

HALF-YEARLY REPORT AND PRESENTATION 2011



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Results in brief

Results from continuing operations	Six months ended 30 June 2011	Restated ¹ Six months ended 30 June 2010	Restated ¹ Year ended 31 December 2010
Sales ²	£9,229m	£10,582m	£22,275m
Underlying EBITA ³	£968m	£1,097m	£2,179m
Operating profit	£757m	£849m	£1,601m
Underlying earnings ⁴ per share	19.2p	19.9p	39.8p
Basic earnings per share ⁵	14.5p	15.6p	27.9p
Order book ⁶	£36.9bn	£43.4bn	£39.5bn
Other results including discontinued operations			
Dividend per share	7.5p	7.0p	17.5p
Cash inflow/(outflow) from operating activities	£176m	£(185)m	£1,535m
Net debt (as defined by the Group) ⁷	£(1,122)m	£(1,202)m	£(242)m

Highlights

- Headline sales² reduced by 13% in line with expectations
- Underlying EBITA³ reduced by 12% after a charge of £160m taken on the Omani Offshore Patrol Vessel (OPV) contract and a one-off benefit of £125m from a Ministry of Defence settlement agreement
- Underlying earnings⁴ per share reduced by 4%
- Operating cash inflow of £176m
- Interim dividend increased by 7.1% to 7.5p per share
- Up to £500m market purchase of shares announced

Outlook

The Group continues to anticipate a reduction in sales² in 2011 as the volume adjustment in Land & Armaments is expected to complete. Earnings have also been impacted by a combination of the first half charge for the Omani OPV programme and foreign exchange movement. These impacts are partially offset by a one-off benefit from a Ministry of Defence settlement agreement. Some further mitigation will result from an anticipated lower tax rate in the year. In aggregate, the Group anticipates that underlying earnings⁴ per share for the year will be broadly similar to 2010's restated earnings.

The level of the Group's operating cash inflow in the second half of the year remains dependent on timely completion of negotiations relating to changes on the Salam programme.

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 4).

2 Including share of equity accounted investments.

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

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

5 Basic earnings per share in accordance with International Accounting Standard 33, *Earnings per Share*.

6 Including share of equity accounted investments' order books and after the elimination of intra-group orders of £1.5bn (2010 £1.8bn).

7 See definition on page 4.

Interim management report

The performance of the Group in the first half of 2011 reflected the anticipated lower volume in the Group's Land activities and the reduced activity resulting from the UK Strategic Defence and Security Review (SDSR) in 2010. In addition, the Group announced in June that it expected significantly higher than planned costs to complete the Omani Offshore Patrol Vessel (OPV) programme and, as a consequence, a £160m pre-tax charge has been taken. There was a one-off benefit of £125m from a Ministry of Defence settlement agreement.

First half headline and like-for-like sales² reduced by 13%. Underlying EBITA³ on a like-for-like basis was 10% lower.

Balance sheet and cash flow

The Group's balance sheet will continue to be managed conservatively, in line with the Group's policy to retain its investment grade credit rating, and to ensure operating flexibility. Consistent with this approach, the Group will meet its pension obligations, continue to pursue organic investment opportunities, plan to pay dividends in line with the Group's policy of long-term sustainable cover of around two times and make accelerated returns of capital to shareholders when the balance sheet allows. Investment in value enhancing acquisitions will be considered where market conditions are right and where they deliver on the Group's strategy.

The continued strength of the balance sheet has enabled the Group to announce a further share repurchase programme of up to £500m. Consistent with last year's programme, the Group anticipates some accelerated pension deficit funding as a result.

As anticipated, there was an increase in working capital as advances were consumed on the Salam and European Typhoon programmes. Cash inflows are expected in the second half as major Salam milestones are scheduled.

Net cash utilisation on acquisitions and disposals was £382m in the first half. Pension contributions in excess of service costs were £169m, including £25m paid into Trust for the benefit of the BAE Systems Pension Scheme. Tax, dividend and net interest payments totalled £590m.

M&A activity

In the period, the Group completed a number of acquisitions.

In Cyber & Intelligence Services, the Group completed the following acquisitions:

- L-1 Identity Solutions, Inc.'s Intelligence Services Group, a leading provider of security and counter threat capabilities to the US government, for \$291m (£180m);
- Norkom Group plc, a market-leading provider of innovative anti-money laundering solutions to counter financial crime to the global financial services industry, for €209m (£177m);
- ETI A/S, a leading Danish provider of advanced technology products and services to government and commercial clients worldwide, for DKK1.2bn (£135m); and
- stratsec.net Pty Limited, an information security company with offices in Australia, Malaysia and Singapore, for A\$25m (£16m).

In Electronic Systems, BAE Systems acquired the 91.3% of outstanding equity of Fairchild Imaging, Inc. not already held by the Group, for \$88m (£55m). Fairchild is a provider of solid-state electronic imaging components, cameras, and systems for aerospace, industrial, medical and scientific imaging applications.

In addition, the Group has undertaken a number of disposals.

In January, BAE Systems sold its Swiss-Photonics AG group for \$11m (£7m).

In June, the Group sold its remaining shareholding in Saab AB for SEK1,553m (£152m).

In May, BAE Systems agreed the sale of its Regional Aircraft Asset Management business for cash consideration of \$187m (£117m). The amount of consideration is subject to an adjustment to reflect the difference between the estimated and actual trading and aircraft sales from 1 January 2011 to completion on 15 July. Consideration of \$9m (£6m) was deferred at completion pending transfer of title of certain aircraft.

On 26 July, BAE Systems completed the sale of its Composite Structures business in California to EnCore Composites Holdings, Inc. for cash consideration of approximately \$33m (£21m).

Pension funding

In April, the trustees of the Group's two largest UK pension schemes, the BAE Systems Pension Scheme and the BAE Systems 2000 Pension Plan, commenced triennial funding valuations. Funding deficits are expected to increase primarily due to lower discount rates. As a result, some increase in recurring deficit funding is likely. Discussions with the trustees regarding the implications for deficit funding are expected to commence in the near future.

Regulatory

In May, the Company and the US Department of State reached a civil settlement in connection with violations of the US defence export control regulations that were the subject of the earlier settlement with the US Justice Department announced by the Company in 2010. Under the agreement with the Department of State, the Company agreed to pay a fine of up to \$79m (£49m) in respect of alleged civil violations. The fine is payable over a period of three years, subject to a reduction of up to \$10m (£6m) in respect of the cost of enhanced export control compliance measures already implemented by the Company and planned for implementation during the four-year period from the settlement date.

In addition, a limited number of the Company's UK-originated export programmes will be subjected to enhanced administrative review, which is not expected to adversely impact the Company's current or future export programmes. The Company will also make additional commitments concerning its ongoing compliance.

Directors and management

George Rose, Group Finance Director, retired from the Board on 31 March after 19 years with the Group. Peter Lynas, previously Director, Financial Control, Reporting and Treasury, was appointed Group Finance Director with effect from 1 April, and joined the Board and Executive Committee on that date.

Also with effect from 1 April, Ravi Uppal, a non-executive director, stood down from the Board and Paula Rosput Reynolds was appointed a non-executive director of the Company. On 1 June, Lee McIntire was appointed a non-executive director.

Dividend

The Board has declared a 7.1% increase in the interim dividend to 7.5p for the first half year to 30 June 2011, reflecting the year's expected financial performance and a reduction in dividend cover towards the Group's policy of long-term sustainable cover of around two times.

Summarised income statement – continuing operations

	Six months ended 30 June 2011 £m	Restated ¹ Six months ended 30 June 2010 £m
Sales²	9,229	10,582
Underlying EBITA³	968	1,097
Loss on disposal of businesses	(6)	–
Regulatory penalties	(49)	(18)
EBITA	913	1,079
Amortisation of intangible assets	(126)	(211)
Impairment of intangible assets	(22)	(8)
Finance costs ²	(62)	(66)
Taxation expense ²	(203)	(242)
Profit for the period	500	552
Underlying earnings ⁴ per share	19.2p	19.9p
Basic earnings per share ⁵	14.5p	15.6p
Dividend per share	7.5p	7.0p

Exchange rates

	Six months ended 30 June 2011	Six months ended 30 June 2010
£/\$ – average	1.617	1.524
£/\$ – period end	1.605	1.497
£/€ – average	1.152	1.150
£/€ – period end	1.107	1.221
£/A\$ – average	1.564	1.706
£/A\$ – period end	1.499	1.769

Segmental analysis – continuing operations

	Sales ²		Underlying EBITA ³	
	Six months ended 30 June 2011 £m	Restated ¹ Six months ended 30 June 2010 £m	Six months ended 30 June 2011 £m	Restated ¹ Six months ended 30 June 2010 £m
Electronics, Intelligence & Support	2,573	2,624	298	296
Land & Armaments	1,846	3,074	180	316
Programmes & Support	3,140	3,035	285	316
International	1,862	2,078	221	218
HQ & Other Businesses	78	74	(16)	(49)
Intra-group	(270)	(303)	–	–
	9,229	10,582	968	1,097

The results of the Regional Aircraft line of business and the Group's share of the results of Saab AB to the date of disposal of half of its 20.5% shareholding in June 2010 are shown within discontinued operations (see note 4).

Income statement – continuing operations

Sales² in the first half of 2011 were £9,229m (2010 £10,582m). On a like-for-like basis, after adjusting for the impact of exchange translation, and acquisitions and disposals, sales² were 13% lower largely driven by the anticipated land vehicle volume adjustment in Land & Armaments. Sales in 2011 are expected to have a second half bias primarily reflecting the negotiation of changes to the Saudi Salam programme anticipated later this year.

Underlying EBITA³ of £968m (2010 £1,097m) includes a charge of £160m taken in respect of the Omani OPV contract. As part of the termination settlements arising from last year's SDRS, there has been an increased and accelerated level of rationalisation costs recovered. In the first half, this benefit was £125m. Return on sales increased to 10.5% (2010 10.4%).

Loss on disposal of businesses of £6m reflects a loss on the disposal of the Swiss-Photonics business, which was part of the Land & Armaments operating group.

Regulatory penalties of £49m in 2011 reflects the US Department of State fine. The prior period charge reflected the US dollar exchange rate movement on payment of the global settlement of the regulatory investigation by the US Department of Justice.

Amortisation of intangible assets is £85m lower at £126m mainly reflecting the profile of vehicle deliveries under the completed Family of Medium Tactical Vehicles (FMTV) contract.

Impairment of intangible assets of £22m in 2011 relates to a charge taken for goodwill impairment on the Surface Ships business.

Net financial expense² was £62m (2010 £66m), which includes £41m relating to the early redemption of debt in June 2011 in connection with the disposal of the Regional Aircraft Asset Management business in July 2011. Net income of £55m (2010 £30m) arose from pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements.

Taxation expense² reflects the Group's effective tax rate for the period of 26% (2010 30%). The effective tax rate is based on profit before taxation excluding regulatory penalties of £49m, goodwill impairment of £22m and loss on disposal of businesses of £6m. The underlying tax rate for the full year is expected to be around 28%, with the final number dependent on the mix of profits between the UK and US. Both the effective tax rate for the period and the expected rate for the full year are lower than previously expected as a result of agreeing prior year tax audits and settlements reached on outstanding items.

Underlying earnings⁴ per share for the period reduced by 4% to 19.2p compared with 2010 (19.9p).

Basic earnings per share⁵ for the period was 14.5p (2010 15.6p).

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 4).

2 Including share of equity accounted investments.

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

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

5 Basic earnings per share in accordance with International Accounting Standard 33, *Earnings per Share*.

Interim management report *continued*

Reconciliation of cash flow from operating activities to net debt (as defined by the Group)

	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m
Cash inflow/(outflow) from operating activities	176	(185)
Capital expenditure (net) and financial investment	(146)	(143)
Dividends received from equity accounted investments	6	24
Assets contributed to Trust	(25)	(25)
Operating business cash flow	11	(329)
Interest	(96)	(83)
Income from financial assets at fair value through profit or loss	4	–
Taxation	(117)	(257)
Free cash flow	(198)	(669)
Acquisitions and disposals	(382)	90
Cash classified as held for sale	(15)	–
Purchase of equity shares (net)	(11)	(466)
Equity dividends paid	(359)	(335)
Dividends paid to non-controlling interests	(18)	(25)
Cash inflow/(outflow) from matured derivative financial instruments	38	(82)
Movement in cash collateral	(3)	11
Movement in cash received on customers' account ⁶	6	11
Foreign exchange translation	53	(227)
Other non-cash movements	9	87
Net outflow	(880)	(1,605)
Opening net (debt)/cash (as defined by the Group)	(242)	403
Closing net debt (as defined by the Group)	(1,122)	(1,202)

Components of net debt (as defined by the Group)

	30 June 2011 £m	30 June 2010 £m
Debt-related derivative financial assets	37	108
Other investments – current	274	246
Cash and cash equivalents	1,742	2,492
Loans – non-current	(1,822)	(2,978)
Loans and overdrafts – current	(1,011)	(800)
Less: Cash received on customers' account ⁶	(10)	(9)
Less: Assets held in Trust	(287)	(261)
Less: Cash held for charitable contribution to Tanzania	(30)	–
Less: Cash classified as held for sale	(15)	–
Net debt (as defined by the Group)	(1,122)	(1,202)

Operating business cash flow

	Six months ended 30 June 2011 £m	Restated ¹ Six months ended 30 June 2010 £m
Electronics, Intelligence & Support	226	267
Land & Armaments	28	465
Programmes & Support	56	(50)
International	(175)	(553)
HQ & Other Businesses	(147)	(470)
Discontinued operations	23	12
Operating business cash flow	11	(329)

Cash flows

Cash inflow from operating activities was £176m (2010 outflow £185m). A £266m payment to the US Department of Justice was made in the prior period in respect of the regulatory penalty. Additional contributions into the UK pension schemes were £71m (2010 £81m).

There was an outflow from **net capital expenditure and financial investment** of £146m (2010 £143m).

Dividends from equity accounted investments, primarily Advanced Electronics Company and Eurofighter GmbH, amounted to £6m (2010 £24m).

Assets contributed to Trust comprises £25m of payments made into Trust during the period for the benefit of the Group's main pension scheme (2010 £25m).

Taxation payments were £140m lower at £117m primarily reflecting timing differences on US tax payments in the prior period.

Net cash outflow in respect of **acquisitions and disposals** of £382m mainly comprises the acquisition of L-1 Identity Solutions, Inc.'s Intelligence Services Group, Norkom Group plc, ETI A/S, Fairchild Imaging, Inc. and stratsec.net Pty Limited (£524m), and deferred consideration paid relating to the 2010 acquisition of OASYS Technology, LLC (£13m), less the proceeds from the disposal of the Group's residual shareholding in Saab AB in June 2011 (£152m). The net cash inflow in the prior period mainly comprises the disposal of half of the Group's shareholding in Saab AB in June 2010 (£92m).

Cash classified as held for sale of £15m has been deducted from the Group's net debt at 30 June 2011.

The **net purchase of equity shares** of £466m in 2010 included 127 million shares purchased under the buyback programme completed in July 2010.

Foreign exchange translation during the period, primarily in respect of the Group's US dollar-denominated borrowing, reduced reported net debt by £53m.

Net debt

The Group's net debt at 30 June 2011 was £1,122m (2010 £1,202m), a net outflow of £880m from the net debt position of £242m at the start of the period.

In connection with the disposal of the Regional Aircraft Asset Management business, which completed in July 2011, the Group redeemed \$514m (£318m) of debt in June 2011, which had been secured against the aircraft now disposed of.

Going concern

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

Principal risks

The principal risks facing the Group for the remaining six months of the year are unchanged from those reported in the Annual Report 2010.

These risks, together with the Group's risk management process, are detailed on pages 56 to 63 of the Annual Report 2010, and relate to the following areas: defence spending; government customers; global market; contract award timing; large contracts; fixed-price contracts; component availability, subcontractor performance and key suppliers; laws and regulations; competition; pension funding; export controls and other restrictions; acquisitions; consortia and joint ventures; and exchange rates.

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 4).

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

Interim management report – Operating group reviews

Electronics, Intelligence & Support

Electronics, Intelligence & Support, with 31,700 employees¹, provides a wide range of electronic systems and subsystems for military and commercial applications, technical and professional services for US national security and federal markets, and ship repair and modernisation services.

	Six months ended 30 June 2011	Six months ended 30 June 2010	Year ended 31 December 2010
Order intake ¹	£2,425m	£2,674m	£5,823m
Order book ¹	£4.5bn	£4.8bn	£4.8bn
Order backlog ^{1, 4}	£7.5bn	£6.8bn	£7.1bn
Sales ¹	£2,573m	£2,624m	£5,653m
Underlying EBITA ²	£298m	£296m	£668m
Return on sales	11.6%	11.3%	11.8%
Cash inflow ³	£226m	£267m	£568m

In the first half of 2011, Electronics, Intelligence & Support achieved underlying EBITA² of £298m (2010 £296m) on sales¹ of £2,573m (2010 £2,624m) and generated an operating cash inflow³ of £226m (2010 £267m).

On a like-for-like basis, sales¹ declined in the first half year by 2% over 2010 primarily reflecting the completing F-22 and Advanced Threat Infrared Countermeasures production programmes.

Electronic Solutions

Electronic Solutions maintained its leadership position in electronic warfare, including on the F-35 Systems Design and Development contracts, which have been aligned to support the US Defense Secretary's programme restructuring announced in January 2011. The related F-35 Low-Rate Initial Production programme performance continues to meet commitments.

Strong performance on programmes continued and several follow-on awards were received during the period, including for Thermal Weapon Sights. The most recent award for the sights, under a five-year, Indefinite-Delivery, Indefinite-Quantity (IDIQ) contract, was a \$56m (£35m) order from the US Army.

After successful tests of the mobile military communications system (MOKYS), BAE Systems is moving forward with production of the remaining 18 units under the contract awarded by the Slovak Ministry of Defence (MoD) in 2010.

Several quick reaction contracts totalling over \$70m (£44m) were awarded in the expanding area of Persistent Surveillance.

In April, the business completed the acquisition of Fairchild Imaging, Inc., expanding BAE Systems' low size, weight and power electro-imaging product manufacturing capabilities.

Platform Solutions

In commercial avionics, key wins have been secured on new programmes, including high integrity flight controls for regional aircraft and business jets, such as the Bombardier CSeries. The signing of long-term supplier agreements with aftermarket airline customers, and increasing production rates on Boeing and Airbus aircraft support future growth.

The business, through its FADEC International joint venture, has been selected by GE to develop and produce the Full Authority Digital Electronic Control for CFM International's next generation engine, the LEAP-X, which is designed to power future narrow body commercial aircraft.

In defence avionics, the business continues to pursue strategic military opportunities for new applications of key technologies, whilst remaining focused on producing mission upgrade and support for platforms such as F-35, F-15, F-18 and Typhoon.

Platform Solutions continues to market its power and energy management products to capitalise on growth opportunities. The business has won 60% of the hybrid drive opportunity arising from the UK Green Bus Funds and has expanded its HybriDrive® series

system to additional original equipment manufacturers in the transit bus market. The business has also introduced its next generation HybriDrive® parallel system to the US and European truck markets.

The Electronic Solutions and Platform Solutions operations combined in July to form a new Electronic Systems business.

Intelligence & Security

The business continues to provide US intelligence, defence, homeland security and law enforcement agencies with a range of intelligence analysis, operational support and analytic tools, and information technology products and services. These provide the timely and accurate information needed to predict, prevent and protect against individual, physical and cyber security threats.

Key contract awards in the period included two competitive task orders totalling \$344m (£214m) over five years from the Defense Intelligence Agency under the Solutions for the Information Technology Enterprise contract, which address the customer's requirements to transform its IT services delivery model worldwide. Orders totalling \$55m (£34m) were received in the period under these contracts.

Two US government IDIQ contracts, totalling \$280m (£174m), for full-motion video and geospatial imagery analysis, were awarded. Orders totalling \$15m (£9m) were received in the period under these contracts.

In February, BAE Systems expanded its presence in the US intelligence community by completing the acquisition of L-1 Identity Solutions, Inc.'s Intelligence Services Group.

Support Solutions

With a leadership role in the ship repair and sustainment market, the business secured more than \$1bn (£623m) in Multi-Ship, Multi-Option contracts to repair and overhaul mission critical US Navy ships over the next five years, including amphibious assault ships, cruisers and amphibious transport ships.

Support Solutions will design, install, integrate and test various communications systems for ten US Navy Littoral Combat Ships under a contract award worth \$147m (£92m).

In May, BAE Systems was selected by the US Army to manage, operate and maintain the Radford Army Ammunition Plant for a ten-year period. The award, potentially worth approximately \$850m (£530m), also has three five-year follow-on option periods. The incumbent contractor, Alliant Techsystems, has protested the award to the US Government Accountability Office.

Outlook

Whilst the overall US defence budget is predicted to flatten, the business continues to capitalise on its technology, service and product positions to address those areas within the budget that are expected to grow.

¹ Including share of equity accounted investments.

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

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

⁴ Comprises both the order book, which includes unexecuted, funded customer orders only, and unfunded customer orders.

Land & Armaments, with 14,200 employees¹, designs, develops, produces, supports and upgrades armoured combat vehicles, tactical wheeled vehicles, naval guns, missile launchers, artillery systems, munitions and law enforcement products.

	Six months ended 30 June 2011	Six months ended 30 June 2010	Year ended 31 December 2010
Order intake ¹	£1,330m	£1,734m	£3,707m
Order book ¹	£5.3bn	£6.9bn	£5.9bn
Sales ¹	£1,846m	£3,074m	£5,930m
Underlying EBITA ²	£180m	£316m	£604m
Return on sales	9.8%	10.3%	10.2%
Cash inflow ³	£28m	£465m	£858m

In the first half of 2011, Land & Armaments achieved underlying EBITA² of £180m (2010 £316m) on sales¹ of £1,846m (2010 £3,074m) and generated an operating cash inflow³ of £28m (2010 £465m).

On a like-for-like basis, and as expected, sales¹ reduced by 38% reflecting the lower level of Bradley reset activity and completed FMTV programme.

The three-year rationalisation programme, which commenced in 2009, has reduced net headcount (including contractors) by more than 40% to date.

United States

During the first half of the year, the business continued to focus on its Heavy Brigade Combat Team positions, supporting the customer's requirements across the Bradley and Paladin Integrated Management (PIM) programmes. In the period, the business received several contracts worth \$188m (£117m) to provide various vehicle and survivability upgrades, as well as field support, for Bradley, and delivered seven test vehicles on or ahead of schedule for the PIM programme as it entered the formal development test phase.

The US Army continues its sourcing process for the Ground Combat Vehicle (GCV) programme and BAE Systems, together with Northrop Grumman, has submitted a proposal for the development phase. With its hybrid electric drive propulsion system, the GCV team's proposal offers enhanced force protection and mobility, whilst provisioning for power requirement growth as new technologies are matured and integrated into the platform. Contract award for the development phase is expected in the third quarter of 2011.

On tactical vehicles, US Marine Corps awards were received totalling \$53m (£33m) under the RG33 Mine Resistant Ambush Protected (MRAP) IDIQ contract, including delivery of Special Operations Command A1 and Armoured Utility Variant vehicles, related equipment, services, and in-theatre maintenance and upgrades.

The business completed the technology development phase of the US Army's Joint Light Tactical Vehicle programme in May, and will compete for the engineering and manufacturing development phase, with the customer scheduled to award up to two contracts in early 2012.

The business has responded to a customer request for information regarding the provision of various vehicle and survivability upgrades on over 60,000 Modernised Expanded Capacity Vehicles. A technology development phase award is scheduled for 2012.

In May, the business completed its last chassis under the US Army FMTV contract. More than 70,000 vehicles have been delivered over 17 years of production. The upgrade of 1,700 Caiman Multi-Terrain Vehicles continues at the Sealy plant in Texas.

In naval armament systems, the business received a contract to deliver 40 Mk 38 Mod 2 gun systems in the first year of a four-year IDIQ contract worth over \$165m (£103m). The award increases the total number of these systems in the US Navy's fleet to more than 220.

The business also received a \$55m (£34m) award for Mk 41 Vertical Launching System mechanical modules, together with related equipment and services, for CG 47 and DDG 51 class surface combatant ships, and Aegis Ashore requirements for the Missile Defense Agency's Ground Ballistic Missile Defense programme.

In July, BAE Systems sold its Composite Structures business in California. Sales in 2010 from this business were \$32m (£21m).

United Kingdom

The munitions business continues to invest in facilities, including the opening of a high technology production facility in Washington, UK, and a laboratory complex at the Glascoed site to bring increased capability and flexibility for the testing of high explosive munitions. The business is performing well under its 15-year partnership with the UK MoD to deliver a range of munitions.

Awards for an additional 22 M777 howitzers for the US Marine Corps and 24 for the US Army totalling \$70m (£44m) take orders since product launch to over 1,000 systems, worth in excess of \$2bn (£1.2bn).

An amendment to the Terrier armoured engineer vehicle contract was agreed with the UK MoD in March, providing a clear way forward for the supply of the 60 vehicles.

Other markets and joint ventures

In the period, the Sweden-based weapons business was awarded two contracts to supply 57mm Mk 110 naval gun systems on 20 US Navy Littoral Combat Ships. Four initial gun systems have been ordered and the programme is expected to run until 2017.

In South Africa, the business began deliveries on the \$130m (£81m) contract received in 2010 for survivability and mobility upgrades on RG31 MRAP vehicles.

In June, FNSS, a 49% owned joint venture with Nurol Group of Turkey, signed a \$559m (£348m) letter of offer and acceptance from DEFTECH of Malaysia for the design, development and manufacture of 257 armoured wheeled vehicles and integrated logistics support for the Malaysian armed forces.

The Swedish business expects an award announcement on a contract to supply CV90 vehicles to the Norwegian Defence Logistics Organisation around the turn of the year.

Outlook

Sales¹ for the full year are expected to be around \$6.0bn (£3.7bn) at a target return on sales of 10%. This anticipated sales¹ reduction includes the impacts of completion of the FMTV contract and lower level of Bradley reset/remanufacture activity. However, the business is well positioned to compete for sustainment and upgrade work on its existing platforms.

Going forward, the focus will be on securing key new domestic programmes, pursuing export opportunities, and sustaining the margin through ongoing restructuring and efficiency programmes.

¹ Including share of equity accounted investments.

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

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

Programmes & Support

Programmes & Support, with 30,300 employees¹, primarily comprises the Group's UK-based air, maritime and Cyber & Intelligence Services activities.

	Six months ended 30 June 2011	Six months ended 30 June 2010	Year ended 31 December 2010
Order intake ¹	£2,463m	£2,441m	£4,139m
Order book ¹	£20.1bn	£23.7bn	£21.1bn
Sales ¹	£3,140m	£3,035m	£6,680m
Underlying EBITA ²	£285m	£316m	£529m
Return on sales	9.1%	10.4%	7.9%
Cash inflow/(outflow) ³	£56m	£(50)m	£227m

In the first half of 2011, Programmes & Support achieved underlying EBITA² of £285m (2010 £316m) on sales¹ of £3,140m (2010 £3,035m). Return on sales reduced to 9.1% (2010 10.4%).

Underlying EBITA² includes a £160m charge in respect of the Omani Offshore Patrol Vessel (OPV) contract, and £125m relating to increased and accelerated rationalisation costs recovered from the UK MoD.

In line with the continuing focus on cost reduction and efficiency, there was a net reduction in headcount of 2,300 during the period.

Military Air & Information

Settlement agreements with the UK MoD have been completed following changes to the programmes impacted by the SDSR in 2010, including those for the terminated Nimrod MRA4 and Harrier programmes, and recovery of rationalisation costs charged to the income statement in prior years.

In the first half of the year, deliveries of Typhoon Tranche 2 aircraft to the four partner nations totalled 16. The UK Typhoon fleet achieved the significant milestone of 100,000 flying hours in the period. The Group continues to support its customer's aircraft and their operational commitments through the Typhoon Availability Service contract.

On Tornado, the business continued to support the fleet through delivery of contractual milestones and operational requirements. Flying hours across the Tornado fleet are expected to reduce as a consequence of the SDSR.

On the F-35 programme, the customer, Lockheed Martin, has now delivered the first production standard aircraft to the US Air Force and BAE Systems has delivered more than 50 rear fuselage assemblies to Lockheed Martin. Full funding for the fourth Low-Rate Initial Production contract covering 32 aircraft has been received.

On the Indian Hawk follow-on contract, secured last year, the first £100m payment from Hindustan Aeronautics has been received for the delivery of products and services for the Indian Air Force and Navy.

In March, a Memorandum of Understanding was signed with Dassault Aviation to bid jointly for new Unmanned Aircraft Systems for the UK and French MoDs in response to the UK-France Defence Co-operation Treaty announced in 2010.

Progress on the FALCON secure deployable communication system contract for the British Army and Royal Air Force remains focused on getting the system into service.

Maritime

Good progress continues to be made on the first of the Royal Navy's new aircraft carriers, the Queen Elizabeth, and the first steel was cut in May for the second ship, the Prince of Wales. A £0.9bn contract amendment was received in the period reflecting the programme's agreed target price.

The Type 45 programme continues to progress to schedule and the support contract is delivering availability of the three ships now in service.

Savings in excess of £150m have been delivered for the MoD against commitments made under the Terms of Business Agreement (ToBA).

The arbitration process between the Group and the Government of the Republic of Trinidad and Tobago, in respect of the cancelled OPV programme, is underway and the main tribunal hearing is scheduled for 2012.

Following recent sea trials, subsequent related engineering reviews and customer discussions, the Group has concluded that it will incur significantly higher than planned costs to complete the Omani OPV programme. As a consequence, a charge of £160m pre-tax has been taken in the period.

A number of support contracts have been secured, including a £46m contract to support the Sampson multi-function radar.

HMS Astute, the first of class attack submarine for the Royal Navy, continues to undertake sea trials and is making good progress. Ambush, the second of class, was launched in January and is progressing through the commissioning phase. Construction continues on the third and fourth boats, and construction of the fifth boat is now underway. Long lead procurement has commenced on the sixth boat.

The UK government has formally announced the approval to develop the Vanguard class replacement submarine design to deliver the UK's nuclear deterrent capability.

Detica

The business continues to develop and deliver information intelligence solutions to government and commercial customers, and grow its business in the areas of cyber security, information assurance and information intelligence products. The acquisitions of Norkom and ETI strengthen the product portfolio for tackling fraud and delivering intelligence. The integration of these businesses continues.

The business has received orders during the period for its advanced cyber security service, Detica Treidan®, from a number of commercial and defence customers.

Orders for DataRetain™, a communications data retention solution, were received from customers in the telecommunications sector.

Orders were also received to supply information assurance, cyber security and integration services for customers, including the Ministry of Justice, Transport for London and the UK MoD, along with a contract to provide a mobile data solution to Strathclyde Police.

Detica is creating a Security Operations Centre that can detect and remediate advanced cyber attacks for both government and business.

Outlook

Programmes & Support has a strong order book of long-term committed programmes, an enduring support business and cost reduction programmes in place. In Military Air & Information, sales are underpinned by combat aircraft production, and in-service support in the UK and on export programmes. Maritime is underpinned by the Type 45 destroyer, Queen Elizabeth class carriers and Astute class submarine manufacturing programmes, the 15-year ToBA, services contracts, and the design of the Vanguard class successor submarine and Type 26 global combat ship. Detica is positioned to benefit from a focus on intelligence and cyber security both in the UK and overseas government markets, and from growing demand for commercial products and services to counter financial fraud.

International, with 17,500 employees¹, comprises the Group's businesses in Australia, India and Saudi Arabia, together with interests in the pan-European MBDA joint venture and Air Astana.

	Six months ended 30 June 2011	Six months ended 30 June 2010	Year ended 31 December 2010
Order intake ¹	£1,098m	£1,092m	£2,908m
Order book ¹	£8.4bn	£9.6bn	£9.1bn
Sales ¹	£1,862m	£2,078m	£4,534m
Underlying EBITA ²	£221m	£218m	£478m
Return on sales	11.9%	10.5%	10.5%
Cash (outflow)/inflow ³	£(175)m	£(553)m	£195m

In the first half of 2011, International achieved underlying EBITA² of £221m (2010 £218m) on sales¹ of £1,862m (2010 £2,078m), generating a return on sales of 11.9% (2010 10.5%).

The cash outflow³ of £175m (2010 £553m) in the period reflects the expected utilisation of advance funding on the Salam programme.

Saudi Arabia

Of the 72 Typhoon aircraft contracted under the Salam programme, 22 have been delivered to the customer on schedule. A further two aircraft are scheduled for delivery later this year, completing the first squadron. Commercial discussions continue on the programme, including the location and pricing of final assembly of the remaining 48 aircraft, the creation of an in-Kingdom maintenance and upgrade facility, and potential modifications to the last 24 aircraft to allow future incorporation of Tranche 3 capability.

The three-year Typhoon support solution agreed in 2009 continues to provide increased levels of capability to the Royal Saudi Air Force (RSAF) and performance against the flying programme remains in line with contract. Discussions have started on the next phase of the support contract which commences in the second half of 2012.

The business continues to support the operational capability of both the RSAF and Royal Saudi Naval Force through the Saudi British Defence Co-operation Programme (SBDPC). Discussions with the customer continue regarding the next five-year phase of the SBDPC which commences in 2012.

The upgrade of the RSAF Tornado fleet to the Tornado Sustainment Programme standard is currently performing ahead of schedule, with 50 of the contracted 81 aircraft delivered back into the fleet as at 30 June 2011.

All 200 of the Tactica vehicles have now been accepted by the Saudi Arabia National Guard. The separate support contract continues to perform in line with expectations.

The C4i⁵ programme remains challenging and agreement on the design completion has not been finalised. Discussions are ongoing with the customer to identify a mutually acceptable way forward.

Australia

Construction of the Landing Helicopter Dock hulls remains on schedule with the first ship being launched in February by the subcontractor, Navantia, in Spain. Construction of the first superstructure blocks has begun in Australia, along with facilities to enable initial weapons and combat systems testing to begin.

On the Air Warfare Destroyer programme, the Group continues to work with the end customer and prime contractor to establish a way forward on a revised schedule. Given the high loading in the shipyard, some of the Group's contracted scope of work may be moved to third-party shipyards.

During the first half of the year, the business was awarded support contract extensions for A\$116m (£77m) on the Over-The-Horizon Radar system for five years and A\$135m (£90m) on Hawk Lead-In Fighter for two years. These awards demonstrate the Group's

success in identifying efficiencies in response to the Australian Strategic Reform Program.

The business has successfully integrated stratsec.net which was acquired to expand the Group's cyber security capabilities in the Asia Pacific region.

MBDA

MBDA has delivered increased sales and return on sales compared with the prior period.

Whilst domestic customer budget issues have delayed certain expected orders, awards for support on the Sea Viper surface-to-air weapons system in the UK and export orders for Exocet anti-ship missiles have been secured.

The business successfully demonstrated both the Pars 3 Long-Range guided anti-tank missile system and the Vertical Launched Mica air defence weapons system, and there have been further successful customer test firings of the Aster missile and development firings of the Meteor missile.

A contract for the supply of Mica missiles on the Indian Mirage upgrade programme is expected in the second half.

India

Typhoon was downselected by the Indian government on the Medium Multi-Role Combat Aircraft programme as one of two preferred aircraft. The final selection process for a contract to supply 126 aircraft is underway.

Defence Land Systems India, the Group's 26% joint venture with Mahindra & Mahindra, won the first order for its new vehicle, the Mine Protected Vehicle India, and is awaiting the results of its bid on the substantial Future Infantry Combat Vehicle competition.

The Group is actively pursuing an opportunity to supply up to 145 M777 howitzers to the Indian Army, but withdrew from the competition for the 155mm towed howitzer following changes to the customer's requirements and specifications.

Air Astana

Air Astana continues to perform profitably, in line with expectations.

Oman

Activity continues on working towards the supply of Typhoon aircraft and associated support to the Royal Air Force of Oman.

Outlook

In the Kingdom of Saudi Arabia, the Group seeks to sustain its long-term presence through delivering current programmes and industrialisation, and developing new business in support of the Saudi military and paramilitary forces. Revisions to the Salam programme, expected to be concluded later this year, will bias both sales¹ and profits to the second half of 2011. In Australia, BAE Systems will continue to work with its customers to identify and deliver cost and service improvements. In India and Oman, the Group is making good progress towards capturing opportunities to address the future requirements of its customers.

¹ Including share of equity accounted investments.

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

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

⁵ Command, Control, Communications, Computers and Intelligence.

Responsibility statement of the directors in respect of the half-yearly financial report

Each of the directors (as detailed opposite) confirms that to the best of his/her knowledge:

- The condensed set of financial statements has been prepared in accordance with IAS 34, *Interim Financial Reporting*, as adopted by the European Union.
- The interim management report includes a fair review of the information required by:
 - (a) DTR 4.2.7R of the Disclosure and Transparency Rules (DTR), requiring an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the year; and
 - (b) DTR 4.2.8R of the DTR, requiring disclosure of related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the Company during that period; and disclosure of any changes in the related party transactions described in the last annual report that have materially affected its financial position or performance during that period.

For and on behalf of the directors:

R L Olver *Chairman*

27 July 2011

Directors

Dick Olver	Chairman
Ian King	Chief Executive
Linda Hudson	President and Chief Executive Officer of BAE Systems, Inc.
Peter Lynas	Group Finance Director
Paul Anderson	Non-executive director
Harriet Green	Non-executive director
Michael Hartnall	Non-executive director
Sir Peter Mason	Non-executive director
Lee McIntire	Non-executive director
Roberto Quarta	Non-executive director
Nick Rose	Non-executive director
Paula Rosput Reynolds	Non-executive director
Carl Symon	Non-executive director

Independent review report to BAE Systems plc

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2011 which comprises the Condensed Consolidated Income Statement, the Condensed Consolidated Statement of Comprehensive Income, the Condensed Consolidated Statement of Changes in Equity, the Condensed Consolidated Balance Sheet, the Condensed Consolidated Cash Flow Statement and the related explanatory notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

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

Directors' responsibilities

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

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

Our responsibility

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

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2011 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA.

A G Cates

for and on behalf of KPMG Audit Plc

Chartered Accountants
15 Canada Square
London
E14 5GL

27 July 2011

Condensed half-yearly financial statements
Condensed consolidated income statement

	Notes	Six months ended 30 June 2011		Restated ¹ Six months ended 30 June 2010	
		£m	£m	£m	£m
Continuing operations					
Combined sales of Group and share of equity accounted investments	2		9,229		10,582
Less: Share of sales of equity accounted investments	2		(549)		(479)
Revenue	2		8,680		10,103
Operating costs			(8,009)		(9,369)
Other income			52		64
<hr/>					
Group operating profit excluding amortisation and impairment of intangible assets			871		1,017
Amortisation	2		(126)		(211)
Impairment	2		(22)		(8)
Group operating profit			723		798
Share of results of equity accounted investments excluding finance costs and taxation expense			42		62
Financial income of equity accounted investments	3		4		2
Taxation expense of equity accounted investments			(12)		(13)
Share of results of equity accounted investments			34		51
<hr/>					
EBITA ² excluding non-recurring items	2		968		1,097
Loss on disposal of businesses ³	2		(6)		-
Regulatory penalties ³	2		(49)		(18)
EBITA ²			913		1,079
Amortisation	2		(126)		(211)
Impairment	2		(22)		(8)
Financial income of equity accounted investments	3		4		2
Taxation expense of equity accounted investments			(12)		(13)
Operating profit			757		849
Finance costs	3				
Financial income			826		905
Financial expense			(892)		(973)
					(68)
Profit before taxation			691		781
Taxation expense					
UK taxation			(82)		(96)
Overseas taxation			(109)		(133)
			(191)		(229)
Profit for the period – continuing operations			500		552
(Loss)/profit for the period – discontinued operations	4		(16)		73
Profit for the period			484		625
<hr/>					
Attributable to:					
BAE Systems shareholders			478		618
Non-controlling interests			6		7
			484		625
<hr/>					
Earnings per share					
Basic earnings per share	5		14.0p		17.7p
Diluted earnings per share			14.0p		17.7p
<hr/>					
Earnings per share – continuing operations					
Basic earnings per share	5		14.5p		15.6p
Diluted earnings per share			14.5p		15.6p

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 4).

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

3 Included in operating costs.

Condensed consolidated statement of comprehensive income

	Six months ended 30 June 2011			Six months ended 30 June 2010		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings £m	Total £m
Profit for the period	–	484	484	–	625	625
Other comprehensive income						
Currency translation on foreign currency net investments:						
Subsidiaries	(58)	–	(58)	243	–	243
Equity accounted investments	33	–	33	(29)	–	(29)
Amounts charged to hedging reserve	–	–	–	(93)	–	(93)
Net actuarial losses on defined benefit pension schemes:						
Subsidiaries	–	(228)	(228)	–	(595)	(595)
Equity accounted investments	–	(16)	(16)	–	(9)	(9)
Fair value movements on available-for-sale investments	–	1	1	–	14	14
Recycling of fair value movements on available-for-sale investments	–	(5)	(5)	–	–	–
Recycling of cumulative currency translation reserve on disposal	–	–	–	(17)	–	(17)
Recycling of cumulative net hedging reserve on disposal	–	–	–	(4)	–	(4)
Current tax on items taken directly to equity	–	22	22	–	18	18
Deferred tax on items taken directly to equity:						
Subsidiaries	–	41	41	24	170	194
Tax rate adjustment ¹	–	(26)	(26)	–	–	–
Equity accounted investments	–	5	5	–	3	3
Total other comprehensive income for the period (net of tax)	(25)	(206)	(231)	124	(399)	(275)
Total comprehensive income for the period	(25)	278	253	124	226	350
Attributable to:						
Equity shareholders	(25)	272	247	124	219	343
Non-controlling interests	–	6	6	–	7	7
	(25)	278	253	124	226	350

Condensed consolidated statement of changes in equity

	Attributable to equity holders of the parent						Total equity £m
	Issued share capital £m	Share premium £m	Other reserves ³ £m	Retained earnings £m	Total £m	Non-controlling interests £m	
At 1 January 2011	90	1,249	5,470	(1,477)	5,332	71	5,403
Profit for the period	–	–	–	478	478	6	484
Total other comprehensive income for the period	–	–	(25)	(206)	(231)	–	(231)
Share-based payments	–	–	–	25	25	–	25
Share options:							
Purchase of own shares	–	–	–	(11)	(11)	–	(11)
Other	–	–	–	–	–	(2)	(2)
Ordinary share dividends	–	–	–	(359)	(359)	(18)	(377)
At 30 June 2011	90	1,249	5,445	(1,550)	5,234	57	5,291
At 1 January 2010	90	1,243	5,399	(2,141)	4,591	72	4,663
Profit for the period	–	–	–	618	618	7	625
Total other comprehensive income for the period	–	–	124	(399)	(275)	–	(275)
Share-based payments	–	–	–	26	26	–	26
Share options:							
Proceeds from shares issued	–	5	–	–	5	–	5
Purchase of own shares	–	–	–	(22)	(22)	–	(22)
Purchase of treasury shares	–	–	–	(464)	(464)	–	(464)
Other	–	–	–	–	–	2	2
Ordinary share dividends	–	–	–	(335)	(335)	(32)	(367)
At 30 June 2010 (restated²)	90	1,248	5,523	(2,717)	4,144	49	4,193

1 The UK current tax rate was reduced from 28% to 26% with effect from 1 April 2011.

2 Other reserves reduced by £5m in the second half of 2010 following finalisation of fair values recognised on acquisition of the 45% shareholding in BVT Surface Fleet Limited.

3 The net decrease in other reserves in 2011 of £25m comprises translation reserve. The net increase in other reserves in 2010 of £124m comprised translation reserve (£197m), less hedging reserve (£73m).

Condensed half-yearly financial statements
Condensed consolidated balance sheet

	Notes	30 June 2011 £m	31 December 2010 £m
Non-current assets			
Intangible assets		11,514	11,216
Property, plant and equipment		2,506	2,714
Investment property		140	134
Equity accounted investments		838	787
Other investments		6	11
Other receivables		304	282
Other financial assets		112	110
Deferred tax assets		1,101	1,160
		16,521	16,414
Current assets			
Inventories		697	644
Trade and other receivables including amounts due from customers for contract work		3,572	3,559
Current tax		50	51
Other investments		274	260
Other financial assets		168	289
Cash and cash equivalents		1,727	2,813
Assets of disposal group held for sale	4	154	–
		6,642	7,616
Total assets		23,163	24,030
Non-current liabilities			
Loans		(1,822)	(2,133)
Trade and other payables		(557)	(694)
Retirement benefit obligations	6	(3,557)	(3,456)
Other financial liabilities		(216)	(255)
Deferred tax liabilities		(40)	(6)
Provisions		(397)	(425)
		(6,589)	(6,969)
Current liabilities			
Loans and overdrafts		(1,011)	(920)
Trade and other payables		(9,005)	(9,352)
Other financial liabilities		(86)	(109)
Current tax		(628)	(625)
Provisions		(503)	(652)
Liabilities of disposal group held for sale	4	(50)	–
		(11,283)	(11,658)
Total liabilities		(17,872)	(18,627)
Net assets		5,291	5,403
Capital and reserves			
Issued share capital		90	90
Share premium		1,249	1,249
Other reserves		5,445	5,470
Accumulated losses		(1,550)	(1,477)
Total equity attributable to equity holders of the parent		5,234	5,332
Non-controlling interests		57	71
Total equity		5,291	5,403

Condensed consolidated cash flow statement

	Notes	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m
Profit for the period		484	625
Taxation expense		196	227
Share of results of equity accounted investments		(34)	(53)
Net finance costs		69	68
Depreciation, amortisation and impairment		366	393
Gain on disposal of property, plant and equipment		(9)	(6)
Gain on disposal of investment property		(2)	–
Loss/(gain) on disposal of businesses		6	(52)
Cost of equity-settled employee share schemes		25	26
Movements in provisions		(185)	(54)
Decrease in liabilities for retirement benefit obligations		(98)	(112)
(Increase)/decrease in working capital:			
Inventories		(53)	228
Trade and other receivables		(67)	(109)
Trade and other payables		(522)	(1,366)
Cash inflow/(outflow) from operating activities		176	(185)
Interest paid		(129)	(97)
Interest element of finance lease rental payments		–	(1)
Taxation paid		(117)	(257)
Net cash outflow from operating activities		(70)	(540)
Dividends received from equity accounted investments		6	24
Interest received		33	15
Income from financial assets at fair value through profit or loss		4	–
Purchase of property, plant and equipment		(153)	(159)
Purchase of investment property		(9)	(4)
Purchase of intangible assets		(7)	(11)
Proceeds from sale of property, plant and equipment		23	30
Proceeds from sale of investment property		–	1
Purchase of subsidiary undertakings	8	(580)	–
Cash and cash equivalents acquired with subsidiary undertakings	8	43	–
Purchase of equity accounted investments		–	(2)
Proceeds from sale of subsidiary undertakings		7	–
Cash and cash equivalents disposed of with subsidiary undertakings		(4)	–
Proceeds from sale of equity accounted investments		–	92
Proceeds from sale of financial assets at fair value through profit or loss		152	–
Purchase of other deposits/securities		(13)	(26)
Net cash outflow from investing activities		(498)	(40)
Capital element of finance lease rental payments		–	(7)
Proceeds from issue of share capital		–	5
Purchase of treasury shares		–	(449)
Purchase of own shares		(11)	(22)
Equity dividends paid		(359)	(335)
Dividends paid to non-controlling interests		(18)	(25)
Cash inflow/(outflow) from matured derivative financial instruments		38	(82)
Cash (outflow)/inflow from movement in cash collateral		(3)	11
Cash inflow from loans		592	527
Cash outflow from repayment of loans		(741)	(248)
Net cash outflow from financing activities		(502)	(625)
Net decrease in cash and cash equivalents		(1,070)	(1,205)
Cash and cash equivalents at 1 January		2,802	3,678
Effect of foreign exchange rate changes on cash and cash equivalents		(21)	8
Cash and cash equivalents at end of period		1,711	2,481
Comprising:			
Cash and cash equivalents		1,727	2,492
Cash and cash equivalents (included within assets of disposal group held for sale)	4	15	–
Overdrafts (included within loans and overdrafts)		(31)	(11)
Cash and cash equivalents at end of period		1,711	2,481

Notes to the condensed half-yearly financial statements

1. Accounting policies

Basis of preparation and statement of compliance

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

Except as described below, the accounting policies adopted in the preparation of these condensed consolidated half-yearly financial statements to 30 June 2011 are consistent with the accounting policies applied by the Group in its consolidated financial statements as at, and for the year ended, 31 December 2010 as required by the Disclosure and Transparency Rules of the UK's Financial Services Authority.

Changes in accounting policies

The following amendments to published standards and interpretations are effective for the Group for the half year ended 30 June 2011:

- Amendment to IAS 32, *Financial instruments: Presentation: Classification of Rights Issues*;
- IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*;
- IAS 24, *Related Party Disclosures*; and
- Amendment to IFRIC 14, *IAS 19, The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.

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

2. Segmental analysis – continuing operations

	Combined sales of Group and share of equity accounted investments		Less: sales by equity accounted investments		Add: sales to equity accounted investments		Revenue	
	Restated ¹						Restated ¹	
	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m
Electronics, Intelligence & Support	2,573	2,624	(23)	–	23	22	2,573	2,646
Land & Armaments	1,846	3,074	(14)	(12)	–	–	1,832	3,062
Programmes & Support	3,140	3,035	(642)	(582)	600	538	3,098	2,991
International	1,862	2,078	(527)	(476)	–	–	1,335	1,602
HQ & Other Businesses	78	74	–	–	–	–	78	74
	9,499	10,885	(1,206)	(1,070)	623	560	8,916	10,375
Intra-operating group sales/revenue	(270)	(303)	13	8	21	23	(236)	(272)
	9,229	10,582	(1,193)	(1,062)	644	583	8,680	10,103

	Underlying EBITA ²		Non-recurring items ³		Amortisation of intangible assets		Impairment of intangible assets		Operating group result	
	Restated ¹								Restated ¹	
	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m
Electronics, Intelligence & Support	298	296	–	–	(20)	(12)	–	(6)	278	278
Land & Armaments	180	316	(6)	–	(63)	(157)	–	(2)	111	157
Programmes & Support	285	316	–	–	(39)	(29)	(22)	–	224	287
International	221	218	–	–	(4)	(12)	–	–	217	206
HQ & Other Businesses	(16)	(49)	(49)	(18)	–	(1)	–	–	(65)	(68)
	968	1,097	(55)	(18)	(126)	(211)	(22)	(8)	765	860
Financial income of equity accounted investments									4	2
Taxation expense of equity accounted investments									(12)	(13)
Operating profit									757	849
Finance costs									(66)	(68)
Profit before taxation									691	781
Taxation expense									(191)	(229)
Profit for the period									500	552

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 4).

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

3 Non-recurring items in 2011 comprises the £49m US Department of State fine (see page 2) and a £6m loss on disposal of the Swiss-Photonics business. Non-recurring items in 2010 comprised the US dollar exchange rate movement on payment of the global settlement of the regulatory investigation by the US Department of Justice.

3. Finance costs – continuing operations

	Six months ended 30 June 2011 £m	Restated ¹ Six months ended 30 June 2010 £m
Net finance costs:		
Group	(66)	(68)
Share of equity accounted investments	4	2
	(62)	(66)
Analysed as:		
Net interest:		
Interest income	29	5
Interest expense	(137)	(92)
Income from financial assets at fair value through profit or loss	4	–
Facility fees	(4)	(2)
Net present value adjustments	(15)	(11)
Share of equity accounted investments	6	4
	(117)	(96)
Other finance costs:		
Group:		
Net financing credit/(charge) on pensions	12	(45)
Market value and foreign exchange movements on financial instruments and investments ²	45	77
Share of equity accounted investments	(2)	(2)
	(62)	(66)

¹ Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 4).

² Includes a £17m (translated at average exchange rates) fair value gain in 2011 in respect of the remaining shareholding in Saab AB, which was sold in June 2011 (2010 loss £8m).

4. Discontinued operations and disposal group held for sale

Regional Aircraft

On 26 May 2011, the Group announced that it had agreed the sale of its Regional Aircraft Asset Management business. The disposal subsequently completed on 15 July 2011.

In addition, the Group has an active programme for the proposed sale of the Regional Aircraft Support & Engineering business and expects to sell the business within a year of the balance sheet date.

The Asset Management and Support & Engineering businesses comprised the Group's Regional Aircraft line of business within the HQ & Other Businesses operating group. Accordingly, the Regional Aircraft line of business is presented as a disposal group held for sale at 30 June 2011 and, as it represented a separate major line of business, it has been presented within discontinued operations for the current and prior periods.

Saab AB

In June 2010, the Group sold half of its 20.5% shareholding in Saab AB. Following the loss of significant influence over the company, the Group discontinued the use of the equity method. Accordingly, the profit on this disposal, together with the Group's share of the results of Saab AB to the date of this disposal, are shown within discontinued operations in the prior period.

Results from discontinued operations

	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m
Revenue	56	67
Operating costs	(74)	(53)
Other income	10	3
Group operating profit	(8)	17
Share of results of equity accounted investments	–	2
Operating profit	(8)	19
Financial income	–	3
Financial expense	(3)	(3)
(Loss)/profit before taxation	(11)	19
Taxation (expense)/credit	(5)	2
(Loss)/profit for the period	(16)	21
Profit on disposal of discontinued operations	–	52
(Loss)/profit for the period – discontinued operations	(16)	73
Regional Aircraft	(16)	19
Saab AB	–	54
(Loss)/profit for the period – discontinued operations	(16)	73

Cash flows from discontinued operations

	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m
Net cash inflow from operating activities	15	19
Net cash inflow from investing activities	10	87
Net cash outflow from financing activities	(39)	(1)
Cash flows from discontinued operations	(14)	105
Regional Aircraft	(14)	9
Saab AB	–	96
Cash flows from discontinued operations	(14)	105

4. Discontinued operations and disposal group held for sale *continued***Assets and liabilities of disposal group held for sale – Regional Aircraft**

	30 June 2011 £m
Property, plant and equipment	96
Inventories	8
Trade and other receivables	22
Deferred tax assets	13
Cash and cash equivalents	15
Assets of disposal group	154
Trade and other payables	(37)
Current tax payable	(6)
Provisions	(7)
Liabilities of disposal group	(50)

5. Earnings per share

	Six months ended 30 June 2011			Restated ¹ Six months ended 30 June 2010		
	£m	Basic pence per share	Diluted pence per share	£m	Basic pence per share	Diluted pence per share
Profit for the period attributable to equity shareholders	478	14.0	14.0	618	17.7	17.7
Represented by:						
<i>Continuing operations</i>	494	14.5	14.5	545	15.6	15.6
<i>Discontinued operations</i>	(16)	(0.5)	(0.5)	73	2.1	2.1
Add back/(deduct):						
Loss on disposal of businesses	6			–		
Regulatory penalties	49			18		
Net financing (credit)/charge on pensions, post tax	(9)			33		
Market value movements on derivatives, post tax	(32)			(55)		
Charges relating to early redemption of debt, post tax	30			–		
Amortisation and impairment of intangible assets, post tax	93			155		
Impairment of goodwill	22			–		
Underlying earnings, post tax	637	18.7	18.6	769	22.0	22.0
Represented by:						
Continuing operations	653	19.2	19.1	696	19.9	19.9
Discontinued operations	(16)	(0.5)	(0.5)	73	2.1	2.1
	637	18.7	18.6	769	22.0	22.0
		Millions	Millions		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		3,411	3,411		3,495	3,495
Incremental shares in respect of employee share schemes			13			2
Weighted average number of shares used in calculating diluted earnings per share			3,424			3,497

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 4).

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

6. Retirement benefit obligations

	UK £m	US and other £m	Total £m
Total IAS 19 deficit at 1 January 2011	(3,438)	(665)	(4,103)
Actual return on assets above expected return	22	30	52
Increase in liabilities due to changes in assumptions	(387)	(42)	(429)
Additional contributions	71	–	71
Recurring contributions above/(below) service cost	89	(16)	73
Past service cost	(21)	(2)	(23)
Net financing (charge)/credit	(7)	17	10
Exchange translation	–	15	15
Movement in US healthcare plans	–	6	6
Total IAS 19 deficit at 30 June 2011	(3,671)	(657)	(4,328)
Allocated to equity accounted investments and other participating employers	823	–	823
Group's share of IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments and other participating employers at 30 June 2011	(2,848)	(657)	(3,505)
Represented by:			
Pension prepayments (within trade and other receivables)	–	52	52
Retirement benefit obligations	(2,848)	(709)	(3,557)
	(2,848)	(657)	(3,505)

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

During the period, the Group contributed an additional £25m into Trust for the benefit of the Group's main pension scheme (2010 £25m). The cumulative contributions totalling £275m, plus fair value gains of £12m, are reported within other investments (£274m), and cash and cash equivalents (£13m) at 30 June 2011. The use of these assets is restricted under the terms of the Trust. The Group considers these contributions to be equivalent to the other lump sum contributions it makes into the Group's pension schemes and, accordingly, presents below a definition of the pension deficit including them.

	30 June 2011 £m	31 December 2010 £m
Group's share of IAS 19 deficit, net	(3,505)	(3,407)
Assets held in Trust	287	261
Pension deficit (as defined by the Group)	(3,218)	(3,146)

The above deficit is £2.2bn (31 December 2010 £2.1bn) after tax.

7. Dividends

	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m
Equity dividends		
Prior year final 10.5p dividend per ordinary share paid in the period (2010 9.6p)	359	335

The directors have declared an interim dividend of 7.5p per ordinary share (2010 7.0p), totalling £256m (2010 £239m). The dividend will be paid on 30 November 2011 to shareholders registered on 21 October 2011. The ex-dividend date is 19 October 2011.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 9 November 2011.

Notes to the condensed half-yearly financial statements *continued***8. Acquisitions****Subsidiaries acquired during the half year ended 30 June 2011**

The Group has acquired L-1 Identity Solutions, Inc.'s Intelligence Services Group (L-1 ISG), Norkom Group plc (Norkom), ETI A/S (ETI) and stratsec.net Pty Limited (stratsec) in the Cyber & Intelligence Services market segment. The Group also acquired Fairchild Imaging, Inc. (Fairchild) in the market segment of Electronic Systems.

If the acquisitions had occurred on 1 January 2011, combined sales of Group and equity accounted investments would have been £9.3bn, revenue £8.7bn and profit £492m from continuing operations for the half year ended 30 June 2011.

For all acquisitions made in the period, fair values remain provisional, but will be finalised within 12 months of acquisition.

Summary

Acquisition	Description	Acquisition date	Percentage share acquired	Total consideration Currency	Total consideration £m
L-1 ISG	Leading provider of security and counter threat capabilities to the US government	15 February 2011	100%	\$291m ¹	180
Norkom	Market-leading provider of innovative anti-money laundering solutions to counter financial crime to the global financial services industry	18 February 2011	100%	€209m	177
ETI	Leading provider of advanced technology products and services to government and commercial clients worldwide	21 March 2011	100%	DKK1.2bn	135
Fairchild	Provider of solid-state electronic imaging components, cameras, and systems for aerospace, industrial, medical and scientific imaging applications	1 April 2011	91.3%	\$88m	55
stratsec	Australian information security company supplying government and commercial customers	14 January 2011	100%	A\$25m	16

1 Total consideration is \$297m, less a working capital adjustment of \$6m.

IFRS 3, *Business Combinations*, disclosures are provided individually for the L-1 ISG, Norkom and ETI acquisitions below. The acquisitions of Fairchild and stratsec are neither individually nor collectively material.

Material acquisitions

Acquisition	Support for residual goodwill ¹	Consolidated results for the period from acquisition to 30 June 2011		
		Revenue £m	EBITA ² £m	Loss after tax ³ £m
L-1 ISG	<ul style="list-style-type: none"> - Complements Intelligence & Security's existing security and intelligence capabilities; - Enhances existing knowledge and expertise, and better positions the Group to compete for future upgrades and new contracts; - Increases penetration of target markets through existing sales, marketing and in-service support capabilities; and - Provides a skilled assembled workforce with high level security clearance. 	50	4	(1)
Norkom	<ul style="list-style-type: none"> - Complements Detica's existing enterprise fraud products, particularly Detica NetReveal®; - The combination of two of the sector's strongest technologies creates a market-leading offering to compete for new customers in new geographies; - Creates opportunities for cost synergies; and - Provides a skilled assembled workforce. 	16	3	(6)
ETI	<ul style="list-style-type: none"> - Complements Detica's existing communications and interception businesses; - Creates a stronger end-to-end solution and a top tier market competitor, which enhances the Group's ability to compete for new customers in new geographies; and - Provides a skilled assembled workforce with high level security clearance. 	19	2	(3)

1 Goodwill recognised is attributable to specific opportunities and synergies which do not translate into separately identifiable intangible assets, but represent a proportion of the assessed value within each acquired entity.

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

3 Loss after tax includes amortisation charges on acquired intangible assets totalling £18m.

The post-acquisition results above exclude acquisition-related costs of £6m incurred by the Group on the L-1 ISG (£1m), Norkom (£4m) and ETI (£1m) acquisitions. These expenses relate to external legal fees and due diligence costs, and are included in operating costs.

8. Acquisitions *continued*

Fair values

The acquisitions had the following effect on the Group's assets and liabilities:

	L-1 ISG £m	Norkom £m	ETI £m	Other £m	Total £m
Intangible assets	63	99	79	29	270
Property, plant and equipment	–	1	8	2	11
Equity accounted investments	–	1	–	–	1
Inventories	–	–	10	8	18
Trade receivables	13	8	3	7	31
Other receivables	10	7	–	1	18
Deferred tax assets	–	2	7	3	12
Trade and other payables	(15)	(24)	(22)	(6)	(67)
Current tax payable	–	–	(8)	–	(8)
Deferred tax liabilities	–	(20)	(22)	(8)	(50)
Provisions	–	–	(3)	(1)	(4)
Cash and cash equivalents	–	37	5	1	43
Net assets acquired	71	111	57	36	275
Goodwill	109	66	78	40	293
Less: Fair value of existing interest in Fairchild	–	–	–	(5)	(5)
Total consideration	180	177	135	71	563
Add: Deferred consideration paid in respect of 2010 acquisitions	–	–	–	13	13
Add: Amounts receivable in respect of purchase price adjustments	4	–	–	–	4
Cash consideration	184	177	135	84	580

The cumulative remeasurement to fair value of the Group's existing 8.7% interest in Fairchild was a gain of £5m, which has been recycled from retained earnings to financial income during the period. There was no material change in the fair value from 1 January 2011 to the date of acquisition of the remaining 91.3% interest.

Purchase of subsidiary undertakings in the condensed consolidated cash flow statement includes \$22m (£13m) of deferred consideration in respect of the acquisition of OASYS Technology, LLC (OASYS) in 2010.

The goodwill expected to be deductible for tax purposes is £109m relating to L-1 ISG.

Intangible assets

Acquisition	Customer relationships £m	Software £m	Trade names/ trademarks £m	Other £m	Total £m
L-1 ISG	62	–	1	–	63
Norkom	74	21	3	1	99
ETI	22	48	5	4	79
Other					29
					270

Trade receivables

Acquisition	Gross contractual amounts due £m	Unrecoverable amount £m	Fair value £m
L-1 ISG	13	–	13
Norkom	8	–	8
ETI	7	(4)	3
Other			7
			31

Subsidiaries acquired in 2010

During the year ended 31 December 2010, the Group acquired Atlantic Marine Holding Company and OASYS. Certain of the fair values assigned to the net assets at the dates of acquisition were provisional and, in accordance with IFRS 3, the Group has adjusted the fair values attributable to these acquisitions during the half year ended 30 June 2011. The net increase in goodwill of £5m mainly reflects additional consideration payable. This has not had a material impact on the consolidated accounts and, as such, the Group has not restated the balance sheet as at 31 December 2010.

9. Related party transactions

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

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

	Six months ended 30 June 2011 £m	Six months ended 30 June 2010 £m
Sales to related parties	644	583
Purchases from related parties	159	200
	30 June 2011 £m	31 December 2010 £m
Amounts owed by related parties	251	307
Amounts owed to related parties	1,238	1,232

10. Events after the balance sheet date

On 15 July 2011, the Group completed the disposal of its Regional Aircraft Asset Management business (see note 4).

11. Annual General Meeting

The Annual General Meeting of BAE Systems plc will be held on 2 May 2012.

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Registered in England and Wales No. 1470151

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