain autonomous systems programme.	– Significant year with significant progress against our Group integrated technology plans. – Furthered our ambition in the future of flight with BAE Systems, Inc. investing in aircraft electrification technologies. – Sustainability-based product innovation including sustainable power and propulsion solutions.
Pursue and deliver growth **Key successes in 2021 –** MBDA secured a number of significant export awards; continued to widen reach and relationships in targeted markets especially in Asia-Pacific; received contracts of over £1bn under UK Ministry of Defence's Future Maritime Support Programme; RBSL secured Challenger 3 Main Battle Tank upgrade contract.		
– Progressed and/or won specific key awards. – Agreement reached in principle to renew Saudi British Defence Co-operation Programme to 31 December 2026.	– Progressed and/or won specific key awards. – Agreement reached in principle to renew Saudi British Defence Co-operation Programme to 31 December 2026.	– Progressed and/or won specific key awards. – BAE Systems, Inc. secured multiple contracts for CV90 and BvS10 work. – 2020 acquisitions within Electronic Systems performing well with more than $600m new contracts in 2021.
Lead and inspire high-performance teams and individuals (see note 2 on page 157 as separately assessed within safety and diversity & inclusion underpin). **Key successes in 2021 –** Implemented stronger talent management framework across all levels and relaunched leadership and learning programmes online; established new gender diversity metrics, embedding our ambitions into process, practices, policies, systems and training.		
– Further increased mobility within our high-potential executive population including cross-sector and stretch assignments. – Successful UK campaign for employees to update their self-identification, supporting our broader diversity and inclusion goals. – Demonstrated inclusive leadership behaviours by understanding employee experiences – through sponsorship and involvement in Employee Resource Groups, visible leadership and direct engagement with key groups, and pledges and commitments to external charters.	– Further increased mobility within our high-potential executive population including cross-sector and stretch assignments. – Successful UK campaign for employees to update their self-identification, supporting our broader diversity and inclusion goals. – Demonstrated inclusive leadership behaviours by understanding employee experiences – through sponsorship and involvement in Employee Resource Groups, visible leadership and direct engagement with key groups, and pledges and commitments to external charters.	– Increased representation of women and people of colour in executive grades. – Progress in providing career development opportunities/support to employees in under-represented groups. – Improved employee sense of belonging through Inclusive Leader Goal for people leaders to engage in employee experience conversations.

Charles Woodburn Chief Executive	Brad Greve Group Finance Director	Tom Arseneault President and Chief Executive Officer of BAE Systems, Inc.
Build trust by operating to the highest standards of business conduct **Key successes in 2021** – Acceleration of our sustainability agenda.		
– Established Environment Net Zero roadmap with key milestones identified and implementation commenced. – Reduced overall significant Group risk rating. – Progressed gender diversity across the Group. – Continued focus on employee safety and adapting to evolving environment to deliver on customers' critical programmes. – Recruited a record number of apprentices and graduates in the UK.	– Established Environment Net Zero roadmap with key milestones identified and implementation commenced. – Reduced overall significant Group risk rating. – Progressed gender diversity across the Group. – Continued focus on employee safety and adapting to evolving environment to deliver on customers' critical programmes. – Recruited a record number of apprentices and graduates in the UK.	– Established Environment Net Zero roadmap with key milestones identified and implementation commenced. – Reduced overall significant Group risk rating. – Progressed gender diversity across the Group. – Continued focus on employee safety and adapting to evolving environment to deliver on customers' critical programmes.
Achievements were offset by not meeting organisation efficiency and effectiveness targets.	Achievements were offset by not meeting organisation efficiency and effectiveness targets.	Achievements were offset by the ongoing impact of the pandemic in certain areas.
Payout (% of maximum): **93%**	**Payout (% of maximum):** **93%**	**Payout (% of maximum):** **93%**
Safety and diversity & inclusion underpin: **95%**	**Safety and diversity & inclusion underpin:** **95%**	**Safety and diversity & inclusion underpin:** **95%**
Overall non-financial outturn: **88.5%**	**Overall non-financial outturn:** **88.5%**	**Overall non-financial outturn:** **88.5%**

In relation to the safety and diversity and inclusion underpin, the requirements for diversity improvements were met but those for safety improvements were not achieved. Given the importance of safety to our Company, it was confirmed a reduction be applied to the non-financial element of the bonus. See page 157 for further details. The shared nature of the common strategic objectives and the fact that the overall level of performance in 2021 had been strong in most areas resulted in the executive directors achieving the same outturn.

Long-Term Incentive Plan (LTIP) performance

Annual average diluted underlying EPS growth

Outperformance of performance conditions ending on 31 December 2021	Threshold	Maximum	Actual	Percentage of maximum achieved
2021 EPS requirement	46.0p	51.1p	57.8p	
Annual average EPS growth	3%	7%	12.3%	100%

Relative TSR against comparator groups

Outperformance of performance conditions ending on 31 December 2021	Threshold	Maximum	Actual	Percentage of maximum achieved
TSR against sectoral comparator group	28.1%	52.1%	24.7%	0%
TSR against FTSE 100 comparator group	19.6%	76.3%	24.7%	31.6%
Overall vesting against TSR				15.8%

2019 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 2021.

With respect to the 2019 LTIP PS TSR award, the threshold TSR performance was met against the FTSE 100 comparator group and therefore the TSR portion of the award will vest at 15.8%.

With respect to the 2019 LTIP PS^{EPS} award, the vesting outturn has been determined as follows. The 2021 fully diluted underlying EPS, on an EBITA basis consistent with the 2018 EPS, is 50.3p.

As detailed on pages 139 and 140, the Committee continued its practice of reviewing all non-recurring items to determine whether they should be included or excluded in determining the outcome of the EPS performance condition. The Committee therefore applied its agreed principles to make the following judgements. Firstly, in line with the terms of the award and the discretion provided to the Committee, it was agreed that the principle of constant currency should be used on the basis that the calculation of EPS will be adjusted if necessary so that the calculation of the EPS is broadly comparable with that for any other financial period. Second, the Committee chose to exercise its judgement over two items of 'one-off' events (EU State Aid and property disposal), noting that the achievement of stretch vesting required recognition of only one of these items.

Annual remuneration report continued

- **EU State Aid** – A full provision for a tax risk was made in 2019 when the EU contended that the Group had been in receipt of state aid provided illegally by the UK government. Management endeavour achieved a decision that the Group had not been in receipt of state aid and, as a result, in 2021, this provision was credited to profits to offset against the charge made in previous years. The Committee considered this decision to be a fair and appropriate adjustment and encouraged provision recognition when appropriate and rewarded successful outcomes when achieved.
- **Property disposal** – During 2021, management completed a long and demanding negotiation for the sale of property at Filton and Broughton. The Committee regarded this disposal as a significant management achievement and exercised its discretion to include the profit achieved in 2021 earnings in determining the performance outcome.

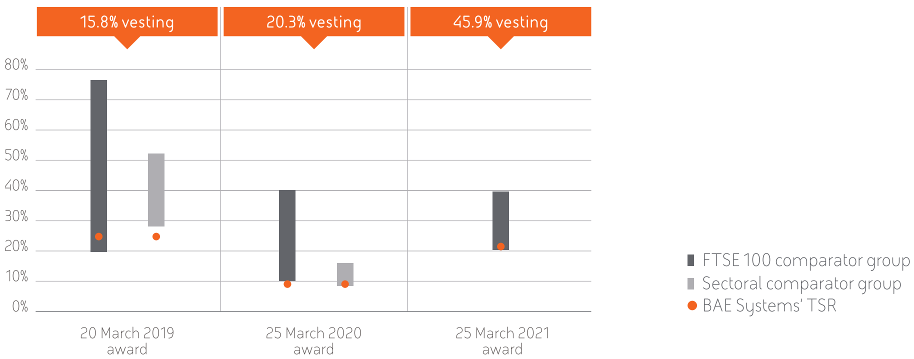
The Committee was therefore satisfied that the performance condition was met and that it was appropriate for vesting at 100% of the EPS portion.

Taking into consideration the overall business performance over the three-year performance period, the Committee believes the vesting outturns for both the TSR and EPS portions of the 2019 awards are appropriate.

A summary of TSR performance to 31 December 2021 on outstanding TSR-related LTIP awards is illustrated in the chart below. The vesting percentage for the 20 March 2019 award is the actual vesting outturn referred to on page 159.

The grey boxes show the range of TSR required for 25% vesting to full vesting in respect of the FTSE 100 and sectoral international defence 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 2021



Pension entitlements

Total pension entitlements

					Figures included in the remuneration table on page 155		
Director	Age	Normal retirement age	Accrued benefit at 1 January 2021[1] £ per annum	Accrued benefit at 31 December 2021[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	50	65	51,457	64,928	n/a	4,000	4,000
Brad Greve	54	65	18,411	24,985	n/a	4,000	4,000
Tom Arseneault	58	65	See notes below		14,143	12,074	26,217

1. Accrued benefit for Charles Woodburn and Brad Greve is the total value of their defined contribution account, including employee contributions and investment returns.

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 £182,200 per annum was paid in 2021 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.

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 (£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 2021	Accrued benefit at 31 December 2021
BAE Systems ERP Qualified Plan – life pension	$39,348 per annum	$39,348 per annum
BAE Systems ERP 2006 Qualified Plan – lump sum	$82,000	$83,000
12/31/2004 BRP Restoration Plan – life pension	$5,283 per annum	$5,283 per annum
2007 BRP – 10-year pension	$108,868 per annum	$109,834 per annum
Section 401(k)	$1,352,745	$1,623,989

Accrued defined benefit for Tom Arseneault is annual pension and lump sum payable at retirement prior to any reduction for early retirement. 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 (2022 $20,500; 2021 $19,500). In 2021, the Company paid contributions of $16,353 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.

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[1] £	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	25.03.21	204,936	92.5% of salary	1,024,475	nil	Three years to 31.12.23	TSR/secondary financial measure	25%
LTIP PS[EFS]	Performance Shares/nil cost option	25.03.21	614,806	277.5% of salary	3,073,415	nil	Three years to 31.12.23	EFS	25%
Brad Greve									
LTIP PS[TSR]	Performance Shares/nil cost option	25.03.21	104,239	83.75% of salary	521,091	nil	Three years to 31.12.23	TSR/secondary financial measure	25%
LTIP PS[EFS]	Performance Shares/nil cost option	25.03.21	312,718	251.25% of salary	1,563,277	nil	Three years to 31.12.23	EFS	25%
Tom Arseneault									
LTIP PS[TSR]	Performance Shares	25.03.21	108,764	74.5% of salary	543,711	n/a	Three years to 31.12.23	TSR/secondary financial measure	25%
LTIP PS[EOS]	Performance Shares	25.03.21	326,290	223.5% of salary	1,631,124	n/a	Three years to 31.12.23	EOS	25%
LTIP RS	Retention	25.03.21	218,987	150% of salary	1,094,716	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.

Key: LTIP – Long-Term Incentive Plan. PS – Performance Shares. RS – Restricted Shares. TSR – Total Shareholder Return. EFS – Earnings per share, Free Cash Flow and Strategic Progress. EOS – Earnings per share, BAE Systems, Inc. Operating Cash Flow and Strategic Progress.

The performance share awards set out above have four performance conditions of EPS, TSR, cash generation and measures reflecting strategic progress with each condition equally weighted at 25%. Further detail on these performance conditions is set out on page 163.

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.

Annual remuneration report continued

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, Restricted Shares and Share Options.

From 2018 executive directors no longer receive share option awards. They are used below executive director level without performance conditions (as detailed on page 146) and are generally exercisable between three and ten years of grant.

LTIP Performance Shares

For 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; EBIT[1]; order book; turnover; risk; and project performance.

1. With effect from 2021, the Group adopted the underlying EBIT profitability measure in place of the previously reported EBITA measure. Further details of this change are provided in the Financial glossary on page 78.

The TSR sectoral comparator group for awards from 2017–2019 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	

For awards granted in 2021, the Company's TSR is measured against a single comparator group of the companies in the FTSE 100 index excluding BAE Systems*.

* As disclosed in the 2020 Annual Report, it was originally intended that the TSR comparator group for the 2021 Performance Share awards would be a defined subset of the FTSE 100 index. At the end of March 2021, awards were granted using such a subset. Following a further review at the May 2021 Committee meeting, the Committee agreed that, for future awards, it would be more appropriate for the comparator group to consist of all the companies within the FTSE 100 index, on the basis that it provided a broader, more stable, durable and relevant group against which to assess relative performance. As only a very short period had elapsed since making the March 2021 Performance Share awards, the Committee agreed it would be appropriate to apply consistency and amended the TSR element of the performance criteria for the 2021 award such that those awards would also be subject to the full FTSE 100 comparator group.

For awards granted from 2021 onwards, four performance conditions of EPS, TSR, cash generation and measures reflecting strategic progress will apply with each condition 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 of the 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; 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. For 2021: 25% vesting for 25bps reduction in 2023 ROCE, 50% vesting for 2023 ROCE consistent with the Integrated Business Plan (IBP) 2020 and 100% vesting for 25bps improvement in 2023 ROCE, with vesting on a straight-line basis between these parameters. For 2022: 25% vesting for 25bps reduction in ROCE compared to 2021, 50% vesting for 2024 ROCE consistent with the IBP 2021 and 100% vesting for 25bps improvement in ROCE compared to 2021, 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. Over the three-year performance period, the selected projects will be measured against their key project milestones. 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, Performance Share awards granted to executive directors are subject to application of reasonableness discretion in light of other important factors in the business.

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.

Annual remuneration report continued

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 2021:

	Initial Value	Subsequent Value	Actual
Charles Woodburn	150%	300%	188%
Brad Greve	100%	200%	51%
Tom Arseneault	212.5%	425%	359%

The actual MSR figures in the table are provided as at 31 December 2021, based on the year-end share price of £5.498.

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 previously, 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 2021 are shown below.

	Post-cessation MSR	Actual
Peter Lynas	100%	308%
Jerry DeMuro	300%	641%

Share interests as at 31 December 2021

The interests of the directors who served during the year ended 31 December 2021 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	–	–	–	–	–	–
N J Anderson	14,000	–	–	–	–	–	–
T A Arseneault	488,758	1,076,041	518,975	–	–	2,028,576	3,623,592
C E Ashby[1]	–	–	–	–	–	–	–
Dame Elizabeth Corley	19,000	–	–	–	–	–	–
Dame Carolyn Fairbairn[2]	15,000	–	–	–	–	–	–
B M Greve	57,938	–	–	838,210	–	–	838,210
J V Griffiths	10,117	–	–	–	–	–	–
C M Grigg	24,555	–	–	–	–	–	–
E M Kirk[3]	–	–	–	–	–	–	–
S T Pearce	10,000	–	–	–	–	–	–
N W Piasecki	–	–	–	–	–	–	–
I P Tyler	–	–	–	–	–	–	–
C N Woodburn	380,328	–	–	2,883,445	–	–	2,883,445

1. Appointed to the Board on 1 September 2021.
2. Appointed to the Board on 1 March 2021.
3. Appointed to the Board on 1 June 2021.

Note: The share options without performance conditions were granted to Tom Arseneault prior to him being appointed as an executive director. Of these options, 1,676,105 are vested but unexercised. The related breakdown of these options is shown on page 166.

The above table has been subject to audit.

The interests of directors include those of their connected persons. Details of the share interests in options and awards held by the executive directors as at 31 December 2021 are given on page 166 together with details of nil-cost options exercised in 2021.

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.

Since 31 December 2021, both Charles Woodburn and Brad Greve have each acquired an additional 74 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 380,402 and 58,012 respectively.

There have been no changes in the interests of the remaining directors in the shares of BAE Systems plc between 31 December 2021 and the date of this report.

Annual remuneration report continued

Breakdown of scheme interests

Charles Woodburn

Options and awards held as at 31 December 2021

	31 December 2021	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS^{EPS}	**44,301**[1]	21.03.17	nil	21.03.22
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**[1]	20.03.19	nil	20.03.24
LTIP PS^{TSR}	**373,737**[4]	25.03.20	nil	25.03.25
LTIP PS^{EPS}	**373,737**[4]	25.03.20	nil	25.03.25
LTIP PS^{TSR}	**204,936**[4]	25.03.21	nil	25.03.26
LTIP PS^{EFS}	**614,806**[4]	25.03.21	nil	25.03.26
	2,883,445			

Performance Shares – nil cost options exercised during 2021

	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	24.03.21	5.00

The Performance Shares nil-cost options exercised by Charles Woodburn attracted notional reinvested dividends which equated to an additional 7,211 shares on exercise of these options.

Brad Greve

Options and awards held as at 31 December 2021

	31 December 2021	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS^{TSR}	**210,626**[4]	25.03.20	nil	25.03.25
LTIP PS^{EPS}	**210,627**[4]	25.03.20	nil	25.03.25
LTIP PS^{TSR}	**104,239**[4]	25.03.21	nil	25.03.26
LTIP PS^{EFS}	**312,718**[4]	25.03.21	nil	25.03.26
	838,210			

Tom Arseneault

Options and awards held as at 31 December 2021

	31 December 2021	Date of grant	Exercise price £	Date from which exercisable or part exercisable
LTIP PS^{EPS}	**21,864**[1]	21.03.17	n/a	21.03.22
LTIP PS^{EPS}	**21,991**[1]	20.03.18	n/a	20.03.22
LTIP PS^{TSR}	**86,572**[3]	20.03.19	n/a	20.03.22
LTIP PS^{EPS}	**86,572**[1]	20.03.19	n/a	20.03.22
LTIP PS^{TSR}	**211,994**[4]	25.03.20	n/a	25.03.23
LTIP PS^{EPS}	**211,994**[4]	25.03.20	n/a	25.03.23
LTIP PS^{TSR}	**108,764**[4]	25.03.21	n/a	25.03.24
LTIP PS^{EOS}	**326,290**[4]	25.03.21	n/a	25.03.24
	1,076,041			
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	**86,572**	20.03.19	n/a	20.03.22
LTIP RS	**213,416**	25.03.20	n/a	25.03.23
LTIP RS	**218,987**	25.03.21	n/a	25.03.24
	518,975			

Note: The share options granted to Tom Arseneault between 2013–2019 as set out above were granted prior to him being appointed as an executive director and do not have performance conditions attached to them. Options are normally exercisable between the third and tenth anniversary of their grant. Share options granted to him from 2015 onwards are subject to a two-year clawback period after the initial three-year vesting period.

Note: As reported in the Remuneration Committee Chair's report in the 2020 Annual Report, in light of the volatility in the market during March 2020, the Committee attached an additional condition to the 2020 awards to retain the ability to exercise discretion to ensure that the value of the 2020 awards at vesting is appropriate. As reported in the Remuneration Committee Chair's report on page 140, a similar condition was applied to the 2021 awards in light of volatility in the market in March 2021.

The tables above have been subject to audit.

Performance conditions for the LTIP are detailed on page 162.

1. Subject to a performance condition that has been met.
2. All shares due to vest subject to agreed terms.
3. The outstanding award or option will partially lapse after the end of the financial year having not met the full performance condition.
4. Subject to a performance condition that is yet to be tested.

Remuneration Committee composition and advisers

The Committee members comprise Ian Tyler (Chair), Dame Carolyn Fairbairn, Dame Elizabeth Corley and Chris Grigg. Dame Carolyn Fairbairn joined the Committee on 1 October 2021 and will succeed Ian Tyler as Chair with effect from the close of the Company's AGM on 5 May 2022, when Ian Tyler retires from the Board. Advisers to the Remuneration Committee are shown below.

During the year under review, the Committee received material assistance and advice on remuneration policy from the Group Human Resources Director, Karin Hoeing and the Human Resources Director, Reward, 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.	£77,879 Fee basis: Fixed fee/ hourly
	Provides support in relation to assessing the TSR performance updates and vesting outcomes for in-flight awards granted under the BAE Systems Long-Term Incentive Plan 2014.	By the Company.	The nature of the advice provided to the Committee is based on factual information concerning the performance of the Company's shares relative to the chosen peer group(s).	£13,000 Fee basis: Fixed fee
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.	£37,677 Fee basis: Hourly
Aon	Until April 2021, provided advice 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.	£9,900 Fee basis: Fixed fee

Preface to the
Directors' remuneration policy

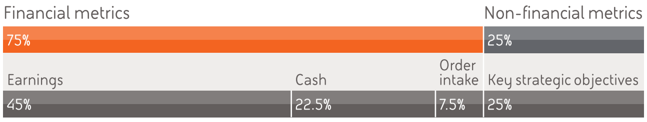
The Directors' remuneration policy (the Policy) set out on pages 169 to 183 was agreed by shareholders at the Annual General Meeting on 7 May 2020 and took legal effect on that date. The approved policy has been printed verbatim from the 2019 Annual Report, updated only so that the page numbers, where appropriate, refer to the 2021 Annual Report in order to aid readability, and to report subsequent Board membership changes.

Directors' remuneration for 2022

For 2022, 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 2022.

Metrics and weightings applicable in 2022

– The performance metrics and weightings applicable to the 2022 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. The remaining 25% is measured on shared key strategic objectives relating to the delivery of the Group's strategy including objectives specifically focused on our sustainability agenda, and the demonstration of leadership behaviours. The safety and diversity underpin to the non-financial element of executive directors' bonus will remain, with the requirement to uphold and deliver our commitment to high standards of safety and a diverse and inclusive workforce. The following metrics and weightings will apply for 2022:



– 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.

– Performance shares will continue to be measured over a three-year period against cumulative cash generation, a metric reflecting strategic progress, Earnings per Share (EPS) and relative Total Shareholder Return (TSR), 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 the FTSE 100 index constituents, 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 2022 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 2022:

– 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 against the operating cash flow of BAE Systems, Inc., strategic progress and EPS metrics set out above, each with equal weighting.

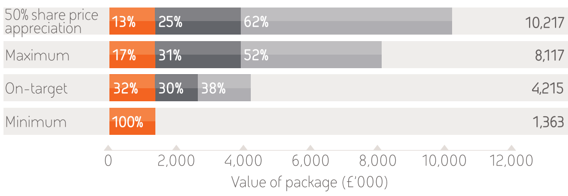
Illustration of application of policy for 2022

The following charts show the value of the package each of the executive directors would receive based on 2022 base salaries, remuneration and 2022 LTI awards assuming the following scenarios:

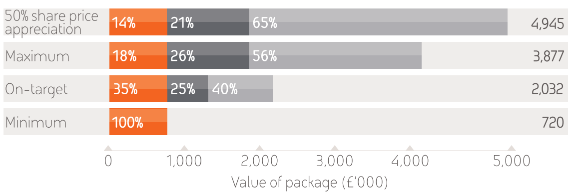
1. minimum fixed pay (including salary, benefits and pension as provided in the single total figure table on page 155), and the Restricted Shares award for the US executive director;
2. pay receivable assuming on-target performance is met;
3. maximum pay assuming all variable elements pay out in full; 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 178). The charts below are reporting the remuneration levels for 2022.

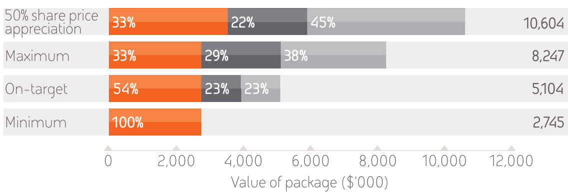
Chief Executive (£'000)



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 173, 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.

Contents

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.

Directors' remuneration policy continued

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 177 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 177 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 177.

Directors' remuneration policy continued

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 162 and 163.
- 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 177.

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 177.

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 155. 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

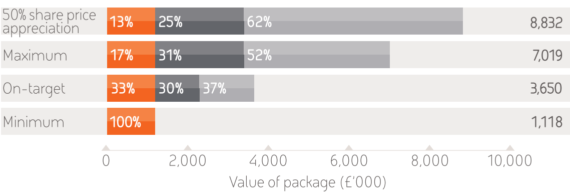
The charts below show the value of the package each of the executive directors would receive in the first year of operation of the Policy. No illustration of Remuneration Policy is shown for Peter Lynas (current Group Finance Director) and Jerry DeMuro (current Chief Executive Officer of BAE Systems, 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:

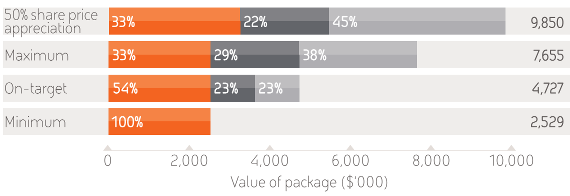
- minimum fixed pay includes salary, benefits and pension as provided in the single figure table on page 118 of the 2019 Annual Report and Restricted Shares award for the US executive director awarded at 150% salary (excluding share price growth);
- on-target pay assumes on-target performance is met 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.

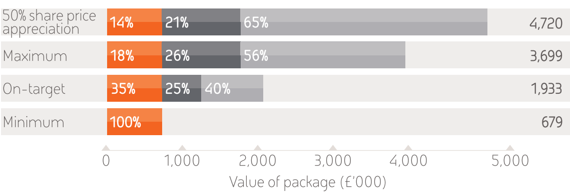
Chief Executive (£'000)



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 179.

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 176.

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 175.

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
Crystal Ashby[3]	01.09.2021	31.08.2024
Dame Elizabeth Corley	01.02.2016	31.01.2025
Dame Carolyn Fairbairn[4]	01.03.2021	29.02.2024
Jane Griffiths[5]	01.04.2020	31.03.2023
Chris Grigg	01.07.2013	04.05.2023
Ewan Kirk[6]	01.06.2021	31.05.2024
Stephen Pearce	01.06.2019	31.05.2025
Nicole Piasecki	01.06.2019	31.05.2025
Paula Rosput Reynolds[7]	01.04.2011	31.12.2020
Nick Rose[7]	08.02.2010	31.12.2020
Ian Tyler	08.05.2013	05.05.2022

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 September 2021.
4. Appointed to the Board on 1 March 2021.
5. Appointed to the Board on 1 April 2020.
6. Appointed to the Board on 1 June 2021.
7. Retired from the Board on 31 December 2020.

The Company announced on 20 October 2021 that Ian Tyler would retire from the Board at the conclusion of the 2022 Annual General Meeting to be held on 5 May 2022.

Directors' remuneration policy continued

Service contracts and letters of appointment continued

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.

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 2021 financial year are listed on pages 115 to 117. Dame Carolyn Fairbairn, Ewan Kirk and Crystal Ashby were appointed to the Board as non-executive directors on 1 March, 1 June and 1 September 2021, respectively.

On 20 October 2021 the Company announced that Ian Tyler would retire from the Board at the conclusion of the Company's Annual General Meeting on 5 May 2022.

Dividend

An interim dividend of 9.9p per share was paid on 30 November 2021. The directors propose a final dividend of 15.2p per ordinary share. Subject to shareholder approval, the final dividend will be paid on 1 June 2022 to shareholders on the share register on 22 April 2022.

Annual General Meeting (AGM)

The Company's AGM will be held on 5 May 2022.

Certain information in the Strategic report

The following items are set out in the Strategic report on pages 1 to 113:

- 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);
- fostering business relationships with suppliers, customers and others; and
- policy in relation to employment of disabled persons.

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 29 July 2021, the Group made the following statement in respect of the year ending 2021, 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 Annual Report 2020):

"Whilst the Group is subject to geopolitical uncertainties and there remain uncertainties arising from the COVID-19 pandemic, progress continues in combatting the virus under the vaccination programme in our major markets and our good operational performance underlines our overall confidence in the full year guidance. Our full year guidance, issued earlier this year, was provided on the basis of an exchange rate of $1.35:£1. Our results for the first half year have been reported at an average rate of $1.39:£1.

"Given the strong operational performance to date, we continue to expect reported underlying EBIT to increase in the range of 6% to 8% over 2020 and underlying EPS to increase in the range of 3% to 5% over 2020, even if the higher than guided $:£ exchange rate continues to year-end."

In the Group's Market Update on 8 November 2021, the Group clarified that the Underlying EPS forecast "Excludes the one-off tax benefit of 2.9p".

Underlying EBIT was £2,205m in 2021. Underlying earnings per share was 47.8p in 2021, excluding the one-off tax benefit of 2.9p.

Political donations

No political donations were made in 2021.

Issued share capital

As at 31 December 2021, BAE Systems' issued share capital of £85,092,881 comprised 3,404,167,171 ordinary shares of 2.5p each and one Special Share of £1.

Share buyback

During the year, 65,124,972 ordinary shares of 2.5p each were repurchased under the buyback programme of up to £500m announced on 29 July 2021 and such repurchased shares have been cancelled. The total consideration for the purchase of the shares, including commission and stamp duty, was £371,035,840. The percentage of called up share capital (excluding treasury shares) as at 31 December 2021, which the shares repurchased in 2021 represents, is 2.06%.

Treasury shares

As at 1 January 2021, 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). During 2021, the Company used 12,188,518 treasury shares (having a total nominal value of £304,713 and representing 0.4% of the Company's called up share capital at 31 December 2021) to satisfy awards under the Free and Matching elements of the Share Incentive Plan (6,880,958 shares in aggregate), awards under the Free and Matching elements of the International Share Incentive Plan (773,801 shares in aggregate), awards vested under the Performance Shares element of the Long-Term Incentive Plan (2,415,958 shares), awards vested under the Restricted Shares element of the Long-Term Incentive Plan (1,704,288 shares), and options exercised under the Executive Share Option Plan (413,513 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 413,513 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 £1,637,002. As at 31 December 2021, the number of shares held in treasury totalled 236,807,031 (having a total nominal value of £5,920,176 and representing 7.0% of the Company's called up share capital at 31 December 2021).

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 2021, 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
Barclays PLC	3.98%
BlackRock, Inc.	9.90%
The Capital Group Companies, Inc.	5.02%
Invesco Limited	4.97%
Silchester International Investors LLP	3.01%
Veritas Asset Management LLP[1]	4.62%

1. The Company was notified on 28 January 2022 that Veritas Asset Management LLP's percentage had increased to 5.01%.

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.

Statutory and other information continued

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 2022 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 2021 AGM, the directors were given the power to buy back a maximum number of 322,018,538 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.

This power will expire at the earlier of the conclusion of the 2022 AGM or 30 June 2022. A special resolution will be proposed at the 2022 AGM to renew the Company's authority to acquire its own shares.

At the 2021 AGM, the directors were given the power to issue new shares up to a nominal amount of £26,832,194. This power will expire on the earlier of the conclusion of the 2022 AGM or 30 June 2022. Accordingly, a resolution will be proposed at the 2022 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 2021 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 27 October 2021. 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 2021.
- 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 FMSP Ships Engineering Management and Delivery agreement between BAE Systems Surface Ships Limited and the MoD was entered into on 31 March 2021 for the provision of surface ship engineering management and delivery 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 agreement.
- 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. The MASS agreement terminates on 31 December 2022 and is replaced by NGMS.
- 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 or BAE Systems Australia Limited, 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 June 2021, BAE Systems Australia Limited entered into a contract providing the framework for the provision of in-service support for the Hawk aircraft until June 2031. If there is a change of control of BAE Systems Australia Limited or BAE Systems plc without consent from the Australian Commonwealth Government, the Australian Commonwealth may terminate the contract.

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.

Statutory and other information continued

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 2022 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 UK (IFRS) 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
Crystal Ashby	Non-executive director
Dame Elizabeth Corley	Non-executive director
Dame Carolyn Fairbairn	Non-executive director
Jane Griffiths	Non-executive director
Chris Grigg	Non-executive director
Ewan Kirk	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
23 February 2022

Directors' report

The Directors' report was approved by the Board of directors on 23 February 2022.

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 2021 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards;
- 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, United Kingdom adopted international accounting standards. 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 we have not provided any non-audit services prohibited by the FRC's Ethical Standard 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:

^ 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 £82.5m which was determined on the basis of forecast adjusted profit before tax, adjusted for non-recurring items as well as fair value and foreign exchange adjustments on financial instruments, as described further in section 6 below.

Scoping

Thirty-one components were subject to audit procedures. Of these, six components were subject to a full-scope audit. Of the remaining twenty-five components, twenty-one were subject to an audit of specified account balances and four were subject to specified audit procedures.

The components, which were either subject to a full-scope audit or audit of specified account balances, contribute 87% of revenue, 84% of profit before tax and 92% of total assets. The remaining components were subject to other procedures, including conducting analytical reviews, making enquiries and evaluating and testing management's group-wide controls.

Significant changes in our approach

There have been no significant changes in our approach from the prior year.

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:

- obtaining an understanding of relevant controls over management's going concern models, including the review of the inputs and assumptions used in those models;
- testing the accuracy of management's models, including agreement to the most recent board approved budgets and forecasts;
- challenging 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;
  - evaluating the historical accuracy of forecasts prepared by management;
  - assessing the sensitivity of the headroom and management's forecasts; and
- assessing the sufficiency of the Group's disclosure concerning the going concern basis.

Independent Auditor's report continued

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 V

Refer to page 129 (Audit Committee report) and Note 1 (accounting policy and financial disclosures)

Revenue:
£19,521m (2020: £19,277m)

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 requires 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 represent 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, the results of prior audits and review of external information about market and geopolitical conditions which might impact certain contracts. We held meetings with key finance and contract managers, attended quarterly business review meetings and other key management meetings, read and understood underlying contract documentation and obtained 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, including any potential climate-related risks.

As a result of our risk assessment we identified two contracts where we consider there to be the highest degree of management judgement required in estimating the outturn margin position. These are:

– Type 26 frigates; and
– Armored Multi-Purpose Vehicles (AMPV).

We consider the level of risk associated with this key audit matter has decreased from the prior year as a result of the reduced number of contracts identified with a higher degree of management judgement.

How the scope of our audit responded to the key audit matter

Our contract testing approach included:

Testing the relevant controls

– We obtained an understanding of and 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

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;
– 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. 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 assess the timeframe for delivery of the product or service and any judgements made in respect of these;
– examining external evidence to assess contract status and estimation of variable consideration (including associated recoverability of contract balances), such as customer correspondence and for certain contracts or meeting with the customer directly;
– enquiring with in-house and external legal counsel regarding contract related litigation and claims;
– considering whether there were any indicators of management override of controls or bias in arriving at their reported position; and
– conducting production site visits to inform our challenge of the cost to complete estimate and understanding of contract status.

Key observations

The results of our testing were satisfactory.

Through our testing of those contracts with the highest degree of management judgement 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 V

Refer to page 129 (Audit Committee report) and Note 8 (accounting policy and financial disclosures)

Goodwill:
£10,910m (2020: £10,846m)

Key audit matter description

The Group holds material goodwill balances, 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 each 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') and Land Munitions ('Munitions') CGUs. These CGUs have goodwill of £3,358m and £427m respectively.

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 Munitions Systems business; 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 these key cash flow assumptions for each of these CGUs.

Specifically, in relation to Munitions, there is a lower level of headroom between the recoverable amount and its carrying value and as such we have identified there to be a higher level of risk of material impairment, which we have pinpointed to the long-term revenue growth assumptions.

In addition, for P&S, the headroom between recoverable and carrying amount remains highly sensitive to changes in long-term growth rate and margin assumptions, particularly in the Combat Munitions Systems business.

In comparison to the prior year there has been an improvement in the headroom of the Munitions business and a reduction in the number of CGUs deemed to have a heightened level of impairment risk. As such, the overall level of risk has reduced.

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 relevant controls for performing the CGU impairment assessment. Specific focus was given to understanding management's process and relevant 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 and external industry benchmarks. 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 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;
- 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;
- operating cash flow and working capital assumptions were challenged, including the impact of climate change-related risks, 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 and Munitions businesses and are satisfied that management's assumptions are reasonable and supportable based on available evidence, both internal and external.

Management has concluded that no reasonably possible change in a key assumption would lead to impairment and we concur with that conclusion.

5.3. Valuation of post-employment benefit obligations ≈

Refer to page 129 (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:
£2,124m (2020: £4,485m)

Valuation of post-employment benefit obligation assets before allocation to equity accounted investments:
£31,580m (2020: £29,729m)

Valuation of post-employment benefit obligation liabilities before allocation to equity accounted investments:
£33,866m (2020: £34,574m)

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 for the UK schemes, including the basis for determining the inflation risk premium;
- discount rates; and
- mortality assumptions.

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.

Independent Auditor's report continued

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.

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;
- we gave specific focus to challenging the basis on which the Group determined the inflation rate actuarial assumptions for the UK and US Schemes, with reference to our own independent modelling and other market data sources;
- we considered the adjustment made by management to the CMI 2020 mortality tables to apply a weighting factor to reflect its assessment of the potential Covid-19 mortality impact, with reference to advice the Company has received from its actuaries;
- we assessed the relevant control environment of the third party administrators who maintain membership data on behalf of the Group through review of their ISAE 3402 controls reporting, including considering and responding to any findings therein;
- 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; 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 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 concluded our testing of the assets and are satisfied that 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	£82.5m (2020: £72.5m)	£39.5m (2020: £44.0m)
Basis for determining materiality	4.7% of adjusted profit before tax of £1,769m (2020: 4.5% of adjusted profit before tax of £1,618m). This includes an adjustment for non-recurring items of £346m relating to property and business disposals and £5m of fair value adjustments and foreign exchange movements on financial instruments detailed in notes 1 and 5 of the financial statements.	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 we consider are one-off in nature 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 equates to 3.9%.	This represents 1% of the Parent Company net assets. 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 component materiality levels between £20.4m and £31.7m (2020: £15.0m and £30.6m).	

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.

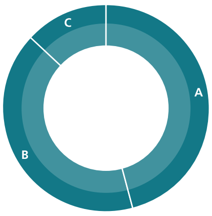
	Group financial statements	Parent Company financial statements
Performance materiality	70% (2020: 65%) of Group materiality	70% (2020: 70%) of Parent Company materiality
Basis and rationale for determining performance materiality	In determining performance materiality for the Group, we considered the 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; – our risk assessment, including our assessment of the overall control environment; and – the size and nature of the contract-based significant risks of material misstatement identified. In the prior year a judgemental reduction was made to the percentage applied to allow for uncertainties associated with Covid-19 in the operation of the Group's controls. Now the impact on the business is well understood, we have reverted to our pre-existing level of performance materiality.	In determining performance materiality for the Parent Company, 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; and – our risk assessment, including our assessment of the overall control environment.

6.3. Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £4.125m (2020: £3.625m), 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.

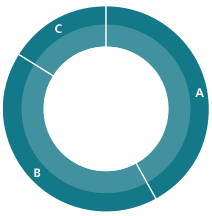
Independent Auditor's report continued

Revenue



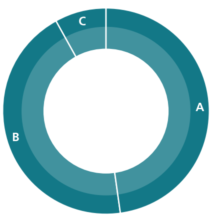
A	Full scope	46%
B	Specified account balances	41%
C	Specified audit procedures and review at the Group level	13%

Profit before tax



A	Full scope	42%
B	Specified account balances	42%
C	Specified audit procedures and review at the Group level	16%

Total assets



A	Full scope	48%
B	Specified account balances	44%
C	Specified audit procedures and review at the Group level	8%

7. An overview of the scope of our audit

7.1. Identification and scoping of components

We performed our scoping of the Group audit by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the audit risks. This exercise 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 considered to be present.

We 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 assessed 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, Matra BAE Dynamics Alenia ("MBDA").

Additionally, our audit planning identified twenty-five non-financially significant components, located in the UK, Saudi Arabia, Australia and the US, where we considered there to be a reasonable possibility of material misstatement in specific balances within the financial statements. We directed these 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 risk of material misstatement in the residual population.

As each of the business units maintains separate financial records, we 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 allowed 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 engaged with the entity's non-Deloitte auditors to perform a full-scope audit under our direction and supervision.

The twenty-seven 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.

In the current year our controls approach was principally designed to inform our risk assessment and also to allow us to test the operating effectiveness of certain relevant revenue controls. We also assessed relevant general IT controls. The Group continues to invest in its IT systems and there is an ongoing programme of remediating any 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 129. Where deficiencies have been identified and the remediation activity remained ongoing during the current year, or the remediated controls were not in place for a sufficient enough period prior to the year-end, 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 obtain an understanding of, and test, relevant 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 for risk assessment purposes.

We also considered head office controls relating to central balances and processes such as pension accounting, consolidation and financial reporting, treasury, tax 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. Our consideration of climate-related risks

As highlighted in management's Task Force on Climate-related Financial Disclosures (TCFD) on page 38 and the principal risks on page 112, the Group is exposed to the impacts of climate change on its business and operations. We considered the risks associated with climate change when determining our scope and audit approach. In particular, we pinpointed potential risks associated with climate change to revenue recognition on long term programmes and goodwill impairment, as described in the key audit matters in sections 5.1 and 5.2 above. Our consideration of climate related risks also extended to our work in respect of going concern and long term viability.

7.4. Working with other auditors

Our oversight of component auditors included directing the planning of their audit work and understanding their risk assessment process to identify key areas of estimates and judgement, as well as the supervising 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 led by the Group audit team. Visits to meet with certain component teams in the UK and Saudi Arabia were conducted and we mitigated our inability to visit other 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 Defence 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, in order to have appropriate oversight of the US component team.

In addition to the work performed by other auditors, 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 subject only to audit of specified account balances. We also perform audit procedures on centrally managed balances including treasury, post-employment benefit obligations, litigation and claims, goodwill, tax and head office costs.

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.

Independent Auditor's report continued

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 appropriate, 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 7.2, we sought to gain an understanding of the ongoing impact of Covid-19 on the risk of management override of controls, including the impact of evolving working practices 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.

John Adam
Senior Statutory Auditor

For and on behalf of
Deloitte LLP Statutory Auditor

London, United Kingdom
23 February 2022

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 123;
- 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 122;
- the directors' statement on fair, balanced and understandable set out on page 132;
- the board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 122;
- the section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on page 122; and
- the section describing the work of the Audit Committee set out on page 129.

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 four years covering the years ending 31 December 2018 to 31 December 2021.

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.

In due course, as required by the Financial Conduct Authority (FCA) Disclosure Guidance and Transparency Rule (DTR) 4.1.14R, these financial statements will form part of the European Single Electronic Format (ESEF) prepared Annual Financial Report filed on the National Storage Mechanism of the UK FCA in accordance with the ESEF Regulatory Technical Standard ('ESEF RTS'). This auditor's report provides no assurance over whether the annual financial report has been prepared using the single electronic format specified in the ESEF RTS.

Financial statements

Group accounts

Company accounts

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 123, and in accordance with UK-adopted 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 established the UK Endorsement Board (UKEB) in order to endorse and adopt international accounting standards issued by the International Accounting Standards Board (IASB) for use by UK companies. In the interim period between the end of the transition period and the UKEB becoming operational, some standards and amendments were adopted by the Secretary of State for Business, Energy and Industrial Strategy. For the year ended 31 December 2020, the Group continued to apply EU-adopted IFRS. From 1 January 2021, the Group has prepared consolidated financial statements in accordance with UK-adopted IFRS, which has not differed from the EU-adopted 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.

Key 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 significant, and its uncertain nature means this may continue as governments continue to respond. While the Group has addressed the impact on its business effectively to date, given the ongoing risks and uncertainties, it continues to conduct ongoing risk assessments and scenario planning in order that it can respond to potential rapid changes in circumstances. The Group will therefore 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:

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. 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, global supply chain issues, volatility in global gas and energy prices, and the ongoing response to climate change, have 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 potential future impact of the current uncertainties, the Group's estimates and assumptions related to revenue recognition could be impacted by issues such as reduced productivity as a result of operational disruption or 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, changing working practices to move towards net zero, 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 (2020 £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, however may not reflect the full potential impact on the contract receivables and contract liabilities balances.	1

Post-employment benefit obligations	A number of actuarial assumptions are made in assessing the value of post-employment benefit obligations, including discount rate, inflation rate, and mortality assumptions. For each of the actuarial assumptions used there is a wide range of possible values and management estimates a point within that range that most appropriately reflects the Group's circumstances. If estimates relating to these actuarial assumptions are no longer valid or change due to changing economic and social conditions, which could be impacted by the longer-term implications of the COVID-19 pandemic, then the potential obligations due under these schemes could change significantly. 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. Similarly, the values of many assets are subject to estimates and assumptions, in particular those which are held in unquoted pooled investment vehicles. The associated fair value of these unquoted pooled investments is estimated with consideration of the most recently available valuations provided by the investment or fund managers. These valuations inherently incorporate a number of assumptions including the risk associated with the COVID-19 pandemic and the impact of climate change on the underlying investments. The overall level of estimation uncertainty in valuing these assets could therefore give rise to a material change in valuation within the next 12 months. Note 24 provides information on the key assumptions and analysis of their sensitivities.	24

In preparing the consolidated financial statements management has considered the potential impact of climate change, in the context of the disclosures included in the Strategic report this year and the Group's net zero targets. These considerations did not have a material impact on the financial reporting judgements and estimates. The following additional areas of estimation were considered in reaching this conclusion:

- estimates of future cash flows to support impairment assessments of the carrying value of non-current assets and the assessment of going concern and the longer-term viability of the Group;
- an assessment of the useful economic lives of assets; and
- potential climate-related impacts on the Group's environmental provisions, in particular with regard to legislative changes.

Critical 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 critical 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.

Changes in accounting policies

The following standards, interpretations and amendments to existing standards became effective on 1 January 2021 and have not had a material impact on the Group:

- Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16: Interest Rate Benchmark Reform (Phase 2), effective from 1 January 2021; and
- Amendments to IFRS 4 Insurance Contracts: deferral of IFRS 9, effective from 1 January 2021.

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 beyond 30 June 2021, effective from 1 April 2021 and adopted by the UK Secretary of State for Business, Energy and Industrial Strategy on 21 May 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 2021. These are expected to be endorsed by the UK Endorsement Board 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 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 8: Accounting Policies, Changes in Accounting Estimates and Errors, effective from 1 January 2023 (not yet endorsed by the UK);
- Amendments to IAS 12: Income Taxes, effective from 1 January 2023 (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).

Preparation of the consolidated financial statements continued

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	2021 £m	2021 Total £m	2020 £m	2020 Total £m
Continuing operations					
Revenue	1		**19,521**		19,277
Operating costs	2		**(17,743)**		(17,686)
Other income	4		**472**		270
Share of results of equity accounted investments	1		**139**		69
Operating profit	1		**2,389**		1,930
Financial income		**32**		17	
Financial expense		**(311)**		(351)	
Net finance costs	5		**(279)**		(334)
Profit before taxation			**2,110**		1,596
Taxation expense	6		**(198)**		(225)
Profit for the year			**1,912**		1,371
Attributable to:					
Equity shareholders			**1,758**		1,299
Non-controlling interests			**154**		72
			1,912		1,371
Earnings per share	7				
Basic earnings per share			**55.2p**		40.7p
Diluted earnings per share			**54.7p**		40.5p

Consolidated statement of comprehensive income for the year ended 31 December

	Notes	2021 Other reserves[1] £m	2021 Retained earnings £m	2021 Total £m	2020 Other reserves[1] £m	2020 Retained earnings £m	2020 Total £m
Profit for the year		**–**	**1,912**	**1,912**	–	1,371	1,371
Other comprehensive income							
Items that will not be reclassified to the income statement:							
Consolidated:							
Remeasurements on post-employment benefit schemes		**–**	**2,451**	**2,451**	–	(1,361)	(1,361)
Tax on items that will not be reclassified to the income statement	6	**–**	**(394)**	**(394)**	–	330	330
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method (net of tax)		**–**	**64**	**64**	–	(55)	(55)
Items that may be reclassified to the income statement:							
Consolidated:							
Currency translation on foreign currency net investments		**32**	**–**	**32**	(224)	–	(224)
Reclassification of cumulative currency translation reserve on disposal of subsidiary	19	**(9)**	**–**	**(9)**	(35)	–	(35)
Fair value gain arising on hedging instruments during the period		**11**	**–**	**11**	46	–	46
Cumulative fair value (gain)/loss on hedging instruments reclassified to the income statement		**(32)**	**–**	**(32)**	42	–	42
Tax on items that may be reclassified to the income statement	6	**4**	**–**	**4**	(16)	–	(16)
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method (net of tax)		**(4)**	**–**	**(4)**	(3)	–	(3)
Total other comprehensive income for the year (net of tax)		**2**	**2,121**	**2,123**	(190)	(1,086)	(1,276)
Total comprehensive income for the year		**2**	**4,033**	**4,035**	(190)	285	95
Attributable to:							
Equity shareholders		**(3)**	**3,882**	**3,879**	(176)	213	37
Non-controlling interests		**5**	**151**	**156**	(14)	72	58
		2	**4,033**	**4,035**	(190)	285	95

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 2021		87	1,249	5,923	(2,616)	4,643	278	4,921
Profit for the year		–	–	–	1,758	1,758	154	1,912
Total other comprehensive income for the year		–	–	(3)	2,124	2,121	2	2,123
Total comprehensive income for the year		–	–	(3)	3,882	3,879	156	4,035
Share-based payments (inclusive of tax)	31	–	–	–	94	94	–	94
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)		–	–	(35)	–	(35)	–	(35)
Ordinary share dividends	26	–	–	–	(777)	(777)	(202)	(979)
Purchase of own shares	26	(2)	–	2	(371)	(371)	–	(371)
Unclaimed assets programme proceeds		–	3	–	–	3	–	3
At 31 December 2021		**85**	**1,252**	**5,887**	**212**	**7,436**	**232**	**7,668**
Balance at 1 January 2020		87	1,249	6,156	(2,085)	5,407	104	5,511
Profit for the year		–	–	–	1,299	1,299	72	1,371
Total other comprehensive income for the year		–	–	(176)	(1,086)	(1,262)	(14)	(1,276)
Total comprehensive income for the year		–	–	(176)	213	37	58	95
Share-based payments (inclusive of tax)	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

1. An analysis of other reserves is provided in note 26.

Consolidated balance sheet as at 31 December

	Notes	2021 £m	2020 £m
Non-current assets			
Intangible assets	8	**11,716**	11,745
Property, plant and equipment	9	**2,852**	2,655
Right-of-use assets	10	**1,091**	1,053
Investment property	11	**67**	128
Equity accounted investments	12	**554**	409
Other investments		**76**	–
Other receivables	13	**551**	506
Post-employment benefit surpluses	24	**483**	408
Other financial assets	14	**305**	248
Deferred tax assets	15	**622**	972
	20	**18,317**	18,124
Current assets			
Inventories	16	**811**	858
Trade, other and contract receivables	13	**4,825**	5,491
Current tax	17	**71**	6
Other financial assets	14	**194**	189
Cash and cash equivalents	18	**2,917**	2,768
Assets held for sale	19	**–**	94
		8,818	9,406
Total assets		**27,135**	27,530
Non-current liabilities			
Loans	21	**(4,604)**	(4,957)
Lease liabilities	10	**(1,083)**	(1,020)
Contract liabilities	22	**(519)**	(524)
Other payables	23	**(1,248)**	(1,164)
Post-employment benefit obligations	24	**(2,607)**	(4,893)
Other financial liabilities	14	**(302)**	(282)
Deferred tax liabilities	15	**(77)**	–
Provisions	25	**(331)**	(386)
		(10,771)	(13,226)
Current liabilities			
Loans and overdrafts	21	**(457)**	(467)
Lease liabilities	10	**(212)**	(236)
Contract liabilities	22	**(2,874)**	(3,238)
Trade and other payables	23	**(4,636)**	(4,898)
Other financial liabilities	14	**(214)**	(181)
Current tax	17	**(27)**	(72)
Provisions	25	**(276)**	(291)
		(8,696)	(9,383)
Total liabilities		**(19,467)**	(22,609)
Net assets		**7,668**	4,921
Capital and reserves			
Issued share capital	26	**85**	87
Share premium		**1,252**	1,249
Other reserves	26	**5,887**	5,923
Retained earnings/(deficit)		**212**	(2,616)
Total equity attributable to equity holders of BAE Systems plc		**7,436**	4,643
Non-controlling interests		**232**	278
Total equity		**7,668**	4,921

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

C N Woodburn
Chief Executive

B M Greve
Group Finance Director

Consolidated cash flow statement for the year ended 31 December

	Notes	2021 £m	2020 £m
Profit for the year		**1,912**	1,371
Taxation expense	6	**198**	225
Adjustment in respect of research and development expenditure credits	4	**(16)**	(28)
Share of results of equity accounted investments	1	**(139)**	(69)
Net finance costs	5	**279**	334
Depreciation, amortisation and impairment	2	**720**	675
Gain on investment revaluation	4	**–**	(6)
Profit on disposal of property, plant and equipment, and investment property	2,4	**(192)**	(25)
Profit on sale and leaseback	4	**–**	(21)
(Gain)/loss in respect of held for sale assets and business disposals	2,4	**(158)**	5
Cost of equity-settled employee share schemes		**92**	74
Movements in provisions		**(66)**	(30)
Difference between pension funding contributions paid and the pension charge		**(18)**	(1,396)
(Increase)/decrease in working capital:			
Inventories		**54**	24
Trade, other and contract receivables		**610**	–
Trade and other payables, and contract liabilities		**(615)**	122
Research and development expenditure credits – cash received		**20**	162
Taxation paid		**(234)**	(251)
Net cash flow from operating activities		**2,447**	1,166
Dividends received from equity accounted investments	12	**57**	27
Interest received		**23**	19
Principal element of finance lease receipts		**10**	10
Purchase of property, plant and equipment, and investment property		**(366)**	(385)
Purchase of intangible assets		**(96)**	(92)
Purchase of non-current other investments		**(15)**	–
Proceeds from sale of property, plant and equipment, and investment property		**271**	68
Proceeds from sale of non-current other investments		**–**	19
Equity accounted investment funding	12	**(3)**	(2)
Purchase of subsidiary undertakings, net of cash and cash equivalents acquired	34	**(30)**	(1,706)
Cash flow in respect of held for sale assets and business disposals, net of cash and cash equivalents disposed	19	**215**	5
Net cash flow from investing activities		**66**	(2,037)
Interest paid		**(247)**	(227)
Equity dividends paid	26	**(777)**	(746)
Purchase of own shares	26	**(368)**	–
Dividends paid to non-controlling interests		**(202)**	(19)
Partial disposal of shareholding in subsidiary undertaking		**28**	27
Principal element of lease payments		**(217)**	(236)
Cash inflow from derivative financial instruments (excluding cash flow hedges)		**61**	59
Cash outflow from derivative financial instruments (excluding cash flow hedges)		**(149)**	(43)
Cash flow from movement in cash collateral		**(18)**	(2)
Cash inflow from loans		**–**	2,666
Cash outflow from repayment of loans		**(367)**	(506)
Net cash flow from financing activities	28	**(2,256)**	973
Net increase in cash and cash equivalents		**257**	102
Cash and cash equivalents at 1 January		**2,667**	2,587
Effect of foreign exchange rate changes on cash and cash equivalents		**(7)**	(22)
Cash and cash equivalents at 31 December		**2,917**	2,667
Comprising:			
Cash and cash equivalents		**2,917**	2,768
Overdrafts		**–**	(101)
Cash and cash equivalents at 31 December		**2,917**	2,667

Notes to the 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.

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 which are reliant on the knowledge and experience of the Group's project managers, engineers, and finance and commercial professionals. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events and circumstances.

The Group typically enters into the following types of contracts with customers:

- to design, build or create assets uniquely available to the customer such as ships and aircraft;
- to service or maintain assets over a period of time;
- to give access to software and licences; and
- to offer bespoke services to customers, for example through training or the offering of cyber, intelligence and security capabilities.

Revenue is recognised against each of these types of contracts in line with the following accounting policies.

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. When cash is received in advance of goods or services being delivered, a contract liability is recognised. 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 is performed (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.

1. Segmental analysis and revenue recognition continued

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.

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 on delivery of the software to the customer or, if the customer chooses not to access and take delivery of the software, on expiry of the licence arrangement. 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;
- **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;
- **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; 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[1] (see page 208) and underlying EBIT[1] (see page 209). Finance costs and taxation expense are managed on a Group basis.

1. Sales and underlying EBIT are alternative performance measures defined in the Financial glossary on page 78.

Notes to the Group accounts continued

1. Segmental analysis and revenue recognition continued

Sales[1] and revenue by reporting segment

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

	Intra-group revenue		Revenue from external customers	
	2021 £m	2020 £m	**2021 £m**	2020 £m
Electronic Systems	**101**	95	**4,390**	4,462
Platforms & Services (US)	**34**	32	**3,284**	3,367
Air	**16**	13	**6,897**	6,580
Maritime	**98**	89	**3,242**	3,106
Cyber & Intelligence	**68**	81	**1,684**	1,731
HQ	**12**	9	**24**	31
	329	319	**19,521**	19,277

Sales[1] and revenue by customer location

	Sales[1]		Revenue	
	2021 £m	2020 £m	**2021 £m**	2020 £m
UK	**4,201**	3,965	**3,935**	3,751
Rest of Europe	**2,435**	2,017	**1,502**	1,235
US	**9,109**	9,315	**9,108**	9,309
Canada	**141**	114	**141**	114
Saudi Arabia	**2,497**	2,716	**2,476**	2,631
Qatar	**1,267**	1,104	**1,014**	913
Rest of Middle East	**326**	335	**275**	309
Australia	**763**	665	**762**	664
Rest of Asia and Pacific	**449**	578	**285**	332
Africa, and Central and South America	**122**	53	**23**	19
	21,310	20,862	**19,521**	19,277

1. Sales is an alternative performance measure defined in the Financial glossary on page 78, it is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

1. Segmental analysis and revenue recognition continued

Revenue from external customers by domain

	2021					2020				
	Air £m	**Maritime £m**	**Land £m**	**Cyber £m**	**Total £m**	Air £m	Maritime £m	Land £m	Cyber £m	Total £m
Electronic Systems	**3,846**	**87**	**457**	**–**	**4,390**	3,884	105	473	–	4,462
Platforms & Services (US)	**37**	**1,061**	**2,186**	**–**	**3,284**	43	1,180	2,144	–	3,367
Air	**6,252**	**454**	**191**	**–**	**6,897**	6,007	396	177	–	6,580
Maritime	**2**	**3,015**	**225**	**–**	**3,242**	–	2,879	227	–	3,106
Cyber & Intelligence	**238**	**390**	**55**	**1,001**	**1,684**	240	414	77	1,000	1,731
HQ	**14**	**2**	**8**	**–**	**24**	31	–	–	–	31
	10,389	**5,009**	**3,122**	**1,001**	**19,521**	10,205	4,974	3,098	1,000	19,277

Revenue by major customer

Revenue from the Group's three principal customers, which individually represent over 10% of total revenue, is as follows:

	2021 £m	2020 £m
US Department of Defense	**7,008**	6,899
UK Ministry of Defence	**4,185**	4,030
Kingdom of Saudi Arabia Ministry of Defence and Aviation	**2,380**	2,559

Revenue from the UK Ministry of Defence and the US Department of Defense was generated by the five reporting segments, excluding HQ. Revenue from the Kingdom of Saudi Arabia Ministry of Defence and Aviation was generated by the Air and Maritime reporting segments.

Operating profit/(loss) by reporting segment

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

1. Underlying EBIT is an alternative performance measure defined in the Financial glossary on page 78, it is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.
2. With effect from 2021, the Group adopted the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the previously reported underlying EBITA measure, as it reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business. The underlying performance for 2020 of segments and the Group has been re-presented on this new basis.

Notes to the Group accounts continued

1. Segmental analysis and revenue recognition continued

Share of results of equity accounted investments within reporting segments

	Underlying EBIT[1,2]		Non-recurring items		Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles[2]		Financial and taxation expense		Share of results of equity accounted investments	
	2021 £m	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m
Electronic Systems	**4**	2	**–**	–	**–**	–	**–**	–	**4**	2
Platforms & Services (US)	**9**	15	**–**	–	**–**	–	**(6)**	(13)	**3**	2
Air	**151**	149	**–**	–	**–**	–	**(45)**	(48)	**106**	101
Maritime	**11**	10	**–**	–	**–**	–	**(3)**	(3)	**8**	7
HQ	**29**	(27)	**–**	–	**–**	–	**(11)**	(16)	**18**	(43)
	204	149	**–**	–	**–**	–	**(65)**	(80)	**139**	69

1. Underlying EBIT is an alternative performance measure defined in the Financial glossary on page 78, it is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.
2. With effect from 2021, the Group adopted the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the previously reported underlying EBITA measure, as it reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business. The underlying performance for 2020 of segments and the Group has been re-presented on this new basis.

Non-recurring items

2021

Non-recurring items in 2021 reflect a gain of £350m, comprising a gain in HQ on the sale of the Filton and Broughton sites (£182m), gains on disposal of Advanced Electronics Company in the Air sector (£132m, of which £63m is attributable to non-controlling interests – see note 19), and on disposal of a business in our Electronic Systems segment (£26m), and a net £10m gain relating to historical and current year acquisitions.

2020

Non-recurring items in 2020 comprises a settlement gain on the US pension annuity buy-out of £64m, partially offset by acquisition-related costs of £20m, a £13m impairment charge relating to Platforms & Services (US)'s legacy Commercial Shipbuilding business which the business exited in 2018, a Guaranteed Minimum Pension equalisation charge of £7m and a loss on business disposals of £5m.

Performance obligations

The Group's order book[1], reconciled to order backlog as defined by the Group, is shown below.

	2021 £bn	2020 £bn
Order backlog[2] as defined by the Group	**44.0**	45.2
Deduct Unfunded order backlog	**(2.3)**	(2.2)
Deduct Share of order backlog[2] of equity accounted investments	**(10.1)**	(10.9)
Add Order backlog[2] in respect of orders from equity accounted investments	**3.9**	4.2
Order book[1]	**35.5**	36.3

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.
2. Order backlog is an alternative performance measure defined in the Financial glossary on page 78, it is presented here as our internal measure of segmental performance, to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

The Group expects that approximately 41% (2020 44%) of the order book will be recognised as revenue during the next year, with the remainder largely recognised over the following four (2020 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 (2020 £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.

	2021 £m	2020 £m
Raw materials, subcontracts and other bought-in items used	**6,934**	6,689
Change in inventories of finished goods and work-in-progress	**27**	88
Staff costs (note 3)	**6,667**	6,687
Guaranteed Minimum Pension equalisation charge	**–**	7
Depreciation	**513**	543
Amortisation	**188**	128
Impairment – property, plant and equipment (note 9), and right-of-use assets (note 10)	**4**	–
Impairment – intangible assets (note 8)	**15**	4
Impairment – inventory write down	**–**	13
Acquisition-related costs	**3**	20
Loss on disposal of property, plant and equipment, and investment property	**2**	–
Loss in respect of held for sale assets and business disposals	**–**	5
Other operating charges	**3,390**	3,502
Operating costs	**17,743**	17,686

Operating costs includes research and development expenditure of £251m (2020 £228m) funded by the Group. Development investment of £4m (2020 £8m) was capitalised during the year (see note 8).

Fees payable to the Company's auditor and its associates included in operating costs

	2021			2020		
	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	**2,349**	**–**	**2,349**	2,555	–	2,555
Fees payable to the Company's auditor and its associates for other services to the Group:						
The audit of the Company's subsidiaries	**4,154**	**5,561**	**9,715**	3,393	5,772	9,165
Total audit fees	**6,503**	**5,561**	**12,064**	5,948	5,772	11,720
Audit-related assurance services[1,2]	**632**	**3**	**635**	1,137	70	1,207
Other non-audit services	**–**	**–**	**–**	25	7	32
Total non-audit fees	**632**	**3**	**635**	1,162	77	1,239
Total fees payable to the Company's auditor and its associates	**7,135**	**5,564**	**12,699**	7,110	5,849	12,959

1. Audit-related assurance services principally comprises fees in respect of the review of the Group's Half-yearly Report.
2. In addition to the amounts shown above, the auditor received fees of £453k (2020 £646k) for the audit of the BAE Systems pension schemes in the US.

Notes to the Group accounts continued

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	
	2021 Number '000	2020 Number '000	**2021 Number '000**	2020 Number '000
Electronic Systems	**16**	16	**16**	16
Platforms & Services (US)	**12**	12	**12**	12
Air	**24**	24	**24**	24
Maritime	**18**	16	**18**	17
Cyber & Intelligence	**10**	10	**10**	10
HQ	**2**	2	**2**	2
	82	80	**82**	81

The aggregate staff costs of Group employees, excluding employees of equity accounted investments, were as follows:

	2021 £m	2020 £m
Wages and salaries[1]	**5,643**	5,727
Social security costs	**428**	426
Share-based payments (note 31)	**92**	74
Pension costs – defined contribution plans (note 24)	**246**	242
Pension costs – defined benefit plans (note 24)	**233**	206
Other post-employment benefit costs (note 24)	**25**	12
	6,667	6,687

1. After excluding the impact of exchange translation, wages and salaries increased by approximately 2.5% per employee in 2021.

4. Other income

Leases

Lease income under operating leases is recognised in the income statement on a straight-line basis over the lease term.

	2021 £m	2020 £m
Research and development expenditure credits	**16**	28
Operating lease income from investment property (note 10)	**9**	30
Operating lease income from subleasing right-of-use assets (note 10)	**1**	–
Profit on disposal of businesses	**158**	–
Profit on disposal of property, plant and equipment	**–**	12
Profit on disposal of investment property	**194**	13
Gain on sale and leaseback	**–**	21
Gain on revaluation of other investments	**–**	6
Management recharges to equity accounted investments (note 32)	**19**	19
Royalties	**17**	20
Settlement gain on transfer of US pension liabilities (note 24)	**–**	64
Gain on historical acquisition	**13**	–
Other[1]	**45**	57
Other income	**472**	270

1. Includes £15m (2020 £15m) for capital spend recovery in respect of Saudi Arabia Industrial Participation investments and a £9m (2020 £9m) 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.

	2021 £m	2020 £m
Interest income on cash and other financial instruments	**29**	16
Interest income on finance lease receivables (note 10)	**1**	1
Net present value adjustments	**2**	–
Financial income	**32**	17
Interest expense on bonds and other financial instruments	**(206)**	(196)
Facility fees	**(3)**	(4)
Interest expense on lease liabilities (note 10)	**(43)**	(44)
Net present value adjustments on provisions and other payables	**–**	(8)
Net interest expense on post-employment benefit obligations (note 24)	**(65)**	(68)
Loss on remeasurement of financial instruments at fair value through profit or loss[1,2]	**(29)**	(158)
Foreign exchange gains[2,3]	**35**	127
Financial expense	**(311)**	(351)
Net finance costs	**(279)**	(334)

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

Additional analysis

	2021 £m	2020 £m
Net finance costs:		
Group	**(279)**	(334)
Share of equity accounted investments	**(27)**	(32)
Total of Group and equity accounted investments' finance costs	**(306)**	(366)
Analysed as:		
Underlying net interest expense[1]:		
Group	**(220)**	(235)
Share of equity accounted investments	**(21)**	(20)
	(241)	(255)
Other:		
Group:		
Net interest expense on post-employment benefit obligations	**(65)**	(68)
Fair value and foreign exchange adjustments on financial instruments and investments	**6**	(31)
Share of equity accounted investments:		
Net interest expense on post-employment benefit obligations	**(2)**	(2)
Fair value and foreign exchange adjustments on financial instruments and investments	**(4)**	(10)
Total of Group and equity accounted investments' finance costs	**(306)**	(366)

1. Underlying net interest expense is an alternative performance measure defined in the Financial glossary on page 78, it is presented here to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

Notes to the Group accounts continued

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

	2021 £m	2020 £m
Current taxation		
UK:		
Current year	**(114)**	(115)
Adjustments in respect of prior years	**96**	–
	(18)	(115)
Overseas:		
Current year	**(204)**	(171)
Adjustments in respect of prior years	**5**	53
	(199)	(118)
Total current taxation	**(217)**	(233)
Deferred taxation		
UK:		
Origination and reversal of temporary differences	**24**	(1)
Adjustments in respect of prior years	**–**	1
Tax rate adjustment	**10**	4
	34	4
Overseas:		
Origination and reversal of temporary differences	**(23)**	(2)
Adjustments in respect of prior years	**8**	(10)
Tax rate adjustment	**–**	16
	(15)	4
Total deferred taxation	**19**	8
Taxation expense	**(198)**	(225)
UK	**16**	(111)
Overseas	**(214)**	(114)
Taxation expense	**(198)**	(225)

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.

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

Calculation of the underlying effective tax rate

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

1. Underlying effective tax rate is an alternative performance measure defined in the Financial glossary on page 78.

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

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

Notes to the Group accounts continued

6. Taxation expense continued

Tax recognised in other comprehensive income

	2021 Before tax £m	2021 Tax (expense)/ benefit £m	2021 Net of tax £m	2020 Before tax £m	2020 Tax benefit/ (expense) £m	2020 Net of tax £m
Items that will not be reclassified to the income statement:						
Consolidated:						
Remeasurements on post-employment benefit schemes	**2,451**	**(482)**	**1,969**	(1,361)	256	(1,105)
Tax rate adjustment	**–**	**88**	**88**	–	74	74
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method	**85**	**(21)**	**64**	(71)	16	(55)
Items that may be reclassified to the income statement:						
Consolidated:						
Currency translation on foreign currency net investments	**32**	**–**	**32**	(224)	–	(224)
Reclassification of cumulative currency translation reserve on disposal of subsidiary	**(9)**	**–**	**(9)**	(35)	–	(35)
Fair value gain arising on hedging instruments during the period	**11**	**(2)**	**9**	46	(9)	37
Cumulative fair value (gain)/loss on hedging instruments reclassified to the income statement	**(32)**	**6**	**(26)**	42	(7)	35
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method	**(1)**	**(3)**	**(4)**	(2)	(1)	(3)
	2,537	**(414)**	**2,123**	(1,605)	329	(1,276)

	2021 Other reserves £m	2021 Retained earnings £m	2021 Total £m	2020 Other reserves £m	2020 Retained earnings £m	2020 Total £m
Current tax						
Consolidated:						
Remeasurements on post-employment benefit schemes	**–**	**61**	**61**	–	83	83
	–	**61**	**61**	–	83	83
Deferred tax						
Consolidated:						
Remeasurements on post-employment benefit schemes	**–**	**(543)**	**(543)**	–	173	173
Tax rate adjustment	**–**	**88**	**88**	–	74	74
Fair value gain arising on hedging instruments during the period	**(2)**	**–**	**(2)**	(9)	–	(9)
Cumulative fair value loss/(gain) on hedging instruments reclassified to the income statement	**6**	**–**	**6**	(7)	–	(7)
Share of the other comprehensive income of associates and joint ventures accounted for using the equity method	**(3)**	**(21)**	**(24)**	(1)	16	15
	1	**(476)**	**(475)**	(17)	263	246
Tax on other comprehensive income	**1**	**(415)**	**(414)**	(17)	346	329

7. Earnings per share

	2021 £m	2021 Basic pence per share	2021 Diluted pence per share	2020 £m	2020 Basic pence per share	2020 Diluted pence per share
Profit for the year attributable to equity shareholders	**1,758**	**55.2**	**54.7**	1,299	40.7	40.5
Add back/(deduct):						
Amortisation of programme, customer-related and other intangible assets, and impairment of intangibles, post tax[1]	**84**			38		
Net interest expense on post-employment benefit obligations, post tax[1]	**55**			58		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax[1]	**(1)**			34		
Non-recurring items attributable to shareholders, post tax[2]	**(279)**			(15)		
Underlying earnings[3], post tax	**1,617**	**50.7**	**50.4**	1,414	44.3	44.0
One-off tax benefit	**(94)**			–		
Underlying earnings[3], excluding one-off tax benefit	**1,523**	**47.8**	**47.4**	1,414	44.3	44.0
		Millions	**Millions**		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		**3,187**	**3,187**		3,191	3,191
Incremental shares in respect of employee share schemes			**24**			19
Weighted average number of shares used in calculating diluted earnings per share			**3,211**			3,210

1. The tax impact is calculated using the underlying effective tax rate of 18% (2020 17%). The calculation of the underlying effective tax rate is shown in note 6.
2. In 2021, £63m of the gain on disposal of AEC was attributable to non-controlling interest. Therefore, only the gain attributable to shareholders has been removed in calculating the underlying earnings attributable to shareholders. See note 19 for more details. The tax on non-recurring items has been determined using the actual tax due on those items, see note 6 for details.
3. Underlying earnings per share is an alternative performance measure defined in the Financial glossary on page 78, it is presented here to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure. With effect from 2021, the Group adopted the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the previously reported underlying EBITA measure, as it reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business. Underlying earnings per share has also been recalculated to ensure consistency with the updated operational profitability measure. The underlying performance for 2020 of segments and the Group has been re-presented on this new basis.

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.

Notes to the Group accounts continued

8. Intangible assets continued

Amortisation

Goodwill is not amortised, but is tested annually for impairment, and carried at cost less accumulated impairment losses. 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.

Goodwill is tested annually for impairment. For the purposes of impairment testing, goodwill is allocated to Cash-Generating Units (CGUs) on a consistent basis. The impairment calculations require the use of estimates of the future profitability and cash-generating ability of the CGU to determine its value in use based the Group's five-year Integrated Business Plan and the pre-tax discount rate used in discounting these projected cash flows.

An impairment loss is recognised whenever the carrying amount of an asset or its CGU exceeds its recoverable amount, which is the higher of its value in use, and its fair value less cost of disposal.

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 2020	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
Additions:						
Acquired separately	–	90	–	–	–	90
Internally developed	–	3	4	–	–	7
Business acquisitions (note 34)	20	2	–	6	9	37
Disposals[1]	–	(38)	–	–	–	(38)
Transfer from property, plant and equipment	–	1	–	–	–	1
Foreign exchange adjustments	49	(2)	1	3	2	53
At 31 December 2021	**15,624**	**893**	**116**	**551**	**110**	**17,294**
Amortisation and impairment						
At 1 January 2020	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
Amortisation[2]	–	104	3	75	11	193
Impairment charge	–	15	–	–	–	15
Disposals[1]	–	(38)	–	–	–	(38)
Foreign exchange adjustments	5	1	1	1	1	9
At 31 December 2021	**4,714**	**569**	**79**	**170**	**46**	**5,578**
Net book value						
At 31 December 2021	**10,910**	**324**	**37**	**381**	**64**	**11,716**
At 31 December 2020	10,846	350	36	448	65	11,745
At 1 January 2020	9,984	339	34	4	10	10,371

1. Includes intangible assets with nil net book value no longer used by the Group.
2. Amortisation of £193m (2020 £133m) includes £188m (2020 £128m) charged to the income statement as an amortisation expense and £5m (2020 £5m) recoverable on customer contracts.

Notes to the Group accounts continued

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 and adjusted for risks specific to the market in which the CGU operates, have been used in discounting these projected risk-adjusted cash flows.

Significant CGUs

Goodwill allocated to CGUs which are largely dependent on US government spending on defence, aerospace and security represents £8.9bn (2020 £8.8bn) 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	**2021 £bn**	2020 £bn	**2021 %**	2020 %
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	**4.9**	4.8	**9**	9
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**	3.3	**9**	9
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**	9

The headroom, calculated as the difference between net assets including allocated goodwill as at 31 December 2021 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	**2021 £bn**	2020 £bn	**2021 £bn**	2020 £bn	**2021 £bn**	2020 £bn	**2021 £bn**	2020 £bn
Electronic Systems	**4.3**	4.7	**2.8**	3.2	**2.6**	2.9	**3.6**	4.0
Platforms & Services (US)	**1.5**	1.2	**0.7**	0.5	**0.5**	0.3	**0.9**	0.7
Intelligence & Security	**0.7**	0.7	**0.5**	0.5	**0.4**	0.4	**0.5**	0.5

Other CGUs

The remaining goodwill balance of £2.0bn (2020 £2.0bn) is allocated across multiple CGUs. 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.

Capital commitments

At 31 December 2021, capital expenditure of £25m (2020 £20m) 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.

Notes to the Group accounts continued

9. Property, plant and equipment continued

	Land and buildings £m	Plant and machinery £m	Total £m
Cost			
At 1 January 2020	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
Additions[1]	239	262	501
Business acquisitions (note 34)	–	1	1
Transfer to intangible assets	–	(1)	(1)
Reclassification between categories	7	(7)	–
Disposals	(23)	(115)	(138)
Foreign exchange adjustments	–	6	6
At 31 December 2021	**2,754**	**3,756**	**6,510**
Depreciation and impairment			
At 1 January 2020	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
Depreciation charge for the year	94	202	296
Impairment charge	–	4	4
Reclassification between categories	4	(4)	–
Disposals	(22)	(112)	(134)
Foreign exchange adjustments	2	4	6
At 31 December 2021	**1,191**	**2,467**	**3,658**
Net book value			
At 31 December 2021	**1,563**	**1,289**	**2,852**
At 31 December 2020	1,418	1,237	2,655
At 1 January 2020	1,241	1,196	2,437

1. Includes £149m (2020 £170m) 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

	2021 £m	2020 £m
Platforms & Services (US)	**4**	–
Electronic Systems	**–**	(2)
	4	(2)

2021

The impairment charge in Platforms & Services in 2021 related to a reduction in manufacturing activities.

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.

Assets in the course of construction

	Land and buildings[1] £m	Plant and machinery £m	Total £m
At 31 December 2021	**398**	**274**	**672**
At 31 December 2020	470	260	730

1. Includes £262m (2020 £350m) at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

Capital commitments

At 31 December 2021, capital expenditure of £210m (2020 £134m) 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.

Notes to the Group accounts continued

10. Leases continued

Right-of-use assets

	2021			2020		
	Land and buildings £m	**Plant and machinery £m**	**Total £m**	Land and buildings £m	Plant and machinery £m	Total £m
Net book value at 1 January	**1,037**	**16**	**1,053**	1,120	18	1,138
Additions during the year	**117**	**9**	**126**	142	11	153
Business acquisitions (note 34)	**–**	**–**	**–**	12	–	12
Lease modifications during the year	**125**	**(1)**	**124**	(1)	(1)	(2)
Depreciation expense for the year	**(206)**	**(8)**	**(214)**	(222)	(10)	(232)
Impairment charge for the year	**–**	**–**	**–**	–	(2)	(2)
Foreign exchange adjustments	**2**	**–**	**2**	(14)	–	(14)
Net book value at 31 December	**1,075**	**16**	**1,091**	1,037	16	1,053

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:

	2021 £m	2020 £m
Payments due:		
Within one year	**240**	270
Between one and five years	**586**	633
Later than five years	**683**	551
Total undiscounted gross payments	**1,509**	1,454
Deduct Impact of discounting	**(214)**	(198)
Lease liabilities	**1,295**	1,256

The Group is also committed to future undiscounted lease payments of £214m in respect of leases which had not yet commenced at 31 December 2021 (2020 £95m).

The total cash outflow for leases in the year ended 31 December 2021, including short-term leases and low-value leases, amounted to £281m (2020 £304m).

Amounts recognised in the income statement

	2021 £m	2020 £m
Included in operating costs:		
Depreciation on right-of-use assets	**(214)**	(232)
Impairment of right-of-use assets	**–**	(2)
Short-term lease expense	**(19)**	(23)
Low-value lease expense	**(4)**	(3)
	(237)	(260)
Included in other income:		
Operating lease income from investment property	**9**	30
Operating lease income from subleasing right-of-use assets	**1**	–
	10	30
Included in net finance costs:		
Interest income on finance lease receivables	**1**	1
Interest expense on lease liabilities	**(43)**	(44)
	(42)	(43)

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:

	2021 £m	2020 £m
Receipts due:		
Within one year	**2**	30
Between one and two years	**1**	29
Between two and three years	**1**	27
Between three and four years	**1**	26
Between four and five years	**1**	–
Later than five years	**2**	4
	8	116

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:

	2021 £m	2020 £m
Receipts due:		
Within one year	**11**	11
Between one and two years	**11**	10
Between two and three years	**10**	11
Between three and four years	**5**	9
Between four and five years	**4**	5
Later than five years	**7**	11
Total undiscounted gross receipts	**48**	57
Deduct: Impact of discounting	**(4)**	(4)
Finance lease receivables (note 13)	**44**	53

Notes to the Group accounts continued

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 2020	209
Additions	8
Disposals	(17)
At 31 December 2020	200
Additions	17
Disposals	(141)
At 31 December 2021	**76**
Depreciation and impairment	
At 1 January 2020	72
Depreciation charge for the year	10
Disposals	(10)
At 31 December 2020	72
Depreciation charge for the year	3
Disposals	(66)
At 31 December 2021	**9**
Net book value	
At 31 December 2021	**67**
At 31 December 2020	128
At 1 January 2020	137

Fair value	
At 31 December 2021	**82**
At 31 December 2020	322

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 2021, capital expenditure of £20m (2020 £34m) 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.

	2021		2020	
	Eurofighter Jagdflugzeug £m	**MBDA £m**	Eurofighter Jagdflugzeug £m	MBDA £m
Revenue (100%)	**3,165**	**3,513**	2,715	3,193
Underlying EBIT[1] excluding depreciation and amortisation	**6**	**512**	12	479
Depreciation and amortisation	**–**	**(117)**	–	(114)
Financial income	**2**	**7**	1	7
Financial expense	**(2)**	**(12)**	–	(18)
Taxation expense	**(3)**	**(107)**	(4)	(106)
Profit for the year (100%)	**3**	**283**	9	248
Remeasurements on post-employment benefit schemes, net of tax	**–**	**172**	–	(148)
Amounts credited to hedging reserve, net of tax	**–**	**17**	–	4
Foreign exchange adjustments	**–**	**13**	–	(6)
Total comprehensive income for the year (100%)	**3**	**485**	9	98
Group's share of total comprehensive income for the year	**1**	**182**	3	37
Non-current assets	**32**	**2,280**	16	2,440
Cash and cash equivalents	**24**	**2,367**	9	2,552
Current assets excluding cash and cash equivalents	**7,630**	**4,210**	1,143	4,410
Current assets	**7,654**	**6,577**	1,152	6,962
Non-current financial liabilities excluding trade and other payables, and provisions	**–**	**(5)**	–	(3)
Other non-current liabilities	**(62)**	**(527)**	(68)	(866)
Non-current liabilities	**(62)**	**(532)**	(68)	(869)
Current financial liabilities excluding trade and other payables, and provisions	**(7)**	**–**	–	–
Other current liabilities	**(7,590)**	**(7,424)**	(1,065)	(7,964)
Current liabilities	**(7,597)**	**(7,424)**	(1,065)	(7,964)
Net assets (100%)	**27**	**901**	35	569

1. Underlying EBIT is an alternative performance measure defined in the Financial glossary on page 78. With effect from 2021, the Group adopted the underlying EBIT profitability measure, to include charges relating to software and development intangible amortisation, in place of the previously reported underlying EBITA measure, as it reflects a better measure of underlying profitability, by including amortisation of software and development intangibles as these charges are viewed as a recurring operational cost for the business.

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Notes to the Group accounts continued

12. Equity accounted investments continued

	2021			2020		
	Eurofighter Jagdflugzeug £m	**MBDA £m**	**Total £m**	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Group's share of net assets	**9**	**338**	**347**	12	213	225
Goodwill adjustment	**–**	**7**	**7**	–	6	6
Carrying value	**9**	**345**	**354**	12	219	231

	2021			2020		
	Eurofighter Jagdflugzeug £m	**MBDA £m**	**Total £m**	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Dividends received	**2**	**41**	**43**	6	–	6

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 2021 are as follows: Rheinmetall BAE Systems Land (RBSL) (£80m), FADEC International (£44m), Air Astana (£19m), FNSS (£17m) 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 and associates in aggregate.

	Principal equity accounted investments £m	Other joint ventures £m	Other associates £m	Total £m
At 1 January 2020	194	153	81	428
Group's share of profit for the year	95	(28)	2	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	(34)	1	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	96	82	409
Group's share of profit for the year	107	28	4	139
Group's share of remeasurements on post-employment benefit schemes	85	–	–	85
Tax on items that will not be reclassified to the income statement	(21)	–	–	(21)
Foreign exchange adjustments	6	–	(1)	5
Amounts credited to hedging reserve	8	4	–	12
Tax on items that may be reclassified to the income statement	(2)	(1)	–	(3)
Group's share of total comprehensive income for the year	183	31	3	217
Equity accounted investment funding	–	3	–	3
Dividends received from equity accounted investments	(43)	(14)	–	(57)
Foreign exchange adjustments	(17)	(1)	–	(18)
At 31 December 2021	**354**	**115**	**85**	**554**

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 and contract 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.

	2021 £m	2020 £m
Non-current		
Contract receivables	**21**	27
Prepayments	**70**	68
Accrued income	**1**	1
US deferred compensation plan assets	**376**	344
Finance lease receivables (note 10)	**33**	43
Other receivables	**50**	23
	551	506
Current		
Contract receivables	**2,671**	2,579
Trade receivables	**1,043**	1,611
Amounts owed by equity accounted investments (note 32)	**34**	69
Prepayments	**444**	646
Accrued income	**53**	89
Finance lease receivables (note 10)	**11**	10
Other receivables[1]	**569**	487
	4,825	5,491

1. Includes £419m (2020 £234m) 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. Any hedges entered into on behalf of equity accounted investments (note 32) are classified as cash flow hedges.

	2021		2020	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	**191**	**(172)**	111	(96)
Other foreign exchange/interest rate contracts	**–**	**–**	–	(4)
Debt-related derivative financial instruments	**114**	**(130)**	137	(182)
	305	**(302)**	248	(282)
Current				
Cash flow hedges – foreign exchange contracts	**186**	**(181)**	180	(136)
Other foreign exchange/interest rate contracts	**8**	**(33)**	9	(28)
Debt-related derivative financial instruments	**–**	**–**	–	(17)
	194	**(214)**	189	(181)

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$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% (2020 50%) and a maximum of 90% (2020 90%) of gross debt is maintained at fixed interest rates. At 31 December 2021, the Group had 87% (2020 88%) of fixed rate debt and 13% (2020 12%) of floating rate debt based on a gross debt of £5.1bn (2020 £5.5bn), 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	2,917	–	–
Loans and overdrafts	661	661	661

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 2021, the Group had a total of $0.9bn (2020 $0.9bn) of this type of swap outstanding with a weighted average duration of 2.8 years (2020 3.8 years). In respect of the fixed rate debt, the weighted average period in respect of which interest is fixed was 12.2 years (2020 12.1 years). Given the level of short-term interest rates during the year, the average cost of the floating rate debt was 2.6% (2020 3.4%) on US dollars. The cost of the fixed rate debt was 3.8% (2020 4.1%).

The Group is undertaking a full review of the impact of IBOR reforms, but due to the utilisation of interest rate swaps, no significant impact is expected.

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 (2020 £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 £21m (2020 £22m).

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 2021					31 December 2020				
		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	**(5,061)**	**(593)**	**(1,785)**	**(4,848)**	**(7,226)**	(5,424)	(676)	(2,240)	(5,013)	(7,929)
Cash flow hedges – financial assets	**377**	**(6,509)**	**(4,081)**	**(173)**	**(10,763)**	291	(6,190)	(4,241)	(343)	(10,774)
Cash flow hedges – financial liabilities	**(353)**	**(6,204)**	**(4,963)**	**(214)**	**(11,381)**	(232)	(6,228)	(4,582)	(431)	(11,241)
Other foreign exchange/interest rate contracts – financial assets	**8**	**(417)**	**–**	**–**	**(417)**	9	(516)	–	–	(516)
Other foreign exchange/interest rate contracts – financial liabilities	**(33)**	**(2,247)**	**(3)**	**–**	**(2,250)**	(32)	(1,515)	–	–	(1,515)
Debt-related derivatives – financial assets[2]	**114**	**(489)**	**(127)**	**(60)**	**(676)**	137	(40)	(144)	(47)	(231)
Debt-related derivatives – financial liabilities[2]	**(130)**	**(486)**	**(141)**	**(123)**	**(750)**	(199)	(457)	(1,040)	(158)	(1,655)
Accruals[1]	**(1,855)**	**(1,832)**	**(23)**	**–**	**(1,855)**	(1,634)	(1,603)	(31)	–	(1,634)
Trade and other payables	**(2,065)**	**(2,043)**	**(22)**	**–**	**(2,065)**	(2,713)	(2,639)	(74)	–	(2,713)
Lease liabilities	**(1,295)**	**(240)**	**(586)**	**(683)**	**(1,509)**	(1,256)	(270)	(633)	(551)	(1,454)
Other financial assets and liabilities	**(5,232)**					(5,629)				

1. Accruals presented in the table excludes £646m (2020 £547m) of accruals which are non-financial liabilities.
2. Cash outflows in relation to currency swaps on external debt-related derivatives (note 21) have been excluded from the liquidity table, on the basis that the repayment of the debt is already presented. The prior year comparative has been re-presented to include principal payments on certain other cross-currency swaps excluded in the prior year disclosure (£899m).

Notes to the Group accounts continued

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 2021, the Group had a committed Revolving Credit Facility (RCF) of £2bn (2020 £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 2021, the Group had no Commercial Paper in issue (2020 £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 does not designate groups of items with offsetting risk positions as 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.

Ineffectiveness due to foreign currency basis was highly immaterial.

The effect of cash flow hedges on the Group's financial position and performance for the year is as follows:

	31 December 2021									
	Currency purchased			Currency sold			Net impact			
	Maturity date	Weighted average hedged rate	Notional value of currency purchased £m	Maturity date	Weighted average hedged rate	Notional value of currency sold £m	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	Carrying amount £m
(Purchase)/sale contracts:										
Sterling/US dollar	to 2029	1.36	(3,048)	to 2029	1.35	4,570	11	(11)	1,522	24
Sterling/euro	to 2031	1.11	(6,455)	to 2031	1.11	6,003	5	(5)	(452)	10
Other	to 2030	n/a	(2,703)	to 2030	n/a	2,693	(5)	5	(10)	(10)
Cash flow hedges			**(12,206)**			**13,266**	**11**	**(11)**	**1,060**	**24**

	31 December 2020									
	Currency purchased			Currency sold			Net impact			
	Maturity date	Weighted average hedged rate	Notional value of currency purchased £m	Maturity date	Weighted average hedged rate	Notional value of currency sold £m	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	Carrying amount £m
(Purchase)/sale contracts:										
Sterling/US dollar	to 2028	1.35	(3,284)	to 2029	1.32	3,147	8	(8)	(137)	58
Sterling/euro	to 2031	1.09	(7,469)	to 2031	1.09	7,113	81	(81)	(356)	4
Other	to 2026	n/a	(1,598)	to 2026	n/a	1,594	(43)	43	(4)	(3)
Cash flow hedges			(12,351)			11,854	46	(46)	(497)	59

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 £203m (2020 £226m).

14. Other financial assets and liabilities and financial risk management continued

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.

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:

	2021 £m	2020 £m
At 1 January	**36**	20
Net remeasurement of loss allowance	**(19)**	19
Amounts written off	**(2)**	(3)
At 31 December	**15**	36

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:

	2021			2020		
	Gross £m	**Provision £m**	**Net £m**	Gross £m	Provision £m	Net £m
Not past due	**783**	**–**	**783**	1,029	–	1,029
Up to 180 days overdue	**223**	**(1)**	**222**	544	–	544
Past 180 days overdue	**52**	**(14)**	**38**	74	(36)	38
	1,058	**(15)**	**1,043**	1,647	(36)	1,611

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 2021 of £2,917m (2020 £2,768m) was invested with 36 (2020 38) 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	**2021**	2020
AAA to AA-	**68%**	59%
A+ to A-	**31%**	40%
BBB+ to BBB-	**1%**	1%

Notes to the Group accounts continued

14. Other financial assets and liabilities and financial risk management continued

Offsetting financial assets and liabilities

	2021			2020		
	Balance sheet £m	**Amounts not offset[1] £m**	**Net balances £m**	Balance sheet £m	Amounts not offset[1] £m	Net balances £m
Assets						
Other financial assets	**499**	**(383)**	**116**	437	(303)	134
Liabilities						
Other financial liabilities	**(516)**	**383**	**(133)**	(463)	285	(178)

1. The amounts subject to a master netting arrangement not offset in the Consolidated balance sheet in accordance with paragraph 42 of IAS 32. Includes £383m (2020 £285m) in respect of recognised financial instruments and £nil (2020 £18m) in respect of cash collateral.

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	
	2021 £m	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m
Property, plant and equipment	**42**	33	**(101)**	(103)	**(59)**	(70)
Intangible assets	**17**	4	**(2)**	–	**15**	4
Provisions and accruals	**203**	199	**–**	–	**203**	199
Goodwill	**–**	–	**(302)**	(279)	**(302)**	(279)
Pension/post-employment schemes:						
Deficits	**430**	845	**–**	–	**430**	845
Additional contributions and other[1]	**228**	251	**–**	–	**228**	251
Share-based payments	**28**	19	**–**	–	**28**	19
Financial instruments	**–**	–	**(9)**	(18)	**(9)**	(18)
Other items	**24**	17	**(19)**	(3)	**5**	14
Rolled over capital gains	**–**	–	**(13)**	(11)	**(13)**	(11)
Capital losses carried forward	**13**	11	**–**	–	**13**	11
Trading losses carried forward	**6**	7	**–**	–	**6**	7
Deferred tax assets/(liabilities)	**991**	1,386	**(446)**	(414)	**545**	972
Set off of tax	**(369)**	(414)	**369**	414	**–**	–
Net deferred tax assets/(liabilities)	**622**	972	**(77)**	–	**545**	972

1. Includes deferred tax assets on US deferred compensation plans and 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 2021 £m	Foreign exchange adjustments £m	Acquisitions and disposals £m	Recognised in income £m	Recognised in equity £m	**At 31 December 2021 £m**
Property, plant and equipment	(70)	(1)	–	12	–	**(59)**
Intangible assets	4	–	(3)	14	–	**15**
Provisions and accruals	199	1	–	3	–	**203**
Goodwill	(279)	(2)	–	(21)	–	**(302)**
Pension/post-employment schemes:						
Deficits	845	(1)	–	11	(425)	**430**
Additional contributions and other[1]	251	1	–	6	(30)	**228**
Share-based payments	19	–	–	7	2	**28**
Financial instruments	(18)	–	–	(3)	12	**(9)**
Other items	14	–	–	(9)	–	**5**
Rolled over capital gains	(11)	–	–	(2)	–	**(13)**
Capital losses carried forward	11	–	–	2	–	**13**
Trading losses carried forward	7	–	–	(1)	–	**6**
	972	(2)	(3)	19	(441)	**545**

	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

1. Includes deferred tax assets on US deferred compensation plans and relief to be claimed in future periods on UK pension contributions.

Unrecognised deferred tax assets and liabilities

Deferred tax assets have not been recognised in respect of the following items:

	2021		2020	
	Gross amount £m	**Unrecognised deferred tax asset £m**	Gross amount £m	Unrecognised deferred tax asset £m
Deductible temporary differences, including tax credits	**6**	**5**	2	2
Capital losses carried forward	**196**	**45**	215	41
Trading and other losses carried forward	**231**	**37**	289	43
	433	**87**	506	86

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 £390m (2020 £467m) 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.

Notes to the Group accounts continued

15. Deferred tax continued

Changes in tax rates

Both recognised and unrecognised UK deferred tax balances as at 31 December 2021 have been calculated at a rate of 22.8% (2020 19%). As at 31 December 2021, an increase in the UK current tax rate has been enacted, from 19% to 25% with effect from 1 April 2023. An adjustment has been made to reflect the fact that a portion of UK deferred tax balances are expected to unwind at 25%. This adjustment has been recorded as a non-recurring gain of £10m in the Consolidated income statement and as a gain of £88m in the Consolidated statement of comprehensive income. US deferred tax balances have not yet been adjusted for a potential increase in the US current tax rate, as an increase has not yet been passed into law.

16. Inventories

Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value.

	2021 £m	2020 £m
Raw materials and consumables	**432**	459
Work-in-progress	**312**	320
Finished goods and goods for resale	**67**	79
	811	858

The Group recognised £13m (2020 £21m) 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.

	2021 £m	2020 £m
Tax provisions	**(106)**	(185)
Research and development expenditure credits receivable	**81**	56
Other	**69**	63
	44	(66)
Represented by:		
Current tax assets	**71**	6
Current tax liabilities	**(27)**	(72)
	44	(66)

Tax provisions of £106m (2020 £185m) are in respect of known tax issues, of which £50m (2020 £146m) relates to the UK.

A provision of £94m has been released in 2021, following agreements reached regarding the exposure arising from the April 2019 European Commission decision regarding the UK's Controlled Foreign Company regime.

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.

	2021 £m	2020 £m
Cash	**903**	919
Money market funds	**1,171**	966
Short-term deposits	**843**	883
	2,917	2,768

Cash and cash equivalents includes £83m (2020 £109m) which is subject to regulatory restrictions and is therefore not available for general use by other entities within the Group.

19. 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.

Business disposals during 2021

Advanced Electronics Company

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

The gain recognised on disposal was as follows:

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

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

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

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

BAE Systems Rokar International

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

Notes to the Group accounts continued

19. Business disposals continued

Business disposals during 2020

Silversky

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

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

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

The loss on disposal was included in the profit for the year from continuing operations, as a component of operating costs (note 2).

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

	2020 £m
Intangible assets	32
Property, plant and equipment	3
Deferred tax assets	5
Trade, other and contract receivables	7
Cash and cash equivalents	5
Trade and other payables	(1)
Net assets disposed	51

20. Geographical analysis of assets

Analysis of non-current assets by geographical location

Asset location	Notes	**2021 £m**	2020 £m
UK		**4,222**	4,153
Rest of Europe		**1,475**	1,047
US		**9,713**	9,849
Saudi Arabia		**449**	538
Australia		**487**	471
Rest of Asia and Pacific		**5**	1
		16,351	16,059
Other investments		**76**	–
Other receivables[1]	13	**480**	437
Post-employment benefit surpluses	24	**483**	408
Other financial assets	14	**305**	248
Deferred tax assets	15	**622**	972
Non-current assets		**18,317**	18,124

1. Amounts relating to prepayments and accrued income have been included within the geographical split of assets. 2020 comparatives have been re-presented to exclude other receivables £437m from the geographical split of assets (£66m, £18m and £353m from the UK, Rest of Europe and US respectively), as IFRS 8 Operating Segments does not require assets of this type to be allocated geographically.

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.

	2021 £m	2020 £m
Loans and overdrafts		
US$500m 4.75% bond, repayable 2021	**–**	366
£400m 4.125% bond, repayable 2022	**409**	399
US$800m 3.8% bond, repayable 2024	**594**	584
US$750m 3.85% bond, repayable 2025	**551**	545
US$500m 7.5% bond, repayable 2027	**382**	364
US$1,300m 3.4% bond, repayable 2030	**959**	942
US$1,000m 1.9% bond, repayable 2031	**738**	724
US$400m 5.8% bond, repayable 2041	**297**	290
US$550m 4.75% bond, repayable 2044	**401**	393
US$1,000m 3% bond, repayable 2050	**730**	716
Overdrafts	**–**	101
	5,061	5,424
Maturity analysis		
Non-current	**4,604**	4,957
Current	**457**	467
	5,061	5,424

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 2021 of 2.4%.

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 2021 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 2021 of 3.7%.

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 2021 of 3.5%.

Notes to the Group accounts continued

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.

	2021 £m	2020 £m
Non-current		
Contract liabilities	**519**	524
Current		
Contract liabilities	**2,874**	3,238
	3,393	3,762

Revenue recognised in the year includes £2,701m (2020 £3,150m) that was included in the opening contract liabilities balance.

Non-current and current contract liabilities as at 1 January 2020 were £527m and £3,536m, respectively.

The reduction in contract liabilities since 2020 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.

	2021 £m	2020 £m
Non-current		
Accruals	**43**	53
Amounts owed to equity accounted investments (note 32)	**7**	11
Other taxes and social security costs	**1**	36
Deferred income[1]	**808**	687
US deferred compensation plan liabilities	**375**	350
Other payables	**14**	27
	1,248	1,164
Current		
Trade payables	**697**	697
Amounts owed to equity accounted investments (note 32)	**923**	1,156
Other taxes and social security costs	**197**	536
Accruals	**2,458**	2,128
Deferred income	**135**	131
Other payables	**226**	250
	4,636	4,898

1. Includes £806m (2020 £678m) 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 245. 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 2021.

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% (2020 93%) of the UK IAS 19 defined benefit obligation at 31 December 2021. The schemes in other countries are primarily defined contribution schemes.

At 31 December 2021, the weighted average durations of the UK and US defined benefit pension obligations were 17 years (2020 18 years) and 12 years (2020 12 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[1]	31	21	48
US schemes[2]	30	18	52

1. Source: 31 October 2019 actuarial valuation reports.
2. Source: Annual updates of the US schemes as at 1 January 2022.

Notes to the Group accounts continued

24. Post-employment benefits 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. A further UK High Court judgment was delivered on 20 November 2020 which rules that past cash-equivalent transfer values needed to account for gender equalisation for the effect of GMPs. In 2018 and 2020, 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 2021, an allowance of £140m (2020 £145m) was included within the pension deficit (before allocation to equity accounted investments) to reflect these rulings.

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 245 to 252.

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

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

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

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

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

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

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

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

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

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

US valuations

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

Notes to the Group accounts continued

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

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

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 45% (2020 42%) 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 79.0% (2020 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 107.8% (2020 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		
	2021	2020	2019	**2021**	2020	2019
Financial assumptions						
Discount rate – past service (%)	**1.9**	1.4	2.1	**2.8**	2.4	3.1
Discount rate – future service (%)	**1.9**	1.6	2.2	**2.8**	2.4	3.1
Retail Prices Index (RPI) inflation (%)	**3.1**	2.7	2.8	**n/a**	n/a	n/a
Rate of increase in salaries (%)	**3.1**	2.7	2.8	**n/a**	n/a	n/a
Rate of increase in deferred pensions (%)	**2.4/3.1**	2.0/2.7	2.0/2.8	**n/a**	n/a	n/a
Rate of increase in pensions in payment (%)	**1.7 – 3.7**	1.6 – 3.6	1.5 – 3.6	**n/a**	n/a	n/a
Demographic assumptions						
Life expectancy of a male currently aged 65 (years)	**86 – 89**	86 – 88	87 – 88	**87**	87	87
Life expectancy of a female currently aged 65 (years)	**88 – 90**	88 – 90	88 – 90	**89**	89	89
Life expectancy of a male currently aged 45 (years)	**86 – 90**	87 – 89	88 – 89	**87**	87	87
Life expectancy of a female currently aged 45 (years)	**89 – 91**	89 – 91	89 – 91	**89**	88	89

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 241.

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 the Company has reviewed its approach to setting inflation assumptions. The inflation risk premium deduction has been set at 0.55% per annum (2020 0.5%) and the CPI assumption has been set at 0.7% per annum (2020 0.7%) lower than RPI. The resulting RPI assumption is 3.1% per annum and the CPI assumption is 2.4% 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 3.1% (2020 RPI inflation of 2.7%), 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 2.4% (2020 CPI inflation of 2.0%), with the exception of the legacy 2000 Plan, which is based on RPI inflation of 3.1% (2020 RPI inflation of 2.7%). 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 S3 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 2020 tables (published by the Institute of Actuaries) have been used (in 2020, the Continuous Mortality Investigation 2019 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% per annum (2020 1.0%), an initial rate adjustment parameter ('A') of 0.25% (2020 0.25%) in conjunction with a smoothing parameter ('S_K') of 7 for all members (2020 7). The Group has chosen to apply a weighting to the 2020 data in recognition of the abnormal excess deaths as a result of COVID-19. No further adjustments have been made to improvements expected in future years. The impacts of COVID-19 will continue to be monitored and assessed at future reporting dates.

Notes to the Group accounts continued

24. Post-employment benefits continued

IAS 19 accounting continued

For the majority of the US schemes, the mortality tables used at 31 December 2021 are a blend of the fully generational PRI-2012 White Collar table and the PRI-2012 Blue Collar table, both projected using Scale MP-2021.

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 2021. These valuations were rolled forward to reflect the information at 31 December 2021. 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 (2020 4.8%). This is based on an assumed increase in 2021 of 6.1% for pre-retirement and 5.4% for post-retirement, with both rates then reducing to 4.5% by 2029 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 2021	(4,362)	(483)	(4,845)
Actual return on assets excluding amounts included in net interest expense	2,274	49	2,323
Decrease in liabilities due to changes in financial assumptions	1,145	220	1,365
Decrease/(increase) in liabilities due to changes in demographic assumptions	74	(8)	66
Experience losses	(1,109)	(8)	(1,117)
Contributions in excess of service cost	64	(9)	55
Past service cost – plan amendments	(3)	–	(3)
Net interest expense	(56)	(10)	(66)
Transfer to other investments[1]	–	(56)	(56)
Foreign exchange adjustments	–	6	6
Movement in other schemes	–	(14)	(14)
Total net IAS 19 deficit at 31 December 2021	**(1,973)**	**(313)**	**(2,286)**
Allocated to equity accounted investments	162	–	162
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 31 December 2021	**(1,811)**	**(313)**	**(2,124)**

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

24. Post-employment benefits continued

IAS 19 accounting continued

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.

	2021				
	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)**	**(131)**	**–**	**(153)**	**(436)**
Present value of funded obligations	**(28,768)**	**(4,512)**	**(150)**	**–**	**(33,430)**
Fair value of scheme assets	**26,947**	**4,415**	**218**	**–**	**31,580**
Total net IAS 19 (deficit)/surplus	**(1,973)**	**(228)**	**68**	**(153)**	**(2,286)**
Allocated to equity accounted investments	**162**	**–**	**–**	**–**	**162**
Group's share of net IAS 19 (deficit)/surplus	**(1,811)**	**(228)**	**68**	**(153)**	**(2,124)**
Represented by:					
Post-employment benefit surpluses	**383**	**32**	**68**	**–**	**483**
Post-employment benefit obligations	**(2,194)**	**(260)**	**–**	**(153)**	**(2,607)**
	(1,811)	**(228)**	**68**	**(153)**	**(2,124)**
Group's share of net IAS 19 deficit of equity accounted investments	**(69)**	**–**	**–**	**–**	**(69)**

The US unfunded pension obligations have associated assets held in deferred compensation schemes with a fair value of £61m which are shown in Other Investments. The funds held in these trusts can be used solely for the satisfaction of the unfunded obligations.

	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)

Total cumulative actuarial losses recognised in equity since the transition to IFRS are £4.1bn (2020 £6.5bn).

Notes to the Group accounts continued

24. Post-employment benefits continued

IAS 19 accounting continued

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 2020	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
Interest income	345	103	5	–	453
Actual return on assets excluding amounts included in interest income	2,274	49	2	–	2,325
Actual return on assets	2,619	152	7	–	2,778
Contributions by employer	313	11	1	14	339
Contributions by employer in respect of employee salary sacrifice arrangements	71	–	–	–	71
Total contributions by employer	384	11	1	14	410
Members' contributions	6	–	–	–	6
Administrative expenses	(12)	(7)	(1)	–	(20)
Transfer to other investments	–	(56)	–	–	(56)
Foreign exchange translation	–	39	2	–	41
Benefits paid	(1,079)	(206)	(9)	(14)	(1,308)
Value of scheme assets at 31 December 2021	**26,947**	**4,415**	**218**	**–**	**31,580**

24. Post-employment benefits continued

IAS 19 accounting continued

Assets of defined benefit pension schemes

	2021								
	UK			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[1]	**1,188**	**–**	**1,188**	**–**	**–**	**–**	**1,188**	**–**	**1,188**
Overseas	**3,468**	**–**	**3,468**	**–**	**–**	**–**	**3,468**	**–**	**3,468**
Pooled investment vehicles[2]	**257**	**8,058**	**8,315**	**990**	**–**	**990**	**1,247**	**8,058**	**9,305**
Fixed interest securities:									
UK gilts	**1,253**	**–**	**1,253**	**–**	**–**	**–**	**1,253**	**–**	**1,253**
UK corporates	**1,850**	**3,171**	**5,021**	**–**	**–**	**–**	**1,850**	**3,171**	**5,021**
Overseas government	**67**	**–**	**67**	**305**	**–**	**305**	**372**	**–**	**372**
Overseas corporates	**1,152**	**50**	**1,202**	**2,990**	**–**	**2,990**	**4,142**	**50**	**4,192**
Index-linked securities:									
UK gilts	**3,397**	**–**	**3,397**	**–**	**–**	**–**	**3,397**	**–**	**3,397**
UK corporates	**–**	**1,270**	**1,270**	**–**	**–**	**–**	**–**	**1,270**	**1,270**
Property[3]	**–**	**1,967**	**1,967**	**–**	**42**	**42**	**–**	**2,009**	**2,009**
Derivatives[4]	**–**	**(1,317)**	**(1,317)**	**–**	**(3)**	**(3)**	**–**	**(1,320)**	**(1,320)**
Cash:									
Sterling	**931**	**91**	**1,022**	**–**	**–**	**–**	**931**	**91**	**1,022**
Foreign currency	**14**	**4**	**18**	**91**	**–**	**91**	**105**	**4**	**109**
Other	**39**	**37**	**76**	**–**	**–**	**–**	**39**	**37**	**76**
Total	**13,616**	**13,331**	**26,947**	**4,376**	**39**	**4,415**	**17,992**	**13,370**	**31,362**

	2020								
	UK			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[1]	1,037	–	1,037	–	–	–	1,037	–	1,037
Overseas	2,763	–	2,763	–	–	–	2,763	–	2,763
Pooled investment vehicles[2]	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[3]	–	1,858	1,858	–	102	102	–	1,960	1,960
Derivatives[4]	–	(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

1. Includes £5m (2020 £6m) of the Company's own ordinary shares.
2. 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.
3. 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 £263m (2020 £257m) of property occupied by Group companies.
4. 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 £464m (2020 £393m) of repurchase agreements. The valuations are based on valuation techniques using underlying market data and discounted cash flows.

Notes to the Group accounts continued

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 2021, 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 2020	(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)
Current service cost	(237)	(13)	(1)	(23)	(274)
Contributions by employer in respect of employee salary sacrifice arrangements	(71)	–	–	–	(71)
Total current service cost	(308)	(13)	(1)	(23)	(345)
Members' contributions	(6)	–	–	–	(6)
Past service cost – plan amendments	(3)	–	(1)	–	(4)
Actuarial gain/(loss) due to changes in financial assumptions	1,145	220	6	(2)	1,369
Actuarial gain/(loss) due to changes in demographic assumptions	74	(8)	1	–	67
Experience losses	(1,109)	(8)	(2)	(6)	(1,125)
Interest expense	(401)	(113)	(4)	(4)	(522)
Foreign exchange translation	–	(33)	(1)	–	(34)
Benefits paid	1,079	206	9	14	1,308
Defined benefit obligations at 31 December 2021	**(28,920)**	**(4,643)**	**(150)**	**(153)**	**(33,866)**

24. Post-employment benefits continued

IAS 19 accounting continued

Amounts recognised in the income statement after allocation to equity accounted investments

	2021			
	UK defined benefit pension schemes £m	US and other pension schemes £m	Other schemes £m	Total £m
Included in operating costs:				
Current service cost	**(217)**	**(13)**	**(24)**	**(254)**
Past service cost – plan amendments	**(3)**	**–**	**(1)**	**(4)**
	(220)	**(13)**	**(25)**	**(258)**
Administrative expenses	**(11)**	**(7)**	**(1)**	**(19)**
	(231)	**(20)**	**(26)**	**(277)**
Included in net finance costs:				
Net interest expense on post-employment benefit obligations	**(52)**	**(10)**	**(3)**	**(65)**
Group defined benefit schemes included in share of results of equity accounted investments:				
Group's share of equity accounted investments' operating costs	**(10)**	**–**	**–**	**(10)**
Group's share of equity accounted investments' finance costs	**(2)**	**–**	**–**	**(2)**

	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)

The Group incurred a charge of £246m (2020 £242m) in relation to defined contribution schemes for employees.

Notes to the Group accounts continued

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 2021 and keeping all other assumptions as set out on page 245.

The pension schemes hold a number of unquoted pooled investment vehicles, which are investments in private markets. These are valued based on latest available valuation reports, and as noted on page 199, these valuations are subject to estimation uncertainty as their valuation techniques incorporate a number of assumptions, including those associated with the COVID-19 pandemic and the impact of climate change. Should these funds' actual valuations at 31 December 2021 be on average 2% different to those assumed, this would result in a £0.2bn (2020 £0.1bn) change in the valuation of the assets.

Financial assumptions

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

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

1. Before allocation to equity accounted investments.

Demographic assumptions

Changes in the life expectancy assumption, including the benefit of longevity swap arrangements (see longevity risk on page 244), would have the following effect on the total net IAS 19 deficit:

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

1. Before allocation to equity accounted investments.

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	51	2	275	58	386
Current	55	36	173	27	291
At 1 January 2021	106	38	448	85	677
Created	51	24	99	27	201
Utilised	(34)	(21)	(69)	(9)	(133)
Transfer to other balance sheet categories	–	–	(1)	–	(1)
Released	(12)	(4)	(91)	(28)	(135)
Net present value adjustments	–	–	(2)	–	(2)
Foreign exchange adjustments	(2)	1	1	–	–
At 31 December 2021	**109**	**38**	**385**	**75**	**607**
Represented by:					
Non-current	57	–	249	25	331
Current	52	38	136	50	276
	109	**38**	**385**	**75**	**607**

Notes to the Group accounts continued

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 (2020 £9m) 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 2020 and 31 December 2020	3,467	87	1	1	87
Purchase of own shares	(63)	(2)	–	–	(2)
At 31 December 2021	**3,404**	**85**	**1**	**1**	**85**

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. 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 2021, 236,807,031 (2020 248,995,549) ordinary shares of 2.5p each with an aggregate nominal value of £5,920,176 (2020 £6,224,889) were held in treasury. During 2021, 12,188,518 (2020 12,902,202) 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 2021, the ESOP held 7,022,472 (2020 5,946,770) ordinary shares of 2.5p each, with a market value of £39m (2020 £29m). 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.

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

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

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 11 May 2022.

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 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
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	27	27
Reclassification of cumulative currency translation reserve on disposal of subsidiary	–	–	–	–	–	(9)	(9)
Net amounts debited to hedging reserve	–	–	–	–	(52)	–	(52)
Equity accounted investments (net of tax)	–	–	–	–	9	(13)	(4)
Purchase of own shares	–	–	–	2	–	–	2
At 31 December 2021	**4,589**	**202**	**10**	**5**	**51**	**1,030**	**5,887**

Notes to the Group accounts continued

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 2021, the Group's capital was £7,617m (2020 £4,827m), which comprises total equity of £7,668m (2020 £4,921m), excluding amounts accumulated in equity relating to cash flow hedges of £51m (2020 £94m). Net debt (excluding lease liabilities) was £2,160m (2020 £2,718m).

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.

Purchase of own shares

On 29 July 2021 the Company announced the details of a share buyback programme to repurchase up to £500m of its own shares over the following 12 months.

As part of the buyback programme, it was agreed that should a better alternative use for the Company's cash reserves be identified, the share buyback programme would be ceased, and the money instead used for the alternative purpose. Therefore, when the Company issued a mandate to the brokers to purchase shares on their behalf, the mandates were structured such that they could be revoked at any point. As such, no financial liability has been recognised for shares not yet purchased under the programme.

During 2021, 63,272,873 shares have been repurchased for a total price, including transaction costs, of £371m. These shares have been subsequently cancelled, with the nominal value of shares cancelled deducted from share capital against the capital redemption reserve.

The share buyback programme was completed on 2 February 2022. In total 87,525,938 shares were repurchased under the scheme for a total price, including transaction costs, of £503m.

27. Cash flow from operating activities

Reconciliation of net cash flow from operating activities to free cash flow[1]

	2021 £m	2020 £m
Net cash flow from operating activities	**2,447**	1,166
Add back Taxation paid	**234**	251
Purchase of property, plant and equipment, and investment property	**(366)**	(385)
Purchase of intangible assets	**(96)**	(92)
Purchase of non-current other investment	**(15)**	–
Proceeds from sale of property, plant and equipment, and investment property	**271**	68
Proceeds from sale of non-current other investments	**–**	19
Equity accounted investment funding	**(3)**	(2)
Principal element of lease payments and receipts	**(207)**	(226)
Net capital expenditure, lease principal amounts and financial investment	**(416)**	(618)
Dividends received from equity accounted investments	**57**	27
Operating business cash flow[1]	**2,322**	826
Taxation paid	**(234)**	(251)
Interest paid, net of interest received	**(224)**	(208)
Free cash flow[1]	**1,864**	367

Reconciliation of operating business cash flow[1] to net cash flow from operating activities by reporting segment

	Operating business cash flow[1]		Deduct Dividends received from equity accounted investments		Add back Net capital expenditure, lease principal amounts and financial investment		Net cash flow from operating activities	
	2021 £m	2020 £m	2021 £m	2020 £m	2021 £m	2020 £m	2021 £m	2020 £m
Electronic Systems	**774**	580	**(3)**	(2)	**180**	189	**951**	767
Platforms & Services (US)	**287**	382	**(6)**	(13)	**70**	89	**351**	458
Air	**628**	718	**(44)**	(8)	**159**	207	**743**	917
Maritime	**321**	243	**(4)**	(4)	**140**	78	**457**	317
Cyber & Intelligence	**173**	221	**–**	–	**29**	30	**202**	251
HQ	**139**	(1,318)	**–**	–	**(162)**	25	**(23)**	(1,293)
	2,322	826	**(57)**	(27)	**416**	618	**2,681**	1,417
Taxation paid[2]							**(234)**	(251)
Net cash flow from operating activities							**2,447**	1,166

1. Operating business cash flow and Free cash flow are alternative performance measures defined in the Financial glossary on page 78, they are presented here to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.
2. Taxation is managed on a Group-wide basis.

Notes to the Group accounts continued

28. Movement in assets and liabilities arising from financing activities

	As at 1 January 2020 £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	Cash (inflow)/ outflow £m	Non-cash movements: Foreign exchange movements £m	Non-cash movements: Fair value and other movements £m	As at 31 December 2021 £m
Non-current assets									
Other financial assets[1]	**117**	–	–	20	**137**	–	–	(23)	**114**
Current assets									
Other financial assets[1]	**7**	(59)	–	61	**9**	(61)	–	60	**8**
	124	(59)	–	81	**146**	(61)	–	37	**122**
Non-current liabilities									
Loans	**(3,020)**	(2,666)	254	475	**(4,957)**	–	(42)	395	**(4,604)**
Lease liabilities	**(1,116)**	–	15	81	**(1,020)**	–	(8)	(55)	**(1,083)**
Other financial liabilities[1]	**(6)**	–	–	(180)	**(186)**	–	–	56	**(130)**
Cash collateral[3]	**(20)**	2	–	–	**(18)**	18	–	–	**–**
Current liabilities									
Loans[2]	**(377)**	506	(12)	(483)	**(366)**	367	(1)	(457)	**(457)**
Lease liabilities	**(238)**	236	(5)	(229)	**(236)**	217	1	(194)	**(212)**
Other financial liabilities[1]	**(58)**	43	(2)	(28)	**(45)**	149	–	(137)	**(33)**
	(4,835)	(1,879)	250	(364)	**(6,828)**	751	(50)	(392)	**(6,519)**
		(1,938)				**690**			
Interest paid		227				247			
Equity dividends paid		746				777			
Purchase of own shares		–				368			
Dividends paid to non-controlling interests		19				202			
Partial disposal of shareholding in subsidiary undertaking		(27)				(28)			
Net cash flow from financing activities		**(973)**				**2,256**			

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 (excluding lease liabilities)

Components of net debt (excluding lease liabilities)

	Notes	2021 £m	2020 £m
Cash and cash equivalents	18	**2,917**	2,768
Debt-related derivative financial instrument assets – non-current	14	**114**	137
Loans – non-current	21	**(4,604)**	(4,957)
Loans and overdrafts – current	21	**(457)**	(467)
Debt-related derivative financial instrument liabilities – non-current	14	**(130)**	(182)
Debt-related derivative financial instrument liabilities – current	14	**–**	(17)
Net debt (excluding lease liabilities)[1]		**(2,160)**	(2,718)

1. Net debt (excluding lease liabilities) is an alternative performance measure defined in the Financial glossary on page 78, it is presented here to provide additional information on performance to the user, and to reconcile to the equivalent IFRS measure.

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 will realise in the future.

Fair value hierarchy

The fair value measurement hierarchy is as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

Carrying amounts and fair values of certain financial instruments

		2021		2020	
	Notes	**Carrying amount £m**	**Fair value £m**	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:					
Non-current					
Other investments at fair value through profit and loss		**76**	**76**	–	–
Other financial assets	14	**305**	**305**	248	248
Other financial liabilities	14	**(302)**	**(302)**	(282)	(282)
Current					
Other financial assets	14	**194**	**194**	189	189
Money market funds	18	**1,171**	**1,171**	966	966
Other financial liabilities	14	**(214)**	**(214)**	(181)	(181)
Financial instruments not measured at fair value:					
Non-current					
Loans	21	**(4,604)**	**(5,045)**	(4,957)	(5,737)
Current					
Cash and cash equivalents (excluding money market funds)	18	**1,746**	**1,746**	1,802	1,802
Loans and overdrafts	21	**(457)**	**(462)**	(467)	(479)

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

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

Notes to the Group accounts continued

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 145 to 167.

Expense in year

	2021 £m	2020 £m
Executive Share Option Plan	**8**	6
Performance Share Plan	**32**	20
Restricted Share Plan	**8**	8
	48	34

The Group also incurred a charge of £44m (2020 £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

	2021		2020	
	Number of shares '000	**Weighted average exercise price £**	Number of shares '000	Weighted average exercise price £
Outstanding at the beginning of the year	**43,561**	**5.20**	38,979	5.36
Granted during the year	**10,995**	**5.02**	11,402	4.86
Exercised during the year	**(2,695)**	**4.68**	(2,368)	4.77
Expired during the year	**(4,581)**	**5.49**	(4,452)	5.91
Outstanding at the end of the year	**47,280**	**5.16**	43,561	5.20
Exercisable at the end of the year	**17,279**	**5.57**	15,297	5.36

	2021	2020
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 (£)	**1.00**	0.96

Performance Share Plan and Restricted Share Plan

	Performance Share Plan		Restricted Share Plan	
	2021 Number of shares '000	2020 Number of shares '000	**2021 Number of shares '000**	2020 Number of shares '000
Outstanding at the beginning of the year	**25,878**	22,495	**4,974**	4,406
Granted during the year	**9,387**	9,525	**2,304**	2,222
Exercised during the year	**(2,108)**	(1,767)	**(1,523)**	(1,270)
Expired during the year	**(5,242)**	(4,375)	**(342)**	(384)
Outstanding at the end of the year	**27,915**	25,878	**5,413**	4,974
Exercisable at the end of the year	**387**	471	**–**	–

	2021	2020	2021	2020
Weighted average remaining contracted life (years)	**5**	5	**5**	5
Weighted average fair value of awards granted (£)	**4.90**	4.38	**5.01**	4.86

The exercise price for the Performance Share Plan and Restricted Share Plan is £nil (2020 £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

	2021	2020
Range of share price at date of grant (£)	**5.00 – 5.68**	4.85 – 5.14
Expected option/award life (years)	**3 – 10**	3 – 10
Volatility (%)	**28**	27 – 28
Risk free interest rate (%)	**0.1 – 0.2**	(0.1) – 0.1

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 £5.33 (2020 £5.24).

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	**2021 £m**	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m	**2021 £m**	2020 £m
Advanced Electronics Company Limited	**1**	49	**–**	142	**–**	–	**–**	43	**–**	–
Eurofighter Jagdflugzeug GmbH	**1,068**	897	**402**	439	**26**	58	**74**	83	**–**	–
FADEC International LLC	**54**	45	**–**	–	**–**	–	**–**	–	**–**	–
MBDA SAS	**23**	24	**114**	188	**2**	8	**837**	1,024	**19**	19
Panavia Aircraft GmbH	**32**	35	**46**	42	**1**	1	**–**	1	**–**	–
BAE Systems Pension Funds Trustees Limited	**–**	–	**16**	20	**–**	–	**207**	212	**–**	–
Other	**12**	17	**8**	–	**5**	2	**19**	16	**–**	–
	1,190	1,067	**586**	831	**34**	69	**1,137**	1,379	**19**	19

1. Also relates to disclosures under IAS 24 Related Party Disclosures, for the parent company, BAE Systems plc. At 31 December 2021, £907m (2020 £967m) was owed by BAE Systems plc and £230m (2020 £412m) by other Group subsidiaries.

The Group also manages certain treasury functions on behalf of some of their equity accounted investments. This includes entering into foreign exchange derivatives on their behalf. As at 31 December 2021 we entered into forward contracts to purchase 250m euros, sell $20m, and purchase £4m worth of other currencies (2020 purchase 296m euros, sell $14m and purchase £4m worth of other currencies) on their behalf. No service fee is charged for these arrangements.

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 145 to 167. Total emoluments for directors and key management personnel charged to the Consolidated income statement were:

	2021 £'000	2020 £'000
Short-term employee benefits	**17,755**	15,518
Post-employment benefits	**1,121**	1,072
Share-based payments	**8,940**	5,877
	27,816	22,467

Notes to the Group accounts continued

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. Acquisitions of businesses

Businesses acquired during 2021

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

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

Businesses acquired during 2020

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

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

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

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

The results and financial position of all three acquired businesses have been consolidated from the date of acquisition. The evaluation of the fair values of the assets and liabilities acquired have been finalised, and there have been no changes to the fair values disclosed in the 2020 Annual Report.

Purchase consideration and fair value of net assets acquired

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

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

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

34. Acquisition of businesses continued

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

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

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

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 was an alternative performance measure used in 2020, defined as operating profit excluding amortisation and impairment of intangible assets, finance costs and taxation expense of equity accounted investments. In 2021, the business moved to the use of Underlying EBIT as defined in the Financial glossary on page 78. The prior year comparative has not been restated within this note to reflect this change, as the impact on EBIT and EBITA are materially the same.

35. Events after the reporting period

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

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 2021 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]
10 Fleet Place, London EC4M 7QS, United Kingdom

Alvis Limited

Alvis Pension Scheme Trustees Limited[3]

Alvis Vickers Limited

Armstrong Whitworth Aircraft Limited[3]

ASC Shipbuilding Pty Limited
Bldg 01, Level 2, 640 Mersey Road North, Osborne SA 5017, Australia

Australian Marine Engineering Corporation (Finance) Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Avro International Aerospace Limited[3]

BAE Systems (Al Diriyah C4i) Limited[3]

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]
10 Fleet Place, London EC4M 7QS, 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 3) Limited

BAE Systems (Finance) Limited

BAE Systems (Funding Four) Unlimited Company
Riverside One, Sir John Rogerson's Quay, Dublin D02 X576, 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]
10 Fleet Place, London EC4M 7QS, 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 (Warwick House) Limited[3,6] (In Strike Off)

BAE Systems 2000 Pension Plan Trustees Limited[3]

BAE Systems AB[7]
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 Integrated Computer Solutions (Kuwait) (S.P.C)
Al Hamra Tower, Al-Shuhada Street, Kuwait City, Kuwait

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[8]
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.
600-1741 Water Street, Halifax NS B3J 0J2, Canada

BAE Systems Applied Intelligence France SAS
19 Boulevard Malesherbes, 75008, Paris, France

BAE Systems Applied Intelligence GCS Inc.[9]
CSC, 100 Shockoe Slip, 2nd Floor Richmond VA 23219, United States

BAE Systems Applied Intelligence Inc.[10]
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
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia (NSW) Holdings Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia (NSW) Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Datagate Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Defence Holdings Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Defence Pty Limited[8]
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Holdings Limited[3]
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Logistics Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

BAE Systems Australia Sea Sentinel Project Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, 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 Communications Limited[2,3]
10 Fleet Place, London EC4M 7QS, 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]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Creole Inc.[11]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Datagate Holdings Limited

BAE Systems Datagate Limited

BAE Systems Deployed Systems Limited[12]

BAE Systems Display Technologies Limited[2]
10 Fleet Place, London EC4M 7QS, United Kingdom

BAE Systems do Brasil Ltda
SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil

36. Information about related undertakings continued

Subsidiaries – wholly-owned continued

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.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Flight Training (Australia) Pty Limited[13]
Level 2, 80 Flinders Street, Adelaide SA 5000, 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]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Hägglunds AB
SE-691 80, Karlskoga, Sweden

BAE Systems Hawaii Shipyards Inc.[7]
The Corporation Company, Inc., 1136 Union Mall, Suite 301, Honolulu HI 96813, 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[15]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Services) Private Limited[15]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Technology) Private Limited[15]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Ventures) Private Limited[15]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems Information and Electronic Systems Integration Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Insurance (Isle of Man) Limited
Tower House, Loch Promenade, Douglas, IM1 2LZ, Isle of Man

BAE Systems Integrated System Technologies (KSA) Limited

BAE Systems Integrated System Technologies (Overseas) Limited

BAE Systems Integrated System Technologies Limited

BAE Systems International Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Jacksonville Ship Repair LLC[1]
8500 Hecksher Drive, Jacksonville FL 32226, United States

BAE Systems Land & Armaments Holdings LLC[1]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Land & Armaments Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Land & Armaments L.P.[1]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, 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]
10 Fleet Place, London EC4M 7QS, 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.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Land Systems Pinzgauer (Holdings) Limited

BAE Systems Land Systems Pinzgauer Limited

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.
4701 Cox Road, Suite 285, Glen Allen VA 23060-6802, United States

BAE Systems Oman LLC[1]
PO Box 74, Postal Code 111, Seeb, Oman

BAE Systems Ordnance Systems Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Overseas Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Pension Funds CIF Trustees Limited[3]

BAE Systems Pension Funds Investment Management Limited[3,16]

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[9]
Minami Azabu T&F Building 8th Floor, 4-11-22 Minami Azabu, Minato-ku, Tokyo, Japan

BAE Systems Regional Aircraft Colombia SAS[17]
c/o Brigard & Urrutia, Calle 70 A No. 4-41, Bogotá, Colombia

BAE Systems Resolution Inc.[8]
1999 Bryan Street, Suite 900, Dallas TX 75201, United States

BAE Systems S&S Operations Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems San Diego Ship Repair Inc.[7]
330 N. Brand Boulevard, Glendale CA 91203-2336, United States

BAE Systems Saudi America Limited
Riyadh Kingdom Centre 28th Floor (REGUS), PO Box 23088, Riyadh 11321, Central Province, Riyadh, 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 Ambrósio Molina, No. 1090. Bloco F, Eugênio de Melo, São José dos Campos, São Paulo 12.247-000, Brazil

BAE Systems Share Plans Trustee Limited[3]

BAE Systems Shared Services (Overseas) Limited

BAE Systems Shared Services Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Ship Repair Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Southeast Shipyards AMHC Inc.[8]
1200 South Pine Island Road, Plantation FL 33324, 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

BAE Systems Surface Ships Limited

BAE Systems Surface Ships Maritime Limited

BAE Systems Surface Ships Portsmouth Limited[7]

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]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Technology Solutions & Services Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Training Services Limited

BAE Systems TVS Holdings LLC[1]
2941 Fairview Park Drive, Suite 100, Falls Church VA 22042, United States

BAE Systems Zephyr Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Zephyr Fifth Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Zephyr Fourth Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Zephyr Second Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington DE 19801, United States

BAE Systems Zephyr Third Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington DE 19801, United States

BAE Systems, Inc.[8]
1209 Orange Street, Wilmington DE 19801, United States

Notes to the Group accounts continued

36. Information about related undertakings continued

Subsidiaries – wholly-owned continued

Brabazon Limited

British Aerospace (Far East) Limited[18]
Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong

British Aerospace (Malaysia) Sdn Bhd[18]
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]

Cashhold Limited[2,3,5]
10 Fleet Place, London EC4M 7QS, 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[7]
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.[9]
c/o Corporation Trust Company, 1209 Orange Street, Wilmington DE 19801, United States

Dividend Training Limited

ETI Engineering, Inc.[9]
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.[15]
521 Fifth Avenue, New York NY 101075, United States

Hadrian Trustees Limited[3,19]

Hägglunds Vehicle GmbH
Ernst-Grote Strasse 13, 30916 Isernhagen, Germany

Hawker Siddeley Aviation Limited[3]

Hawker Siddeley Dynamics Limited[3]

HSA/HSD Pension Fund Trustees Limited[3]

Hunter Aerospace Corporation Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

In-Space Missions Limited[20,21]
8 Oriel Court, Omega Park, Alton GU34 2YT, United Kingdom

International Military Sales Limited

Jetstream Aircraft Limited[3]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Lemacrown Limited[20]

MES Holdco Limited
Charter Place, 23/27 Seaton Place, St. Helier, Jersey JE1 1JY

MES Interco[14]

Meslink Limited

Newcombe Properties Limited

Piper Group plc[2]
10 Fleet Place, London EC4M 7QS, 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

Prismatic Limited[5]
2 Omega Park, Alton GU34 2QE, 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

Pulse Power and Measurement Inc.
1717 Pennsylvania Avenue, NW Suite, 1025 Washington DC 20006, United States

Pulse Power and Measurement Limited[22]
65 Shrivenham Hundred Business Park, Watchfield, Swindon, Wiltshire SN6 8TY, United Kingdom

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
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Shipbuilding (VIC) Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, 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[1,17]
House No. 145, Street No. 1, Qtr. 611, Al Andulous Area, Al Mansour, Baghdad, Iraq

TDS International Holdings Pty Limited[23]
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

TDS International Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, 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 Supermarine Aviation Works Limited[3,4]

Thomas Sopwith Aviation Company Limited[3]

VSEL Birkenhead Limited

Warship Design Services Limited

Westover Controls Incorporated[9]
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%)[3,19]
Manton Lane, Bedford MK41 7PF, United Kingdom

BAE Systems Saudi Development and Training Company Limited (50.98%)[24]
PO Box 67775, Riyadh 11517, Saudi Arabia

BAE Systems SDT (UK) Limited (51%)

Flight Control System Management GmbH (66.6%)[25]
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

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

Air Astana (49%)[10]
121 Kabanbay Batyr Avenue, Yessil District, Astana 010000, Kazakhstan

AMSH B.V. (50%)[26]
Coolsingel 61, 7th Floor – right, 3012 AB 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%)[3,15]
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%)[27]
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%)[1,18]
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%)[3,23]

FADEC International LLC (50%)[1]
1098 Clark Street, Endicott NY 13760, United States

FAST Holdings Limited (50%)[14,23]

FAST Training Services Limited (50%)[15]

FNSS Savunma Sistemleri A.S (49%)[23]
Oğulbey Mahallesi, Oğulbey Kumeevleri, No. 441/A, 441/B, Gölbaşı, Ankara, Turkey

KBS Maritime Limited (50%)[7]

MBDA B.V. (37.5%)
Coolsingel 61, 7th Floor – right, 3012 AB Rotterdam, Netherlands

MBDA Holdings S.A.S. (25%)
1 Avenue Réaumur, 92350 Le Plessis-Robinson, France

MBDA S.A.S. (37.5%)
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%)[26]
Üniversiteler 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%)
Box 418, SE-691 27 Karlskoga, Sweden

Sealand Support Services Limited (33.3%)[8]
MoD Sealand, Welsh Road, Sealand, Deeside, Flintshire CH5 2LS, United Kingdom

Spectrum Technologies Limited (20%)[3,15]
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. Ownership held in ordinary shares, ordinary A and ordinary B shares.
14. Unlimited company.
15. Year end 31 March.
16. Year end 5 April.
17. In liquidation.
18. Year end 30 September.
19. Limited by Guarantee.
20. Ownership held in ordinary shares and class of A shares.
21. Year end 31 August.
22. Ownership held in class of A, B, C, D, E, F and G ordinary shares.
23. Ownership held in class of A shares.
24. 1% owned by BAE Systems plc.
25. 33.3% owned by BAE Systems plc.
26. Ownership held in class of B shares.
27. Ownership held in common shares and B Preferred shares.

Company statement of comprehensive income for the year ended 31 December

	2021 £m	2020 £m
Profit for the year	**902**	600
Other comprehensive income		
Items that will not be reclassified to the income statement:		
Remeasurements on post-employment benefit schemes	**205**	(137)
Items that may be reclassified to the income statement:		
Amounts debited to hedging reserve	**–**	(2)
Total other comprehensive income for the year (net of tax)	**205**	(139)
Total comprehensive income for the year	**1,107**	461

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 2020		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
Profit for the year		–	–	–	902	902
Total other comprehensive income for the year		–	–	–	205	205
Total comprehensive income for the year		–	–	–	1,107	1,107
Share-based payments	10	–	–	–	92	92
Purchase of own shares	9	(2)	–	2	(371)	(371)
Unclaimed assets programme proceeds		–	3	–	–	3
Ordinary share dividends[2]		–	–	–	(777)	(777)
At 31 December 2021		**85**	**1,252**	**206**	**2,798**	**4,341**

1. The non-distributable portion of retained earnings is £875m (2020 £827m).
2. Details of ordinary share dividends are provided in note 26 to the Group accounts.

Company balance sheet as at 31 December

	Notes	**2021 £m**	2020 £m
Non-current assets			
Intangible assets		**52**	53
Property, plant and equipment		**5**	7
Right-of-use assets		**21**	25
Investments in subsidiary undertakings and participating interests	2	**9,117**	9,047
Amounts owed by subsidiary undertakings	3	**4,500**	4,173
Other receivables		**7**	10
Post-employment benefit surpluses	8	**151**	121
Other financial assets	4	**401**	301
		14,254	13,737
Current assets			
Trade and other receivables	3	**63**	69
Current tax		**13**	14
Other financial assets	4	**307**	274
Cash and cash equivalents		**2,131**	2,149
		2,514	2,506
Total assets		**16,768**	16,243
Non-current liabilities			
Loans	5	**(2,701)**	(3,071)
Lease liabilities		**(27)**	(30)
Other payables	6	**–**	(21)
Post-employment benefit obligations	8	**(288)**	(469)
Other financial liabilities	4	**(409)**	(350)
Provisions	7	**(126)**	(120)
		(3,551)	(4,061)
Current liabilities			
Loans	5	**(432)**	(467)
Lease liabilities		**(3)**	(4)
Trade and other payables	6	**(8,087)**	(7,086)
Other financial liabilities	4	**(340)**	(312)
Provisions	7	**(14)**	(26)
		(8,876)	(7,895)
Total liabilities		**(12,427)**	(11,956)
Net assets		**4,341**	4,287
Capital and reserves			
Issued share capital		**85**	87
Share premium		**1,252**	1,249
Other reserves	9	**206**	204
Retained earnings[1]		**2,798**	2,747
Total equity		**4,341**	4,287

1. The Company's profit for the year is £902m (2020 £600m).

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

C N Woodburn
Chief Executive

B M Greve
Group Finance Director

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 123, 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. The amount 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 2021, as detailed on page 199 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 2021	9,066
Additions	73
Disposal	(16)
At 31 December 2021	**9,123**
Impairment provisions	
At 1 January 2021	19
Disposal	(13)
At 31 December 2021	**6**
Net carrying value	
At 31 December 2021	**9,117**
At 31 December 2020	9,047

3. Trade and other receivables

	2021 £m	2020 £m
Non-current		
Amounts owed by subsidiary undertakings[1]	**4,500**	4,173
Current		
Amounts owed by equity accounted investments	**3**	6
Prepayments	**19**	14
Accrued income	**26**	23
Other receivables	**15**	26
	63	69

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.

4. Other financial assets and liabilities

	2021		2020	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Non-current				
Other foreign exchange/interest rate contracts	**287**	**(279)**	164	(168)
Debt-related derivative financial instruments	**114**	**(130)**	137	(182)
	401	**(409)**	301	(350)
Current				
Cash flow hedges – foreign exchange contracts	**1**	**–**	–	(1)
Other foreign exchange/interest rate contracts	**306**	**(340)**	274	(294)
Debt-related derivative financial instruments	**–**	**–**	–	(17)
	307	**(340)**	274	(312)

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 and overdrafts

	2021 £m	2020 £m
Loans and overdrafts		
US$500m 4.75% bond, repayable 2021	**–**	366
£400m 4.125% bond, repayable 2022	**409**	399
US$1,300m 3.4% bond, repayable 2030	**959**	942
US$1,000m 1.90% bond, repayable 2031	**738**	724
US$400m 5.8% bond, repayable 2041	**297**	290
US$1,000m 3.0% bond, repayable 2050	**730**	716
Overdrafts	**–**	101
	3,133	3,538
Maturity analysis		
Non-current	**2,701**	3,071
Current	**432**	467
	3,133	3,538

6. Trade and other payables

	2021 £m	2020 £m
Non-current		
Other payables	**–**	21
Current		
Amounts owed to subsidiary undertakings[1]	**6,947**	5,869
Amounts owed to equity accounted investments	**907**	967
Accruals	**128**	105
Deferred income	**40**	49
Other payables	**65**	96
	8,087	7,086

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	120
Current	26
At 1 January 2021	146
Created	2
Utilised	(8)
At 31 December 2021	**140**
Represented by:	
Non-current	126
Current	14
	140

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.

	2021 £m	2020 £m
Present value of unfunded obligations	**(108)**	(87)
Present value of funded obligations	**(2,699)**	(2,837)
Fair value of scheme assets	**2,670**	2,576
Company's share of net IAS 19 deficit	**(137)**	(348)
Represented by:		
Post-employment benefit surpluses	**151**	121
Post-employment benefit obligations	**(288)**	(469)
	(137)	(348)

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 2020	202	3	1	206
Amounts debited to hedging reserve	–	–	(2)	(2)
At 31 December 2020	202	3	(1)	204
Purchase of own shares	–	2	–	2
At 31 December 2021	**202**	**5**	**(1)**	**206**

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.

Purchase of own shares

On 29 July 2021 the Company announced the details of a share buyback programme to repurchase up to £500m of its own shares over the following 12 months.

As part of the buyback programme, it was agreed that should a better alternative use for the Company's cash reserves be identified, the share buyback programme would be ceased, and the money instead used for the alternative purpose. Therefore, when the Company issued a mandate to the brokers to purchase shares on their behalf, the mandates were structured such that they could be revoked at any point. As such, no financial liability has been recognised for shares not yet purchased under the programme.

During 2021, 63,272,873 shares have been repurchased for a total price, including transaction costs, of £371m. These shares have been subsequently cancelled, with the nominal value of shares cancelled deducted from share capital against the capital redemption reserve.

The share buyback programme was completed on 2 February 2022. In total 87,525,938 shares were repurchased under the scheme for a total price, including transaction costs, of £503m.

Notes to the Company accounts continued

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 145 to 167.

	2021		2020	
	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 (ExSOP)	**3.01 – 6.49**	**7**	3.01 – 6.49	7
Performance Share Plan (PSP)	**–**	**5**	–	5
Restricted Share Plan (RSP)	**–**	**6**	–	6

The average share price in the year was £5.33 (2020 £5.24).

11. Employees

The total number of employees of the Company at 31 December 2021 was 1,786 (2020 1,743). 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:

	2021 £m	2020 £m
Wages and salaries	**126**	109
Social security costs	**15**	12
Pension costs – defined contribution plans	**2**	4
Pension costs – defined benefit plans	**28**	27
	171	152

12. Other information

Company audit fee

Fees payable to the Company's auditor for the audit of the Company's annual accounts totalled £2,349,000 (2020 £2,555,000). 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 £2m (2020 £nil) 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 £9,370,074 (2020 £6,267,009); 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 2021 as at the date of exercise was £257,493 (2020 £1,010,527) and the net aggregate value of assets received by directors in 2021 from Long-Term Incentive Plans as calculated at the date of vesting was £1,467,959 (2020 £1,753,203); 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 £1,928m (2020 £1,886m), 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

6 Carlton Gardens
London
SW1Y 5AD
United Kingdom

Telephone: +44 (0)1252 373232

Company website: **baesystems.com**

Registered in England and Wales, No. 1470151

Registrars

Equiniti Limited (0140)
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 2021 was 549.8p and the range during the year was 462p to 599p.

For more information

Visit the Shareholder information section of our website: **investors.baesystems.com**

Financial calendar

Financial year end	31 December
Annual General Meeting	5 May 2022
2021 final ordinary dividend payable	1 June 2022
2022 half-yearly results announcement	28 July 2022
2022 interim ordinary dividend payable	30 November 2022
2022 full-year results: – preliminary announcement – Annual Report	 February 2023 March 2023
2022 final ordinary dividend payable	June 2023

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.

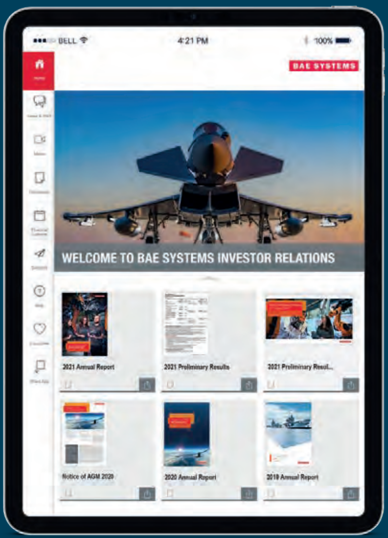
Check the FCA Warning List

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



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