OFFERING MEMORANDUM | **NOT FOR GENERAL DISTRIBUTION IN THE UNITED STATES**

BAE SYSTEMS

BAE Systems plc

(incorporated with limited liability in England and Wales under the Companies Acts 1948 to 1980 with registered number 1470151)

US$1,000,000,000 1.900% Notes due 2031
Issue price: 99.232%
US$1,000,000,000 3.000% Notes due 2050
Issue price: 98.537%

BAE Systems plc, a public limited company registered in England and Wales (the "*Issuer*"), is offering (the "*Offering*") $1,000,000,000 aggregate principal amount of its 1.900% Notes due 2031 (the "*2031 Notes*") and $1,000,000,000 aggregate principal amount of its 3.000% Notes due 2050 (the "*2050 Notes*" and, together with the 2031 Notes, the "*Securities*"). The Issuer is the parent holding company of the BAE Systems group of companies (which, together with the Issuer, are referred to herein as "*BAE Systems*").

The 2031 Notes and the 2050 Notes will mature on February 15, 2031 and September 15, 2050, respectively (in each case, the "*Stated Maturity Date*" of the respective series of Securities), and upon surrender will be repaid in an amount equal to the principal amount thereof together with accrued and unpaid interest thereon. Interest on the Securities will be payable semi-annually in arrears on February 15 and August 15 of each year (in the case of the 2031 Notes), commencing on February 15, 2021 and on March 15 and September 15 of each year (in the case of the 2050 Notes), commencing on March 15, 2021. The Securities will be redeemable at any time at the option of the Issuer at a redemption price calculated as set forth under "*Description of Securities—Optional Redemption.*"

The Securities will be direct, unsecured and unsubordinated obligations of the Issuer and will rank *pari passu* with all other direct, unsecured and unsubordinated obligations (except those obligations preferred by statute or operation of law) of the Issuer.

Application has been made to the Financial Conduct Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "*FCA*") for the Securities to be admitted to the official list of the FCA (the "*Official List*") and to the London Stock Exchange plc (the "*London Stock Exchange*") for the Securities to be admitted to trading on the London Stock Exchange's Regulated Market (the "*Market*"). References in this Offering Memorandum to the Securities being "listed" (and all related references) shall mean that the Securities have been admitted to the Official List and have been admitted to trading on the Market. The Market is a regulated market for the purposes of Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments, as amended.

This Offering Memorandum has been approved as a prospectus (the "*Prospectus*") by the FCA as competent authority under Regulation (EU) 2017/1129 (the "*Prospectus Regulation*"). The FCA only approves this Prospectus as meeting the standards of completeness, comprehensibility and consistency imposed by the Prospectus Regulation. Such approval should not be considered as an endorsement of either the Issuer or the quality of the Securities that are the subject of this Prospectus and investors should make their own assessment as to the suitability of investing in the Securities.

This investment involves risk. See "Risk Factors" beginning on page 12.

The Securities have not been registered under the United States Securities Act of 1933, as amended (the "*Securities Act*"), or any state securities laws and are being offered and sold within the United States only to "qualified institutional buyers" ("*QIBs*") as defined in Rule 144A under the Securities Act and non-U.S. persons outside the United States in accordance with Regulation S under the Securities Act. For a description of certain restrictions on transfers of the Securities, see "*Plan of Distribution*" and "*Transfer Restrictions.*"

As of the date of this Offering Memorandum, the Issuer's long-term credit ratings are Baa2 ("Stable Outlook") (Moody's Investors Service Limited ("*Moody's*")), BBB ("Stable Outlook") (S&P Global Ratings Europe Limited ("*S&P*")) and BBB ("Stable Outlook") (Fitch Ratings Limited ("*Fitch*")). A rating is not a recommendation to buy, sell or hold Securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating agency. Each of Moody's and Fitch is established in the United Kingdom and has been registered under Regulation (EC) No. 1060/2009 (the "*CRA Regulation*"). S&P is established in the European Union and has been registered under the CRA Regulation.

It is expected that delivery of beneficial interests in the Securities will be made through the facilities of The Depository Trust Company ("*DTC*") and its participants, including Euroclear Bank, S.A./N.V. ("*Euroclear*"), and Clearstream Banking, S.A. ("*Clearstream*"), on or about September 15, 2020, against payment therefor in immediately available funds.

This Prospectus will be valid for one year from September 9, 2020. The obligation to supplement the Prospectus in the event of significant new factors, material mistakes or material inaccuracies will not apply when the Prospectus is no longer valid. For this purpose, "valid" means valid for making offers to the public or admission to trading on a regulated market by or with the consent of the Issuer and the obligation to supplement the Prospectus is only required within its period of validity between the time when the Prospectus is approved and the closing of the offer period for the Securities or the time when trading on a regulated market begins, whichever occurs later.

Joint Bookrunners

Barclays **BofA Securities** **Citigroup** **RBC Capital Markets** **Wells Fargo Securities**

BNP PARIBAS **SOCIETE GENERALE**

September 9, 2020

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IMPORTANT: You must read the following before continuing. The following applies to this Offering Memorandum. You are therefore advised to read this carefully before reading, accessing or making any other use of this Offering Memorandum. In accessing this Offering Memorandum, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information.

This Offering Memorandum does not constitute an offer of any securities other than those to which it relates or an offer to sell, or solicitation of an offer to buy, to any person in any jurisdiction where such an offer or solicitation would be unlawful.

The Securities have not been registered with, or recommended or approved by, the U.S. Securities and Exchange Commission (the "*SEC*") or any other federal, state or foreign securities commission or regulatory authority, nor has the SEC or any such other commission or regulatory authority passed upon the accuracy or adequacy of this Offering Memorandum. Any representation to the contrary is a criminal offense.

This Prospectus comprises a prospectus for the purposes of the Prospectus Regulation. The Issuer accepts responsibility for the information contained in this Prospectus. To the best knowledge of the Issuer, the information contained in this Prospectus is in accordance with the facts and this Prospectus makes no omission likely to affect the import of such information.

EXTENDED SETTLEMENT

It is expected that delivery of the Securities will be made against payment therefor on or about the fifth business day following the date of pricing of the Securities (this settlement cycle being referred to as "T+5"). Under Rule 15c6-1 of the Securities Exchange Act of 1934, as amended (the "*Exchange Act*"), trades in the secondary market generally are required to settle in two business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade the Securities on any date prior to two business days before delivery will be required, by virtue of the fact that the Securities initially will settle in T+5, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Purchasers of the Securities who wish to make such trades should consult their own advisors.

IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO ARE EITHER (1) QUALIFIED INSTITUTIONAL BUYERS ("*QIBs*") UNDER RULE 144A OR (2) NON-U.S. PERSONS OUTSIDE OF THE UNITED STATES IN ACCORDANCE WITH REGULATION S.

This Offering Memorandum is being provided to QIBs and to certain prospective investors outside of the United States for use solely in connection with the Offering of the Securities. Its use for any other purpose is not authorized. This Offering Memorandum may not be copied or reproduced in whole or in part, nor may it be distributed or any of its contents be disclosed to any person other than the prospective investors to whom it is being provided.

Prospective investors should note that there are further restrictions on the offering and sale of the Securities and the distribution of this Offering Memorandum. See "*Plan of Distribution*" and "*Transfer Restrictions*."

No dealer, salesperson or other person has been authorized to give any information or to make any representation not contained in this Offering Memorandum and, if given or made, such information or representation must not be relied upon as having been authorized by the Issuer, any of its subsidiaries and equity accounted investments or the Initial Purchasers. Neither the delivery of this Offering Memorandum nor any sale made under it shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer since the date of this Offering Memorandum or that the information contained in this Offering Memorandum is correct as of any time subsequent to that date. In making an investment decision, investors must rely on their own examination of the Issuer and its subsidiaries and equity accounted investments, the terms of the Offering of the Securities and the merits and risks involved. By receiving this Offering Memorandum, investors acknowledge that they have had an opportunity to request for review, and have received, all additional information they deem necessary to verify the accuracy and completeness of the information contained in this Offering Memorandum. Investors also acknowledge that they have not relied on the Initial Purchasers in connection with their investigation of the accuracy of this information or their decision on whether to invest in the Securities. The contents of this Offering Memorandum are not to be considered as legal, business or tax advice. Prospective investors should consult their own counsel, accountants and other advisors as to legal, tax, business, financial and related aspects of a purchase of the Securities.

This offering is being made in reliance upon exemptions from registration under the Securities Act for an offer and sale of securities that does not involve a public offering. The Securities may not be offered or sold within the United States or to, or for the account or benefit of, any U.S. persons (as defined in Regulation S) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Securities are being offered and sold only (i) to QIBs in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A and (ii) in offers and sales that occur outside the United States to purchasers who are not U.S. persons (as defined in Regulation S) in offshore transactions in reliance on Regulation S under the Securities Act. By purchasing the Securities, investors are deemed to have made the acknowledgements, representations, warranties and agreements set forth under "*Transfer Restrictions*."

The Initial Purchasers reserve the right to withdraw this offering of Securities at any time and to reject any commitment to subscribe for the Securities, in whole or in part. The Initial Purchasers also reserve the right to allot less than the full amount of Securities sought by investors. The Initial Purchasers and certain related entities may acquire a portion of the Securities for their own account.

No action has been taken by the Initial Purchasers, the Issuer or any other person that would permit an offering of the Securities or the circulation or distribution of this Offering Memorandum or any offering material in relation to the Issuer or its subsidiaries and equity accounted investments or the Securities in any country or jurisdiction where action for that purpose is required.

The laws of certain jurisdictions may restrict the distribution of this Offering Memorandum and the offer and sale of the Securities. Persons into whose possession this Offering Memorandum or any Securities may come must inform themselves about, and observe, any such restrictions on the distribution of this Offering Memorandum and the offering and sale of the Securities. In particular, there are restrictions on the distribution of this Offering Memorandum and the offer or sale of the Securities in the United States, Canada, the European Economic Area, the United Kingdom, Hong Kong, Japan, Singapore and Switzerland. For a further description of certain restrictions on the offering and sale of the Securities and the distribution of this Offering Memorandum, see "*Plan of Distribution*" and "*Transfer Restrictions.*" None of the Issuer, the Initial Purchasers or their respective representatives is making any representation to any offeree or any purchaser of the Securities regarding the legality of any investment in the Securities by such offeree or purchaser under applicable legal investment or similar laws or regulations. Accordingly, no Securities may be offered or sold, directly or indirectly, and neither this Offering Memorandum nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations.

The Securities will be issued in fully registered form and only in denominations of $200,000 and integral multiples of $1,000 in excess thereof. The Securities will be issued initially in fully registered form as beneficial interests in Global Securities (defined below). QIBs may elect to hold Global Securities (the "*Rule 144A Global Securities*") purchased by them through the facilities of the Depository Trust Company ("*DTC*"), which will act as depositary for the Securities. Holders of Securities sold in offshore transactions in reliance on Regulation S under the Securities Act may elect to hold Global Securities (the "*Regulation S Global Securities*" and, together with the Rule 144A Global Securities, the "*Global Securities*") through the facilities of Euroclear and Clearstream as participants in DTC. Prior to the date that is 40 days after the later of the commencement of the Offering or the closing date, beneficial interests in such Regulation S Global Securities may be held only through Euroclear and Clearstream. See "*Description of Securities—Book-Entry; Delivery and Form.*"

To purchase the Securities, investors must comply with all applicable laws and regulations in force in any jurisdiction in which investors purchase, offer or sell the Securities or possess or distribute this Offering Memorandum. Investors must also obtain any consent, approval or permission required by such jurisdiction for investors to purchase, offer or sell any of the Securities under the laws and regulations in force in any jurisdiction in which investors are subject or in which investors make such purchase, offer or sale. None of the Issuer, its subsidiaries and equity accounted investments or the Initial Purchasers will have responsibility therefor.

Any prospective investor subject to the United States Employee Retirement Income Security Act of 1974, as amended ("*ERISA*") and/or Section 4975 of the United States Internal Revenue Code of 1986, as amended (the "*Code*") should consult with its own counsel and other advisors regarding the consequences under ERISA and/or the Code of an investment in the Securities. See "*Certain ERISA Considerations*" and "*Transfer Restrictions.*"

STABILIZATION

In connection with the Offering of the Securities, each of Barclays Capital Inc., BofA Securities, Inc., Citigroup Global Markets Inc., RBC Capital Markets, LLC and Wells Fargo Securities, LLC (collectively, the "*Stabilization Managers*" and each a "*Stabilization Manager*") (or any person acting on behalf of a Stabilization Manager) may purchase and sell the Securities in the open market or effect transactions with a view to supporting the market price of the Securities at a level higher than that which might otherwise prevail. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by a Stabilization Manager of a greater number of Securities than they are required to purchase in the Offering. Stabilizing transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the Securities while the Offering is in progress. However, there is no assurance that any Stabilization Manager (or any person acting on behalf of any Stabilization Manager) will undertake stabilization action. Any stabilization action may begin on or after the date on which adequate public disclosure of the terms of the Offering of the Securities is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Securities and 60 days after the date of the allotment of the Securities. Any stabilization action or over-allotment must be conducted by the Stabilization Managers (or any person acting on behalf of a Stabilization Manager) in accordance with all applicable laws and rules.

These activities by the Stabilization Managers, as well as other purchases by any Stabilization Manager for its own account, may stabilize, maintain or otherwise affect the market price of the Securities. As a result, the price of the Securities may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the Stabilization Managers at any time. These transactions may be effected in the over-the-counter market or otherwise.

AVAILABLE INFORMATION AND REPORTS TO HOLDERS OF SECURITIES

The Issuer is not subject to reporting requirements under the Exchange Act. The Issuer, however, makes available information under Rule 12g3-2(b) under the Exchange Act. In addition, the Issuer files information, including annual reports, with the FCA. Copies of the Issuer's annual reports, the contents of which are not part of this Offering Memorandum, may be obtained through the website maintained by BAE Systems plc at http://www.baesystems.com. Information on BAE Systems' website is not incorporated by reference into this Offering Memorandum.

The Issuer has agreed that it will make available, upon request, to any holder or prospective purchaser of the Securities the information required pursuant to Rule 144A(d)(4) under the Securities Act with respect to itself, during any period in which the Issuer is not subject to Section 13 or 15(d) of the Exchange Act or not exempt by virtue of Rule 12g3-2(b) thereunder. Any such requests should be directed to the Issuer in care of the Company Secretary at BAE Systems plc, 6 Carlton Gardens, London, SW1Y 5AD, United Kingdom.

BAE Systems plc publishes the following information regarding its financial accounts:

Annual Report. The full, consolidated, annual, audited accounts for BAE Systems plc, together with additional information on BAE Systems plc, which are published annually in March/April.

Half-Yearly Report. The extracted, consolidated, unaudited accounts for the first six months of the financial year for BAE Systems plc, which are published annually in July/August.

Preliminary Announcement. The extracted, consolidated accounts for BAE Systems plc for the financial year, which are published annually in February.

PRESENTATION OF CURRENCY AND FINANCIAL AND OTHER INFORMATION

Unless otherwise specified or the context otherwise requires, references to "$," "US$," "dollars" and "U.S. dollars" are to the lawful currency of the United States of America (the "*United States*"), references to "pounds," "pounds Sterling," "£" and "p" are to the lawful currency of the United Kingdom of Great Britain and Northern Ireland (the "*United Kingdom*"), references to "Australian dollar" are to the lawful currency of the Commonwealth of Australia ("*Australia*"), references to "Saudi riyal" are to the lawful currency of the Kingdom of Saudi Arabia ("*Saudi Arabia*") and references to "€" and "euro" are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended. Unless otherwise stated, all monetary amounts with respect to the financial information of BAE Systems plc in this Offering Memorandum are expressed in pounds Sterling.

The consolidated annual financial statements of BAE Systems plc for the year ended December 31, 2019 included in this Offering Memorandum are referred to herein as the "*BAE Systems 2019 Annual Financial Statements*". The consolidated annual financial statements of BAE Systems plc for the year ended December 31, 2018 included in this Offering Memorandum are referred to herein as the "*BAE Systems 2018 Annual Financial Statements*". The BAE Systems 2019 Annual Financial Statements and the BAE Systems 2018 Annual Financial Statements are referred to herein collectively as the "*BAE Systems Annual Financial Statements*". The BAE Systems Annual Financial Statements are prepared in accordance with applicable law and EU-endorsed International Financial Reporting Standards ("*IFRS*"). The unaudited consolidated condensed interim financial statements of BAE Systems plc as of and for the six months ended June 30, 2020 included in this Offering Memorandum are referred to herein as the "*BAE Systems Interim Financial Statements*". The BAE Systems Annual Financial Statements and the BAE Systems Interim Financial Statements are referred to herein collectively as the "*BAE Systems Financial Statements*". The BAE Systems Interim Financial Statements are prepared in accordance with applicable law and International Accounting Standard ("*IAS*") 34, *Interim Financial Reporting*, as adopted by the European Union.

Subsequent Events

The impact of the COVID-19 coronavirus pandemic on BAE Systems is considered a non-adjusting post balance sheet event with respect to the BAE Systems 2019 Annual Financial Statements, is therefore not reflected in the BAE Systems 2019 Annual Financial Statements, and may have a material adverse effect on BAE Systems' business, financial condition and results of operations. See "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business,*" "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources*."

Factors Affecting the Comparability of the BAE Systems Financial Statements

On January 1, 2019, BAE Systems adopted IFRS 16, *Leases* ("*IFRS 16*") using the modified retrospective approach, and therefore has not restated the comparative amounts for the year ended December 31, 2018. In the majority of cases BAE Systems has elected to measure right-of-use assets at the amount of the lease liability on adoption (adjusted for any lease prepayments or accrued lease expenses, onerous lease provisions, and leased assets which have subsequently been subleased). For a number of property leases BAE Systems has elected to measure the right-of-use asset as if IFRS 16 had been applied since the start of the lease, but using the incremental borrowing rate at January 1, 2019, with the difference between the right-of-use asset and the lease liability taken to retained earnings. Upon transition on January 1, 2019, BAE Systems recognized a right-of-use lease asset of £1,298 million (after adjustments for onerous lease provisions, lease prepayments and accrued lease expenses at December 31, 2018), and lease liabilities of £1,486 million (non-current £1,270 million; current £216 million), along with a deferred tax asset of £2 million. A sublease finance receivable of £72 million was also recognized. A transition adjustment of £92 million was recognized as a debit to retained earnings. BAE Systems did not capitalize low-value leases on transition, or those which expire before December 31, 2019, and has opted not to apply IFRS 16 to leases relating to intangible assets. The right-of-use lease asset principally consists of property. Under IFRS 16, BAE Systems sees a different pattern of expense within the income statement, as the IAS 17 operating lease expense is replaced by depreciation and interest charges. There is no overall cash flow impact from the adoption of IFRS 16.

In the BAE Systems 2019 Annual Financial Statements, BAE Systems reclassified certain comparative information as of, and for the year ended, December 31, 2018 (the "*2018 Comparative Information*") to adjust the presentation of certain line items in the consolidated balance sheet and consolidated cash flow statement for the year ended December 31, 2018. A reconciliation from the BAE Systems 2018 Annual Financial Statements to the 2018 Comparative Information for these line items has been included below.

Consolidated Balance Sheet

	Year Ended December 31, 2018 (BAE Systems 2018 Annual Financial Statements)	Reclassification	Year Ended December 31, 2018 (BAE Systems 2019 Annual Financial Statements)
		(In £ millions)	
Non-current liabilities			
Post-employment benefit obligations	4,240	97[(1)]	4,337
Other payables	1,536	(75)[(1)]	1,461
Current liabilities			
Trade and other payables	7,740	(22)[(1)]	7,718

(1) In preparing the BAE Systems 2019 Annual Financial Statements, BAE Systems plc identified that it would be more appropriate to present the end-of-service benefit to employees in Saudi Arabia within post-employment benefits rather than trade and other payables (current portion) and other payables (non-current portion). As such, the comparative balance sheet has been reclassified to include this balance within post-employment benefits in the BAE Systems 2019 Annual Financial Statements.

Consolidated Statement of Cash Flows

	Year Ended December 31, 2018 (BAE Systems 2018 Annual Financial Statements)	Reclassification	Year Ended December 31, 2018 (BAE Systems 2019 Annual Financial Statements)
		(In £ millions)	
Cash flow from investing activities			
Partial disposal of shareholding in subsidiary undertaking	17	(17)[(1)]	0
Cash flow from financing activities			
Partial disposal of shareholding in subsidiary undertaking	0	17[(1)]	17

(1) 2018 comparatives have been reclassified to present a cash inflow of £17 million in respect of a partial disposal of BAE Systems' shareholding in a subsidiary undertaking within financing activities. This cash flow was previously presented in investing activities.

For these reasons, the BAE Systems 2019 Annual Financial Statements are not directly comparable to the BAE Systems 2018 Annual Financial Statements.

As a result of the reclassifications described above, unless stated otherwise, the financial information as of and for the year ended December 31, 2018 included in the Offering Memorandum has been derived from the restated 2018 Comparative Information included within the BAE Systems 2019 Annual Financial Statements.

Various numbers and percentages set out in this Offering Memorandum have been subject to rounding adjustments. Accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be the sum of the figures that precede them.

See "*Independent Auditors*" for a description of the independent auditor's reports to the members of BAE Systems plc dated July 29, 2020, February 19, 2020 and February 20, 2019 on the BAE Systems Interim

Financial Statements, BAE Systems 2019 Annual Financial Statements and BAE Systems 2018 Annual Financial Statements, respectively. In accordance with guidance issued by The Institute of Chartered Accountants in England and Wales, each of the independent auditor's reports on the BAE Systems Annual Financial Statements incorporates language that states that: "This report is made solely to [BAE Systems plc]'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 [BAE Systems plc]'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 [BAE Systems plc] and [BAE Systems plc]'s members, as a body, for our audit work, for this report, or for the opinions we have formed." The independent auditor's report on the BAE Systems Interim Financial Statements incorporates language that states that: "This report is made solely to [BAE Systems plc] 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 Financial Reporting Council. Our work has been undertaken so that we might state to [BAE Systems plc] those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than [BAE Systems plc], for our review work, for this report, or for the conclusions we have formed." The independent auditor's reports are included on pages F-3, F-78 and F-155 of this Offering Memorandum. Investors in the Securities should understand that in making these statements the independent auditors confirmed that they do not accept or assume any liability to parties (such as the purchasers of the Securities) other than BAE Systems plc and BAE Systems plc's members as a body, as applicable, with respect to the reports and to the independent auditor's audit work, review work, opinions and conclusions, as applicable. The SEC would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act, or in a report filed under the Exchange Act. If a U.S. court (or any other court) were to give effect to such limiting language, the recourse that investors in the Securities may have against the independent auditor based on its report or the consolidated financial statements to which it relates could be limited.

Alternative Performance Measures

Certain alternative performance measures ("*APMs*"), including Adjusted profit before taxation (including equity accounted investments), Adjusted taxation expense (including equity accounted investments), Constant currency basis, EBITA as defined by BAE Systems, Free cash flow as defined by BAE Systems, Net debt as defined by BAE Systems, Net finance costs (including equity accounted investments), Non-recurring items, Operating business cash flow, Order backlog, Order intake, Return on revenue, Return on sales, Sales, Underlying EBITA, Underlying effective tax rate and Underlying net interest expense are included or referred to in this Offering Memorandum. APMs are non-IFRS measures used by BAE Systems within its financial publications to supplement disclosures. BAE Systems considers that these measures provide useful information to enhance the understanding of its financial performance. These may not be comparable to other similarly titled measures of other companies and should be viewed as complementary to, rather than a substitute for, the figures determined in accordance with IFRS and other regulatory measures. An explanation of each APM's components and calculation method is set forth below.

Unless otherwise specified or the context otherwise requires, as used or presented in this Offering Memorandum:

- References to the number of employees of BAE Systems or of a reporting segment include share of equity accounted investments, unless otherwise specified.
- Certain financial information and percentages have been rounded, and, as a result, the sum of the numbers or percentages in a column or row of tables or in paragraphs may not conform exactly to the total figure or percentage for that column or row or paragraph.
- The presentation of sales, revenue, Underlying EBITA and operating profit by reporting segment includes the effects of intra-group sales or revenue, as applicable. Total consolidated group sales, revenue, Underlying EBITA and operating profit of BAE Systems are presented after the elimination of such effects. The presentation of sales, revenue, Underlying EBITA and operating profit by reporting segment as a percentage of total sales, revenue, Underlying EBITA and operating profit of BAE Systems, respectively, excludes (i) the elimination of intra-group sales or revenue, as applicable, and (ii) sales, revenue, Underlying EBITA or operating profit, as applicable, attributable to the HQ reporting segment.

- "*Adjusted profit before taxation (including equity accounted investments)*" is defined as profit before taxation including taxation expense of equity accounted investments forming part of the share of results of equity accounted investments and excluding non-taxable non-recurring items.

  The following table presents a reconciliation of profit before taxation to adjusted profit before taxation (including equity accounted investments) for the six months ended June 30, 2020 and June 30, 2019 and the years ended December 31, 2019 and December 31, 2018.

	Six Months Ended June 30,		Year Ended December 31,	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Profit before taxation	689	776	1,626	1,224
Add: Taxation expense of equity accounted investments	2	16	53	38
Deduct: Non-taxable non-recurring items	7	(8)	(22)	—
Adjusted profit before taxation (including equity accounted investments)	**698**	**784**	**1,657**	**1,262**

- "*Adjusted taxation expense (including equity accounted investments)*" is defined as taxation expense including taxation expense of equity accounted investments forming part of the share of results of equity accounted investments and excluding one-off tax benefits described in note 6 to the BAE Systems 2019 Annual Financial Statements.

  The following table presents a reconciliation of taxation expense to adjusted taxation expense (including equity accounted investments) for the six months ended June 30, 2020 and June 30, 2019 and the years ended December 31, 2019 and December 31, 2018.

	Six Months Ended June 30,		Year Ended December 31,	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Taxation expense / (credit)	130	(41)	94	191
Add: Taxation expense of equity accounted investments	2	16	53	38
Add: One-off tax benefit[(1)]	—	161	161	—
Adjusted taxation expense (including equity accounted investments)	**132**	**136**	**308**	**229**

(1) See note 6 to the BAE Systems 2019 Annual Financial Statements.

- "*Basic earnings per share*" is defined in accordance with IAS 33 Earnings per Share.
- "*Constant currency basis*" is defined as financial information that is calculated by translating the results from entities that have functional currencies other than pound Sterling into pound Sterling. These calculations are performed by translating results from such entities in such other functional currencies for the six months ended June 30, 2019 to pound Sterling at the average exchange rate of such currencies for the six months ended June 30, 2020 and for the year ended December 31, 2018 to pound Sterling at the average exchange rate of such currencies for the year ended December 31, 2019. This is referred to in this presentation as "*constant currency basis*." The most important of these other functional currencies is the U.S. dollar and to a lesser extent the euro. These constant currency presentations are based on an average exchange rate of U.S. dollar for pounds Sterling of $1.260 = £1.000 for the six months ended June 30, 2020 (compared to the actual average exchange rate of $1.294 = £1.000 for the six months ended June 30, 2019) and of $1.277 = £1.000 for the year ended December 31, 2019 (compared to the actual average exchange rate of $1.335 = £1.000 for the year ended December 31, 2018), and an average exchange rate of euro for pounds Sterling of €1.144 = £1.000 for the six months ended June 30, 2020 (compared to the actual average exchange rate of €1.146 = £1.000 for the six months ended June 30, 2019) and of €1.141 = £1.000 for the year ended December 31, 2019 (compared to the actual average exchange rate of €1.130 = £1.000 for the year ended December 31, 2018).
- "*EBITA as defined by BAE Systems*" is defined as profit for the period / year excluding amortization and impairment of intangible assets, finance costs and taxation expense of equity accounted

investments, financial income, financial expense and taxation expense. EBITA as defined by BAE Systems is used by management for internal performance analysis as a measure of operating profitability that is comparable over time. EBITA as defined by BAE Systems eliminates potential differences in performance caused by variations in capital structures (affecting net finance costs), tax positions, and the extent to which intangible assets are identifiable (affecting relative amortization expense).

The following table presents a reconciliation of profit for the period / year to EBITA as defined by BAE Systems for the six months ended June 30, 2020 and June 30, 2019 and the years ended December 31, 2019 and December 31, 2018.

	Six Months Ended June 30,		Year Ended December 31,	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Profit for the period / year	559	817	1,532	1,033
Add: Impairment of intangible assets	—	—	6	33
Add: Amortization of intangible assets	49	49	109	85
Add: Finance costs of equity accounted investments	15	10	23	13
Add: Taxation expense of equity accounted investments	2	16	53	38
Deduct: Financial income	(12)	(16)	(27)	(26)
Add: Financial expense	131	136	300	407
Add: Taxation expense / (credit)	130	(41)	94	191
EBITA as defined by BAE Systems	**874**	**971**	**2,090**	**1,774**

- "*Free cash flow as defined by BAE Systems*" is defined as net cash flow from operating activities including net capital expenditure including equity accounted investment funding, principal element of lease payments and receipts, dividends received from equity accounted investments and interest paid, net of interest received. Free cash flow as defined by BAE Systems is used by management for internal liquidity analysis as a measure of the operational cash generation of BAE Systems. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources*" for a reconciliation of net cash flow from operating activities to free cash flow as defined by BAE Systems.
- "*Net cash flow from operating activities*" is defined in accordance with IAS 7 Statement of Cash Flows.
- "*Net debt as defined by BAE Systems*" is defined as cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments). Net debt as defined by BAE Systems does not include lease liabilities. Net debt as defined by BAE Systems is used by management for internal performance analysis as a measure of indebtedness of BAE Systems. See note 28 to the BAE Systems 2019 Annual Financial Statements.
- "*Net finance costs*" is defined as finance costs for BAE Systems, including net interest expense on retirement benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.
- "*Net finance costs (including equity accounted investments)*" is defined as net finance costs, including BAE Systems' share of equity accounted investments.
- The following table presents a reconciliation of net finance costs to net finance costs (including equity accounted investments) for the six months ended June 30, 2020 and June 30, 2019 and the years ended December 31, 2019 and December 31, 2018.

	Six Months Ended June 30,		Year Ended December 31,	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Net finance costs	119	120	273	381
Add: Net finance costs of equity accounted investments	15	10	23	13
Net finance costs (including equity accounted investments)	**134**	**130**	**296**	**394**

- "*Non-recurring items*" is defined as items of financial performance which have been determined by BAE Systems' management as being material by their size or incidence and not relevant to an understanding of BAE Systems' underlying performance. BAE Systems' definition of non-recurring items includes profit or loss on business transactions, and costs incurred which are one-off in nature, for example, non-routine costs or income relating to post-retirement benefit schemes, and other exceptional items which BAE Systems' management has determined as not being relevant to an understanding of BAE Systems' underlying business performance. See note 2 to the BAE Systems Interim Financial Statements and note 1 to the BAE Systems 2019 Annual Financial Statements for items comprising non-recurring items.
- "*Operating business cash flow*" is defined as net cash flow from operating activities excluding taxation and including net capital expenditure including equity accounted investment funding and lease principal amounts and dividends received from equity accounted investments. Net capital expenditure is defined as proceeds from sale of property, plant and equipment and investment property plus proceeds from sale of intangible assets less purchases of property, plant and equipment and investment property less purchase of intangible assets less equity accounted investment funding. Operating business cash flow is used by management for internal liquidity analysis as a measure of the operational cash generation of BAE Systems.
- "*Operating profit*" is defined as profit for the period / year before net finance costs and taxation expense. Unless in respect of reporting segments or as otherwise indicated, "*Operating profit*" refers to any such amounts after elimination of intra-group sales.
- "*Order backlog*" is defined as funded and unfunded unexecuted customer orders including BAE Systems' share of order backlog of equity accounted investments. Unfunded orders include the elements of United States multi-year contracts for which funding has not been authorized by the customer. Order backlog is used by management to assess future years' sales performance of subsidiaries and equity accounted investments. Unless otherwise indicated, "Order backlog" includes BAE Systems' share of equity accounted investments' order backlog and is after the elimination of intra-group orders. See note 1 to the BAE Systems 2019 Annual Financial Statements for a reconciliation of Order backlog to Order book, which represents the transaction price allocated to unsatisfied and partially satisfied performance obligation as defined by IFRS 15, *Revenue from Contracts with Customers*.
- "*Order intake*" is defined as funded orders received from customers including BAE Systems' share of order intake of equity accounted investments. Order intake is used by management for internal performance analysis as a measure of order intake of subsidiaries and equity accounted investments.
- "*Return on revenue*" is defined as operating profit expressed as a percentage of revenue.
- "*Return on sales*" is defined as Underlying EBITA expressed as a percentage of sales.
- "*Revenue*" is defined as income derived from the provision of goods and services by BAE Systems and its subsidiary undertakings.
- "*Sales*" is defined as revenue plus BAE Systems' share of revenue of equity accounted investments less BAE Systems' share of revenue from sales to equity accounted investments. Unless in respect of reporting segments or as otherwise indicated, "*Sales*" refers to any such amounts after elimination of intra-group sales. Sales is used by management for internal performance analysis as a measure of sales performance of subsidiaries and equity accounted investments.

- The following table presents a reconciliation of BAE Systems' and BAE Systems' reporting segments' revenue to sales for the six months ended June 30, 2020 and June 30, 2019.

	Six Months Ended June 30, 2020				Six Months Ended June 30, 2019			
	Revenue	*Deduct*: Revenue from sales to equity accounted investments	*Add*: Share of revenue from equity accounted investments	Sales	Revenue	*Deduct*: Revenue from sales to equity accounted investments	*Add*: Share of revenue from equity accounted investments	Sales
	(In £ millions)							
Electronic Systems	2,203	(18)	18	2,203	2,142	(61)	61	2,142
Cyber & Intelligence	913	—	—	913	853	—	—	853
Platforms & Services (US)	1,688	(3)	33	1,718	1,459	—	63	1,522
Air	3,029	(475)	1,056	3,610	2,824	(452)	994	3,366
Maritime	1,478	(1)	28	1,505	1,512	—	13	1,525
HQ	26	—	76	102	23	—	140	163
Subtotal	**9,337**	**(497)**	**1,211**	**10,051**	**8,813**	**(513)**	**1,271**	**9,571**
Deduct: Intra-Group	(157)	(20)	(3)	(180)	(139)	(16)	—	(155)
Total	**9,180**	**(517)**	**1,208**	**9,871**	**8,674**	**(529)**	**1,271**	**9,416**

- The following table presents a reconciliation of BAE Systems' and BAE Systems' reporting segments' revenue to sales for the years ended December 31, 2019 and December 31, 2018.

	Year Ended December 31, 2019				Year Ended December 31, 2018			
	Revenue	*Deduct*: Revenue from sales to equity accounted investments	*Add*: Share of revenue from equity accounted investments	Sales	Revenue	*Deduct*: Revenue from sales to equity accounted investments	*Add*: Share of revenue from equity accounted investments	Sales
	(In £ millions)							
Electronic Systems	4,439	(114)	114	4,439	3,965	(101)	101	3,965
Cyber & Intelligence	1,732	—	—	1,732	1,678	—	—	1,678
Platforms & Services (US)	3,185	(1)	153	3,337	2,864	—	141	3,005
Air	6,153	(917)	2,221	7,457	5,579	(1,091)	2,224	6,712
Maritime	3,071	(5)	50	3,116	2,940	(2)	37	2,975
HQ	43	—	344	387	41	—	309	350
Subtotal	**18,623**	**(1,037)**	**2,882**	**20,468**	**17,067**	**(1,194)**	**2,812**	**18,685**
Deduct: Intra-Group	(318)	(37)	(4)	(359)	(246)	(32)	—	(278)
Total	**18,305**	**(1,074)**	**2,878**	**20,109**	**16,821**	**(1,226)**	**2,812**	**18,407**

- "*Taxation expense*" is defined as current and deferred tax recognized in profit or loss except to the extent that it relates to a business combination or items recognized directly in equity or other comprehensive income.

- "*Underlying EBITA*" is defined as profit for the period / year excluding amortization and impairment of intangible assets, financial expense and taxation expense of equity accounted investments, financial income, financial expense and taxation expense and non-recurring items. Underlying EBITA is used by management for internal performance analysis as a measure of operating profitability that is comparable over time. In the first half of 2020, non-recurring items of £21 million comprised a £14 million impairment charge related to the Platforms & Services (US) reporting segment's legacy commercial shipbuilding business which BAE Systems exited in 2018 and advisory fees of £7 million related to BAE Systems' acquisition and disposal activities. In the first half of 2019, non-recurring items of £28 million represented a £36 million charge related to the derecognition of enterprise resource planning software intangible assets in the Air reporting segment and a gain of £8 million related to the disposal of Aircraft Accessories and Components Company ("*AACC*"). In 2019, non-recurring items of £27 million comprised a £36 million charge relating to the derecognition of Enterprise Resource Planning software intangible assets in the Air reporting segment, charges of £13 million relating to legal disputes arising from historical disposals, a gain of £14 million on the sale of BAE Systems' 55%

shareholding in BAE Systems Global Combat Systems Limited upon formation of Rheinmetall BAE Systems Land ("*RBSL*") and a gain of £8 million relating to the disposal of AACC. In 2018, non-recurring items of £154 million included a Guaranteed Minimum Pension equalization charge of £114 million, and a loss on disposal of the Mobile, Alabama shipyard of £40 million.

- The following table presents a reconciliation of profit for the period / year to underlying EBITA for the six months ended June 30, 2020 and June 30, 2019 and the years ended December 31, 2019 and December 31, 2018.

	Six Months Ended June 30,		**Year Ended December 31,**	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Profit for the period / year	559	817	1,532	1,033
Add: Impairment of intangible assets	—	—	6	33
Add: Amortization of intangible assets	49	49	109	85
Add: Taxation expense of equity accounted investments	2	16	53	38
Add: Financial expense of equity accounted investments	15	10	23	13
Deduct: Financial income	(12)	(16)	(27)	(26)
Add: Financial expense	131	136	300	407
Add: Taxation expense / (credit)	130	(41)	94	191
Add: Non-recurring items	21	28	27	154
Underlying EBITA	**895**	**999**	**2,117**	**1,928**

- "*Underlying effective tax rate*" is defined as adjusted taxation expense (including equity accounted investments) expressed as a percentage of adjusted profit before taxation (including equity accounted investments).
- "*Underlying net interest expense*" is defined as net finance costs excluding net interest expense on post-employment benefit obligations, (loss)/gain on remeasurement of financial instruments at fair value through profit or loss and foreign exchange gains/(losses).
- The following table presents a reconciliation of net finance costs to underlying net interest expense for the six months ended June 30, 2020 and June 30, 2019 and the years ended December 31, 2019 and December 31, 2018.

	Six Months Ended June 30,		**Year Ended December 31,**	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Net finance costs	119	120	273	381
Deduct: Net interest expense on post-employment benefit obligations	(43)	(58)	(114)	(103)
(Deduct)/Add: (Loss)/gain on remeasurement of financial instruments at fair value through profit or loss	353	73	(73)	146
Add/(Deduct): Foreign exchange (gains)/losses	(311)	(12)	154	(211)
Underlying net interest expense	**118**	**123**	**240**	**213**

Exchange Rates

The following table presents, for each of the periods indicated, the period end, average, high and low Bloomberg Composite Rate (New York) expressed as U.S. dollars per £1.00. The Bloomberg Composite Rate is a "best market" calculation, in which, at any point in time, the bid rate is equal to the highest bid rate of all contributing bank indications and the ask rate is set to the lowest ask rate offered by these banks. The Bloomberg Composite Rate is a mid-value rate between the applied highest bid rate and the lowest ask rate.

Year Ended December 31,	Period End	Average(1)	High	Low
2018	1.2760	1.3303	1.4338	1.2489
2019	1.3255	1.2793	1.3339	1.2028
2020 (through September 7, 2020)	1.3166	1.2779	1.3384	1.1485

(1) The average of the Bloomberg Composite Rate (New York) in effect on the last business day of each month during the relevant period. The Bloomberg Composite Rate (New York) on September 7, 2020 was $1.3166 per £1.00.

The above rates may differ from the actual rates used in the preparation of the financial statements and other financial information appearing in this Offering Memorandum. The Issuer's inclusion of these exchange rates and other exchange rates specified elsewhere in this Offering Memorandum is not meant to suggest that the pound Sterling amounts actually represent such U.S. dollar amounts or that such amounts have been, could have been or could, in the future, be converted into U.S. dollars at any particular rate, if at all.

Unless otherwise indicated in this Offering Memorandum, the exchange rates used to translate amounts shown in U.S. dollars represent, as applicable, the average exchange rate for the relevant period or the exchange rate at period end. The exchange rates used to translate amounts for individual transactions, including business acquisitions and disposals and debt redemption, represent either (i) the spot rate on the day of the transaction, (ii) the weighted average of the relevant foreign exchange contract rates or (iii) a blended rate based on a combination of (i) and (ii).

INDUSTRY AND MARKET DATA

The global and national defense market and competitive position data in this Offering Memorandum generally have been obtained from industry publications and from surveys or studies conducted by third-party sources. There are a variety of limitations with respect to the availability, accuracy, completeness and comparability of such data. The Issuer and the Initial Purchasers cannot assure prospective investors of the accuracy and completeness of such information and the Issuer and the Initial Purchasers have not independently verified such defense market and competitive position data.

In addition, in many cases, statements made in this Offering Memorandum regarding the defense market and the position in the market of BAE Systems and its competitors are based on the internal analyses of the Issuer of market conditions, which analyses contain certain assumptions and estimates. There can be no assurance that any of these assumptions or estimates are accurate or correctly reflect the position of BAE Systems or its competitors in the defense market, and none of the internal analyses have been verified by any independent sources.

FORWARD-LOOKING STATEMENTS

This Offering Memorandum contains and refers to certain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act with respect to the financial condition, results of operations and business of the Issuer and its subsidiaries and equity accounted investments. These forward-looking statements include, but are not limited to, statements about BAE Systems' plans, objectives, expectations and intentions and other statements contained in this Offering Memorandum that are not historical facts. Forward-looking statements are typically identified by the words "may," "will," "believe," "anticipate," "intend," "estimate" and similar expressions. All of these forward-looking statements are based on estimates and assumptions made by BAE Systems that, although believed to be reasonable, are inherently uncertain. Therefore, you should not place undue reliance on forward-looking statements, which are based on the information currently available to BAE Systems and speak only as of the date of this Offering Memorandum. Because these forward-looking statements involve known and unknown risks and uncertainties, there are important factors that could cause actual results to differ materially from those contemplated by such forward-looking statements. These factors include, among other things:

- the outbreak of contagious diseases, including the current COVID-19 coronavirus pandemic;
- operating in international markets;
- the significant competition in international markets;
- the dependence of BAE Systems on government spending on defense;
- the dependence of BAE Systems on a small number of large contracts and fixed-price contracts;
- the performance on government contracts;
- the dependence of BAE Systems on the award timing and cash profile of its contracts;
- the exposure to funding risks under pension schemes;
- the exposure to information technology security threats;
- the ability to recruit and retain people with appropriate talent and skills;
- the ability to integrate acquired businesses successfully; and
- the failure to comply with laws and regulations of multiple governments.

For further information regarding factors that could affect the business and financial results of the Issuer or its subsidiaries and equity accounted investments and such forward-looking statements, see "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities" and* "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments.*"

The forward-looking statements speak only as of the date of this Offering Memorandum. The Issuer expressly disclaims any obligation or undertaking, and does not intend, to release publicly any updates or revisions to any forward-looking statements contained in this Offering Memorandum, to reflect any change in its expectations or any change in events, conditions or circumstances, on which any forward-looking statement contained in this Offering Memorandum is based.

OVERVIEW

The following overview is qualified in its entirety by, and should be read in conjunction with, the more detailed information appearing elsewhere in this Offering Memorandum. Capitalized terms used but not defined in this overview are defined in the text of this Offering Memorandum. Investors should thoroughly consider this Offering Memorandum in its entirety, including the information set forth under "Available Information and Reports to Holders of Securities" and "Risk Factors," prior to an investment in the Securities. For information regarding the use of certain financial terms used in this Offering Memorandum, including APMs, investors should refer to the information set forth under "Presentation of Currency and Financial and Other Information."

BAE Systems plc (the "Issuer") is a public limited company registered in England and Wales. The Issuer is the parent holding company of the BAE Systems group of companies (which, together with the Issuer, is referred to herein as "BAE Systems").

The Issuer

Business of BAE Systems

BAE Systems is an international defense, aerospace and security solutions company with a significant presence in its principal markets—the United States, United Kingdom, Saudi Arabia and Australia—as well as established positions in a number of other international markets. BAE Systems has a diverse portfolio, including an enduring services and support business, long-term platform and product programs, electronic systems, and activities in cyber and intelligence.

As of June 30, 2020, BAE Systems employed approximately 88,400 employees.

In the first half of 2020, BAE Systems generated sales and revenue of £9,871 million and £9,180 million, respectively, and Underlying EBITA and profit for the period of £895 million and £559 million, respectively. In 2019, BAE Systems generated sales and revenue of £20,109 million and £18,305 million, respectively, and Underlying EBITA and profit for the year of £2,117 million and £1,532 million, respectively. The issued ordinary shares of the Issuer are traded on the London Stock Exchange and the Issuer is a member of the FTSE 100 with a market capitalization of £16.7 billion as of September 7, 2020.

BAE Systems reports based on the following reporting segments:

Electronic Systems. The Electronic Systems reporting segment comprises electronics activities based primarily in the United States with some presence in the United Kingdom. These activities include electronic warfare 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 and hybrid electric drive systems. The reporting segment comprises six lines of businesses: Electronic Combat Solutions; Countermeasure & Electromagnetic Attack Solutions; Precision Strike & Sensing Solutions; C4ISR Systems; Controls & Avionics Solutions and Power & Propulsion Solutions.

Sales, revenue and Underlying EBITA of the Electronic Systems reporting segment (£2,203 million, £2,203 million and £291 million, respectively) represented approximately 22%, 24% and 31%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Electronic Systems reporting segment (£4,439 million, £4,439 million and £687 million, respectively) represented approximately 22%, 24% and 31%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

The Electronic Combat Solutions business, Countermeasure & Electromagnetic Attack Solutions business, Precision Strike & Sensing Solutions business, C4ISR Systems business, Controls & Avionics Solutions business and Power & Propulsion Solutions business represented approximately 24%, 17%, 13%, 29%, 13% and 4%, respectively, of Electronic Systems sales, in the first half of 2020, and approximately 22%, 14%, 13%, 28%, 18% and 5%, respectively, of Electronic Systems sales, in 2019. Defense sales and commercial sales represented approximately 85% and 15%, respectively, of Electronic Systems sales, in the first half of 2020, and approximately 79% and 21%, respectively, of Electronic Systems sales, in 2019.

Electronic Systems had approximately 16,300 employees as of June 30, 2020.

Cyber & Intelligence. The Cyber & Intelligence reporting segment comprises the United States-based Intelligence & Security business and United Kingdom-headquartered Applied Intelligence business and covers BAE Systems' cyber security, secure government, and commercial financial security activities. The reporting segment comprises two lines of businesses: Intelligence & Security and Applied Intelligence.

Sales, revenue and Underlying EBITA of the Cyber & Intelligence reporting segment (£913 million, £913 million and £59 million, respectively) represented approximately 9%, 10% and 6%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Cyber & Intelligence reporting segment (£1,732 million, £1,732 million and £91 million, respectively) represented approximately 9%, 9% and 4%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

The Intelligence & Security business and the Applied Intelligence business represented approximately 72% and 28%, respectively, of Cyber & Intelligence sales, in the first half of 2020, and approximately 70% and 30%, respectively, of Cyber & Intelligence sales, in 2019.

Cyber & Intelligence had approximately 9,900 employees as of June 30, 2020.

Platforms & Services (US). The Platforms & Services (US) reporting segment, with operations in the United States, Sweden and United Kingdom, manufactures 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. The business also has a 49% interest in the FNSS joint venture in Turkey. The reporting segment comprises seven lines of businesses: Combat Mission Systems; Ordnance Systems; US Ship Repair; BAE Systems Hägglunds; Weapon Systems Sweden; Weapon Systems UK and FNSS.

Sales, revenue and Underlying EBITA of the Platforms & Services (US) reporting segment (£1,718 million, £1,688 million and £121 million, respectively) represented approximately 17%, 18% and 13%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Platforms & Services (US) reporting segment (£3,337 million, £3,185 million and £267 million, respectively) represented approximately 17%, 17% and 12%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

The Combat Mission Systems business, Ordnance Systems business, US Ship Repair business, BAE Systems Hägglunds business, Weapon Systems Sweden business, Weapon Systems UK business and FNSS business represented approximately 49%, 15%, 23%, 4%, 4%, 3% and 2%, respectively, of Platforms & Services (US) sales, in the first half of 2020, and approximately 42%, 15%, 25%, 5%, 4%, 5%, and 4%, respectively, of Platforms & Services (US) sales, in 2019.

Platforms & Services (US) had approximately 12,600 employees as of June 30, 2020.

Air. The Air reporting segment comprises BAE Systems' United Kingdom-based air activities for European and International Markets, US Programmes, and its businesses in Saudi Arabia and Australia, together with its 37.5% interest in the European MBDA joint venture of Airbus, BAE Systems and Leonardo (the "*European MBDA Joint Venture*"). The reporting segment comprises five lines of businesses: European and International Markets; US Programmes; Saudi Arabia; Australia and MBDA. BAE Systems will introduce a sixth line of business, Future Combat Air Systems, in the second half of 2020.

Sales, revenue and Underlying EBITA of the Air reporting segment (£3,610 million, £3,029 million and £356 million, respectively) represented approximately 36%, 33% and 38%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Air reporting segment (£7,457 million, £6,153 million and £887 million, respectively) represented approximately 37%, 33% and 40%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

The European and International Markets business, US Programmes business, Saudi Arabia business, Australia business and MBDA business represented approximately 31%, 12%, 33%, 9% and 15%, respectively, of Air sales, in the first half of 2020, and approximately 28%, 11%, 35%, 10% and 16%, respectively, of Air sales, in 2019.

Air had approximately 28,800 employees as of June 30, 2020.

Maritime. The Maritime reporting segment comprises BAE Systems' United Kingdom-based maritime and land activities. The reporting segment currently comprises four lines of businesses: Naval Ships; Submarines; Maritime Services and Land UK.

Sales, revenue and Underlying EBITA of the Maritime reporting segment (£1,505 million, £1,478 million and £122 million, respectively) represented approximately 15%, 16% and 13%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Maritime reporting segment (£3,116 million, £3,071 million and £268 million, respectively) represented approximately 16%, 17% and 12%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

Maritime sales and land sales represented approximately 92% and 8%, respectively, of Maritime sales in the first half of 2020, and approximately 91% and 9%, respectively, of Maritime sales in 2019. The Naval Ships business, Submarines business, Maritime Services business, and Land UK business represented approximately 22%, 48%, 22% and 8%, respectively, of Maritime sales, in the first half of 2020, and approximately 25%, 47%, 20% and 9%, respectively, of Maritime sales, in 2019.

Maritime had approximately 16,600 employees as of June 30, 2020.

HQ. The HQ reporting segment comprises BAE Systems' head office activities, together with a 49% interest in Air Astana.

BAE Systems' Strategy

BAE Systems' strategy is comprised of five key long-term areas of focus to help it achieve its vision of being the premier international defense, aerospace and security company and its mission to provide a vital advantage to help its customers protect what really matters. This strategy is centered on maintaining and growing BAE Systems' core franchises and securing growth opportunities through advancing its three strategic priorities and demonstrating the company behaviors.

BAE Systems' strategy is to:

- Maintain and grow its defense businesses.
- Continue to grow its business in adjacent markets.
- Develop and expand its international business.
- Inspire and develop a diverse workforce to drive success.
- Enhance financial performance and deliver sustainable growth in shareholder value.

The following three strategic priorities are embedded throughout BAE Systems and provide the link between its longer-term strategy and near-term business objectives for all of its employees.

BAE Systems' three strategic priorities are to:

- Drive operational excellence.
- Continuously improve competitiveness and efficiency.
- Advance and further leverage its technology.

Financial Results

For the six months ended June 30, 2020, BAE Systems had sales and revenue of £9,871 million and £9,180 million, respectively, compared with £9,416 million and £8,674 million, respectively, for the six months ended June 30, 2019. Underlying EBITA and profit for the period were £895 million and £559 million, respectively, for the six months ended June 30, 2020, compared with £999 million and £817 million, respectively, for the six months ended June 30, 2019. For the six months ended June 30, 2020, BAE Systems had operating profit for the period of £808 million, compared with £896 million for the six months ended June 30, 2019.

For the year ended December 31, 2019, BAE Systems had sales and revenue of £20,109 million and £18,305 million, respectively, compared with £18,407 million and £16,821 million, respectively, for the year ended December 31, 2018. Underlying EBITA and profit for the year were £2,117 million and £1,532 million, respectively, for 2019 compared with £1,928 million and £1,033 million, respectively, for 2018. For 2019, BAE Systems had operating profit for the year of £1,899 million, compared with £1,605 million for 2018.

Recent Developments

BAE Systems' response to the COVID-19 coronavirus pandemic dominated the first half of 2020 and impacted its financial results for the six months ended June 30, 2020. BAE Systems has remained focused during the pandemic on its near-term priorities, while also ensuring it built further resilience into its operations for a prolonged period of disruption. These near-term priorities include protecting the wellbeing of its employees; meeting customer priorities as they face unique challenges; supporting BAE Systems' supply chain in dealing with pandemic-related disruption; preserving and protecting BAE Systems' capabilities and the strength of its business which is underpinned by BAE Systems' £46.1 billion order backlog and program positions as of June 30, 2020; and ensuring that BAE Systems maintains appropriate liquidity and balance sheet strength.

From the start of this pandemic's disruptions, BAE Systems embarked on implementing new working practices such as home working capabilities, reconfiguring floorplans, shift patterns, enhanced cleaning regimes and appropriate safe working measures. Additionally, BAE Systems advanced the key actions for the long-term strength of the business of completing the acquisitions of the Airborne Tactical Radios ("*Airborne Tactical Radios*") business and the Collins Aerospace Military Global Positioning System ("*Military Global Positioning System*") business from Raytheon Technologies Corporation in May 2020 and July 2020, respectively, raising and injecting into BAE Systems' UK pensions scheme £1.0 billion in a one-off pension deficit funding contribution in the first half of 2020, and investing in new facilities to meet the growth profile in a number of sectors. The COVID-19 coronavirus pandemic has clearly had a short-term impact and its long-term impact remains uncertain. See "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.*"

The pandemic impacted BAE Systems' business in the second quarter of 2020, with sites in the Air and Maritime reporting segments and the U.S. commercial operations in the Controls & Avionics Solutions and Power & Propulsion Solutions businesses within the Electronic Systems reporting segment being most affected. However, as a result of the actions taken, productivity levels in June 2020 improved within the defense businesses (which account for over 90% of BAE Systems' revenue in the first half of 2020). As of the end of July 2020, many of these operations have well over 90% of employees working. This includes a high proportion working from home and critical on-site workers having returned under adjusted protective safety measures in response to the pandemic. Further improvements are expected to be progressively achieved during the third quarter of 2020. In parallel, the business continues to drive cost control measures.

Within BAE Systems' United Kingdom-based Air and Maritime reporting segments, second quarter 2020 disruptions have particularly impacted cost recoveries and sales volumes, offset to some degree by strong underlying performance and cost control measures. In the Electronic Systems reporting segment, BAE Systems' United States-based Controls & Avionics Solutions business has been impacted for the near term, especially in the commercial aftermarket and product delivery lines. The Power & Propulsion Solutions business has been impacted by the reduced demand for mass transit in recent months. In Applied Intelligence, commercial cyber operations have also seen reduced trading levels.

In the United States, BAE Systems' defense manufacturing facilities and shipyards have continued to operate during the pandemic following the implementation of appropriate safe working measures. There has been some disruption to manufacturing operations primarily due to impacts on the supply chain, as well as some intermittent production delays in BAE Systems' own lines where precautionary measures to reduce COVID-19 coronavirus exposure were necessary.

Despite having to rapidly adjust to new working practices due to the pandemic in the second quarter of 2020, the defense business has continued to deliver strong operational performance in support of BAE Systems' customers' critical activities. A number of highlights include:

- Astute Boat 4 and the fourth Offshore Patrol Vessel were accepted by the Royal Navy, and HMS Queen Elizabeth was able to commence the next phase of Royal Navy sea trials;
- Key milestones on the Qatar Typhoon program were achieved ahead of schedule;
- The Combat Mission Systems Business continued to make progress towards achieving consistent quality and production across multiple combat vehicle programs by investing in modernizing facilities and implementing improved manufacturing technologies; and
- APKWS® successfully demonstrated a ground-launch capability.

In July 2020, BAE Systems was awarded a $32 million prototype agreement by the United States Army's Rapid Capabilities and Critical Technologies Office to integrate a Hybrid Electric Drive system onto a Bradley Fighting Vehicle. The development program is part of the United States Army's effort to increase vehicle efficiency and boost power generation to support integration of future technologies and greater mobility for combat vehicles on the battlefield.

In July 2020, BAE Systems received a $33 million multi-year contract from the United States Army to further develop its Long Range Precision Guidance Kit ("*LR-PGK*") for 155mm artillery shells, enabling the United States Army to conduct long range precision strikes in challenging electromagnetic environments. LR-PGK is a critical program in the United States Army's 155mm Extended Range Cannon Artillery munitions suite, designed to deliver accurate, lethal fires at greater ranges than near-peer adversaries.

In July 2020, BAE Systems received $179 million in total awards from the United States Army as part of the Limited Interim Missile Warning System Quick Reaction Capability program. This award includes orders for the first two production lots and funding to enable fielding of the next-generation Missile Warning System ("*MWS*"). The MWS provides aircrews with advanced threat detection capabilities, improving survivability and mission effectiveness in contested environments.

In July 2020, the United States Army awarded BAE Systems an initial order under its Distributed Common Ground System Capability Drop 2 Program. The multiple award, indefinite delivery-indefinite quantity contract is worth up to $823 million, and provides enhanced intelligence to see and better understand threats and other relevant aspects of the operational environment. BAE Systems' solution for Capability Drop 2 is the Intelligence Knowledge Environment, a software framework of modular data and artificial intelligence analytic capabilities built to autonomously transform information into knowledge.

In July 2020, the Board of Directors declared an interim dividend of 13.8p per ordinary share in respect of the year ended December 31, 2019, payable in September 2020, being the value of the dividend proposed but subsequently deferred earlier in 2020. In addition, the Board of Directors also declared an interim dividend of 9.4p per share in respect of the six months ended June 30, 2020. This additional interim dividend will be paid in November 2020 assuming there are no major additional or unforeseen pandemic-related disruptions.

In July 2020, BAE Systems completed the acquisition of the Military Global Positioning System business for cash consideration of $1,925 million, excluding customary purchase price adjustments.

In August 2020, the United States Air Force Research Laboratory awarded BAE Systems a five-year $85 million contract to continue to develop, deploy, modernize, and maintain cross-domain solutions that allow for secure transfer of sensitive information between government networks. The work on the contract will enable the secure exchange of data, including streaming video, images and audio, to enhance mission collaboration. BAE Systems will also provide research, development, and evaluation of new technologies, including the integration of innovative artificial intelligence and machine learning capabilities.

In August 2020, BAE Systems received an $83.5 million contract from the United States Navy to modernize the guided-missile destroyers USS Carney (DDG 64) and USS Winston S. Churchill (DDG 81). The modernization work will be performed sequentially at BAE Systems's shipyard in Jacksonville. The contract includes options that, if exercised, would bring the cumulative value to $211.6 million.

In August 2020, BAE Systems completed the small bolt-on acquisition of Techmodal, a United Kingdom-based data consultancy and digital services company with approximately 120 employees and 30 associates, including data scientists, consultants and systems analysts. BAE Systems believes that Techmodal's capabilities strongly complement the digital and data services BAE Systems currently provides to the Royal Navy and that Techmodal's experience and expertise in data analytics, data science and digital transformation will strengthen its ability to support all of the United Kingdom's armed forces and other customers around the world. The Techmodal acquisition will be integrated into the Maritime reporting segment.

The Offering

Issuer	BAE Systems plc.
Issuer LEI	8SVCSVKSGDWMW2QHOH83.
Issuer Website	http://www.baesystems.com. The information on the Issuer's website is not incorporated by reference into this Offering Memorandum.
The Offering	1.900% Notes due 2031 (the "*2031 Notes*"); and 3.000% Notes due 2050 (the "*2050 Notes*" and, together with the 2031 Notes, the "*Securities*"). The Securities will be issued under a Fiscal and Paying Agency Agreement dated as of September 15, 2020 (the "*Fiscal and Paying Agency Agreement*") among the Issuer, Citibank, N.A., London Branch, as fiscal and paying agent (the "*Fiscal and Paying Agent*") and Citigroup Global Markets Europe AG, as registrar, and will be treated as a single class for all purposes under the Fiscal and Paying Agency Agreement. The Securities are being offered in the United States only to QIBs in reliance on Rule 144A under the Securities Act and outside the United States to non-U.S. persons in reliance upon Regulation S.
Principal Amount	2031 Notes: $1,000,000,000 aggregate principal amount; and 2050 Notes: $1,000,000,000 aggregate principal amount.
Issue Price	2031 Notes: 99.232% of the principal amount, plus accrued interest from the issue date, if any; and 2050 Notes: 98.537% of the principal amount, plus accrued interest from the issue date, if any.
Stated Maturity Date	2031 Notes: February 15, 2031; and 2050 Notes: September 15, 2050.
Interest	The 2031 Notes will bear interest at a rate of 1.900% per year from September 15, 2020, based upon a 360-day year consisting of twelve 30-day months. The 2050 Notes will bear interest at a rate of 3.000% per year from September 15, 2020, based upon a 360-day year consisting of twelve 30-day months.
Interest Payment Dates	Interest on the 2031 Notes will be payable semi-annually in arrears on February 15 and August 15 of each year, commencing February 15, 2021. Interest on the 2050 Notes will be payable semi-annually in arrears on March 15 and September 15 of each year, commencing March 15, 2021.
Status of Securities	The Securities will be direct, unsecured and unsubordinated obligations of the Issuer, ranking *pari passu* among themselves and with all other direct, unsecured and unsubordinated obligations (except those obligations preferred by statute or operation of law) of the Issuer.

Restrictive Covenants . . . . The Issuer has agreed to observe certain covenants with respect to the Securities, including, among other things, limitations on liens and conditions relating to consolidation, merger and conveyance transactions. See "*Description of Securities—Certain Covenants*."

Events of Default . . . . For a discussion of certain events that will permit acceleration of the Securities, including acceleration of certain other indebtedness of the Issuer, see "*Description of Securities—Events of Default*."

Optional Redemption . . . . The Securities will be redeemable at the option of the Issuer at any time, in whole or in part, at a redemption price equal to the greater of (i) 100% of the outstanding principal amount of the Securities to be redeemed plus accrued but unpaid interest, if any, to the date of redemption and (ii) the sum of the present values of the Remaining Scheduled Payments (as defined herein) thereon discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the applicable Treasury Rate (as defined herein) plus 20 basis points (in the case of the 2031 Notes) or the applicable Treasury Rate plus 25 basis points (in the case of the 2050 Notes); *provided* that on or after the applicable Par Call Date (as defined herein), the 2031 Notes and 2050 Notes will be redeemable at the option of the Issuer, in whole or in part, at a redemption price equal to 100% of the principal amount of the Securities of such series to be redeemed plus accrued but unpaid interest on the principal amount being redeemed to, but not including, the redemption date. See "*Description of Securities—Optional Redemption*."

Use and Estimated Amount of Net Proceeds . . . . The net amount of proceeds to the Issuer from the Offering is estimated to be approximately $1.968 billion, after deducting discounts but before deducting any expenses associated with the Offering. The net proceeds of the Offering will be used predominantly to refinance up to $1,925 million in aggregate principal amount outstanding under the Bridge Loan Facility Agreement dated January 17, 2020 (the "*Bridge Loan Facility Agreement,*" and the term loan facility thereunder, the "*Bridge Facility*"), among, *inter alios*, BAE Systems Holdings Inc. as original borrower, the Issuer as guarantor, and certain financial institutions as lenders, incurred to fund the acquisition of the Military Global Positioning System business on July 31, 2020. See "*Use and Estimated Amount of Net Proceeds*."

Denomination, Form and Registration of Securities . . . . The Securities will be issued in fully registered form and only in denominations of $200,000 and integral multiples of $1,000 in excess thereof. The Securities will be issued initially as Global Securities. QIBs may elect to hold Securities purchased by them through the facilities of DTC, which will act as depositary for the Securities. Holders of Securities sold in offshore transactions in reliance on Regulation S under the Securities Act may elect to hold Global Securities through Euroclear and Clearstream. Prior to the date that is 40 days after the later of the commencement of the Offering and the closing date, beneficial interests in a Regulation S Global Security may be held only through Euroclear and Clearstream. See "*Description of Securities—Book-Entry; Delivery and Form.*"

Further Issues	The Issuer may from time to time without the consent of the holders of the Securities issue additional debt securities having the same terms and conditions as the relevant series of Securities so that the further issue is consolidated and forms a single series of notes with the 2031 Notes or the 2050 Notes, as applicable; *provided* that, unless issued under a separate CUSIP number, such additional debt securities will be fungible with the applicable outstanding Securities for U.S. Federal income tax purposes. The period of the resale restrictions applicable to any Securities previously offered and sold in reliance on Rule 144A under the Securities Act shall automatically be extended to the last day of the period of any resale restrictions imposed on any such additional Securities of the same series.
Fiscal and Paying Agent	Citibank, N.A., London Branch.
Transfer Restrictions	The Securities have not been and will not be registered under the Securities Act and may be offered or sold (1) in the United States only to QIBs in reliance upon the exemption from the registration requirement of the Securities Act provided by Rule 144A and (2) outside the United States to non-U.S. persons in reliance upon Regulation S. See "*Transfer Restrictions*."
Governing Law	The Fiscal and Paying Agency Agreement and the Securities will be governed by, and construed in accordance with, the laws of the State of New York.
Ratings	As of the date of this Offering Memorandum, the Issuer's long-term credit ratings are Baa2 ("Stable Outlook") (Moody's), BBB ("Stable Outlook") (S&P) and BBB ("Stable Outlook") (Fitch). A rating is not a recommendation to buy, sell or hold Securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating agency. Each of Moody's and Fitch is established in the United Kingdom and has been registered under the CRA Regulation. S&P is established in the European Union and has been registered under the CRA Regulation.
Listing	Application has been made to the Financial Conduct Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "FCA") for the Securities to be admitted to the official list of the FCA (the "*Official List*") and to the London Stock Exchange plc (the "*London Stock Exchange*") for the Securities to be admitted to trading on the London Stock Exchange's Regulated Market (the "*Market*").
Risk Factors	Investing in the Securities involves a high degree of risk. See "*Risk Factors*" for a description of certain of the risks you should carefully consider before investing in the Securities.
Rule 144A 2031 Notes CUSIP/ISIN	CUSIP: 05523R AF4/ ISIN: US05523RAF47.
Rule 144A 2050 Notes CUSIP/ISIN	CUSIP: 05523R AE7/ ISIN: US05523RAE71.
Regulation S 2031 Notes CUSIP/ISIN	CUSIP: G06940 AG8/ ISIN: USG06940AG87.
Regulation S 2050 Notes CUSIP/ISIN	CUSIP: G06940 AF0/ ISIN: USG06940AF05.

Summary Financial and Other Data

The following tables present summary consolidated financial and certain other operating data for BAE Systems and have been derived from the BAE Systems Interim Financial Statements, the BAE Systems 2019 Annual Financial Statements and the restated 2018 Comparative Information included within the BAE Systems 2019 Annual Financial Statements. The BAE Systems Annual Financial Statements and related notes were audited by Deloitte LLP, independent auditors. These tables should be read in conjunction with "*Management's Discussion and Analysis of Financial Condition and Results of Operations,*" "*Business*" and the BAE Systems Financial Statements and related notes.

The BAE Systems Annual Financial Statements and BAE Systems Interim Financial Statements are prepared in accordance with EU-endorsed IFRS and IAS 34, *Interim Financial Report*, respectively, and include supplemental measures and APMs.

	Six Months Ended June 30,		Year Ended December 31,	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Income Statement Data:				
Sales[1]	9,871	9,416	20,109	18,407
Underlying EBITA[1]	895	999	2,117	1,928
Non-recurring items[1]	(21)	(28)	(27)	(154)
EBITA as defined by BAE Systems[1]	**874**	**971**	**2,090**	**1,774**
Amortization of intangible assets	(49)	(49)	(109)	(85)
Impairment of intangible assets	—	—	(6)	(33)
Financial expense of equity accounted investments	(15)	(10)	(23)	(13)
Taxation expense of equity accounted investments	(2)	(16)	(53)	(38)
Operating profit	**808**	**896**	**1,899**	**1,605**
Net finance costs	(119)	(120)	(273)	(381)
Profit before taxation	**689**	**776**	**1,626**	**1,224**
Taxation (expense) / credit	(130)	41	(94)	(191)
Profit for the period / year	**559**	**817**	**1,532**	**1,033**

	As of June 30,		As of December 31,	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Balance Sheet Data:				
Intangible assets	10,992	10,648	10,371	10,658
Property, plant and equipment	2,611	2,392	2,437	2,365
Right-of-use assets	1,144	1,256	1,138	—
Investment property	137	142	137	98
Non-current investments[2]	380	346	441	442
Inventories	951	847	835	774
Payables less receivables[3]	(1,270)	(1,092)	(1,984)	(2,189)
Other net financial assets and liabilities[4]	176	117	34	70
Net post-employment benefit obligations[5]	(5,970)	(4,304)	(4,455)	(4,029)
Provisions	(725)	(696)	(685)	(761)
Net tax[6]	1,109	711	690	449
Net debt as defined by BAE Systems[1]	(2,038)	(1,889)	(743)	(904)
Lease liabilities	(1,363)	(1,486)	(1,354)	—
Other payables	(1,578)	(1,642)	(1,481)	(1,461)
Net assets held for sale[7]	142	164	130	106
Non-controlling interests	(148)	(88)	(104)	(72)
Total equity attributable to equity holders of Issuer	**4,550**	**5,426**	**5,407**	**5,546**

	Six Months Ended June 30,		Year Ended December 31,	
	2020	2019	2019	2018
	(In £ millions, except order intake/backlog (in £ billions) and personnel numbers)			
Summarized Cash Flow Data:				
Operating business cash flow[1]	**(880)**	**(309)**	**1,307**	**993**
Add back: Net capital expenditure and financial investment[8]	189	201	454	464
Add back: Principal element of lease payments and receipts	116	114	230	—
Deduct: Dividends received from equity accounted investments	(24)	(90)	(142)	(57)
Deduct: Taxation	(128)	(148)	(252)	(200)
Net cash flow from operating activities	**(727)**	**(232)**	**1,597**	**1,200**
Net cash flow from investing activities	**(366)**	**(72)**	**(232)**	**(358)**
Interest paid	(114)	(134)	(233)	(203)
Net sale of own shares	—	—	—	1
Equity dividends paid	—	(423)	(724)	(703)
Partial disposal of shareholding in subsidiary undertaking	—	14	31	17
Dividends paid to non-controlling interests	(3)	(26)	(56)	(28)
Principal element of lease payments	(120)	(119)	(239)	—
Cash flow from matured derivative financial instruments (excluding cash flow hedges)	72	47	40	6
Movement in cash collateral	14	4	1	2
Cash outflow from repayment of loans	1,136	(773)	(782)	(7)
Net cash flow from financing activities	**985**	**(1,410)**	**(1,962)**	**(915)**
Net decrease in cash and cash equivalents	**(108)**	**(1,714)**	**(597)**	**(73)**
Other Data:				
Number of employees, including share of employees of equity accounted investments, at period / year end	88,400	87,300	87,800	85,800
Order intake[1]	9.3	8.4	18.4	28.3
Order backlog[1]	46.1	47.4	45.4	48.4

(1) See "*Presentation of Currency and Financial and Other Information*" for an explanation of the components and calculation method of this measure.

(2) Non-current investments is derived from the line items Equity accounted investments *plus* Other investments in the applicable BAE Systems Financial Statements.

(3) Payables less receivables is derived from the line items Non-current other receivables *plus* Trade, other and contract receivables *less* Trade and other payables in the applicable BAE Systems Financial Statements.

(4) Other net financial assets and liabilities is derived from the line items Non-current other financial assets *plus* Current other financial assets *less* Non-current other financial liabilities *less* Current other financial liabilities excluding debt-related derivative financial instruments in the applicable BAE Systems Financial Statements.

(5) Net post-employment benefit obligations is derived from the line items Post-employment benefit surpluses *less* Post-employment benefit obligations in the applicable BAE Systems Financial Statements.

(6) Net tax is derived from the line items Deferred tax assets *plus* Current tax assets *less* Current tax liabilities in the applicable BAE Systems Financial Statements.

(7) Net assets held for sale is derived from the line items Assets held for sale *less* Liabilities held for sale in the applicable BAE Systems Financial Statements.

(8) Net capital expenditure and financial investment is derived from the line items Proceeds from sale of property, plant and equipment and investment property *plus* proceeds from sale of intangible assets *less* Purchases of property, plant and equipment and investment property *less* Purchase of intangible assets *less* equity accounted investment funding in the applicable BAE Systems Financial Statements.

RISK FACTORS

The Issuer believes that the following factors may affect its ability to fulfill its obligations under the Securities. All of these factors are contingencies which may or may not occur. Factors which the Issuer believes may be material for the purpose of assessing the market risks associated with the Securities are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in the Securities, but the Issuer may be unable to pay interest, principal or other amounts on or in connection with the Securities for other reasons, and the Issuer does not represent that the statements below regarding the risks of holding the Securities are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Offering Memorandum and reach their own views prior to making any investment decision.

1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities

A. Risks relating to the industry and BAE Systems' business

The outbreak of contagious diseases may have an adverse effect on BAE Systems' business, financial condition and results of operations.

Contagious diseases can have an adverse effect on BAE Systems' business, financial condition and results of operations. There is currently a COVID-19 coronavirus 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. It is not clear for how long this pandemic will last or how much more extensive it will become, or the further measures that will be taken by governments and others to seek to control this pandemic and its impact.

Since the outbreak of the COVID-19 coronavirus pandemic, BAE Systems 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 its employees. A significant proportion of BAE Systems' employees are working from home. While BAE Systems 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 BAE Systems may be affected.

The COVID-19 coronavirus pandemic has resulted in changes to the outlook in BAE Systems' markets. Areas of BAE Systems' business that could be impacted include a decrease in spending by BAE Systems' major defense and commercial customers, the failure to obtain awards for defense and commercial contracts, the failure of suppliers to deliver parts to BAE Systems, the requirement for BAE Systems or its suppliers to reduce site operational levels or close sites, the inability of BAE Systems 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 external funding. If BAE Systems' 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 programs. Any of the above could have a material adverse effect on BAE Systems' business, financial condition and results of operations.

BAE Systems operates in international markets.

BAE Systems is an international company conducting business in a number of regions, including the United States 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 United Kingdom, United States, and all other relevant jurisdictions and the inability to obtain or maintain necessary export licenses. The risk of BAE Systems' inability to obtain and maintain the necessary export licenses for its business in Saudi Arabia could affect BAE Systems' provision of capability to the country. The occurrence of any of the above events could have a material adverse effect on BAE Systems' future results of operations and financial condition.

BAE Systems is also exposed to volatility arising from movements in currency exchange rates, particularly in respect of the U.S. dollar, euro, Saudi riyal and Australian dollar. There has been volatility in currency exchange rates in the period since the referendum in the United Kingdom to withdraw from the European Union ("*Brexit*") in June 2016. This volatility has increased in recent months due in part to the impact and the expected future impact of the COVID-19 coronavirus pandemic on the global economy. Significant fluctuations in currency exchange rates to which BAE Systems is exposed could have a material adverse effect on BAE Systems' future results of operations and financial condition.

On January 31, 2020, Brexit became effective and the United Kingdom entered into a transition period from January 31, 2020 to December 31, 2020, during which the European Union will treat the United Kingdom as if it were still a member of the European Union (the "*Transition Period*"). The terms of the United Kingdom's relationship with the European Union after the end of the Transition Period are currently uncertain, rendering it difficult for BAE Systems to prepare in detail for the changes in the regulatory environment that are likely to apply beyond the Transition Period. The terms may require BAE Systems to put in place a set of actions and mitigations to prepare for the end of the Transition Period in relation to a range of business activities, including customs procedures, export control and the use of specialty chemicals whose use is currently authorized by an agency of the European Union. There is also a risk that, as a result of Brexit, BAE Systems' ability to take part in collaborative industrial programs in Europe could encounter new European Union barriers. These risks and uncertainties could adversely affect BAE Systems' future results of operations and financial condition.

BAE Systems is subject to significant competition in international markets.

BAE Systems' business plan depends upon its ability to win and contract for high-quality new programs, an increasing number of which are expected to be in markets outside the United States and United Kingdom. BAE Systems is dependent upon United States and United Kingdom government support in relation to a number of its business opportunities in export markets.

BAE Systems' 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.

BAE Systems is dependent on defense spending.

In 2019, 92% of BAE Systems' sales were defense-related. Defense 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 BAE Systems' principal markets, in particular in the United Kingdom. Defense spending by governments has also been impacted by the COVID-19 coronavirus outbreak due to reprioritization of funds. For example, earlier this year, the United States government approved a $2 trillion stimulus package to mitigate the impact of the COVID-19 coronavirus pandemic on the United States economy and the United Kingdom government announced a £330 billion rescue package of loan guarantees to help businesses in the United Kingdom offset the economic fallout from the COVID-19 coronavirus pandemic. See *"Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—The outbreak of contagious diseases may have an adverse effect on BAE Systems' business, financial condition and results of operations."*

Lower defense spending by BAE Systems' major customers could have a material adverse effect on BAE Systems' future results of operations and financial condition.

BAE Systems has many contracts, including a small number of large contracts and fixed-price contracts.

In 2019, 46% of BAE Systems' sales were generated by its 15 largest programs. At December 31, 2019, BAE Systems had seven programs with order backlog in excess of £1 billion. A significant portion of BAE Systems' revenue is derived from fixed-price contracts. Actual costs may exceed the projected costs on which the fixed prices are agreed and, since these contracts can extend over many years, it can be difficult to predict the ultimate outturn costs. It is important that BAE Systems 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 BAE Systems 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 BAE Systems' future results of operations and financial condition.

BAE Systems' largest customers are governments.

BAE Systems has long-standing relationships and security arrangements with a number of its government customers, including its three largest customers, the governments of the United States, United Kingdom and Saudi Arabia, and their agencies. It is important that these relationships and arrangements are maintained.

In the defense and security industries, governments can typically modify contracts for their convenience or terminate them at short notice. Long-term United States government contracts, for example, are funded annually and are subject to cancellation if funding appropriations for subsequent periods are not made. The risk of modification, termination or cancellation of government contracts has recently increased due to the reprioritization of government funds as a result of the outbreak of the COVID-19 coronavirus pandemic. *See* "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—BAE Systems is dependent on defense spending*" *and* "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—The outbreak of contagious diseases may have an adverse effect on BAE Systems' business, financial condition and results of operations.*"

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.

BAE Systems' performance on its contracts with some government customers is subject to audits and other reviews which can result in adjustments to prices and costs.

Deterioration in BAE Systems' 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 BAE Systems' future results of operations and financial condition.

BAE Systems is dependent on the award timing and cash profile of its contracts.

BAE Systems' profits and cash flows are dependent, to a significant extent, on the timing of, or failure to receive, award of defense contracts and the profile of cash receipts on its contracts.

Amounts receivable under BAE Systems' defense contracts can be substantial and, therefore, the timing of, or failure to receive, awards and associated cash advances and milestone payments could materially affect BAE Systems' profits and cash flows for the periods affected, thereby reducing cash available to meet BAE Systems' cash allocation priorities, potentially resulting in the need to arrange external funding and impact BAE Systems' investment-grade credit rating. The timing of these cash advances and milestone payments could be impacted by the reprioritization of government funds as a result of the outbreak of the COVID-19 coronavirus pandemic and any effects on BAE Systems' profits and cash flows could require BAE Systems to raise additional capital. *See* "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—The outbreak of contagious diseases may have an adverse effect on BAE Systems' business, financial condition and results of operations.*"

BAE Systems has an aggregate funding deficit in its defined benefit pension schemes.

In aggregate, there is an actuarial deficit between the value of the projected liabilities of BAE Systems' defined benefit pension schemes and the assets they hold. The funding deficits may be adversely affected by changes in a number of factors, including investment returns and members' anticipated longevity.

Increases in pension scheme deficits may require BAE Systems to increase the amount of cash contributions payable to these schemes, thereby reducing cash available to meet BAE Systems' other cash allocation priorities.

See "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies—Post-Employment Benefit Obligations*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Pension Schemes.*"

BAE Systems could be negatively impacted by information technology security threats.

The security threats faced by BAE Systems include threats to its information technology infrastructure, unlawful attempts to gain access to its proprietary or classified information and the potential for business disruptions associated with information technology failures.

Failure to combat these risks effectively could negatively impact BAE Systems' reputation among its customers and the public, cause disruption to its business operations, and could result in a negative impact on BAE Systems' future results and financial condition.

BAE Systems' strategy is dependent on its ability to recruit and retain people with appropriate talent and skills.

Delivery of BAE Systems' 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. BAE Systems' business plan is targeting an increasing level of business in international export markets outside the United States and United Kingdom. It is important that BAE Systems recruits and retains management with the necessary international skills and experience in the relevant jurisdictions.

The loss of key employees or the inability to attract the appropriate people on a timely basis could adversely impact BAE Systems' ability to deliver its strategy, meet the business plan and, accordingly, have a negative impact on BAE Systems' future results and financial condition.

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 realizes 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.

B. Legal and regulatory risks

BAE Systems is subject to risk from a failure to comply with laws and regulations.

BAE Systems operates in a highly-regulated environment across many jurisdictions and is subject, without limitation, to laws and regulations relating to import-export controls, money laundering, false accounting, anti-bribery and anti-boycott provisions. It is important that BAE Systems maintains a culture in which it focuses on embedding responsible business behaviors and that all employees act in accordance with the requirements of BAE Systems' 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 BAE Systems being unable to obtain or maintain necessary export licenses.

Failure by BAE Systems, or its sales representatives, marketing advisers or others acting on its behalf, to comply with these laws and regulations could result in fines and penalties and/or the suspension or debarment of BAE Systems from government contracts or the suspension of BAE Systems' export privileges, which could have a material adverse effect on BAE Systems. Reduced access to export markets could have a material adverse effect on BAE Systems' future results of operations and financial condition.

2. Risks related to the nature of the Securities

The Issuer is a holding company with no revenue-generating operations of its own.

The Issuer is a holding company and does not directly conduct any business operations. The business of BAE Systems is carried out through several operating subsidiaries and joint ventures. Therefore, holders of Securities will not have any direct claim on any of the income generated from BAE Systems' business operations.

Because the Issuer does not have significant business operations of its own, the Issuer will depend upon operating subsidiaries to provide the funds necessary to pay the principal of, and interest on, the Securities. These operating subsidiaries have not guaranteed the Securities, and have no obligation, contingent or otherwise, to pay amounts due under the Securities or to make funds available for these payments, whether in the form of loans, dividends or otherwise. Payments from the operating subsidiaries to the Issuer might not be able to be made in some circumstances, due to corporate law or contractual or other legal restrictions.

Holders of Securities will have a direct claim based on the Securities against the Issuer, but will not have a direct claim based on the Securities against any operating subsidiaries. The right of holders of Securities to receive payments under the Securities will be structurally subordinated to all liabilities of the operating subsidiaries. In the event of a bankruptcy, liquidation, reorganization or similar proceeding relating to a subsidiary, the right of holders of Securities to participate in a distribution of the assets of such subsidiary will rank behind such subsidiary's creditors (including trade creditors) and preferred stockholders (if any), except to the extent that the Issuer has direct claims against such subsidiary.

3. Factors which are material for the purpose of assessing the market risks associated with the Securities

There is no prior market for the Securities and the liquidity of any trading market for the Securities may be limited.

The Securities are new securities with no established trading market and the Issuer cannot assure you that any market will develop, or, if it does develop, that it will continue to exist. Although application has been made to the FCA for the Securities to be admitted to the Official List and to the London Stock Exchange for the Securities to be admitted to trading on the Market, there can be no assurance that the Securities will be approved for listing or that such listing will be maintained. If a market for the Securities were to develop, prevailing interest rates and general market conditions could affect the price of the Securities. This could cause the Securities to trade at prices that may be lower than their principal amount or their initial offering price. As a result, the Issuer cannot assure you as to the liquidity of any trading market for the Securities.

The Issuer does not intend to register the Securities for resale or to exchange a new series of registered securities for the Securities offered pursuant to this Offering Memorandum.

The Securities have not been registered under the Securities Act, and the Issuer has no obligation or intention subsequently to register or exchange registered securities for the Securities. Accordingly, the Securities can only be offered or sold pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Therefore, a holder of Securities may be required to bear the risk of its investment for an indefinite period. For a discussion of certain restrictions on resale and transfer, see "*Transfer Restrictions.*"

4. Other risks

Investors in the Securities may have limited recourse against the independent auditor.

See "*Independent Auditors*" for a description of the independent auditor's reports to the members of BAE Systems plc dated July 29, 2020, February 19, 2020 and February 20, 2019 on the BAE Systems Interim Financial Statements, BAE Systems 2019 Annual Financial Statements and BAE Systems 2018 Annual Financial Statements, respectively. In accordance with guidance issued by The Institute of Chartered Accountants in England and Wales, each of the independent auditor's reports on the BAE Systems Annual Financial Statements incorporates language that states that: "This report is made solely to [BAE Systems plc]'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 [BAE Systems plc]'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 [BAE Systems plc] and [BAE Systems plc]'s members, as a body, for our audit work, for this report, or for the opinions we have formed." The independent auditor's report on the BAE Systems Interim Financial Statements incorporates language that states that: "This report is made solely to [BAE Systems plc] 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 Financial Reporting Council. Our work has been undertaken so that we might state to [BAE Systems plc] those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than [BAE Systems plc], for our review work, for this report, or for the conclusions we have formed.” The independent auditor’s reports are included on pages F-3, F-78 and F-155 of this Offering Memorandum.

Investors in the Securities should understand that in making these statements the independent auditors confirmed that they do not accept or assume any liability to parties (such as the purchasers of the Securities) other than BAE Systems plc and BAE Systems plc’s members as a body, as applicable, with respect to the reports and to the independent auditor’s audit work, review work, opinions and conclusions, as applicable. The SEC would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act, or in a report filed under the Exchange Act. If a U.S. court (or any other court) were to give effect to such limiting language, the recourse that investors in the Securities may have against the independent auditor based on its report or the consolidated financial statements to which it relates could be limited.

CAPITALIZATION

The following table presents the share capital and reserves and indebtedness of BAE Systems as of June 30, 2020. This table does not give effect to this offering and the use of proceeds from this offering and does not include $1,925 million aggregate principal amount incurred on July 31, 2020 under the Bridge Facility in relation to the acquisition of the Military Global Positioning System business. See "*Use and Estimated Amount of Net Proceeds*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.*"

	As of June 30, 2020
	(In £ millions)
Share Capital and Reserves:	
Issued share capital—equity[1]	87
Issued share capital—non-equity[1]	—
Share premium	1,249
Other reserves[2]	6,748
Retained earnings—deficit	(3,534)
Total equity attributable to equity holders of parent	4,550
Non-controlling interests	148
Total equity	4,698
Indebtedness and Other Borrowing:[3][4][5][6]	
Long-term loans guaranteed by the Issuer	2,085
Long-term loans not guaranteed by the Issuer	2,166
Total long-term loans	4,251
Short-term loans	525
Long-term lease liabilities	1,106
Short-term lease liabilities	257
Total capitalization[7]	10,837

(1) The following table presents the share capital of BAE Systems at June 30, 2020.

	Issued	
	Number	Value
		(In £)
Equity: Ordinary shares of £0.025 each	3,467 million	87 million
Non-Equity: Special share of £1.00	1	1

(2) Other Reserves

	(In £ millions)
Statutory reserve[A]	202
Hedging reserve	52
Translation reserve	1,892
Revaluation reserve	10
Capital redemption reserve	3
Merger reserve	4,589
Total reserve	**6,748**

(A) Under Section 4 of the British Aerospace Act of 1980, the statutory reserve may only be applied in paying up unissued shares of BAE Systems to be allotted to members of BAE Systems as fully paid bonus shares.

(3) Except as set out in the table and excluding intercompany arrangements, BAE Systems did not have outstanding at June 30, 2020 any loan capital (either issued or created but unissued), term loans or other borrowings or indebtedness in the nature of borrowings, including bank overdrafts and liabilities under acceptances (other than normal trade bills) or acceptance credits, hire purchase commitments or commitments under leases (other than short-term leases, low-value leases and leases of intangible assets).

(4) Under IFRS 16 *Leases*, commitments under leases (other than short-term leases, low-value leases and leases of intangible assets) are recognized on the balance sheet by lessees. See note 36 to the BAE Systems 2019 Annual Financial Statements.

(5) All debt is unsecured and not guaranteed by any third party.

(6) The carrying amount of loans and overdrafts at June 30, 2020 excludes debt-related derivative financial instruments assets of £216 million presented as other financial assets on BAE Systems' balance sheet.

(7) Total equity *plus* Total long-term loans *plus* Short term loans *plus* Long-term lease liabilities *plus* Short-term lease liabilities.

USE AND ESTIMATED AMOUNT OF NET PROCEEDS

The net amount of proceeds to the Issuer from the Offering is estimated to be approximately $1.968 billion, after deducting discounts but before deducting any expenses associated with the Offering. The net proceeds of the Offering will be used predominantly to refinance up to $1,925 million in aggregate principal amount outstanding under the Bridge Loan Facility Agreement incurred to fund the acquisition of the Military Global Positioning System business on July 31, 2020.

Certain of the Initial Purchasers or their affiliates have lending relationships with the Issuer and its subsidiaries, including under the Issuer's $2.0 billion committed Revolving Credit Facility (the "*RCF*") and under the Bridge Facility and will therefore receive a portion of the net proceeds of the Offering. See also "*Plan of Distribution.*"

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the financial condition and results of operations of BAE Systems should be read in conjunction with the BAE Systems Financial Statements and related notes, and the other financial information included elsewhere in this Offering Memorandum. For information regarding the definitions and use of certain APMs used in the following discussion and analysis investors should refer to the information set forth under "Presentation of Currency and Financial and Other Information."

Overview

General

BAE Systems is an international defense, aerospace and security solutions company with a significant presence in its principal markets—the United States, United Kingdom, Saudi Arabia and Australia—as well as established positions in a number of other international markets. BAE Systems has a diverse portfolio, including an enduring services and support business, long-term platform and product programs, electronic systems capabilities, and activities in cyber and intelligence.

Acquisitions and Joint Ventures

In December 2018, BAE Systems acquired 100% of the issued share capital of ASC Shipbuilding Pty ("*ASCS*"). Following the acquisition, ASCS was awarded a framework agreement for the Australian Hunter Class Future Frigate program including the scope for the initial design and production readiness phase. ASCS forms part of the Air reporting segment's Australian operations.

In June 2019, BAE Systems acquired the Riptide Autonomous Solutions ("*Riptide*") business, a developer of unmanned underwater vehicles. The Riptide business forms part of the Electronics Systems reporting segment.

In January 2019, following an initial collaboration with Prismatic Ltd. ("*Prismatic*") in April 2018 to invest in the development and flight testing of the PHASA-35™ system, a solar electric unmanned aerial vehicle, BAE Systems entered into an agreement to acquire Prismatic as part of BAE Systems' strategy to develop breakthrough technologies. The Prismatic business forms part of the Air reporting segment.

In July 2019, the Land UK business formed a joint venture with Rheinmetall, RBSL, to create a joint United Kingdom-based military land vehicle design, manufacturing and support business. Rheinmetall purchased a 55% stake in the existing BAE Systems United Kingdom-based combat vehicles business with BAE Systems retaining 45% ownership.

In May 2020, BAE Systems acquired the Airborne Tactical Radios business for cash consideration of $275 million and, in July 2020, BAE Systems acquired the Military Global Positioning System business for cash consideration of $1,925 million, excluding customary purchase price adjustments. BAE Systems will treat each acquisition as an asset sale and purchase for U.S. federal income tax purposes and expects to generate associated cash tax benefits with estimated present values of approximately $50 million and $365 million, respectively. BAE Systems believes that these acquisitions represent a unique opportunity to purchase high-quality technology-based businesses with market-leading capabilities and long histories of pioneering innovation in their fields. The Military Global Positioning System business has approximately 715 employees, an extensive patent and intellectual property portfolio with over 1.5 million devices fielded on 280 platform types, and generated total revenue of approximately $330 million in 2019 with strong margins. BAE Systems expects the Military Global Positioning System acquisition to be earnings and cash accretive due to the business' strong growth profile underpinned by a congressional mandate to update GPS receivers to M-Code. The Airborne Tactical Radios and Military Global Positioning System businesses form part of the Electronics Systems reporting segment.

Divestitures and Sales

In October 2018, BAE Systems sold its Mobile, Alabama shipyard. With the delivery of the final constructed ship in March 2019, BAE Systems exited commercial shipbuilding in the United States.

BAE Systems continues to reorganize its portfolio of interests in a number of industrial companies in Saudi Arabia. In February 2020, Riyadh Wings Aviation Academy LLC increased its ownership in Overhaul and Maintenance Company ("*OMC*") to 26.5%, and in January 2019, OMC disposed of its 85.7% shareholding in AACC. OMC also entered into a heads of terms for the sale of its 50% shareholding in Advanced Electronics Company ("*AEC*") to Saudi Arabian Military Industries ("*SAMI*"), the Saudi Arabian national development and support holding company for local defense industries, which is expected to conclude in the second half of 2020.

Following a strategic review in 2019, BAE Systems commenced a process for the disposal of the United States-based Applied Intelligence SilverSky business. Negotiations regarding the sale have continued despite the temporary market uncertainty caused by the pandemic. BAE Systems divested the United Kingdom-based Applied Intelligence Managed Security Services business in April 2020.

BAE Systems continually examines the options for its business and reviews its portfolio to ensure it remains aligned to BAE Systems' strategy. Investment in value-enhancing acquisitions will be considered where market conditions are right and where they deliver on BAE Systems' strategy.

Currency Exchange Rate Fluctuations

BAE Systems' business is exposed to a number of foreign currencies, the most significant being the U.S. dollar, the euro, the Saudi riyal and the Australian dollar. BAE Systems' objective is to reduce its exposure to transactional volatility in earnings and cash flows from movements in foreign currency exchange rates.

BAE Systems is exposed to movements in foreign currency exchange rates in respect of foreign currency denominated transactions. To mitigate this risk, BAE Systems' policy is to hedge all material firm transactional currency exchange rate exposures. BAE Systems aims, where possible, to apply hedge accounting treatment for all derivatives that hedge material transactional foreign currency exposures.

BAE Systems is also 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. BAE Systems does not hedge the translation effect of exchange rate movements on the income statements or balance sheets of foreign subsidiaries and equity accounted investments that it regards as long-term investments.

Recent Developments

BAE Systems' response to the COVID-19 coronavirus pandemic dominated the first half of 2020 and impacted its financial results for the six months ended June 30, 2020. BAE Systems has remained focused during the pandemic on its near-term priorities, while also ensuring it built further resilience into its operations for a prolonged period of disruption. These near-term priorities include protecting the wellbeing of its employees; meeting customer priorities as they face unique challenges; supporting BAE Systems' supply chain in dealing with pandemic-related disruption; preserving and protecting BAE Systems' capabilities and the strength of its business which is underpinned by BAE Systems' £46.1 billion order backlog and program positions as of June 30, 2020; and ensuring that BAE Systems maintains appropriate liquidity and balance sheet strength.

From the start of this pandemic's disruptions, BAE Systems embarked on implementing new working practices such as home working capabilities, reconfiguring floorplans, shift patterns, enhanced cleaning regimes and appropriate safe working measures. Additionally, BAE Systems advanced the key actions for the long-term strength of the business of completing the acquisitions of the Airborne Tactical Radios ("*Airborne Tactical Radios*") business and the Collins Aerospace Military Global Positioning System ("*Military Global Positioning System*") business from Raytheon Technologies Corporation in May 2020 and July 2020, respectively, raising and injecting into BAE Systems' UK pensions scheme £1.0 billion in a one-off pension deficit funding contribution in the first half of 2020, and investing in new facilities to meet the growth profile in a number of sectors. The COVID-19 coronavirus pandemic has clearly had a short-term impact and its long-term impact remains uncertain. See "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.*"

The pandemic impacted BAE Systems' business in the second quarter of 2020, with sites in the Air and Maritime reporting segments and the U.S. commercial operations in the Controls & Avionics Solutions and

Power & Propulsion Solutions businesses within the Electronic Systems reporting segment being most affected. However, as a result of the actions taken, productivity levels in June 2020 improved within the defense businesses (which account for over 90% of BAE Systems' revenue in the first half of 2020). As of the end of July 2020, many of these operations have well over 90% of employees working. This includes a high proportion working from home and critical on-site workers having returned under adjusted protective safety measures in response to the pandemic. Further improvements are expected to be progressively achieved during the third quarter of 2020. In parallel, the business continues to drive cost control measures.

Within BAE Systems' United Kingdom-based Air and Maritime reporting segments, second quarter 2020 disruptions have particularly impacted cost recoveries and sales volumes, offset to some degree by strong underlying performance and cost control measures. In the Electronic Systems reporting segment, BAE Systems' United States-based Controls & Avionics Solutions business has been impacted for the near term, especially in the commercial aftermarket and product delivery lines. The Power & Propulsion Solutions business has been impacted by the reduced demand for mass transit in recent months. In Applied Intelligence, commercial cyber operations have also seen reduced trading levels.

In the United States, BAE Systems' defense manufacturing facilities and shipyards have continued to operate during the pandemic following the implementation of appropriate safe working measures. There has been some disruption to manufacturing operations primarily due to impacts on the supply chain, as well as some intermittent production delays in BAE Systems' own lines where precautionary measures to reduce COVID-19 coronavirus exposure were necessary.

Despite having to rapidly adjust to new working practices due to the pandemic in the second quarter of 2020, the defense business has continued to deliver strong operational performance in support of BAE Systems' customers' critical activities. A number of highlights include:

- Astute Boat 4 and the fourth Offshore Patrol Vessel were accepted by the Royal Navy, and HMS Queen Elizabeth was able to commence the next phase of Royal Navy sea trials;
- Key milestones on the Qatar Typhoon program were achieved ahead of schedule;
- The Combat Mission Systems Business continued to make progress towards achieving consistent quality and production across multiple combat vehicle programs by investing in modernizing facilities and implementing improved manufacturing technologies; and
- APKWS® successfully demonstrated a ground-launch capability.

In July 2020, BAE Systems was awarded a $32 million prototype agreement by the United States Army's Rapid Capabilities and Critical Technologies Office to integrate a Hybrid Electric Drive system onto a Bradley Fighting Vehicle. The development program is part of the United States Army's effort to increase vehicle efficiency and boost power generation to support integration of future technologies and greater mobility for combat vehicles on the battlefield.

In July 2020, BAE Systems received a $33 million multi-year contract from the United States Army to further develop its Long Range Precision Guidance Kit ("*LR-PGK*") for 155mm artillery shells, enabling the United States Army to conduct long range precision strikes in challenging electromagnetic environments. LR-PGK is a critical program in the United States Army's 155mm Extended Range Cannon Artillery munitions suite, designed to deliver accurate, lethal fires at greater ranges than near-peer adversaries.

In July 2020, BAE Systems received $179 million in total awards from the United States Army as part of the Limited Interim Missile Warning System Quick Reaction Capability program. This award includes orders for the first two production lots and funding to enable fielding of the next-generation Missile Warning System ("*MWS*"). The MWS provides aircrews with advanced threat detection capabilities, improving survivability and mission effectiveness in contested environments.

In July 2020, the United States Army awarded BAE Systems an initial order under its Distributed Common Ground System Capability Drop 2 Program. The multiple award, indefinite delivery-indefinite quantity contract is worth up to $823 million, and provides enhanced intelligence to see and better understand threats and other relevant aspects of the operational environment. BAE Systems' solution for Capability Drop 2 is the Intelligence Knowledge Environment, a software framework of modular data and artificial intelligence analytic capabilities built to autonomously transform information into knowledge.

In July 2020, the Board of Directors declared an interim dividend of 13.8p per ordinary share in respect of the year ended December 31, 2019, payable in September 2020, being the value of the dividend proposed but subsequently deferred earlier in 2020. In addition, the Board of Directors also declared an interim dividend of 9.4p per share in respect of the six months ended June 30, 2020. This additional interim dividend will be paid in November 2020 assuming there are no major additional or unforeseen pandemic-related disruptions.

In July 2020, BAE Systems completed the acquisition of the Military Global Positioning System business for cash consideration of $1,925 million, excluding customary purchase price adjustments.

In August 2020, the United States Air Force Research Laboratory awarded BAE Systems a five-year $85 million contract to continue to develop, deploy, modernize, and maintain cross-domain solutions that allow for secure transfer of sensitive information between government networks. The work on the contract will enable the secure exchange of data, including streaming video, images and audio, to enhance mission collaboration. BAE Systems will also provide research, development, and evaluation of new technologies, including the integration of innovative artificial intelligence and machine learning capabilities.

In August 2020, BAE Systems received an $83.5 million contract from the United States Navy to modernize the guided-missile destroyers USS Carney (DDG 64) and USS Winston S. Churchill (DDG 81). The modernization work will be performed sequentially at BAE Systems's shipyard in Jacksonville. The contract includes options that, if exercised, would bring the cumulative value to $211.6 million.

In August 2020, BAE Systems completed the small bolt-on acquisition of Techmodal, a United Kingdom-based data consultancy and digital services company with approximately 120 employees and 30 associates, including data scientists, consultants and systems analysts. BAE Systems believes that Techmodal's capabilities strongly complement the digital and data services BAE Systems currently provides to the Royal Navy and that Techmodal's experience and expertise in data analytics, data science and digital transformation will strengthen its ability to support all of the United Kingdom's armed forces and other customers around the world. The Techmodal acquisition will be integrated into the Maritime reporting segment.

Outlook in BAE Systems' Markets

In the United States, a two-year budget agreement was signed in July 2019 to lift the deficit ceiling and budget caps. The passage and signing of the fiscal year 2020 Defense Appropriations bill in December 2019 ended the Continuing Resolution then in place and maintained funding support for many key BAE Systems programs, including combat vehicles, the F-35 Lightning II fifth-generation combat aircraft ("*F-35*"), electronic warfare programs, and current and future precision weapons systems. This fiscal year 2020 includes a top line budget of $738 billion for defense, a 3% increase over fiscal year 2019, and lawmakers have already agreed to a bipartisan deal setting the defense spending cap for fiscal year 2021 at $740.5 billion, maintaining support for BAE Systems' medium-term planning assumptions and positive momentum for military readiness and modernization programs. While BAE Systems continues to closely monitor the budget process, the significant COVID-19 coronavirus pandemic-related relief spending, coupled with the national election in November, may impact the fiscal year 2021 defense budget and the timely passage of appropriations legislation.

In the United Kingdom, the government has stated its commitment to meeting the NATO target of spending of at least 2.0% of Gross Domestic Product on defense, and to increase the defense budget by at least 0.5% above inflation, in every year of the current parliament. The government has now recommenced its Integrated Foreign Policy, Defence and Security Review. BAE Systems believes that the United Kingdom Combat Air Strategy announced in July 2018 and the existing National Shipbuilding Strategy send a strong signal about the United Kingdom's commitment to retaining a leading position in the combat air and maritime domains and that these strategies enable long-term planning and joint government and industry investment in next-generation platforms, systems and technologies and the workforce required to deliver them.

Saudi Arabia's Vision 2030 strategy to promote in-kingdom industrialization and diversification away from reliance on oil continues to shape BAE Systems' activities in support of Saudi Arabia's national objectives of technology development, local skills, and the development of an indigenous defense industry and capability. Through the restructuring of BAE Systems' portfolio of interests in a number of industrial companies, along with sustaining current industrialized capability and building on its strong history in Saudi Arabia, BAE Systems is working with Saudi Arabian Military Industries, the Saudi Arabian national development and support holding company for local defense industries, to explore how it can collaborate to deliver further in-kingdom industrial participation.

In Australia, regional instability, the impact of the COVID-19 coronavirus pandemic, and the rapid pace of military modernization and technology advancement in the Asia-Pacific region continue to drive the Australian government's commitment to defense spending, with major recapitalization programs underway in the air, maritime and land domains, underpinned also by its policies of developing a strong, sustainable and secure Australian defense industry and supporting leading-edge technical innovation. The Australian government has indicated it is on track to meet its commitment to growing defense spending to 2.0% of GDP in 2020/21. As part of this commitment, the Australian government has made clear its objective to build a robust, resilient and internationally competitive domestic defense industry to ensure the expertise resident in the industrial base effectively supports Australia's national security.

Changes in Accounting Policies and Estimates

With effect from January 1, 2019, BAE Systems adopted IFRS 16 *Leases*. This results in almost all leases being recognized on the balance sheet by lessees. BAE Systems has applied the modified retrospective transition approach and therefore has not restated comparative amounts for the year ended December 31, 2018.

Additional details concerning BAE Systems' adoption of IFRS 16 *Leases* are provided in note 36 to the BAE Systems 2019 Annual Financial Statements. Other standards, interpretations and amendments to existing standards that became effective on January 1, 2019 did have not have a material impact on BAE Systems.

There are no accounting policy changes which are expected to have a significant impact on BAE Systems with effect from January 1, 2020. See note 1 "*Preparation*" to the BAE Systems Interim Financial Statements and the note titled "*Preparation*" to the BAE Systems 2019 Annual Financial Statements.

Results of Operations for the Six Months Ended June 30, 2020 Compared with the Six Months Ended June 30, 2019

The following table presents BAE Systems' and BAE Systems' reporting segments' sales, revenue, Underlying EBITA and operating profit for the six months ended June 30, 2020 and June 30, 2019.

	Six Months Ended June 30, 2020				Six Months Ended June 30, 2019			
	Sales[(1)]	Revenue[(1)]	Underlying EBITA[(1)]	Operating profit[(1)]	Sales[(1)]	Revenue[(1)]	Underlying EBITA[(1)]	Operating profit[(1)]
	(In £ millions)							
Electronic Systems	2,203	2,203	291	281	2,142	2,142	316	308
Cyber & Intelligence	913	913	59	56	853	853	25	22
Platforms & Services (US)	1,718	1,688	121	105	1,522	1,459	135	130
Air	3,610	3,029	356	324	3,366	2,824	438	379
Maritime	1,505	1,478	122	108	1,525	1,512	133	120
HQ	102	26	(54)	(66)	163	23	(48)	(63)
Subtotal	**10,051**	**9,337**	**895**	**808**	**9,571**	**8,813**	**999**	**896**
Deduct: Intra-Group	(180)	(157)	—	—	(155)	(139)	—	—
Total	**9,871**	**9,180**	**895**	**808**	**9,416**	**8,674**	**999**	**896**

(1) See "*Presentation of Currency and Financial and Other Information*" for an explanation of the components and calculation method of this measure.

Sales

Sales is used by management for internal performance analysis as a measure of sales performance of subsidiaries and equity accounted investments, and is defined as revenue plus BAE Systems' share of revenue of equity accounted investments. The definition is consistent with the sales performance measure disclosed in note 2 to the BAE Systems Interim Financial Statements and note 1 to the BAE Systems 2019 Annual Financial Statements on a segmental basis.

Sales increased by £455 million (4.8%) to £9,871 million in the first half of 2020 from £9,416 million in the first half of 2019, a 3.8% increase on a constant currency basis.

Revenue

Revenue is defined as income derived from the provision of goods and services by BAE Systems and its subsidiary undertakings.

Revenue increased by £506 million (5.8%) to £9,180 million in the first half of 2020 from £8,674 million in the first half of 2019, a 4.8% increase on a constant currency basis.

Underlying EBITA

Underlying EBITA is used by management for internal performance analysis as a measure of operating profitability that is comparable over time, and is defined as operating profit excluding amortization and impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBITA), and non-recurring items. The definition is consistent with the profit measure disclosed in note 2 to the BAE Systems Interim Financial Statements and note 1 to the BAE Systems 2019 Annual Financial Statements on a segmental basis. Non-recurring items are defined as items of financial performance which have been determined by BAE Systems' management as being material by their size or incidence and not relevant to an understanding of BAE Systems' underlying performance. BAE Systems' definition of non-recurring items includes profit or loss on business transactions, and costs incurred which are one-off in nature, for example, non-routine costs or income relating to post-retirement benefit schemes, and other exceptional items which BAE Systems' management has determined as not being relevant to an understanding of BAE Systems' underlying business performance.

Underlying EBITA decreased by £104 million (10.4%) to £895 million in the first half of 2020, compared with £999 million in the first half of 2019. Underlying EBITA decreased by 11.5% on a constant currency basis and excluding the impact of the Airborne Tactical Radios acquisition in May 2020. Non-recurring items of £21 million in the first half of 2020 comprised a £14 million impairment charge related to the Platforms & Services (US) reporting segment's legacy commercial shipbuilding business which BAE Systems exited in 2018 and advisory fees of £7 million related to BAE Systems' acquisition and disposal activities. Non-recurring items of £28 million in the first half of 2019 represented a £36 million charge related to the derecognition of enterprise resource planning software intangible assets in the Air reporting segment and a gain of £8 million related to the disposal of AACC. Return on sales was 9.1% in the first half of 2020 and 10.6% in the first half of 2019.

Operating Profit

Operating profit is defined as profit for the period before finance costs and taxation expense. This measure includes finance costs and taxation expense of equity accounted investments.

Operating profit decreased by £88 million (9.8%) to £808 million in the first half of 2020 from £896 million in the first half of 2019. Return on revenue was 8.8% in the first half of 2020 and 10.3% in the first half of 2019.

Amortization of Intangible Assets

Amortization of intangible assets of £49 million in the first half of 2020 remained unchanged from £49 million in the first half of 2019.

Net Finance Costs

Net finance costs (including equity accounted investments) is used by management as a measure of finance costs of subsidiaries and equity accounted investments and is defined as finance costs for BAE Systems and its share of equity accounted investments, including net interest expense on retirement benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.

Net finance costs (including equity accounted investments) increased to £134 million in the first half of 2020 from £130 million in the first half of 2019. The underlying net interest expense, including BAE Systems' share of equity accounted investments, decreased to £127 million in the first half of 2020 compared to £130 million in the first half of 2019. The net interest expense on retirement benefit obligations, including BAE Systems' share of equity accounted investments, decreased to £44 million in the first half of 2020 compared to £60 million in the first half of 2019. There was a credit in respect of fair value and foreign exchange adjustments on financial instruments and investments, including BAE Systems' share of equity accounted investments, of £37 million in the first half of 2020 compared to a credit of £60 million in the first half of 2019.

Net finance costs as defined in IFRS decreased to £119 million in the first half of 2020 from £120 million in the first half of 2019. The underlying net interest expense decreased to £118 million in the first half of 2020 compared to £123 million in the first half of 2019. The net interest expense on retirement benefit obligations decreased to £43 million in the first half of 2020 compared to £58 million in the first half of 2019. There was a credit in respect of fair value and foreign exchange adjustments on financial instruments and investments of £42 million in the first half of 2020 compared to a credit of £61 million in the first half of 2019.

Taxation Expense

Adjusted taxation expense (including equity accounted investments) is used by management as a measure of taxation expense of subsidiaries and equity accounted investments and is defined as current and deferred tax recognized in profit or loss except to the extent that it relates to a business combination or items recognized directly in equity or other comprehensive income and includes BAE Systems' share of equity accounted investments.

Adjusted taxation expense (including equity accounted investments) was £132 million in the first half of 2020, reflecting an underlying effective tax rate of 19% compared with taxation expense of £136 million (which excludes a £161 million one-off tax benefit) and an underlying effective tax rate of 17% in the first half of 2019. The underlying effective tax rate in the first half of 2020 is based on adjusted profit before taxation (including equity accounted investments) of £698 million.

Taxation expense as defined in IFRS was £130 million in the first half of 2020, reflecting an effective tax rate of 19%, compared with a credit of £41 million and an effective tax rate of (5)%, respectively, in the first half of 2019. This effective tax rate in the first half of 2020 is based on profit before taxation of £689 million.

Basic Earnings per Share

Basic earnings per share is defined in accordance with IAS 33 *Earnings per Share*.

Basic earnings per share decreased by 33.2% to 16.7p in the first half of 2020, compared with 25.0p in the first half of 2019, primarily a result of lower operating profit as well as a one-off tax benefit in 2019.

Operating Business Cash Flow

Operating business cash flow is used by management for internal performance analysis as a measure of the operational cash generation of BAE Systems, and is defined as net cash flow from operating activities excluding taxation and including net capital expenditure, lease principal amounts, financial investment and dividends from equity accounted investments.

Operating business cash outflow increased by £571 million (184.8%) to £880 million in the first half of 2020 from £309 million in the first half of 2019, primarily due to the one-off pension deficit funding contribution of £1.0 billion in the first half of 2020, partly offset by the remaining inflow of £120 million, which reflects BAE Systems' strong focus on liquidity and proactive efforts from governments in its major markets related to the COVID-19 coronavirus pandemic.

Net Cash Flow from Operating Activities

Net Cash Flow from Operating Activities is defined in accordance with IAS 7 *Statement of Cash Flows*.

Net cash outflow from operating activities increased by £495 million (213.4%) to £727 million in the first half of 2020 from £232 million in the first half of 2019, primarily due to the one-off pension deficit funding contribution of £1.0 billion in the first half of 2020, partly offset by the remaining inflow, which reflects BAE Systems' focus on liquidity and proactive efforts from governments in its major markets related to the COVID-19 coronavirus pandemic.

Order Intake

Order intake is used by management for internal performance analysis as a measure of order intake of subsidiaries and equity accounted investments and is defined as funded orders received from customers including BAE Systems' share of order intake of equity accounted investments.

Order intake increased by £0.9 billion (10.9%) to £9.3 billion in the first half of 2020 from £8.4 billion in the first half of 2019, driven by the Electronic Systems reporting segment, including awards on F-35, APKWS® and Threat Detection Solutions, and the Platforms & Services (US) reporting segment, including awards on M109, Bradley and Armored Multi-Purpose Vehicles.

Order Backlog

Order backlog is used by management to assess future years' sales performance of subsidiaries and equity accounted investments, and is defined as funded and unfunded unexecuted customer orders including the BAE Systems' share of order backlog of equity accounted investments. Unfunded orders include the elements of United States multi-year contracts for which funding has not been authorized by the customer.

Order backlog increased by £0.7 billion (1.5%) to £46.1 billion in the first half of 2020 from £45.4 billion for 2019, with a 7% increase in BAE Systems' U.S. businesses and a foreign exchange benefit partly offset by trading on multi-year, long-term contracts in the Air reporting segment.

Electronic Systems

In the first half of 2020, the Electronic Systems reporting segment had Underlying EBITA of £291 million on sales of £2,203 million, representing a £25 million (7.9%) decrease in Underlying EBITA from £316 million and a £61 million (2.8%) increase in sales from £2,142 million in the first half of 2019. Operating profit of £281 million on revenue of £2,203 million in the first half of 2020 represented a £27 million (8.8%) decrease in operating profit from £308 million and a £61 million (2.8%) increase in revenue from £2,142 million in the first half of 2019. The increase in sales and revenue is in line with last year, excluding the impact of the Airborne Tactical Radios acquisition in May 2020, and is due to growth of 9.0% in the defense business driven by the F-35 program, APKWS® volumes and increased classified activity, partly offset by a 31.6% decline in commercial sales.

Return on sales decreased to 13.2% in the first half of 2020 from 14.8% in the first half of 2019 while return on revenue decreased to 12.8% from 14.4%, reflecting the impact of higher margin commercial sales declines. The Electronic Systems reporting segment generated an operating business cash inflow of £64 million in the first half of 2020, down from £137 million in the first half of 2019 and a cash inflow from operating activities of £163 million, down from £213 million.

Order backlog for the Electronic Systems reporting segment was £7.3 billion as of June 30, 2020, compared to £6.0 billion as of December 31, 2019, with significant awards on F-35 for LRIP 14 and Block 4 development, APKWS® volumes and Threat Detection Solutions.

In the first half of 2020, BAE Systems introduced two lines of businesses: Countermeasure & Electromagnetic Attack Solutions and Precision Strike & Sensing Solutions. These two lines of businesses and the retained Electronic Combat Solutions, C4ISR Systems, Controls & Avionics Solutions and Power & Propulsion Solutions were structured with a sharpened focus on three prime capabilities: radio frequency electronic warfare; precision guided munitions; and countermeasures.

While the first quarter of 2020 closed with solid performance, the onset of the COVID-19 coronavirus pandemic over the course of the second quarter of 2020 caused some production and supply chain disruptions. Two of the reporting segment's businesses, Controls & Avionics Solutions and Power & Propulsion Solutions were more notably impacted by the pandemic, stemming from the significant economic downturns in the commercial air travel and mass transit markets. Cost reduction actions have been implemented and some workforce adjustments have been necessary to adjust to changes in demand across impacted businesses. In Controls & Avionics Solutions, reduced demand for electronic controls in Original Equipment Manufacturer deliveries as well as aftermarket services have impacted BAE Systems' commercial business. As a result, the United States business furloughed approximately 700 employees for up to two months and reduced the workforce by approximately 250 employees in the first half of 2020. While the impact is being realized in the near-term, BAE Systems does not expect the underlying long-term need for new aircraft to change. BAE Systems expects a return of overall demand as the market recovers for which it believes the business to be well positioned. In Power & Propulsion Solutions, declines in mass transit and bus travel caused five of BAE Systems' seven bus manufacturing customers to shut down operations for six to eight weeks. These customers have resumed operations, and BAE Systems is coming back online to meet restored requirements.

Cyber & Intelligence

In the first half of 2020, the Cyber & Intelligence reporting segment had Underlying EBITA of £59 million on sales of £913 million, representing a £34 million (136.0%) increase in Underlying EBITA from £25 million and a £60 million (7.0%) increase in sales from £853 million in the first half of 2019. Operating profit of £56 million on revenue of £913 million in the first half of 2020 represented a £34 million (154.4%) increase in operating profit from £22 million and a £60 million (7.0%) increase in revenue from £853 million in the first half of 2019. Sales and revenue increased 5.1% on a constant currency basis with the growth led by the United States-based Intelligence & Security business.

Return on sales increased to 6.5% in the first half of 2020 from 2.9% in the first half of 2019 while return on revenue increased to 6.1% from 2.6%. Return on sales for the first half of 2020 in the United States business of 8.5% was down from 9.5% in the first half of 2019. Within Applied Intelligence, the business recorded a small operating profit compared to an operating loss for the first half of 2019 following the restructuring charge taken in the first half of 2019. The Cyber & Intelligence reporting segment generated an operating business cash inflow of £107 million in the first half of 2020, up from £23 million in the first half of 2019 and a cash inflow from operating activities of £120 million, up from £38 million, with the increase primarily due to accelerated collections on a number of government contracts in the Intelligence & Security business.

Order backlog for the Cyber & Intelligence reporting segment was £1.7 billion as of June 30, 2020, compared to £1.8 billion as of December 31, 2019, with continued strong demand in the Applied Intelligence government business.

The United States-based Intelligence & Security business continues to maintain its bid pipeline, perform on existing contracts, and win new orders, although a number of new awards and program opportunities have been delayed due to the COVID-19 coronavirus pandemic. The financial impact on contract performance has been minimal to date, supported by the implementation of targeted business cost reductions. Further offsets have resulted from six- to twelve-month extensions on several Intelligence Solutions programs that are deferring their re-competes to 2021, and the business is seeking recovery of costs under the US CARES Act Section 3610 for employees who are on standby and ready to work.

Platforms & Services (US)

In the first half of 2020, the Platforms & Services (US) reporting segment had Underlying EBITA of £121 million on sales of £1,718 million, representing a £14 million (10.4%) decrease in Underlying EBITA from £135 million and a £196 million (12.9%) increase in sales from £1,522 million in the first half of 2019. Operating profit of £105 million on revenue of £1,688 million in the first half of 2020 represented a £25 million (19.2%) decrease in operating profit from £130 million and a £229 million (15.7%) increase in revenue from £1,459 million in the first half of 2019. Sales increased 9.9% on a constant currency basis with the growth driven by the ramp up of combat vehicle production, as the M109 delivered at consistent full rate production levels, and activity on the Armored Multi-Purpose Vehicle ("*AMPV*"), Bradley and Mobile Protected Firepower programs increased.

Return on sales decreased to 7.0% in the first half of 2020 from 8.9% in the first half of 2019 while return on revenue decreased to 6.2% from 8.9%, reflecting some COVID-19 coronavirus pandemic-related under-recoveries and supply chain interruptions, as well as the impact of higher Combat Vehicle sales with margin being traded on the AMPV and Amphibious Combat Vehicle ("*ACV*") programs at an initial low level as is typical with projects at similar maturity levels. The Platforms & Services (US) reporting segment generated an operating business cash inflow of £143 million in the first half of 2020, up from £5 million in the first half of 2019 and a cash inflow from operating activities of £164 million, up from £25 million in the first half of 2019, as vehicle production deliveries increased, working capital improved, the business benefited from COVID-19 coronavirus pandemic-related customer actions on higher progress payments and lower customer retentions in US Ship Repair.

Order backlog for the Platforms & Services (US) reporting segment was £6.5 billion as of June 30, 2020, compared to £5.8 billion as of December 31, 2019, as significant awards were received on M109, Bradley and AMPV.

In the first half of 2020, BAE Systems merged its legacy Combat Vehicles and Weapon Systems US lines of businesses into Combat Mission Systems, while separating out two other businesses to become Weapon Systems Sweden and Weapon Systems UK.

The reporting segment works almost exclusively on military contracts, which has enabled the business to temper impacts of the COVID-19 coronavirus pandemic on sales and revenues. However, operational disruptions have resulted in delivery delays on most vehicle programs, some stemming from a temporary pause in manufacturing operations at BAE Systems' York, Pennsylvania manufacturing hub to implement expanded preventative measures. Overall, BAE Systems' manufacturing facilities and shipyards have continued to operate with the implementation of safety measures, including social distancing where possible, use of masks, and temperature screenings. The majority of office-based employees are working remotely from home but employee furloughs have occurred where work on programs has slowed, and a small number of reductions in workforce unrelated to the pandemic were made in the naval weapons line of the United States business. BAE Systems is working with its customers to meet ongoing demand, and when there is a pandemic-related impact, it works quickly to determine levels of disruption and maintains open dialogues to establish new delivery timeframes as appropriate.

Air

In the first half of 2020, the Air reporting segment had Underlying EBITA of £356 million on sales of £3,610 million, representing a £82 million (18.7%) decrease in Underlying EBITA from £438 million and a £244 million (7.2%) increase in sales from £3,366 million in the first half of 2019. Operating profit of £324 million on revenue of £3,029 million in the first half of 2020 represented a £55 million (14.5%) decrease in operating profit from £379 million and a £205 million (7.3%) increase in revenue from £2,824 million in the first half of 2019. Sales increased 7.7% on a constant currency basis on the back of higher year-on-year production activity on the Typhoon program for Qatar and F-35 and due to growth in MBDA sales on deliveries to Qatar and India.

Return on sales decreased to 9.9% in the first half of 2020 from 13.0% in the first half of 2019 while return on revenue decreased to 10.7% from 13.4%, due to the impact of COVID-19 coronavirus pandemic-related unrecovered costs, a year-on-year increase in self-funded research and development expenditure on the Tempest future combat air development program, and the fact that the business is still in the early phase of the Qatar program. The Air reporting segment generated an operating business cash inflow of £17 million in the first half of 2020, up from a cash outflow of £163 million in the first half of 2019 and a cash inflow from operating activities of £100 million, up from a cash outflow of £132 million, reflecting the utilization of advances on a number of Middle East programs.

Order backlog for the Air reporting segment was £23.2 billion as of June 30, 2020, compared to £23.9 billion as of December 31, 2019, with the decrease primarily due to the trading on multi-year orders, received in prior years, for Saudi support and the Qatar program, partially offset by funding on the F-35 Lot 14.

BAE Systems will introduce a sixth line of business, Future Combat Air Systems, in the second half of 2020.

The COVID-19 coronavirus pandemic had an impact across all markets and countries of the reporting segment, and the priority throughout has been and remains the delivery of customer critical activity while ensuring the safety of BAE Systems' employees. Swift enactment of business continuity plans has enabled some mitigation against the adverse financial effects of the pandemic, ensuring continuity of cash flow both from customers and into the supply chain. In the United Kingdom, following a temporary suspension of operations, on-site facilities have been extensively reconfigured to enable social distancing and enhanced cleaning regimes have been implemented. While a majority of employees continue to work remotely, a sizeable population has returned to site operating under newly established safe systems of work. In Saudi Arabia, access to customer sites has at times been limited, and BAE Systems' ability to deliver training was impacted due to the enforced closure of teaching and training facilities. The business has however continued to operate throughout the disruption in line with Saudi government-issued regulations. In Australia, the impact on the business has not been significant to date, however the majority of personnel are working remotely with only those performing critical roles which cannot be undertaken remotely attending sites. In MBDA, although productivity levels have been impacted, the business has continued with deliveries to both domestic and export customers, and all of MBDA's European sites remain operational with appropriate safe and remote working practices in place.

Maritime

In the first half of 2020, the Maritime reporting segment had Underlying EBITA of £122 million on sales of £1,505 million, representing a £11 million (8.3%) decrease in Underlying EBITA from £133 million and a £20 million (1.3%) decrease in sales from £1,525 million in the first half of 2019. Operating profit of £108 million on revenue of £1,478 million in the first half of 2020 represented a £12 million (10.0%) decrease in operating profit from £120 million and a £34 million (2.2%) decrease in revenue from £1,512 million in the first half of 2019.

Return on sales decreased to 8.1% in the first half of 2020 from 8.7% in the first half of 2019 while return on revenue decreased to 7.3% from 7.9%, due to pandemic-related costs. The Maritime reporting segment generated an operating business cash outflow of £67 million in the first half of 2020, up from £92 million in the first half of 2019 and a cash outflow from operating activities of £35 million, up from £45 million, reflecting utilization of advances on a number of programs and a usual first half of the year timing profile with the second half of the year expected to be stronger and the annual funding on the United Kingdom munitions supply contract scheduled for December.

Order backlog for the Maritime reporting segment was £8.1 billion as of June 30, 2020, compared to £8.6 billion as of December 31, 2019, reflecting trading on the long-term contracts for the Astute and Type 26 programs.

Following formal declaration of the COVID-19 coronavirus pandemic, BAE Systems made significant changes to its facilities and working practices to ensure a safe system of work to provide critical services in support of national security and defense contracts. BAE Systems executed robust business continuity plans at pace with the majority of its employees quickly enabled to work from home. At HM Naval Base Portsmouth, arrangements were put in place to ensure that the majority of employees that could not carry out their roles from home were able to continue to work on site. At BAE Systems' other sites, the majority of employees unable to work from home have returned to the sites to deliver critical operations following a thorough safety induction. In order to ensure the health and safety of those working from BAE Systems' sites, new working arrangements have been introduced which comply with government safety guidelines. Measures include the reconfiguration of offices and workshops to support social distancing, additional hand washing and hygiene facilities, enhanced cleaning regimes and, where appropriate, the use of additional personal protective equipment. BAE Systems has worked closely with its main customer, the UK Ministry of Defence, to understand and respond to the impacts of the pandemic on the sector. On its major programs, BAE Systems has sought and agreed interim payment mechanisms to secure and maintain cash flow. In addition, BAE Systems has increased engagement with its supply chain to ensure that pressures as a consequence of the pandemic are managed closely to limit program impacts.

HQ

In the first half of 2020, the HQ reporting segment had Underlying EBITA of £(54) million on sales of £102 million, representing a £6 million (12.5%) decrease in Underlying EBITA from £(48) million and a £61 million (37.4%) decrease in sales from £163 million in the first half of 2019. Operating profit of £(66) million on revenue of £26 million in the first half of 2020 represented a £3 million (4.8%) decrease in operating profit from £63 million and a £3 million (13.0%) increase in revenue from £23 million in the first half of 2019. The decrease in sales in the first half of 2020 was primarily due to lower sales in the Air Astana business.

The HQ reporting segment generated an operating business cash outflow of £1,144 million in the first half of 2020, up from £219 million in the first half of 2019 and a cash outflow from operating activities of £1,111 million, up from £183 million.

Results of Operations for the Year Ended December 31, 2019 Compared with the Year Ended December 31, 2018

The following table presents BAE Systems' and BAE Systems' reporting segments' sales, revenue, Underlying EBITA and operating profit for the years ended December 31, 2019 and December 31, 2018.

	Year Ended December 31, 2019				Year Ended December 31, 2018			
	Sales[1]	Revenue[1]	Underlying EBITA[1]	Operating profit[1]	Sales[1]	Revenue[1]	Underlying EBITA[1]	Operating profit[1]
	(In £ millions)							
Electronic Systems	4,439	4,439	687	672	3,965	3,965	606	590
Cyber & Intelligence	1,732	1,732	91	80	1,678	1,678	111	59
Platforms & Services (US)	3,337	3,185	267	239	3,005	2,864	210	161
Air	7,457	6,153	887	777	6,712	5,579	859	810
Maritime	3,116	3,071	268	253	2,975	2,940	209	191
HQ	387	43	(83)	(122)	350	41	(67)	(206)
Subtotal	**20,468**	**18,623**	**2,117**	**1,899**	**18,685**	**17,067**	**1,928**	**1,605**
Deduct: Intra-Group	(359)	(318)	—	—	(278)	(246)	—	—
Total	**20,109**	**18,305**	**2,117**	**1,899**	**18,407**	**16,821**	**1,928**	**1,605**

(1) See "*Presentation of Currency and Financial and Other Information*" for an explanation of the components and calculation method of this measure.

Sales

Sales is used by management for internal performance analysis as a measure of sales performance of subsidiaries and equity accounted investments, and is defined as revenue plus BAE Systems' share of revenue of equity accounted investments. The definition is consistent with the sales performance measure disclosed in note 2 to the BAE Systems Interim Financial Statements and note 1 to the BAE Systems 2019 Annual Financial Statements on a segmental basis.

Sales increased by £1,702 million (9.2%) to £20,109 million in 2019 from £18,407 million in 2018, a 7% increase on a constant currency basis.

Revenue

Revenue is defined as income derived from the provision of goods and services by BAE Systems and its subsidiary undertakings.

Revenue increased by £1,484 million (8.8%) to £18,305 million in 2019 from £16,821 million in 2018, a 7% increase on a constant currency basis.

Underlying EBITA

Underlying EBITA is used by management for internal performance analysis as a measure of operating profitability that is comparable over time, and is defined as operating profit excluding amortization and impairment of intangible assets, finance costs and taxation expense of equity accounted investments (EBITA), and non-recurring items. The definition is consistent with the profit measure disclosed in note 2 to the BAE Systems Interim Financial Statements and note 1 to the BAE Systems 2019 Annual Financial Statements on a segmental basis. Non-recurring items are defined as items of financial performance which have been determined by BAE Systems' management as being material by their size or incidence and not relevant to an understanding of BAE Systems' underlying performance. BAE Systems' definition of non-recurring items includes profit or loss on business transactions, and costs incurred which are one-off in nature, for example, non-routine costs or income relating to post-retirement benefit schemes, and other exceptional items which BAE Systems' management has determined as not being relevant to an understanding of BAE Systems' underlying business performance.

Underlying EBITA increased by £189 million (9.8%) to £2,117 million in 2019, compared with £1,928 million in 2018. Underlying EBITA increased by 5% on a constant currency basis and excluding the impacts of IFRS 16 *Leases*. In 2019, non-recurring items of £27 million comprised a £36 million charge relating to the derecognition of Enterprise Resource Planning software intangible assets in the Air reporting segment, charges of £13 million relating to legal disputes arising from historical disposals, a gain of £14 million on the sale of BAE Systems' 55% shareholding in BAE Systems Global Combat Systems Limited upon formation of RBSL and a gain of £8 million relating to the disposal of AACC. In 2018, Non-recurring items of £154 million included a guaranteed minimum pension equalization charge of £114 million, and a loss on disposal of the Mobile, Alabama shipyard of £40 million. Return on sales was 10.5% in 2019 and 10.5% in 2018.

IFRS 16 *Leases* has been applied for the first time in 2019, and as a result Underlying EBITA in 2019 is £50 million higher than in 2018 as a depreciation charge on leased assets is reported, rather than the operating lease expense previously recognized.

Operating Profit

Operating profit is defined as profit for the year before finance costs and taxation expense. This measure includes finance costs and taxation expense of equity accounted investments.

Operating profit increased by £294 million (18.3%) to £1,899 million in 2019 from £1,605 million in 2018, due to favorable effects of currency exchange translation of £36 million. Return on revenue was 10.4% in 2019 and 9.5% in 2018.

IFRS 16 *Leases* has been applied for the first time in 2019, and as a result operating profit in 2019 is £50 million higher than in 2018 as a depreciation charge on leased assets is reported, rather than the operating lease expense previously recognized.

Amortization of Intangible Assets

Amortization of intangible assets increased by £24 million in 2019 to £109 million, from £85 million in 2018, the increase mainly a result of new IT systems becoming operational.

Impairment of Intangible Assets

Impairment of intangible assets totaled £6 million in 2019 compared with £33 million in 2018. In 2018, the charge represented the impairment of SilverSky customer-related intangibles in the Applied Intelligence business.

Net Finance Costs

Net finance costs (including equity accounted investments) is used by management as a measure of finance costs of subsidiaries and equity accounted investments and is defined as finance costs for BAE Systems and its share of equity accounted investments, including net interest expense on retirement benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.

Net finance costs (including equity accounted investments) decreased to £296 million in 2019 from £394 million in 2018. The underlying net interest expense, including BAE Systems' share of equity accounted investments, increased to £257 million in 2019 compared to £215 million in 2018. The net interest expense on retirement benefit obligations, including BAE Systems' share of equity accounted investments, increased to £117 million in 2019 compared to £106 million in 2018. There was a credit in respect of fair value and foreign exchange adjustments on financial instruments and investments, including BAE Systems' share of equity accounted investments, of £78 million in 2019 compared to a charge of £73 million in 2018.

Net finance costs as defined in IFRS decreased to £273 million in 2019 from £381 million in 2018. The underlying net interest expense increased to £240 million in 2019 compared to £213 million in 2018. The net interest expense on retirement benefit obligations increased to £114 million in 2019 compared to £103 million in 2018. There was a credit in respect of fair value and foreign exchange adjustments on financial instruments and investments of £81 million in 2019 compared to a charge of £65 million in 2018.

Net finance costs have increased under IFRS 16 due to the recognition of the interest charge on the lease liabilities. This increase in net finance costs has broadly been offset by a decrease in depreciation expense on the right-of-use lease asset as compared to the operating lease expense previously recognized in 2018 under IAS 17 reporting.

Taxation Expense

Adjusted taxation expense (including equity accounted investments) is used by management as a measure of taxation expense of subsidiaries and equity accounted investments and is defined as current and deferred tax recognized in profit or loss except to the extent that it relates to a business combination or items recognized directly in equity or other comprehensive income and includes BAE Systems' share of equity accounted investments.

Adjusted taxation expense (including equity accounted investments) was £308 million in 2019, reflecting an underlying effective tax rate of 19%, which excludes a one-off benefit of £161 million as discussed in note 6 to the BAE Systems 2019 Annual Financial Statements, compared with taxation expense of £229 million and an underlying effective tax rate of 18% in 2018. The one-off benefit in 2019 includes a one-off benefit related to agreements reached in respect of overseas tax matters and a provision for the estimated exposure related to the review of the April 2019 EU Commission decision that concluded that the United Kingdom's Controlled Foreign Company regime partially represents State Aid. The underlying effective tax rate in 2019 is based on adjusted profit before taxation (including equity accounted investments) of £1,657 million.

Taxation expense as defined in IFRS was £94 million in 2019, reflecting an effective tax rate of 5.8%, compared with £191 million and 15.6%, respectively, in 2018. This effective tax rate in 2019 is based on profit before taxation of £1,626 million.

Basic Earnings per Share

Basic earnings per share is defined in accordance with IAS 33 *Earnings per Share*.

Basic earnings per share increased by 48.2% to 46.4p in 2019, compared with 31.3p in 2018. The application of IFRS 16 *Leases* for the first time in 2019 has had no material impact on basic earnings per share.

Operating Business Cash Flow

Operating business cash flow is used by management for internal performance analysis as a measure of the operational cash generation of BAE Systems, and is defined as net cash flow from operating activities excluding taxation and including net capital expenditure, lease principal amounts, financial investment and dividends from equity accounted investments.

Operating business cash flow increased by £314 million (31.6%) to £1,307 million in 2019 from £993 million in 2018.

Net Cash Flow from Operating Activities

Net Cash Flow from Operating Activities is defined in accordance with IAS 7 *Statement of Cash Flows*.

Net cash flow from operating activities increased by £397 million (33.1%) to £1,597 million in 2019 from £1,200 million in 2018.

Order Intake

Order intake is used by management for internal performance analysis as a measure of order intake of subsidiaries and equity accounted investments and is defined as funded orders received from customers including BAE Systems' share of order intake of equity accounted investments.

Order intake decreased by £9.8 billion (34.8%) to £18.4 billion in 2019 from £28.3 billion in 2018.

Order Backlog

Order backlog is used by management to assess future years' sales performance of subsidiaries and equity accounted investments, and is defined as funded and unfunded unexecuted customer orders including the BAE Systems' share of order backlog of equity accounted investments. Unfunded orders include the elements of United States multi-year contracts for which funding has not been authorized by the customer.

Order backlog decreased by £3.0 billion (6.2%) to £45.4 billion in 2019 from £48.4 billion in 2018, with trading on multi-year, long-term contracts in the Air reporting segment partly offset by growth in the United States businesses.

Electronic Systems

In 2019, the Electronic Systems reporting segment had Underlying EBITA of £687 million on sales of £4,439 million, representing a £81 million (13.4%) increase in Underlying EBITA from £606 million and a £474 million (12.0%) increase in sales from £3,965 million in 2018. Operating profit of £672 million on revenue of £4,439 million in 2019 represented a £82 million (13.9%) increase in operating profit from £590 million and a £474 million (12.0%) increase in revenue from £3,965 million in 2018. The increase in sales and revenue is due to growth of 9% in the defense business driven by the F-35 program, APKWS® volumes and increased classified activity, and growth in the commercial sales of engine and flight controls and hybrid-electric drive systems.

Return on sales increased to 15.5% in 2019 from 15.3% in 2018 while return on revenue increased to 15.1% from 14.9%. The Electronic Systems reporting segment generated an operating business cash inflow of £672 million in 2019, up from £431 million in 2018 and a cash inflow from operating activities of £833 million, up from £575 million.

Order backlog for the Electronic Systems reporting segment was £6.0 billion as of December 31, 2019, compared to £5.4 billion as of December 31, 2018, with significant awards on F-35 for LRIP 14 and Block 4 development, APKWS® volumes and the Radar Warning Receiver upgrade.

Cyber & Intelligence

In 2019, the Cyber & Intelligence reporting segment had Underlying EBITA of £91 million on sales of £1,732 million, representing a £20 million (18.0%) decrease in Underlying EBITA from £111 million and a £54 million (3.2%) increase in sales from £1,678 million in 2018. Operating profit of £80 million on revenue of £1,732 million in 2019 represented a £21 million (35.6%) increase in operating profit from £59 million and a £54 million (3.2%) increase in revenue from £1,678 million in 2018. Sales and revenue were broadly unchanged on a constant currency basis. Sales and revenue in the United States business were 2% lower than the prior year owing to customer awards made but then protested. In the Applied Intelligence business, sales and revenue were up 4%, all arising in the Government business line.

Return on sales decreased to 5.3% in 2019 from 6.6% in 2018 while return on revenue increased to 4.6% from 3.5%. Return on sales and return on revenue in the United States business was in line with the prior year. Within Applied Intelligence, the business recorded an operating loss of £30 million following the restructuring charge taken in the first half of 2019. The Cyber & Intelligence reporting segment generated an operating business cash inflow of £68 million in 2019, down from £85 million in 2018 and a cash inflow from operating activities of £99 million, up from £96 million.

Order backlog for the Cyber & Intelligence reporting segment of £1.8 billion as of December 31, 2019, was stable compared to £1.9 billion as of December 31, 2018 after adjusting for the Applied Intelligence disposal.

Platforms & Services (US)

In 2019, the Platforms & Services (US) reporting segment had Underlying EBITA of £267 million on sales of £3,337 million, representing a £57 million (27.1%) increase in Underlying EBITA from £210 million and a £332 million (11.0%) increase in sales from £3,005 million in 2018. Operating profit of £239 million on revenue of £3,185 million in 2019 represented a £78 million (48.4%) increase in operating profit from £161 million and a £321 million (11.2%) increase in revenue from £2,864 million in 2018. In the US Combat Vehicles business, delivery targets for the M109A7 program were met in the second half of 2019.

Return on sales increased to 8.0% in 2019 from 7.0% in 2018 while return on revenue increased to 7.5% from 5.6%. The Platforms & Services (US) reporting segment generated an operating business cash inflow of £241 million in 2019, up from a cash outflow of £30 million in 2018 and a cash inflow from operating activities of £305 million, up from £31 million in 2018, due to a strong second half of the year as vehicle production deliveries increased and working capital was liquidated.

Order backlog for the Platforms & Services (US) reporting segment was £5.8 billion as of December 31, 2019, compared to £5.4 billion as of December 31, 2018, with total in-year funded Combat Vehicle orders received of £1.9 billion.

Air

In 2019, the Air reporting segment had Underlying EBITA of £887 million on sales of £7,457 million, representing a £28 million (3.3%) increase in Underlying EBITA from £859 million and a £745 million (11.1%) increase in sales from £6,712 million in 2018. Operating profit of £777 million on revenue of £6,153 million in 2019 represented a £33 million (4.1%) decrease in operating profit from £810 million and a £574 million (10.3%) increase in revenue from £5,579 million in 2018. As expected, there was higher production activity on the new Typhoon and Hawk program for the State of Qatar ("*Qatar*"), and the F-35 program continues to ramp up towards full rate in 2020. In addition, sales from MBDA grew on deliveries to Egypt and Qatar.

Return on sales decreased to 11.9% in 2019 from 12.8% in 2018 while return on revenue decreased to 12.6% from 14.5%, ahead of expectations on strong program execution. It reflects low initial profit recognition on the early stages of the Qatar program, and increased self-funded research and development on the Tempest future combat air development. In 2018, the margin benefited by 70 bps from the completion of the Typhoon contract with the Sultanate of Oman ("*Oman*"). The Air reporting segment generated an operating business cash inflow of £408 million in 2019, down from £666 million in 2018 and a cash inflow from operating activities of £497 million, down from £719 million, reflecting the utilization of provisions, timing of receivables, and the difference between joint venture profits and cash dividends received. There was also some usage of prior-year Qatar funding.

Order backlog for the Air reporting segment was £23.9 billion as of December 31, 2019, compared to £27.4 billion as of December 31, 2018, primarily due to the trading on multi-year orders, received in prior years, for the Saudi Arabian support and Qatar programs.

Maritime

In 2019, the Maritime reporting segment had Underlying EBITA of £268 million on sales of £3,116 million, representing a £59 million (28.2%) increase in Underlying EBITA from £209 million and a £141 million (4.7%) increase in sales from £2,975 million in 2018. Operating profit of £253 million on revenue of £3,071 million in 2019 represented a £62 million (32.5%) increase in operating profit from £191 million and a £131 million (4.5%) increase in revenue from £2,940 million in 2018. While the Dreadnought submarine and Type 26 programs continued to ramp up, the Carrier and Offshore Patrol Vessel programs are close to completion. Activity levels in Portsmouth Naval Base support remained strong through the year.

Return on sales increased to 8.6% in 2019 from 7.0% in 2018 while return on revenue increased to 8.2% from 6.5%. The Maritime reporting segment generated an operating business cash inflow of £150 million in 2019, up from £67 million in 2018 and a cash inflow from operating activities of £289 million, up from £190 million, reflecting utilization of a Naval Ships provision created in 2018 and the completion of the Carrier program.

Order backlog for the Maritime reporting segment was £8.6 billion as of December 31, 2019, compared to £9.0 billion as of December 31, 2018, as further awards for funding on the Dreadnought program were outweighed by trading on the Astute, Carrier and Type 26 programs.

HQ

In 2019, the HQ reporting segment had Underlying EBITA of negative £83 million on sales of £387 million, representing a £16 million (23.9%) decrease in Underlying EBITA from negative £67 million and a £37 million (10.6%) increase in sales from £350 million in 2018. Operating profit of negative £122 million on revenue of £43 million in 2019 represented an £84 million (40.8%) increase in operating profit from negative £206 million and a £2 million (4.9%) increase in revenue from £41 million in 2018.

The HQ reporting segment generated an operating business cash outflow of £232 million in 2019, down from an outflow of £226 million in 2018 and a cash outflow from operating activities of £174 million, up from an outflow of £211 million.

Liquidity and Capital Resources

The following table presents a reconciliation of operating business cash flow and free cash flow to net cash flow from operating activities as included in the BAE Systems 2019 Annual Financial Statements to Net (debt)/cash (as defined by BAE Systems) for the six months ended June 30, 2020 and June 30, 2019 and the years ended December 31, 2019 and December 31, 2018.

	Six Months Ended June 30,		Year Ended December 31,	
	2020	**2019**	**2019**	**2018**
	(In £ millions)			
Operating business cash flow[(1)]	**(880)**	**(309)**	**1,307**	**993**
Add: Net capital expenditure including equity accounted investment funding[(2)]	189	201	454	464
Add: Principal element of lease payments and receipts	116	114	230	—
Deduct: Dividends received from equity accounted investments	(24)	(90)	(142)	(57)
Deduct: Taxation	(128)	(148)	(252)	(200)
Net cash flow from operating activities	**(727)**	**(232)**	**1,597**	**1,200**
Net capital expenditure including equity accounted investment funding[(2)]	(189)	(201)	(454)	(464)
Principal element of finance lease receipts	4	5	9	—
Dividends received from equity accounted investments	24	90	142	57
Interest received	12	17	28	25
Acquisitions and disposals[(3)]	(217)	17	43	24
Net cash flow from investing activities	**(366)**	**(72)**	**(232)**	**(358)**
Interest paid	(114)	(134)	(233)	(203)
Net sale of own shares	—	—	—	1
Equity dividends paid	—	(423)	(724)	(703)
Partial disposal of shareholding in subsidiary undertaking	—	14	31	17
Dividends paid to non-controlling interests	(3)	(26)	(56)	(28)
Principal element of lease payments	(120)	(119)	(239)	—
Cash flow from matured derivative financial instruments (excluding cash flow hedges)	72	47	40	6
Movement in cash collateral	14	4	1	2
Cash outflow from repayment of loans	1,136	(773)	(782)	(7)
Net cash flow from financing activities	**985**	**(1,410)**	**(1,962)**	**(915)**
Net decrease in cash and cash equivalents	**(108)**	**(1,714)**	**(597)**	**(73)**
Opening Net debt as defined by BAE Systems[(1)]	**(743)**	**(904)**	**(904)**	**(752)**
Net decrease in cash and cash equivalents	(108)	(1,714)	(597)	(73)
Net cash flow from loans	(1,136)	773	782	7
Foreign exchange translation[(4)]	(193)	(8)	72	(188)
Other non-cash movements[(5)]	142	(36)	(96)	102
Net debt as defined by BAE Systems[(1)]	**(2,038)**	**(1,889)**	**(743)**	**(904)**
Net cash flow from operating activities	**(727)**	**(232)**	**1,597**	**1,200**
Deduct: Net capital expenditure including equity accounted investment funding[(2)]	(189)	(201)	(454)	(464)
Deduct: Principal element of lease payments and receipts	(116)	(114)	(230)	—
Add: Dividends received from equity accounted investments	24	90	142	57
Interest paid, net of Interest received[(6)]	(102)	(117)	(205)	(178)
Free cash flow as defined by BAE Systems[(1)]	**(1,110)**	**(574)**	**850**	**615**

(1) See "*Presentation of Currency and Financial and Other Information*" for an explanation of the components and calculation method of this measure.

(2) Net capital expenditure including equity accounted investment funding is derived from the line items Proceeds from sale of property, plant and equipment and investment property *plus* Proceeds from sale of intangible assets *less* Purchases of property, plant and equipment and investment property *less* Purchase of

intangible assets *less* Equity accounted investment funding included, in case of the years ended December 31, 2019 and December 31, 2018, in the BAE Systems Annual Financial Statements, and, in case of the six months ended June 30, 2020 and June 30, 2019, in the BAE Systems Interim Financial Statements and BAE Systems' internal accounting records, as applicable.

(3) Acquisitions and disposals is derived from the line items Purchase of equity accounted investment *plus* Purchase of subsidiary undertaking, net of cash and cash equivalents acquired *plus* Cash flow in respect of held for sale assets and business disposals, net of cash and cash equivalents disposed included, in case of the years ended December 31, 2019 and December 31, 2018, in the BAE Systems Annual Financial Statements, and, in case of the six months ended June 30, 2020 and June 30, 2019, in the BAE Systems Interim Financial Statements and BAE Systems' internal accounting records, as applicable.

(4) Foreign exchange translation is derived from the line item Effect of foreign exchange rate changes on cash and cash equivalents in the applicable BAE Systems Financial Statements *plus* Foreign exchange movements of current and non-current loans and overdrafts included, in case of the years ended December 31, 2019 and December 31, 2018, in the BAE Systems Annual Financial Statements, and, in case of the six months ended June 30, 2020 and June 30, 2019, in the BAE Systems Interim Financial Statements and BAE Systems' internal accounting records, as applicable.

(5) Other non-cash movements is derived from fair value movements of current and non-current debt related derivative financial instrument assets and liabilities included in note 28 to the applicable BAE Systems Financial Statements *plus* fair value and other movements included in current and non-current loans and overdrafts included, in case of the years ended December 31, 2019 and December 31, 2018, in the BAE Systems Annual Financial Statements, and, in case of the six months ended June 30, 2020 and June 30, 2019, in the BAE Systems Interim Financial Statements and BAE Systems' internal accounting records, as applicable.

(6) Interest paid net of interest received is derived from the line items Interest paid *less* Interest received in the applicable BAE Systems Financial Statements.

Operating Business Cash Flow by Segment

	Six Months Ended June 30, 2020 (In £ millions)						
	Electronic Systems	**Cyber & Intelligence**	**Platforms & Services (US)**	**Air**	**Maritime**	**HQ**	**Total**
Operating Business Cash Flow	64	107	143	17	(67)	(1,144)	**(880)**
Deduct: Dividends received from equity accounted investments							(24)
Add back: Net capital expenditure, lease principal amounts and financial investment							305
Taxation paid							(128)
Net cash flow from operating activities							**(727)**

	Six Months Ended June 30, 2019 (In £ millions)						
	Electronic Systems	**Cyber & Intelligence**	**Platforms & Services (US)**	**Air**	**Maritime**	**HQ**	**Total**
Operating Business Cash Flow	137	23	5	(163)	(92)	(219)	**(309)**
Deduct: Dividends received from equity accounted investments							(90)
Add back: Net capital expenditure, lease principal amounts and financial investment							315
Taxation paid							(148)
Net cash flow from operating activities							**(232)**

	Year Ended December 31, 2019						
	(In £ millions)						
	Electronic Systems	Cyber & Intelligence	Platforms & Services (US)	Air	Maritime	HQ	Total
Operating Business Cash Flow	672	68	241	408	150	(232)	**1,307**
Deduct: Dividends received from equity accounted investments							(142)
Add back: Net capital expenditure, lease principal amounts and financial investment							684
Taxation paid							(252)
Net cash flow from operating activities							**1,597**

	Year Ended December 31, 2018						
	(In £ millions)						
	Electronic Systems	Cyber & Intelligence	Platforms & Services (US)	Air	Maritime	HQ	Total
Operating Business Cash Flow	431	85	(30)	666	67	(226)	**993**
Deduct: Dividends received from equity accounted investments							(57)
Add back: Net capital expenditure, lease principal amounts and financial investment							464
Taxation paid							(200)
Net cash flow from operating activities							**1,200**

Operating business cash outflow in the first half of 2020 was £880 million, up from £309 million in the first half of 2019, which includes cash contributions in respect of pension deficit funding, over and above service costs, for the United Kingdom, United States and other schemes of £1,196 million in the first half of 2020, compared with £191 million in the first half of 2019.

Operating business cash inflow in 2019 was £1,307 million, up from £993 million in 2018, which includes cash contributions in respect of pension deficit funding, over and above service costs, for the United Kingdom, United States and other schemes of £221 million in 2019, compared with £290 million in 2018.

Net cash outflow from operating activities in the first half of 2020 was £727 million, up from £232 million in the first half of 2019, which includes cash contributions in respect of pension deficit funding, over and above service costs, for the United Kingdom, United States and other schemes of £1,196 million in the first half of 2020, compared with £191 million in the first half of 2019.

Net cash inflow from operating activities in 2019 was £1,597 million, up from £1,200 million in 2018, reflecting the impact of net lease cash outflows of £273 million which are now classified under financing and investing activities under IFRS 16 *Leases*. Net lease cash outflow consists of total cash outflow for leases for the year ended December 31, 2019, excluding short-term leases and low-value leases offset by proceeds from principal element of finance lease receipts.

Taxation payments decreased to £128 million in the first half of 2020 from £148 million in the first half of 2019 due to lower profit for the period, and increased to £252 million in 2019 from £200 million in 2018, partly reflecting payments in Australia following the end of utilization of prior year losses.

Cash outflow from net capital expenditure including equity accounted investment funding was £189 million in the first half of 2020, compared to £201 million in the first half of 2019, and £454 million in 2019, compared to £464 million in 2018.

Dividends received from equity accounted investments in the first half of 2020 decreased to £24 million in the first half of 2020, compared to £90 million in the first half of 2019, primarily including receipts from FNSS (£13 million) and Eurofighter (£6 million). Dividends received from equity accounted investments in 2019 increased to £142 million in 2019, compared to £57 million in 2018, primarily including dividends received from MBDA (£73 million), AEC (£38 million) and FNSS (£17 million).

Interest received decreased to £12 million in the first half of 2020 from £17 million in the first half of 2019 while interest paid decreased to £114 million in the first half of 2020 from £134 million in the first half of 2019. Interest received increased to £28 million in 2019 from £25 million in 2018 while interest paid increased to £233 million in 2019 from £203 million in 2018.

Net cash outflow from the partial disposal of shareholdings in subsidiary undertakings, held for sale assets and business disposals, net of cash and cash equivalents disposed, as reduced by purchase of shareholdings in subsidiary undertakings and held for sale assets, net of cash and cash equivalents acquired, was £217 million in the first half of 2020 compared to a cash inflow of £31 million in the first half of 2019. In the first half of 2020, this comprised the acquisition of the Airborne Tactical Radios business for £217 million and, in the first half of 2019, this comprised the disposal of AACC for consideration of £26 million, the reduction of BAE Systems' shareholding in OMC of £14 million, partly offset by the investment in Riptide for £9 million. Net cash inflow from the partial disposal of shareholdings in subsidiary undertakings, held for sale assets and business disposals, net of cash and cash equivalents disposed, as reduced by purchase of shareholdings in subsidiary undertakings and held for sale assets, net of cash and cash equivalents acquired, was £74 million in 2019 compared to £43 million in 2018. In 2019, this comprised the reduction of BAE Systems' shareholding in OMC of £31 million, the contribution of the United Kingdom-based land vehicles business into RBSL for consideration of £29 million and the disposal of AACC for consideration of £26 million, partly offset by the investments in Riptide for £9 million and the Prismatic acquisition for £3 million and, in 2018, this comprised the reduction of BAE Systems' shareholding in OMC of £17 million, cash acquired as part of the ASC Shipbuilding acquisition of £14 million and cash received on the sale of the Mobile, Alabama shipyard of £12 million.

No equity dividends were paid in the first half of 2020. Equity dividends paid in 2019 represent the 2018 final dividend of £423 million and the 2019 interim dividend of £301 million. Dividends paid to non-controlling interests in the first half of 2020 decreased to £3 million, compared to £26 million in the first half of 2019, reflecting a lower payment by Saudi Maintenance & Supply Chain Management Company ("*SMSCMC*"), in which BAE Systems has a 51% shareholding. Dividends paid to non-controlling interests 2019 increased to £56 million in 2019, compared to £28 million in 2018, reflecting a higher payment by SMSCMC.

As a consequence of rolling hedges relating to balances within BAE Systems' subsidiaries and equity accounted investments during the first half of 2020 and during 2019, there were financing cash inflows from matured derivative financial instruments of £72 million and £40 million, respectively, compared with £47 million in the first half of 2019 and £6 million in 2018.

Foreign exchange translation primarily arises in respect of BAE Systems' U.S. dollar-denominated borrowing.

Net debt as defined by BAE Systems is used by management for internal performance analysis as a measure of indebtedness of BAE Systems and is defined as cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments). Net debt as defined by BAE Systems does not include lease liabilities. The definition is consistent with the indebtedness measure in note 28 to the BAE Systems 2019 Annual Financial Statements. Net debt as defined by BAE Systems increased by £1,295 million to £2,038 million as of June 30, 2020 from £743 million as of December 31, 2019, primarily due to indebtedness incurred to fund the one-off pension deficit funding contribution of £1.0 billion and the acquisition of the Airborne Tactical Radios business for £217 million in cash in the first half of 2020. Total current and non-current loans and overdrafts were £4,776 million and £3,397 million as of June 30, 2020 and December 31, 2019, respectively, compared with £3,520 million and £4,299 million as of June 30, 2019 and December 31, 2018, respectively. Cash and cash equivalents were £2,523 million and £2,587 million as of June 30, 2020 and December 31, 2019, respectively, compared with £1,501 million and £3,232 million as of June 30, 2019 and December 31, 2018, respectively, and were being held primarily for the repayment of debt securities, pension deficit funding, payment of the 2020 interim dividends and management of working capital.

Liquidity

BAE Systems had cash and cash equivalents of £2,523 million as of June 30, 2020 compared with £2,587 million as of December 31, 2019. Gross cash on hand, together with the committed RCF of £2.0 billion, the maturity of which was extended in April 2020 to April 2025 (and which is syndicated amongst BAE Systems' core relationship banks), is available to meet general corporate funding requirements. The RCF provides standby funding for draw downs and for BAE Systems' U.S. Dollar Commercial Paper Program. The RCF remained undrawn throughout the first half of 2020 and throughout 2019.

The net proceeds of the Offering will be used predominantly to refinance up to $1,925 million in aggregate principal amount outstanding under the Bridge Loan Facility Agreement incurred to fund the acquisition of the Military Global Positioning System business on July 31, 2020.

As of June 30, 2020 and as of December 31, 2019, BAE Systems had total contracted cash outflows on current and non-current loans and overdrafts of £6,625 million and £4,867 million, respectively, which mature between 2020 and 2044. No more than £1,128 million of such liabilities mature in any given year and BAE Systems' contracted cash outflows on loans and overdrafts maturing in the second half of 2020 are £618 million.

Profit for the year / period and free cash flow as defined by BAE Systems could also be affected by various risks and uncertainties, including, but not limited to, the effects of the COVID-19 coronavirus pandemic. See "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments.*" In addition, net cash flow from operating activities has been and will be affected by offsetting impacts from government efforts related to the COVID-19 coronavirus pandemic, including deferred payroll taxes in the United States in 2020 becoming due in 2021 and in 2022.

BAE Systems continues to conduct ongoing risk assessments of the potential impact of this pandemic on its business (including modelling of adverse scenarios and mitigating actions available to BAE Systems) and monitor availability of its existing internal and external funding sources.

BAE Systems adopts a conservative approach to the investment of its surplus cash. It is deposited with financial institutions with the strongest credit ratings for short periods. A credit limit is allocated to each institution taking account of its market capitalization, credit rating and credit default swap price.

The maturity of contracted cash outflows on loans and overdrafts of BAE Systems is as follows:

	As of June 30, 2020	**As of December 31, 2019[(1)]**
	(In £ millions)	**(In £ millions)**
Less than one year	722	533
Between one and five years	2,082	1,874
More than five years	3,821	2,460
Loans and overdrafts—current and non-current	**6,625**	**4,867**

(1) See note 14 to the BAE Systems 2019 Annual Financial Statements.

BAE Systems' non-current borrowings as of June 30, 2020 are as follows:

	As of June 30, 2020
	(In £ millions)
$500 million 4.75% bond, repayable 2021	404
£400 million 4.125% bond, repayable 2022	399
$800 million 3.8% bond, repayable 2024	646
$750 million 3.85% bond, repayable 2025	602
$500 million 7.5% bond, repayable 2027	403
$1,300 million 3.4% bond, repayable 2030	1,041
$400 million 5.8% bond, repayable 2041	321
$550 million 4.75% bond, repayable 2044	435
Total	**4,251**

BAE Systems believes that its current cash balances, together with its existing credit lines and other available sources of liquidity, and expected cash flow from its operating activities will be sufficient for the foreseeable future to fund its working capital requirements and operations, permit anticipated capital expenditures and make required payments of principal and interest on its debt.

Capital Structure

BAE Systems funds its operations through a mixture of equity funding and debt financing, including bank and capital market borrowings. All of BAE Systems' material borrowings are arranged by the central treasury department and funds raised are lent onward to operating subsidiaries as required. Surplus cash held by the businesses over and above balances required for working capital management is loaned to BAE Systems' centralized treasury department.

BAE Systems repaid a $1,000 million 6.375% bond at maturity in June 2019. A $500 million 2.85% bond is due to be repaid in the second half of 2020. It remains BAE Systems' intention to ensure the business is funded conservatively and to be proactive in accessing the bank and capital markets in achieving this aim.

Capital Expenditure

Capital expenditure during the six months ended June 30, 2020 and the year ended December 31, 2019 was primarily funded by cash from business operations. Cash outflow from net capital expenditure including equity accounted investment funding was £189 million in the first half of 2020, compared to £201 million in the first half of 2019, and £454 million in 2019, compared to £464 million in 2018.

Insurance

BAE Systems operates a policy of partial self-insurance, with the majority of cover placed in the external market. BAE Systems continues to monitor its insurance arrangements to ensure the quality and adequacy of cover.

Credit Rating

Three credit rating agencies, Moody's, S&P and Fitch, publish credit ratings for BAE Systems.

As of the date of this Offering Memorandum, BAE Systems' long-term credit ratings provided by these agencies were as follows:

Rating agency	Rating	Outlook	Category
Moody's	Baa2	Stable	Investment grade
S&P	BBB	Stable	Investment grade
Fitch	BBB	Stable	Investment grade

The Board of Directors continues to view the maintenance of an investment-grade credit rating as important to the efficient operation of BAE Systems' activities.

Each of Moody's and Fitch is established in the United Kingdom and has been registered under the CRA Regulation. S&P is established in the European Union and has been registered under the CRA Regulation.

Pension Schemes

BAE Systems operates pension plans for its qualifying employees in the United Kingdom, the United States and other countries. The principal plans in the United Kingdom and the United States are funded defined benefit plans, and the assets are held in separate trustee-administered funds. BAE Systems also operates a number of non-pension post-retirement benefit plans, 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 BAE Systems' U.S. subsidiaries.

At present, there is an actuarial deficit between the aggregate value of projected liabilities of BAE Systems' defined benefit pension schemes and the value of the assets that the schemes hold. At June 30, 2020, the total

IAS 19 deficit was £6,410 million, compared to £4,779 million at December 31, 2019, and BAE Systems' share of the IAS 19 deficit excluding BAE Systems' share of amounts allocated to equity accounted investments and other participating employers was £5,970 million compared to £4,455 million at December 31, 2019. The increase in the first half of 2020 was mainly driven by the impact of lower discount rates increasing liabilities, partially offset by contributions paid (including the one-off pension deficit funding contribution of £1.0 billion), lower inflation assumptions and asset returns.

In October 2019, the assets and liabilities of six of BAE Systems' nine pension schemes in the United Kingdom were consolidated in the BAE Systems Pension Scheme. This was carried out to drive long-term efficiencies. Following the merger, BAE Systems and the trustees of the BAE Systems Pension Scheme agreed to carry out an early triennial funding valuation as of October 31, 2019. In February 2020, that valuation and deficit recovery plan was agreed with the trustees of the BAE Systems Pension Scheme after consultation with The Pensions Regulator in the United Kingdom. The funding deficit as of October 31, 2019 was £1.9 billion. Following a one-off contribution of £1.0 billion into the BAE Systems Pension Scheme in the first half of 2020 in respect of deficit contributions due between 2022 and 2026, a new deficit recovery plan was adopted on May 1, 2020 under which BAE Systems is to make a final £250 million payment in the scheme year ending March 31, 2021.

BAE Systems made total contributions to its pension schemes of £1,319 million in the first half of 2020, compared to £312 million in the first half of 2019, and of £461 million in 2019, compared to £554 million in 2018, including those amounts allocated to equity accounted investments and participating employers of £119 million, £26 million, £40 million and £38 million, respectively.

The performance of BAE Systems' pension schemes and deficit recovery plans is regularly reviewed by both BAE Systems and the trustees of the schemes, taking actuarial and investment advice as appropriate. The results of these reviews are discussed with the Board of Directors and appropriate action is taken.

Growth of defined benefit pension liabilities is expected to be curtailed as, in the United Kingdom, new employees have been offered membership of defined contribution rather than defined benefit schemes since April 2012 and, in the United States, employees have not accrued salary-related benefits in defined benefit schemes since January 2013.

Additional details concerning BAE Systems' retirement benefit plans are provided in note 6 to the BAE Systems Interim Financial Statements and note 23 to the BAE Systems 2019 Annual Financial Statements. *See* "*Critical Accounting Policies—Post-employment benefit obligations.*"

Critical Accounting Policies

BAE Systems' significant accounting policies are outlined in the BAE Systems 2019 Annual Financial Statements. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates.

The following is intended to provide an understanding of those policies that management considers critical because of the level of complexity, judgment or estimation involved in their application and their impact on the consolidated financial statements. These judgments involve assumptions or estimates in respect of future events, which can vary from what is anticipated. However, the directors believe that the consolidated financial statements in the BAE Systems Financial Statements reflect appropriate judgments and estimates, and provide a true and fair view of BAE Systems' financial performance and position over the relevant period.

Revenue and Profit Recognition

BAE Systems accounts for revenue in accordance with IFRS 15 *Revenue from Contracts with Customers*. For most of BAE Systems' contracts, revenue and associated margin are recognized 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 BAE Systems' 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.

Additional details are in note 1 to the BAE Systems Interim Financial Statements and note 1 to the BAE Systems 2019 Annual Financial Statements.

Carrying Value of Goodwill

Goodwill is not amortized, but is tested annually for impairment and carried at cost less accumulated impairment losses. For the purposes of impairment testing, goodwill is allocated to cash-generating units on a consistent basis.

The impairment review calculations require the use of estimates of the future profitability and cash-generating ability of the acquired businesses based on BAE Systems' five-year integrated business plan and the pre-tax discount rate used in discounting these projected cash flows.

Additional details are in note 1 to the BAE Systems Interim Financial Statements and note 8 to the BAE Systems 2019 Annual Financial Statements.

Deferred Tax Asset on Post-Employment Benefit Obligations

BAE Systems has recognized a deferred tax asset, which mainly relates to the deficits in its post-employment benefit schemes.

It is the management's judgement that BAE Systems will generate sufficient taxable profits to recover the net deferred tax asset recognized. This judgement requires the use of estimates of future taxable profits based on BAE Systems' integrated business plan.

Additional details are in note 15 to the BAE Systems 2019 Annual Financial Statements.

Tax Provisions

Provision is made for known issues based on management's interpretation of country-specific legislation and management's assessment of the likely outcome of negotiations or litigation. BAE Systems' approach is to consider each uncertain tax position separately. Where management considers it is probable that there will be a future outflow of funds to a tax authority, a provision is recognized. The position is reviewed on an ongoing basis.

Provisions are measured using management's best estimate of the most likely amount, being the single most likely amount in a range of possible outcomes. BAE Systems discloses any significant uncertainties in relation to tax matters to the relevant tax authority. The resolution of tax positions taken by BAE Systems can take a considerable period of time to conclude and, in some cases, it is difficult to predict the outcome.

Additional details are in note 17 to the BAE Systems 2019 Annual Financial Statements.

Post-Employment Benefit Obligations

Defined benefit pension scheme accounting valuations are prepared by independent actuaries. The liabilities of the pension schemes are valued based on a number of actuarial assumptions.

For each of the actuarial assumptions used there is a range of possible values and management estimates the point within that range that most appropriately reflects BAE Systems' circumstances. Small changes in these assumptions can have a significant impact on the size of the deficit.

Additional details are in note 6 to the BAE Systems Interim Financial Statements and note 23 to the BAE Systems 2019 Annual Financial Statements.

Treasury Policy

BAE Systems' treasury activities are overseen by the Treasury Review Management Committee ("*TRMC*"). Two Executive Directors are members of the TRMC, including BAE Systems' Group Finance Director who chairs the Committee. The TRMC also has representatives with legal and tax expertise.

BAE Systems operates a centralized treasury department that is accountable to the TRMC for managing treasury activities in accordance with the treasury policies approved by the Board of Directors.

Other key policies are:

- to 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 BAE Systems' risk profile;
- to 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;
- to maintain adequate undrawn committed borrowing facilities;
- to monitor and control counterparty credit risk and credit limit utilization; and
- to reduce BAE Systems' exposure to transactional volatility in earnings and cash flows from movements in foreign currency exchange rates.

Within this policy framework the treasury department's principal responsibilities are:

- to manage BAE Systems' core funding and liquidity;
- to manage exposure to interest rate movements;
- to manage exposure to foreign currency movements; and
- to manage BAE Systems' relationship with debt capital market investors, banks and rating agencies.

The treasury department transacts with a number of counterparty banks and financial institutions, and adopts a systematic approach to the control and monitoring of counterparty credit risk. BAE Systems has a credit limit system to manage actively its exposure to treasury counterparties. The cash and cash equivalents balance at June 30, 2020 of £2,523 million and at December 31, 2019 of £2,587 million was invested with 30 and 28 different financial institutions, respectively. The system assigns a maximum exposure based on the counterparty's size, a composite credit rating and credit default swap price. These limits are regularly monitored and updated.

BAE Systems, through its internal audit department, monitors compliance against the principal policies and guidelines (including the utilization against credit limits) and any exceptions found are reported to the TRMC.

Further disclosure on financial risk management is set out in note 9 to the BAE Systems Interim Financial Statements and note 14 to the BAE Systems 2019 Annual Financial Statements.

BUSINESS

Background

The Issuer was incorporated on December 31, 1979 and is the parent holding company of the BAE Systems group of companies. In November 1999, the Issuer (then known as British Aerospace Public Limited Company) merged with the Marconi Electronic Systems business of The General Electric Company, and the resulting entity was renamed BAE Systems plc. Since 1999, through a series of acquisitions and disposals, BAE Systems has transformed itself from a group focused primarily on the manufacture of military and commercial aircraft in the United Kingdom to become a premier international defense, aerospace and security solutions company with leading positions in its principal markets – the United States, United Kingdom, Saudi Arabia and Australia – as well as established positions in a number of other international markets. BAE Systems has a diverse portfolio, including an enduring services and support business, long-term platform and product programs, electronic systems, and activities in cyber and intelligence. As of December 31, 2019, BAE Systems employed approximately 87,800 people and in 2019 generated sales and revenue of £20,109 million and £18,305 million, respectively, and Underlying EBITA and profit for the year of £2,117 million and £1,532 million, respectively.

In addition to organic growth since 1999, BAE Systems made a series of acquisitions which have established BAE Systems' United States business as a major defense company in the United States defense market, the largest defense market in the world. Following the creation of BAE Systems in 1999, BAE Systems completed a number of formative acquisitions in the United States market including the $510 million acquisition of Lockheed Martin Controls Systems, a designer and producer of flight control systems and full authority digital engine controls, in September 2000 and the acquisition of Lockheed Martin Aerospace Electronic Systems for a cash cost of approximately $1,670 million, in November 2000. BAE Systems has since grown this business in the Electronic Systems sector through a series of smaller acquisitions and organic growth. In the United States land market, BAE Systems completed the acquisition of United Defense Industries, Inc., a leading producer of military ground combat vehicles and a supplier of artillery systems, naval weapon systems and missile launchers and precision munitions, for a total consideration of approximately $3,794 million, in June 2005 and the acquisition of Armor Holdings, Inc., a manufacturer of tactical wheeled vehicles and survivability technologies for a total consideration of £1,696 million ($3,430 million), in July 2007. BAE Systems' business in the Platforms & Services (US) reporting segment also includes the heritage Atlantic Marine, Bofors and Hägglunds businesses. In the United States technology services area, BAE Systems acquired L-1 Identity Solutions for total consideration of approximately $303 million, in February 2011, and expanded its footprint in the cyber domain through the acquisition of Perimeter Internetworking Corp., which traded as SilverSky, a commercial cyber services provider for consideration of £149 million ($232 million), in December 2014, as well as a number of other acquisitions. Outside the United States, BAE Systems has completed a series of additional acquisitions in the cyber market. BAE Systems completed the acquisition of Detica, an Irish developer of intelligence and analytical systems for commercial and government clients, for consideration of £543 million, in September 2008, followed by the acquisition of Norkom Group plc, an Irish financial software company specializing in regulatory compliance and financial crime detection products, for consideration of €209 million, in January 2011. BAE Systems also completed the acquisition of stratsec.net Pty Limited, an Australian information security consulting and testing company, in January 2011, followed by the acquisition of ETI A/S, a Danish digital telecommunications security provider, for consideration of $223 million, in March 2011. In February 2014, Detica was re-named Applied Intelligence and has integrated the acquisitions of SilverSky, Norkom Group plc, ETI A/S and stratsec.net Pty Limited and converged their products and services into a single portfolio.

In May 2020, BAE Systems acquired the Airborne Tactical Radios business for cash consideration of $275 million and, in July 2020, BAE Systems acquired the Military Global Positioning System business for cash consideration of $1,925 million, excluding customary purchase price adjustments. BAE Systems will treat each acquisition as an asset sale and purchase for U.S. federal income tax purposes and expects to generate associated cash tax benefits with estimated present values of approximately $50 million and $365 million, respectively. BAE Systems believes that these acquisitions represent a unique opportunity to purchase high-quality technology-based businesses with market-leading capabilities and long histories of pioneering innovation in their fields. The Military Global Positioning System business has approximately 715 employees, an extensive patent and intellectual property portfolio with over 1.5 million devices fielded on 280 platform types, and generated total revenue of approximately $330 million in 2019 with strong margins. BAE Systems expects the Military Global Positioning System acquisition to be earnings and cash accretive due to the business' strong growth profile underpinned by a congressional mandate to update GPS receivers to M-Code. The Airborne Tactical Radios and Military Global Positioning System businesses form part of the Electronics Systems reporting segment.

In August 2020, BAE Systems completed the small bolt-on acquisition of Techmodal, a United Kingdom-based data consultancy and digital services company with approximately 120 employees and 30 associates, including data scientists, consultants and systems analysts. BAE Systems believes that Techmodal's capabilities strongly complement the digital and data services BAE Systems currently provides to the Royal Navy and that Techmodal's experience and expertise in data analytics, data science and digital transformation will strengthen its ability to support all of the United Kingdom's armed forces and other customers around the world. The Techmodal acquisition will be integrated into the Maritime reporting segment.

BAE Systems continually examines the options for its business and reviews its portfolio to ensure it remains aligned to BAE Systems' strategy. Investment in value-enhancing acquisitions will be considered where market conditions are right and where they deliver on BAE Systems' strategy. This includes investing in smaller, technology-based acquisitions in strategic markets, such as the acquisitions in 2019 of Riptide Autonomous Solutions, a developer of unmanned underwater vehicles, and Prismatic Ltd, a developer of a solar electric unmanned aerial vehicle.

Organization

BAE Systems reports based on the following reporting segments:

Electronic Systems. The Electronic Systems reporting segment comprises electronics activities based primarily in the United States with some presence in the United Kingdom. These activities include electronic warfare 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 and hybrid electric drive systems. The reporting segment comprises six lines of businesses: Electronic Combat Solutions; Countermeasure & Electromagnetic Attack Solutions; Precision Strike & Sensing Solutions; C4ISR Systems; Controls & Avionics Solutions and Power & Propulsion Solutions.

Sales, revenue and Underlying EBITA of the Electronic Systems reporting segment (£2,203 million, £2,203 million and £291 million, respectively) represented approximately 22%, 24% and 31%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Electronic Systems reporting segment (£4,439 million, £4,439 million and £687 million, respectively) represented approximately 22%, 24% and 31%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

The Electronic Combat Solutions business, Countermeasure & Electromagnetic Attack Solutions business, Precision Strike & Sensing Solutions business, C4ISR Systems business, Controls & Avionics Solutions business and Power & Propulsion Solutions business represented approximately 24%, 17%, 13%, 29%, 13% and 4%, respectively, of Electronic Systems sales, in the first half of 2020, and approximately 22%, 14%, 13%, 28%, 18% and 5%, respectively, of Electronic Systems sales, in 2019. Defense sales and commercial sales represented approximately 85% and 15%, respectively, of Electronic Systems sales, in the first half of 2020, and approximately 79% and 21%, respectively, of Electronic Systems sales, in 2019.

Electronic Systems had approximately 16,300 employees as of June 30, 2020.

Cyber & Intelligence. The Cyber & Intelligence reporting segment comprises the United States-based Intelligence & Security business and United Kingdom-headquartered Applied Intelligence business and covers BAE Systems' cyber security, secure government, and commercial financial security activities. The reporting segment comprises two lines of businesses: Intelligence & Security and Applied Intelligence.

Sales, revenue and Underlying EBITA of the Cyber & Intelligence reporting segment (£913 million, £913 million and £59 million, respectively) represented approximately 9%, 10% and 6%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Cyber & Intelligence reporting segment (£1,732 million, £1,732 million and £91 million, respectively) represented approximately 9%, 9% and 4%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

The Intelligence & Security business and the Applied Intelligence business represented approximately 72% and 28%, respectively, of Cyber & Intelligence sales, in the first half of 2020, and approximately 70% and 30%, respectively, of Cyber & Intelligence sales, in 2019.

Cyber & Intelligence had approximately 9,900 employees as of June 30, 2020.

Platforms & Services (US). The Platforms & Services (US) reporting segment, with operations in the United States, Sweden and United Kingdom, manufactures 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. The business also has a 49% interest in the FNSS joint venture in Turkey. The reporting segment comprises seven lines of businesses: Combat Mission Systems; Ordnance Systems; US Ship Repair; BAE Systems Hägglunds; Weapon Systems Sweden; Weapon Systems UK and FNSS.

Sales, revenue and Underlying EBITA of the Platforms & Services (US) reporting segment (£1,718 million, £1,688 million and £121 million, respectively) represented approximately 17%, 18% and 13%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Platforms & Services (US) reporting segment (£3,337 million, £3,185 million and £267 million, respectively) represented approximately 17%, 17% and 12%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

The Combat Mission Systems business, Ordnance Systems business, US Ship Repair business, BAE Systems Hägglunds business, Weapon Systems Sweden business, Weapon Systems UK business and FNSS business represented approximately 49%, 15%, 23%, 4%, 4%, 3% and 2%, respectively, of Platforms & Services (US) sales, in the first half of 2020, and approximately 42%, 15%, 25%, 5%, 4%, 5%, and 4%, respectively, of Platforms & Services (US) sales, in 2019.

Platforms & Services (US) had approximately 12,600 employees as of June 30, 2020.

Air. The Air reporting segment comprises BAE Systems' United Kingdom-based air activities for European and International Markets, US Programmes, and its businesses in Saudi Arabia and Australia, together with its 37.5% interest in the European MBDA joint venture of Airbus, BAE Systems and Leonardo (the "*European MBDA Joint Venture*"). The reporting segment comprises five lines of businesses: European and International Markets; US Programmes; Saudi Arabia; Australia and MBDA. BAE Systems will introduce a sixth line of business, Future Combat Air Systems, in the second half of 2020.

Sales, revenue and Underlying EBITA of the Air reporting segment (£3,610 million, £3,029 million and £356 million, respectively) represented approximately 36%, 33% and 38%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Air reporting segment (£7,457 million, £6,153 million and £887 million, respectively) represented approximately 37%, 33% and 40%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

The European and International Markets business, US Programmes business, Saudi Arabia business, Australia business and MBDA business represented approximately 31%, 12%, 33%, 9% and 15%, respectively, of Air sales, in the first half of 2020, and approximately 28%, 11%, 35%, 10% and 16%, respectively, of Air sales, in 2019.

Air had approximately 28,800 employees as of June 30, 2020.

Maritime. The Maritime reporting segment comprises BAE Systems' United Kingdom-based maritime and land activities. The reporting segment currently comprises four lines of businesses: Naval Ships; Submarines; Maritime Services and Land UK.

Sales, revenue and Underlying EBITA of the Maritime reporting segment (£1,505 million, £1,478 million and £122 million, respectively) represented approximately 15%, 16% and 13%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for the first half of 2020. Sales, revenue and Underlying EBITA of the Maritime reporting segment (£3,116 million, £3,071 million and £268 million, respectively) represented approximately 16%, 17% and 12%, respectively, of BAE Systems' sales, revenue and Underlying EBITA for 2019.

Maritime sales and land sales represented approximately 92% and 8%, respectively, of Maritime sales in the first half of 2020, and approximately 91% and 9%, respectively, of Maritime sales in 2019. The Naval Ships business, Submarines business, Maritime Services business, and Land UK business represented approximately 22%, 48%, 22% and 8%, respectively, of Maritime sales, in the first half of 2020, and approximately 25%, 47%, 20% and 9%, respectively, of Maritime sales, in 2019.

Maritime had approximately 16,600 employees as of June 30, 2020.

HQ. The HQ reporting segment comprises BAE Systems' head office activities, together with a 49% interest in Air Astana.

Strategy

BAE Systems' strategy is comprised of five key long-term areas of focus to help it achieve its vision of being the premier international defense, aerospace and security company and its mission to provide a vital advantage to help its customers protect what really matters. This strategy is centered on maintaining and growing BAE Systems' core franchises and securing growth opportunities through advancing its three strategic priorities and demonstrating the company behaviors.

BAE Systems' strategy is to:

- Maintain and grow its defense businesses.
- Continue to grow its business in adjacent markets.
- Develop and expand its international business.
- Inspire and develop a diverse workforce to drive success.
- Enhance financial performance and deliver sustainable growth in shareholder value.

The following three strategic priorities are embedded throughout BAE Systems and provide the link between its longer-term strategy and near-term business objectives for all of its employees.

BAE Systems' three strategic priorities are to:

- Drive operational excellence.
- Continuously improve competitiveness and efficiency.
- Advance and further leverage its technology.

Principal Markets

BAE Systems is an international defense, aerospace and security solutions company with a significant presence in its principal markets – the United States, United Kingdom, Saudi Arabia and Australia – as well as established positions in a number of other international markets. BAE Systems delivers a wide range of products and services in the air, maritime, land and cybersecurity domains and has strong, established positions supplying defense equipment, electronics and services, as well as cyber, intelligence and security solutions for governments. In 2019, BAE Systems was one of the largest and most geographically diverse global defense and security companies. The following chart illustrates BAE Systems' global market position among defense companies:

BAE Systems' global defense market position

Top ten global defense contractors' defense revenue ($ billion)

Source: Defense News Top 100 for 2020 (based on 2019 numbers). Exchange rate applied to BAE Systems is $1.277 / £1.000

From the start of the COVID-19 coronavirus pandemic's disruptions, BAE Systems embarked on implementing new working practices such as home working capabilities, reconfiguring floorplans, shift patterns, enhanced cleaning regimes and appropriate safe working measures. Additionally, BAE Systems advanced the key actions for the long-term strength of the business of completing the acquisitions of the Airborne Tactical Radios business and the Collins Aerospace Military Global Positioning System business from Raytheon Technologies Corporation in May 2020 and July 2020, respectively, raising and injecting into BAE Systems' UK pensions scheme £1.0 billion in a one-off pension deficit funding contribution in the first half of 2020, and investing in new facilities to meet the growth profile in a number of sectors. The COVID-19 coronavirus pandemic has clearly had a short-term impact and its long-term impact remains uncertain. See "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.*"

United States

The United States continues to represent the single largest defense market in the world and BAE Systems remains a top-ten defense supplier to the United States Department of Defense, according to market data for 2019. The United States accounted for £4,517 million and £4,514 million of BAE Systems' sales and revenues, respectively, in the six months ended June 30, 2020 and for £8,642 million and £8,635 million of BAE Systems' sales and revenues, respectively, in the year ended December 31, 2019.

BAE Systems believes that it is well positioned to support its United States and international customers, delivering a broad set of products, technologies and services across a diverse range of air, land and maritime markets, and offering advanced electronics, security, intelligence, information technology solutions and support services to a diverse customer base. BAE Systems believes that this diversity across markets, programs and its customer base results in relatively low exposure to any single program in the United States market.

Outlook

For a number of years, the United States budget environment has been marked by strong bipartisan support for defense, military readiness and modernization programs. The BAE Systems United States business portfolio is well aligned with the focus areas outlined in the United States National Defense Strategy, including combat vehicles, precision-guided munitions, naval ship repair and modernization, electronic warfare, hypersonics, space resilience and security. While the United States market continues to be subject to broader spending constraints due to the United States federal deficit, recent fiscal year budgets have maintained positive momentum for United States Department of Defense priorities. Budget constraints will continue to impact government spending and procurement decisions; however, BAE Systems supports some of the most important, long-term defense programs for the United States armed forces and its allies.

Near-term clarity in United States defense spending was enhanced in July 2019, when a two-year budget agreement was signed to lift the deficit ceiling and set new budget caps for fiscal years 2020 and 2021. The passage and signing of the fiscal year 2020 Defense Appropriations bill in December 2019 ended the Continuing Resolution then in place and maintained funding support for many key BAE Systems programs, including combat vehicles, F-35, electronic warfare programs, and current and future precision weapons systems. This fiscal year 2020 includes a top line budget of $738 billion for defense, a 3% increase over fiscal year 2019, and lawmakers have already agreed to a defense spending cap for fiscal year 2021 of $740.5 billion, maintaining support for BAE Systems' medium-term planning assumptions and positive momentum for military readiness and modernization programs. While BAE Systems continues to closely monitor the budget process, the significant COVID-19 coronavirus pandemic-related relief spending, coupled with the national election in November, may impact the fiscal year 2021 defense budget and the timely passage of appropriations legislation.

Over the past seven years, BAE Systems has streamlined the organization of its United States-based business to more effectively align it with the evolving market and to lower costs, and the United States-based combat vehicles business has implemented a number of process and automation improvements to meet increased production volumes across multiple programs with lessons learned being applied across the portfolio.

As a result, the United States-based organization has strong positions in:

- premier defense programs in air, as evidenced by continued awards for additional F-35 aircraft and systems;
- key franchise programs in combat vehicles, as evidenced by continued awards for the M109 family of self-propelled howitzers, AMPV, ACV, Bradley A4, M88A3, and other vehicle upgrades and modernization;
- design and manufacture of artillery systems and missile launchers for the United States, United Kingdom and other armed forces as evidenced by domestic and international M777 programs;
- ship repair, naval gun systems and submarine system and support franchises in the United States that are well supported by the growth outlook in the United States Navy budget and projected fleet size;
- design, manufacture and support of high-end defense electronics and avionics equipment;
- real-time intelligence analysis and information technology services, where the business has been awarded a number of key service contracts for the United States Department of Defense, civilian markets and United States intelligence communities and continues to pursue opportunities with emphasis on the ISR domain; and
- international exports through both Foreign Military Sales and direct international sales to allied nations.

Despite recent downturns due to the COVID-19 coronavirus pandemic, BAE Systems continues to look to enhance its existing commercial programs, including in areas such as engine and flight controls and electric drive propulsion systems where the business has historically earned strong market positions.

Opportunities

The United States business remains focused on investment in emerging technologies and leveraging customer funding to maintain, develop and grow BAE Systems' strong market positions. BAE Systems continues to deliver on and look to enhance existing commercial programs, including engine and flight controls, and electric drive propulsion systems.

In the Electronic Systems reporting segment, BAE Systems continues to invest and grow its differentiated positions in electronic warfare, precision guidance and seeker solutions, secure global positioning products, mobile networked communications equipment, military and commercial aircraft electronics, and classified programs. This focus on investments in mission-critical electronic systems was underpinned in 2020 with the acquisition of the Airborne Tactical Radios business in May and the Military Global Positioning System business in July. In October 2019, the United States Department of Defense expanded its commitment and support for some priority capabilities and programs, including a new contract for delivery of 478 additional F-35 / Joint Strike Fighters, a program in which BAE Systems is a key partner. In addition to its strong military customer base, the business remains focused on adapting some of its military capabilities for application in the commercial aviation market, where BAE Systems anticipates maintaining its long-standing key customer positions, and leveraging its developing technologies in emerging areas of demand, such as precision weaponry, space resilience, autonomy, and electrification. Within BAE Systems' commercial operations, the Controls & Avionics Solutions business has been impacted by the COVID-19 coronavirus pandemic, especially in the aftermarket and product delivery lines, and the Power & Propulsion Solutions business has been impacted by the reduced demand for mass transit in recent months.

In the Platforms & Services (US) reporting segment, the business retains its focus on sustaining key franchise programs and building a strong domestic and international order pipeline, while shaping and scaling operational resources to optimize competitiveness. BAE Systems is working to protect key industrial capabilities and investing to further support existing franchise programs including upgrading of tracked vehicles such as Bradley Fighting Vehicles and M88 recovery vehicles, designing and manufacturing the M109 self-propelled howitzer and AMPV, developing light combat vehicles under the Mobile Protected Firepower program for the United States Army and manufacturing amphibious vehicles for the United States Marine Corps and international customers. The M109A7 is consistently delivering at full rate production levels and low rate initial production deliveries were made on the ACV program. Further contract awards were received for the M88A3 modernization and Bradley A4 programs throughout 2019 and the first half of 2020, strengthening the order backlog. Looking forward, BAE Systems is working on, and is closely following, the United States Army's acquisition plans for its next generation of combat vehicles, in particular the mobile protected firepower and robotic combat vehicle programs and BAE Systems will have three upgrade and three new-build programs underway in its expanded and modernized manufacturing facilities. In the maritime domain, the sector has a strong position on naval gun programs and United States Navy ship repair activities where the business has invested in facilities in key homeports. To this end, it was a strategic step forward in October 2019 when the first destroyer tandem docking in BAE Systems' San Diego facility was achieved. In the first half of 2020, BAE Systems received orders totaling $430 million in the United States Navy ship repair business, including a $200 million award to service the USS Boxer in San Diego. With the delivery of the final constructed ship in March 2019 and the sale of the Mobile, Alabama shipyard in 2018, BAE Systems exited commercial shipbuilding in the United States.

In the Intelligence & Security business, BAE Systems is maintaining a high level of bid activity and a strong pipeline despite a highly competitive and evolving market. The business is delivering reliably on its military and intelligence customer contracts with good program and financial performance in the first half of 2020.

United Kingdom

BAE Systems is the largest defense company in the United Kingdom according to Stockholm International Peace Research Institute data for 2018, with strong and long-standing relationships with its principal customer in the United Kingdom, the United Kingdom Ministry of Defence, and with its supply chain.

BAE Systems plays an important role in providing capabilities to support the United Kingdom government and its armed forces in the air, maritime, land and cyber domains.

BAE Systems' involvement runs across the major defense programs in the United Kingdom, including Typhoon aircraft, Type 26 frigates, and Astute and Dreadnought Class submarines. This is in addition to extensive support for the United Kingdom armed forces in the air and maritime sectors, including maintenance, support and training for Typhoon and maritime support at Portsmouth Naval Base. In the United Kingdom, BAE Systems also designs and manufactures subassemblies for all F-35 aircraft, including the aft fuselage and empennage.

Much of BAE Systems' business in the United Kingdom is concentrated on several large programs with multi-year contracts.

BAE Systems' United Kingdom-managed global cyber business has a focused strategy to ensure that BAE Systems supports its government and commercial customers as cyber security becomes an increasingly important part of both national and corporate security in a sophisticated and persistent threat environment.

Outlook

The United Kingdom government has stated its commitment to meeting the NATO target of spending of at least 2.0% of Gross Domestic Product on defense, and to increase the defense budget by at least 0.5% above inflation, in every year of the current parliament. The government has now recommenced its Integrated Foreign Policy, Defence and Security Review. BAE Systems believes that the United Kingdom Combat Air Strategy announced in July 2018 and the existing National Shipbuilding Strategy send a strong signal about the United Kingdom's commitment to retaining a leading position in the combat air and maritime domains and that these strategies enable long-term planning and joint government and industry investment in next-generation platforms, systems and technologies and the workforce required to deliver them.

Opportunities

In the Air reporting segment, work under the Team Tempest contract to develop next-generation combat air technologies, skills and experience, in collaboration with the United Kingdom government and industry partners, continues towards the program's outline business case that is expected to be submitted in December 2020. The governments of Italy and Sweden have also committed to working with the United Kingdom government to develop next-generation combat air strategy and discussions with other prospective partner nations are ongoing. Production ramp-up of rear fuselage assemblies for the F-35 Lightning II aircraft progressed well with 142 sets delivered in 2019 and 50 sets delivered in the first half of 2020 and BAE Systems now targets full-rate production levels by 2021. As the United Kingdom and global fleets grow, securing a long-term support position on the F-35 Lightning II remains a key focus for the Air business. Typhoon production is currently focused on the sub-assembly build on the Kuwait and Qatar programs, which sustain production for the coming years. The potential pipeline for Typhoon additional orders remains positive, with opportunities both with partner nations and through exports with existing and new customers.

In the Maritime reporting segment, the Queen Elizabeth Class aircraft carrier build program has been completed and four of the five River Class Offshore Patrol Vessels have now been accepted by the Ministry of Defence, and the Maritime business is working to a schedule which would see program completion in 2020. Manufacturing work on the Type 26 program continues to increase following cut steel on the second ship in August 2019 and activity on the Dreadnought program continues following initial disruption related to the COVID-19 coronavirus pandemic, with revenues now exceeding those on the Astute program while the associated major program of building works continues to progress.

In the Cyber & Intelligence reporting segment, the business continues to focus on national security and intelligence solutions to the United Kingdom and international allied governments, enterprise-level data and digital services to United Kingdom government departments and anti-fraud and regulatory compliance solutions to banking and insurance customers across Europe, North America, the Middle East, Africa and Asia-Pacific.

International

Saudi Arabia

Saudi Arabia continues to be a leading military power and one of the largest defense markets globally. Saudi Arabia has a strong commitment to defense and security spending driven by regional security instability. See "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A.*

Risks relating to the industry and BAE Systems' business—BAE Systems is dependent on defense spending," and "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—BAE Systems operates in international markets.*"

BAE Systems has a long-standing history as a proven provider to the Royal Saudi Air Force ("*RSAF*"), a position which is underpinned by strong relationships between the governments of the United Kingdom and Saudi Arabia. BAE Systems is the nominated prime contractor to the United Kingdom government in respect of the United Kingdom/Saudi Arabia government-to-government defense agreement and also holds certain direct contracts with the government of Saudi Arabia.

Outlook

The business continues to perform against the contract secured in 2018 to provide Typhoon support services to RSAF through to 2022.

The Saudi British Defence Co-operation Programme five-year funding agreement through to 2021 comprises a number of contracts, including support to the Tornado fleet and provision of Officer and Aircrew Training for the RSAF, as well as engineering and logistics services for the Royal Saudi Naval Forces ("*RSNF*"). The security market continues to mature and opportunities are being pursued. Over the coming years, partnerships with local companies and utilization of the Saudi Arabia portfolio companies are expected to generate opportunities to access additional business.

Saudi Arabia's Vision 2030 strategy to promote in-kingdom industrialization and diversification away from reliance on oil continues to shape BAE Systems' activities in support of Saudi Arabia's national objectives of technology development, local skills, and the development of a local defense industry and capability. Through related restructurings of BAE Systems' portfolio of interests in a number of industrial companies, along with sustaining current industrialized capability and building on its strong history in Saudi Arabia, BAE Systems is working with Saudi Arabian Military Industries, the Saudi Arabian national development and support holding company for local defense industries, to explore how it can collaborate to deliver further in-kingdom industrial participation.

Opportunities

BAE Systems believes that it remains well placed as a leading in-country contractor in support of air defense platforms and training systems for the RSAF, as well as support for mine countermeasure vessels for the RSNF.

Australia

BAE Systems is one of the largest defense companies in Australia with strong activities across all domains.

BAE Systems currently provides support to the Australian Defence Force through engineering, program management and sustainment solutions, including Jindalee Operational Radar Network upgrade, Hawk Lead-In Fighter support, F-35 sustainment, Anzac frigate support and upgrade and the Hunter Class Frigate program performed through BAE System's Australian shipbuilding subsidiary, ASC Shipbuilding.

Outlook

Regional instability, the impact of the COVID-19 coronavirus pandemic, and the rapid pace of military modernization and technology advancement in the Asia-Pacific region continue to drive the Australian government's commitment to defense spending, with major recapitalization programs underway in the air, maritime and land domains, underpinned also by its policies of developing a strong, sustainable and secure Australian defense industry and supporting leading-edge technical innovation. The Australian government has indicated it is on track to meet its commitment to growing defense spending to 2.0% of GDP in 2020/21.

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

BAE Systems believes that it is well positioned to assist the Australian government to meet its defense and security objectives through an established business and a 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 Australian products in international markets.

Opportunities

BAE Systems believes that the award to ASC Shipbuilding in 2018 of the nine-ship Hunter Class Frigate program, to be built at ASC Shipbuilding's leased shipyard facility in Adelaide will in time give the business a balanced portfolio of build and support work.

Other Key International Markets

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

In Qatar, BAE Systems contracted to provide 24 Typhoon and nine Hawk aircraft to the Qatar Emiri Air Force along with a bespoke support and training package in 2018, which is progressing with milestones achieved as planned.

In Oman, BAE Systems provides support to Typhoon and Hawk aircraft and naval vessels. Negotiations for the transition to mid-2022 to a reduced scope support solution for the Omani Typhoon fleet are ongoing and expected to conclude early in the second half of 2020.

In Sweden, BAE Systems has a strong presence through its BAE Systems Hägglunds business supplying and supporting tracked vehicles, such as CV90 and BvS10s for Sweden and other international customers.

In Turkey, BAE Systems is collaborating on the first development phase of an indigenous fifth-generation fighter jet, TF-X, for the Turkish Air Force and BAE Systems maintains a position in armored combat vehicles through the FNSS joint venture.

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

In Malaysia, BAE Systems is a supplier to the armed forces, both directly and through joint ventures.

In Canada, BAE Systems is the design partner on the Canadian Surface Combatant program of 15 ships for the Royal Canadian Navy. This long-term program has now commenced, and BAE Systems is working on other prospects with the Canadian customer.

Outlook

BAE Systems' United States businesses export combat vehicles and weapon systems to a number of international customers and access further international markets through its partnerships. The businesses continue to pursue opportunities in the Asia-Pacific region.

Through its 37.5% interest in the European MBDA Joint Venture, BAE Systems' position in the missiles and missile systems market continues to grow in European domestic and other international markets. While operating under a difficult geopolitical and COVID-19 coronavirus backdrop, the MBDA joint venture has continued to win orders in both domestic and export markets with a strong order backlog supporting revenue in the coming years. BAE Systems believes that MBDA and the Eurofighter consortium are well placed to benefit from the expected European defense spending increases as a number of countries look to move nearer to their NATO commitments. Eurofighter partner nations Germany and Spain have stated that they are considering future Typhoon orders, and other Typhoon and support opportunities are being pursued in the Middle East and Europe.

Reporting Segments

BAE Systems reports based on the following segments: Electronic Systems, Cyber & Intelligence, Platforms & Services (US), Air, Maritime and HQ.

The following table presents BAE Systems' and BAE Systems' reporting segments' sales and revenue for the six months ended June 30, 2020 and June 30, 2019.

	Six Months Ended June 30, 2020				Six Months Ended June 30, 2019			
	Sales(1)	% of Total Sales(1)	Revenue(1)	% of Total Revenue(1)	Sales(1)	% of Total Sales(1)	Revenue(1)	% of Total Revenue(1)
	(In £ millions, except percentages)							
Electronic Systems	2,203	22%	2,203	24%	2,142	23%	2,142	24%
Cyber & Intelligence	913	9%	913	10%	853	9%	853	10%
Platforms & Services (US)	1,718	17%	1,688	18%	1,522	16%	1,459	17%
Air	3,610	36%	3,029	33%	3,366	36%	2,824	32%
Maritime	1,505	15%	1,478	16%	1,525	16%	1,512	17%
HQ	102		26		163		23	
Subtotal	**10,051**		**9,337**		**9,571**		**8,813**	
Deduct: Intra-Group	(180)		(157)		(155)		(139)	
Total	**9,871**		**9,180**		**9,416**		**8,674**	

(1) See "*Presentation of Currency and Financial and Other Information*" for an explanation of the components and calculation method of this measure.

The following table presents BAE Systems' and BAE Systems' reporting segments' sales and revenue for the years ended December 31, 2019 and December 31, 2018.

	Year Ended December 31, 2019				Year Ended December 31, 2018			
	Sales(1)	% of Total Sales(1)	Revenue(1)	% of Total Revenue(1)	Sales(1)	% of Total Sales(1)	Revenue(1)	% of Total Revenue(1)
	(In £ millions, except percentages)							
Electronic Systems	4,439	22%	4,439	24%	3,965	22%	3,965	23%
Cyber & Intelligence	1,732	9%	1,732	9%	1,678	9%	1,678	10%
Platforms & Services (US)	3,337	17%	3,185	17%	3,005	16%	2,864	17%
Air	7,457	37%	6,153	33%	6,712	37%	5,579	33%
Maritime	3,116	16%	3,071	17%	2,975	16%	2,940	17%
HQ	387		43		350		41	
Subtotal	**20,468**		**18,623**		**18,685**		**17,067**	
Deduct: Intra-Group	(359)		(318)		(278)		(246)	
Total	**20,109**		**18,305**		**18,407**		**16,821**	

(1) See "*Presentation of Currency and Financial and Other Information*" for an explanation of the components and calculation method of this measure.

Order Backlog by Reporting Segment

A summary of the total order backlog as of June 30, 2020 and as of December 31, 2019 for each of BAE Systems' reporting segments is set forth in the following below:

Reporting Segment	As of June 30, 2020	As of December 31, 2019
	(in £ billions)	
Electronic Systems	7.3	6.0
Cyber & Intelligence	1.7	1.8
Platforms & Services (US)	6.5	5.8
Air	23.2	23.9
Maritime	8.1	8.6
HQ	—	—
Deduct: Intra-Group	(0.7)	(0.7)
Total Order Backlog	**46.1**	**45.4**

Order backlog represents funded and unfunded unexecuted customer orders including BAE Systems' share of order backlog of equity accounted investments. Unfunded orders include the elements of United States multi-year contracts for which funding has not been authorized by the customer.

Electronic Systems

Electronic Systems, with approximately 16,300 employees as of June 30, 2020, comprises BAE Systems' United States and United Kingdom-based electronics activities, including electronic warfare systems, electro-optical sensors, military and commercial digital engine and flight controls, precision guidance and seeker solutions, secure global positioning products, next-generation military communications systems and data links, persistent surveillance capabilities and hybrid electric drive systems.

The reporting segment comprises six lines of businesses: Electronic Combat Solutions; Countermeasure & Electromagnetic Attack Solutions; Precision Strike & Sensing Solutions; C4ISR Systems; Controls & Avionics Solutions and Power & Propulsion Solutions.

Electronic Combat Solutions provides a depth of capability in advanced electronic warfare solutions for airborne applications, including electronic support, electronic attack, and electronic protection technologies. Key programs include:

- F-35 programs, under which BAE Systems has delivered over 650 electronic warfare systems to date, most of which were delivered in recent years to pace the F-35 program ramp-up;
- A series of F-15 aircraft programs including the Eagle Passive Active Warning Survivability System for the United States Air Force, the ALR-56 Radar Warning Receiver System and the Digital Electronic Warfare System providing advanced electronic warfare capability for international F-15 aircraft; and
- Long-range sensor technology for the Long Range Anti-Ship Missile.

Due to the sensitive nature of electronic combat systems and technology, many BAE Systems Electronic Combat Solutions programs are classified. As a world leader in electronic warfare, the business continues to provide next-generation technologies in support of the warfighter.

Countermeasure & Electromagnetic Attack Solutions exploits the electro-optical and infrared spectrum to provide leading threat warning and infrared countermeasures systems, head-up displays and state-of-the-art tactical imaging systems. Key programs include:

- Sustaining and upgrading prime mission equipment on the existing EC-130H fleet and cross-decking of the mission system to a special-mission Gulfstream G550 jet, which will be designated as the EC-37B and is targeted to field in 2023; and
- A next-generation missile warning system for the United States Army under the Limited Interim Missile Warning System program.

Precision Strike & Sensing Solutions exploits the electro-optical and infrared spectrum to provide precision guidance and seeker solutions, advanced targeting solutions, secure global positioning products, head-up displays and state-of-the-art tactical imaging systems. Key programs include:

- The APKWS® laser-guided rocket program continues to execute at full rate production under two indefinite delivery contracts to satisfy both U.S. and international demand for aircraft platforms, and recently demonstrated a successful ground-launch capability;
- Fixed- and rotary-wing demonstrations of BAE System's Striker® II helmet-mounted display systems;
- The Terminal High Altitude Area Defense seeker program, which is executing at full rate production and was awarded a contract to design and manufacture next-generation infrared seekers providing critical targeting technology; and
- Acquired in July 2020, the Military Global Positioning System business provides complementary capabilities to support our priority growth area of precision guided munitions, and the business is well positioned to provide next-generation upgrades, to include M-Code GPS technologies, across its sizeable installed base.

C4ISR Systems addresses the market for actionable intelligence through innovative technical solutions for airborne persistent surveillance, identification systems, signals intelligence, underwater and surface warfare solutions, and space resiliency products. Key programs include:

- Space-qualified subsystems and components in the space resilience domain;
- Integrated on-board processors, reconfigurable processing payloads and secure communications;
- Defense Advanced Research Projects Agency funded programs to integrate machine-learning into platforms that exploit radio frequency signals in increasingly crowded electromagnetic spectrum environments;
- Solutions to address emerging requirements in the maritime domain stemming from the 2019 acquisition of Riptide Autonomous Solutions to provide an unmanned underwater vehicle for integrating BAE Systems' innovative technology capabilities in affordable, modular, flexible payload options;
- Acquired in May 2020, the Airborne Tactical Radios business providing a full spectrum communications portfolio with multi-band radios and advanced cryptographic technologies; and
- Link 16 technology programs producing, retrofitting, and sustaining joint tactical radios for the United States Navy through the Data Link Solutions venture with Collins Aerospace.

Controls & Avionics Solutions develops and produces electronics for military and commercial aircraft, including fly-by-wire flight controls, full authority digital engine controls, flight deck systems, cabin management systems and mission computers. While the business is experiencing significant impacts from the COVID-19 coronavirus pandemic, key programs include:

- Integrated flight control electronics, remote electronic units and engine control solutions for Boeing's next-generation 777X aircraft;
- Active inceptors, which recently received certification for the Gulfstream G500 and G600 while initial production and flight testing for the G700 is ongoing;
- LinkEdge™ (Active Parallel Actuation Subsystem) for the Chinook CH-47;
- An engine control product line with strong performance from FADEC Alliance, a joint venture between GE Aviation and FADEC International (BAE Systems' joint venture with Safran Electronics & Defense);
- Electronic Engine Controls to modernize the United States Army's Black Hawk and Apache fleets; and
- F-35 vehicle management computer technology.

Power & Propulsion Solutions delivers electric propulsion and power management performance, with innovative products and solutions that advance vehicle mobility, efficiency and capability in the transit, military, marine and rail markets. Key programs include:

- Next-generation battery electric systems to serve markets moving to zero emission technology;
- Alexander Dennis Limited's recent selection of BAE Systems' clean propulsion systems to power up to 600 buses for the new fleet of the Republic of Ireland's National Transport Authority;
- The New York City Transit (Metropolitan Transportation Authority)'s recently solidified commitment to purchase 435 electric-hybrid power and propulsion systems from BAE Systems; and
- Electric hybrid systems powering passenger and cargo vessels in the maritime domain.

BAE Systems believes that Electronic Systems is well positioned to address current and evolving United States defense priority programs from its strong franchise positions in electronic warfare, precision guidance and seeker solutions. Electronic Systems has a long-standing program of research and development, and its focus remains on maintaining a diverse portfolio of defense and commercial products and capabilities for United States and international customers. BAE Systems expects the business to benefit from its ability to apply innovative technology solutions that meet defense customers' changing requirements and believes the business is well positioned for the medium term with strong significant roles on F-35, F-15 upgrade and classified programs, 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 projectiles, secure communications and autonomous vehicles. In the commercial aviation market, BAE Systems believes that its Electronic Systems' technology innovations enable the business to maintain its long-standing customer positions. BAE Systems expects the demand profile, especially in aftermarket services and original equipment production, to be affected in the mid-term by the COVID-19 coronavirus pandemic impacts on civil aviation. Within its electric and hybrid-electric propulsion capability, BAE Systems expects short-term impacts will be felt by the recent bus manufacturing shutdowns and the reduced demand for mass transit, but will continue to be well placed to address the global environmental need for low- and zero-emission technology.

Cyber & Intelligence

Cyber & Intelligence, with approximately 9,900 employees as of June 30, 2020, comprises the United States-based Intelligence & Security business and United Kingdom-headquartered Applied Intelligence business and covers BAE Systems' cybersecurity, secure government and commercial financial security activities.

The reporting segment comprises two lines of businesses: Intelligence & Security and Applied Intelligence.

Intelligence & Security

The United States-based Intelligence & Security business provides comprehensive and strategic support to customers' missions around the world. The sector serves a diverse customer base, including the United States Department of Defense, the intelligence community, United States federal civilian agencies including the Department of Justice, the Department of Homeland Security and commercial clients. Intelligence & Security currently operates three business divisions: Air Force Solutions; Integrated Defense Solutions and Intelligence Solutions.

The Air Force Solutions business focuses on providing the United States Air Force and its combatant commands with innovative solutions to help modernize, maintain, test, and cyber-harden aircraft, radars, missile systems, and mission applications that detect and deter threats to national security. Key programs include:

- Logistics sustainment support to United States Air Force Space Command for instrumentation tracking (radar, telemetry and optics) systems, which includes various agencies across the United States Department of Defense, Department of Energy, and National Aeronautics and Space Administration, plus six foreign governments;
- The United States Air Force Intercontinental Ballistic Missile Integration Support Contractor Program, where BAE Systems performs program management, systems engineering, integration and testing, sustainment and cyber defense services;
- A multi-year indefinite delivery, indefinite quantity contract to provide electronic hardware and engineering services for a U.S. government customer;
- A five-year enterprise IT solutions contract with the Air Force Research Laboratories for systems engineering, evaluation and analysis; and
- A multi-year United States Navy program for KC-130J Large Aircraft Infrared Countermeasures installations.

The Integrated Defense Solutions business provides the United States Army, Navy, and federal civilian markets with systems engineering, integration and sustainment services for C4ISR systems and enterprise IT networks that enhance mission effectiveness. BAE Systems' solutions are deployed across platforms and networks in the air, maritime, land and cyber domains. Key programs include:

- A contract to support weapons systems on board United States Ohio and United Kingdom Vanguard Class submarines, as well as future United States Columbia Class and United Kingdom Dreadnought Class submarines;
- A contract for the United States Marshals Service ("*USMS*"), a component of the United States Department of Justice to provide mission-critical IT infrastructure support, sustainment operations and engineering services to the USMS Information Technology Division;

- A United States Navy contract to modernize and maintain command, control, communications, computers, cyber, intelligence, surveillance and reconnaissance systems aboard new construction aircraft carriers and large deck amphibious ships;
- A United States Navy contract for the design, acquisition, integration and test of radio communication suites for Guided Missile Destroyers and other United States Navy and Coast Guard ships;
- A United States Navy contract to provide full rate production of mission system avionics and aircraft components, and production and installation of modification kits for the Naval Air Warfare Center Aircraft Division;
- A United States Navy contract to provide critical large-scale system engineering, integration and testing expertise for the AEGIS Weapons and Combat Systems aboard the United States Navy's surface combatant ships;
- A contract to provide systems engineering, security management, modelling and simulation, and training services to help in the United States government defense cyber mission; and
- A ten-year contract to distribute documents for the United States Bankruptcy Courts to creditors.

The Intelligence Solutions business provides innovative mission-enabling solutions and services to enhance the collection, analysis, and processing of data across United States civilian and military intelligence communities and develops and deploys high-assurance networks that facilitate the secure sharing of data amongst intelligence agencies in support of national security. Key programs include:

- Several task order contracts to provide motion-imagery analysis, training, and research support services to the United States intelligence community, and provide technical, functional, and general support to enhance the situational awareness and training of United States Army troops deployed around the world;
- Subcontracting under the five-year Joint Artificial Intelligence Center Joint Warfighting National Mission Initiative contract to provide a full spectrum of technical support and deliver AI-enabled systems;
- High-performance computing and infrastructure support to the United States intelligence community;
- Critical intelligence support to the United States government;
- Open source support for the Army and Army Intelligence & Security Command approved partners, to provide training, policy and governance recommendations, assessments and implementation of emerging capabilities, and to establish and manage a secure cloud hosting environment for these efforts;
- Worldwide coverage, support and assistance to the Defense Intelligence Agency delivering timely, objective and cogent military intelligence to defense planners and policy makers;
- Federated Secure Cloud implementation, supporting multiple independent levels of security; and
- Multiple commercial cloud partnerships.

The outlook for the United States government services sector is stable, although market conditions remain highly competitive and continue to evolve. BAE Systems believes that the United States business remains well positioned and will continue to leverage its established market positions and reputation for reliable and adaptable performance to meet customer demands for innovative, cost-effective and cyber-hardened solutions to pursue both recompeted contracts and new business across its portfolio of sustainment, integration and modernization solutions for military and intelligence customers.

Applied Intelligence

Applied Intelligence provides data intelligence solutions which enable governments and commercial organizations to defend against national-scale threats, protect their networks and data against sophisticated attacks and operate successfully in cyberspace. BAE Systems' solutions are delivered as licensed technologies, software-as-a-service subscriptions, through outsourced managed services, and via consulting and systems integration projects. Applied Intelligence operates two business divisions: Government and Financial Services.

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

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

Following a strategic review in 2019, BAE Systems commenced a process for the disposal of the United States-based Applied Intelligence SilverSky business. Negotiations regarding the sale have continued despite the temporary market uncertainty caused by the pandemic. BAE Systems divested the United Kingdom-based Applied Intelligence Managed Security Services business in April 2020. BAE Systems believes the services and products it offers in the Government division of its Applied Intelligence business are well placed to deliver growth as cyber security becomes an increasingly important part of a nation's security. BAE Systems continues to shape the Financial Services division to deliver sustainable demand and increased profitability given cyber is, and will continue to be, a core element of stewardship for companies in a sophisticated and persistent threat environment.

The business has continued to operate at full capacity during the pandemic but the adverse macroeconomic situation is creating risk in terms of the ability to complete international deals and uncertainty regarding levels of customer spending that remain under review.

Platforms & Services (US)

Platforms & Services (US), with approximately 12,600 employees as of June 30, 2020, and operations in the United States, United Kingdom and Sweden, manufactures 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.

The reporting segment comprises seven lines of businesses: Combat Mission Systems; Ordnance Systems; US Ship Repair; BAE Systems Hägglunds; Weapon Systems Sweden; Weapon Systems UK and FNSS.

Combat Mission Systems focuses on a portfolio of tracked combat vehicles, amphibious vehicles, accessories, protection systems and tactical support services, as well as naval weapons, artillery, advanced weapons, precision munitions, high explosives and propellants for the United States military and international customers. Key programs include:

- Production and sustainment of the M88 recovery vehicles for the United States Army;
- Design and manufacture of M109A5 and M109A7 self-propelled howitzers;
- Design and manufacture of AMPVs for the United States Army;
- Development of light combat vehicles under the Mobile Protected Firepower program for the United States Army;
- Manufacture of ACVs for the United States Marine Corps;
- Upgrading of Bradley Fighting Vehicles;
- Delivering initial Assault Amphibious Vehicles under contract with Taiwan;
- Working on a United States Navy contract for the production of missile canisters supporting the Vertical Launching System;
- Working on a United States Navy program for delivery of Mk45 Mod 4 gun systems and 57mm Mk110 gun systems;
- Producing Virginia Payload Module tubes for the United States Navy's Block V Virginia-class submarines; and
- Performing on a contract that includes Mk45 Mod 4 gun systems, automated ammunition handling systems and gun fire control under the Maritime reporting segment's Maritime Indirect Fire System contract for the UK Royal Navy's Type 26 frigate program.

Ordnance Systems provides complex munition site management and operation services for the United States Army's Holston and Radford facilities. Key programs include:

- Modernization activities at the United States Army's Holston site for a natural gas-fired steam facility, a waste water management facility, and the design, construction and commissioning of new production facilities; and
- Construction of a modernized nitrocellulose facility at the United States Army's Radford site, where BAE Systems is actively managing ongoing subcontractor performance issues, cost and schedule overruns, and related disputes.

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

- Servicing the USS The Sullivans, the USS Lassen and the USS Farragut in Jacksonville and the USS Vicksburg in Norfolk;
- Post dry-docking work for the guided-missile destroyers USS Stethem and USS Decatur and service of the USS Boxer in San Diego; and
- Completing existing contracts for the United States Navy in Pearl Harbor (BAE Systems informed the United States Navy that it will not bid for future work in Hawaii and intends to cease operations at the Pearl Harbor facility by early 2021).

BAE Systems Hägglunds focuses on the tracked vehicle market for Swedish and international customers. Key programs include:

- Design, manufacture and support of the CV90 and BvS10 combat vehicles in Sweden and across six other international markets;
- Refurbishment of Swedish CV90s and integration of 40 Mjölner mortar systems; and
- Integration of the Elbit Systems' Iron Fist Active Protection System on the Dutch Army's fleet of CV90s.

Weapon Systems Sweden focuses on naval weapons, artillery, advanced weapons, precision munitions, high explosives and propellants for Swedish, United States and international customers. Key programs include:

- Swedish Army and United States Army contracts for 155mm BONUS ammunition programs;
- Multiple export contracts to deliver Mk4 and Mk3 naval gun systems; and
- A 57mm Mk110 gun systems program for the United States Navy and Coast Guard.

Weapon Systems UK focuses on naval weapons, artillery, advanced weapons, precision munitions, high explosives and propellants for United Kingdom and international customers. The key program is manufacturing M777 ultra-lightweight howitzers for the Indian Army with subsequent assembly in India by Mahindra Defence Systems.

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. Key programs include:

- Production of 8x8 wheeled armored vehicles for the Royal Malaysian Army;
- Delivery of PARS wheeled armored vehicles in 8x8 and 6x6 configurations to Oman;
- Delivery under multiple contracts for the Turkish Armed Forces to provide 260 anti-tank vehicles, air defense vehicles, 27 assault amphibious vehicles and 100 special purpose 8x8 and 6x6 vehicles and modernizing 133 amphibious vehicles; and
- Supply of medium weight tanks to Indonesia.

Combat Mission Systems is underpinned by a growing order backlog and incumbencies on BAE Systems' key franchise programs. FNSS continues to execute on its order book of both Turkish and international orders.

BAE Systems believes that these long-term contracts and franchise positions make the combat vehicles business well placed for growth in the medium term and is working on, and is closely following, the United States Army's acquisition plans for its next generation of combat vehicles, in particular the mobile protected firepower and robotic combat vehicle programs. In the maritime domain, the sector has a strong position on naval gun programs and United States Navy ship repair activities where the business has invested in facilities in key homeports. This capitalized infrastructure represents a material barrier to entry, and the business remains well aligned with the United States Navy's operational strategy, maintaining a strong bid pipeline for repair and modernization services and working with the United States Navy to improve utilization levels. BAE Systems remains a leading provider of gun systems and precision strike capabilities and, in the complex ordnance manufacturing business, continues to manage and operate the United States Army's Radford and Holston munitions facilities under previously awarded contracts.

Air

Air, with approximately 28,800 employees as of June 30, 2020, comprises BAE Systems' United Kingdom-based air activities for European and International Markets and US Programmes, and its businesses in Saudi Arabia and Australia, together with a 37.5% interest in the European MBDA Joint Venture.

The Air reporting segment currently comprises five lines of businesses: European and International Markets; US Programmes; Saudi Arabia; Australia and MBDA. BAE Systems will introduce a sixth line of business, Future Combat Air Systems, in the second half of 2020.

European and International Markets

The European and International Markets line of business comprises BAE Systems' United Kingdom-based business for the production of Typhoon combat and Hawk trainer aircraft, support and upgrades for Typhoon, Tornado and Hawk aircraft, and development of next-generation Air Systems and defense information systems.

BAE Systems is the United Kingdom shareholder in Eurofighter Jagdflugzeug GmbH ("*Eurofighter GmbH*"), the joint venture established to be the prime contractor for the Typhoon program, one of BAE Systems' largest projects. Eurofighter GmbH holds the Typhoon program prime contract from NETMA (the NATO agency representing the four core nations who originally commissioned development of the Typhoon aircraft (Germany, Spain, Italy and the United Kingdom)). BAE Systems, Airbus Defence and Space GmbH, Airbus Defence and Space S.A. and Leonardo currently hold 33%, 33%, 13% and 21%, respectively, of Eurofighter GmbH shares.

This business is responsible for all activity associated with BAE Systems' subcontract responsibilities to Eurofighter GmbH, including the production of front fuselages and a number of other significant components for all contracted Typhoon deliveries, and final assembly of any United Kingdom, Saudi Arabia, Qatar and Oman aircraft, as well as contracted upgrade programs associated with Typhoon.

In the United Kingdom, Royal Air Force Typhoons are operational in Air Defence and Quick Reaction Alert roles and have an expanding multirole capability. Typhoon support in the United Kingdom continues to meet operational performance levels and, with the Centurion standard having been declared, the United Kingdom Tornado fleet successfully has now retired from service on schedule.

In the Middle East, mobilization activity on the 24 Typhoon and nine Hawk aircraft (and associated support and training) contract for the Government of the State of Qatar has progressed to plan with milestones achieved. The first eleven of 28 major units on the Kuwait Typhoon contract, secured by Italian Eurofighter partner Leonardo, have been delivered as of June 30, 2020. The remaining major units are planned for delivery by 2022. During the first half of 2020, BAE Systems was asked to enter into negotiations with the Omani customer regarding a transition to a reduced scope support solution for the Typhoon fleet. These negotiations remain ongoing, and are expected to conclude early in the second half of 2020. The future electronically scanned European Common Radar Solution is progressing with initial entry into service contracted on Kuwait and Qatar aircraft. German and Spanish Air Forces have also awarded contracts to enhance the capability of their in-service aircraft by upgrading some of their fleet with the new radar standard.

The business now includes 85 employees engaged on the collaboration for the design and development phase of an indigenous fifth-generation fighter jet for the Turkish Air Force.

The final Italian Typhoon of the 88 aircraft Tranche 3 contract is planned to be delivered in the second half of 2020. BAE Systems is supporting Eurofighter in its bid for 38 aircraft to replace the original Typhoon Batch 1 aircraft of the German Air Force.

The business is also responsible for the development of future air system capabilities, including joint investment with the United Kingdom government and industry in next-generation combat air systems and the Tempest program which was launched in 2018 in support of the United Kingdom Combat Air Strategy. The Swedish and Italian governments are engaged with the United Kingdom government to develop these capabilities.

The Defence Information business develops, integrates and supports hardware, systems and software to maximize the value of information to customers and delivers products and services to defense, security and commercial clients in the United Kingdom and overseas. Areas of specialization include through-life capabilities in design, development, integration and testing of secure, assured networks and information systems, Tactical Data Link Integration and Simulation; Synthetic Training Software and 3D Visualization; High integrity software; Assured applications; Analytics and business intelligence and Human Factors.

Discussions continue with current and prospective customers in relation to potential further contract awards for Typhoon production and support which would extend current revenues . Defense and security remain priorities for the United Kingdom government. The United Kingdom Combat Air Strategy provides the base to enable long-term planning and investment in a key strategic part of the business.

US Programmes

The US Programmes line of business comprises BAE Systems' United Kingdom-based F-35 manufacture, engineering development and support activity. As a subcontractor to Lockheed Martin, BAE Systems is involved in the development, manufacture and sustainment of the F-35. The single engine, single seat F-35 is being produced in three variants: (i) a conventional take-off and landing ("*CTOL*") variant for the United States Air Force and, it is anticipated, most international F-35 partner countries, (ii) a short take-off and vertical landing ("*STOVL*") variant for the United States Marine Corps (as well as the United Kingdom and Italy) and (iii) an aircraft carrier ("*CV*") variant for the United States Navy and the United States Marine Corps. The participation of BAE Systems includes the design and manufacture of the aft fuselage and horizontal and vertical tails, and design and procurement of other aircraft systems, all of which are also expected to support business opportunities in the F-35 global sustainment environment.

At Royal Air Force Marham in the United Kingdom, following the declaration of Initial Operational Capability in 2018, BAE Systems continues to support its customers in integrating the F-35 into its operational fleet and forward deployments. BAE Systems also continues to play a growing role on the F-35 sustainment program including the supply of spares and technical support, software products, upgrades and specialist manpower services.

Israel, Japan, South Korea, Belgium, Singapore and Poland have selected the F-35 in addition to the United States and the international F-35 partner countries (the United Kingdom, Italy, Australia, Canada, Denmark, the Netherlands and Norway). It is believed that there are further potential export markets for the F-35. All three F-35 variants, CTOL, STOVL and CV, are in manufacture with production set to increase over prior years based on current defense budgets of existing participating countries.

BAE Systems believes that production of rear fuselage assemblies for the F-35 will ramp up to full rate by 2021. In the first half of 2020, 50 rear fuselage assemblies were delivered on the production contracts across Lots 11 to 13, falling slightly below the planned level as a result of COVID-19 coronavirus pandemic-related disruptions. Deliveries in the second half of 2020 are expected to recover, with the full year position expected to be in line with contractual requirements. The Lots 15 to 17 negotiations are expected to commence during the second half of 2020 and are likely to conclude during 2021. The business plays a significant role in the F-35 sustainment program, and revenues are set to grow as the number of aircraft deployed increases over the coming years.

Saudi Arabia

The Saudi Arabia line of business comprises BAE Systems' operational capability support to the country's air and naval forces through United Kingdom/Saudi Arabia government-to-government programs. The Saudi

British Defence Co-operation Programme and Salam Typhoon project provide for multi-year contracts between the governments.

The business continues to perform against the contract secured in 2018 to provide Typhoon support services to RSAF through to 2022.

The Saudi British Defence Co-operation Programme five-year funding agreement through to 2021 comprises a number of contracts, including support to the Tornado fleet and provision of Officer and Aircrew Training for RSAF, as well as engineering and logistics services for the RSNF. While BAE Systems continues to meet the majority of its contractual obligations under these contracts, there has been some disruption as a result of the COVID-19 coronavirus pandemic.

A total of seven Hawk aircraft assembled in-kingdom have been completed and entered service with the RSAF as of June 30, 2020, including three in the first half of 2020. BAE Systems has delivered all 22 major units to meet this final assembly program.

BAE Systems continues to reorganize its portfolio of interests in a number of industrial companies in Saudi Arabia. In February 2020, Riyadh Wings Aviation Academy LLC increased its ownership in OMC to 26.5%, and in January 2019, OMC disposed of its 85.7% shareholding in AACC. OMC also entered into a heads of terms for the sale of its 50% shareholding in AEC to SAMI, which is expected to conclude in the second half of 2020.

Through the restructuring of BAE Systems' portfolio of interests in its Saudi Arabian industrial companies, it is working in partnership with SAMI to explore how BAE Systems can collaborate to deliver further in-kingdom industrial participation, in line with the Kingdom's National Transformation Plan and Vision 2030.

BAE Systems is reliant on the continued approval of export licenses by a number of governments in order to continue supplies to Saudi Arabia. The withholding of such export licenses may have an adverse effect on BAE Systems' provision of capability to Saudi Arabia and BAE Systems will seek to work closely with the United Kingdom government to manage the impact of any such occurrence. See "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—B. Legal and regulatory risks—BAE Systems is subject to risk from a failure to comply with laws and regulations*."

Australia

The Australia line of business comprises BAE Systems' upgrade and support programs for customers in the defense and commercial sectors across the air, maritime and land domains. Services contracts include the provision of sustainment, training solutions and upgrades. The Type 26 frigate was selected for the Commonwealth of Australia's Hunter Class nine-ship Future Frigate program, with a framework agreement including the scope for the initial design and production readiness phase signed in December 2018.

The initial design and production readiness phase of the Hunter Class program for the Royal Australian Navy continues to make progress, and ASC Shipbuilding has been integrated into BAE Systems' Australian operations. The first Integrated Baseline Review for the program occurred in March 2020 as planned and handover of the new shipyard commenced as planned in July 2020. The next major milestone due to commence is prototyping, which remains on target for December 2020.

The Jindalee Operational Radar Network continues to meet operational targets and the upgrade schedule is under joint review with the Commonwealth of Australia to optimize the project delivery strategy to mitigate late delivery of a design milestone.

Final acceptance of the Royal Australian Navy's two Landing Helicopter Docks is expected in the second half of 2020.

Supply chain quality issues have affected the Hawk Mk127 Lead-In Fighter aircraft availability, however pilot training for the Australian Defence Force has not been impacted. Plans have been enacted within the supply chain which are returning availability to required levels.

Sustainment activity continues for the regional F-35 fleet at BAE Systems' Williamtown facility, with 17 aircraft on base as of July 2020.

Research and development activity in Australia has increased, with progress made supporting the Boeing Australia Loyal Wingman program and the Australian Army assessment of autonomous M113 armored personnel carriers.

The Australian business has long-term sustainment and upgrade activities in maritime, air, wide-area surveillance, missile defense and electronic systems. It has expanded into ship design and production on the Hunter Class frigate program. BAE Systems expects the Hunter Class Frigate program to drive growth in the coming years.

MBDA

MBDA is a leading global prime contractor of missiles and missile systems across the air, maritime and land domains. BAE Systems holds a 37.5% interest in the European MBDA Joint Venture.

During 2019, MBDA secured development contracts for Enhanced Modular Air Defence Solutions in Italy and for Enforcer missile systems in Germany. Further contracts for Meteor were secured for additional tranches in France and Germany, as well as an integration contract for the South Korean KF-X fighter aircraft. Other contract awards include ASRAAM for Typhoon in Oman and in Qatar (the latter having already ordered Meteor and Brimstone); and a number of key support contracts for both European domestic and international customers.

MBDA continued to win domestic and export orders during the first half of 2020, including the Brimstone Capability Upgrade Programme for the United Kingdom Armed Forces air platforms and the mid-life update of the Aster Air Defence missile for the French customer. MBDA is preparing its response to the German customer's renewed request for a further proposal iteration for TLVS (Ground-Based Air Defence System), with a contract award now anticipated in 2021.

BAE Systems believes that good progress has been made on a number of development programs including Spear Capability 3 and Aster Block 1 New Technology.

MBDA has a strong order backlog supporting future years' sales. Development programs continue to improve the long-term capabilities of the business, and as European nations embark on new combat air systems development, BAE Systems believes that MBDA will be well placed to provide the technologies and system solutions required to deliver efficient and competitive common effects for these platforms. MBDA has several significant bids underway, positioning it to benefit from defense spending in a number of European countries and from export opportunities.

Maritime

Maritime, with approximately 16,600 employees as of June 30, 2020, comprises BAE Systems' United Kingdom-based maritime and land activities.

The services sector includes the provision of class management, equipment management, maintenance and upgrade and synthetic training solutions.

The reporting segment currently comprises four lines of businesses: Naval Ships; Submarines; Maritime Services and Land UK.

Naval Ships

The Naval Ships business is responsible for the construction of five River Class Offshore Patrol Vessels and up to eight Type 26 frigates.

The first Queen Elizabeth Class aircraft carrier, HMS Queen Elizabeth, was accepted by the Ministry of Defence in December 2017. The second Queen Elizabeth Class aircraft carrier, HMS Prince of Wales, departed Rosyth in September 2019 to undertake comprehensive sea trials before entering Portsmouth for the first time in November 2019 and being accepted in December 2019. Four of the five River Class Offshore Patrol Vessels have now been accepted by the Ministry of Defence and BAE Systems is working on a schedule that would see program completion in 2020. The first three City Class Type 26 frigates are on contract with construction underway on the first two ships.

The program continues to see strong progress with all 57 units of the first of class, HMS Glasgow, in construction, of which approximately 40% are being integrated to form the ship. HMS Glasgow remains on track to be delivered to the Royal Navy in the mid-2020s. The second ship, HMS Cardiff, entered the manufacturing phase in August 2019 following the ceremonial cut steel ceremony at BAE Systems' Govan yard in Glasgow with approximately 10% of her units in construction. Investment in site infrastructure in BAE Systems' Glasgow shipyards continues with dock readiness works progressing well and new office space completed in early 2020.

Following the selection of the Type 26 platform design by the Commonwealth of Australia for its own future frigate program, the knowledge transfer program between teams in the United Kingdom and Australia is now in place with critical data being exchanged to support the Hunter Class build strategy. Preparations have also commenced for the Hunter Class Frigate program's prototyping phase where BAE Systems will build five test blocks and test the entire value chain.

BAE Systems is now in the preliminary design phase for the Canadian Surface Combatant program working with Lockheed Martin Canada and Irving Shipbuilding Inc. With the signing of a Support Services contract with Irving Shipbuilding in the first half of 2020, BAE Systems expects to start seeing opportunities to transfer product and process knowledge and share experience of complex operations.

In shipbuilding, sales are underpinned by the manufacture of Type 26 frigates.

Submarines

The Submarines business is responsible for the design and production of the Royal Navy's future Dreadnought Class submarine and the construction of seven Astute Class submarines for the Royal Navy. BAE Systems is a member of the Dreadnought Alliance, working alongside the Submarine Delivery Agency and Rolls-Royce to deliver a replacement for the Royal Navy's Vanguard class, which carries the United Kingdom's independent nuclear deterrent. Four Dreadnought Class submarines are planned to be built in Barrow, with the first of these due to be in operational service in the early 2030s. Construction of the first two Dreadnought Class submarines continues to advance, with £1.4 billion of funding received in 2019 and £0.2 billion received in the first half of 2020. The major program of investment to redevelop the Barrow site to support the delivery of Dreadnought is progressing, with several of the new facilities now complete and in operation. The first four Astute Class submarines have now been delivered to the Royal Navy. The remaining three boats are at an advanced stage of construction. The fourth boat, Audacious, left the Barrow site in April 2020 to begin sea trials with the Royal Navy. The final boat is expected to enter service in the mid-2020s.

Maritime Services

The Maritime Services business is responsible for management and maintenance of HM Naval Base Portsmouth and supports the Royal Navy's surface fleet, including the Type 45 destroyers, Queen Elizabeth Class aircraft carriers, Type 23 frigates and Hunt Class mine countermeasure vessels through the Maritime Support Delivery Framework contract, an 18-month extension of which was signed in March 2020. Maritime Services revenues are derived from the delivery of surface warship support, naval base and dockyard services at Portsmouth Naval Base, the provision of capability upgrades for radars, in-service support for torpedoes and the provision of training solutions for surface and sub-surface platforms and systems. In November 2019, HMS Prince of Wales arrived at HM Naval Base Portsmouth, her home port. In October 2019, BAE Systems was awarded the Torpedo Repair and Maintenance contract which will be performed at the Broad Oak site in Portsmouth. Further progress was made on the Spearfish torpedo upgrade program, with the demonstration phase forecast to complete in 2020. In 2019, BAE Systems was also awarded four contracts to support the repair and maintenance of over 600 small boats operated by the Royal Navy, the Royal Marines, the Royal Fleet Auxiliary, the Army and the Ministry of Defence Police over a period of six-and-a-half years. BAE Systems also secured a contract to deliver an autonomous version of its Pacific 24 sea boat under the NavyX autonomy and lethality program. The upkeep of HMS Dauntless was completed in May 2020 and the ship is the first Type 45 to enter the Power Improvement Programme, being delivered by BAE Systems, Cammell Laird and BMT. Through life support of surface ship platforms, capability upgrades for radars and in-service support for torpedoes are expected to form the basis of Maritime Services sales in the coming years.

Land UK

Land UK designs, develops and manufactures a comprehensive range of munitions products servicing its main customer, the United Kingdom Ministry of Defence, as well as international customers. In July 2019, following receipt of regulatory approvals, the business formed a joint venture with Rheinmetall (Rheinmetall BAE Systems Land Limited (RBSL)) to create a joint United Kingdom-based land vehicle design, manufacturing and support business. Rheinmetall purchased a 55% stake in the existing BAE Systems United Kingdom-based combat vehicles business for £31 million with BAE Systems retaining 45%. Land UK also develops and manufactures cased-telescoped weapons through its CTA International joint venture.

The Munitions business continues to provide United Kingdom and international customers with a wide range of light and heavy munitions, as well as offering complementary support services for development, testing and evaluation. BAE Systems continues to work with the United Kingdom Ministry of Defence to agree its Next Generation Munitions Solution, which is the proposed replacement to the existing Munitions Acquisition Supply Solution partnership agreement that completes in 2022. In the land vehicle business, the United Kingdom Ministry of Defence has awarded a contract for 500 8x8 armored vehicles to Artec GmbH (comprising Rheinmetall Military Vehicles GmbH, Rheinmetall Defence Nederland B.V. and Krauss-Maffei Wegmann). Rheinmetall Military Vehicles GmbH will subcontract approximately one half the production to RBSL which will undertake vehicle structure fabrication, assembly, integration, and test of the vehicles at its Telford facility. During 2019, 95 40mm cased-telescopic cannons were delivered to the Ministry of Defence by CTA International, bringing cumulative deliveries to 370. This entirely new cannon design, currently being integrated in the British Army's new Ajax and upgraded Warrior vehicles, has also been selected by the Belgian Army for its Jaguar vehicles. Future work will be underpinned by existing support contracts and the expected workshare on the Mechanised Infantry Vehicle Programme, the contract for which is expected to be secured in the second half of 2020.

HQ

The HQ reporting segment, with approximately 4,200 employees as of June 30, 2020, comprises the head office activities, together with a 49% interest in Air Astana.

Research and Development

BAE Systems is engaged in leading edge R&D programs, with a focus on electronic systems, platforms and its investments in cyber security. BAE Systems' R&D activities cover a wide range of programs, and include technological innovations and techniques to improve the manufacturing and service of products.

Application of this research is managed through business-focused research and development programs. BAE Systems and its partners fund strategic R&D across the business and customers fund directly much of the near-term product development work undertaken by BAE Systems.

In 2019, a significant part of R&D investments was focused on BAE Systems' Electronic Systems business in the United States where innovation spans the areas of advanced electronics, autonomy, cyber, electronic warfare and sensors and processing for applications on programs across the defense, aerospace and security domains. In the United Kingdom, BAE Systems undertook significant new R&D investment in the development of the cutting-edge technologies required for next-generation combat air systems.

Regulatory

General

As a defense company, BAE Systems is subject to various laws and regulations that are particular to the defense industry in the United Kingdom, the United States and other countries. These include restrictions on sales, export and sharing of technology and the disclosure of information. In addition, where applicable, BAE Systems' acquisitions, disposals and/or joint ventures have been subject to review by the competition authorities in the relevant jurisdictions.

Like other companies that derive a substantial portion of their sales from contracts for defense-related products, BAE Systems is subject to business risks that include changes in governmental appropriations, national defense and export control policies and regulations and availability of government funds. These factors and other risks could materially adversely affect BAE Systems' business with governments in the future.

See also "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—BAE Systems is dependent on defense spending*," "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—BAE Systems' largest customers are governments*" *and* "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—B. Legal and regulatory risks—BAE Systems is subject to risk from a failure to comply with laws and regulations.*"

United Kingdom

As a consequence of the merger between British Aerospace and the former Marconi Electronics Systems businesses in 1999, BAE Systems gave certain undertakings to the United Kingdom Secretary of State for Trade and Industry (now the Secretary of State for Business, Energy and Industrial Strategy). In February 2007, BAE Systems 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.

United States

BAE Systems, BAE Systems (Holdings) Limited, BAE Systems, Inc. and BAE Systems Holdings Inc. entered into a Special Security Agreement dated October 23, 2015 with the United States Department of Defense regarding the management of BAE Systems, Inc. in order to comply with the United States government's national security requirements. The Company was granted an extension of this Special Security Agreement that was executed on August 26, 2019, and extends the October 23, 2015 agreement through December 31, 2022.

Australia

BAE Systems and certain of its wholly owned Australian subsidiaries entered into an Overarching Deed with the Commonwealth of Australia dated June 19, 2008 regarding the management of the BAE Systems Australian business in order to protect the Commonwealth of Australia's national security and other interests following the acquisition by BAE Systems of Tenix Defence Holdings Pty Ltd.

Government Contracts

Some government contracts, including United States and United Kingdom government contracts, are, by their terms, subject to termination by the contracting government either for its convenience or default by the contractor. Such contracts typically provide for payment upon termination for items delivered to and accepted by the government, and, if termination is for convenience, for payment of fair compensation of work performed (with profits) plus the costs of settling and paying claims by terminated subcontractors, and for payment of other settlement expenses. Typically, however, if a contract termination is for default (i) the contractor is paid an amount agreed upon for completed and partially completed products and services already accepted by the government, (ii) the government is not liable for the contractor's costs with respect to unaccepted items, and is entitled to repayment of advance payments and progress payments, if any, and (iii) the contractor may be liable for costs incurred by the government in procuring undelivered items from another source or for the government's costs and expenses in rectifying contract deliverables in order that they comply with the contract.

In addition to the right of governments to terminate contracts, government contracts, particularly in the United States, are conditional upon the continuing appropriation of funds by legislative bodies. Most notably, funds for United States government contracts are often appropriated for particular projects on a fiscal year basis, even though contract performance may take many years to complete. Consequently, at the outset of a major United States program, the contract may be partially funded, and additional monies are normally committed to the contract by the procuring agency only as appropriations are made by the relevant legislative body for future fiscal years.

See also "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—BAE Systems is dependent on defense spending*" and "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—BAE Systems' largest customers are governments.*"

Environmental, Health and Safety ("EHS") Regulation and Liability

BAE Systems is subject to comprehensive EHS laws and regulations in each of the countries in which it operates. Such laws and regulations impose standards with respect to air emissions, wastewater discharges, the use, handling and storage of hazardous wastes and materials, remediation of soil and ground water contamination and the prevention of pollution. Violations of and/or liabilities under such laws and regulations can result in substantial costs, including fines, penalties or other sanctions, investigation and cleanup costs, and third-party claims for property damage or personal injury. Although EHS requirements are most highly developed and restrictive in the United Kingdom, continental Europe, the United States and Australia, such requirements are developing rapidly in other countries as well. Increasing EHS regulation exposes BAE Systems to increasing capital and operating costs associated with compliance, remediation and protection of human health and the environment.

BAE Systems has a long history of industrial operations and may incur liability for the cost of investigation and cleanup if contamination is discovered at one of its current or former facilities, in some circumstances even if such contamination was caused by a prior owner or other third party. BAE Systems also may incur liability if contamination is discovered at a landfill or other locations where it may have sent wastes for disposal, even where historic disposal practices were conducted in accordance with all applicable requirements at the time of disposal. BAE Systems and its subsidiaries have been identified as responsible parties for investigation and remediation costs at certain contaminated sites, including at and/or in the vicinity of current and former sites. Based upon currently available information about the nature and extent of the contamination, as well as the likely participation of other responsible parties, BAE Systems does not believe that the cost of the environmental cleanup for these sites will have a material adverse effect on its financial condition. See note 24 to the BAE Systems 2019 Annual Financial Statements for further details.

Employees

At June 30, 2020, BAE Systems' workforce amounted to approximately 88,400 employees, including share of equity accounted investments. At June 30, 2020, in the United Kingdom, approximately 55% of staff were members of trade unions and 69% were covered by collective bargaining agreements and, in the United States, BAE Systems had approximately 3,500 employees covered by a collective bargaining agreement. There is also a population of employees in Australia who are members of trade unions, and to whom local site-based collective bargaining arrangements apply.

In recent years, BAE Systems has made reductions to its workforce and continues to review its workforce requirements in light of changing market conditions. While reductions in the workforce can increase the likelihood of industrial action causing workforce disruption, BAE Systems' approach to managing any proposed reductions has meant that it has been possible to complete these programs without significant workforce disruption. It is BAE Systems' expectation that any further proposed reductions would be similarly executed.

The following table shows BAE Systems' number of employees by reporting segment, including its share of equity accounted investments, at June 30, 2020.

Employees by Reporting Segment	As of June 30, 2020
Electronic Systems	16,300
Cyber & Intelligence	9,900
Platforms & Services (US)	12,600
Air	28,800
Maritime	16,600
HQ	4,200
Total Employees	**88,400**

BAE Systems has adopted various share-based incentive plans for directors, management and employees. These plans are described in note 30 to the BAE Systems 2019 Annual Financial Statements. BAE Systems also operates pension plans for its qualifying employees in the United Kingdom, the United States and other countries. See note 6 to the BAE Systems Interim Financial Statements and note 23 to the BAE Systems 2019 Annual Financial Statements.

Real and Intellectual Property

Real Property

BAE Systems owns or leases approximately 3.9 million square meters of buildings in the United Kingdom, the United States and Australia and approximately 2,800 hectares of land in the United Kingdom. BAE Systems believes that its main facilities are adequate for its present needs and, as supplemented by planned improvements and construction, are expected to remain adequate for the foreseeable future.

Intellectual Property

The use of intellectual property rights enables BAE Systems to prevent competitors from exploiting protected technologies and imitating protected brands. BAE Systems' Operational Framework mandates a policy to protect BAE Systems' intellectual property (including patents, copyrights and trademarks) through appropriate use and observance of intellectual property law, so that returns made from the investment in research and development and technological innovation and commercial and business innovations are adequately safeguarded.

BAE Systems does not believe that the loss of any single patent or trademark would have a material adverse effect on its operations or financial condition. In addition, it is BAE Systems' policy to ensure that the resources associated with the protection and exploitation of intellectual property are deployed efficiently and in a manner that seeks to obtain the appropriate level of protection for such assets.

Legal Proceedings

BAE Systems is involved in a number of claims and arbitrations that have arisen in the ordinary course of business. BAE Systems believes that it has made adequate provisions to cover current or contemplated general and specific litigation risks. See note 12 to the BAE Systems Interim Financial Statements and note 24 to the BAE Systems 2019 Annual Financial Statements for further details. Reflecting the inherent uncertainty within many legal proceedings, the timing and amount of the outflows could differ significantly from the amount provided.

BAE Systems is not, and, during the 12 months preceding the date of this Offering Memorandum, has not been, involved in any governmental, legal or arbitration proceeding (including any such proceedings which are pending or threatened of which the Issuer is aware) which may have or have had in the recent past significant effects on the financial position or profitability of the Issuer or BAE Systems.

MANAGEMENT

Board of Directors, Chairman and Chief Executive Officer of the Issuer

The Board of Directors presently consists of twelve directors, three of whom are executives of the Issuer and nine of whom (including the Chairman) serve in a non-executive capacity.

The Board of Directors is scheduled to meet eight times each year, with additional meetings called on an ad hoc basis. All directors receive regular information on BAE Systems' operational and financial performance. Among other things, each year the Board of Directors formally reviews BAE Systems' business plan, strategy, management resources, investor relations, corporate social responsibility matters and risk management. The Board of Directors has agreed to a schedule of matters that are reserved to it for decision.

The Board of Directors has established four principal standing committees: the Audit Committee, the Corporate Responsibility Committee, the Nominations Committee and the Remuneration Committee.

The Audit Committee is responsible for reviewing in detail the effectiveness of BAE Systems' risk management and internal control systems. Additionally, among other things, the Audit Committee makes recommendations to the Board of Directors on the appointment of the auditors, reviews all significant issues concerning the financial statements and is also responsible for assessing audit independence and effectiveness.

The Corporate Responsibility Committee is responsible for setting BAE Systems' priorities and objectives relating to corporate responsibility-related matters, with a particular focus on health and safety, ethics and responsible business conduct, responsible trading principles, diversity and inclusion, stakeholder and workforce engagement and supplier conduct. In addition, the Corporate Responsibility Committee monitors and reviews BAE Systems' performance in managing operational and reputational risk.

The Nominations Committee is responsible for matters relating to the engagement of new directors. This includes identifying and nominating candidates for both Executive and Non-Executive directorship vacancies for the Board of Directors' approval.

The Remuneration Committee is responsible for setting, among other things, the remuneration and benefits payable to the Executive Directors. This includes approving any annual and long-term incentive plans-based remuneration and selecting and weighing performance metrics used for such plans. The Remuneration Committee also sets the remuneration of the Chairman.

Name	Age	Position
Sir Roger Carr	73	Chairman
Executive Directors		
Charles Woodburn	49	Chief Executive
Tom Arseneault	57	Chief Executive Officer of BAE Systems, Inc.
Brad Greve	53	Group Finance Director
Non-Executive Directors		
Dame Elizabeth Corley	63	Non-Executive Director
Jane Griffiths	64	Non-Executive Director
Chris Grigg	61	Non-Executive Director
Stephen Pearce	56	Non-Executive Director
Nicole Piasecki	58	Non-Executive Director
Nick Rose	62	Non-Executive Director
Paula Rosput Reynolds	63	Non-Executive Director
Ian Tyler	60	Non-Executive Director

The Board of Directors initially appoints directors, who serve until the next Annual General Meeting ("*AGM*"), at which time the Issuer's Articles of Association require the new directors to retire and seek reelection. The Non-Executive Directors are usually appointed for an initial three-year term that, subject to review, may be extended subsequently for further such terms. All directors are subject to annual election or re-election at the AGM.

The Board of Directors will be looking to make a further Non-Executive Director appointment in 2020.

Executive Directors

Charles Woodburn, Chief Executive. Mr. Woodburn was appointed as Chief Executive on July 1, 2017, having originally been appointed to the Board of Directors as Chief Operating Officer in May 2016. Prior to joining BAE Systems, he spent over 20 years in the oil and gas industry, holding a number of senior management positions in the Far East, Australia, Europe and the United States. He joined BAE Systems from the oilfield services business, Expro Group, where he served as Chief Executive Officer. Prior to that, he spent 15 years with Schlumberger Limited.

Tom Arseneault, President and Chief Executive Officer of BAE Systems, Inc. Mr. Arseneault was appointed as President and Chief Executive Officer of BAE Systems, Inc. and to the Board of Directors on April 1, 2020, having previously served as the President and Chief Operating Officer of BAE Systems, Inc. Prior to that, Mr. Arseneault held the positions of President of the Electronic Systems sector, where he was responsible for the reporting segment's operations spanning commercial and defense electronics markets, and its broad portfolio of vehicle and mission critical electronic systems, and Executive Vice President of the legacy Product sectors, where he was responsible for business performance across the Electronic Systems and legacy Land & Armaments businesses. Prior to his senior leadership appointments, Mr. Arseneault managed various organizations and programs for Sanders, a Lockheed Martin Company, which was acquired by BAE Systems in 2000. Earlier in his career, he held a variety of engineering and program management positions with General Electric, The Analytic Sciences Corporation, and Weather Services International.

Brad Greve, Group Finance Director. Mr. Greve was appointed as Group Finance Director and to the Board of Directors on April 1, 2020, having previously served as Group Finance Director designate after being recruited in September 2019 from a senior financial role at Schlumberger. Prior to joining BAE Systems, Mr. Greve spent over 30 years in the energy industry, holding a number of leadership positions including Head of Finance for the group of companies called Wells, which accounted for nearly 70% of Schlumberger's overall profit. He also served as Director of Internal Audit in addition to numerous other Finance Director roles and assignments in the United Kingdom, Romania, Nigeria, Italy, France, Brazil, and the United States.

Non-Executive Directors

Sir Roger Carr, Chairman. Sir Roger joined the Board of Directors on October 1, 2013, as Chairman designate and was appointed as Chairman in February 2014. He was chairman of the board of Centrica plc from 2004 until he stepped down from that role on December 31, 2013. He has previously held a number of senior appointments including Chairman of Cadbury plc, Thames Water plc and Mitchells & Butlers plc, President of the Confederation of British Industry, Vice Chairman of the BBC Trust and Senior Independent Director of the Court of the Bank of England. Throughout his career, he has served on a number of external committees, including the United Kingdom Prime Minister's Business Advisory Group, the Higgs Committee on Corporate Governance and Business for New Europe. Sir Roger chairs the Nominations Committee. He is a senior advisor to Kohlberg Kravis Roberts and chairman of the English National Ballet. He is a fellow of the Royal Society for the encouragement of the Arts, Manufactures and Commerce, and a visiting fellow to the Said Business School, Oxford.

Dame Elizabeth Corley CBE, Non-Executive Director. Dame Elizabeth currently chairs the board of the Impact Investment Institute, having previously been chair of the industry taskforce for the United Kingdom government on social impact investing. She has served as Chief Executive Officer of Allianz Global Investors, initially for Europe, then globally, from 2005 to 2016. Prior to that, she worked for Merrill Lynch Investment Managers. Dame Elizabeth is active in representing the investment industry and developing standards within it. She is a member of the CFA Future of Finance Advisory Council and the AQR Institute of Asset Management at the London Business School. In 2017, she stepped down from the board of the UK Financial Reporting Council after completing her second three-year term of appointment. Dame Elizabeth was appointed a Non-Executive Director in 2016.

Jane Griffiths, Non-Executive Director. Ms. Griffiths is currently a non-executive director of Johnson Matthey Plc and a member of the board of directors of TB Alliance, a not-for-profit organization. Prior to her retirement in December 2019, Ms. Griffiths enjoyed a long career with Johnson & Johnson during which she held executive roles in clinical research, international and strategic marketing, product management and operational management. In her last role before retirement, Ms. Griffiths was Global Head of Actelion, where she led the integration of the Swiss biotech business following its acquisition by Johnson & Johnson. Prior to that, she served as Company Group Chair of Janssen EMEA, the group's research-based pharmaceutical arm. During her time at Johnson & Johnson, Ms. Griffiths led its Corporate Citizen Trust in EMEA and sponsored its Women's Leadership Initiative and the Janssen's Global Pharmaceuticals Sustainability Council. She also served as chair of the Executive Committee of the European Federation of Pharmaceutical Industries and Associations, as Chairwoman of the PhRMA Europe Committee and as a member of the Corporate Advisory Board of the 'Your Life' campaign backed by the United Kingdom government. Ms. Griffiths was appointed a Non-Executive Director in 2020.

Chris Grigg, Non-Executive Director. Mr. Grigg is Chief Executive of The British Land Company PLC and has more than 30 years' experience in the financial and real estate industries in a range of leadership roles. Prior to joining British Land as its chief executive in 2009, he was an executive with Barclays Bank and a partner at Goldman, Sachs & Co. Mr. Grigg was appointed a Non-Executive Director in 2013 and assumed the role of Senior Independent Director effective April 1, 2020.

Stephen Pearce, Non-Executive Director. Mr. Pearce is currently Finance Director of Anglo American plc, a role he has held since April 2017. He has more than 16 years of public company director experience and over 30 years of financial and commercial experience in the mining, oil and gas, and utilities industries. Prior to joining Anglo American, Stephen served as CFO and an executive director of the Australian iron ore company Fortescue Metals Group Limited from 2010-2016. He is a Fellow of the Institute of Chartered Accountants, a Member of the Governance Institute of Australia and a member of the Australian Institute of Company Directors. Mr. Pearce is Chair of the Audit Committee and was appointed a Non-Executive Director in 2019.

Nicole Piasecki, Non-Executive Director. Ms. Piasecki was Vice President and General Manager of the Propulsion Systems Division of Boeing's commercial aircraft business until September 2017. She previously held a number of engineering, sales, marketing and business strategy roles during her 25-year career with The Boeing Company, including Senior Vice President—Business Development & Strategic Integration and Vice President of Business Strategy and Marketing for Boeing Commercial Airplanes. She also served as President of Boeing Japan. She is currently a director of Weyerhaeuser Company, the US forestry products group, and is Chair of the Board of Trustees of Seattle University. She 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. Ms. Piasecki was appointed a Non-Executive Director in 2019.

Nick Rose, Non-Executive Director. Mr. Rose is currently non-executive chairman of Williams Grand Prix Holdings PLC, non-executive director and senior independent director of BT Group plc and non-executive chairman of Loch Lomond Group. He is also an adviser to CCMP Capital Advisors, LLC. He has considerable financial expertise and boardroom experience and was formerly Chief Financial Officer of Diageo plc for over ten years until 2010. In this role, he was responsible for supply, procurement, strategy and IT on a global basis. His financial experience was developed during his time as group treasurer and group controller at Diageo, and also in his earlier career at Ford Finance. He is a former Chairman of the engineering technology company Edwards Group Limited and former non-executive director of Moët Hennessy SNC and Scottish Power plc. Mr. Rose was appointed Non-Executive Director in 2010 and served as the Senior Independent Director until March 31, 2020. Mr. Rose was expected to retire as a Non-Executive Director on March 31, 2020 but has agreed to extend his term of appointment as a Non-Executive Director for up to one further year in order to support BAE Systems through a challenging period associated with the COVID-19 coronavirus pandemic.

Paula Rosput Reynolds, Non-Executive Director. Ms. Rosput Reynolds is chief executive officer and president of the business advisory group PreferWest, LLC. She had previously spent over 20 years in the energy sector in a variety of operational roles, culminating in her appointment as president and chief executive officer of AGL Resources in 2002. She subsequently served as president and chief executive officer of Safeco Corporation (Safeco), an insurance company located in Seattle, Washington. She was then appointed as vice chairman and chief restructuring officer of American International Group Inc. (AIG) from October 2008 to September 2009. She is a non-executive director of BP p.l.c. and General Electric Company. She is a former non-executive director of Coca-Cola Enterprises, Inc., Air Products and Chemicals, Inc., Delta Air Lines, Inc., Anadarko Petroleum Corporation and TransCanada Corporation. Ms. Rosput Reynolds chairs the Remuneration Committee and was appointed a Non-Executive Director in 2011. It is anticipated that Ms. Rosput Reynolds will retire from the Board of Directors in April 2021, when Ian Tyler is expected to succeed her as Chair of the Remuneration Committee.

Ian Tyler, Non-Executive Director. Mr. Tyler is currently Chairman of Cairn Energy PLC and Vistry Group PLC (formerly Bovis Homes Group PLC). Previously, he served as Chief Executive of Balfour Beatty plc for a period of eight years stepping down from that position in 2013. A Chartered Accountant, he joined Balfour Beatty as Finance Director in 1996 having spent his earlier career in a variety of finance roles. He is a former non-executive director of Cable & Wireless Communications Plc and VT Group plc. Mr. Tyler chairs the Corporate Responsibility Committee and was appointed a Non-Executive Director in 2013. He is expected to succeed Paula Rosput Reynolds in her role as Chair of the Remuneration Committee in April 2021.

The business address of each of the directors is c/o 6 Carlton Gardens, London, SW1Y 5AD, United Kingdom.

There are no actual or potential conflicts of interest between the duties to BAE Systems of any of the directors and his/her private interests and/or other duties.

Remuneration

The overall remuneration package for Executive Directors consists of base salary, an incentive designed to reward annual performance on both financial and non-financial metrics, long-term incentives based on share awards, and retirement and other benefits. All Executive Directors are required to establish and maintain a minimum personal shareholding equal in value to 300% of base salary in the case of the Chief Executive, 200% of annual base salary in the case of the Group Finance Director, and 425% of base salary in the case of the Chief Executive Officer of BAE Systems, Inc. As a minimum, a holding equal to one half of the prescribed percentage of annual base salary must be achieved as quickly as possible using shares vesting or options exercised through the executive share option schemes or long-term incentive schemes, by retaining 50% of the net value of the shares that vest or the options that are exercised on each occasion. Thereafter, Executive Directors are required to increase their personal shareholding gradually, on each occasion retaining 25% of the shares that vest or the options exercised each year, until a personal shareholding equal to the prescribed percentage of annual base salary is achieved and maintained.

The Executive Directors have contracts requiring BAE Systems to give not less than 12 months' notice of termination. No Executive Director has provisions in his service contract that relate to a change of control of BAE Systems. The Executive Directors are also members of group pension schemes.

It is the Board of Directors' policy that Non-Executive Directors do not have service contracts, but do have letters of appointment detailing the basis of their appointment. The Nominations Committee proposes candidates, and the Board of Directors appoints them based on their experience to provide independent judgment on issues of strategy, performance, resources and standards of conduct. The Non-Executive Directors' Fees Committee agrees on the level of fees payable to Non-Executive Directors (other than the Chairman) after reviewing practice in other comparable companies. Non-Executive Directors do not participate in the annual incentive scheme or long-term incentive plans and do not receive retirement benefits.

For the year ended December 31, 2019, the single total figure of remuneration for the Chairman, the Chief Executive, the other Executive Directors of 2019 and the Non-Executive Directors of 2019 paid by BAE Systems was £0.700 million, £3.934 million, £7.849 million and £0.877 million, respectively.

Audit Committee

The current members of BAE Systems' Audit Committee are:

- Stephen Pearce (Chairman)
- Dame Elizabeth Corley
- Ian Tyler

All members of the Audit Committee are independent Non-Executive Directors. The Audit Committee has requested that the Chief Executive, Group Finance Director, Group Financial Controller and the head of internal audit normally attend its meetings. Each year, the Audit Committee holds individual meetings without group executives present, with and without the head of internal audit and the external auditors present. BAE Systems' external auditors and head of internal audit have direct access to the Chairman of the Audit Committee.

The Audit Committee may obtain at BAE Systems' expense independent professional advice on any matters covered by its terms of reference.

The Audit Committee's tasks include the following:

- reviewing the effectiveness of BAE Systems' financial reporting, internal control policies and procedures for the identification, assessment and reporting of risk;
- monitoring the integrity of BAE Systems' financial statements;
- monitoring the role and effectiveness of the internal audit function;
- approving an annual program of internal audit work and reviewing its output;
- making recommendations to the Board of Directors on the appointment of the auditors;
- agreeing the scope of the auditors' annual audit program and reviewing the output;
- keeping the relationship with the auditors under review;
- assessing the effectiveness of the audit process; and
- developing and implementing policy on the engagement of the auditors to supply non-audit services.

Special Share

BAE Systems has issued one 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 BAE Systems' 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 BAE Systems, 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 BAE Systems' 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 BAE Systems to redeem the Special Share at par or convert the Special Share into one ordinary share at any time.

DESCRIPTION OF SECURITIES

The following is a summary of the material provisions of the Fiscal and Paying Agency Agreement and the Securities, each as defined below. The summary does not purport to be complete and is qualified in its entirety by reference to all of the provisions of the Fiscal and Paying Agency Agreement and the Securities, copies of which will be available for inspection during normal business hours at any time after the closing date at the offices of the Fiscal and Paying Agent. Any capitalized term used herein but not defined shall have the meaning assigned to such term in the Fiscal and Paying Agency Agreement.

BAE Systems plc (the "*Issuer*") is offering $1,000,000,000 aggregate principal amount of its 1.900% Notes due 2031 (the "*2031 Notes*") and $1,000,000,000 aggregate principal amount of its 3.000% Notes due 2050 (the "*2050 Notes*" and, together with the 2031 Notes, the "*Securities*"). The 2031 Notes and the 2050 Notes will mature on February 15, 2031 and September 15, 2050, respectively, (in each case, the "*Stated Maturity Date*" of the respective Series (as defined below)), and upon surrender will be repaid at 100% of the principal amount thereof together with any unpaid and accrued interest. Application has been made to the FCA for the Securities to be admitted to the Official List and to the London Stock Exchange for the Securities to be admitted to trading on the Market. The 2031 Notes and the 2050 Notes each constitute a separate series of debt securities to be issued under the Fiscal and Paying Agency Agreement (each a "*Series*") but will be treated as a single class for all purposes under the Fiscal and Paying Agency Agreement.

Principal (and premium, if any) of and interest (and any Additional Amounts, if any) on the Securities are payable in U.S. dollars, or in such other coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts. Interest on the Securities will be payable semi-annually in arrears on February 15 and August 15 of each year (in the case of the 2031 Notes), commencing on February 15, 2021 and on March 15 and September 15 of each year (in the case of the 2050 Notes), commencing on March 15, 2021, and until the principal amount has been paid or made available for payment, to holders of Securities at the close of business on the respective Record Date (as defined below). Interest on the Securities shall be calculated on the basis of a 360-day year of twelve 30-day months. The Securities will not be entitled to the benefit of any sinking fund. A "*Business Day*" for the Securities shall be a day which is not, in London or New York City, a Saturday, Sunday, a legal holiday or a day on which banking institutions are authorized or obligated by law to close.

The aggregate principal amount of Securities issuable under the Fiscal and Paying Agency Agreement (as defined below) is unlimited. The Issuer may from time to time without the consent of the holders of the Securities issue further debt securities having the same terms and conditions as the relevant Series of Securities so that the further issue is consolidated and forms a single Series of notes with the 2031 Notes or the 2050 Notes, as applicable, having the same terms, other than issue date, interest commencement date, issue price and in some cases, the first interest payment date; *provided* that, unless issued under a separate CUSIP number, such additional debt securities will be fungible with the applicable outstanding Securities for U.S. Federal income tax purposes. The period of the resale restrictions applicable to any Securities previously offered and sold in reliance on Rule 144A under the Securities Act shall automatically be extended to the last day of the period of any resale restrictions imposed on any such additional Securities.

The Securities will be issued under a Fiscal and Paying Agency Agreement dated as of September 15, 2020 (the "*Fiscal and Paying Agency Agreement*") among the Issuer, Citibank, N.A., London Branch, as fiscal and paying agent (the "*Fiscal and Paying Agent*") and Citigroup Global Markets Europe AG, as registrar. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the Fiscal and Paying Agency Agreement and the Securities.

All Securities surrendered for payment or exchange shall be delivered to the Fiscal and Paying Agent. The Fiscal and Paying Agent shall cancel and may destroy all such Securities surrendered for payment or exchange, in accordance with its note destruction policy, and if Securities are destroyed, the Fiscal and Paying Agent shall deliver a certificate of destruction to the Issuer.

The Securities

The 2031 Notes will mature on February 15, 2031 and the 2050 Notes will mature on September 15, 2050. The 2031 Notes and the 2050 Notes will bear interest from September 15, 2020, and interest will be payable semi-annually in arrears on each February 15 and August 15 (in the case of the 2031 Notes) and each March 15 and September 15 (in the case of the 2050 Notes) (each such date, an "*Interest Payment Date*"), commencing

February 15, 2021 at the rate of 1.900% per year (in the case of the 2031 Notes) and March 15, 2021 at the rate of 3.000% per year (in the case of the 2050 Notes) and to the holders in whose names the 2031 Notes or the 2050 Notes, as applicable, are registered at the close of business on the February 1 and August 1 (in the case of the 2031 Notes) and March 1 and September 1 (in the case of the 2050 Notes) preceding such Interest Payment Date (whether or not a Business Day), immediately preceding the related interest payment date, each such date, a "*Record Date.*"

If any Interest Payment Date or Stated Maturity Date (or the date of redemption) with respect to any Securities falls on a day that is not a Business Day, the required payment of principal and/or interest will be made on the next succeeding Business Day as if made on the date such payment was due, and no interest will accrue on such payment for the period from and after such Interest Payment Date or Stated Maturity Date (or the date of redemption), as the case may be, to the date of such payment on the next succeeding Business Day.

Prescription

Amounts held by the Fiscal and Paying Agent for payment of the principal (and premium, if any) of and interest on any Securities need not be segregated from other funds except as required by law, and will be applied as set forth in the Fiscal and Paying Agency Agreement and in the Securities. Any amounts held by the Fiscal and Paying Agent for the payment of the principal (and premium, if any) of or interest on any Securities which remain unclaimed for two years after such principal (and premium, if any) or interest has become due and payable and paid to the Fiscal and Paying Agent shall be repaid to the Issuer upon its written request, and all liability of the Fiscal and Paying Agent with respect to such amounts shall cease. Any funds held by the Fiscal and Paying Agent will be held by it as a banker and not subject to the UK FCA Client Money Rules.

Rank

The Securities will constitute direct, unsecured and unsubordinated obligations of the Issuer and will rank *pari passu* among themselves and with all other existing and future direct, unsecured and unsubordinated obligations of the Issuer (except those obligations preferred by statute or operation of law). The Securities will effectively rank junior to any existing and future secured indebtedness of the Issuer to the extent of the assets securing such indebtedness and to any existing and future indebtedness of the Issuer's subsidiaries to the extent of the assets of such subsidiaries.

The Fiscal and Paying Agency Agreement contains no restrictions on the amount of additional indebtedness which may be incurred by the Issuer; however, the Fiscal and Paying Agency Agreement contains certain restrictions on the ability of the Issuer to secure certain of its indebtedness. See " *—Certain Covenants.*"

Governing Law

The Fiscal and Paying Agency Agreement and the Securities will be governed by the laws of the State of New York.

Optional Redemption

Each Series of the Securities will be redeemable at the option of the Issuer, in whole or in part, at any time upon giving not less than 10 nor more than 60 days' notice to the holders, at a redemption price equal to the greater of (i) 100% of the outstanding principal amount of the Securities to be redeemed plus accrued but unpaid interest, if any, to the date fixed by the Issuer for redemption and all Additional Amounts, if any, then due and (ii) the sum of the present values of the Remaining Scheduled Payments (as hereinafter defined) thereon discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate plus 20 basis points (in the case of the 2031 Notes) or the Treasury Rate plus 25 basis points (in the case of the 2050 Notes); *provided* that if any Securities are redeemed on or after the applicable Par Call Date, the redemption price for such Securities will equal 100% of the aggregate principal amount of such Securities redeemed, plus accrued but unpaid interest, if any, to, but not including, the date fixed by the Issuer for redemption. The Issuer shall determine the redemption price of the Securities and shall promptly notify the Fiscal and Paying Agent of the redemption price so determined.

"*Comparable Treasury Issue*" means the United States Treasury security selected by the Independent Investment Banker as having a maturity comparable to the remaining term of the Securities to be redeemed (assuming the Securities mature on the applicable Par Call Date) that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of such Securities (assuming such Securities mature on the applicable Par Call Date).

"*Comparable Treasury Price*" means, with respect to any redemption date prior to the applicable Par Call Date, (1) the average of the Reference Treasury Dealer Quotations for such redemption date, after excluding the highest and lowest such Reference Treasury Dealer Quotations or (2) if the Independent Investment Banker obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such quotations or, if only one such quotation is obtained, such quotation.

"*Independent Investment Banker*" means the Reference Treasury Dealer appointed by the Issuer.

"Par Call Date" means November 15, 2030 for any 2031 Notes (the date that is three months prior to the maturity of the 2031 Notes) and March 15, 2050 for any 2050 Notes (the date that is six months prior to the maturity of the 2050 Notes).

"*Reference Treasury Dealer*" means each of Barclays Capital Inc., BofA Securities, Inc., Citigroup Global Markets Inc., RBC Capital Markets, LLC and Wells Fargo Securities, LLC and their respective successors and two other nationally recognized investment banking firms that are Primary Treasury Dealers (as defined below) specified from time to time by the Issuer; *provided, however*, that if any of the foregoing shall cease to be a primary U.S. Government securities dealer in New York City (a "*Primary Treasury Dealer*"), the Issuer shall substitute therefor another nationally recognized investment banking firm that is a Primary Treasury Dealer.

"*Reference Treasury Dealer Quotations*" means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by the Independent Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Independent Investment Banker by such Reference Treasury Dealer at 3:30 p.m. United States Eastern Time on the third Business Day preceding such redemption date.

"*Remaining Scheduled Payments*" means, with respect to the Securities to be redeemed, the remaining scheduled payments of the principal thereof to be redeemed and interest thereon to the applicable Par Call Date that would be due after the related redemption date but for such redemption; *provided, however*, that, if such redemption date is not an Interest Payment Date with respect to such Securities, the amount of the next succeeding scheduled interest payment thereon will be reduced by the amount of interest accrued thereon to such redemption date.

"*Treasury Rate*" means, with respect to any redemption date, the rate per annum equal to the semi-annual equivalent yield to maturity of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date.

Notice of any redemption will be given by the Issuer by first-class mail at least 10 days but no more than 60 days before the redemption date to the holders of the Securities to be redeemed and to the Fiscal and Paying Agent.

Any redemption and notice may, in the Issuer's discretion, be subject to one or more conditions precedent and, in the Issuer's discretion, the redemption date may be delayed until such time as any or all such conditions precedent included in the Issuer's discretion shall be satisfied (or waived by the Issuer) or the redemption date may not occur and such notice may be rescinded if all such conditions precedent included in the Issuer's discretion shall not have been satisfied (or waived by the Issuer).

Unless the Issuer defaults in payment of the redemption price, on and after the redemption date interest will cease to accrue on the Securities or portions thereof called for redemption.

Additional Amounts

All payments of principal and interest (and premium, if any) by the Issuer in respect of the Securities shall be made without withholding or deduction for or on account of any present or future taxes, duties, assessments, or other governmental charges of whatsoever nature imposed or levied ("*Taxes*") by or on behalf of the United Kingdom or any political subdivision or taxing authority thereof or therein having power to tax, any jurisdiction in which the Issuer is organized, the jurisdiction of residence of the Issuer for tax purposes or any jurisdiction from or through which any amount is paid by the Issuer (or any political subdivision or taxing authority of or in any such jurisdiction) (a "*Taxing Jurisdiction*"), unless such withholding or deduction is required by law. If the Issuer is compelled by the law of a Taxing Jurisdiction to deduct or withhold such Taxes in respect of any amount to be paid by the Issuer on the Securities, then the Issuer shall pay such additional amounts ("*Additional Amounts*") as may be necessary to ensure that the amounts received by each holder of a Security after such withholding or deduction (including any withholding or deduction with respect to such Additional Amounts) shall equal the amount of principal (and premium, if any) and interest which such holder would have received in respect of each Security in the absence of such withholding or deduction; *provided, however,* that the Issuer shall not be required to make any payment of Additional Amounts to a holder for or on account of:

(i) any Tax which would not have been imposed but for (a) the existence of any present or former connection between such holder (or between a fiduciary, settlor, beneficiary, member or shareholder of, or possessor of a power over, such holder, if such holder is an estate, trust, partnership, corporation or other Person) and the Taxing Jurisdiction including, without limitation, such holder (or such fiduciary, settlor, beneficiary, member, shareholder or possessor) being or having been a domiciliary, national or resident thereof or being or having been present or engaged in trade or business therein or having or having had a permanent establishment therein or otherwise having or having had some connection with the Taxing Jurisdiction other than the holding or ownership of a Security or the collection of principal (and premium, if any) of and interest, if any, on, or the enforcement of, a Security or (b) the presentation of a Security for payment (x) on a date more than 30 days after the date on which such payment became due and payable or the date on which payment thereof is duly provided for, whichever occurs later, except to the extent that the holder would have been entitled to such Additional Amounts if it had presented such Security for payment on the last day of such period of 30 days, or (y) by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting for payment to another fiscal or paying agent in a member state of the European Union;

(ii) any estate, inheritance, gift, sale, transfer, personal property or similar Tax;

(iii) any Tax which is payable otherwise than by deduction or withholding from payments of (or in respect of) principal (and premium, if any) of, or any interest on the Securities;

(iv) any Tax that is imposed or withheld by reason of the failure to comply by the holder or, if different, the beneficial owner of the Security or the payment in question with a request of the Issuer addressed to the holder (a) to provide information concerning the nationality, residence, identity or place of incorporation or organization of the holder or such beneficial owner or (b) to make any declaration or other similar claim to satisfy any information or reporting requirement, which in the case of (a) or (b), is required or imposed by a statute, treaty, regulation or administrative practice of the Taxing Jurisdiction as a precondition to exemption from all or part of such Tax; *provided* that the Issuer has given the holder or the beneficial owner at least 30 days' notice that the holder or beneficial owner will be required to provide such information, declaration or other reporting requirement;

(v) any Tax imposed, deducted or withheld pursuant to section 1471(b) of the Code or otherwise imposed pursuant to sections 1471 through 1474 of the Code, in each case, as of the issue date (and any amended or successor version that is substantively comparable), any current or future regulations or agreements thereunder, official interpretations thereof or similar law or regulation implementing an intergovernmental agreement relating thereto; or

(vi) any combination of clauses (i) through (v) above;

nor shall Additional Amounts be paid with respect to any payment of the principal (and premium, if any) of, or any interest on, any Security to any holder of a Security who is a fiduciary or partnership or other than the sole beneficial owner of such payment to the extent such payment would be required by the laws of the United Kingdom (or any political subdivision or taxing authority thereof or therein) to be included in the income for tax purposes of a beneficiary or settlor with respect to such fiduciary or a member of such partnership or a beneficial owner who would not have been entitled to such Additional Amounts had it been the holder of such Security.

The Issuer will make all withholdings and deductions as required by law and will timely remit the full amount deducted or withheld to the relevant Tax authority in accordance with applicable law.

Within 60 days after the date of any payment of any Tax in respect of any payment under any Security pursuant to the provisions set forth above, the Issuer shall furnish to each holder of a Security the original tax receipt for the payment of such Tax (or, if such original tax receipt is not available, a duly certified copy of any original tax receipt) together with such other documentary evidence with respect to such payments as may be reasonably requested from time to time by any holder or beneficial owner of a Security.

The obligations of the Issuer set forth above shall survive the transfer or payment of a Security. The Issuer will pay any present or future stamp, court or documentary taxes or any other excise or property taxes, charges or similar levies which arise in any jurisdiction from the execution, delivery or registration of the Securities or any other document or instrument referred to therein, excluding any such taxes, charges or similar levies imposed by any jurisdiction outside of the United Kingdom except those resulting from, or required to be paid in connection with, the enforcement of the Securities or any other such document or instrument following the occurrence of any Event of Default (as defined herein).

Whenever in the Fiscal and Paying Agency Agreement or in this "*Description of Securities*" there is mentioned, in any context, the payment of amounts based upon the principal amount of the Securities or of principal, interest or premium (if any) payable under, or with respect to, any of the Securities, such mention shall be deemed to include mention of the payment of Additional Amounts to the extent that, in such context, Additional Amounts are, were or would be payable in respect thereof thereunder, hereunder or under the Notes.

Redemption for Taxation Reasons

The Securities of each Series may be redeemed, at the option of the Issuer, in whole but not in part, at any time upon giving not less than 10 nor more than 60 days' notice to the holders, at a redemption price equal to 100% of the principal amount thereof, together with accrued and unpaid interest to the date fixed by the Issuer for redemption (a "*Tax Redemption Date*") and all Additional Amounts, if any, then due and which will become due on the Tax Redemption Date, as a result of the redemption or otherwise, if the Issuer determines that, as a result of (i) any change in, or amendment to, the laws or treaties (or any regulation or rulings promulgated thereunder) of any Taxing Jurisdiction affecting taxation or (ii) any change in position regarding the application, administration or interpretation of such laws, treaties, regulations or rulings (including a holding, judgment or order by a court of competent jurisdiction), which change, amendment, application or interpretation becomes effective on or after the date of this Offering Memorandum, the Issuer is, or on the next Interest Payment Date would be, required to pay Additional Amounts with respect to the Securities of such Series, and the Issuer determines that such payment obligation cannot be avoided by the Issuer taking reasonable measures available to it. Notwithstanding the foregoing, no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obligated to make such payment or withholding if a payment in respect of the Securities were then due. Prior to the mailing of any notice of redemption of the Securities pursuant to the foregoing, the Issuer will deliver to the Fiscal and Paying Agent an opinion of a tax counsel of recognized standing to the effect that the circumstances referred to in (i) or (ii) above exist along with a certificate signed by a duly authorized representative stating that the Issuer is entitled to effect the redemption and setting forth a statement of facts showing that the conditions precedent to the right to redeem have occurred. The Fiscal and Paying Agent shall take receipt of such opinion of a tax counsel and certificate signed by a duly authorized representative solely for the purposes of making the same available for inspection by holders of the Securities, which receipt shall constitute sufficient evidence of the satisfaction of the conditions precedent described above, in which event they shall be conclusive and binding on the holders of Securities.

Amendments of Securities

The holders of the Securities of any Series may, with the written consent of the Issuer and, solely to the extent that the proposed amendments affect the Fiscal and Paying Agent or the performance of its duties under the Fiscal and Paying Agency Agreement, the Fiscal and Paying Agent (such consent from the Fiscal and Paying Agent not to be unreasonably withheld or delayed), modify, amend or supplement the terms of such Securities or the Fiscal and Paying Agency Agreement, in any way, and may make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action provided by the Fiscal and Paying Agency Agreement or such Securities to be made, given or taken by holders of such Securities either (i) at any meeting of holders of the Securities affected thereby duly called and held, by the affirmative vote, in person or by proxy or (ii) with the written consent, in each case in (i) and (ii) above, of the holders of a majority in aggregate principal amount of the Securities affected thereby then outstanding voting together as a single class; *provided, however*, that no such action, modification, amendment, or supplement may, without the written consent of the holders of the Securities affected thereby, (i) change the due date for the payment of the principal (and premium, if any) of or any installment of interest on the Securities, (ii) reduce the principal amounts of the Securities or the interest rate thereon or the premium payable upon redemption thereof, (iii) change the currency in which or change the required place at which payment with respect to principal (and premium, if any) or interest, if any, in respect of the Securities is payable to a place outside the United States, (iv) amend the procedures provided for or the circumstances under which the Securities may be redeemed or (v) reduce the proportion of the principal amount of the Securities the consent of the holders of which is necessary to modify or amend the Fiscal and Paying Agency Agreement or the terms and conditions of the Securities or to make, take or give consent, waiver or other action provided thereby to be made, taken or given.

The Issuer, any guarantor and the Fiscal and Paying Agent may, without the vote or consent of any holder of Securities, amend the Fiscal and Paying Agency Agreement, the Securities or any guarantees in respect thereof for the purpose of (i) adding to the covenants of, or the restrictions, conditions or provisions applicable to, the Issuer or any guarantor, as the case may be, for the benefit of the holders of Securities or providing any additional rights or benefits to the holders of the Securities, (ii) surrendering any right or power conferred upon the Issuer or any guarantor, (iii) securing the Securities pursuant to the requirements thereof or otherwise, (iv) evidencing the addition of any guarantor of the Securities, or the release of any guarantor from its obligations with respect to the Securities, (v) evidencing the succession of another corporation or other Person to the Issuer or any guarantor, as the case may be, or successive successions, and the assumption by such successor(s) of the covenants, agreements and obligations of the Issuer or guarantor, as the case may be, therein and in the Securities as permitted by the Fiscal and Paying Agency Agreement and the Securities, (vi) modifying the restrictions on and procedures for resale and other transfers of the Securities to reflect any change in applicable law or regulation (or the interpretation thereof) or in practices relating to the resale or transfer of restricted securities generally, (vii) accommodating the issuance, if any, of Securities in book-entry form and matters related thereto, (viii) curing any ambiguity or correcting or supplementing any provision contained in the Fiscal and Paying Agency Agreement or the Securities which may be defective or inconsistent with any other provision contained therein or making such other provision in regard to matters or questions arising thereunder as the Issuer, any guarantor or the Fiscal and Paying Agent may deem necessary or desirable and which does not, as determined by the Issuer, adversely affect the interest of a holder of the Securities in any material respect, (ix) effecting any other amendment which the Issuer, any guarantor and the Fiscal and Paying Agent may determine and which, as determined solely by the Issuer, shall not adversely affect the interest of any holder of the Securities in any material respect or (x) making any modification which is of a minor or technical nature or correcting a manifest error.

Events of Default

Each of the following events will constitute an "*Event of Default*" with respect to the Securities of any Series:

(i) the Issuer shall fail to pay when due the principal of the Securities of such Series within five Business Days following the date such payment is due;

(ii) the Issuer shall fail to pay an installment of interest on the Securities of such Series within 30 days following the date such payment is due;

(iii) the Issuer shall fail to perform or observe any other term, covenant or agreement contained in the Securities of such Series for a period of 90 days after written notice thereof shall have been given to the Issuer by the holders of not less than 25% in aggregate principal amount of the Securities of such Series;

(iv) a decree or order by a court having jurisdiction shall have been entered adjudging the Issuer bankrupt or insolvent, or approving as properly filed a petition seeking reorganization of the Issuer under any Bankruptcy Law or any other similar applicable Federal, state or foreign law, and such decree or order shall have continued undischarged and unstayed for a period of 60 days; or a decree or order of a court having jurisdiction for the appointment of a receiver or liquidator or trustee or assignee in bankruptcy or insolvency of the Issuer or of the property of the Issuer or for the winding up or liquidation of the affairs of the Issuer shall have been entered and such decree or order shall have continued undischarged and unstayed for a period of 60 days; or

(v) the Issuer shall institute proceedings to be adjudicated voluntarily bankrupt or shall consent to the filing of a bankruptcy proceeding against it, or shall file a petition or answer or consent seeking reorganization under any Bankruptcy Law or any other similar applicable Federal, state or foreign law, or shall consent to the filing of any such petition, or shall consent to the appointment of a receiver or liquidator or trustee or assignee in bankruptcy or insolvency of it or its property, or shall make a general assignment for the benefit of creditors, or shall admit in writing its inability to pay its debts generally as they become due.

In each and every such case (other than an Event of Default specified in clause (i) or (ii) above or an Event of Default in respect of the Issuer specified in clause (iv) or (v) above), the holders of not less than a majority percent in aggregate principal amount of the Securities of the applicable Series then outstanding may, by notice in writing to the Issuer, declare the principal amount (and premium, if any) of and all accrued interest on all the Securities of such Series to be due and payable immediately. Upon any such declaration the same shall become and shall be immediately due and payable upon the date that such written notice is received by the Issuer, unless prior to such date all Events of Default in respect of all the Securities of such Series shall have been cured; *provided* that, if at any time after the principal of the Securities of any Series shall have been so declared due and payable, and before any sale of property under any judgment or decree for the payment of the monies due shall have been obtained or entered as hereinafter provided, the Issuer shall pay or shall deposit with the Fiscal and Paying Agent a sum sufficient to pay all matured installments of interest and principal upon all the Securities of such Series which shall have become due otherwise than solely by acceleration (with interest on overdue installments of interest, to the extent permitted by law, and on such principal of each Security of such Series at the rate of interest specified therein, to the date of such payment or deposit) and such amount as shall be sufficient to cover reasonable compensation to the Fiscal and Paying Agent and each predecessor, their respective agents, attorneys and counsel, and all other documented expenses and liabilities reasonably incurred, and all advances made for documented expenses and legal fees reasonably incurred by the Fiscal and Paying Agent and each predecessor Fiscal and Paying Agent, and if any and all Events of Default, other than the non-payment of the principal of the Securities of any Series then outstanding, which shall have become due solely by acceleration, shall have been cured, waived or otherwise remedied as provided in such Securities and the Fiscal and Paying Agency Agreement, then and in every such case, the holders of two-thirds in aggregate principal amount of the Securities of such Series then outstanding by written notice to the Issuer and to the Fiscal and Paying Agent may, on behalf of all of the holders of the Securities of such Series, waive all defaults and rescind and annul such declaration and its consequences but no such waiver or rescission and annulment shall extend to or shall affect any subsequent default, or shall impair any right consequent thereon. Actions by holders of Securities pursuant to this provision need not be taken at a meeting pursuant to the provisions regarding meetings of holders of Securities. If an Event of Default specified in clause (i) or (ii) above occurs, each holder of Securities of the applicable Series may, by written notice to the Issuer and the Fiscal and Paying Agent, declare the principal (and premium, if any) of and all accrued interest on the Securities of such Series of such holder to be due and payable upon the date that written notice is received by or on behalf of the Issuer and the Fiscal and Paying Agent unless prior to such date all Events of Default in respect of such holder's Securities of such Series shall have been cured. If an Event of Default specified in clause (iv) or (v) above occurs, the principal (and premium, if any) of and accrued interest on the Securities will be immediately due and payable without any declaration or other act on the part of any holder of Securities or other person.

Certain Covenants

So long as any amount remains unpaid on the Securities, the Issuer will comply with the terms of the covenants set forth herein.

Payment of Principal and Interest

The Issuer will duly and punctually pay the principal of (and premium, if any) and interest on the Securities in accordance with their terms.

Existence

Except as provided below in "*—Merger, Consolidation, Sale or Lease,*" the Issuer will do or cause to be done all things necessary to preserve and keep in full force and effect its existence.

Merger, Consolidation, Sale or Lease

The Issuer will not, directly or indirectly, consolidate or merge with, or sell, lease or otherwise dispose of substantially all of its assets to, any other Person unless (i) the Issuer is the survivor in such transaction or the Issuer procures that the survivor is a corporation or other Person organized under the laws of England and Wales, the United States or a state thereof or the District of Columbia which expressly assumes in writing the Issuer's obligations under the Securities and (ii) immediately after giving effect to the transaction, no Event of Default, and no event which, after notice or lapse of time or both, would become an Event of Default, shall have occurred and be continuing.

Limitation on Liens

The Issuer will not, and will not permit any member of the BAE Systems Group (as defined below) to, create or permit to exist any Lien (as defined below) upon any of its or their present or future assets or revenues to secure any of its present or future Relevant Borrowings (as defined below) without making effective provision whereby all of the Securities shall be directly secured equally and ratably with such Relevant Borrowings.

Information

So long as any Securities are outstanding, and except at such time as the Issuer is a reporting company under Section 13 or 15(d) of the Exchange Act or is exempt from registration under the Exchange Act by virtue of the exemption from registration set forth in Rule 12g3-2(b) under the Exchange Act, the Issuer shall provide the information required pursuant to Rule 144A(d)(4) under the Securities Act upon request of the holders of the Securities, a prospective purchaser of the Securities designated by such holder, a beneficial owner of such a Global Security or a prospective purchaser designated by such beneficial owner.

Definitions

The terms hereinafter set forth when used in connection with the covenants and events of default applicable to the Securities shall have the meanings set forth below.

For purposes of the following definitions, borrowings of any member of the BAE Systems Group expressed in or calculated by reference to a currency other than pounds Sterling or a combination of currencies including a currency or currencies other than pounds Sterling shall (as regards the currency or currencies other than pounds Sterling) be converted into pounds Sterling by reference to the rates of exchange used for the conversion of such currencies in the Latest Consolidated Balance Sheet or, if no such conversion was so required for any relevant currency, by reference to the rate of exchange or approximate rate of exchange in effect on the date of the Latest Consolidated Balance Sheet.

"*BAE Systems Group*" means the Issuer and its consolidated Subsidiaries.

"*BAE Systems Group Total Assets*" means, at any time, the aggregate book value of the current and non-current assets and investments of the BAE Systems Group as determined by reference to the Latest Consolidated Balance Sheet.

"*Bankruptcy Law*" means Title 11, United States Code, or any similar U.S. Federal or state law, any applicable English bankruptcy, insolvency, reorganization or other similar law of England, or any other similar foreign law for the relief of debtors.

"*Latest Consolidated Balance Sheet*" means the latest published annual consolidated balance sheet of the Issuer which has been audited and reported on by the Issuer's independent auditors (the "*Auditors*") in the full financial statements of the BAE Systems Group.

"*Lien*" means any lien, mortgage, charge, encumbrance or other security interest; *provided* that Liens shall not include: (i) in the case of a Subsidiary, any liens, mortgages, charges, encumbrances or other security interests in existence at the date it became a Subsidiary and which was not created in anticipation of such acquisition and (ii) any security interests not falling within (i) above securing an amount in the aggregate not exceeding 3.5% of the BAE Systems Group Total Assets.

"*Person*" means an individual, partnership, corporation, company, undertaking, joint venture, trust, unincorporated organization or other entity, and a government or agency or political subdivision thereof.

"*Relevant Borrowings*" means any indebtedness for borrowed money of any member of the BAE Systems Group in the form of, or represented by, bonds, notes, debentures or other securities which are or are to be quoted, listed or ordinarily dealt in or traded on any stock exchange, over-the-counter or other securities market (whether or not initially distributed by way of private placement), but excluding any such indebtedness which upon the issuance thereof had a stated maturity not exceeding one year.

"*Subsidiary*" means a subsidiary corporation or other Person which is required to be fully consolidated in the consolidated financial statements of the Issuer in accordance with the accounting principles under which the Issuer is required to produce its financial statements from time to time.

Book-Entry; Delivery and Form

Each Series of the Securities being offered hereby is being offered and sold only (i) to qualified institutional buyers ("*QIBs*") in reliance on Rule 144A and (ii) in offshore transactions in reliance on Regulation S.

Each Series of the Securities will be issued in fully registered form and only in denominations of $200,000 and integral multiples of $1,000 in excess thereof. Each Series of the Securities will be issued on the closing date only against payment in immediately available funds.

Summary of Provisions Relating to Securities in Global Form

The certificates representing each Series of the Securities will be issued in fully registered form without interest coupons. Securities of each Series sold in offshore transactions in reliance on Regulation S under the Securities Act will initially be represented by one or more permanent global Securities in definitive, fully registered form without interest coupons (each a "*Regulation S Global Security*") and will be deposited with Citibank, N.A. as custodian for, and registered in the name of, a nominee of The Depository Trust Company, as depositary ("*DTC*") for the accounts of its participants, including Euroclear and Clearstream. Prior to the 40th day after the later of the commencement of the Offering of the Securities and the date of the Fiscal and Paying Agency Agreement, any resale or other transfer of such interests to U.S. persons shall not be permitted unless such resale or transfer is made pursuant to Rule 144A or Regulation S, as applicable, and in accordance with the certification requirements described below.

Securities of each Series sold in reliance on Rule 144A will be represented by one or more permanent global securities in definitive, fully registered form without interest coupons (each, a "*Rule 144A Global Security*" and, together with the Regulation S Global Security, the "*Global Securities*") and will be deposited with Citibank, N.A. as custodian for, and registered in the name of a nominee of, DTC. Beneficial interests in a Rule 144A Global Security may be transferred to a person who takes delivery in the form of an interest in a Regulation S Global Security only upon receipt by the Fiscal and Paying Agent of written certifications (in the form(s) provided in the Fiscal and Paying Agency Agreement) and pursuant to the transfer restrictions related to a Rule 144A Global Security as described in this Offering Memorandum.

Each Global Security (and any Security issued in exchange therefor) will be subject to certain restrictions on transfer set forth therein described under "*Transfer Restrictions*". Except in the limited circumstances described below under "*—Summary of Provisions Relating to Certificated Securities,*" owners of beneficial interests in the Global Securities will not be entitled to receive physical delivery of Certificated Securities (as defined below).

Ownership of beneficial interests in a Global Security will be limited to persons who have accounts with DTC ("*participants*") or persons who hold interests through participants. Ownership of beneficial interests in a Global Security will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of participants) and the records of participants (with respect to interests of persons other than participants). QIBs may hold their interests in a Rule 144A Global Security directly through DTC if they are participants in such system, or indirectly through organizations which are participants in such system.

Investors may hold their interests in a Regulation S Global Security directly through Euroclear and Clearstream, if they are participants in such systems, or indirectly through organizations that are participants in such systems. Euroclear and Clearstream will hold interests in the Regulation S Global Securities on behalf of their participants through DTC.

So long as DTC, or its nominee, is the registered owner or holder of a Global Security, DTC or such nominee, as the case may be, will be considered the sole owner or holder of the Securities represented by such

Global Security for all purposes under the Fiscal and Paying Agency Agreement and the Securities. No beneficial owner of an interest in a Global Security will be able to transfer that interest except in accordance with DTC's applicable procedures, in addition to those provided for under the Fiscal and Paying Agency Agreement and, if applicable, those of Euroclear and Clearstream.

Payments of the principal of, and interest on, a Global Security will be made to DTC or its nominee, as the case may be, as the registered owner thereof. Neither the Issuer nor the Fiscal and Paying Agent will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in a Global Security or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

The Issuer expects that DTC or its nominee, upon receipt of any payment of principal or interest in respect of a Global Security, will credit participants' accounts with payments in amounts proportionate to their respective beneficial interests in the principal amount of such Global Security as shown on the records of DTC or its nominee. The Issuer also expects that payments by participants to owners of beneficial interests in such Global Security held through such participants will be governed by standing instructions and customary practices, as is now the case with securities held for the accounts of customers registered in the names of nominees for such customers. Such payments will be the responsibility of such participants.

Transfers between participants in DTC will be effected in the ordinary way in accordance with DTC rules and will be settled in same-day funds. Transfers between participants in Euroclear and Clearstream will be effected in the ordinary way in accordance with their respective rules and operating procedures.

Cross-market transfers between persons holding, directly or indirectly through DTC, on the one hand, and directly or indirectly through Euroclear or Clearstream participants, on the other, will be effected in DTC in accordance with DTC rules on behalf of the relevant European international clearing system by the relevant European depositary; however, those cross-market transactions will require delivery of instructions to the relevant European international clearing system by the counterparty in that system in accordance with its rules and procedures and within its established deadlines (European time). The relevant European international clearing system will, if the transaction meets its settlement requirements, deliver instructions to the relevant European depositary to take action to effect final settlement on its behalf by delivering or receiving securities in DTC, and making or receiving payment in accordance with normal procedures for same-day funds settlement applicable to DTC. Euroclear and Clearstream participants may not deliver instructions directly to the European depositaries.

Because of time zone differences, credits of securities received in Euroclear or Clearstream as a result of a transaction with a person that does not hold the Securities through Euroclear or Clearstream will be made during subsequent securities settlement processing and dated the business day following the DTC settlement date. Those credits or any transactions in those securities settled during that processing will be reported to the relevant Euroclear or Clearstream participants on that business day. Cash received in Euroclear or Clearstream as a result of sales of securities by or through a Euroclear participant or a Clearstream participant to a DTC participant will be received with value on the DTC settlement date, but will be available in the relevant Euroclear or Clearstream cash account only as of the business day following settlement in DTC.

The Issuer expects that DTC will take any action permitted to be taken by a holder of Securities (including the presentation of Securities for exchange as described below) only at the direction of one or more participants to whose account the DTC interests in a Global Security is credited and only in respect of such portion of the aggregate principal amount of Securities as to which such participant or participants has or have given such direction. However, if there is an Event of Default under the Securities, DTC will exchange the applicable Global Security for Certificated Securities, which it will distribute to its participants and which may be legended as set forth under the heading "*Transfer Restrictions.*"

The Issuer understands that DTC is a limited purpose trust company organized under the laws of the State of New York, a "*banking organization*" within the meaning of New York Banking Law, a member of the Federal Reserve System, a "*clearing corporation*" within the meaning of the Uniform Commercial Code and a "*Clearing Agency*" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates and certain other organizations. Direct participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. Indirect access to the DTC system is available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant, either directly or indirectly ("*indirect participants*").

Euroclear advises that it was created in 1968 to hold securities for participants of Euroclear and to clear and settle transactions among Euroclear participants through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates and any risk from lack of simultaneous transfers of securities and cash. Euroclear includes various other services, including securities lending and borrowing, and interfaces with domestic markets in several countries. Euroclear is operated by Euroclear Bank S.A./N.V. (the "*Euroclear Operator*"), under contract with Euroclear Clearance Systems S.C., a Belgian cooperative corporation (the "*Euroclear Clearance System*"). All operations are conducted by the Euroclear Operator, and all Euroclear securities clearance accounts and Euroclear cash accounts are accounts with the Euroclear Operator, not the Euroclear Clearance System. The Euroclear Clearance System establishes policies for Euroclear on behalf of Euroclear participants. Euroclear participants include banks (including central banks), securities brokers and dealers and other professional financial intermediaries and may include the underwriters. Indirect access to Euroclear is also available to other firms that clear through or maintain a custodial relationship with Euroclear participants, either directly or indirectly. Euroclear is an indirect participant in DTC. The Euroclear Operator is a Belgian bank. The Belgian Banking Commission and the National Bank of Belgium regulate the Euroclear Operator.

Securities clearance accounts and cash accounts with the Euroclear Operator are governed by the Terms and Conditions Governing Use of Euroclear and the related Operating Procedures of the Euroclear System, and applicable Belgian law (collectively, the "*Terms and Conditions*"). The Terms and Conditions govern transfer of securities and cash within Euroclear, withdrawals of securities and cash from Euroclear, and receipts of payments with respect to securities in Euroclear. All securities in Euroclear are held on a fungible basis without attribution of specific certificates to specific securities clearance accounts. The Euroclear Operator acts under the Terms and Conditions only on behalf of Euroclear participants, and has no record of or relationship with persons holding through Euroclear participants. Distributions with respect to the Securities held beneficially through Euroclear will be credited to the cash accounts of Euroclear participants in accordance with the Terms and Conditions.

Clearstream advises that it is incorporated under the laws of Luxembourg and licensed as a bank and professional depositary. Clearstream holds securities for its participating organizations and facilitates the clearance and settlement of securities transactions among its participants through electronic book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates. Clearstream provides to its participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Clearstream interfaces with domestic markets in several countries. Clearstream has established an electronic bridge with the Euroclear Operator, to facilitate the settlement of trades between Clearstream and Euroclear. As a registered bank in Luxembourg, Clearstream is subject to regulation by the Luxembourg Commission for the Supervision of the Financial Sector. Clearstream customers are recognized financial institutions around the world, including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. In the United States, Clearstream customers are limited to securities brokers and dealers and banks, and may include the Initial Purchasers of the Securities. Other institutions that maintain a custodial relationship with a Clearstream customer may obtain indirect access to Clearstream. Clearstream is an indirect participant in DTC.

Distributions with respect to Securities held beneficially through Clearstream will be credited to cash accounts of Clearstream participants in accordance with its rules and procedures.

Although DTC, Euroclear and Clearstream are expected to follow the foregoing procedures in order to facilitate transfers of interests in a Global Security among participants of DTC, Euroclear and Clearstream, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither the Issuer nor the Fiscal and Paying Agent will have any responsibility for the performance by DTC, Euroclear or Clearstream or their respective participants or indirect participants of their respective obligations under the rules and procedures governing their respective operations.

Summary of provisions relating to Certificated Securities

If DTC is at any time unwilling or unable to continue as a depositary for the Global Securities and a successor depositary is not appointed by the Issuer within 90 days, or if there shall have occurred and be continuing an Event of Default (as described above) with respect to the Securities, the Issuer will issue Certificated Securities in exchange for the Global Securities. Certificated Securities delivered in exchange for beneficial interests in any Global Security will be registered in the names, and issued in denominations of $200,000 or integral multiples of $1,000 in excess thereof, requested by or on behalf of the DTC or successor depositary (in accordance with its customary procedures). Holders of an interest in the Global Securities may receive Certificated Securities, which may bear the legend referred to under "*Transfer Restrictions,*" in accordance with DTC's rules and procedures in addition to those provided for under the Fiscal and Paying Agency Agreement.

Except in the limited circumstances described above, owners of interests in the Global Securities will not be entitled to receive physical delivery of individual definitive certificates. The Securities are not issuable in bearer form.

Subject to such transfer restrictions, the holder of a Certificated Security bearing such a legend may transfer or exchange such Securities in whole or in part by surrendering them to the Fiscal and Paying Agent. Prior to any proposed transfer of Securities in certificated form, the holder may be required to provide certifications and other documentation to the Fiscal and Paying Agent as described above. In the case of a transfer of only part of a Security, the original principal amount of both the part transferred and the balance not transferred must be in authorized denominations, and Securities will be issued to the transferor and transferee, respectively, by the Fiscal and Paying Agent. Upon the transfer, exchange or replacement of Certificated Securities not bearing the legend described above, the Fiscal and Paying Agent will deliver Certificated Securities that do not bear such legend.

Upon the transfer, exchange or replacement of Certificated Securities bearing the legend described above, or upon a specific request for removal of the legend from such Certificated Security, the Fiscal and Paying Agent will deliver only Certificated Securities bearing such legend or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer such satisfactory evidence, which may include an opinion of legal counsel of recognized standing, as may be reasonably required by the Issuer that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

Payment of principal and interest in respect of the Certificated Securities shall be payable at the office of agency of the Issuer in London which shall initially be the corporate trust office of the Fiscal and Paying Agent, at Citibank, N.A., London Branch, Citigroup Centre, 25 Canada Square, Canary Wharf, London E14 5LB, United Kingdom, Attention: Agency & Trust – Paying Agent; *provided* that at the option of the Issuer, payment may be made by wire transfer, direct deposit or check mailed to the address of the holder entitled thereto as such address appears in the Security register.

The Certificated Securities, at the option of the holder of such Certificated Securities and subject to the restrictions contained in the Securities and in the Fiscal and Paying Agency Agreement, may be transferred or exchanged, upon surrender or exchange or registration for transfer at the office of the Fiscal and Paying Agent. Any Certificated Security surrendered for exchange or presented for registration of transfer shall be duly endorsed, or be accompanied by a written instrument of transfer in form satisfactory to the Fiscal and Paying Agent, duly endorsed by the holder thereof or his attorney duly authorized in writing. Securities issued upon such transfer will be executed by the Issuer and authenticated by the Fiscal and Paying Agent, registered in the name of the designated transferee or transferees and delivered at the office of the Fiscal and Paying Agent or mailed, at the request, risk and expense of, and to the address requested by, the designated transferee or transferees.

Payments of Interest and Principal

Payments of interest and principal (and premium, if any) to owners of a beneficial interest in Global Securities are expected to be made in accordance with the procedures of DTC, DTC Participants, Euroclear and Clearstream in effect from time to time as described above under "*—Book-Entry, Delivery and Form.*"

Interest payments will be made on the 2031 Notes on each February 15 and August 15 and at the Stated Maturity Date thereof and upon redemption. Interest payments will be made on the 2050 Notes on each March 15 and September 15 and at the Stated Maturity Date thereof and upon redemption. Interest payments (other than interest due at the Stated Maturity thereof or upon redemption) will be made to the holders of the Securities in whose names such notes are registered at the close of business on the applicable Record Date.

When and if the Securities are in certificated form, interest payments on the Securities (other than interest due at the Stated Maturity thereof or upon redemption) will be made on the relevant Interest Payment Date, subject to the second paragraph below, by the Fiscal and Paying Agent either (i) by transfer of immediately available funds to such account at a bank in New York City (or at a bank in such other place as may be consented to by the Issuer) as such holder of Securities shall have designated at least ten calendar days prior to the relevant Interest Payment Date or (ii) by check mailed, postage prepaid, payable to the order of the holder at its address appearing in the register of Securities maintained by the Issuer or to such other address as any holder shall designate to the Fiscal and Paying Agent in writing not later than ten calendar days prior to the Interest Payment Date. The Fiscal and Paying Agent shall have no responsibility to obtain wire transfer instructions from any holder. The Fiscal and Paying Agent will withhold taxes, if any, on interest to the extent that such Fiscal and Paying Agent has been instructed by the Issuer that any taxes should be withheld or to the extent required by law including then existing United Kingdom law or U.S. Treasury Regulations.

Upon presentation of the Securities of a Series on or after the Stated Maturity Date thereof, the Fiscal and Paying Agent shall pay the principal amount of such Securities in accordance with such terms of the Securities together with accrued interest, if any, due at the Stated Maturity Date thereof in immediately available funds against presentation of the Securities at the office of the Fiscal and Paying Agent in London. The Fiscal and Paying Agent will cancel such Securities and, unless otherwise instructed by the Issuer, destroy such Securities. The Fiscal and Paying Agent will withhold taxes, if any, on principal to the extent that such Fiscal and Paying Agent has been instructed by the Issuer that any taxes should be withheld or to the extent required by law including then existing United Kingdom law or U.S. Treasury Regulations.

If any Interest Payment Date or the Stated Maturity Date (or the date of redemption) falls on a day that is not a Business Day, the payment will be made on the next Business Day with the same force and effect as if made on the date such payment was due, and no interest shall be payable in respect of any such delay.

The Issuer shall, not later than 10:00 a.m. New York City time on each date on which interest is payable on a Security, deposit with the Fiscal and Paying Agent, or as it shall direct, U.S. dollars in immediately available funds sufficient to pay all interest due on the Securities on such date and shall, not later than 10:00 a.m. New York City time on the Stated Maturity Date of any Securities, deposit with the Fiscal and Paying Agent, or as it shall direct, U.S. dollars in immediately available funds sufficient to pay the principal of and accrued interest, if any, on the Securities.

TAXATION

Prospective investors should consult their professional advisors on the possible tax consequences of buying, holding or selling any Securities under the laws of their country of citizenship, residence or domicile. The discussions that follow for each jurisdiction are based upon the applicable laws and interpretations thereof as in effect as of the date hereof, all of which laws and interpretations are subject to change or differing interpretations, which changes or differing interpretations could apply retroactively.

U.S. Taxation of U.S. Persons

This section summarizes the material U.S. tax consequences to U.S. persons. It represents the views of the Issuer's U.S. tax counsel, Cravath, Swaine & Moore LLP. However, the discussion is limited in the following ways:

- The discussion only covers you if you buy your Securities in the initial offering.
- The discussion only covers you if you hold your Securities as a capital asset (that is, for investment purposes), and if you do not have a special tax status.
- The discussion does not cover tax consequences that depend upon your particular tax situation in addition to your ownership of Securities, nor does it address specific tax consequences that may be relevant to particular holders (including, for example, financial institutions, broker-dealers, thrifts, real estate investment trusts, regulated investments companies, traders in securities that elect mark-to-market treatment, insurance companies, individual retirement accounts or qualified pension plans or investors in pass-through entities, including partnerships and Subchapter S corporations, U.S. expatriates, tax-exempt organizations, U.S. holders of the Securities that have a functional currency other than the U.S. dollar, persons subject to special tax accounting rules as a result of any item of gross income with respect to the Securities being taken into account in an applicable financial statement, persons that purchase or sell the Securities as part of a wash sale for tax purposes or persons who hold the Securities as part of a straddle, hedge, conversion or other integrated financial transaction).
- The discussion is based on current law. Changes in the law may change the tax treatment of the Securities.
- The discussion does not cover state, local or foreign law.

If you are considering buying Securities, the Issuer suggests that you consult your tax advisors about the tax consequences of holding the Securities in your particular situation.

For purposes of the following discussion, a "*U.S. person*" is:

- an individual that is a citizen or resident of the United States;
- a corporation (or other entity treated as a corporation for U.S. Federal income tax purposes) organized or created under U.S. law; or
- an estate or trust that is taxable in the United States on its worldwide income.

Payments of Interest

Stated interest on the Securities, and any Additional Amounts with respect to withholding tax on the Securities (including the amount of tax withheld from payments of interest and Additional Amounts) generally will be taxable to you as ordinary income at the time that it is paid or accrued in accordance with your method of accounting for U.S. Federal income tax purposes.

Interest on the Securities generally will be treated as foreign source income for U.S. Federal income tax purposes and generally will constitute "passive category" income for most U.S. persons.

Sale, Exchange or Other Disposition of the Securities

Upon the sale, exchange or other disposition of a note, you would recognize gain or loss equal to the difference, if any, between the amount realized on the sale, exchange or other disposition (excluding accrued but unpaid stated interest, which generally would be taxable as interest to the extent not previously included in income) and your adjusted tax basis in the note. Your adjusted tax basis in the note would generally be the amount you paid for the note.

The gain or loss recognized by the U.S. holder on the disposition of the note will be long-term capital gain or loss if it has held the note for more than one year, or short-term capital gain or loss if it has held the note for one year or less, at the time of the disposition. Long-term capital gains of non-corporate taxpayers currently are taxed at preferential rates. Short-term capital gains are taxed at ordinary income rates. The deductibility of capital losses against ordinary income is subject to limitations.

Information Reporting and Backup Withholding

The Code and U.S. Treasury Regulations generally require persons who make specified payments to report the payments to the U.S. Internal Revenue Service (the "*IRS*"). Among the specified payments are interest, dividends, and proceeds paid by brokers to their customers. This reporting regime is reinforced by "backup withholding" rules, which generally require the payor to withhold from payments subject to information reporting if the recipient has failed to provide a taxpayer identification number to the payor, furnished an incorrect identification number, failed to comply with applicable certification requirements or has been repeatedly notified by the IRS that it has failed to report interest or dividends on its U.S. Federal income tax returns.

Payments of interest to U.S. holders of Securities and payments made to U.S. holders by a broker upon a sale of Securities generally will be subject to information reporting and backup withholding, unless the U.S. holder (1) is an exempt recipient or (2) in the case of backup withholding, provides the payor with a correct taxpayer identification number and complies with applicable certification requirements. If a sale is made through a foreign office of a foreign broker, however, the sale will generally not be subject to either information reporting or backup withholding. This exception may not apply if the foreign broker is owned or controlled by U.S. persons or is engaged in a U.S. trade or business.

U.S. Return Disclosure Requirements

If you hold certain "specified foreign financial assets," which may include the Securities, you may be required to report information relating to such assets, subject to certain exceptions (including an exception for assets held in accounts maintained by certain financial institutions), by attaching a complete IRS Form 8938 (Statement of Specified Foreign Financial Assets) with your tax return for each year in which you hold an interest in such assets. "Specified foreign financial asset" generally includes any financial account maintained with a non-U.S. financial institution and may also include the Securities if they are not held in an account maintained with a financial institution. Penalties may apply for failure to properly complete and file IRS Form 8938.

FATCA

Pursuant to Sections 1471 through 1474 of the Code (provisions commonly known as "*FATCA*"), a "foreign financial institution" may be required to withhold U.S. tax on certain "foreign passthru payments" made after December 31, 2018, to the extent such payments are treated as attributable to certain U.S. source payments. Obligations issued on or prior to the date that is six months after the date on which applicable final U.S. Treasury Regulations defining "foreign passthru payments" are filed generally would be "grandfathered" unless such obligations are materially modified after such date. As of the date of this Offering Memorandum, applicable final U.S. Treasury Regulations defining "foreign passthru payments" have not yet been filed. Accordingly, if the Issuer is treated as a foreign financial institution, FATCA would apply to payments on the notes only if there is a significant modification of the notes for U.S. Federal income tax purposes after the expiration of this grandfathering period. However, if additional notes are issued after the expiration of the grandfathering period, have the same CUSIP or ISIN as the relevant notes issued hereby, and are subject to withholding under FATCA, then withholding agents may treat all notes in such series, including the relevant notes issued hereby, as subject to withholding under FATCA. Non-U.S. governments have entered into intergovernmental agreements with the United States (and additional non-U.S. governments are expected to enter into such agreements) to implement FATCA in a manner that alters the rules described herein. U.S. holders should consult their own tax advisors on how these rules may apply to their investment in the notes. In the event any withholding under FATCA is imposed with respect to any payments on the notes, there generally will be no additional amounts payable to compensate for the withheld amount.

The preceding discussion of certain U.S. Federal tax considerations is for general information only. It is not tax advice. You should consult your own tax advisor regarding the particular U.S. Federal, state, local, and foreign tax consequences of purchasing, holding, and disposing of Securities, including the consequences of any proposed change in applicable laws.

UK Taxation

This section summarizes the material UK tax consequences to holders of the Securities.

General

The comments below are of a general nature and are not intended to be exhaustive. They assume that there will be no substitution of the Issuer or further issues of securities that will form a single series with the Securities, and do not address the consequences of any such substitution or further issue (notwithstanding that such substitution or further issue may be permitted by the terms and conditions of the Securities). Any holders of Securities who are in doubt as to their own tax position should consult their professional advisers. In particular, holders of Securities should be aware that the tax legislation of any jurisdiction where a holder of Securities is resident or otherwise subject to taxation (as well as the jurisdiction discussed below) may have an impact on the tax consequences of an investment in the Securities including in respect of any income received from the Securities.

The comments in this part are based on current United Kingdom tax law as applied in England and Wales and HM Revenue & Customs practice (which may not be binding on HM Revenue & Customs), in each case as at the latest practicable date before the date of this Offering Memorandum. They do not necessarily apply where the income is deemed for tax purposes to be the income of any other person. They relate only to the position of persons who hold their Securities as investments (regardless of whether the holder also carries on a trade, profession or vocation through a permanent establishment, branch or agency to which the Securities are attributable) and are the absolute beneficial owners thereof. In particular, holders of Securities holding their Securities via a depositary receipt system or clearance service should note that they may not always be the beneficial owners thereof. Certain classes of persons such as dealers, certain professional investors, or persons connected with the Issuer may be subject to special rules and this summary does not apply to such holders of Securities.

Withholding

While the Securities are listed on a recognized stock exchange within the meaning of Section 1005 Income Tax Act 2007, payments of interest by the Issuer may be made without withholding or deduction for or on account of United Kingdom income tax. The London Stock Exchange is a recognized stock exchange for these purposes. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List maintained by the FCA and are admitted to trading on the London Stock Exchange.

If the Securities cease to be listed, interest which has a United Kingdom source will generally be paid by the Issuer under deduction of income tax at the basic rate (currently 20%) unless (i) another relief applies under domestic law or (ii) the Issuer has received a direction to the contrary from HM Revenue & Customs in respect of such relief as may be available pursuant to the provisions of any applicable double taxation treaty.

If interest were paid under deduction of United Kingdom income tax (*e.g.*, if the Securities lost their listing), holders of Securities who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in an applicable double taxation treaty.

Interest

The interest is expected to have a United Kingdom source and accordingly may be chargeable to United Kingdom tax by direct assessment irrespective of the residence of the holder of the Security. Where the interest is paid without withholding or deduction on account of United Kingdom tax, the interest will not be assessed to

United Kingdom tax in the hands of holders of the Securities (other than certain trustees) who are not resident for tax purposes in the United Kingdom, except where the holder carries on a trade, profession or vocation through a branch or agency, or in the case of a corporate holder, carries on a trade through a permanent establishment in the United Kingdom, in connection with which the interest is received or to which the Securities are attributable, in which case (subject to exemptions for interest received by certain categories of agent) tax may be levied on the United Kingdom branch or agency, or permanent establishment.

Holders of Securities should note that the provisions relating to Additional Amounts referred to in "*Description of Securities*" above would not apply if HM Revenue & Customs sought to assess directly the person entitled to the relevant interest to United Kingdom tax. However, exemption from, or reduction of, such United Kingdom tax liability might be available under an applicable double taxation treaty.

Information Reporting

Holders of Securities may wish to note that HM Revenue & Customs has power to obtain information (including, in certain cases, the name and address of the beneficial owner of the interest), including from any person in the United Kingdom who either pays certain amounts in respect of the Securities to, or receives certain amounts in respect of the Securities for the benefit of, an individual. Such information may, in certain circumstances, be exchanged by HM Revenue & Customs with the tax authorities of other jurisdictions.

United Kingdom Stamp Duty and Stamp Duty Reserve Tax

No United Kingdom stamp duty or stamp duty reserve tax is payable on the issue or transfer by delivery of a Security or on its redemption.

Investors who are in any doubt as to their position should consult their professional advisers.

CERTAIN ERISA CONSIDERATIONS

ERISA and Section 4975 of the Code prohibit certain transactions ("*prohibited transactions*") involving the assets of (i) an employee benefit plan that is subject to the prohibited transaction provisions of Title I of ERISA or Section 4975 of the Code (including individual retirement accounts, Keogh plans and other plans described in Section 4975(e)(1) of the Code) and (ii) entities whose underlying assets are considered to include "plan assets" of any such plan, account or arrangement (each of the foregoing described in clauses (i) and (ii), a "*Plan*" and collectively, the "*Plans*") and certain persons who are "parties in interest" (within the meaning of ERISA) or "disqualified persons" (within the meaning of the Code) with respect to the Plan.

The Issuer, the Initial Purchasers and their respective affiliates may be considered a "party in interest" or a "disqualified person" with respect to many Plans, and, accordingly, prohibited transactions may arise if Securities are acquired or held by or on behalf of a Plan unless the Securities are acquired or held pursuant to an available exemption, of which there are many. In this regard the U.S. Department of Labor has issued prohibited transaction class exemptions that may apply to the purchasing and holding of the Securities. These exemptions include transactions effected on behalf of a Plan by a "qualified professional asset manager" (prohibited transaction exemption 84-14) or an "in-house asset manager" (prohibited transaction exemption 96-23), transactions involving insurance company general accounts (prohibited transaction exemption 95-60), transactions involving insurance company pooled separate accounts (prohibited transaction exemption 90-1), and transactions involving bank collective investment funds (prohibited transaction exemption 91-38). In addition, Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code provide relief from the prohibited transaction provisions of ERISA and Section 4975 of the Code for certain transactions, *provided* that neither the issuer of the securities nor any of its affiliates (directly or indirectly) have or exercise any discretionary authority or control or render any investment advice with respect to the assets of any Plan involved in the transaction and; *provided, further*, that the Plan receives no less and pays no more than "adequate consideration" (within the meaning of Section 408(b)(17) of ERISA and Section 4975(f)(10) of the Code). There can be no assurance that all of the conditions of any such exemptions will be satisfied.

Governmental plans, certain church plans and non-U.S. plans may not be subject to the prohibited transaction provisions of ERISA or the Code but may be subject to similar laws ("*Similar Laws*"). Fiduciaries of any such plans should consult with counsel before acquiring or continuing to hold the Securities.

Because of the foregoing, the person making the decision on behalf of a Plan or a governmental, church or foreign plan will be deemed, by purchasing or holding the Securities, to represent on behalf of itself and the plan that the purchase or holding of the Securities will not result in a non-exempt prohibited transaction under ERISA or Section 4975 of the Code or any applicable Similar Law.

In addition, the person making the decision on behalf of a Plan will be deemed to have represented and warranted that none of the Issuer, the Initial Purchasers or any of their respective affiliates is undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the purchase or holding of the Securities by any Plan.

The foregoing discussion is general in nature and is not intended to be all inclusive. Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries, or other persons considering the purchase or continued holding of the Securities on behalf of, or with the assets of, any Plan, consult with their counsel regarding the potential applicability of ERISA, Section 4975 of the Code and any Similar Laws to such decision and whether an exemption would be applicable to the purchase or holding of the Securities.

PLAN OF DISTRIBUTION

Barclays Capital Inc. is acting as the representative of the Initial Purchasers named below. Subject to the terms and conditions stated in the purchase agreement dated the date of this Offering Memorandum, each Initial Purchaser named below has agreed, severally and not jointly, to purchase, and the Issuer has agreed to sell to that Initial Purchaser, the principal amount of the Securities set forth opposite the Initial Purchaser's name.

Initial Purchasers	Principal Amount of 2031 Notes	Principal Amount of 2050 Notes
Barclays Capital Inc.	$ 180,000,000	$ 180,000,000
BofA Securities, Inc.	$ 180,000,000	$ 180,000,000
Citigroup Global Markets Inc.	$ 180,000,000	$ 180,000,000
RBC Capital Markets, LLC	$ 180,000,000	$ 180,000,000
Wells Fargo Securities, LLC	$ 180,000,000	$ 180,000,000
BNP Paribas Securities Corp.	$ 50,000,000	$ 50,000,000
SG Americas Securities, LLC	$ 50,000,000	$ 50,000,000
Total	$1,000,000,000	$1,000,000,000

The purchase agreement provides that the obligations of the Initial Purchasers to purchase the Securities are subject to approval of legal matters by counsel and to other conditions. The Offering of the Securities by the Initial Purchasers is subject to receipt and acceptance and subject to the Initial Purchasers' right to reject any order in whole or in part. The Initial Purchasers have agreed, severally and not jointly, to purchase all the Securities if they purchase any of the Securities. If an Initial Purchaser defaults, the purchase agreement provides that the purchase commitments of the non-defaulting Initial Purchasers may be increased or the purchase agreement may be terminated.

The Issuer has agreed to indemnify the several Initial Purchasers against certain liabilities, including liability under the Securities Act, or to contribute to payments that the Initial Purchasers may be required to make because of any of those liabilities.

The Initial Purchasers propose to resell the Securities at the issue prices set forth on the cover page of this Offering Memorandum within the United States only to qualified institutional buyers (as defined in Rule 144A) in reliance on Rule 144A and, through their respective selling agents, outside the United States in reliance on Regulation S. See "*Transfer Restrictions*" and the representations of each Initial Purchaser set forth below. The price at which the Securities are offered may be changed at any time without notice.

The Securities have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S) except in transactions exempt from, or not subject to, the registration requirements of the Securities Act. See "*Transfer Restrictions*."

Accordingly, in connection with sales outside the United States, each Initial Purchaser has agreed that, except as permitted by the purchase agreement and set forth in "*Transfer Restrictions*," it will not offer or sell the Securities within the United States or to, or for the account or benefit of, U.S. persons (i) as part of its distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the Offering and the closing date, and it will have sent to each dealer to which it sells Securities during the 40-day restricted period a confirmation or other notice setting forth the restrictions on offers and sales of the Securities within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the later of the commencement of the Offering and the closing date, an offer or sale of Securities within the United States by a dealer that is not participating in this offering may violate the registration requirement of the Securities Act if that offer or sale is made otherwise than in accordance with Rule 144A.

The Securities will constitute a new class of securities with no established trading market. Application has been made to the FCA for the Securities to be admitted to the Official List and to the London Stock Exchange for the Securities to be admitted to trading on the Market, but there can be no assurance that the Securities will be approved for listing or that such listing will be maintained. The Issuer cannot assure you that the prices at which the Securities will sell after the Offering will not be lower than the initial offering price or that any trading market for the Securities will develop and continue after the Offering. The Initial Purchasers currently intend to make a market in the Securities. However, they are not obligated to do so and they may discontinue any market-making activities with respect to the Securities at any time without notice. In addition, market-making activity will be subject to the limits imposed by the Securities Act and the Exchange Act. Accordingly, the Issuer can neither assure investors that there will be a trading market for the Securities nor that there will be sufficient liquidity in any trading market. See "*Risk Factors—3. Factors which are material for the purpose of assessing the market risks associated with the Securities—There is no prior market for the Securities and the liquidity of any trading market for the Securities may be limited.*"

In connection with the Offering, the Stabilization Managers may purchase and sell the Securities in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by a Stabilization Manager of a greater number of Securities than they are required to purchase in the Offering. Stabilizing transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the Securities while the Offering is in progress.

These activities by the Stabilization Managers, as well as other purchases by any Stabilization Manager for its own account, may stabilize, maintain or otherwise affect the market price of the Securities. As a result, the price of the Securities may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the Stabilization Managers at any time. These transactions may be effected in the over-the-counter market or otherwise.

It is expected that delivery of the Securities will be made against payment therefor on or about the fifth business day following the date of pricing of the Securities (this settlement cycle being referred to as "T+5"). Under Rule 15c6-1 of the Exchange Act, trades in the secondary market generally are required to settle in two business days unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade the Securities on any date prior to two business days before delivery will be required, by virtue of the fact that the Securities initially will settle in T+5, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Purchasers of the Securities who wish to make such trades should consult their own advisors.

Other Relationships

The Initial Purchasers and their respective affiliates are full-service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities and other commercial dealings in the ordinary course of business. Certain of the Initial Purchasers and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for the Issuer and its subsidiaries and affiliates and equity accounted investments, for which they received or will receive customary fees and expenses, and certain of the Initial Purchasers have provided and are providing general financing and banking services to the Issuer and its subsidiaries and affiliates and equity accounted investments and may also act as lenders under the Issuer's credit facilities. In addition, certain of the Initial Purchasers or their affiliates have direct or indirect interests in the issued ordinary share capital of the Issuer.

In the ordinary course of their various business activities, the Initial Purchasers and their respective affiliates have made or held, and may in the future make or hold, a broad array of investments including serving as counterparties to certain derivative and hedging arrangements, and may have actively traded, and, in the future may actively trade, debt and equity securities (or related derivative securities), and financial instruments (including bank loans) for their own account and for the accounts of their customers and may have in the past and at any time in the future hold long and short positions in such securities and instruments. Such investment and securities activities may have involved, and in the future may involve, securities and instruments of the Issuer and its subsidiaries. Certain of the Initial Purchasers or their affiliates have lending relationships with the Issuer and its subsidiaries, including under the RCF and under the Bridge Facility and will therefore receive a portion of the net proceeds of the Offering as set forth under "*Use and Estimated Amount of Net Proceeds.*" Certain of the Initial Purchasers or their affiliates routinely hedge, and certain other of those underwriters may hedge, their credit exposure to the Issuer and its subsidiaries consistent with their customary risk management policies.

Typically, these Initial Purchasers and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in the Issuer's or its affiliates' securities, including potentially the Securities offered hereby. Any such credit default swaps or short positions could adversely affect future trading prices of the Securities offered hereby. The Initial Purchasers and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

Selling Restrictions

Canada

The Securities may be sold only to purchasers purchasing, or deemed to be purchasing, as principal that are accredited investors, as defined in National Instrument 45-106 Prospectus Exemptions or subsection 73.3(1) of the Securities Act (Ontario), and are permitted clients, as defined in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. Any resale of the Securities must be made in accordance with an exemption from, or in a transaction not subject to, the prospectus requirements of applicable securities laws.

Securities legislation in certain provinces or territories of Canada may provide a purchaser with remedies for rescission or damages if this Offering Memorandum (including any amendment thereto) contains a misrepresentation, provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province or territory for particulars of these rights or consult with a legal advisor.

Pursuant to section 3A.3 (or, in the case of securities issued or guaranteed by the government of a non-Canadian jurisdiction, section 3A.4) of National Instrument 33-105 Underwriting Conflicts ("*NI 33-105*"), the Initial Purchasers are not required to comply with the disclosure requirements of NI 33-105 regarding underwriter conflicts of interest in connection with this Offering.

European Economic Area ("EEA") and United Kingdom Retail Investors

The Securities are not intended to be offered, sold or otherwise made available to and should not be offered, sold or otherwise made available to any retail investor in the EEA or the United Kingdom. For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, "*MiFID II*"); or (ii) a customer within the meaning of Directive (EU) 2016/97, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II. Consequently, no key information document required by Regulation (EU) No 1286/2014 (as amended or superseded, the "*PRIIPs Regulation*") for offering or selling the Securities or otherwise making them available to retail investors in the EEA or the United Kingdom has been prepared and therefore offering or selling the Securities or otherwise making them available to any retail investor in the EEA or the United Kingdom may be unlawful under the PRIIPs Regulation.

Hong Kong

The Securities may not be offered or sold in Hong Kong, by means of any document, other than (a) to "professional investors" as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance or (b) in other circumstances which do not result in the document being a "prospectus" as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance. No invitation or advertisement or document relating to the Securities has been issued, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Securities which are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" as defined in the Securities and Futures Ordinance (Cap. 571) and any rules made under that Ordinance.

Japan

The Securities have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (the "*Financial Instruments and Exchange Act*"). Accordingly, the Securities may not, directly or indirectly, be offered or sold in Japan or to, or for the benefit of, any resident of Japan (which term as used in this Offering Memorandum means any person resident in Japan, including any corporation or other entity organized under the laws of Japan) or to others for re-offering or re-sale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Act and other applicable laws, regulations and ministerial guidelines of Japan.

Singapore

This Offering Memorandum will not be registered as a prospectus with the Monetary Authority of Singapore ("*MAS*"). Accordingly, the Securities may not be offered or sold or be made the subject of an invitation for subscription or purchase and neither this Offering Memorandum nor any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Securities may be circulated or distributed, whether directly or indirectly, to any person in Singapore other than (i) to an institutional investor (as defined in Section 4A of the Securities and Futures Act (the "*SFA*")) pursuant to Section 274 of the SFA, (ii) to a relevant person (as defined in Section 275(2) of the SFA) pursuant to Section 275(1) of the SFA, or any person pursuant to Section 275(1A) of the SFA, and in accordance with the conditions specified in Section 275 of the SFA and (where applicable) Regulation 3 of the Securities and Futures (Classes of Investors) Regulations 2018, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the Securities are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

(i) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

(ii) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

Securities or Securities-based derivative contracts (each term, as defined in Section 2(1) of the SFA) of that corporation or the beneficiaries' rights and interest (howsoever described) in that trust may not be transferred within six months after that corporation or that trust has acquired the Securities pursuant to an offer made under Section 275 of the SFA except:

(a) to an institutional investor or to a relevant person defined in Section 275(2) of the SFA, or to any person arising from an offer referred to in Section 275(1A) or Section 276(4)(i)(B) of the SFA;

(b) where no consideration is or will be given for the transfer;

(c) where the transfer is by operation of law;

(d) as specified in Section 276(7) of the SFA; or

(e) as specified in Regulation 37A of the Securities and Futures (Offers of Investments) (Securities and Security-based Derivatives Contracts) Regulation 2018 of Singapore.

Switzerland

The Securities may not be publicly offered, sold or advertised, directly or indirectly, in or from Switzerland, and will not be listed on the SIX Swiss Exchange Ltd or any other exchange or regulated trading venue in Switzerland. Neither this Offering Memorandum nor any other offering or marketing material relating to the Securities constitutes a prospectus as such term is understood pursuant to article 652a or article 1156 of the Swiss Federal Code of Obligations or a listing prospectus within the meaning of the listing rules of the SIX Swiss Exchange Ltd or any other exchange or regulated trading venue in Switzerland, and neither this Offering Memorandum nor any other offering or marketing material relating to the Securities may be publicly distributed or otherwise made publicly available in Switzerland.

Taiwan (Republic of China)

The Securities will not be registered or filed with, or approved by, the Financial Supervisory Commission of the Republic of China ("*ROC*") and/or other regulatory authority of the ROC pursuant to relevant securities laws and regulations and may not be sold, issued or offered within the ROC through a public offering or in circumstances which constitute an offer within the meaning of the Securities and Exchange Act of the ROC or relevant laws and regulations that requires a registration, filing or approval of the Financial Supervisory Commission of the ROC and/or other regulatory authority of the ROC. No person or entity in the ROC has been authorized to offer or sell the Securities in the ROC.

United Kingdom

Each Initial Purchaser has represented and agreed that: (i) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (the "*FSMA*")) received by it in connection with the issue or sale of any Securities in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and (ii) it has complied and will comply with all applicable provisions of the FSMA in respect of anything done by it in relation to any Securities in, from or otherwise involving the United Kingdom.

TRANSFER RESTRICTIONS

The Securities have not been registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act ("*Regulation S*")) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Securities are being offered and sold only (i) to "qualified institutional buyers" (as defined in Rule 144A under the Securities Act ("*Rule 144A*")), commonly referred to as "QIBs," in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A; and (ii) in offers and sales that occur outside the United States to purchasers who are not U.S. persons (as defined in Regulation S) in reliance on Regulation S.

Each holder of a Security, or of any interest therein, will be deemed to acknowledge, represent, warrant and agree that, at the time of its acquisition and throughout the period of its holding and disposition of such Security or interest therein, either (a) the holder is not a Plan and it is not purchasing the Security on behalf of, or with the "plan assets" of, any Plan; or (b) the holder's purchase, holding and subsequent disposition of the Security either (i) are not a prohibited transaction under ERISA or the Code and are otherwise permissible under all applicable Similar Laws or (ii) are entitled to exemptive relief from the prohibited transaction provisions of ERISA and the Code in accordance with one or more available statutory, class or individual prohibited transaction exemptions and are otherwise permissible under all applicable Similar Laws.

Rule 144A

Each purchaser of the Securities (other than the Initial Purchasers) offered hereby in the United States will be deemed, by its acceptance or purchase thereof, to have represented to and agreed with the Issuer and each Initial Purchaser as follows:

1. It is not an "affiliate," as defined under Rule 144, of the Issuer or acting on behalf of such an affiliate and that it (A) is a QIB, (B) is acquiring the Securities for its own account or for the account of a QIB and (C) is aware that the sale of the Securities to it is being made in reliance on Rule 144A.

2. The purchase of the Securities is not part of a plan or scheme to evade the registration requirements of the Securities Act.

3. It acknowledges and understands that the Securities have not been registered under the Securities Act or any other applicable securities laws and that the Securities are being offered for resale in a transaction not requiring registration under the Securities Act or any other securities laws, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S), except as set forth below.

4. It agrees that if in the future it decides to offer, resell, pledge or otherwise transfer any of the Securities, it shall not offer, resell, pledge or otherwise transfer any of the Securities except (A) (i) to the Issuer or any of its subsidiaries, (ii) for so long as the Securities are eligible for resale pursuant to Rule 144A, in the United States to a person whom the seller reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, (iii) outside the United States in an offshore transaction (as defined in Regulation S) in compliance with Rule 903 or Rule 904 of Regulation S, and, in the case of transfers on or prior to the 40th day after the later of the commencement of the Offering of the Securities and the date of the initial issuance of the Securities, which is to a non-U.S. person, (iv) pursuant to the exemption from registration provided by Rule 144 under the Securities Act (if available), (v) pursuant to another available exemption from registration under the Securities Act or (vi) pursuant to an effective registration statement under the Securities Act and (B) in each case, in accordance with all applicable laws of any state of the United States or any other jurisdiction.

5. It understands and agrees that the Securities offered in the United States to QIBs will be represented by Rule 144A Global Securities and that Securities offered outside the United States in reliance on Regulation S will be represented by Regulation S Global Securities. Before any beneficial interest in a Rule 144A Global Security may be offered, sold, pledged or otherwise transferred to a purchaser outside the United States in compliance with Rule 903 or Rule 904 under the Securities Act, the transferor will be required to provide the Fiscal and Paying Agent with a written certificate (the form of which certification can be obtained from the Fiscal and Paying Agent) as to compliance with the transfer restrictions referred to above.

6. It agrees that it will deliver to each person to whom it transfers Securities notice of any restrictions on transfer of such Securities.

7. It understands that the Securities will bear a legend to the following effect unless otherwise agreed by the Issuer and the holder thereof:

   "THIS SECURITY HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR OTHER SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION. NEITHER THIS SECURITY NOR ANY INTEREST OR PARTICIPATION HEREIN MAY BE OFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION UNLESS THE TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT.

   THE HOLDER OF THIS SECURITY BY ITS ACCEPTANCE HEREOF (1) REPRESENTS THAT IT IS A "QUALIFIED INSTITUTIONAL BUYER" (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT ("RULE 144A")); (2) AGREES ON ITS OWN BEHALF AND ON BEHALF OF ANY ACCOUNT FOR WHICH IT HAS PURCHASED SECURITIES THAT IT WILL NOT OFFER, SELL OR OTHERWISE TRANSFER THIS SECURITY EXCEPT (A)(I) TO THE ISSUER OR ANY OF ITS SUBSIDIARIES, (II) FOR SO LONG AS THIS SECURITY IS ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, IN THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (III) OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT ("REGULATION S")) IN COMPLIANCE WITH RULE 903 OR RULE 904 OF REGULATION S, AND, IN THE CASE OF TRANSFERS ON OR PRIOR TO THE 40TH DAY AFTER THE LATER OF THE COMMENCEMENT OF THE OFFERING OF THE SECURITIES AND THE DATE OF THE INITIAL ISSUANCE OF THIS SECURITY, WHICH IS TO A NON-U.S. PERSON, (IV) PURSUANT TO THE EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE), (V) PURSUANT TO ANOTHER AVAILABLE EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT, OR (VI) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, AND (B) IN EACH CASE, IN ACCORDANCE WITH ALL APPLICABLE LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION; AND (3) AGREES THAT IT WILL DELIVER TO EACH PERSON TO WHOM IT TRANSFERS SECURITIES A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

   THE FISCAL AND PAYING AGENCY AGREEMENT CONTAINS A PROVISION REQUIRING THE FISCAL AND PAYING AGENT TO REFUSE TO REGISTER ANY TRANSFER OF THIS SECURITY IN VIOLATION OF THE FOREGOING RESTRICTIONS. EACH HOLDER OF THIS SECURITY, OR OF ANY INTEREST THEREIN, WILL BE DEEMED TO ACKNOWLEDGE, REPRESENT, WARRANT AND AGREE THAT, AT THE TIME OF ITS ACQUISITION AND THROUGHOUT THE PERIOD OF ITS HOLDING AND DISPOSITION OF SUCH SECURITY OR INTEREST THEREIN, EITHER (A) IT IS NOT, AND IT WILL NOT BECOME, AN "EMPLOYEE BENEFIT PLAN" (AS DEFINED IN SECTION 3(3) OF THE U.S. EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED ("ERISA")) THAT IS SUBJECT TO ERISA, A "PLAN" SUBJECT TO SECTION 4975 OF THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE "CODE"), OR AN ENTITY WHOSE UNDERLYING ASSETS INCLUDE "PLAN ASSETS" BY REASON OF ANY SUCH EMPLOYEE BENEFIT PLAN'S OR PLAN'S INVESTMENT IN THE ENTITY OR OTHERWISE, OR A GOVERNMENTAL PLAN, CHURCH PLAN, NON-U.S. PLAN OR OTHER PLAN THAT IS SUBJECT TO ANY FEDERAL, STATE, LOCAL OR NON-U.S. LAW THAT IS SUBSTANTIALLY SIMILAR TO THE PROVISIONS OF SECTION 406 OF ERISA OR SECTION 4975 OF THE CODE OR (B) ITS PURCHASE, HOLDING AND DISPOSITION OF SUCH SECURITY OR INTEREST THEREIN WILL NOT CONSTITUTE OR RESULT IN A NON-EXEMPT PROHIBITED TRANSACTION UNDER SECTION 406 OF ERISA AND/OR SECTION 4975 OF THE CODE (OR, IN THE CASE OF A GOVERNMENTAL PLAN, CHURCH PLAN, NON-U.S. PLAN OR OTHER PLAN, A VIOLATION OF ANY SUBSTANTIALLY SIMILAR FEDERAL, STATE, LOCAL OR NON-U.S. LAW) BY REASON OF AN APPLICABLE STATUTORY OR ADMINISTRATIVE EXEMPTION. THE FISCAL AND PAYING AGENCY AGREEMENT CONTAINS A PROVISION REQUIRING THE FISCAL AND

PAYING AGENT TO REFUSE TO REGISTER ANY TRANSFER OF ANY SECURITY IN VIOLATION OF THE FOREGOING RESTRICTIONS."

8. It represents and agrees that (i) no other representation with respect to the offer or sale of the Securities has been made, other than the information contained in this Offering Memorandum; (ii) its investment decision is solely based on the information contained in this Offering Memorandum; (iii) the Initial Purchasers make no representation or warranty as to the accuracy or completeness of this Offering Memorandum; and (iv) it has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of its prospective investment and can afford the complete loss of such investment.

9. It represents and agrees that it has received a copy of this Offering Memorandum and acknowledges that it has had access to such financial and other information, and it has been afforded the opportunity to ask questions of the Issuer and receive answers thereto, as it deemed necessary in connection with its decision to purchase Securities.

10. It acknowledges that the Issuer, the Initial Purchasers and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations, warranties and agreements and agrees that, if any of the acknowledgments, representations, warranties and agreements deemed to have been made by its purchase of the Securities is no longer accurate, it shall promptly notify the Issuer and the Initial Purchasers. If it is acquiring any Securities as a fiduciary or agent of one or more investor accounts, it represents that it has sole investment discretion with respect to each such investor account and that it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such investor account.

Regulation S

Each purchaser of the Securities (other than the Initial Purchasers) offered hereby outside the United States will be deemed, by its acceptance or purchase thereof, to have represented to and agreed with the Issuer and each Initial Purchaser as follows:

1. It is not an "affiliate," as defined under Rule 144, of the Issuer or acting on behalf of such an affiliate and that it (A) is not a U.S. person (as defined in Regulation S), (B) is not purchasing the Securities for the account or benefit of any U.S. person and (C) is purchasing the Securities in an offshore transaction (as defined in Regulation S) in accordance with Regulation S.

2. The purchase of the Securities is not part of a plan or scheme to evade the registration requirements of the Securities Act.

3. It acknowledges and understands that the Securities have not been registered under the Securities Act or any other applicable securities laws and that the Securities are being offered for resale in a transaction not requiring registration under the Securities Act or any other securities laws, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S), except as set forth below.

4. It agrees that if in the future it decides to offer, resell, pledge or otherwise transfer any of the Securities, it shall not offer, resell, pledge or otherwise transfer any of the Securities except (A) (i) to the Issuer or any of its subsidiaries, (ii) for so long as the Securities are eligible for resale pursuant to Rule 144A, in the United States to a person whom the seller reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, (iii) outside the United States in an offshore transaction (as defined in Regulation S) in compliance with Rule 903 or Rule 904 of Regulation S, and, in the case of transfers on or prior to the 40th day after the later of the commencement of the Offering of the Securities and the date of the initial issuance of the Securities, which is to a non-U.S. person, (iv) pursuant to the exemption from registration provided by Rule 144 under the Securities Act (if available), (v) pursuant to another available exemption from registration under the Securities Act or (vi) pursuant to an effective registration statement under the Securities Act, and (B) in each case, in accordance with all applicable laws of any state of the United States or any other jurisdiction.

5. It understands and agrees that the Securities offered in the United States to QIBs will be represented by Rule 144A Global Securities and that Securities offered outside the United States in reliance on Regulation S will be represented by Regulation S Global Securities.

6. It agrees that it will deliver to each person to whom it transfers Securities notice of any restrictions on transfer of such Securities.

7. It understands that the Regulation S Global Securities will initially be restricted as described under "*Description of Securities—Book-Entry; Delivery and Form*" for a period ending 40 days after the later of the commencement of the Offering and the closing date. Before any beneficial interest in a Regulation S Global Security may be offered, sold, pledged or otherwise transferred, the transferor will be required to provide the Fiscal and Paying Agent with a written certificate (the form of which certification can be obtained from the Fiscal and Paying Agent) as to compliance with the transfer restriction referred to above.

8. It understands that the Securities will bear a legend to the following effect unless otherwise agreed by the Issuer and the holder thereof:

   "THIS SECURITY HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "*SECURITIES ACT*"), OR OTHER SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION. NEITHER THIS SECURITY NOR ANY INTEREST OR PARTICIPATION HEREIN MAY BE OFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION UNLESS THE TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT.

   THE HOLDER OF THIS SECURITY BY ITS ACCEPTANCE HEREOF (1) REPRESENTS THAT IT IS ACQUIRING THIS SECURITY IN AN "OFFSHORE TRANSACTION" (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT ("*REGULATION S*")) IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S AND, IF THE SECURITY HAS BEEN ACQUIRED ON OR PRIOR TO THE 40TH DAY AFTER THE LATER OF THE COMMENCEMENT OF THE OFFERING OF THE SECURITIES AND THE DATE OF THE INITIAL ISSUANCE OF THIS SECURITY (THE "*RESTRICTED PERIOD*"), IT IS NOT A U.S. PERSON (AS DEFINED IN REGULATION S) AND IT HAS NOT ACQUIRED THE SECURITY FOR THE ACCOUNT OR BENEFIT OF ANY U.S. PERSON; (2) AGREES ON ITS OWN BEHALF AND ON BEHALF OF ANY ACCOUNT FOR WHICH IT HAS PURCHASED SECURITIES THAT IT WILL NOT, ON OR PRIOR TO THE END OF THE RESTRICTED PERIOD, OFFER, SELL OR OTHERWISE TRANSFER THIS SECURITY EXCEPT (A) (I) TO THE ISSUER OR ANY OF ITS SUBSIDIARIES, (II) FOR SO LONG AS THIS SECURITY IS ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, IN THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A UNDER THE SECURITIES ACT ("*RULE 144A*"), (III) TO A NON-U.S. PERSON OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION (AS DEFINED IN REGULATION S) IN COMPLIANCE WITH RULE 903 OR RULE 904 OF REGULATION S, (IV) PURSUANT TO THE EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE), (V) PURSUANT TO ANOTHER AVAILABLE EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT, OR (VI) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, AND (B) IN EACH CASE, IN ACCORDANCE WITH ANY APPLICABLE LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION; AND (3) AGREES THAT IT WILL DELIVER TO EACH PERSON TO WHOM IT TRANSFERS SECURITIES A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

   THE FISCAL AND PAYING AGENCY AGREEMENT CONTAINS A PROVISION REQUIRING THE FISCAL AND PAYING AGENT TO REFUSE TO REGISTER ANY TRANSFER OF THIS SECURITY IN VIOLATION OF THE FOREGOING RESTRICTIONS. AFTER THE END OF THE RESTRICTED PERIOD, THIS SECURITY AND ANY INTEREST HEREIN MAY BE TRANSFERRED ONLY IN ACCORDANCE WITH THE SECURITIES ACT AND ALL APPLICABLE LAWS OF ANY OTHER JURISDICTION. EACH HOLDER OF THIS SECURITY, OR OF ANY INTEREST THEREIN, WILL BE DEEMED TO ACKNOWLEDGE, REPRESENT, WARRANT AND AGREE THAT, AT THE TIME OF ITS ACQUISITION AND THROUGHOUT THE PERIOD OF ITS HOLDING AND DISPOSITION OF SUCH SECURITY OR INTEREST THEREIN, EITHER (A) IT IS NOT, AND IT WILL NOT BECOME, AN "EMPLOYEE BENEFIT PLAN" (AS DEFINED IN SECTION 3(3) OF THE U.S. EMPLOYEE RETIREMENT INCOME

SECURITY ACT OF 1974, AS AMENDED ("*ERISA*")) THAT IS SUBJECT TO ERISA, A "PLAN" SUBJECT TO SECTION 4975 OF THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE "*CODE*"), OR AN ENTITY WHOSE UNDERLYING ASSETS INCLUDE "PLAN ASSETS" BY REASON OF ANY SUCH EMPLOYEE BENEFIT PLAN'S OR PLAN'S INVESTMENT IN THE ENTITY OR OTHERWISE, OR A GOVERNMENTAL PLAN, CHURCH PLAN, NON-U.S. PLAN OR OTHER PLAN THAT IS SUBJECT TO ANY FEDERAL, STATE, LOCAL OR NON-U.S. LAW THAT IS SUBSTANTIALLY SIMILAR TO THE PROVISIONS OF SECTION 406 OF ERISA OR SECTION 4975 OF THE CODE OR (B) ITS PURCHASE, HOLDING AND DISPOSITION OF SUCH SECURITY OR INTEREST THEREIN WILL NOT CONSTITUTE OR RESULT IN A NON-EXEMPT PROHIBITED TRANSACTION UNDER SECTION 406 OF ERISA AND/OR SECTION 4975 OF THE CODE (OR, IN THE CASE OF A GOVERNMENTAL PLAN, CHURCH PLAN, NON-U.S. PLAN OR OTHER PLAN, A VIOLATION OF ANY SUBSTANTIALLY SIMILAR FEDERAL, STATE, LOCAL OR NON-U.S. LAW) BY REASON OF AN APPLICABLE STATUTORY OR ADMINISTRATIVE EXEMPTION. THE FISCAL AND PAYING AGENCY AGREEMENT CONTAINS A PROVISION REQUIRING THE FISCAL AND PAYING AGENT TO REFUSE TO REGISTER ANY TRANSFER OF ANY SECURITY IN VIOLATION OF THE FOREGOING RESTRICTIONS."

9. It represents and agrees that (i) no other representation with respect to the offer or sale of the Securities has been made, other than the information contained in this Offering Memorandum; (ii) its investment decision is solely based on the information contained in this Offering Memorandum; (iii) the Initial Purchasers make no representation or warranty as to the accuracy or completeness of this Offering Memorandum; and (iv) it has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of its prospective investment and can afford the complete loss of such investment.

10. It represents and agrees that it has received a copy of this Offering Memorandum and acknowledges that it has had access to such financial and other information, and it has been afforded the opportunity to ask questions of the Issuer and receive answers thereto, as it deemed necessary in connection with its decision to purchase Securities.

11. It acknowledges that the Issuer, the Initial Purchasers and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations, warranties and agreements and agrees that, if any of the acknowledgments, representations, warranties and agreements deemed to have been made by its purchase of the Securities is no longer accurate, it shall promptly notify the Issuer and the Initial Purchasers. If it is acquiring any Securities as a fiduciary or agent of one or more investor accounts, it represents that it has sole investment discretion with respect to each such investor account and that it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such investor account.

For further discussion of the requirements (including the presentation of transfer certificates) under the Fiscal and Paying Agency Agreement to effect exchanges or transfer of interests in Global Securities, see "*Description of Securities—Book-Entry; Delivery and Form*."

LEGAL MATTERS

The validity of the Securities offered by this Offering Memorandum and certain legal matters will be passed upon for the Issuer by Cravath, Swaine & Moore LLP, United States counsel for the Issuer. Certain United Kingdom legal matters and certain United States legal matters will be passed upon for the Issuer by internal counsel for the Issuer. Cravath, Swaine & Moore LLP will rely, without independent investigation, upon internal counsel for the Issuer with respect to all matters of United Kingdom law. Certain United States legal matters in connection with the Securities will be passed upon for the Initial Purchasers by Milbank LLP, United States counsel for the Initial Purchasers.

INDEPENDENT AUDITORS

BAE Systems Annual Financial Statements for the years ended December 31, 2019 and December 31, 2018 have been audited by Deloitte LLP, independent auditors. BAE Systems unaudited interim financial information for the periods ended June 30, 2020 and June 30, 2019 included in this Offering Memorandum have been reviewed by Deloitte LLP, as stated in their Independent review report appearing therein. Deloitte LLP is registered to carry out audit work in the United Kingdom and Ireland by the Institute of Chartered Accountants in England and Wales. Its business address is 1 New Street Square, London, EC4A 3HQ, United Kingdom.

In accordance with guidance issued by The Institute of Chartered Accountants in England and Wales, each of the independent auditor's reports dated February 19, 2020 and February 20, 2019 on the consolidated financial statements of BAE Systems plc incorporates language that states that: "This report is made solely to [BAE Systems plc]'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 [BAE Systems plc]'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 [BAE Systems plc] and [BAE Systems plc]'s members, as a body, for our audit work, for this report, or for the opinions we have formed." The independent auditor's reports are included on pages F-3, F-78 and F-155 of this Offering Memorandum. Investors in the Securities should understand that in making these statements the independent auditors confirmed that they do not accept or assume liability to parties (such as the purchasers of the Securities) other than BAE Systems plc and BAE Systems plc's members as a body with respect to the report and to the independent auditor's audit work and opinions. The SEC would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act, or in a report filed under the Exchange Act. If a U.S. court (or any other court) were to give effect to such limiting language, the recourse that investors in the Securities may have against the independent auditor based on its report or the consolidated financial statements to which it relates could be limited.

SERVICE OF PROCESS AND ENFORCEMENT OF JUDGMENTS

The Issuer is incorporated in England and Wales. Although the Issuer will agree, in accordance with the terms of the Fiscal and Paying Agency Agreement, to accept service of process in the United States by an agent designated for such purpose, it may not be possible for investors: (i) to effect service of process in the United States upon the directors or officers of the Issuer or (ii) to enforce against either the Issuer or its officers or directors, judgments obtained in U.S. courts predicated upon the civil liability provisions of the federal or state securities laws of the United States.

If a judgment is obtained in a U.S. court against the Issuer, or any of its directors or executive officers, investors may need to enforce such judgment in jurisdictions where the relevant defendant has assets. Even though the enforceability of U.S. court judgments outside the United States is described below for England and Wales, you should consult with your own advisers in any pertinent jurisdictions as needed to enforce a judgment in those countries or elsewhere outside the United States.

The following summary with respect to the enforceability of certain U.S. court judgments in England and Wales is based upon advice provided to us by U.S. and English legal advisers. The United States and England and Wales currently do not have a treaty providing for the reciprocal recognition and enforcement of judgments in civil and commercial matters. Consequently, a final judgment for payment rendered by any federal or state court in the United States based on civil liability, whether or not predicated solely upon U.S. Federal securities laws, would not automatically be recognized or enforceable in England and Wales. In order to enforce any such U.S. judgment in England and Wales, proceedings must first be initiated before a court of competent jurisdiction in England and Wales. In such an action, the courts of England and Wales would not generally reinvestigate the merits of the original matter decided by the U.S. court (subject to what is said below) and it would usually be possible to obtain summary judgment on such a claim (assuming that there is no good defense to it). Recognition and enforcement of a U.S. judgment by the courts of England and Wales in such an action is conditional upon (among other things) the following:

- the U.S. court having had jurisdiction over the original proceedings according to English conflicts of laws principles in England and Wales;
- the U.S. judgment being final and conclusive on the merits in the sense of being final and unalterable in the court which pronounced it and being for a debt for a definite sum of money;
- the U.S. judgment not contravening public policy in England and Wales;
- the U.S. judgment not being for a sum payable in respect of tax, or other charges of a like nature in respect of a penalty or fine;
- the U.S. judgment not having been arrived at by doubling, trebling or otherwise multiplying a sum assessed as compensation for the loss or damages sustained and not being otherwise in breach of Section 5 of the Protection of Trading Interests Act 1980;
- the U.S. judgment not having been obtained by fraud or in breach of principles of natural justice in England and Wales;
- the U.S. judgment not having been given in proceedings brought in breach of an agreement for settlement of disputes;
- there not having been a prior inconsistent decision of the courts of England and Wales or a non-U.S. court between the same parties; and
- the enforcement proceedings in England and Wales being commenced within six years from the date of the U.S. judgment.

Subject to the foregoing, investors may be able to enforce in England and Wales judgments in civil and commercial matters that have been obtained from U.S. Federal or state courts. However, there can be no assurance that those judgments will be recognized or enforceable in England and Wales.

GENERAL INFORMATION

1. It is expected that listing of the Securities on the Official List and admission of the Securities to trading on the Market will be granted on or around September 15, 2020, subject only to the issue of the Global Securities. Prior to official listing and admission to trading, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. Transactions will normally be effected for delivery on the third working day after the day of the transaction. The expenses in connection with the admission to trading of the Securities are expected to amount to £5,250.
2. The Issuer has obtained all necessary consents, approvals and authorizations in the United Kingdom in connection with the issue and performance of the Securities. The issue of the Securities was authorized by written resolution of an ad-hoc banking committee of the Board of Directors passed on September 7, 2020.
3. Save as disclosed in "*Risk Factors—1. Factors that may affect the Issuer's ability to fulfil its obligations under the Securities—A. Risks relating to the industry and BAE Systems' business—The outbreak of contagious diseases may have an adverse effect on BAE Systems' business, financial condition and results of operations*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments*," there has been no significant change in the financial performance or financial position of BAE Systems since June 30, 2020 and no material adverse change in the prospects of the Issuer since December 31, 2019.
4. The website of the Issuer is http://www.baesystems.com/investors. The information on http://www.baesystems.com/investors does not form part of this Prospectus.
5. The yield to maturity of the 2031 Notes is 1.982% on an annual basis, and the yield to maturity of the 2050 Notes is 3.075% on an annual basis. The yield is calculated as of September 8, 2020 on the basis of the issue price. It is not an indication of future yield.
6. There are no material contracts entered into other than in the ordinary course of the Issuer's business, which could result in any member of BAE Systems being under an obligation or entitlement that is material to the Issuer's ability to meet its obligations to holders of Securities in respect of the Securities.
7. Where information in this Prospectus has been sourced from third parties, this information has been accurately reproduced and, as far as the Issuer is aware and is able to ascertain from the information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third-party information is identified where used.
8. For so long as the Securities remain outstanding, copies of the following documents will be available for inspection at http://www.baesystems.com/investors:
   a) the Fiscal and Paying Agency Agreement (which includes the form of the Global Securities);
   b) the Memorandum and Articles of Association of the Issuer;
   c) a copy of this Prospectus together with any supplement to this Prospectus or further Prospectuses; and
   d) all reports, letters and other documents, balance sheets, valuations and statements by any expert, any part of which is extracted or referred to in this Prospectus.

   This Prospectus will be published on the website of the Regulatory News Service operated by the London Stock Exchange at http://www.londonstockexchange.com/exchange/prices-and-news/news/market-news/market-news-home.html.
9. Deloitte LLP of 1 New Street Square, London EC4A 3HQ, United Kingdom have audited, and rendered an unqualified opinion in their independent auditor's reports on, the financial statements of the Issuer and its subsidiaries for each of the two years ended December 31, 2019 and December 31, 2018, included elsewhere in this Offering Memorandum. Deloitte LLP is registered to carry out audit work in the United Kingdom and the Republic of Ireland by the Institute of Chartered Accountants in England and Wales.
10. Certain of the Initial Purchasers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with and may perform services for the Issuer and its affiliates in the ordinary course of business. Certain of the Initial Purchasers and their affiliates may have positions, deal or make markets in the Securities, related derivatives and

reference obligations, including (but not limited to) entering into hedging strategies on behalf of the Issuer and its affiliates, investor clients, or as principal in order to manage their exposure, their general market risk, or other trading activities.

In addition, in the ordinary course of their business activities, the Initial Purchasers and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of the Issuer and its affiliates. Certain of the Initial Purchasers and their affiliates that have a lending relationship with the Issuer routinely hedge their credit exposure to the Issuer consistent with their customary risk management policies. Typically, such Initial Purchasers and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in securities, including potentially the Securities. Any such positions could adversely affect future trading prices of the Securities. The Initial Purchasers and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

INDEX TO FINANCIAL INFORMATION

* The information provided in this Offering Memorandum has been extracted from the 2019 Annual Report of BAE Systems. As the information only represents extracts of the 2019 Annual Report, there are certain references made to pages of the 2019 Annual Report which have different pagination in this Offering Memorandum, or to other pages of the 2019 Annual Report that have not been included in this Offering Memorandum. Copies of the Annual Report for 2019 can be obtained through the website maintained by BAE Systems at http://www.baesystems.com/investors. The information on the Issuer's website does not form part of this Offering Memorandum.

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*** The information provided in this Offering Memorandum has been extracted from the Half-Yearly Report 2020 of BAE Systems. As the information only represents extracts of the Half-Yearly Report, there are certain references made to pages of the Half-Yearly Report which have different pagination in this Offering Memorandum, or to other pages of the Half-Yearly Report that have not been included in this Offering Memorandum. Copies of the Half-Yearly Report can be obtained through the website maintained by BAE Systems at http://www.baesystems.com/investors. The information on the Issuer's website does not form part of this Offering Memorandum.

BAE SYSTEMS 2019 ANNUAL FINANCIAL STATEMENTS

Independent Auditor's report

to the members of BAE Systems plc only

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 2019 and of the Group's profit for the year then ended;

– the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;

– the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 Reduced Disclosure Framework; and

– the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

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, including the associated accounting policies.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 Reduced Disclosure Framework (United Kingdom Generally Accepted Accounting Practice).

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. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company. The non-audit services provided to the Group and Parent Company for the year are disclosed in note 2 to the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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.

These are consistent with the prior year.

Key audit matters with increased, stable or lower levels of risk compared to the prior year are identified with , and .

Materiality

We concluded that users of the financial statements would consider errors in excess of £75 million to be material, determined on the basis of adjusted profit before tax on continuing operations as defined on page 154 below. Errors in excess of this amount would equate to more than 4.8% of adjusted profit before tax and 4.6% of profit before tax.

Scoping

23 components were subject to audit procedures. Of these, six components were subjected to a full-scope audit. The remaining 17 were subject to an audit of specified account balances. These components contribute 94% of revenue, 79% of profit before tax and 81% of net assets.

Significant changes in our approach

There have been no significant changes in our approach this year.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement in the Basis of preparation on page 158 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Parent Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We considered as part of our risk assessment the nature of the Group, its business model and related risks including, where relevant, the impact of Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the directors' assessment of the Group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the directors' plans for future actions in relation to their going concern assessment.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the Group's and the Parent Company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

– the disclosures on pages 78 to 81 that describe the principal risks, procedures to identify emerging risks and an explanation of how these are being managed or mitigated;

– the directors' confirmation on page 89 that they have carried out a robust assessment of the principal and emerging risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or

– the directors' explanation on page 89 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We are also required to report whether the directors' statement relating to the prospects of the Group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

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 that 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.

Revenue and margin recognition on long-term contracts

Refer to page 91 (Audit Committee report) and note 1 (accounting policy and financial disclosure)

Revenue:
£18,305m (2018 £16,821m)

Key audit matter description

The estimation of both overall lifetime contract margin and the appropriate level of revenue and profit to recognise in any single accounting period require the exercise of management judgement. Within BAE Systems' contract portfolio there are a number of programmes where the estimates required in reaching these judgements are complex and could lead to a material error within the financial statements if reached incorrectly. Consequently, we consider that revenue and margin recognition represents a significant risk to our audit and a key audit matter.

We focus a greater proportion of audit effort on a number of contracts where we consider there to be the highest degree of management judgement required, and design contract-specific tests and 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 the latest contract information, our understanding of the business 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 Reviews and other key management meetings, read and understood underlying contract documentation and reviewed management support for key contract judgements. In addition, we looked for contracts that might have higher levels of judgement associated with the risk of schedule delivery or technical complexity, fixed price contracts which increase the risk of contract losses and other indicators that could increase the risk of a material impact on the financial statements.

As a result of our risk assessment we identified four contracts where we consider there to be the highest degree of management judgement required. These are:

– Astute Class submarines;
– Type 26 frigate;
– Saudi Salam Typhoon (Salam); and
– Saudi British Defence Co-operation Programme (SBDCP).

We consider the level of risk associated with this key audit matter has remained consistent with the prior year. As a result of developments during the year we have removed the Offshore Patrol Vessel, Queen Elizabeth carrier and Radford Nitrocellulose plant contracts from our identified significant risk. The Type 26 frigate contract has been added as a new significant risk contract in the current year.

How the scope of our audit responded to the key audit matter

Our contract testing approach included:

Testing the relevant controls on significant contracts

– We obtained an understanding of and, where deemed appropriate, tested the key manual and IT controls within management's Lifecycle Management (LCM) Framework and project accounting processes which management have established to ensure that contracts are appropriately forecast, managed, challenged and accounted for.
– As part of this, we observed the controls in operation by attending a sample of project contract status review meetings, Quarterly Business Review meetings and Group-level meetings to validate the various levels of challenge applied to the forecasts.

Challenging management's assumptions and estimates on significant risk contracts

To gain assurance over the contract judgements and estimates made, our work included:

– making enquiries 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 support the timeframe for delivery of the product or service and any judgements made in respect of these;
– examining external evidence to support contract status and estimation of variable consideration (including associated recoverability of contract balances), such as customer correspondence and for certain contracts, meeting with the customer directly;
– enquiring with in-house and external legal counsel regarding contract-related litigation and claims; and
– considering whether there were any indicators of management override of controls or bias in arriving at their reported position.

Key observations

The results of our testing were satisfactory.

Through our testing of significant risk contracts we did not identify any audit adjustments and consider the judgements made by management in recognising revenue and profit to be reasonable. We noted an increased level of judgement required in the current year in determining consideration under IFRS 15 when there was increased uncertainty about the potential recoverability of amounts on certain contracts.

Our testing of the remaining population identified certain immaterial audit adjustments but we conclude overall that the judgements made by management are reasonable.

Carrying value of goodwill

Refer to page 91 (Audit Committee report) and note 8 (accounting policy and financial disclosures)

Goodwill:
£9,984m (2018 £10,239m)

Key audit matter description

The Group holds material goodwill balances relating to UK and overseas acquisitions, the majority of which are in the US. Management performs an impairment review of the carrying value of each Cash-Generating Unit (CGU) on an annual basis in line with the requirements of IAS 36.

The impairment assessment involves management judgement in considering whether the carrying value of the CGU is recoverable. Determining the recoverable amount involves significant estimation including:

– forecasting future cash flows;
– determining the discount rate; and
– determining future growth rates.

As a result of market changes, discount rates have generally fallen since the prior year which, in conjunction with certain other factors, has provided more headroom in management's impairment assessments. As such, this area is no longer considered a key source of estimation uncertainty by the Group.

In planning our audit, we determined there to be a heightened level of impairment risk in relation to the carrying value of goodwill associated with the Platforms & Services (US) (P&S), Applied Intelligence (AI) and Land Munitions (Land) CGUs. These CGUs have goodwill of £3,428m, £206m and £427m, respectively. Unlike in the prior year, where we identified a significant risk over the carrying value of goodwill in AI, we have not identified a significant risk associated with any CGUs in the current year, due to the increased levels of headroom as explained above.

The size of the balance and the level of audit effort involved in assessing the carrying value of goodwill means we consider this to be a key audit matter.

Through our risk assessment, we determined that the key drivers of future cash flows in each CGU were as follows:

– **P&S:** future demand, long-term contract margin and operating cash flow assumptions, predominantly within the Combat Vehicles business;
– **AI:** impact of current year restructuring on future revenue and margin growth assumptions for the remaining business, as a result of the announced exit of the Technology & Commercial business; and
– **Land:** future demand linked to renewal of key programmes and long-term contract margin assumptions.

As a result, we have performed additional procedures over these key cash flow assumptions.

How the scope of our audit responded to the key audit matter

We have performed a series of specific audit procedures to address the key audit matter identified in relation to these CGUs. This included the following:

- we obtained a detailed understanding of management's process and key controls for performing the CGU impairment assessment. Specific focus was given to understanding management's process and controls over forecasting future cash flows and determination of the key assumptions as detailed above;
- we challenged forecast performance with reference to the recent and historical performance of each CGU, historical forecasting accuracy, external industry benchmarks and specific forecast events. This included performing sensitivity analysis to evaluate the impact of changing a range of assumptions including suppressed growth, lower margin assumptions and changes in the discount rate;
- we critically assessed the risks and opportunities identified by management in their forecasts and modelled different scenarios to understand the impact of both adverse and positive changes to the future forecasts and the level of associated headroom;
- where the cash flows 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 with reference to our revenue contract audit work for key programmes, as well as historical trends for each line of business;
- we tested the integrity of management's impairment model used to derive the recoverable amount; and
- we involved Deloitte valuation specialists to support our challenge of the applicable discount rate.

Key observations

We completed our audit of the forecasts of the P&S, AI and Land 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.

Valuation of post-employment benefit obligations

Refer to page 91 (Audit Committee report) and note 23 (accounting policy and financial disclosures)

Group's share of the net IAS 19 deficit after allocation to equity accounted investments:
£4,455m (2018 £4,029m)

Valuation of post-employment benefit obligation assets:
£27,687m (2018 £25,653m)

Valuation of post-employment benefit obligation liabilities:
£32,466m (2018 £29,986m)

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;
- discount rates; and
- mortality assumptions.

Given the significant size of the deficit at year-end, small changes to these input assumptions can lead to material changes in the valuation. Assumptions are also made in the determination of the Group's share of assets and liabilities of multi-employer schemes in which it participates and the corresponding amounts attributed to other participating employers.

Assets

Given the size and nature of the scheme assets there is significant audit effort required in ensuring the valuation of assets is supportable.

Certain asset classes are inherently more judgemental to value and have a higher level of associated valuation risk, namely:

- private equity investments;
- pooled investment vehicles without published market prices;
- private placements; and
- longevity swaps.

How the scope of our audit responded to the key audit matter

Liabilities

In relation to the 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 have assessed the competence, capabilities and objectivity of the third-party administrators who maintain membership data on behalf of the Group and performed analytical procedures to challenge key changes in membership data since the last triennial valuation (March 2017), the most recent pension scheme accounts (March 2019) and that used in the IAS 19 valuation; 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; and
- we reviewed publicly available information on the assets, comparing to internal benchmarks and reconciling inputs used by management to determine the asset values.

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 they are appropriately valued.

Our application of 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	£75m (2018 £70m)	£46m (2018 £38.5m)
Basis for determining materiality	4.8% of adjusted profit before tax of £1,575m. This includes adjustment for non-recurring items of £27m (see note 1) and fair value and foreign exchange adjustments on financial instruments and investments of £78m (see note 5).	Materiality has been set with reference to the net assets of the Parent Company.
Rationale for the benchmark applied	Adjusted profit before tax from continuing operations was considered to be the most relevant benchmark as it is considered the most stable and comparable profit metric. The adjustments excluded relate to items that are considered one-off in nature or relate to complex financial instrument valuations, which are volatile and not reflective of the underlying performance of the business. We consider the measure suitable having also considered the other relevant benchmarks of profit before taxation, where our materiality equates to 4.6%.	This represents 1% of the Parent Company net assets. In addition, we consider the materiality of the Parent Company in the context of the Group materiality and have capped this at 55% of that of the Group. We consider net assets the key benchmark used by members of the Parent Company in assessing financial performance.
Component materiality	Audit work at the 23 components identified in our Group audit scope (excluding the Parent Company) was completed to a component materiality level between £21m and £34m (2018 £18m to £38.5m).	
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 performance materiality was set at 70% of Group materiality for the 2019 audit (2018 70%). In determining performance materiality, we considered the following factors: – the quantum and nature of the uncorrected misstatements identified in the prior year audit; – our assessment of the potential for uncorrected misstatements in the current year; – the size and nature of the contract-based significant risks of material misstatement identified; – the fact two of our three key audit matters are audited centrally by the Group audit team; and – our planned reliance on controls for a number of areas of the audit for the current year.	
Error reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £3.75m (2018 £3.5m), 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.	

An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the audit risks. This exercise has considered the relative size of each reporting unit's contribution to revenue, profit before tax and adjusted profit before tax, alongside further financial or contractual risks which we consider to be present.

We have considered units that contribute more than 10% of the Group's revenue or adjusted profit before tax to be 'financially significant', and requiring a full-scope audit. In addition, as part of our risk assessment procedures and using our knowledge of the business, we assess where else we consider it appropriate to perform a full-scope audit. This resulted in full-scope audits for six components located in the UK, Saudi Arabia and the US, and included the Group's largest joint venture, MBDA.

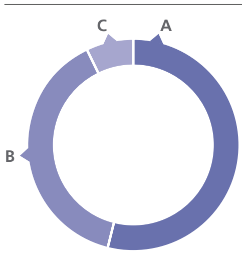
Additionally our audit planning identified 17 non-financially significant components, located in the UK, Saudi Arabia, Australia and the US, where we consider there to be a reasonable possibility of material misstatement in specific balances within the financial statements. Accordingly, we have directed component auditors to perform an audit of specified account balances and additional analytical procedures on the respective income statements and balance sheets for these components.

For all in-scope components, whether 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 or audit of specified account balance scope, we performed centrally-directed analytical review procedures to confirm our conclusion that there was no significant material misstatement in the residual population.

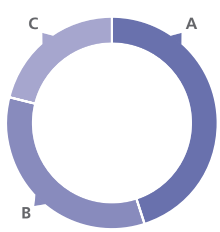
The 23 components within the scope of our audit work contribute the following proportions of the total Group results:

Revenue



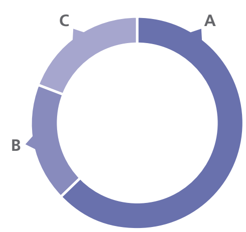
A	Full audit scope	54%
B	Specified account balances	39%
C	Review at a Group level	7%

Profit before tax



A	Full audit scope	45%
B	Specified account balances	34%
C	Review at a Group level	21%

Net assets



A	Full audit scope	63%
B	Specified account balances	18%
C	Review at a Group level	19%

As each of the business units maintains separate financial records, we have engaged component auditors from the Deloitte member firms in the US, UK, Saudi Arabia and Australia to perform procedures at all the wholly-owned components under our direction and supervision. This approach also allows us to engage local auditors who have appropriate knowledge of local regulations to perform the audit work, under a common Deloitte audit approach.

In respect of MBDA, we have engaged with the entity's non-Deloitte auditor to perform a full-scope audit under our direction and supervision.

Working with other auditors

We have issued detailed instructions to the component auditors, directed and supervised their work through a number of visits to each of the component auditors during the planning and performance stages of our audit, alongside frequent remote communication and review of their work.

Our oversight of component auditors focused on the planning of their audit work and understanding of their risk assessment process to identify key areas of estimates and judgement, as well as the execution of their audit work in line with our Group-issued referral instructions. All teams were involved in our annual planning workshop, which was overseen and directed by the Group audit team. 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 BAE Systems, Inc. business units in the US are subject to a Department of Defense Special Security Arrangement (SSA), which is a government requirement setting out specific protocol that foreign-controlled companies must comply with in order to be able to undertake government defence contracts. As part of this there is restriction on the flow of information outside of the US. Therefore, for the US components there are restrictions around access to the audit file and specific workpapers for non-US nationals. As such we have designed alternative procedures, including involvement of an additional independent US national partner, to ensure that appropriate oversight of the US component team is obtained.

In addition to the work performed at a component level, at Group level we have audited the consolidation process and carried out analytical procedures over the residual financial information of the remaining components not subject to audit or audit of specified account balances. At a Group level we also perform audit procedures on centrally-held balances including treasury, post-employment benefit obligations, goodwill, tax, head office costs and litigation and claims.

Other information

The directors are responsible for the other information. The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report thereon.

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.

In connection with our audit of the financial statements, 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 audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. 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.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit Committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code** – the parts of the directors' statement required under the Listing Rules relating to the Group's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

We have nothing to report in respect of these matters.

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.

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.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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.

Extent to which the audit was considered capable of detecting irregularities, including fraud

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.

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, our procedures included the following:

- enquiring of management, internal legal counsel, internal audit and the Audit Committee, including obtaining and reviewing supporting documentation, concerning the Group's 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; and
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations, including obtaining an understanding of the Group's bribery and corruption and whistleblowing policies;
- discussing among the 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 part of this discussion, we identified potential for fraud in relation to the level of judgement involved in estimating costs to complete on long-term contracts and the subsequent impact on revenue and margin recognition; and
- obtaining an understanding of the legal and regulatory frameworks that the Group operates in, focusing on those laws and regulations that had a direct effect on the financial statements, including the UK Companies Act, Listing Rules, pension and taxation legislation. In addition, owing to the sector the Group operates in, we considered laws and regulations that had a fundamental effect on the operations of the Group, including in respect of export controls, defence contracting and anti-bribery and corruption legislation. These areas were identified through enquiries with directors, management and legal counsel, our knowledge and understanding of the Group accumulated throughout the audit and our sector-specific experience.

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. 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 the 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 of supporting documentation to assess compliance with relevant laws and regulations described above as having a direct effect on the financial statements;
- enquiring of management, the Audit Committee, in-house legal counsel and, where necessary, circularising external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing Internal Audit reports and reviewing correspondence with relevant tax authorities;
- obtaining a detailed understanding of and performing process walkthroughs in relation to the Group's process for engaging third parties to support business development, including testing a sample of these transactions;
- 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.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and significant component audit teams and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

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 of 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.

Matters on which we are required to report by exception

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.

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.

Other matters

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 two years.

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).

Use of our report

This report is made solely to the Parent 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 Parent 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 Parent Company and the Parent Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

John Adam
Senior Statutory Auditor

For and on behalf of
Deloitte LLP
Statutory Auditor

London, United Kingdom
19 February 2020

Group accounts

Preparation

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

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

Transactions in foreign currencies are translated at the exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the balance sheet date, with the resulting exchange differences recognised in the income statement.

Significant accounting policies
The significant accounting policies applied in the preparation of these consolidated financial statements are set out in the relevant notes. These policies have been applied consistently to all the years presented, unless otherwise stated. The directors believe that the consolidated financial statements reflect appropriate judgements and estimates, and provide a true and fair view of the Group's financial performance and position.

Critical accounting policies
Certain of the Group's significant accounting policies are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the consolidated financial statements. The critical accounting policies are listed below and explained in more detail in the relevant notes to the Group accounts:

Critical accounting policy	Description	Notes
Revenue and profit recognition	The Group accounts for revenue in accordance with IFRS 15 Revenue from Contracts with Customers. For most of the Group's contracts, revenue and associated margin are recognised progressively over time as costs are incurred, and as risks have been mitigated or retired. The ultimate profitability of contracts is based on estimates of revenue and costs, including allowances for technical and other risks, which are reliant on the knowledge and experience of the Group's project managers, engineers and finance and commercial professionals. Material changes in these estimates could affect the profitability of individual contracts. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events or circumstances.	1
Carrying value of goodwill	Goodwill is not amortised, but is tested annually for impairment and carried at cost less accumulated impairment losses. For the purposes of impairment testing, goodwill is allocated to Cash-Generating Units on a consistent basis. The impairment review calculations require the use of estimates of the future profitability and cash-generating ability of the acquired businesses based on the Group's five-year Integrated Business Plan and the pre-tax discount rate used in discounting these projected cash flows.	8
Deferred tax asset on post-employment benefit obligations	The Group has recognised a deferred tax asset in respect of the deficits in its pension/post-employment schemes. It is management's judgement that the Group will generate sufficient taxable profits to recover the net deferred tax asset recognised. This judgement requires the use of estimates of future taxable profits based on the Group's Integrated Business Plan.	15
Tax provisions	Provision is made for known issues based on management's interpretation of country-specific legislation and management's assessment of the likely outcome of negotiations or litigation. The Group's approach is to consider each uncertain tax position separately. Where management considers it is probable that there will be a future outflow of funds to a tax authority, a provision is recognised. The position is reviewed on an ongoing basis. Provisions are measured using management's best estimate of the most likely amount, being the single most likely amount in a range of possible outcomes. The Group discloses any significant uncertainties in relation to tax matters to the relevant tax authority. The resolution of tax positions taken by the Group can take a considerable period of time to conclude and, in some cases, it is difficult to predict the outcome.	17
Valuation of post-employment benefit obligations	Defined benefit pension scheme accounting valuations are prepared by independent actuaries. The liabilities of the pension schemes are valued based on a number of actuarial assumptions. For each of the actuarial assumptions used there is a range of possible values and management estimates the point within that range that most appropriately reflects the Group's circumstances. Small changes in these assumptions can have a significant impact on the size of the deficit.	23

Preparation continued

Judgements made in applying accounting policies
In the course of preparing the financial statements, no judgements have been made in the process of applying the Group's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

Sources of estimation uncertainty
The application of the Group's accounting policies requires the use of estimates. In the event that these estimates prove to be incorrect, there may be an adjustment to the carrying amounts of assets and liabilities within the next financial year. The key significant risks of a material adjustment to the carrying amounts of assets and liabilities during 2020 have been considered and assessed as relating to the following:

- The determination of the discount rate and inflation assumptions underpinning the valuation of the liabilities of the Group's defined benefit pension schemes, where there is a range of possible values for each of the actuarial assumptions and small changes in assumptions may have a significant impact on the size of the deficit. Note 23 provides information on the key assumptions and analysis of their sensitivities.
- Revenue and margin recognition on contracts is based on constraints on variable consideration, estimates of future costs and an assessment of technical and other risks, including geopolitical uncertainty such as the Group's inability to obtain or maintain the necessary export licences. 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, which impacts when revenue and associated margin are recognised. As shown in note 1, the Group has recognised £0.3bn of revenue in both the current and prior financial year in respect of performance obligations satisfied or partially satisfied in previous periods. The Group currently considers that, based on the existing portfolio of contracts, this is a potential indicator of an amount up to which revenue may be recognised in the next 12 months relating to performance obligations already satisfied or partially satisfied.
- Tax provisioning is based on estimates of the potential outcomes of tax litigation or negotiations, the amount recorded being the single most likely amount in a range of possible outcomes. Such provisions can be difficult to estimate due to the complexity involved and the uncertainty in the process for their resolution. Note 17 provides information relating to potential material changes regarding tax provisions in the next financial year.

Changes in accounting policies
IFRS 16 Leases became effective from 1 January 2019. The impact of adoption is set out in note 36.

The following other standards, interpretations and amendments to existing standards became effective on 1 January 2019 and have not had a material impact on the Group:

- IFRIC 23 Uncertainty over Income Tax Treatments, effective from 1 January 2019;
- Amendments to IFRS 9: Prepayment Features with Negative Compensation, effective from 1 January 2019;
- Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures, effective from 1 January 2019;
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement, effective from 1 January 2019; and
- Annual Improvements to IFRS Standards 2015–2017 Cycle, effective from 1 January 2019.

The following other standards, interpretations and amendments to existing standards have been issued but were not mandatory for accounting periods beginning on 1 January 2019 and are not expected to have a material impact on the Group:

- Amendments to References to the Conceptual Framework in IFRS Standards, effective 1 January 2020;
- Amendments to IAS 1 and IAS 8: Definition of Material, effective from 1 January 2020;
- Amendments to IFRS 9, IAS 39 and IFRS 7: Interest Rate Benchmark Reform, effective from 1 January 2020;
- Amendments to IFRS 3: Definition of a Business, effective from 1 January 2020 (not yet endorsed by the EU);
- IFRS 17 Insurance Contracts, effective from 1 January 2021 (not yet endorsed by the EU); and
- Amendments to IFRS 10 and IAS 28: Sale or contribution of assets between an investor and its associate or joint venture, effective date deferred indefinitely.

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	2019 £m	2019 Total £m	2018 £m	2018 Total £m
Continuing operations					
Sales	1	**20,109**		18,407	
Deduct Share of sales by equity accounted investments	1	**(2,878)**		(2,812)	
Add Sales to equity accounted investments	1	**1,074**		1,226	
Revenue	1		**18,305**		16,821
Operating costs	2		**(16,724)**		(15,514)
Other income	4		**150**		158
Group operating profit			**1,731**		1,465
Share of results of equity accounted investments	1		**168**		140
Underlying EBITA	1	**2,117**		1,928	
Non-recurring items	1	**(27)**		(154)	
EBITA		**2,090**		1,774	
Amortisation of intangible assets	1	**(109)**		(85)	
Impairment of intangible assets	1	**(6)**		(33)	
Financial expense of equity accounted investments	5	**(23)**		(13)	
Taxation expense of equity accounted investments	6	**(53)**		(38)	
Operating profit	1		**1,899**		1,605
Financial income[1]		**27**		26	
Financial expense[1]		**(300)**		(407)	
Net finance costs	5		**(273)**		(381)
Profit before taxation			**1,626**		1,224
Taxation expense	6		**(94)**		(191)
Profit for the year			**1,532**		1,033
Attributable to:					
Equity shareholders			**1,476**		1,000
Non-controlling interests			**56**		33
			1,532		1,033
Earnings per share	7				
Basic earnings per share			**46.4p**		31.3p
Diluted earnings per share			**46.1p**		31.2p

1. Gains on remeasurement of financial instruments at fair value through profit or loss and foreign exchange gains for the year ended 31 December 2018 have been reclassified to remove them from financial income and present all movements within financial expense. See note 5 for details.

Consolidated statement of comprehensive income for the year ended 31 December

	Notes	2019 Other reserves[1] £m	2019 Retained earnings £m	2019 Total £m	2018 Other reserves[1] £m	2018 Retained earnings £m	2018 Total £m
Profit for the year		**–**	**1,532**	**1,532**	–	1,033	1,033
Other comprehensive income							
Items that will not be reclassified to the income statement:							
Subsidiaries:							
Remeasurements on post-employment benefit schemes		**–**	**(556)**	**(556)**	–	74	74
Tax on items that will not be reclassified to the income statement	6	**–**	**57**	**57**	–	5	5
Equity accounted investments (net of tax)		**–**	**(38)**	**(38)**	–	6	6
Items that may be reclassified to the income statement:							
Subsidiaries:							
Currency translation on foreign currency net investments		**(327)**	**–**	**(327)**	400	–	400
Reclassification of cumulative currency translation reserve on disposal		**(8)**	**–**	**(8)**	–	–	–
Fair value gain arising on hedging instruments during the period		**11**	**–**	**11**	14	–	14
Cumulative fair value gain on hedging instruments reclassified to the income statement		**(7)**	**–**	**(7)**	(39)	–	(39)
Tax on items that may be reclassified to the income statement	6	**–**	**–**	**–**	5	–	5
Equity accounted investments (net of tax)		**6**	**–**	**6**	15	–	15
Total other comprehensive income for the year (net of tax)		**(325)**	**(537)**	**(862)**	395	85	480
Total comprehensive income for the year		**(325)**	**995**	**670**	395	1,118	1,513
Attributable to:							
Equity shareholders		**(320)**	**940**	**620**	391	1,085	1,476
Non-controlling interests		**(5)**	**55**	**50**	4	33	37
		(325)	**995**	**670**	395	1,118	1,513

1. An analysis of other reserves is provided in note 25.

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 2019 as originally presented		87	1,249	6,481	(2,271)	5,546	72	5,618
Transition adjustment upon adoption of IFRS 16 Leases	36	–	–	–	(92)	(92)	–	(92)
Balance at 1 January 2019		87	1,249	6,481	(2,363)	5,454	72	5,526
Profit for the year		–	–	–	1,476	1,476	56	1,532
Total other comprehensive income for the year		–	–	(320)	(536)	(856)	(6)	(862)
Total comprehensive income for the year		–	–	(320)	940	620	50	670
Share-based payments (inclusive of tax)	30	–	–	–	75	75	–	75
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)		–	–	(5)	–	(5)	–	(5)
Ordinary share dividends	25	–	–	–	(724)	(724)	(56)	(780)
Partial disposal of shareholding in subsidiary undertaking		–	–	–	(13)	(13)	38	25
At 31 December 2019		**87**	**1,249**	**6,156**	**(2,085)**	**5,407**	**104**	**5,511**
Balance at 1 January 2018		87	1,249	6,090	(2,714)	4,712	43	4,755
Profit for the year		–	–	–	1,000	1,000	33	1,033
Total other comprehensive income for the year		–	–	391	85	476	4	480
Total comprehensive income for the year		–	–	391	1,085	1,476	37	1,513
Share-based payments (inclusive of tax)	30	–	–	–	63	63	–	63
Net sale of own shares		–	–	–	1	1	–	1
Ordinary share dividends	25	–	–	–	(703)	(703)	(28)	(731)
Partial disposal of shareholding in subsidiary undertaking		–	–	–	(3)	(3)	20	17
At 31 December 2018		87	1,249	6,481	(2,271)	5,546	72	5,618

1. An analysis of other reserves is provided in note 25.

Consolidated balance sheet as at 31 December

	Notes	2019 £m	2018[1] £m
Non-current assets			
Intangible assets	8	**10,371**	10,658
Property, plant and equipment	9	**2,437**	2,365
Right-of-use assets	10	**1,138**	–
Investment property	11	**137**	98
Equity accounted investments	12	**428**	429
Other investments		**13**	13
Other receivables	13	**484**	352
Post-employment benefit surpluses	23	**302**	308
Other financial assets	14	**350**	245
Deferred tax assets	15	**726**	702
		16,386	15,170
Current assets			
Inventories	16	**835**	774
Trade, other and contract receivables	13	**5,458**	5,177
Current tax	17	**19**	81
Other financial assets	14	**210**	166
Cash and cash equivalents	18	**2,587**	3,232
Assets held for sale	19	**135**	146
		9,244	9,576
Total assets	20	**25,630**	24,746
Non-current liabilities			
Loans	21	**(3,020)**	(3,514)
Lease liabilities	10	**(1,116)**	–
Other payables	22	**(1,481)**	(1,461)
Post-employment benefit obligations	23	**(4,757)**	(4,337)
Other financial liabilities	14	**(227)**	(104)
Provisions	24	**(385)**	(427)
		(10,986)	(9,843)
Current liabilities			
Loans and overdrafts	21	**(377)**	(785)
Lease liabilities	10	**(238)**	–
Trade and other payables	22	**(7,926)**	(7,718)
Other financial liabilities	14	**(232)**	(74)
Current tax	17	**(55)**	(334)
Provisions	24	**(300)**	(334)
Liabilities held for sale	19	**(5)**	(40)
		(9,133)	(9,285)
Total liabilities		**(20,119)**	(19,128)
Net assets		**5,511**	5,618
Capital and reserves			
Issued share capital	25	**87**	87
Share premium		**1,249**	1,249
Other reserves	25	**6,156**	6,481
Retained earnings – deficit		**(2,085)**	(2,271)
Total equity attributable to equity holders of BAE Systems plc		**5,407**	5,546
Non-controlling interests		**104**	72
Total equity		**5,511**	5,618

1. The Saudi Arabia end of service benefit obligation of £97m at 31 December 2018 has been reclassified from trade and other payables to post-employment benefit obligations (see note 23).

Approved by the Board of BAE Systems plc on 19 February 2020 and signed on its behalf by:

C N Woodburn
Chief Executive

P J Lynas
Group Finance Director

Consolidated cash flow statement for the year ended 31 December

	Notes	2019 £m	2018[1] £m
Profit for the year		**1,532**	1,033
Taxation expense	6	**94**	191
Research and development expenditure credits	4	**(12)**	(27)
Share of results of equity accounted investments	1	**(168)**	(140)
Net finance costs	5	**273**	381
Depreciation, amortisation, impairment and derecognition	2	**660**	411
Gain on investment revaluation		**–**	(7)
Profit on disposal of property, plant and equipment, and investment property	2,4	**(9)**	(18)
(Gain)/loss in respect of held for sale assets and business disposals	2,4	**(9)**	9
Cost of equity-settled employee share schemes		**74**	64
Movements in provisions		**(73)**	(101)
Decrease in liabilities for post-employment benefit obligations		**(214)**	(153)
(Increase)/decrease in working capital:			
Inventories		**(76)**	(16)
Trade, other and contract receivables		**(481)**	(757)
Trade and other payables		**258**	530
Taxation paid		**(252)**	(200)
Net cash flow from operating activities		**1,597**	1,200
Dividends received from equity accounted investments	12	**142**	57
Interest received		**28**	25
Principal element of finance lease receipts		**9**	–
Purchase of property, plant and equipment, and investment property		**(360)**	(358)
Purchase of intangible assets		**(110)**	(139)
Proceeds from sale of property, plant and equipment, and investment property		**21**	34
Proceeds from sale of intangible assets		**1**	–
Purchase of equity accounted investment		**–**	(2)
Equity accounted investment funding	12	**(6)**	(1)
Purchase of subsidiary undertakings, net of cash and cash equivalents acquired	33	**(12)**	14
Cash flow in respect of held for sale assets and business disposals, net of cash and cash equivalents disposed		**55**	12
Net cash flow from investing activities		**(232)**	(358)
Interest paid		**(233)**	(203)
Net sale of own shares		**–**	1
Equity dividends paid	25	**(724)**	(703)
Dividends paid to non-controlling interests		**(56)**	(28)
Partial disposal of shareholding in subsidiary undertaking		**31**	17
Principal element of lease payments		**(239)**	–
Cash flow from matured derivative financial instruments (excluding cash flow hedges)		**40**	6
Cash flow from movement in cash collateral		**1**	2
Cash outflow from repayment of loans		**(782)**	(7)
Net cash flow from financing activities	27	**(1,962)**	(915)
Net decrease in cash and cash equivalents		**(597)**	(73)
Cash and cash equivalents at 1 January		**3,232**	3,264
Effect of foreign exchange rate changes on cash and cash equivalents		**(48)**	41
Cash and cash equivalents at 31 December		**2,587**	3,232

1. 2018 comparatives have been reclassified to present a cash inflow of £17m in respect of a partial disposal of the Group's shareholding in a subsidiary undertaking within financing activities. This cash flow was previously presented in investing activities.

1. Segmental analysis

Revenue and profit recognition

Revenue represents income derived from contracts for the provision of goods and services, over time or at a point in time, by the Group to customers in exchange for consideration in the ordinary course of the Group's activities.

Performance obligations

Upon approval by the parties to a contract, the contract is assessed to identify each promise to transfer either a distinct good or service or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Goods and services are distinct and accounted for as separate performance obligations in the contract if the customer can benefit from them either on their own or together with other resources that are readily available to the customer and they are separately identifiable in the contract.

The Group provides warranties to its customers to give them assurance that its products and services will function in line with agreed-upon specifications. Warranties are not provided separately and, therefore, do not represent separate performance obligations.

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 price escalation, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Group's products and services, which are designed and/or manufactured under contract to the customer's individual specifications, there are typically no observable stand-alone selling prices. Instead, stand-alone selling prices are typically estimated based on expected costs plus contract margin consistent with the Group's pricing principles.

Whilst payment terms vary from contract to contract, on many of the Group's contracts, an element of the transaction price is received in advance of delivery. The Group therefore has significant contract liabilities (note 22). The Group's contracts are not considered to include significant financing components on the basis that there is no difference between the consideration and the cash selling price. UK Ministry of Defence contracting rules prohibit the inclusion of financing in the sales price. Negotiations on competitive international export contracts do not make allowance for the cash payment profile.

Revenue and profit recognition

Revenue is recognised as performance obligations are satisfied as control of the goods and services is transferred to the customer.

For each performance obligation within a contract, the Group determines whether it is satisfied over time or at a point in time. Performance obligations are satisfied over time if one of the following criteria is satisfied:

- the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs;
- the Group's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date.

The Group has determined that most of its contracts satisfy the over time criteria, either because the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs (typically services or support contracts) 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).

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.

If the over time criteria for revenue recognition are not met, revenue is recognised at the point in time that control is transferred to the customer, which is usually when legal title passes to the customer and the business has the right to payment, for example, on delivery.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

1. Segmental analysis continued

Software licences

The Group sells software licences either separately or together with other goods and services, including computer hardware and implementation, hosting and support. Revenue recognition in respect of software licences sold as part of a bundle of goods and services is considered separately when the licence is determined to be a separate performance obligation. Software licences either represent a right to access the Group's intellectual property as it exists throughout the licence period or a right to use the Group's intellectual property as it exists at the point in time at which the licence is granted. Revenue in respect of right to access licences is recognised over the licence term or, in relation to perpetual licences, over the related customer relationship and revenue in respect of right to use licences is recognised upfront on delivery to the customer. A software licence is considered to be a right to access the Group's intellectual property as it exists throughout the licence period if all of the following criteria are satisfied:

– the contract requires, or the customer reasonably expects, that the Group will undertake activities that significantly affect the intellectual property; and
– the licence directly exposes the customer to the effects of those activities; and
– those activities do not result in the transfer of a good or service to the customer.

Contract modifications

The Group's contracts are often amended for changes in customers' requirements and specifications. A contract modification exists when the parties to the contract approve a modification that either changes existing or creates new enforceable rights and obligations. The effect of a contract modification on the transaction price and the Group's measure of progress towards the satisfaction of the performance obligation to which it relates is recognised in one of the following ways:

1. prospectively, as an additional, separate contract;
2. prospectively, as a termination of the existing contract and creation of a new contract; or
3. as part of the original contract using a cumulative catch-up.

The majority of the Group's contract modifications are treated under either 1 (for example, the requirement for additional distinct goods or services) or 3 (for example, a change in the specification of the distinct goods or services for a partially completed contract), although the facts and circumstances of any contract modification are considered individually as the types of modifications will vary contract-by-contract and may result in different accounting outcomes.

Costs to obtain a contract

The Group expenses pre-contract bidding costs which are incurred regardless of whether a contract is awarded. The Group does not typically incur costs to obtain contracts that it would not have incurred had the contracts not been awarded, such as sales commission.

Costs to fulfil a contract

Contract fulfilment costs in respect of over time contracts are expensed as incurred. Contract fulfilment costs in respect of point in time contracts are accounted for under IAS 2 Inventories.

Reporting segments

The Group has the following six reporting segments:

– **Electronic Systems** comprises the US- and UK-based electronics activities, including electronic warfare systems, 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, and hybrid electric drive systems;
– **Cyber & Intelligence** comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber security, secure government, and commercial and financial security activities;
– **Platforms & Services (US),** with operations in the US, UK and Sweden, manufactures combat vehicles, weapons and munitions, and delivers services and sustainment activities, including ship repair, and the management and operation of government-owned munitions facilities;
– **Air** comprises the Group's UK-based air activities for European and International Markets, and US Programmes, and its businesses in Saudi Arabia and Australia, together with its 37.5% interest in the European MBDA joint venture;
– **Maritime** comprises the Group's UK-based maritime and land activities; and
– **HQ** comprises the Group's head office and UK-based shared services activities, together with a 49% interest in Air Astana.

The Board (the chief operating decision maker as defined by IFRS 8 Operating Segments) monitors the results of these reporting segments to assess performance and make decisions about the allocation of resources. Segmental performance is evaluated based on Key Performance Indicators – sales (see page 167) and underlying EBITA (see page 168). Finance costs and taxation expense are managed on a Group basis.

1. Segmental analysis continued

Key Performance Indicator – Sales
Definition Revenue plus the Group's share of revenue of equity accounted investments.

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

Sales and revenue by reporting segment

	Sales		Deduct Share of sales by equity accounted investments		Add Sales to equity accounted investments		Revenue	
	2019 £m	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m
Electronic Systems	**4,439**	3,965	**(114)**	(101)	**114**	101	**4,439**	3,965
Cyber & Intelligence	**1,732**	1,678	**–**	–	**–**	–	**1,732**	1,678
Platforms & Services (US)	**3,337**	3,005	**(153)**	(141)	**1**	–	**3,185**	2,864
Air	**7,457**	6,712	**(2,221)**	(2,224)	**917**	1,091	**6,153**	5,579
Maritime	**3,116**	2,975	**(50)**	(37)	**5**	2	**3,071**	2,940
HQ	**387**	350	**(344)**	(309)	**–**	–	**43**	41
	20,468	18,685	**(2,882)**	(2,812)	**1,037**	1,194	**18,623**	17,067
Intra-group sales/revenue	**(359)**	(278)	**4**	–	**37**	32	**(318)**	(246)
	20,109	18,407	**(2,878)**	(2,812)	**1,074**	1,226	**18,305**	16,821

	Intra-group revenue		Revenue from external customers	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Electronic Systems	**89**	54	**4,350**	3,911
Cyber & Intelligence	**102**	91	**1,630**	1,587
Platforms & Services (US)	**43**	39	**3,142**	2,825
Air	**12**	10	**6,141**	5,569
Maritime	**62**	40	**3,009**	2,900
HQ	**10**	12	**33**	29
	318	246	**18,305**	16,821

Sales and revenue by customer location

	Sales		Revenue	
	2019 £m	2018 £m	**2019 £m**	2018 £m
UK	**3,850**	3,819	**3,681**	3,622
Rest of Europe[1]	**2,095**	2,007	**1,156**	1,176
US	**8,642**	7,729	**8,635**	7,713
Canada	**129**	115	**129**	115
Saudi Arabia	**2,693**	2,593	**2,593**	2,464
Rest of Middle East	**1,180**	801	**992**	694
Australia	**667**	562	**667**	560
Rest of Asia and Pacific	**564**	636	**423**	430
Africa, and Central and South America	**289**	145	**29**	47
	20,109	18,407	**18,305**	16,821

1. Includes £0.6bn (2018 £0.7bn) generated under the Typhoon workshare agreement with Eurofighter Jagdflugzeug GmbH.

Revenue from external customers by domain

	2019					2018				
	Air £m	**Maritime £m**	**Land £m**	**Cyber £m**	**Total £m**	Air £m	Maritime £m	Land £m	Cyber £m	Total £m
Electronic Systems	**3,502**	**109**	**739**	**–**	**4,350**	3,105	151	655	–	3,911
Cyber & Intelligence	**219**	**412**	**93**	**906**	**1,630**	246	371	132	838	1,587
Platforms & Services (US)	**42**	**1,196**	**1,904**	**–**	**3,142**	32	1,187	1,606	–	2,825
Air	**5,557**	**413**	**171**	**–**	**6,141**	5,136	290	143	–	5,569
Maritime	**–**	**2,774**	**235**	**–**	**3,009**	16	2,623	261	–	2,900
HQ	**33**	**–**	**–**	**–**	**33**	29	–	–	–	29
	9,353	**4,904**	**3,142**	**906**	**18,305**	8,564	4,622	2,797	838	16,821

1. Segmental analysis continued

Revenue by major customer

Revenue from the Group's three principal customers, which individually represent over 10% of total revenue, is as follows:

	2019 £m	2018 £m
US Department of Defense	**6,547**	5,148
UK Ministry of Defence[1]	**3,868**	3,848
Kingdom of Saudi Arabia Ministry of Defence and Aviation	**2,541**	2,366

1. Includes £0.6bn (2018 £0.7bn) generated under the Typhoon workshare agreement with Eurofighter Jagdflugzeug GmbH.

Revenue from the UK Ministry of Defence and the US Department of Defense was generated by the five principal reporting segments. Revenue from the Kingdom of Saudi Arabia Ministry of Defence and Aviation was generated by the Air and Maritime reporting segments.

Key Performance Indicator – Underlying EBITA

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

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

Amortisation and impairment of intangible assets are excluded because they are not related to the in-year operational performance of the business, being driven by the timing and amount of investment in acquired businesses and software.

Finance costs and taxation expense of equity accounted investments are excluded for consistency with pre-interest, pre-tax business performance.

Non-recurring items are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying business performance. The Group's definition of non-recurring items includes profit or loss on business transactions, and costs incurred which are one-off in nature, for example non-routine costs or income relating to post-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.

2019

Non-recurring items of £27m comprises a £36m charge relating to the derecognition of Enterprise Resource Planning software intangible assets in the Air sector, charges of £13m relating to legal disputes arising from historical disposals, a gain of £14m on the sale of the Group's 55% shareholding in BAE Systems Global Combat Systems Limited upon formation of the Rheinmetall BAE Systems Land joint venture, and a gain of £8m relating to the disposal of Aircraft Accessories and Components Company.

2018

Non-recurring items of £154m represented a Guaranteed Minimum Pension equalisation charge of £114m, and a loss on disposal of the Mobile, Alabama, shipyard of £40m.

Operating profit/(loss) by reporting segment

	Underlying EBITA		Non-recurring items		Amortisation and impairment of intangible assets		Financial and taxation expense of equity accounted investments		Operating profit/(loss)	
	2019 £m	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m
Electronic Systems	**687**	606	**–**	–	**(15)**	(16)	**–**	–	**672**	590
Cyber & Intelligence	**91**	111	**–**	–	**(11)**	(52)	**–**	–	**80**	59
Platforms & Services (US)	**267**	210	**(13)**	(40)	**(11)**	(8)	**(4)**	(1)	**239**	161
Air	**887**	859	**(28)**	–	**(32)**	(12)	**(50)**	(37)	**777**	810
Maritime	**268**	209	**14**	–	**(25)**	(16)	**(4)**	(2)	**253**	191
HQ	**(83)**	(67)	**–**	(114)	**(21)**	(14)	**(18)**	(11)	**(122)**	(206)
	2,117	1,928	**(27)**	(154)	**(115)**	(118)	**(76)**	(51)	**1,899**	1,605
Net finance costs									**(273)**	(381)
Profit before taxation									**1,626**	1,224
Taxation expense									**(94)**	(191)
Profit for the year									**1,532**	1,033

1. Segmental analysis continued

Share of results of equity accounted investments within reporting segments

	Underlying EBITA		Non-recurring items		Amortisation of intangible assets		Financial and taxation expense		Share of results of equity accounted investments	
	2019 £m	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m
Electronic Systems	**5**	9	**–**	–	**–**	–	**–**	–	**5**	9
Platforms & Services (US)	**21**	23	**–**	–	**(1)**	–	**(4)**	(1)	**16**	22
Air	**188**	150	**–**	–	**(7)**	(7)	**(50)**	(37)	**131**	106
Maritime	**8**	7	**–**	–	**–**	–	**(4)**	(2)	**4**	5
HQ	**30**	13	**–**	(4)	**–**	–	**(18)**	(11)	**12**	(2)
	252	202	**–**	(4)	**(8)**	(7)	**(76)**	(51)	**168**	140

Key Performance Indicator – Order backlog

Definition Funded and unfunded unexecuted customer orders including the Group's share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.

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

Performance obligations

The Group's order book[1], reconciled to order backlog as defined by the Group, is shown below.

	2019 £bn	2018 £bn
Order backlog as defined by the Group	**45.4**	48.4
Deduct Unfunded order backlog	**(2.2)**	(2.0)
Deduct Share of order backlog of equity accounted investments	**(9.2)**	(9.9)
Add Order backlog in respect of orders from equity accounted investments	**3.2**	3.3
Order book[1]	**37.2**	39.8

1. Order book represents the transaction price allocated to unsatisfied and partially satisfied performance obligations as defined by IFRS 15 Revenue from Contracts with Customers.

The Group expects that approximately 40% (2018 35%) of the order book will be recognised as revenue during the next year, with the remainder largely recognised over the following four (2018 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 (2018 £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.

	2019 £m	2018 £m
Raw materials, subcontracts and other bought-in items used	**6,448**	5,816
Change in inventories of finished goods and work-in-progress	**(20)**	44
Staff costs (note 3)	**6,417**	5,876
Guaranteed Minimum Pension equalisation charge (note 23)	**–**	110
Depreciation[1]	**511**	269
Amortisation	**101**	78
Impairment – property, plant and equipment (note 9), and right of use assets (note 10)	**6**	31
Impairment – intangible assets (note 8)	**6**	33
Derecognition – intangible assets (note 8)	**36**	–
Operating lease expense[2]	**–**	287
Loss on disposal of property, plant and equipment, and investment property	**1**	1
Loss in respect of held for sale assets and business disposals	**13**	9
Other operating charges	**3,205**	2,960
Operating costs	**16,724**	15,514

1. 2019 includes £217m of depreciation of right-of-use assets recognised under IFRS 16 Leases, which became effective on 1 January 2019 (see note 10).
2. Operating lease expense is no longer applicable under IFRS 16 Leases, which became effective on 1 January 2019. Amounts recognised in the income statement in respect of leases for 2019 are disclosed in note 10.

Operating costs includes research and development expenditure of £224m (2018 £212m) funded by the Group. Development investment of £13m (2018 £10m) was capitalised during the year (see note 8).

Fees payable to the Company's auditor and its associates included in operating costs

	2019			2018		
	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	**2,032**	**–**	**2,032**	2,000	–	2,000
Fees payable to the Company's auditor and its associates for other services to the Group:						
The audit of the Company's subsidiaries	**3,082**	**4,624**	**7,706**	2,687	4,091	6,778
Total audit fees	**5,114**	**4,624**	**9,738**	4,687	4,091	8,778
Audit-related assurance services[1]	**655**	**422**	**1,077**	690	–	690
Other assurance services	**–**	**–**	**–**	175	–	175
Other services[2]	**–**	**–**	**–**	1,776	–	1,776
Total non-audit fees	**655**	**422**	**1,077**	2,641	–	2,641
Total fees payable to the Company's auditor and its associates	**5,769**	**5,046**	**10,815**	7,328	4,091	11,419

1. Audit-related assurance services comprises fees in respect of the review of the Group's Half-yearly Report and fees in respect of the audit of BAE Systems pension schemes.
2. Other services in 2018 primarily related to consultancy work in relation to the Group's Submarines business.

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	
	2019 Number '000	2018 Number '000	**2019 Number '000**	2018 Number '000
Electronic Systems	**16**	15	**16**	16
Cyber & Intelligence	**10**	10	**10**	10
Platforms & Services (US)	**12**	11	**12**	11
Air	**23**	22	**23**	23
Maritime	**16**	16	**16**	16
HQ	**2**	2	**2**	2
	79	76	**79**	78

The aggregate staff costs of Group employees, excluding employees of equity accounted investments, were as follows:

	2019 £m	2018 £m
Wages and salaries[1]	**5,505**	5,019
Social security costs	**402**	367
Share-based payments (note 30)	**74**	63
Pension costs – defined contribution plans (note 23)	**226**	203
Pension costs – defined benefit plans (note 23)	**192**	223
Other post-employment benefit costs (note 23)	**18**	1
	6,417	5,876

1. After excluding the impact of exchange translation, wages and salaries increased by approximately 3% per employee in 2019.

4. Other income

Leases
Lease income under operating leases is recognised in the income statement on a straight-line basis over the lease term.

	2019 £m	2018 £m
Research and development expenditure credits	**12**	27
Operating lease income from investment property	**28**	22
Operating lease income from subleasing right-of-use assets	**1**	–
Other operating lease income	**–**	15
Profit on disposal of businesses	**22**	–
Profit on disposal of property, plant and equipment	**–**	13
Profit on disposal of investment property	**10**	6
Management recharges to equity accounted investments (note 31)	**19**	18
Royalties	**11**	11
Other[1]	**47**	46
Other income	**150**	158

1. Includes £15m (2018 £15m) for capital spend recovery in respect of Saudi Arabia Industrial Participation investments and a £7m (2018 £8m) recovery of site development costs for the Dreadnought programme in Barrow.

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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.

	2019 £m	2018 £m
Interest income on cash and other financial instruments	**26**	26
Interest income on finance lease receivables (note 10)	**1**	–
Financial income[1]	**27**	26
Interest expense on bonds and other financial instruments	**(187)**	(204)
Facility fees	**(4)**	(4)
Interest expense on lease liabilities (note 10)	**(48)**	–
Net present value adjustments on provisions and other payables	**(28)**	(31)
Net interest expense on post-employment benefit obligations (note 23)	**(114)**	(103)
(Loss)/gain on remeasurement of financial instruments at fair value through profit or loss[2]	**(73)**	146
Foreign exchange gains/(losses)[3]	**154**	(211)
Financial expense[1]	**(300)**	(407)
Net finance costs	**(273)**	(381)

1. Gains on remeasurement of financial instruments at fair value through profit or loss of £186m and foreign exchange gains of £16m were previously presented within financial income in 2018. The Group believes it is more representative to present these items net within financial expense, since the gains and losses relate to the same underlying transactions. Accordingly, amounts previously included within financial income in 2018 have been reclassified to financial expense.
2. 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.
3. The foreign exchange gains and losses primarily reflect exchange rate movements on US dollar-denominated borrowings.

Additional analysis

	2019 £m	2018 £m
Net finance costs:		
Group	**(273)**	(381)
Share of equity accounted investments	**(23)**	(13)
	(296)	(394)
Analysed as:		
Underlying net interest expense[1]:		
Group	**(240)**	(213)
Share of equity accounted investments	**(17)**	(2)
	(257)	(215)
Other:		
Group:		
Net interest expense on post-employment benefit obligations	**(114)**	(103)
Fair value and foreign exchange adjustments on financial instruments and investments[2]	**81**	(65)
Share of equity accounted investments:		
Net interest expense on post-employment benefit obligations	**(3)**	(3)
Fair value and foreign exchange adjustments on financial instruments and investments	**(3)**	(8)
	(296)	(394)

1. Underlying net interest expense is defined as finance costs for the Group and its share of equity accounted investments, excluding net interest expense on post-employment benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.
2. The net gain (2018 loss) primarily reflects foreign exchange translational gains (2018 losses) on US dollar-denominated bonds held by BAE Systems plc.

6. Taxation expense

Income tax expense comprises current and deferred tax. Current and deferred tax is recognised in profit or loss except to the extent that it relates to a business combination or items recognised directly in equity or other comprehensive income.

Current tax
Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax
Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences:

- on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- related to investments in subsidiaries and equity accounted investments to the extent that it is probable that they will not reverse in the foreseeable future; and
- arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Taxation expense

	2019 £m	2018 £m
Current taxation		
UK:		
Current year	**(91)**	(64)
Adjustments in respect of prior years	**(89)**	(2)
	(180)	(66)
Overseas:		
Current year	**(208)**	(183)
Adjustments in respect of prior years	**297**	42
	89	(141)
Total current taxation	**(91)**	(207)
Deferred taxation		
UK:		
Origination and reversal of temporary differences	**3**	15
Adjustments in respect of prior years	**(3)**	15
Tax rate adjustment	**(1)**	–
	(1)	30
Overseas:		
Origination and reversal of temporary differences	**11**	(1)
Adjustments in respect of prior years	**(13)**	(18)
Tax rate adjustment	**–**	5
	(2)	(14)
Total deferred taxation	**(3)**	16
Taxation expense	**(94)**	(191)

UK	**(181)**	(36)
Overseas	**87**	(155)
Taxation expense	**(94)**	(191)

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.

	2019 £m	2018 £m
Profit before taxation	**1,626**	1,224
UK corporation tax rate	**19%**	19%
Expected income tax expense	**(309)**	(233)
Effect of tax rates in foreign jurisdictions, including US state taxes	**(52)**	(43)
Effect of intra-group financing	**–**	14
Expenses not tax effected	**(14)**	(14)
Income not subject to tax	**61**	18
Research and development tax credits and patent box benefits	**10**	14
Non-taxable non-recurring items	**4**	–
Chargeable gains	**(3)**	(1)
Utilisation of previously unrecognised tax losses	**3**	1
Current year losses not tax effected	**(3)**	–
Adjustments in respect of prior years	**192**	37
Adjustments in respect of equity accounted investments	**32**	27
Tax rate adjustment	**(1)**	5
Other	**(14)**	(16)
Taxation expense	**(94)**	(191)

Calculation of the underlying effective tax rate

	2019 £m	2018 £m
Profit before taxation	**1,626**	1,224
Add back: Taxation expense of equity accounted investments	**53**	38
Deduct: Non-taxable non-recurring items	**(22)**	–
Adjusted profit before taxation	**1,657**	1,262
Taxation expense	**(94)**	(191)
Taxation expense of equity accounted investments	**(53)**	(38)
Exclude: One-off tax benefit	**(161)**	–
Adjusted taxation expense (including equity accounted investments)	**(308)**	(229)
Underlying effective tax rate	**19%**	18%

The one-off tax benefit relates to two items. Firstly, following agreements reached in respect of overseas tax matters, a benefit has been recognised. Secondly, following review of the April 2019 EU Commission decision that concluded that the UK's Controlled Foreign Company regime partially represents State Aid, a provision has been recognised for the estimated exposure. There remains uncertainty surrounding HMRC's likely approach to the assessment of the deemed State Aid and recovery of amounts which they consider to be due, and, accordingly, developments will continue to be monitored and assessed.

6. Taxation expense continued

Tax recognised in other comprehensive income

	2019 Before tax £m	2019 Tax benefit/ (expense) £m	2019 Net of tax £m	2018 Before tax £m	2018 Tax benefit/ (expense) £m	2018 Net of tax £m
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on post-employment benefit schemes	**(556)**	**76**	**(480)**	74	3	77
Tax rate adjustment	**–**	**(19)**	**(19)**	–	2	2
Equity accounted investments	**(52)**	**14**	**(38)**	8	(2)	6
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	**(327)**	**–**	**(327)**	400	–	400
Reclassification of cumulative currency translation reserve on disposal	**(8)**	**–**	**(8)**	–	–	–
Fair value gain arising on hedging instruments during the period	**11**	**(2)**	**9**	14	(3)	11
Cumulative fair value gain on hedging instruments reclassified to the income statement	**(7)**	**2**	**(5)**	(39)	8	(31)
Equity accounted investments	**12**	**(6)**	**6**	16	(1)	15
	(927)	**65**	**(862)**	473	7	480

	2019 Other reserves £m	2019 Retained earnings £m	2019 Total £m	2018 Other reserves £m	2018 Retained earnings £m	2018 Total £m
Current tax						
Subsidiaries:						
Remeasurements on post-employment benefit schemes	**–**	**28**	**28**	–	24	24
	–	**28**	**28**	–	24	24
Deferred tax						
Subsidiaries:						
Remeasurements on post-employment benefit schemes	**–**	**48**	**48**	–	(21)	(21)
Tax rate adjustment	**–**	**(19)**	**(19)**	–	2	2
Fair value gain arising on hedging instruments during the period	**(2)**	**–**	**(2)**	(3)	–	(3)
Cumulative fair value gain on hedging instruments reclassified to the income statement	**2**	**–**	**2**	8	–	8
Equity accounted investments	**(6)**	**14**	**8**	(1)	(2)	(3)
	(6)	**43**	**37**	4	(21)	(17)
Tax on other comprehensive income	**(6)**	**71**	**65**	4	3	7

7. Earnings per share

Key Performance Indicator – Underlying earnings per share
Definition Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives and non-recurring items.

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

Amortisation and impairment of intangible assets are excluded because they are not related to the in-year operational performance of the business, being driven by the timing and quantum of investment in acquired businesses and software.

Non-cash finance movements on pensions are excluded because they are driven by external factors, such as corporate bond yields and inflation.

Non-cash finance movements on financial derivatives are excluded because they are driven by external factors, such as foreign exchange rates and interest rates.

Non-recurring items (as defined in note 1) are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying performance.

	2019			2018		
	£m	**Basic pence per share**	**Diluted pence per share**	£m	Basic pence per share	Diluted pence per share
Profit for the year attributable to equity shareholders	**1,476**	**46.4**	**46.1**	1,000	31.3	31.2
Add back/(deduct):						
Amortisation and impairment of intangible assets, post tax[1]	**93**			97		
Net interest expense on post-employment benefit obligations, post tax[1]	**95**			87		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax[1]	**(64)**			60		
Non-recurring items, post tax[1]	**18**			126		
Underlying earnings, post tax	**1,618**	**50.8**	**50.5**	1,370	42.9	42.8
One-off tax benefit	**(161)**			–		
Underlying earnings, excluding one-off tax benefit	**1,457**	**45.8**	**45.5**	1,370	42.9	42.8
		Millions	**Millions**		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		**3,183**	**3,183**		3,192	3,192
Incremental shares in respect of employee share schemes			**18**			9
Weighted average number of shares used in calculating diluted earnings per share			**3,201**			3,201

1. The tax impact is calculated using the underlying effective tax rate of 19% (2018 18%). The calculation of the underlying effective tax rate is shown in note 6.

8. Intangible assets

Intangible assets are carried at cost or valuation, less accumulated amortisation and impairment losses.

Cost or valuation

Goodwill

Under the acquisition method for business combinations, goodwill is the acquisition-date fair value of the consideration transferred, less the net of the acquisition-date fair values of the identifiable assets acquired and liabilities assumed. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of joint ventures and associates is included in the carrying value of equity accounted investments. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Software

Software includes:

– Computer software licences acquired for use within the Group are capitalised as an intangible asset on the basis of the costs incurred to acquire and bring to use the specific software; and

– Software development costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Group-funded expenditure associated with enhancing or maintaining computer software programs for sale is recognised as an expense as incurred.

Development costs

Development costs funded by the Group on activities applied to a plan or design for the production of new or substantially improved products are capitalised as an internally-generated intangible asset if certain conditions are met. The costs capitalised include materials, direct labour and related overheads.

Programme and customer-related

Intangible assets recognised by the Group include those relating to ongoing programmes within businesses acquired, mainly in respect of customer relationships and order backlog. These assets are initially recognised at their fair value at the acquisition date.

Other

Other intangible assets includes patents, trademarks and licences.

Amortisation

Goodwill is not amortised. Amortisation on intangible assets, excluding goodwill, is charged to the income statement on a straight-line basis over their estimated useful lives.

For programme-related intangibles, amortisation is set on a programme-by-programme basis over the life of the individual programme. Amortisation for customer-related intangibles is also set on an individual basis.

The estimated useful lives are as follows:

Software	up to 5 years
Development costs	up to 10 years
Programme and customer-related	up to 15 years
Other	up to 20 years

The Group has no indefinite-life intangible assets other than goodwill.

Impairment of intangible assets, property, plant and equipment, right-of-use assets, investment property and equity accounted investments

The carrying amounts of the Group's intangible assets (excluding goodwill), property, plant and equipment, right-of-use assets, investment property and equity accounted investments are reviewed at each balance sheet date to determine whether there is any indication of impairment as required by IAS 36 Impairment of Assets. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangible assets that are not yet available for use, impairment testing is performed annually.

An impairment loss is recognised whenever the carrying amount of an asset or its Cash-Generating Unit (CGU) exceeds its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an appropriate pre-tax discount rate. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs.

Impairment losses are recognised in the income statement.

An impairment loss in respect of goodwill is not reversed. An impairment loss in respect of other intangible assets, property, plant and equipment, investment property and equity accounted investments is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised or if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

8. Intangible assets continued

	Goodwill £m	Software £m	Development costs £m	Programme and customer-related £m	Other £m	Total £m
Cost or valuation						
At 1 January 2018	14,722	647	90	265	89	15,813
Additions:						
Acquired separately	–	98	–	5	2	105
Internally developed	–	28	10	–	–	38
Disposals[1]	–	(16)	–	(43)	(2)	(61)
Reclassification as held for sale	(80)	(10)	–	–	–	(90)
Net transfer from property, plant and equipment	–	13	–	–	–	13
Foreign exchange adjustments	436	15	5	9	4	469
At 31 December 2018	15,078	775	105	236	93	16,287
Additions:						
Acquired separately	–	67	–	–	9	76
Internally developed	–	18	13	–	–	31
Business acquisitions	30	–	–	1	3	34
Derecognition	–	(36)	–	–	–	(36)
Disposals[1]	–	(79)	(7)	(1)	(65)	(152)
Reclassification as held for sale	(48)	(8)	–	(60)	–	(116)
Transfer from property, plant and equipment	–	19	–	–	–	19
Foreign exchange adjustments	(320)	(13)	(5)	(9)	(2)	(349)
At 31 December 2019	**14,740**	**743**	**106**	**167**	**38**	**15,794**
Amortisation and impairment						
At 1 January 2018	4,726	322	62	240	85	5,435
Amortisation[2]	–	63	7	11	3	84
Impairment charge[3]	–	–	–	33	–	33
Disposals[1]	–	(16)	–	(43)	(2)	(61)
Transfer to property, plant and equipment	–	(3)	–	–	–	(3)
Reclassification as held for sale	–	(3)	–	–	–	(3)
Reclassification between categories	–	23	–	(23)	–	–
Foreign exchange adjustments	113	14	4	9	4	144
At 31 December 2018	4,839	400	73	227	90	5,629
Amortisation[2]	–	87	10	5	5	107
Impairment charge	–	6	–	–	–	6
Disposals[1]	–	(78)	(7)	(1)	(65)	(151)
Reclassification as held for sale	–	(8)	–	(60)	–	(68)
Transfer from property, plant and equipment	–	9	–	–	–	9
Foreign exchange adjustments	(83)	(12)	(4)	(8)	(2)	(109)
At 31 December 2019	**4,756**	**404**	**72**	**163**	**28**	**5,423**
Net book value						
At 31 December 2019	**9,984**	**339**	**34**	**4**	**10**	**10,371**
At 31 December 2018	10,239	375	32	9	3	10,658
At 1 January 2018	9,996	325	28	25	4	10,378

1. Includes intangible assets with nil net book value no longer used by the Group.
2. Amortisation of £107m (2018 £84m) includes £101m (2018 £78m) charged to the income statement as an amortisation expense and £6m (2018 £6m) recoverable on customer contracts.
3. The impairment charge for 2018 in Cyber & Intelligence related to Silversky customer-related intangible assets.

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. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital of 6.62% (2018 7.24%) (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 £8.0bn (2018 £8.2bn) 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	**2019 £bn**	2018 £bn	**2019 %**	2018 %
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	**3.9**	4.0	**8**	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	**8**	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	**3.4**	3.5	**8**	9

The headroom, calculated as the difference between net assets including allocated goodwill as at 31 December 2019 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 and a 1% and 2% increase in the discount rate 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 2% increase in the discount rate	
Cash-Generating Unit	**2019 £bn**	2018 £bn	**2019 £bn**	2018 £bn	**2019 £bn**	2018 £bn	**2019 £bn**	2018 £bn
Electronic Systems	**5.7**	4.4	**4.1**	3.0	**3.8**	2.8	**2.5**	1.6
Intelligence & Security	**0.9**	0.7	**0.7**	0.5	**0.6**	0.5	**0.5**	0.4
Platforms & Services (US)	**2.2**	1.8	**1.3**	0.9	**1.1**	0.8	**0.4**	0.1

Other CGUs

The remaining goodwill balance of £2.0bn (2018 £2.0bn) is allocated across multiple CGUs, including £0.2bn (2018 £0.2bn) in the Applied Intelligence CGU, with no individual CGU exceeding 10% of the Group's total goodwill balance. The majority of the projected cash flows within these CGUs are underpinned by expected levels of primarily UK government spending on defence, aerospace and security, and the Group's ability to capture a broadly consistent market share. In the case of Applied Intelligence, the future cash flow projections are based on the expectation of growth in cyber and intelligence, in the UK and overseas government markets, together with increasing demand for products and services in commercial markets.

Software

The software intangible net book value balance includes £85m (2018 £135m) relating to an Enterprise Resource Planning transformation programme which went live across the Air segment during the year. The remaining amortisation period is four years.

Capital commitments

At 31 December 2019, capital expenditure of £16m (2018 £21m) in respect of intangible assets was contracted for but not provided for in the accounts.

9. Property, plant and equipment

Cost

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. The cost of demonstration assets is written off as incurred. The reimbursement of the cost of an item of property, plant and equipment by way of a government grant is presented as deferred income and recognised in the income statement on a basis consistent with the depreciation of the asset over its estimated useful life.

Assets held for leasing out under operating leases are included in property, plant and equipment at cost less accumulated depreciation and impairment losses.

Depreciation

Depreciation is provided, normally on a straight-line basis, to write off the cost of items of property, plant and equipment over their estimated useful lives to any estimated residual value, using the following rates:

Buildings	up to 50 years, or the lease term if shorter
Plant and machinery:	
Computing equipment and motor vehicles	4 to 5 years
Other equipment	10 to 20 years, or the project life if shorter

No depreciation is provided on freehold land and assets in the course of construction.

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment

The carrying amounts of the Group's property, plant and equipment are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

9. Property, plant and equipment continued

	Land and buildings £m	Plant and machinery £m	Total £m
Cost			
At 1 January 2018	2,212	3,232	5,444
Additions[1]	154	288	442
Reclassification as held for sale	(11)	(12)	(23)
Transfer (to)/from intangible assets	(17)	4	(13)
Reclassification between categories	44	(60)	(16)
Disposals	(117)	(141)	(258)
Foreign exchange adjustments	50	87	137
At 31 December 2018	2,315	3,398	5,713
Additions[1]	199	238	437
Reclassification as held for sale	(37)	(25)	(62)
Transfer to intangible assets	–	(19)	(19)
Reclassification between categories	(14)	23	9
Disposals	(21)	(108)	(129)
Foreign exchange adjustments	(48)	(72)	(120)
At 31 December 2019	**2,394**	**3,435**	**5,829**
Depreciation and impairment			
At 1 January 2018	1,083	2,131	3,214
Depreciation charge for the year	84	183	267
Impairment charge for the year	27	4	31
Reclassification as held for sale	(7)	(6)	(13)
Transfer from intangible assets	–	3	3
Reclassification between categories	18	(34)	(16)
Disposals	(89)	(136)	(225)
Foreign exchange adjustments	29	58	87
At 31 December 2018	1,145	2,203	3,348
Depreciation charge for the year	87	199	286
Impairment charge for the year	2	1	3
Reclassification as held for sale	(21)	(22)	(43)
Transfer to intangible assets	–	(9)	(9)
Reclassification between categories	(13)	22	9
Disposals	(19)	(105)	(124)
Foreign exchange adjustments	(28)	(50)	(78)
At 31 December 2019	**1,153**	**2,239**	**3,392**
Net book value			
At 31 December 2019	**1,241**	**1,196**	**2,437**
At 31 December 2018	1,170	1,195	2,365
At 1 January 2018	1,129	1,101	2,230

1. Includes £93m (2018 £70m) of land and buildings, and £nil (2018 £20m) of plant and machinery at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

9. Property, plant and equipment continued

Net impairment

	2019 £m	2018 £m
Electronic Systems	**2**	–
Platforms & Services (US)	**1**	31
	3	31

2019
The impairment charge in Electronic Systems relates to building structural issues in Austin, Texas.

2018
The impairment charge in Platforms & Services (US) related to the Mobile shipyard prior to its disposal.

Assets in the course of construction

	Land and buildings[1] £m	Plant and machinery £m	Total £m
At 31 December 2019	**313**	**214**	**527**
At 31 December 2018	198	230	428

1. Includes £210m (2018 £129m) at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

Capital commitments
At 31 December 2019, capital expenditure of £205m (2018 £243m) 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.

IFRS 16 Leases became effective from 1 January 2019. The impact of adoption is set out in note 36.

The Group leases land, buildings, vehicles and equipment under non-cancellable lease arrangements. The leases have varying terms, including escalation clauses, renewal rights and purchase options. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

10. Leases continued

Right-of-use assets

	31 December 2019		
	Land and buildings £m	Plant and machinery £m	Total £m
Additions during the year	**129**	**9**	**138**
Depreciation expense for the year	**207**	**10**	**217**
Impairment charge for the year	**3**	**–**	**3**
Net book value	**1,120**	**18**	**1,138**

Lease liabilities

A maturity analysis of the future undiscounted lease payments in respect of the Group's lease liabilities is presented in the table below:

	2019 £m
Payments due:	
Within one year	**297**
Between one and five years	**710**
Later than five years	**566**
	1,573

The Group is also committed to future undiscounted lease payments of £84m in respect of leases which had not yet commenced at 31 December 2019.

The total cash outflow for leases in the year ended 31 December 2019, including short-term leases and low-value leases, amounted to £317m.

Amounts recognised in the income statement

	2019 £m
Included in operating costs:	
Depreciation on right-of-use assets	**(217)**
Short-term lease expense	**(30)**
Low-value lease expense	**(5)**
	(252)
Included in other income:	
Operating lease income from investment property	**28**
Operating lease income from subleasing right-of-use assets	**1**
	29
Included in net finance costs:	
Interest income on finance lease receivables	**1**
Interest expense on lease liabilities	**(48)**
	(47)

10. Leases continued

Operating leases

The Group is party to operating leases in which it is the lessor, primarily relating to investment property. Under the terms of the lease agreements, no contingent rents are receivable. The leases have varying terms including escalation clauses and renewal rights. None of these terms represent unusual arrangements or create material onerous or beneficial rights or obligations.

A maturity analysis of the future undiscounted lease receipts from operating leases in which the Group is lessor is presented in the table below:

	2019 £m
Receipts due:	
Within one year	**28**
Between one and two years	**25**
Between two and three years	**24**
Between three and four years	**23**
Between four and five years	**22**
Later than five years	**3**
	125

	2018 £m
Receipts due:	
Within one year	24
Between one and five years	95
Later than five years	28
	147

Finance lease receivables

From 1 January 2019, certain of the Group's subleases where the Group is an intermediate lessor are now classified as finance leases under IFRS 16. 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. The Group did not have any leases classified as finance leases in 2018 before the adoption of IFRS 16.

A maturity analysis of the future undiscounted lease receipts from finance leases in which the Group is lessor is presented in the table below:

	2019 £m
Receipts due:	
Within one year	**11**
Between one and two years	**11**
Between two and three years	**11**
Between three and four years	**10**
Between four and five years	**10**
Later than five years	**15**
Total undiscounted gross receipts	**68**
Deduct: Impact of discounting	**(5)**
Finance lease receivables (note 13)	**63**

11. Investment property

Cost
Land and buildings that are leased to non-Group entities are classified as investment property. The Group measures investment property at its cost less accumulated depreciation and impairment losses.

Depreciation
Depreciation is provided, on a straight-line basis, to write off the cost of investment property over its estimated useful life of up to 50 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment
The carrying amounts of the Group's investment property are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

	£m
Cost	
At 1 January 2018	161
Additions	8
Disposals	(9)
At 31 December 2018	160
Cost recognised on transition to IFRS 16 (note 36)	45
Additions	15
Disposals	(11)
At 31 December 2019	**209**
Depreciation and impairment	
At 1 January 2018	60
Depreciation charge for the year	2
At 31 December 2018	62
Impairment recognised on transition to IFRS 16 (note 36)	2
Depreciation charge for the year	8
At 31 December 2019	**72**
Net book value	
At 31 December 2019	**137**
At 31 December 2018	98
At 1 January 2018	101

Fair value	
At 31 December 2019	**222**
At 31 December 2018	176

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 2019, capital expenditure of £45m (2018 £10m) 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.

	2019		2018	
	Eurofighter Jagdflugzeug £m	**MBDA £m**	Eurofighter Jagdflugzeug £m	MBDA £m
Revenue (100%)	**2,558**	**3,246**	3,110	2,799
Underlying EBITA[1] excluding depreciation	**28**	**454**	12	398
Non-recurring items	**–**	**–**	–	(11)
Depreciation and amortisation	**–**	**(101)**	(1)	(95)
Financial income	**1**	**64**	–	60
Financial expense	**–**	**(72)**	–	(63)
Taxation expense	**(4)**	**(110)**	(2)	(86)
Profit for the year (100%)	**25**	**235**	9	203
Remeasurements on post-employment benefit schemes, net of tax	**–**	**(103)**	–	15
Amounts credited/(charged) to hedging reserve, net of tax	**–**	**36**	–	(11)
Foreign exchange adjustments	**–**	**8**	–	9
Total comprehensive income for the year (100%)	**25**	**176**	9	216
Group's share of total comprehensive income for the year	**8**	**66**	3	81
Non-current assets	**14**	**2,297**	14	2,190
Cash and cash equivalents	**24**	**2,343**	32	2,324
Current assets excluding cash and cash equivalents	**823**	**4,102**	1,006	4,537
Current assets	**847**	**6,445**	1,038	6,861
Non-current financial liabilities excluding trade and other payables, and provisions	**–**	**(5)**	–	(8)
Other non-current liabilities	**(65)**	**(805)**	(33)	(719)
Non-current liabilities	**(65)**	**(810)**	(33)	(727)
Current financial liabilities excluding trade and other payables, and provisions	**–**	**(20)**	–	–
Other current liabilities	**(753)**	**(7,446)**	(988)	(7,808)
Current liabilities	**(753)**	**(7,466)**	(988)	(7,808)
Net assets (100%)	**43**	**466**	31	516

1. Operating profit excluding amortisation and impairment of intangible assets (EBITA), and non-recurring items.

12. Equity accounted investments continued

	2019 Eurofighter Jagdflugzeug £m	2019 MBDA £m	2019 Total £m	2018 Eurofighter Jagdflugzeug £m	2018 MBDA £m	2018 Total £m
Group's share of net assets	**14**	**175**	**189**	10	193	203
Goodwill adjustment	**–**	**5**	**5**	–	6	6
Carrying value	**14**	**180**	**194**	10	199	209

	2019 Eurofighter Jagdflugzeug £m	2019 MBDA £m	2019 Total £m	2018 Eurofighter Jagdflugzeug £m	2018 MBDA £m	2018 Total £m
Dividends received	**3**	**73**	**76**	2	24	26

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 2019 are as follows: Rheinmetall BAE Systems Land (RBSL) (£76m), FADEC International (£45m), FNSS (£42m), Air Astana (£38m), and Panavia Aircraft (£17m). The following table shows a reconciliation of opening to closing carrying value for both the Group's principal and immaterial joint ventures in aggregate.

	Principal equity accounted investments £m	Other £m	Total £m
At 1 January 2018	148	174	322
Group's share of profit for the year	79	61	140
Group's share of remeasurements on post-employment benefit schemes	8	–	8
Tax on items that will not be reclassified to the income statement	(2)	–	(2)
Foreign exchange adjustments	3	–	3
Amounts (charged)/credited to hedging reserve	(4)	4	–
Tax on items that may be reclassified to the income statement	–	(1)	(1)
Group's share of total comprehensive income for the year	84	64	148
Purchase of equity accounted investments	–	2	2
Equity accounted investment funding	–	1	1
Dividends received from equity accounted investments	(26)	(31)	(57)
Foreign exchange adjustments	3	10	13
At 31 December 2018	209	220	429
Transition adjustment upon adoption of IFRS 16 Leases (note 36)	(2)	(9)	(11)
At 1 January 2019	207	211	418
Group's share of profit for the year	96	72	168
Group's share of remeasurements on post-employment benefit schemes	(52)	–	(52)
Tax on items that will not be reclassified to the income statement	14	–	14
Foreign exchange adjustments	3	–	3
Amounts credited to hedging reserve	16	15	31
Tax on items that may be reclassified to the income statement	(3)	(3)	(6)
Group's share of total comprehensive income for the year	74	84	158
Equity accounted investment reclassified as held for sale (note 19)	–	(66)	(66)
Fair value of 45% investment retained in RBSL (note 19)	–	76	76
Equity accounted investment funding	–	6	6
Dividends received from equity accounted investments	(76)	(66)	(142)
Foreign exchange adjustments	(11)	(11)	(22)
At 31 December 2019	**194**	**234**	**428**

Contingent liabilities

The Group is not aware of any material contingent liabilities in respect of its equity accounted investments.

13. Trade, other and contract receivables

Trade receivables are measured at amortised cost under IFRS 9 Financial Instruments as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest on the principal amount outstanding.

Contract receivables represent amounts for which the Group has an unconditional right to consideration in respect of unbilled revenue recognised at the balance sheet date and comprise costs incurred plus attributable margin.

Trade receivables, contract receivables, amounts owed by equity accounted investments and finance lease receivables include a provision for expected credit losses. The Group measures the provision at an amount equal to lifetime expected credit losses, estimated by reference to past experience and relevant forward-looking factors.

The Group writes off a receivable when there is objective evidence that the debtor is in significant financial difficulty and there is no realistic prospect of recovery, for example, when a debtor enters bankruptcy or financial reorganisation.

US deferred compensation plan assets are measured at fair value in accordance with IAS 19 Employee Benefits.

	2019 £m	2018 £m
Non-current		
Contract receivables	**38**	–
Prepayments and accrued income	**62**	25
US deferred compensation plan assets	**322**	306
Finance lease receivables (note 10)	**53**	–
Other receivables	**9**	21
	484	352
Current		
Contract receivables	**2,649**	2,331
Trade receivables	**1,405**	1,427
Amounts owed by equity accounted investments (note 31)	**53**	67
Prepayments and accrued income	**937**	1,025
Finance lease receivables (note 10)	**10**	–
Other receivables[1]	**404**	327
	5,458	5,177

1. Includes £129m (2018 £46m) in relation to VAT receivable in Saudi Arabia.

Contract receivables as at 1 January 2018 were £1,484m.

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.

The Group has applied the IFRS 9 general hedge accounting requirements from the date of initial application on 1 January 2018.

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.

Fair value hedges

Where a derivative financial instrument is designated as a fair value hedge, changes in the fair value of the underlying asset or liability attributable to the hedged risk, and gains and losses on the derivative instrument, are recognised within finance costs in the income statement for the period.

	2019		2018	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	**233**	**(221)**	125	(95)
Other foreign exchange/interest rate contracts	**14**	**–**	33	(9)
Debt-related derivative financial instruments	**103**	**(6)**	87	–
	350	**(227)**	245	(104)
Current				
Cash flow hedges – foreign exchange contracts	**203**	**(174)**	79	(63)
Other foreign exchange/interest rate contracts	**7**	**(28)**	9	(9)
Debt-related derivative financial instruments	**–**	**(30)**	78	(2)
	210	**(232)**	166	(74)

Debt-related derivative financial instruments

The debt-related derivative financial instruments represent the fair value of cross-currency, interest rate and foreign exchange derivatives relating to the US$500m 2.85% bond, repayable 2020, the US$500m 4.75% bond, repayable 2021, the US$800m 3.8% bond, repayable 2024, the US$500m 7.5% bond, repayable 2027 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.

None of these debt-related derivative financial instruments are in designated hedge relationships as at 31 December 2019. Interest rate swaps with a fair value of £2m were in a designated fair value hedge relationship at 31 December 2018.

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% (2018 50%) and a maximum of 90% (2018 90%) of gross debt is maintained at fixed interest rates. At 31 December 2019, the Group had 80% (2018 81%) of fixed rate debt and 20% (2018 19%) of floating rate debt based on a gross debt of £3.3bn (2018 £4.1bn), 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	2,587	–	–
Loans and overdrafts	675	675	675

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 2019, the Group had a total of $0.9bn (2018 $1.0bn) of this type of swap outstanding with a weighted average duration of 4.8 years (2018 5.8 years). In respect of the fixed rate debt, the weighted average period in respect of which interest is fixed was 7.1 years (2018 8.5 years). Given the level of short-term interest rates during the year, the average cost of the floating rate debt was 5.3% (2018 5.5%) on US dollars. The cost of the fixed rate debt was 4.7% (2018 4.8%).

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 (2018 £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 £15m (2018 £20m).

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 2019					31 December 2018				
		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	**(3,397)**	**(533)**	**(1,874)**	**(2,460)**	**(4,867)**	(4,299)	(971)	(1,742)	(3,301)	(6,014)
Cash flow hedges – financial assets	**436**	**(5,098)**	**(5,006)**	**(438)**	**(10,542)**	204	(3,754)	(2,722)	(376)	(6,852)
Cash flow hedges – financial liabilities	**(395)**	**(5,078)**	**(5,933)**	**(602)**	**(11,613)**	(158)	(3,897)	(3,253)	(345)	(7,495)
Other foreign exchange/interest rate contracts – financial assets	**21**	**(351)**	**–**	**–**	**(351)**	42	(756)	–	–	(756)
Other foreign exchange/interest rate contracts – financial liabilities	**(28)**	**(1,679)**	**–**	**–**	**(1,679)**	(18)	(816)	(154)	(36)	(1,006)
Debt-related derivatives – financial assets	**103**	**(53)**	**(213)**	**(370)**	**(636)**	165	(1,109)	(93)	(393)	(1,595)
Debt-related derivatives – financial liabilities	**(36)**	**(442)**	**(248)**	**–**	**(690)**	(2)	(14)	–	–	(14)
Other financial assets and liabilities	**101**					233				

A maturity analysis of the contracted cash outflows on lease liabilities is provided in note 10.

Contractual cash outflows in respect of all other financial liabilities are materially equivalent to the balance sheet carrying amount. Contractual amounts relating to other non-derivative financial liabilities, such as trade payables, are settled within the normal operating cycle of the business (within one year for current liabilities and within two years for the majority of non-current liabilities).

14. Other financial assets and liabilities and financial risk management continued

Borrowing facilities

The Group's objective is to maintain adequate undrawn committed borrowing facilities.

At 31 December 2019, the Group had a committed Revolving Credit Facility (RCF) of £2bn (2018 £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 2019, the Group had no Commercial Paper in issue (2018 £nil).

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 credit ratings for short periods. The cash and cash equivalents balance at 31 December 2019 of £2,587m (2018 £3,232m) was invested with 28 (2018 31) 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.

Currency risk

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

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

The currency and notional amount of the designated hedging instruments match the currency and principal amounts of the forecast transactions being hedged, therefore the hedging instruments and hedged items have values which will generally move in opposite directions because of the same hedged risk. As the critical terms of the hedging instruments match those of the hedged items, an economic relationship can be demonstrated on an ongoing basis.

The hedge ratio is 1:1 on the basis that the notional amount of the designated hedging instruments matches the principal amount of the forecast foreign currency sales/purchases designated as the hedged items.

The Group considers the potential sources of hedge ineffectiveness to be:

- valuation adjustments for credit risk made to derivative hedging instruments at each hedge effectiveness measurement date;
- changes to the timing and amount of forecast transactions; and
- non-occurrence of the designated hedged items.

The effect of cash flow hedges on the Group's financial position and performance for the year is as follows:

	31 December 2019					31 December 2018				
	Maturity date	**Weighted average hedged rate**	**Change in the value of hedging instruments since 1 January £m**	**Change in the value of hedged items since 1 January £m**	**Notional amount £m**	Maturity date	Weighted average hedged rate	Change in the value of hedging instruments since 1 January £m	Change in the value of hedged items since 1 January £m	Notional amount £m
Purchase/(sale) contracts:										
Sterling/US dollar	**to 2029**	**1.32**	**71**	**(71)**	**(83)**	to 2028	1.37	25	(25)	(872)
Sterling/euro	**to 2029**	**1.11**	**(34)**	**34**	**(640)**	to 2029	1.17	6	(6)	(475)
Other	**to 2026**	**n/a**	**(26)**	**26**	**(46)**	to 2026	n/a	(17)	17	(35)
Cash flow hedges			**11**	**(11)**	**(769)**			14	(14)	(1,382)

The notional amount is the sterling equivalent of the net currency amount purchased or sold. For designated sterling/US dollar cash flow hedges, the Group has purchased $4,527m at a cost of £3,372m and sold $4,267m for £3,289m, resulting in a net purchase of $260m at a cost of £83m. For designated sterling/euro cash flow hedges, the Group has purchased €8,159m at a cost of £7,335m and sold €7,441m for £6,695m, resulting in a net purchase of €718m at a cost of £640m.

14. Other financial assets and liabilities and financial risk management continued

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 £52m (2018 £56m).

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 sub-contractors 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, 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 objective evidence that individual receivables in this category are recoverable.

Excluding the UK, US, Saudi Arabian and Qatari governments where credit risk is not considered an issue, no one counterparty constitutes more than 4% of the trade receivables balance (2018 7%).

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:

	2019 £m	2018 £m
At 1 January	30	35
Net remeasurement of loss allowance	(9)	(3)
Amounts written off	(1)	(2)
At 31 December	**20**	30

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 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. 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:

	2019			2018		
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Not past due	750	–	750	873	–	873
Up to 180 days overdue	388	–	388	304	–	304
Past 180 days overdue	287	(20)	267	280	(30)	250
	1,425	(20)	1,405	1,457	(30)	1,427

Trade receivables past 180 days overdue primarily relate to contracts in Saudi Arabia. The Group has assessed the risk of default and recoverability of these receivables at the balance sheet date and the expected credit losses in respect of these balances are not considered to be material.

Offsetting financial assets and liabilities

		2019					2018				
	Notes	Gross balances[1] £m	Amounts offset[2] £m	Balance sheet[3] £m	Amounts not offset[4] £m	Net balances[5] £m	Gross balances[1] £m	Amounts offset[2] £m	Balance sheet[3] £m	Amounts not offset[4] £m	Net balances[5] £m
Assets											
Cash and cash equivalents	18	2,593	(6)	2,587	–	2,587	3,244	(12)	3,232	–	3,232
Other financial assets		560	–	560	(432)	128	411	–	411	(172)	239
Liabilities											
Overdrafts	21	(6)	6	–	–	–	(12)	12	–	–	–
Other financial liabilities		(459)	–	(459)	412	(47)	(178)	–	(178)	153	(25)

1. The gross amounts of the recognised financial assets and liabilities.
2. The amounts offset in accordance with paragraph 42 of IAS 32.
3. The net balances presented in the Consolidated balance sheet.
4. The amounts subject to a master netting arrangement not offset in the Consolidated balance sheet in accordance with paragraph 42 of IAS 32. Includes £412m (2018 £153m) in respect of recognised financial instruments and £20m (2018 £19m) in respect of cash collateral.
5. The net balances after deducting the amounts in (4) from (3).

15. Deferred tax

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

The most significant recognised deferred tax assets relate to the deficits on the Group's pension/post-employment schemes (see below). This is because post-employment benefit costs are deducted in determining accounting profit as service is provided by employees, but deducted in determining taxable profit either when contributions are paid to the pension/post-employment schemes or when post-employment benefits are paid. In reviewing the probability that taxable profits will be available in the future against which such contributions/payments can be deducted, account has been taken of the deficit recovery plans agreed with the trustees of the relevant schemes under which the deficits are expected to be cleared in 2026 (see note 23).

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	
	2019 £m	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m
Property, plant and equipment	**36**	28	**(85)**	(85)	**(49)**	(57)
Intangible assets	**–**	2	**(1)**	(3)	**(1)**	(1)
Provisions and accruals	**194**	202	**–**	–	**194**	202
Goodwill	**–**	–	**(278)**	(283)	**(278)**	(283)
Pension/post-employment schemes:						
Deficits	**759**	722	**–**	–	**759**	722
Additional contributions and other[1]	**98**	97	**(1)**	(1)	**97**	96
Share-based payments	**20**	12	**–**	–	**20**	12
Financial instruments	**–**	–	**(7)**	(12)	**(7)**	(12)
Other items	**10**	14	**(27)**	(8)	**(17)**	6
Rolled over capital gains	**–**	–	**(10)**	(10)	**(10)**	(10)
Capital losses carried forward	**10**	10	**–**	–	**10**	10
Trading losses carried forward	**8**	17	**–**	–	**8**	17
Deferred tax assets/(liabilities)	**1,135**	1,104	**(409)**	(402)	**726**	702
Set off of tax	**(409)**	(402)	**409**	402	**–**	–
Net deferred tax assets	**726**	702	**–**	–	**726**	702

1. Includes deferred tax assets on US deferred compensation plans.

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15. Deferred tax continued

Movement in temporary differences during the year

	At 1 January 2019 £m	Foreign exchange adjustments £m	Acquisitions and disposals[1] £m	Recognised in income £m	Recognised in equity £m	**At 31 December 2019 £m**
Property, plant and equipment	(57)	3	–	5	–	**(49)**
Intangible assets	(1)	1	(1)	–	–	**(1)**
Provisions and accruals	202	(8)	–	–	–	**194**
Goodwill	(283)	10	–	(5)	–	**(278)**
Pension/post-employment schemes:						
Deficits	722	(4)	–	12	29	**759**
Additional contributions and other[2]	96	(3)	–	4	–	**97**
Share-based payments	12	1	–	6	1	**20**
Financial instruments	(12)	1	–	4	–	**(7)**
Other items[3]	8	1	–	(26)	–	**(17)**
Rolled over capital gains	(10)	–	–	–	–	**(10)**
Capital losses carried forward	10	–	–	–	–	**10**
Trading losses carried forward	17	(2)	(4)	(3)	–	**8**
	704	–	(5)	(3)	30	**726**

	At 1 January 2018 £m	Foreign exchange adjustments £m	Acquisitions and disposals[1] £m	Recognised in income £m	Recognised in equity £m	At 31 December 2018 £m
Property, plant and equipment	(78)	(5)	–	26	–	(57)
Intangible assets	(1)	–	–	–	–	(1)
Provisions and accruals	205	9	–	(12)	–	202
Goodwill	(275)	(16)	–	8	–	(283)
Pension/post-employment schemes:						
Deficits	728	9	–	4	(19)	722
Additional contributions and other[2]	99	6	–	(9)	–	96
Share-based payments	14	–	–	(1)	(1)	12
Financial instruments	(11)	–	–	(6)	5	(12)
Other items	5	(1)	–	2	–	6
Rolled over capital gains	(10)	–	–	–	–	(10)
Capital losses carried forward	10	–	–	–	–	10
Trading losses carried forward	12	1	–	4	–	17
	698	3	–	16	(15)	702

1. Comprises the transfer of net deferred tax assets to held for sale.
2. Includes deferred tax assets on US deferred compensation plans.
3. Balance at 1 January 2019 includes £2m recognised on adoption of IFRS 16 Leases (see note 36).

Unrecognised deferred tax assets and liabilities

Deferred tax assets have not been recognised in respect of the following items:

	2019		2018	
	Gross amount £m	**Unrecognised deferred tax asset £m**	Gross amount £m	Unrecognised deferred tax asset £m
Deductible temporary differences, including tax credits	**3**	**2**	2	2
Capital losses carried forward	**221**	**38**	233	41
Trading and other losses carried forward	**202**	**24**	217	26
	426	**64**	452	69

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 £191m (2018 £354m) relating to potentially taxable unremitted earnings of overseas subsidiaries and equity accounted investments because any withholding tax due on the remittance of those earnings is expected to be insignificant.

15. Deferred tax continued

Changes in tax rates

Recognised US deferred tax balances have been calculated at a combined federal and state tax rate of 25.7% (2018 25.7%).

Legislation is in place for the UK current tax rate to be reduced from 19% to 17% with effect from 1 April 2020. Both recognised and unrecognised UK deferred tax balances as at 31 December 2019 have therefore been calculated at a rate of 17% (2018 17.5%). However, the Conservative Party's 2019 election manifesto included a pledge to keep the rate unchanged and so there is an expectation that the Budget in March will bring forward legislation to retain the UK current tax rate at 19%. The estimated impact of increasing the rate at which recognised UK deferred tax balances are calculated from 17% to 19% is an increase in net assets of £78m, the majority of which will be recorded in the Consolidated statement of comprehensive income.

16. Inventories

Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value.

	2019 £m	2018 £m
Raw materials and consumables	**375**	354
Work-in-progress	**348**	319
Finished goods and goods for resale	**112**	101
	835	774

The Group recognised £14m (2018 £11m) 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.

	2019 £m	2018 £m
Tax provisions	**(180)**	(361)
Research and development expenditure credits receivable	**187**	163
Other	**(43)**	(55)
	(36)	(253)
Represented by:		
Current tax assets	**19**	81
Current tax liabilities	**(55)**	(334)
	(36)	(253)

Tax provisions of £180m (2018 £361m) are in respect of known tax issues, of which £142m (2018 £44m) relates to the UK. Whilst there is inherent uncertainty regarding the timing of any resolution of tax positions, the Group considers there to be a possibility of a material change in UK tax positions in the next financial year.

Following review of the April 2019 EU Commission decision that concluded that the UK's Controlled Foreign Company regime partially represents State Aid, a provision has been recognised in the UK for the estimated exposure. There remains uncertainty surrounding HMRC's likely approach to the assessment of the deemed State Aid and recovery of amounts which they consider to be due, and, accordingly, developments will continue to be monitored and assessed.

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.

	2019 £m	2018 £m
Cash	**1,039**	735
Money market funds	**680**	908
Short-term deposits	**868**	1,589
	2,587	3,232

Cash and cash equivalents includes £283m (2018 £278m) which is subject to regulatory restrictions and is therefore not available for general use by other entities within the Group.

19. Assets and liabilities held for sale and business disposals

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

AACC
In January 2019, as part of a planned reorganisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia, the Group's Overhaul and Maintenance Company (OMC) subsidiary disposed of its 85.7% shareholding in Aircraft Accessories and Components Company (AACC) to Saudi Arabian Military Industries (SAMI). AACC was presented as held for sale at 31 December 2018.

AACC was included in the Air segment.

UK-based combat vehicles
In January 2019, the Group announced an agreement with Rheinmetall to create a joint UK-based military land vehicle design, manufacturing and support business. Rheinmetall purchased a 55% stake in the existing BAE Systems UK-based combat vehicles business, with BAE Systems retaining 45%. The UK-based combat vehicles business was presented as held for sale at 31 December 2018.

The sale of the stake to Rheinmetall and creation of Rheinmetall BAE Systems Land (RBSL), completed on 1 July 2019. The Group's stake in RBSL is accounted for as an equity accounted investment from 1 July 2019.

The UK-based combat vehicles business and RBSL are included in the Maritime segment.

AEC
In 2019, the Group's OMC subsidiary entered into a heads of terms for the sale of its 50% shareholding in Advanced Electronics Company (AEC) to SAMI. Negotiations are continuing and the sale is expected to complete in 2020. Accordingly, AEC is presented as held for sale at 31 December 2019.

AEC is included in the Air segment.

Silversky
Divestment of the Silversky business is in progress. Accordingly, the business is presented as held for sale at 31 December 2019.

Silversky is included in the Cyber & Intelligence segment.

Business disposals
The profit recognised on the disposal of each business was as follows:

	2019		
	UK-based combat vehicles £m	AACC £m	Total £m
Fair value of consideration received	31	26	57
Net assets disposed	(93)	(26)	(119)
Fair value of 45% investment retained in RBSL (note 12)	76	–	76
Cumulative currency translation gain	–	8	8
Profit on disposal	**14**	**8**	**22**
Net cash inflow arising on disposal:			
Cash consideration received	31	26	57
Less: cash and cash equivalents disposed	(2)	–	(2)
	29	**26**	**55**

The profit on disposal is included in the profit for the year from continuing operations, as a component of other income (note 4).

19. Assets and liabilities held for sale and business disposals continued

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

	2019 UK-based combat vehicles £m	2019 AACC £m	2019 Total £m
Intangible assets	87	–	87
Property, plant and equipment	9	8	17
Inventories	2	17	19
Trade, other and contract receivables	15	9	24
Cash and cash equivalents	2	–	2
Trade and other payables	(15)	(8)	(23)
Provisions	(7)	–	(7)
Net assets disposed	**93**	**26**	**119**

There were no disposals of subsidiaries in 2018.

Assets and liabilities held for sale

Assets and liabilities presented as held for sale comprise:

	2019			2018		
	Silversky £m	**AEC £m**	**Total £m**	UK-based combat vehicles £m	AACC £m	Total £m
Intangible assets	**31**	**17**	**48**	87	–	87
Property, plant and equipment	**3**	**8**	**11**	9	6	15
Equity accounted investments	**–**	**66**	**66**	–	–	–
Deferred tax assets	**5**	**–**	**5**	–	–	–
Inventories	**–**	**–**	**–**	2	17	19
Trade, other and contract receivables	**5**	**–**	**5**	16	9	25
Assets held for sale	**44**	**91**	**135**	114	32	146
Trade and other payables	**(5)**	**–**	**(5)**	(19)	(14)	(33)
Provisions	**–**	**–**	**–**	(7)	–	(7)
Liabilities held for sale	**(5)**	**–**	**(5)**	(26)	(14)	(40)

20. Geographical analysis of assets

Analysis of non-current assets by geographical location

Asset location	Notes	**2019 £m**	2018 £m
UK		**4,119**	3,610
Rest of Europe		**935**	909
US		**8,830**	8,466
Saudi Arabia		**679**	503
Australia		**435**	420
Rest of Asia and Pacific		**10**	7
Non-current segment assets		**15,008**	13,915
Post-employment benefit surpluses	23	**302**	308
Other financial assets	14	**560**	411
Tax	15,17	**745**	783
Inventories	16	**835**	774
Current trade, other and contract receivables	13	**5,458**	5,177
Cash and cash equivalents	18	**2,587**	3,232
Assets held for sale	19	**135**	146
Consolidated total assets		**25,630**	24,746

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.

	2019 £m	2018 £m
Non-current		
US$500m 2.85% bond, repayable 2020	**–**	391
US$500m 4.75% bond, repayable 2021	**377**	392
£400m 4.125% bond, repayable 2022	**399**	399
US$800m 3.8% bond, repayable 2024	**602**	626
US$750m 3.85% bond, repayable 2025	**561**	583
US$500m 7.5% bond, repayable 2027	**376**	391
US$400m 5.8% bond, repayable 2041	**299**	311
US$550m 4.75% bond, repayable 2044	**406**	421
	3,020	3,514
Current		
US$1bn 6.375% bond, repayable 2019	**–**	785
US$500m 2.85% bond, repayable 2020	**377**	–
	377	785

The US$1bn 6.375% bond, of which US$500m had been converted to a floating rate bond by utilising interest rate swaps, matured and was repaid in June 2019.

The US$500m 2.85% bond, repayable 2020, has been converted to a sterling fixed rate bond by utilising foreign exchange swaps that mature in February 2020 and give an effective rate during 2019 of 1.2%.

US$278m of the US$500m 4.75% bond, repayable 2021, has been converted to a sterling fixed rate bond by utilising foreign exchange swaps that mature in October 2021 and give an effective rate during 2019 of 4.7%.

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 2019 of 3.8%.

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 2019 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 2019 of 5.7%.

22. Trade and other payables

Trade and other payables are stated at amortised cost.

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.

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.

	2019 £m	2018[1] £m
Non-current		
Contract liabilities	**527**	560
Accruals and deferred income[2]	**584**	520
US deferred compensation plan liabilities	**339**	333
Other payables	**31**	48
	1,481	1,461
Current		
Contract liabilities	**3,536**	3,496
Trade payables	**675**	703
Amounts owed to equity accounted investments (note 31)	**1,134**	955
Other taxes and social security costs	**123**	130
Accruals and deferred income	**2,229**	2,201
Other payables	**229**	233
	7,926	7,718

1. Comparatives as at 31 December 2018 have been reclassified to present the Saudi Arabia end of service benefit obligation within post-employment benefit obligations (£97m previously presented within other payables, see note 23) and to present accruals for goods received not invoiced within accruals and deferred income (£208m previously presented within trade payables).
2. Includes £525m (2018 £439m) of funding received from the UK government for property, plant and equipment at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme.

Revenue recognised in the year includes £3,422m (2018 £2,571m) that was included in the opening contract liabilities balance.

Non-current and current contract liabilities as at 1 January 2018 were £802m and £2,717m, respectively.

23. 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 204. 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 2019.

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. During 2019, several legacy BAE Systems pension arrangements were merged into the BAE Systems Pension Scheme (Main Scheme). Contributions and members' benefits are unchanged. The largest funded defined benefit scheme is the Main Scheme which represents 93% (2018 93%) of the UK IAS 19 defined benefit obligation at 31 December 2019. The schemes in other countries are primarily defined contribution schemes.

At 31 December 2019, the weighted average durations of the UK and US defined benefit pension obligations were 17 years (2018 17 years) and 11 years (2018 11 years), respectively.

The split of the defined benefit pension liability on a funding basis between active, deferred and pensioner members for the Main Scheme and US schemes in aggregate is set out below:

	Active %	Deferred %	Pensioner %
Main Scheme (merged)[1]	31	21	48
US schemes[2]	28	16	56

1. Source: 31 October 2019 actuarial valuation reports for the legacy schemes within the recently-merged Main Scheme.
2. Source: Annual updates of the US schemes as at 1 January 2019.

23. Post-employment benefits continued

Background continued

Regulatory framework

The funded UK schemes are registered and subject to the statutory scheme specific-funding requirements outlined in UK legislation, including the payment of levies to the Pension Protection Fund as set out in the Pension Act 2004. These schemes were established under trust and the responsibility for their governance lies jointly with the trustees and the Group.

The funded US schemes are tax-qualified pension schemes regulated by the Pension Protection Act 2006 and insured by the Pension Benefit Guaranty Corporation (PBGC) up to certain limits. These schemes were established under, and are governed by, the US Employee Retirement Income Security Act 1974 and the BAE Systems Administrative Committee is a named fiduciary with the authority to manage their operation.

Benefits

The UK defined benefit schemes provide benefits to members in the form of a set level of pension payable for life based on members' final salaries. The benefits attract inflation-related increases both in deferment and payment. All UK defined benefit schemes are closed to new entrants, with benefits for new employees being provided through a defined contribution scheme. The Normal Retirement Age for the majority of active members of the Main Scheme is 65. Specific benefits applicable to members differ between schemes. Further details on the benefits provided by each scheme are provided on the BAE Systems Pensions website: baesystemspensions.com.

A UK High Court judgement was delivered on 26 October 2018 concerning gender equalisation for the effect of Guaranteed Minimum Pensions (GMPs) for occupational pension schemes. In 2018, a non-recurring past service cost was included in the income statement to reflect the expectation that the impact of GMP equalisation would increase the pension deficit in the balance sheet. In 2019, an allowance of £132m (2018 £121m) was included within the pension deficit (before allocation to equity accounted investments). This is a consistent proportion of the UK liabilities as applied in 2018 and reflects the updated UK IAS 19 valuations as at 31 December 2019.

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.

The Group provides an end of service benefit to employees in Saudi Arabia. These liabilities are presented within post-employment benefits as at 31 December 2019; however, as at 31 December 2018, these liabilities were presented within other payables. The balance sheet has been reclassified to include this balance within post-employment benefits as the Group considers this to be a more appropriate presentation. This balance is not considered material, however the comparative balance sheet has been reclassified for consistency. This reclassification has had no impact on the net assets, the income statement or the statement of comprehensive income. A third balance sheet as at 1 January 2018 is not presented as the reclassification does not have a material effect at that date.

Funding

Introduction

Disclosures in respect of pension funding are provided below. Disclosures in respect of pension accounting under IAS 19 are provided on pages 204 to 210.

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 204. 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.

23. 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 next funding valuations for the other UK schemes will have an effective date of no later than 31 March 2020.

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

	Main Scheme as at 31 October 2019 £bn	Other schemes as at 31 March 2017 £bn
Market value of assets	20.6	2.2
Present value of liabilities	(22.5)	(2.0)
Funding (deficit)/surplus	(1.9)	0.2
Percentage of accrued benefits covered by the assets at the valuation date	92%	110%

The valuations in 2017 and 2019 were determined using the following mortality assumptions:

Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	87 – 90
Life expectancy of a male currently aged 45 (years)	88 – 92
Life expectancy of a female currently aged 45 (years)	90 – 93

The discount rate assumptions used in the 2017 and 2019 valuations were directly based on prudent levels of expected returns for the assets held by the schemes, reflecting the planned investment strategies and maturity profiles of each scheme. The discount rates are curves which provide a different rate for each year into the future.

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

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

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

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

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

US valuations

The Group's US pension schemes are valued annually, with the latest valuations performed as at 1 January 2019.

23. 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 2019, total employer contributions to the Group's pension schemes were £461m (2018 £554m), including amounts funded by equity accounted investments of £40m (2018 £38m), and included approximately £231m (2018 £211m) of deficit recovery payments in respect of the UK schemes, and £nil (2018 £119m) in respect of the US schemes.

Deficit contributions will further increase in line with any percentage growth in dividend payments made by the Group. As part of the 31 October 2019 valuation agreement, the Company has agreed to pay £1bn into the Main Scheme in the coming months representing an advancement of £1bn in deficit contributions that were due, under the 2017 valuation deficit recovery plan, between 2022 and 2026. The annual payments are expected to end in 2021 and the deficit is expected to be cleared in 2026.

In 2020, Group contributions to the US pension schemes are expected to increase by approximately £60m.

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% (2018 43%) 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.
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 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 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.

23. 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		
	2019	2018	2017	**2019**	2018	2017
Financial assumptions						
Discount rate – past service (%)	**2.1**	2.9	2.6	**3.1**	4.2	3.7
Discount rate – future service (%)	**2.2**	3.0	2.7	**3.1**	4.2	3.7
Retail Prices Index (RPI) inflation (%)	**2.8**	3.1	3.1	**n/a**	n/a	n/a
Rate of increase in salaries (%)	**2.8**	3.1	3.1	**n/a**	n/a	n/a
Rate of increase in deferred pensions (%)	**2.0/2.8**	2.1/3.1	2.1/3.1	**n/a**	n/a	n/a
Rate of increase in pensions in payment (%)	**1.5 – 3.6**	1.6 – 3.7	1.6 – 3.7	**n/a**	n/a	n/a
Demographic assumptions						
Life expectancy of a male currently aged 65 (years)	**87 – 88**	86 – 88	86 – 88	**87**	87	87
Life expectancy of a female currently aged 65 (years)	**88 – 90**	88 – 90	88 – 90	**89**	89	89
Life expectancy of a male currently aged 45 (years)	**88 – 89**	88 – 90	88 – 90	**87**	87	87
Life expectancy of a female currently aged 45 (years)	**89 – 91**	90 – 91	90 – 92	**89**	89	89

Discount rate

The discount rate assumptions are derived through discounting the projected benefit payments using a third-party AA corporate bond yield curve to produce a single equivalent discount rate for the UK and US territories. This inherently captures the maturity profile of the expected benefit payments. For the UK territory, the discount rate used for future service differs from that used for past service as it only uses the cash flows relating to active members, which have a different duration. Further information on the duration of the schemes is detailed on page 200.

Retail Prices Index (RPI) 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. As a consequence of RPI reform announcements during 2019, the Company has reviewed its approach to setting inflation assumptions and has decided to set the Consumer Prices Index (CPI) assumption at 0.8% lower than RPI. The resulting CPI assumption is 2.0%. In the US, inflation assumptions are not relevant as the Group's US pension schemes are not indexed with inflation.

Rate of increase in salaries

The rate of increase in salaries for the UK schemes is assumed to be RPI inflation of 2.8% (2018 RPI inflation of 3.1%), plus a promotional scale. From 1 January 2013, employees in the US schemes no longer accrue salary-related benefits.

Rate of increase in deferred pensions

The rate of increase in deferred pensions for the UK schemes is based on CPI inflation of 2.0% (2018 CPI inflation of 2.1%), with the exception of the legacy 2000 Plan, which is based on RPI inflation of 2.8% (2018 RPI inflation of 3.1%). For all UK schemes, the rate of increase in deferred pensions is subject to inflation caps.

Rate of increase in pensions in payment

The rate of increase in pensions in payment differs between UK schemes. Different tranches of the schemes' benefits increase at rates based on either RPI or CPI inflation, and some are subject to an inflation cap. With the exception of two smaller schemes, the rate of increase in pensions in payment is based on RPI inflation.

Life expectancy

For its UK pension schemes, the Group has used the Self-Administered Pension Schemes S2 mortality tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of scheme members and information on the demographic profile of the scheme's membership. In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2018 tables (published by the Institute of Actuaries) have been used (in 2018, the Continuous Mortality Investigation 2017 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.0% (2018 1.25%), an initial rate adjustment parameter ('A') of 0.25% in conjunction with a smoothing parameter ('S_k') of 7 for all members.

In October 2019, the Society of Actuaries in the US released updated mortality assumptions reflecting the results of its comprehensive mortality study. For the majority of the US schemes, the mortality tables used at 31 December 2019 are a blend of the fully generational PRI-2012 White Collar table and the PRI-2012 Blue Collar table, both projected using Scale MP-2019.

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 2019. These valuations were rolled forward to reflect the information at 31 December 2019. The method of accounting for these is similar to that used for defined benefit pension schemes.

The assumption for long-term healthcare cost increases is 4.8% (2018 4.9%) based on the assumptions that the increases are 7.4% in 2019 reducing to 4.5% by 2026 and 4.5% each year thereafter for pre-retirement, and 8% in 2019 reducing to 4.5% by 2026 and 4.5% each year thereafter for post-retirement.

23. Post-employment benefits continued

IAS 19 accounting continued

Summary of movements in post-employment benefit obligations

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2019[1]	(3,554)	(779)	(4,333)
Actual return on assets excluding amounts included in net interest expense	1,491	766	2,257
Increase in liabilities due to changes in financial assumptions	(2,547)	(638)	(3,185)
Decrease in liabilities due to changes in demographic assumptions	448	19	467
Experience losses	(96)	(28)	(124)
Contributions in excess of/(below) service cost	243	(22)	221
Past service cost – plan amendments	(4)	–	(4)
Net interest expense	(92)	(28)	(120)
Foreign exchange adjustments	–	28	28
Movement in other schemes	–	14	14
Total net IAS 19 deficit at 31 December 2019	**(4,111)**	**(668)**	**(4,779)**
Allocated to equity accounted investments	324	–	324
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 31 December 2019	**(3,787)**	**(668)**	**(4,455)**

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.

	2019				
	UK defined benefit pension schemes £m	**US and other pension schemes £m**	**US healthcare schemes £m**	**Saudi Arabia end of service benefit[1] £m**	**Total £m**
Present value of unfunded obligations	**(118)**	**(143)**	**–**	**(105)**	**(366)**
Present value of funded obligations	**(26,758)**	**(5,174)**	**(168)**	**–**	**(32,100)**
Fair value of scheme assets	**22,765**	**4,703**	**219**	**–**	**27,687**
Total net IAS 19 (deficit)/surplus	**(4,111)**	**(614)**	**51**	**(105)**	**(4,779)**
Allocated to equity accounted investments	**324**	**–**	**–**	**–**	**324**
Group's share of net IAS 19 (deficit)/surplus	**(3,787)**	**(614)**	**51**	**(105)**	**(4,455)**
Represented by:					
Post-employment benefit surpluses	**234**	**11**	**57**	**–**	**302**
Post-employment benefit obligations	**(4,021)**	**(625)**	**(6)**	**(105)**	**(4,757)**
	(3,787)	**(614)**	**51**	**(105)**	**(4,455)**
Group's share of net IAS 19 deficit of equity accounted investments	**(129)**	**–**	**–**	**–**	**(129)**

1. At 31 December 2018 the Saudi Arabia end of service benefit was presented within other payables. The comparative balance sheet has been reclassified to include this balance within post-employment benefits as the Group considers this to be a more appropriate presentation.

23. Post-employment benefits continued

IAS 19 accounting continued

	2018				
	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Saudi Arabia end of service benefit[1] £m	Total £m
Present value of unfunded obligations	(100)	(142)	–	(97)	(339)
Present value of funded obligations	(24,700)	(4,782)	(165)	–	(29,647)
Fair value of scheme assets	21,246	4,213	194	–	25,653
Total net IAS 19 (deficit)/surplus	(3,554)	(711)	29	(97)	(4,333)
Allocated to equity accounted investments	304	–	–	–	304
Group's share of net IAS 19 (deficit)/surplus	(3,250)	(711)	29	(97)	(4,029)
Represented by:					
Post-employment benefit surpluses	219	48	41	–	308
Post-employment benefit obligations	(3,469)	(759)	(12)	(97)	(4,337)
	(3,250)	(711)	29	(97)	(4,029)
Group's share of net IAS 19 deficit of equity accounted investments	(119)	–	–	–	(119)

1. At 31 December 2018 the Saudi Arabia end of service benefit was presented within other payables. The comparative balance sheet has been reclassified to include this balance within post-employment benefits as the Group considers this to be a more appropriate presentation.

Total cumulative actuarial losses recognised in equity since the transition to IFRS are £5.2bn (2018 £4.6bn).

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[1] £m	Total £m
Value of scheme assets at 1 January 2018	22,332	4,352	199	–	26,883
Interest income	575	156	7	–	738
Actual return on assets excluding amounts included in interest income	(1,022)	(422)	(12)	–	(1,456)
Actual return on assets	(447)	(266)	(5)	–	(718)
Contributions by employer	423	131	1	77	632
Contributions by employer in respect of employee salary sacrifice arrangements	80	–	–	–	80
Total contributions by employer	503	131	1	77	712
Members' contributions	7	–	–	–	7
Administrative expenses	(14)	(14)	(1)	–	(29)
Foreign exchange translation	–	248	12	–	260
Benefits paid	(1,135)	(238)	(12)	(77)	(1,462)
Value of scheme assets at 31 December 2018	21,246	4,213	194	–	25,653
Interest income	609	173	8	–	790
Actual return on assets excluding amounts included in interest income	1,491	766	32	–	2,289
Actual return on assets	2,100	939	40	–	3,079
Contributions by employer	451	10	2	37	500
Contributions by employer in respect of employee salary sacrifice arrangements	78	–	–	–	78
Total contributions by employer	529	10	2	37	578
Members' contributions	7	–	–	–	7
Administrative expenses	(15)	(21)	(1)	–	(37)
Foreign exchange translation	–	(185)	(9)	–	(194)
Benefits paid	(1,102)	(253)	(7)	(37)	(1,399)
Value of scheme assets at 31 December 2019	**22,765**	**4,703**	**219**	**–**	**27,687**

1. At 31 December 2018 the Saudi Arabia end of service benefit was presented within other payables. The comparative balance sheet has been reclassified to include this balance within post-employment benefits as the Group considers this to be a more appropriate presentation.

23. Post-employment benefits continued

IAS 19 accounting continued

Assets of defined benefit pension schemes

	2019								
	UK[1]			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[2]	**2,214**	**1**	**2,215**	**–**	**–**	**–**	**2,214**	**1**	**2,215**
Overseas	**1,935**	**1**	**1,936**	**–**	**–**	**–**	**1,935**	**1**	**1,936**
Pooled investment vehicles[3]	**1,931**	**5,161**	**7,092**	**1,178**	**1**	**1,179**	**3,109**	**5,162**	**8,271**
Fixed interest securities:									
UK gilts	**1,280**	**–**	**1,280**	**–**	**–**	**–**	**1,280**	**–**	**1,280**
UK corporates	**1,476**	**2,359**	**3,835**	**–**	**–**	**–**	**1,476**	**2,359**	**3,835**
Overseas government	**41**	**–**	**41**	**34**	**–**	**34**	**75**	**–**	**75**
Overseas corporates	**1,480**	**16**	**1,496**	**3,304**	**–**	**3,304**	**4,784**	**16**	**4,800**
Index-linked securities:									
UK gilts	**2,105**	**297**	**2,402**	**–**	**–**	**–**	**2,105**	**297**	**2,402**
UK corporates	**268**	**994**	**1,262**	**–**	**–**	**–**	**268**	**994**	**1,262**
Property[4]	**–**	**1,778**	**1,778**	**–**	**113**	**113**	**–**	**1,891**	**1,891**
Derivatives[5]	**–**	**(1,405)**	**(1,405)**	**–**	**–**	**–**	**–**	**(1,405)**	**(1,405)**
Cash:									
Sterling	**619**	**29**	**648**	**–**	**–**	**–**	**619**	**29**	**648**
Foreign currency	**31**	**5**	**36**	**72**	**–**	**72**	**103**	**5**	**108**
Other	**13**	**136**	**149**	**–**	**1**	**1**	**13**	**137**	**150**
Total	**13,393**	**9,372**	**22,765**	**4,588**	**115**	**4,703**	**17,981**	**9,487**	**27,468**

	2018								
	UK[1]			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[2]	3,192	1	3,193	–	–	–	3,192	1	3,193
Overseas	1,882	12	1,894	284	–	284	2,166	12	2,178
Pooled investment vehicles[3]	1,280	3,713	4,993	659	2	661	1,939	3,715	5,654
Fixed interest securities:									
UK gilts	1,500	–	1,500	–	–	–	1,500	–	1,500
UK corporates	1,543	1,949	3,492	–	–	–	1,543	1,949	3,492
Overseas government	47	–	47	19	–	19	66	–	66
Overseas corporates	1,260	43	1,303	3,074	–	3,074	4,334	43	4,377
Index-linked securities:									
UK gilts	2,156	177	2,333	–	–	–	2,156	177	2,333
UK corporates	526	653	1,179	–	–	–	526	653	1,179
Property[4]	–	1,935	1,935	–	125	125	–	2,060	2,060
Derivatives[5]	–	(1,121)	(1,121)	–	–	–	–	(1,121)	(1,121)
Cash:									
Sterling	270	33	303	–	–	–	270	33	303
Foreign currency	10	5	15	49	–	49	59	5	64
Other	46	134	180	–	1	1	46	135	181
Total	13,712	7,534	21,246	4,085	128	4,213	17,797	7,662	25,459

1. The Main Scheme and one of the Group's smaller UK defined benefit pension schemes participate in a Combined Investment Fund (CIF), covering £10.1bn (2018 £9.7bn) of assets. The purpose of the CIF is to provide economies of scale for the CIF schemes' investment administration.
2. Includes £15m (2018 £24m) of the Company's own ordinary shares.
3. Primarily invested in private markets and exchange traded funds. The amounts classified as unquoted primarily comprise investments in private markets, with the majority held in infrastructure, alternatives and direct funds, valued in accordance with International Private Equity and Venture Capital Valuation Guidelines.
4. Valued on the basis of open market value at the end of the year determined in accordance with the Royal Institution of Chartered Surveyors' Appraisal and Valuation Standards and the Practice Note contained therein. Includes £233m (2018 £245m) of property occupied by Group companies.
5. Includes equity protection options, forward foreign exchange contracts, futures, and interest rate, inflation and longevity swaps. In addition, the total derivative figures shown are net of £358m (2018 £479m) of repurchase agreements. The valuations are based on valuation techniques using underlying market data and discounted cash flows.

23. Post-employment benefits continued

IAS 19 accounting continued

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[1] £m	Total £m
Defined benefit obligations at 1 January 2018	(26,120)	(4,949)	(168)	(148)	(31,385)
Current service cost	(224)	(12)	(1)	(22)	(259)
Contributions by employer in respect of employee salary sacrifice arrangements	(80)	–	–	–	(80)
Total current service cost	(304)	(12)	(1)	(22)	(339)
Members' contributions	(7)	–	–	–	(7)
Past service cost – plan amendments	(131)	–	–	–	(131)
Actuarial gain due to changes in financial assumptions	1,295	265	9	–	1,569
Actuarial gain due to changes in demographic assumptions	171	17	–	–	188
Experience losses	(176)	(17)	(1)	–	(194)
Interest expense	(663)	(180)	(6)	(7)	(856)
Foreign exchange translation	–	(286)	(10)	3	(293)
Benefits paid	1,135	238	12	77	1,462
Defined benefit obligations at 31 December 2018	(24,800)	(4,924)	(165)	(97)	(29,986)
Current service cost	(193)	(11)	(1)	(17)	(222)
Contributions by employer in respect of employee salary sacrifice arrangements	(78)	–	–	–	(78)
Total current service cost	(271)	(11)	(1)	(17)	(300)
Members' contributions	(7)	–	–	–	(7)
Past service cost – plan amendments	(4)	–	–	–	(4)
Actuarial loss due to changes in financial assumptions	(2,547)	(638)	(19)	(26)	(3,230)
Actuarial gain due to changes in demographic assumptions	448	19	1	–	468
Experience (losses)/gains	(96)	(28)	8	(2)	(118)
Interest expense	(701)	(201)	(6)	(5)	(913)
Foreign exchange translation	–	213	7	5	225
Benefits paid	1,102	253	7	37	1,399
Defined benefit obligations at 31 December 2019	**(26,876)**	**(5,317)**	**(168)**	**(105)**	**(32,466)**

1. At 31 December 2018 the Saudi Arabia end of service benefit was presented within other payables. The comparative balance sheet has been reclassified to include this balance within post-employment benefits as the Group considers this to be a more appropriate presentation.

23. Post-employment benefits continued

IAS 19 accounting continued

Amounts recognised in the income statement after allocation to equity accounted investments

	2019			
	UK defined benefit pension schemes £m	**US and other pension schemes £m**	**Other schemes £m**	**Total £m**
Included in operating costs:				
Current service cost	**(177)**	**(11)**	**(18)**	**(206)**
Past service cost – plan amendments	**(4)**	**–**	**–**	**(4)**
	(181)	**(11)**	**(18)**	**(210)**
Administrative expenses	**(14)**	**(21)**	**(1)**	**(36)**
	(195)	**(32)**	**(19)**	**(246)**
Included in net finance costs:				
Net interest expense on post-employment benefit obligations	**(83)**	**(28)**	**(3)**	**(114)**
Group defined benefit schemes included in share of results of equity accounted investments:				
Group's share of equity accounted investments' operating costs	**(9)**	**–**	**–**	**(9)**
Group's share of equity accounted investments' finance costs	**(3)**	**–**	**–**	**(3)**

	2018			
	UK defined benefit pension schemes £m	US and other pension schemes £m	Other schemes £m	Total £m
Included in operating costs:				
Current service cost	(201)	(12)	(1)	(214)
Past service cost – plan amendments	(10)	–	–	(10)
	(211)	(12)	(1)	(224)
Guaranteed Minimum Pension equalisation charge	(110)	–	–	(110)
Administrative expenses	(13)	(14)	(1)	(28)
	(334)	(26)	(2)	(362)
Included in net finance costs:				
Net interest (expense)/income on post-employment benefit obligations	(80)	(24)	1	(103)
Group defined benefit schemes included in share of results of equity accounted investments:				
Group's share of equity accounted investments' operating costs[1]	(15)	–	–	(15)
Group's share of equity accounted investments' finance costs	(3)	–	–	(3)

1. The 2018 Group's share of equity accounted investments' operating costs included £4m relating to the Guaranteed Minimum Pension equalisation charge.

The Group incurred a charge of £226m (2018 £203m) in relation to defined contribution schemes for employees.

23. 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 2019 and keeping all other assumptions as set out on page 204.

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	(0.5)	0.3
Inflation:		
0.1 percentage point increase	(0.4)	0.2
0.1 percentage point decrease	0.3	(0.2)

1. Before allocation to equity accounted investments.

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

	(Increase)/decrease in pension obligation[1] £bn
Inflation:	
0.5 percentage point increase	(1.5)
0.5 percentage point decrease	1.4
1.0 percentage point increase	(3.0)
1.0 percentage point decrease	2.8

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 203), would have the following effect on the total net IAS 19 deficit:

	(Increase)/decrease in net deficit[1] £bn
Life expectancy:	
One-year increase	(1.3)
One-year decrease	1.3

1. Before allocation to equity accounted investments.

24. 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	46	51	294	36	427
Current	58	30	212	34	334
At 1 January 2019	104	81	506	70	761
Transition adjustment upon adoption of IFRS 16 Leases (note 36)	–	–	(31)	–	(31)
Created	65	29	99	14	207
Utilised	(42)	(25)	(57)	(12)	(136)
Arising on business combinations	–	–	–	19	19
Reclassification between categories	–	–	12	(12)	–
Transfer from other balance sheet categories	–	–	24	–	24
Reclassification as held for sale	–	–	(8)	–	(8)
Released	(14)	(31)	(105)	(10)	(160)
Net present value adjustments	–	–	23	3	26
Foreign exchange adjustments	(3)	(2)	(11)	(1)	(17)
At 31 December 2019	**110**	**52**	**452**	**71**	**685**
Represented by:					
Non-current	54	18	266	47	385
Current	56	34	186	24	300
	110	**52**	**452**	**71**	**685**

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 £18m (2018 £46m) 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.

25. 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 2018, 31 December 2018 and 31 December 2019	**3,467**	**87**	**1**	**1**	**87**

Special Share

One Special Share of £1 in the Company is held on behalf of the Secretary of State for Business, Energy and Industrial Strategy (the Special Shareholder). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British citizens. The effect of these requirements can also be amended by regulations made by the directors and approved by the Special Shareholder.

The Special Shareholder may require the Company at any time to redeem the Special Share at par or to convert the Special Share into one ordinary voting share. The Special Shareholder is entitled to receive notice of and to attend general meetings and class meetings of the Company's shareholders, but has no voting right, nor other rights, other than to speak in relation to any business in respect of the Special Share.

Treasury shares

As at 31 December 2019, 261,897,751 (2018 271,650,137) ordinary shares of 2.5p each with an aggregate nominal value of £6,547,444 (2018 £6,791,253) were held in treasury. During 2019, 9,752,386 (2018 9,582,602) 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 June and December 2019.

At 31 December 2019, the ESOP held 2,887,846 (2018 2,299,585) ordinary shares of 2.5p each, with a market value of £16m (2018 £11m). 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 June and December 2019 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.

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.

	2019 £m	2018 £m
Prior year final 13.2p dividend per ordinary share paid in the year (2018 13.0p)	**423**	415
Interim 9.4p dividend per ordinary share paid in the year (2018 9.0p)	**301**	288
	724	703

After the balance sheet date, the directors proposed a final dividend of 13.8p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 1 June 2020 to shareholders registered on 17 April 2020. The ex-dividend date is 16 April 2020.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 7 May 2020.

25. Share capital and other reserves continued

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 2018	4,589	202	10	3	59	1,227	6,090
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	396	396
Net amounts charged to hedging reserve	–	–	–	–	(25)	–	(25)
Tax on net amounts charged to hedging reserve	–	–	–	–	5	–	5
Equity accounted investments, net of tax	–	–	–	–	(1)	16	15
At 1 January 2019	4,589	202	10	3	38	1,639	6,481
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	(322)	(322)
Reclassification of cumulative currency translation reserve on disposal	–	–	–	–	–	(8)	(8)
Net amounts charged to hedging reserve	–	–	–	–	(1)	–	(1)
Equity accounted investments, net of tax	–	–	–	–	25	(19)	6
At 31 December 2019	**4,589**	**202**	**10**	**3**	**62**	**1,290**	**6,156**

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 2019, the Group's capital was £5,449m (2018 £5,580m), which comprises total equity of £5,511m (2018 £5,618m), excluding amounts accumulated in equity relating to cash flow hedges of £62m (2018 £38m). Net debt was £743m (2018 £904m).

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.

26. Operating business cash flow

Key Performance Indicator – Operating business cash flow
Definition Net cash flow from operating activities excluding taxation and including net capital expenditure and lease principal amounts, financial investment and dividends from equity accounted investments.

Purpose Allows management to monitor the operational cash generation of the Group.

Taxation is excluded because it is not relevant to the pre-tax operational cash generation of the Group.

Net capital expenditure, lease principal amounts and financial investment are included as a measure of the investment in the business to support the operational performance of the Group.

Dividends received from equity accounted investments are included as a measure of the operating cash generation of the Group's equity accounted investments.

Reconciliation of net cash flow from operating activities to operating business cash flow

	2019 £m	2018 £m
Net cash flow from operating activities	**1,597**	1,200
Add back Taxation paid	**252**	200
Purchase of property, plant and equipment, and investment property	**(360)**	(358)
Purchase of intangible assets	**(110)**	(139)
Proceeds from sale of property, plant and equipment, and investment property	**21**	34
Proceeds from sale of intangible assets	**1**	–
Equity accounted investment funding	**(6)**	(1)
Principal element of lease payments and receipts	**(230)**	–
Net capital expenditure, lease principal amounts and financial investment	**(684)**	(464)
Dividends received from equity accounted investments	**142**	57
Operating business cash flow	**1,307**	993

Reconciliation of operating business cash flow to net cash flow from operating activities by reporting segment

	Operating business cash flow		Deduct Dividends received from equity accounted investments		Add back Net capital expenditure, lease principal amounts and financial investment		Net cash flow from operating activities	
	2019 £m	2018 £m	2019 £m	2018 £m	2019 £m	2018 £m	2019 £m	2018 £m
Electronic Systems	**672**	431	**(5)**	(7)	**166**	151	**833**	575
Cyber & Intelligence	**68**	85	**–**	–	**31**	11	**99**	96
Platforms & Services (US)	**241**	(30)	**(17)**	(7)	**81**	68	**305**	31
Air	**408**	666	**(117)**	(36)	**206**	89	**497**	719
Maritime	**150**	67	**(3)**	(3)	**142**	126	**289**	190
HQ	**(232)**	(226)	**–**	(4)	**58**	19	**(174)**	(211)
	1,307	993	**(142)**	(57)	**684**	464	**1,849**	1,400
Taxation paid[1]							**(252)**	(200)
Net cash flow from operating activities							**1,597**	1,200

1. Taxation is managed on a Group-wide basis.

27. Movement in assets and liabilities arising from financing activities

	As at 1 January 2018 £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 2018 £m	Recognised on transition to IFRS 16 Leases £m	Cash (inflow)/ outflow £m	Non-cash movements: Foreign exchange movements £m	Non-cash movements: Fair value and other movements £m	As at 31 December 2019 £m
Non-current assets										
Other financial assets[1]	**79**	–	–	41	**120**	–	–	–	(3)	**117**
Current assets										
Other financial assets[1]	**12**	(112)	–	187	**87**	–	(167)	–	87	**7**
	91	(112)	–	228	**207**	–	(167)	–	84	**124**
Non-current liabilities										
Loans	**(4,069)**	–	(229)	784	**(3,514)**	–	–	117	377	**(3,020)**
Lease liabilities	**–**	–	–	–	**–**	(1,270)	–	17	137	**(1,116)**
Other financial liabilities[1]	**(19)**	–	–	10	**(9)**	–	–	–	3	**(6)**
Cash collateral[2]	**(17)**	(2)	–	–	**(19)**	–	(1)	–	–	**(20)**
Current liabilities										
Loans	**(7)**	7	–	(785)	**(785)**	–	782	3	(377)	**(377)**
Lease liabilities	**–**	–	–	–	**–**	(216)	239	1	(262)	**(238)**
Other financial liabilities[1]	**(56)**	106	–	(61)	**(11)**	–	127	–	(174)	**(58)**
	(4,168)	111	(229)	(52)	**(4,338)**	(1,486)	1,147	138	(296)	**(4,835)**
		(1)					**980**			
Interest paid		203					233			
Net sale of own shares		(1)					–			
Equity dividends paid		703					724			
Dividends paid to non-controlling interests		28					56			
Partial disposal of shareholding in subsidiary undertaking[3]		(17)					(31)			
Net cash flow from financing activities[3]		**915**					**1,962**			

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. Reported in other payables.
3. 2018 comparatives have been reclassified to present a cash inflow of £17m in respect of a partial disposal of the Group's shareholding in a subsidiary undertaking within financing activities. This cash flow was previously presented in investing activities.

28. Net debt

Key Performance Indicator – Net debt
Definition Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments).

Purpose Allows management to monitor the indebtedness of the Group.

Components of net debt

	Notes	2019 £m	2018 £m
Cash and cash equivalents	18	**2,587**	3,232
Debt-related derivative financial instrument assets – non-current	14	**103**	87
Debt-related derivative financial instrument assets – current	14	**–**	78
Loans – non-current	21	**(3,020)**	(3,514)
Loans and overdrafts – current	21	**(377)**	(785)
Debt-related derivative financial instrument liabilities – non-current	14	**(6)**	–
Debt-related derivative financial instrument liabilities – current	14	**(30)**	(2)
Net debt		**(743)**	(904)

29. Fair value measurement

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

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

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

- the fair values of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates;
- the fair values of both interest rate and cross-currency swaps are calculated by discounting expected future principal and interest cash flows and translating at the appropriate balance sheet rates; and
- the fair values of money market funds are calculated by multiplying the net asset value per share by the investment held at the balance sheet date.

Due to the variability of the valuation factors, the fair values presented at 31 December may not be indicative of the amounts the Group would expect to realise in the current market environment.

Fair value hierarchy
The fair value measurement hierarchy is as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

Carrying amounts and fair values of certain financial instruments

		2019		2018	
	Notes	**Carrying amount £m**	**Fair value £m**	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:					
Non-current					
Equity investments at fair value through profit and loss		**13**	**13**	13	13
Other financial assets	14	**350**	**350**	245	245
Other financial liabilities	14	**(227)**	**(227)**	(104)	(104)
Current					
Other financial assets	14	**210**	**210**	166	166
Money market funds	18	**680**	**680**	908	908
Other financial liabilities	14	**(232)**	**(232)**	(74)	(74)
Financial instruments not measured at fair value:					
Non-current					
Loans	21	**(3,020)**	**(3,315)**	(3,514)	(3,597)
Current					
Cash and cash equivalents (excluding money market funds)	18	**1,907**	**1,907**	2,324	2,324
Loans and overdrafts	21	**(377)**	**(380)**	(785)	(794)

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.

30. 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 109 to 130.

Expense in year

	2019 £m	2018 £m
Executive Share Option Plan	**6**	7
Performance Share Plan	**21**	13
Restricted Share Plan	**7**	7
	34	27

The Group also incurred a charge of £40m (2018 £36m) in respect of the equity-settled all-employee Free Shares and Matching Partnership Shares elements of the Share Incentive Plan.

Executive Share Option Plan

	2019		2018	
	Number of shares '000	Weighted average exercise price £	Number of shares '000	Weighted average exercise price £
Outstanding at the beginning of the year	**36,164**	**5.44**	32,907	5.28
Granted during the year	**11,610**	**4.89**	8,971	5.83
Exercised during the year	**(4,077)**	**4.62**	(3,174)	4.74
Expired during the year	**(4,718)**	**5.46**	(2,540)	5.60
Outstanding at the end of the year	**38,979**	**5.36**	36,164	5.44
Exercisable at the end of the year	**12,476**	**4.74**	9,482	4.52

	2019	2018
Range of exercise price of outstanding options (£)	**3.01 – 6.49**	3.01 – 6.49
Weighted average remaining contracted life (years)	**7**	7
Weighted average fair value of options granted (£)	**0.64**	0.86

Performance Share Plan and Restricted Share Plan

	Performance Share Plan		Restricted Share Plan	
	2019 Number of shares '000	2018 Number of shares '000	2019 Number of shares '000	2018 Number of shares '000
Outstanding at the beginning of the year	**22,380**	20,758	**4,100**	3,769
Granted during the year	**9,653**	7,851	**2,084**	1,540
Exercised during the year	**(964)**	(965)	**(1,305)**	(1,012)
Expired during the year	**(8,574)**	(5,264)	**(473)**	(197)
Outstanding at the end of the year	**22,495**	22,380	**4,406**	4,100
Exercisable at the end of the year	**223**	250	**8**	–

	2019	2018	2019	2018
Weighted average remaining contracted life (years)	**5**	5	**5**	5
Weighted average fair value of awards granted (£)	**3.89**	4.63	**4.90**	5.83

The exercise price for the Performance Share Plan and Restricted Share Plan is £nil (2018 £nil).

30. 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

	2019	2018
Range of share price at date of grant (£)	**4.85 – 5.63**	5.82 – 6.07
Expected option/award life (years)	**3 – 10**	3 – 10
Volatility (%)	**19**	19
Risk free interest rate (%)	**0.3**	0.8

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 £5.21 (2018 £5.89).

31. 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 23).

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	**2019 £m**	2018 £m	**2019 £m**	2018[2] £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m	**2019 £m**	2018 £m
Advanced Electronics Company Limited	**41**	38	**215**	166	**–**	18	**35**	24	**–**	–
CTA International SAS	**2**	1	**–**	–	**1**	–	**13**	15	**–**	–
Eurofighter Jagdflugzeug GmbH	**854**	1,028	**248**	313	**41**	37	**42**	52	**–**	–
FADEC International LLC	**114**	101	**–**	–	**–**	–	**–**	–	**–**	–
FAST Training Services Limited	**2**	2	**–**	–	**–**	–	**–**	–	**–**	–
MBDA SAS	**28**	23	**164**	199	**8**	8	**1,041**	864	**19**	18
Panavia Aircraft GmbH	**27**	32	**16**	26	**1**	4	**–**	–	**–**	–
Reaction Engines Limited	**–**	1	**–**	–	**–**	–	**–**	–	**–**	–
Rheinmetall BAE Systems Land Limited	**4**	–	**–**	–	**–**	–	**–**	–	**–**	–
BAE Systems Pension Funds Trustees Limited[3]	**–**	–	**20**	19	**–**	4	**225**	10	**–**	–
Other	**2**	–	**1**	–	**2**	–	**3**	–	**–**	–
	1,074	1,226	**664**	723	**53**	71	**1,359**	965	**19**	18

1. Also relates to disclosures under IAS 24 Related Party Disclosures, for the parent company, BAE Systems plc. At 31 December 2019, £862m (2018 £869m) was owed by BAE Systems plc and £497m (2018 £96m) by other Group subsidiaries.
2. 2018 purchases from related parties have been restated to include £313m of purchases from Eurofighter Jagdflugzeug GmbH.
3. Transactions with BAE Systems Pension Funds Trustees Limited represent lease arrangements for land and buildings leased by the Group. Amounts owed at 31 December 2019 include £225m in respect of lease liabilities measured under IFRS 16. The undiscounted minimum lease commitments to this related party at 31 December 2018 were £297m, which is not included within amounts owed to related parties in the table above.

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 109 to 130. Total emoluments for directors and key management personnel charged to the Consolidated income statement were:

	2019 £'000	2018 £'000
Short-term employee benefits	**18,163**	15,140
Post-employment benefits	**1,275**	1,127
Share-based payments	**8,538**	6,578
	27,976	22,845

32. 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 24).

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.

33. Acquisition of subsidiaries

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

Subsidiaries acquired during 2018
On 14 December 2018, the Group acquired 100% of the issued share capital of ASC Shipbuilding Pty (ASCS) for consideration of A$1. Following the acquisition, ASCS was awarded the contract for the Australian Hunter Class Future Frigate programme.

The Group determined that it controls ASCS; therefore the acquisition was accounted for as a business combination and its results and financial position have been consolidated from the date of acquisition.

The fair values of the assets and liabilities of ASCS at the date of acquisition were as follows:

	£m
Cash and cash equivalents	14
Trade and other receivables	1
Trade and other payables	(15)
Net identifiable assets acquired	–
Goodwill arising	–
Net assets acquired	**–**

Acquisition-related costs of £1m were included in operating expenses in the Consolidated income statement in the year ending 31 December 2018.

ASCS contributed £1m to the Group's revenue and £nil to the Group's operating profit between the date of acquisition and 31 December 2018.

If ASCS had been acquired on 1 January 2018, the Group's revenue and operating profit would have been £16,904m and £1,604m, respectively, for the year ending 31 December 2018.

34. 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 2019 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
Lupin Way, Alvington, Yeovil, Somerset BA22 8UZ, United Kingdom

Alvis Limited

Alvis Pension Scheme Trustees Limited[2]

Alvis Vickers Limited

Armstrong Whitworth Aircraft Limited[2]

ASC Shipbuilding Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Australian Marine Engineering Corporation (Finance) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Avro International Aerospace Limited[2]

BAE Systems (Al Diriyah C4i) Limited[2]

BAE Systems (Aviation Services) Limited

BAE Systems (Canada) Inc.
220 Laurier Avenue West, Suite 1200, Ottawa ON K1P 5Z9, Canada

BAE Systems (Combat and Radar Systems) Limited
4th Floor, St. Paul's Gate, 22-24 New Street, St. Helier JE1 4TR, Jersey

BAE Systems (Consultancy Services) Limited

BAE Systems (Corporate Air Travel) Limited

BAE Systems (CS&SI – Qatar) Limited[2]

BAE Systems (Defence Systems) Limited

BAE Systems (Dynamics) Limited

BAE Systems (Farnborough 1) Limited

BAE Systems (Farnborough 2) Limited

BAE Systems (Farnborough 3) Limited

BAE Systems (Finance) Limited

BAE Systems (Funding Four) Unlimited Company
Riverside One, Sir John Rogerson's Quay, Dublin 2, Ireland

BAE Systems (Funding Three) Limited

BAE Systems (Funding Two) Limited

BAE Systems (Gripen Overseas) Limited

BAE Systems (Hawk Synthetic Training) Limited

BAE Systems (Holdings) Limited[2]

BAE Systems (Insurance) Limited[3]
15 Canada Square, London E14 5GL, United Kingdom

BAE Systems (International) Limited

BAE Systems (Kazakhstan) Limited

BAE Systems (Kuwait) Limited

BAE Systems (Land and Sea Systems) Limited[4]

BAE Systems (Malaysia) Sdn Bhd
Level 25 Menara Hong Leong, No. 6 Jalan Damanlela, Bukit Damansara, 50490 Kuala Lumpur, Malaysia

BAE Systems (MEH) Limited

BAE Systems (Military Air) Overseas Limited

BAE Systems (Nominees) Limited[2]

BAE Systems (Oman) Limited

BAE Systems (Operations) Limited[5]

BAE Systems (Operations) Singapore Pte Limited
One Marina Boulevard #28-00, Singapore 018989, Singapore

BAE Systems (Overseas Holdings) Limited

BAE Systems (Poland) Sp. z o.o.
ul. Abp. A. Baraniaka 88, 61-131 Poznan, Poland

BAE Systems (Projects) Limited

BAE Systems (Property Investments) Limited

BAE Systems (Vehicles and Equipment) Limited

BAE Systems 2000 Pension Plan Trustees Limited[2]

BAE Systems AB[6]
Box 5676, SE-114 86 Stockholm, Sweden

BAE Systems Al Diriyah Programme Limited[2]

BAE Systems Applied Intelligence (Asia Pacific) Pte Limited
United Square, 101 Thomson Road, #25-03/04, 307591, Singapore

BAE Systems Applied Intelligence (Australia) Pty Limited
Level 12, 16-20 Bridge Street, Sydney NSW 2000, Australia

BAE Systems Applied Intelligence (Belgium) NV
Geldenaaksebaan 329, B-3001, Heverlee, Leuven, Belgium

BAE Systems Applied Intelligence (Connect) A/S
c/o Kromann Reumert, Sundkrogsgade 5, Copenhagen East, 2100, Denmark

BAE Systems Applied Intelligence (GCS) Limited
Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (Germany) GmbH
Mainzer Landstrasse 50, 60325 Frankfurt am Main, Germany

BAE Systems Applied Intelligence (Integration) Limited
Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (International) Limited
Priestley Road, Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (Ireland) Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

BAE Systems Applied Intelligence (Japan) KK
12/F Ark Mori Building, 1-12-32 Akasaka, Minato-ku, Tokyo, 107-6024, Japan

BAE Systems Applied Intelligence (Spain) S.A.
Paseo de la Castellana, 141, Cuzco IV, 28046 Madrid, Spain

BAE Systems Applied Intelligence (UK) Limited

BAE Systems Applied Intelligence A/S
c/o Kromann Reumert, Sundkrogsgade 5, Copenhagen East, 2100, Denmark

BAE Systems Applied Intelligence Canada Inc.
1959 Upper Water Street, Suite 900, Halifax NS B3J 2X2, Canada

BAE Systems Applied Intelligence France SAS
19 Boulevard Malesherbes, 75008, Paris, France

BAE Systems Applied Intelligence GCS Inc.[7]
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

BAE Systems Applied Intelligence Inc.[8]
5th Floor, Suite 1920, 256 Franklin Street, Boston MA 02110, 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 Applied Intelligence US Corp[7]
440 Wheelers Farms Road, Suite 202, Milford CT 06461, United States

BAE Systems Australia (Electronic Systems) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (NSW) Holdings Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (NSW) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (Singapore) Pte Limited[9]
9 Raffles Place #26-01, Republic Plaza, Singapore 048619

BAE Systems Australia Datagate Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Defence Holdings Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Defence Pty Limited[10]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Holdings Limited[2]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Logistics Pty Limited[5]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Sea Sentinel Project Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Avionics Singapore Pte Limited
One Marina Boulevard, #28-00, Singapore 018989, Singapore

BAE Systems Bofors AB
SE-691 80 Karlskoga, Sweden

BAE Systems Bofors Holdings Sdn Bhd
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia

BAE Systems C-ITS AB
Box 5676, SE-114 86 Stockholm, Sweden

BAE Systems China (Exports) Limited

BAE Systems Communications Limited[2]

BAE Systems Communications Solutions, LLC[1]
Knowledge Oasis, Building 4, Second Floor, 0402-Z427, Knowledge Oasis Muscat, PO Box 16, Postal Code 135, Muscat, Oman

BAE Systems Controls Inc.[8]
1098 Clark Street, Endicott NY 13760, United States

BAE Systems Creole Inc.[11]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474, United States

BAE Systems Datagate Holdings Limited

BAE Systems Datagate Limited

BAE Systems Deployed Systems Limited[12]

BAE Systems Display Technologies Limited

BAE Systems do Brasil Ltda
SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil

BAE Systems Electronic Systems (Overseas) Limited

BAE Systems Electronics Limited

BAE Systems Enterprises Limited

BAE Systems Executive Pension Scheme Trustees Limited[2]

34. Information about related undertakings continued

Subsidiaries – wholly-owned continued

BAE Systems Finance B.V.
c/o IQ-EQ, Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

BAE Systems Finance Inc.[7]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems Flight Training (Australia) Pty Limited[5]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Funds Management[2,13]

BAE Systems GCS International Limited

BAE Systems Global Combat Systems Bridging Limited

BAE Systems Global Combat Systems Munitions Limited

BAE Systems Global LLC[1]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems Hägglunds AB
SE-691 80, Karlskoga, Sweden

BAE Systems Hawaii Shipyards Inc.[7]
3049 Ualena Street, Suite 915, Honolulu HI 96819, United States

BAE Systems Holding GmbH
Hauptstrasse 48, 82433 Bad Kohlgrub, Germany

BAE Systems Holdings (South Africa) (Pty) Limited
Central Office Park No. 5, 257 Jean Avenue, Centurion, Gauteng, 0157, South Africa

BAE Systems Holdings B.V.
c/o IQ-EQ, Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

BAE Systems Holdings Inc.[8]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems Holdings International LLC[1]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems IAP Research LLC[1]
2000 North 15th Street, 11th Floor, Arlington VA 22201, United States

BAE Systems Imaging Solutions Inc.[8]
1841 Zanker Road, Suite 50, San Jose CA 95112, United States

BAE Systems India (Homeland Security) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Services) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Technology) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Ventures) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems Information and Electronic Systems Integration Inc.[2]
65 Spit Brook Road, Nashua NH 03061, United States

BAE Systems Insurance (Isle of Man) Limited
Tower House, Loch Promenade, Douglas, IM1 2LZ, Isle of Man, United Kingdom

BAE Systems Integrated System Technologies (KSA) Limited

BAE Systems Integrated System Technologies (Overseas) Limited

BAE Systems Integrated System Technologies GmbH[3]
Hans-Stießberger-Str. 2b, 85540 Haar, Germany

BAE Systems Integrated System Technologies Limited

BAE Systems International Inc.[8]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems Jacksonville Ship Repair LLC[1]
8500 Heckscher Drive, Jacksonville FL 32226, United States

BAE Systems Land & Armaments Holdings LLC[1,7]
2000 North 15th Street, 11th Floor, Arlington VA 22201, United States

BAE Systems Land & Armaments Inc.[7]
2000 North 15th Street, 11th Floor, Arlington VA 22201, United States

BAE Systems Land & Armaments L.P.[1]
2000 North 15th Street, 11th Floor, Arlington VA 22201, United States

BAE Systems Land Systems (Finance) Limited

BAE Systems Land Systems (Investments South Africa) Limited

BAE Systems Land Systems (Investments) Limited

BAE Systems Land Systems (Logistics) Limited

BAE Systems Land Systems (Ranges) Limited

BAE Systems Land Systems (Singapore Investments) Limited

BAE Systems Land Systems ATF Limited

BAE Systems Land Systems FMTV International Inc.[11]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems Land Systems Pinzgauer (Holdings) Limited

BAE Systems Land Systems Pinzgauer Limited

BAE Systems Logistica Ltda
SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil

BAE Systems MAI Turkey Hava Sistemleri A.Ş
Üniversiteler Mahallesi, Beytepe Lodumlu Köy Yolu Cad. No: 5/348 Çankaya, Ankara, Turkey

BAE Systems Marine (Holdings) Limited

BAE Systems Marine (YSL) Limited

BAE Systems Marine Limited

BAE Systems Norfolk Ship Repair Inc.[7]
750 West Berkley Avenue, Norfolk VA 23523, United States

BAE Systems Oman LLC[1]
PO Box 74, Postal Code 111, Seeb, Oman

BAE Systems Ordnance Systems Inc.[7]
4509 West Stone Drive, Kingsport TN 37660-9982, United States

BAE Systems Overseas Inc.[7]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

BAE Systems Pension Funds CIF Trustees Limited[2]

BAE Systems Pension Funds Investment Management Limited[2,15]

BAE Systems Pension Funds Trustees Limited[2]

BAE Systems Project Services Limited

BAE Systems Projects (Canada) Limited

BAE Systems Properties Limited

BAE Systems Quest Limited[2]

BAE Systems Regional Aircraft (Japan) KK[7]
Minami Azabu T&F Building 8th Floor, 4-11-22 Minami Azabu, Minato-ku, Tokyo, Japan

BAE Systems Regional Aircraft Colombia SAS[16]
c/o Brigard & Urrutia, Calle 70 A No. 4-41, Bogota, Colombia

BAE Systems Resolution Inc.[11]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Rokar International Limited
PO Box 45059, 11 Hartom Street, Mount Hotzvim, 91450 Jerusalem, Israel

BAE Systems S&S Operations Inc.[7]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems San Diego Ship Repair Inc.[7]
2205 East Belt Street, Foot of Sampson Street, San Diego CA 92113, United States

BAE Systems Saudi America Limited
Business Gate Building 7, Floor 1, Riyadh 11482, Saudi Arabia

BAE Systems Saudi Arabia (Maintenance and Equipment Services) Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

BAE Systems Saudi Arabia (Vehicles and Equipment Holdings) Limited[2]

BAE Systems Saudi Arabia (Vehicles and Equipment Nominees) Limited[2]

BAE Systems Saudi Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

BAE Systems Serviços de Aviônicos Ltda.
Rua Boa Vista, No. 254, 13th Floor, Suite 15, Centro, São Paulo, São Paulo 01014-907, Brazil

BAE Systems Share Plans Trustee Limited[2]

BAE Systems Shared Services (Overseas) Limited

BAE Systems Shared Services Inc.[7]
11215 Rushmore Drive, Charlotte NC 28277, United States

BAE Systems Ship Repair Inc.[7]
750 West Berkley Ave., Norfolk VA 23523, United States

BAE Systems Southeast Shipyards AMHC Inc.[7]
8500 Heckscher Drive, Jacksonville FL 32226, United States

BAE Systems Surface Ships (Holdings) Limited

BAE Systems Surface Ships (Overseas) Limited

BAE Systems Surface Ships (Projects) Limited

BAE Systems Surface Ships Integrated Support Limited

BAE Systems Surface Ships Intermediate Holdings Limited

BAE Systems Surface Ships International Limited[6]

BAE Systems Surface Ships Limited

BAE Systems Surface Ships Maritime Limited

BAE Systems Surface Ships Portsmouth Limited[6]

BAE Systems Surface Ships Projects (Malaysia) Sdn Bhd
Level 14, West Block, Wisma Golden Eagle Realty, 142C, 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]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Technology Solutions & Services Inc.[7]
520 Gaither Road, Rockville, MD 20850, United States

BAE Systems Training Services Limited

BAE Systems TVS Holdings Inc.[7]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems TVS Holdings LLC[1]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems TVS Inc.[11]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Zephyr Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Fifth Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Fourth Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Second Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Third Corporation[8]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems, Inc.[7]
1101 Wilson Blvd, Suite 2000, Arlington VA 22209, United States

34. Information about related undertakings continued

Subsidiaries – wholly-owned continued

Brabazon Limited

British Aerospace (Far East) Limited[17]
Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong

British Aerospace (Malaysia) Sdn Bhd[17]
Unit 30-01, Level 30, Tower A, Vertical Business Suite, Avenue 3, Bangsar South, No.8, Jalan Kerinchi, 59200 Kuala Lumpur, Malaysia

British Aircraft Corporation (Pension Fund Trustees) Limited[2]

British Aircraft Corporation Limited[2]

Buckfield Properties Limited

Cashhold Limited[2,3,5]
15 Canada Square, London E14 5GL, United Kingdom

CPS International, Inc.[11]
c/o Benedetti & Benedetti, Comosa Building, 21st Floor, Ave. Samuel Lewis, PO Box 850120, Panama 5, Panama

Creole (Nigeria) Limited[5]
Tapa House (2nd Floor), 45, Imman Dauda St (Abosede Kuboye Crescent Entrance) Surulere, Lagos, Nigeria

Detica B.V.
Luna ArenA, Herikerbergweg 238, 1101 CM Amsterdam, Netherlands

Detica Group Holdings (Ireland) Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Group Limited

Detica Ireland Limited[6]
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Mexico S. de R.L. de C.V.
Torre Esmeralda II, Blvd Manuel Avila Camacho No. 36 Piso 18, Lomas de Chapultepec, 11000 D.F., Mexico

Detica Patent Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Services, Inc.
5th Floor, Suite 1920, 256 Franklin Street, Boston MA 02110, United States

ETI Engineering, Inc.[7]
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

Gloster Aircraft Limited[2]

Granada Enterprises Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

H-B Utveckling, H-B Development AB
Nybrogatan 7, SE-114 34 Stockholm, Sweden

Hadrian Holdings, Inc.[14]
521 Fifth Avenue, New York NY 101075, United States

Hadrian Trustees Limited[2,14]

Hägglunds Vehicle GmbH
Ernst-Grote Strasse 13, 30916 Isernhagen, Germany

Hawker Siddeley Aviation Limited[2]

Hawker Siddeley Dynamics Limited[2]

Hertfordshire Estates Limited[5]

HSA/HSD Pension Fund Trustees Limited[2]

Hunter Aerospace Corporation Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

International Military Sales Limited

Jetstream Aircraft Limited[2]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Lemacrown Limited[18]

MES Holdco Limited
4th Floor, St. Paul's Gate, 22-24 New Street, St. Helier JE1 4TR, Jersey

MES Interco[13]

Meslink Limited

Newcombe Properties Limited

Piper Group plc

Pitch Technologies AB
Repslagaregatan 25, SE-582 22 Linköping, Sweden

Pitch Technologies Limited
Sweden House, 5 Upper Montagu Street, London W1H 2AG, United Kingdom

Port Solent Limited[19]

Port Solent Marina Limited[19]

PT. BAE Systems Services[7]
Wisma 46, Kota BNI, 34th Floor, Suite 34.01.A, Jl. Jenderal Sudirman Kavling 71, Jakarta 10220, Indonesia

Representaciones SSTS, CA[11]
Ave Francisco de Miranda, Centro Lido El Rosal Oficina 71B, Caracas, Venezuela

Riptide Autonomous Solutions Canada Company
1300-1969 Upper Water Street, Purdy's Wharf Tower II, Halifax, NS, BJ3 3R7, Canada

Royal Ordnance (Crown Service) Pension Scheme Trustees Limited

Royal Ordnance B.V.
c/o IQ-EQ, Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

Royal Ordnance Senior Staff Pension Scheme Trustees Limited

Royal Ordnance Speciality Metals Limited[2]

RWT Limited[2]

Salford Electrical Instruments Limited

Scentcivil Limited

Scottish Aviation Limited[2]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Sepia, LLC[1]
4219 Lafayette Center Drive, Chantilly VA 20151, United States

Shipbuilding (MSF) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Shipbuilding (VIC) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Silversky Technology Sdn. Bhd.
Level 25, Menara Hong Leong, No. 6 Jalan Damanlela, Bukit Damansara, 50490 Kuala Lumpur, Malaysia

Stewart & Stevenson Operations (Nigeria) Limited[11]
Tapa House (2nd Floor), 45, Imman Dauda St (Abosede Kuboye Crescent Entrance), Surulere, Lagos, Nigeria

Stewart & Stevenson TVS UK Limited

Stratsec.net Sdn Bhd
Unit F-3-1, Blok F, Third Floor, CBD Perdana 3, Jalan Perdana, Cyber 12, 63000 Cyberjaya, Selangor Darul Ehsan, Malaysia

Support Solutions General Services and Contracting Company/Limited Liability company[1,16]
House No. 145, Street No. 1, Qtr. 611, Al Andulous Area, Al Mansour, Baghdad, Iraq

TDS International Holdings Pty Limited[20]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

TDS International Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

The Blackburn Aeroplane & Motor Co Limited[2]

The Bristol Aviation Company Limited[2]

The British & Colonial Aeroplane Co. Limited[2]

The Leeds Partnership Limited[5]

The Supermarine Aviation Works Limited[2,4]

Thomas Sopwith Aviation Company Limited[2]

VSEL Birkenhead Limited

Warship Design Services Limited

Westover Controls Incorporated[7]
1098 Clark Street, Endicott NY 13760, United States

34. Information about related undertakings continued

Subsidiaries – not wholly-owned

Advanced National Company for Aircraft Maintenance Limited (76.5%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Aircraft Research Association Limited (92.8%)[2]
Manton Lane, Bedford MK41 7PF, United Kingdom

BAE Systems Saudi Development and Training Company Limited (74.9%)[21]
PO Box 67775, Riyadh 11517, Saudi Arabia

BAE Systems SDT (UK) Limited (74.9%)

Flight Control System Management GmbH (66.6%)[22]
PO Box 801109, 81663 Munich, Germany

Hadrian Properties, Inc. (95%)[14]
521 Fifth Avenue, New York NY 101075, United States

International Systems Engineering Company Limited (69.3%)
PO Box 54002, Riyadh 11514, Saudi Arabia

Overhaul and Maintenance Company Holding (76.5%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Prismatic Limited (51%)
2 Omega Park, Alton GU34 2QE, United Kingdom

Saudi Maintenance & Supply Chain Management Company Limited (51%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Saudi Technology & Logistics Services Limited (65%)[2]
PO Box 1732, Riyadh 11441, Saudi Arabia

SMSCMC (UK) Limited (51%)

Equity accounted investments

Abercromby Property International (20.42%)
521 Fifth Avenue, New York NY 101075, United States

Advanced Electronics Company Limited (38.2%)
PO Box 90916, Riyadh 11623, Saudi Arabia

Air Astana (49%)[8]
121 Kabanbay Batyr Avenue, Yessil District, Astana 010000, Kazakhstan

AMSH B.V. (50%)[23]
Weena 210-212, 3012 NJ Rotterdam, Netherlands

BAE Systems Strategic Aerospace Services WLL (49%)
Building 52, Floor 2, Area 23, Qatari Bin Al Fajaa, Doha, Qatar

BAeHAL Software Limited (40%)[2,14]
Airport Lane, HAL Estate, Bangalore 560010, India

BHIC Bofors Defense Asia Sdn Bhd (49%)
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia

Canadian Naval Support Limited (50%)[24]
3099 Barrington Street, Halifax NS B3K 5M7, Canada

CTA International SAS (50%)
13 Route De La Miniere, 78034 Versailles Cedex, France

Data Link Solutions L.L.C. (50%)[1,17]
400 Collins Ave, Cedar Rapids IA 52498, United States

Eurofighter Aircraft Management GmbH (33%)[2,16]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

Eurofighter Jagdflugzeug GmbH (33%)[2]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

European Aerosystems Limited (50%)[2,20]

FADEC International LLC (50%)[1]
1098 Clark Street, Endicott NY 13760, United States

FAST Holdings Limited (50%)[14,20]

FAST Training Services Limited (50%)[14]

FNSS Savunma Sistemleri A.S (49%)[20]
Oğulbey Mahallesi, Oğulbey Kumeevleri, No. 441/A, 441/B, Gölbaşı, Ankara, Turkey

MBDA Holdings SAS (25%)
1 Avenue Réaumur, 92350 Le Plessis-Robinson, France

Nobeli Business Support AB (34%)
SE-691 80 Karlskoga, Sweden

Nurol BAE Systems Hava Sistemleri Anonim Şirketi (49%)[23]
Üniversiteler Mah, 1605.Cad, No:3/1-3, 06800, Ankara, Turkey

Panavia Aircraft GmbH (42.5%)[2]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

Rheinmetall BAE Systems Land Limited (45%)
Hadley Castle Works, PO Box 106, Telford TF1 6QW, United Kingdom

Saab Bofors Test Center AB (30%)
SE-691 80 Karlskoga, Sweden

Saab-BAe Systems Gripen AB (50%)[2,3]
SE-581 88 Linköping, Sweden

Sealand Support Services Limited (33.3%)[10]
MoD Sealand, Welsh Road, Sealand, Deeside, Flintshire CH5 2LS, United Kingdom

Spectrum Technologies Limited (20%)[2,14]
Western Avenue, Bridgend Industrial Estate, Bridgend, Mid Glamorgan CF31 3RT, United Kingdom

Winner Developments Limited (33.3%)

Notes

1. Unincorporated entity for which the address given is the principal place of business.
2. Directly owned by BAE Systems plc.
3. In members' voluntary liquidation.
4. Ownership held in class of A shares, B shares and preference shares.
5. Ownership held in class of A shares and B shares.
6. Ownership held in ordinary shares and preference shares.
7. Ownership held in common shares.
8. Ownership held in common stock.
9. Year end 30 June.
10. Ownership held in ordinary shares and redeemable preference shares.
11. Ownership held in authorized shares.
12. 40% owned by BAE Systems plc.
13. Unlimited company.
14. Year end 31 March.
15. Year end 5 April.
16. In liquidation.
17. Year end 30 September.
18. Ownership held in ordinary shares and class of A shares.
19. In strike off.
20. Ownership held in class of A shares.
21. 1% owned by BAE Systems plc.
22. 33.3% owned by BAE Systems plc.
23. Ownership held in class of B shares.
24. Ownership held in common shares and B Preferred shares.

35. Events after the reporting period

In January 2020, the Group announced that it has entered into a definitive Asset Purchase Agreement to acquire Collins Aerospace's Military Global Positioning System business for $1.9bn in cash, subject to customary closing adjustments. The Group has also entered into a definitive Asset Purchase Agreement to acquire Raytheon's Airborne Tactical Radios business for $275m in cash, subject to customary closing adjustments. Completion of both acquisitions is subject to successful closure of the Raytheon-United Technologies Corporation merger, as well as customary regulatory approvals and conditions.

In October, six of the Group's nine UK pension schemes (including the two largest schemes) were consolidated into a single scheme. Following that consolidation, the Company agreed with the new Trustee Board to bring forward the funding valuation of the combined scheme to 31 October 2019 from the previously scheduled date of 31 March 2020.

After consultation with The Pensions Regulator in the UK, the Group has reached agreement with the Trustee Board of the combined scheme on the accelerated funding valuation and revised deficit recovery plan.

At the 31 October 2019 funding valuation date, the deficit was £1.9bn. The current deficit recovery plan which runs to 2026 will be replaced by a new deficit recovery plan, under which a one-off payment of £1bn is to be made in the coming months, with approximately £240m of funding payable in the scheme year ending 31 March 2020 and approximately £250m by 31 March 2021.

36. Adoption of IFRS 16 Leases

IFRS 16 became effective from 1 January 2019 and has replaced IAS 17 Leases and related interpretations. It has resulted in almost all leases being recognised on the balance sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, a right-of-use asset and a financial liability for future lease payments are recognised. The only exceptions are short-term leases, low-value leases and leases of intangible assets.

The Group has applied the modified retrospective transition approach and has not restated comparative amounts for the year ended 31 December 2018. In the majority of cases the Group has elected to measure right-of-use assets at the amount of the lease liability on adoption (adjusted for any lease prepayments or accrued lease expenses, onerous lease provisions, and leased assets which have subsequently been subleased). For a number of property leases the Group has elected to measure the right-of-use asset as if IFRS 16 had been applied since the start of the lease, but using the incremental borrowing rate at 1 January 2019, with the difference between the right-of-use asset and the lease liability taken to retained earnings.

The Group has elected to adopt the following practical expedients on transition:

- not to capitalise a right-of-use lease asset or related lease liability where the lease expires before 31 December 2019;
- not to reassess contracts to determine if the contract contains a lease and not to separate lease and non-lease elements;
- where an onerous lease provision is in existence, to utilise this provision to reduce the right-of-use asset value rather than undertaking an impairment review;
- to use hindsight in determining the lease term;
- to exclude initial direct costs from the measurement of the right-of-use asset; and
- to apply the portfolio approach where a group of leases has similar characteristics.

Impact of adoption of IFRS 16 Leases

Balance sheet

Upon transition on 1 January 2019, the Group recognised a right-of-use lease asset of £1,298m (after adjustments for onerous lease provisions, lease prepayments and accrued lease expenses at 31 December 2018), and lease liabilities of £1,486m (non-current £1,270m; current £216m), along with a deferred tax asset of £2m. A sublease finance receivable of £72m was also recognised. A transition adjustment of £92m was recognised as a debit to retained earnings. The Group did not capitalise low-value leases on transition, or those which expire before 31 December 2019, and has opted not to apply IFRS 16 to leases relating to intangible assets. The right-of-use lease asset principally consists of property.

Income statement

Under IFRS 16 the Group sees a different pattern of expense within the income statement, as the IAS 17 operating lease expense is replaced by depreciation and interest charges. In 2019, the Group's EBITA metric has improved by approximately £50m under IFRS 16 as the new depreciation expense is lower than the IAS 17 operating lease charge; however the new finance costs have broadly offset this, such that net profit after tax and the underlying earnings metrics are not materially different compared to the previous IAS 17 reporting basis.

Cash flow statement

The change in presentation as a result of the adoption of IFRS 16 has seen an improvement in 2019 of approximately £46m in operating business cash flow, offset by a corresponding decline in cash flow from financing activities. There is no overall cash flow impact from the adoption of the new Standard.

Lessor accounting under IFRS 16 is largely unchanged from IAS 17.

Accounting policy

The accounting policy in respect of leases applied from 1 January 2019 is set out in note 10.

36. Adoption of IFRS 16 Leases continued

Impact on Consolidated balance sheet at 1 January 2019 (extract)

The following table shows the effect of adopting IFRS 16 on the Consolidated balance sheet at 1 January 2019.

	£m
Non-current assets	
Right-of-use assets	1,255
Investment property	43
Equity accounted investments	(11)
Finance lease receivable	62
Deferred tax assets	2
	1,351
Current assets	
Finance lease receivable	10
Trade, other and contract receivables	(26)
	(16)
Total assets	**1,335**
Non-current liabilities	
Lease liabilities	(1,270)
Provisions	24
	(1,246)
Current liabilities	
Lease liabilities	(216)
Trade and other payables	28
Provisions	7
	(181)
Total liabilities	**(1,427)**
Net assets	**(92)**
Capital and reserves	
Retained earnings	(92)
Total equity attributable to equity holders of BAE Systems plc	**(92)**
Non-controlling interests	**–**
Total equity	**(92)**

The weighted average incremental borrowing rate applied to lease liabilities was 3.4%.

Reconciliation between operating lease commitments and lease liability

The following table explains the difference between the operating lease commitments disclosed applying IAS 17 at 31 December 2018 and the lease liability recognised on adoption of IFRS 16 at 1 January 2019.

	£m
Total minimum lease payments reported at 31 December 2018 under IAS 17	1,706
Change in assessment of lease term under IFRS 16	107
Leases outside the scope of IFRS 16	(81)
Impact of discounting lease liability under IFRS 16	(246)
Lease liability recognised on transition to IFRS 16 at 1 January 2019	**1,486**

Independent Auditor's report
to the members of BAE Systems plc only

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 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

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 38, including the associated accounting policies.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 Reduced Disclosure Framework (United Kingdom Generally Accepted Accounting Practice).

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. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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;
- valuation of goodwill; and
- valuation of retirement benefit obligations.

These key audit matters were also identified by the Group's auditor in the prior year, KPMG. In addition, they also identified key audit matters in relation to tax accruals and deferred tax assets, and, with respect to the Parent company, amounts relating to Group affiliates. We did not consider these matters to have the greatest effect on our overall audit strategy and consequently on the allocation of resources or the engagement team's audit efforts in the current year.

Materiality

The materiality that we used for the Group financial statements was £70m, which was determined on the basis of adjusted profit before tax on continuing operations as defined on page 138 below. Our materiality equates to 4.7% of adjusted profit before tax and 5.7% of profit before tax.

Scoping

18 components were subject to audit. Of these, six were subjected to a full-scope audit whilst the remaining 12 were subject to an audit of specified account balances. These components give us audit coverage of 89% of revenue and 88% of profit before tax.

First year audit transition

We developed a detailed audit transition plan, designed to deliver an effective transition from the Group's predecessor auditor, KPMG. Our transition activities were performed across the Group's business units and included, but were not limited to, meeting with management across all business units, obtaining an understanding of the Group's system of internal control and evaluating the Group's accounting policies and areas of accounting judgement.

The key transition activities included (but were not limited to) the following:

1. In May 2017 we established a detailed audit transition plan in conjunction with BAE Systems' management, including setting key milestone dates to monitor transition progress. This was monitored with management on at least a monthly basis;
2. On 1 October 2017 we confirmed our independence to the Audit Committee and commenced our audit planning in relation to the 2018 audit;
3. In October 2017, a global transition workshop was held with senior members of our Group and global component audit teams in order to develop our audit strategy. Senior members of client management also participated in this workshop;
4. We shadowed KPMG throughout the 2017 year-end audit and attended key audit meetings. This included, but was not limited to, attendance at the business unit year-end audit close meetings in January 2018 and the Audit Committee meeting in February 2018 where the final report on the audit was presented;
5. We reviewed KPMG's 2017 audit work papers and met with relevant partners and senior staff from KPMG to further our understanding of the predecessor auditor's approach;
6. We attended key management and contract meetings throughout the 2018 financial year across the business to deepen our understanding of BAE Systems' key contract judgements and continue to develop our understanding of the business and audit risks; and
7. In May 2018 a second global workshop was held with senior members of our global Group and component teams as part of our audit planning, in order to further develop our audit strategy and deep dive into certain areas of our audit approach.

This transition process helped us build an understanding of the Group, which, in turn, informed our risk assessment process and identification of the risks of material misstatement to the Group's financial statements.

We presented our proposed audit plan to the Audit Committee in June 2018 and re-confirmed the scope, significant risks and audit approach at the meeting in December 2018.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement in the Basis of Preparation on page 142 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Parent company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We considered as part of our risk assessment the nature of the Group, its business model and related risks including, where relevant, the impact of the applicable political and economic environments including Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the directors' assessment of the Group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the directors' plans for future actions in relation to their going concern assessment.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the Group's and the Parent company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 68 to 71 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 81 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on page 81 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We are also required to report whether the directors' statement relating to the prospects of the Group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

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 that 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.

Revenue and margin recognition on long-term contracts

Refer to page 84 (Audit Committee report), note 1 (accounting policy and financial disclosure) and note 37 (for IFRS 15 restatement disclosure)

Revenue:
£16,821m (2017 restated £17,224m)

Key audit matter description

The estimation of both overall lifetime contract margin and the appropriate level of revenue and profit to recognise in any single accounting period require the exercise of management judgement. Within BAE Systems' contract portfolio there are a number of programmes where the estimates required in reaching these judgements are highly complex and could lead to a material error within the financial statements if reached incorrectly. Consequently, we consider that revenue and margin recognition represents a significant risk to our audit and a key audit matter. This risk is further heightened in 2018 owing to it being the first year that the businesses will be required to account for the contracts under IFRS 15. The standard has a number of judgements that the Group is required to apply to its contracts, including the identification of performance obligations and estimation of the amount of consideration to be recognised.

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 tests and procedures to mitigate the associated risks.

In order to identify the key contracts over which there is a significant risk of material misstatement, we undertook a contract risk assessment process at each component, utilising the latest contract information and our understanding of the business. We held meetings with key finance and contract managers, attended Quarterly Business Reviews and other key management meetings, read and understood underlying contract documentation and reviewed management support for key contract judgements (from both a qualitative and quantitative perspective). In addition we looked for contracts that might have higher levels of judgement associated with the risk of schedule delivery or technical complexity, fixed price contracts which increase the risk of contract losses and other indicators that could increase the risk of a material impact on the financial statements.

As a result of our risk assessment we identified a number of contracts where we consider there to be the highest degree of management judgement required. These are:

- Astute Class submarines;
- Queen Elizabeth Class (QEC) aircraft carrier;
- Offshore Patrol Vessel (OPV);
- Saudi Salam Typhoon (Salam);
- Saudi British Defence Co-operation Programme (SBDCP); and
- Radford Nitrocellulose plant.

How the scope of our audit responded to the key audit matter

Our contract testing approach included:

Testing the relevant controls

- We assessed the design and implementation and, where deemed appropriate, tested the operating effectiveness of key controls within management's Lifecycle Management (LCM) Framework and project accounting processes which management have established to ensure that contracts are appropriately 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 contracts.

Challenging management's assumptions and estimates

To gain assurance over the contract judgements and estimates made, our work included:

- making enquiries 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;
- examining external correspondence to support the timeframe for delivery of the product or service and any judgements made in respect of these;
- examining external evidence to support contract status and recoverability of receivables, such as customer correspondence and for certain contracts, meeting with the customer directly;
- enquiring with in-house and external legal counsel regarding contract-related litigation and claims;
- using Deloitte subject matter experts to provide support in evaluating specific contract judgements taken; and
- considering whether there were any indicators of management override of controls or bias in arriving at their reported position.

Assessing the impact of IFRS 15

In respect of ensuring that the Group is appropriately applying IFRS 15 we:

- reviewed and challenged management's accounting papers on the impact of the transition;
- reviewed and challenged management's updated accounting policies manual;
- embedded IFRS 15 considerations in our contract review work, in particular determining whether management had appropriately considered the existence of performance obligations and elements of variable consideration; and
- reviewed the Annual Report disclosures.

Key observations

The results of our testing were satisfactory.

Through our testing of significant risk contracts we did not identify any audit adjustments and consider the judgements made by management in recognising revenue and profit to be balanced.

Our testing of the remaining population identified certain immaterial audit adjustments but we conclude overall that the judgements made by management are reasonable.

Valuation of goodwill

Refer to page 84 (Audit Committee report) and note 8 (accounting policy and financial disclosures)

Goodwill:
£10,239m (2017 £9,996m)

Key audit matter description

The Group holds material goodwill balances relating to UK and overseas acquisitions, the majority of which are in the US. Management performs an impairment review of the carrying value of each Cash-Generating Unit (CGU) on an annual basis in line with the requirements of IAS 36.

The impairment assessment involves management judgement in considering whether the carrying value of the cash-generating units is recoverable and hence we considered this to be a key audit matter. 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 significant risk in relation to the valuation of the Applied Intelligence (AI) CGU which has a carrying value of £257m, including goodwill of £237m, at 31 December 2018. In 2017, the Group recorded a goodwill impairment charge of £384m in relation to this CGU. Given the goodwill is now held at fair value based on forecast future cash flows, small changes in assumptions could trigger further impairment.

Through our risk assessment we determined that the key drivers of future growth in AI are the Government and Technology & Commercial divisions. As a result, we have performed additional procedures over the revenue and cost assumptions in these divisions.

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 the AI CGU. This included the following:

- we obtained a detailed understanding of management's process for identifying indicators of impairment and for performing the CGU impairment assessment. As part of this we assessed the design and implementation of the key controls. Specific focus was given to understanding management's process and controls over forecasting future cash flows and determination of the key assumptions as detailed above;
- we evaluated and challenged underlying assumptions and cash flows, including forecast revenue and cost assumptions, with reference to the recent and historical performance of the AI CGU, external industry benchmarks and specific forecast events. This included performing sensitivity analysis to evaluate the impact of changing a range of assumptions including suppressed growth and changes in the discount rate;
- 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 and other assumptions.

Key observations

We completed our audit of the forecasts of the AI business and are satisfied that management's assumptions are reasonable and supportable based on available evidence, both internal and external.

Valuation of retirement benefit obligations

Refer to page 84 (Audit Committee report) and note 22 (accounting policy and financial disclosures)

Group's share of the net IAS 19 deficit:
£3,932m (2017 £4,022m)

Valuation of retirement benefit scheme assets:
£25,653m (2017 £26,883m)

Valuation of retirement benefit scheme liabilities:
£29,889m (2017 £31,237m)

Key audit matter description

The principal retirement 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 retirement benefit obligations as a key audit matter:

Liabilities

The key judgements relating to the retirement benefit obligations include inflation assumptions, discount rates and mortality assumptions applied to its members. Given the significant size of the deficit at year-end, small changes to these input assumptions can lead to large changes in the valuation. Assumptions are also made in the determination of the Group's share of assets and liabilities of multi-employer schemes in which it participates and the corresponding amounts attributed to other participating employers.

Assets

Given the size of the scheme assets there is significant audit effort required in ensuring the valuation of assets is supportable.

GMP equalisation

During the year, the High Court ruled that companies are required to equalise Guaranteed Minimum Pensions (GMPs) between men and women. Previously, the Group made no allowance in the accounting liabilities for GMP equalisation and therefore for 2018 the Group is required to estimate the impact of equalising GMP payments. This was estimated to be £114m. Given the high level of estimation required in determining the impact of GMP and the size of the Group's deficit this has also been considered a key audit matter in the period.

Restatement

During the year, management identified an error in relation to the treatment of asset collateral on longevity swaps that impacted previously reported asset values of the Group's pension schemes. It was determined that the prior year asset values had been overstated by £108m leading to a corresponding understatement of the net retirement benefit obligation as at 31 December 2017. Given the size of the adjustment, the Group has restated the 2017 comparatives as described in note 37.

How the scope of our audit responded to the key audit matter

Liabilities

In relation to the retirement benefit obligation we have performed the following procedures:

- we obtained a detailed understanding and performed walkthroughs of management's process, with specific focus on assessing the design and implementation of key controls relating to the valuation of the retirement benefit obligation;
- 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; and
- we assessed the objectivity, independence and competence of the actuaries engaged by management to perform the valuations of the schemes.

Assets

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. Our work has included reviewing publicly available information on these assets, comparing to internal benchmarks and reconciling inputs used by management to determine the asset values.

GMP equalisation

In conjunction with Deloitte actuarial specialists, we challenged the methodology and assumptions applied by management to estimate the impacts of GMP equalisation in the current year.

Restatement

We audited management's restatement of the 2017 financial statements for the prior year error identified and are satisfied with the treatment and disclosure made.

Disclosure

We also audited the disclosures made in the 2018 financial statements for compliance with IAS 19.

Key observations

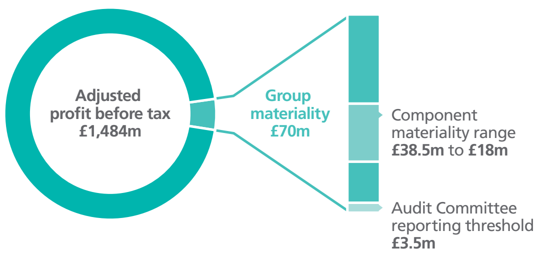
We have completed our audit work in line with the procedures outlined above. Overall we consider the discount rate and other key pension assumptions used by management in calculating the retirement benefit obligation to be within our independently developed reasonable range. The Group's approach to estimating the impacts of GMP equalisation was also considered to be reasonable and in line with market practice. We concluded our testing of the assets and are satisfied they are appropriately valued.

Our application of 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	£70m (2017 £55m)	£38.5m (2017 £32m)
Basis for determining materiality	4.7% of adjusted profit before tax of £1,484m. This includes adjustment for non-recurring items of £154m (see note 1), impairment of intangible assets of £33m (see note 8) and fair value and foreign exchange adjustments on financial instruments and investments of £73m (see note 5). The predecessor auditor determined materiality using 4.9% of Group profit before taxation.	Materiality has been set with reference to the net assets of the Parent company.
Rationale for the benchmark applied	Adjusted profit before tax from continuing operations was considered to be the most relevant benchmark as it is considered the most stable and comparable profit metric. The adjustments excluded relate to items that are considered one-off in nature or relate to complex financial instrument valuations, which are volatile and not reflective of the underlying performance of the business. We consider the measure suitable having also considered the other relevant benchmarks: our materiality equates to 5.7% of profit before tax and 1.2% of net assets. The increase in the materiality is driven by the increase in profit before tax and adjusted profit before tax.	This represents 0.9% of the Parent company net assets. In addition, we consider the materiality of the Parent company in the context of the Group materiality and have capped this at 55% of that of the Group. We consider net assets the key benchmark used by members of the Parent company in assessing financial performance.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £3.5m (2017 £3m), 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.

An overview of the audit scope

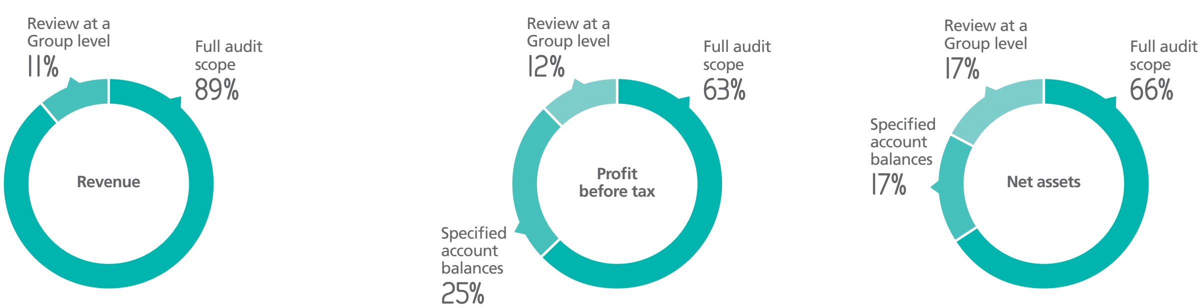
Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the audit risks. This exercise has considered the relative size of each reporting unit's contribution to revenue, profit before tax and adjusted profit before tax, alongside further financial or contractual risks which we consider to be present. In doing this, we also considered the impact of the reorganisation of reporting lines in the business to ensure that we have appropriate coverage across the new segments, as well as the Group as a whole.

We have considered units that contribute more than 10% of the Group's revenue or adjusted profit before tax to be 'financially significant', and requiring a full-scope audit. In addition, we have used our knowledge of the business obtained throughout transition and as part of our risk assessment procedures to assess where else we consider it appropriate to perform a full-scope audit. This resulted in full-scope audits for six business units located in the UK, Saudi Arabia and the US, as well as the Group's largest joint venture, MBDA.

Additionally our audit planning identified 12 non-financially significant components, located in the UK, Saudi Arabia, Australia and the US, where we consider there to be a reasonable possibility of material misstatement in specific balances within the financial statements. Accordingly, we have directed component auditors to perform an audit of specified account balances and additional analytical procedures on the respective income statements and balance sheets for these components. For all in-scope components, whether 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 or audit of specified account balance scope, we performed centrally-directed analytical review procedures.

The scope of our work gives us coverage over the following proportions of the total Group results:



As each of the business units maintains separate financial records, we have engaged component auditors from the Deloitte member firms in the US, UK, Saudi Arabia and Australia to perform procedures at all the wholly-owned components under our direction and supervision. This approach also allows us to engage local auditors who have appropriate knowledge of local regulations to perform the audit work, under a common Deloitte audit approach.

In respect of MBDA, we have engaged with the entity's non-Deloitte auditor to perform a full-scope audit under our direction and supervision.

We have issued detailed instructions to the component auditors, directed and supervised their work through a number of visits to each of the component auditors during the transition, planning and performance stages of our audit, alongside frequent remote communication and review of their work.

Our oversight of component auditors focused on the planning of their audit work and understanding of their risk assessment process to identify key areas of estimates and judgement, as well as the execution of their audit work in line with our Group-issued referral instructions. All teams were involved in our transition workshops and other transition activities as outlined on page 135, which were overseen and directed by the Group audit team. 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 BAE Systems, Inc. business units in the US are subject to a Department of Defense Special Security Arrangement (SSA), which is a government requirement setting out specific protocol that foreign-controlled companies must comply with in order to be able to undertake government defence contracts. As part of this there is restriction on the flow of information outside of the US. Therefore, for the US components there are restrictions around access to the audit file and specific workpapers for non-US nationals. As such we have designed alternative procedures, including involvement of an additional independent US national partner, to ensure that appropriate oversight of the US component team is obtained.

In addition to the work performed at a component level, at Group level we have audited the consolidation process and carried out analytical procedures over the residual financial information of the remaining components not subject to audit or audit of specified account balances. At a Group level we also perform audit procedures on centrally held balances including treasury, retirement benefit obligations, goodwill, tax, head office costs and litigation and claims.

Other information

The directors are responsible for the other information. The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report thereon.

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.

In connection with our audit of the financial statements, 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 audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. 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.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit Committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code** – the parts of the directors' statement required under the Listing Rules relating to the Group's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

We have nothing to report in respect of these matters.

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.

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.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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.

Extent to which the audit was considered capable of detecting irregularities, including fraud

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.

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, our procedures included the following:

- enquiring of management, internal legal counsel, internal audit and the Audit Committee, including obtaining and reviewing supporting documentation, concerning the Group's 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; and
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations, including obtaining an understanding of the Group's bribery & corruption and whistleblowing policies;
- discussing among the 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 part of this discussion, we identified potential for fraud in relation to the level of judgement involved in estimating costs to complete on long-term contracts and the subsequent impact on revenue and margin recognition; and
- obtaining an understanding of the legal and regulatory frameworks that the Group operates in, focusing on those laws and regulations that had a direct effect on the financial statements, including the UK Companies Act, Listing Rules, pension and taxation legislation. In addition, owing to the sector the Group operates in, we considered laws and regulations that had a fundamental effect on the operations of the Group, including in respect of export controls, defence contracting and anti-bribery and corruption legislation. These areas were identified through enquiries with directors, management and legal counsel, our knowledge and understanding of the Group accumulated throughout the audit and our sector-specific experience.

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. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to the 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 of supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the Audit Committee and in-house 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 HMRC;
- obtaining a detailed understanding of and performing process walkthroughs in relation to the Group's process for engaging third parties to support business development;
- 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.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and significant component audit teams and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

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 of 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.

Matters on which we are required to report by exception

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.

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.

Other matters

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 therefore one year.

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).

Use of our report

This report is made solely to the Parent 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 Parent 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 Parent company and the Parent company's members as a body, for our audit work, for this report, or for the opinions we have formed.

John Adam
Senior Statutory Auditor

For and on behalf of
Deloitte LLP
Statutory Auditor

London, United Kingdom
20 February 2019

Preparation

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

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

Transactions in foreign currencies are translated at the exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rates ruling at the balance sheet date, with the resulting exchange differences recognised in the income statement.

Significant accounting policies

The significant accounting policies applied in the preparation of these consolidated financial statements are set out in the relevant notes. These policies have been applied consistently to all the years presented, unless otherwise stated. The directors believe that the consolidated financial statements reflect appropriate judgements and estimates, and provide a true and fair view of the Group's financial performance and position.

Critical accounting policies

Certain of the Group's significant accounting policies are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the consolidated financial statements. The critical accounting policies are listed below and explained in more detail in the relevant notes to the Group accounts:

Critical accounting policy	Description	Notes
Revenue and profit recognition	The Group accounts for revenue in accordance with IFRS 15 Revenue from Contracts with Customers. For most of the Group's contracts, revenue and associated margin are recognised progressively over time as costs are incurred, and as risks have been mitigated or retired. The ultimate profitability of contracts is based on estimates of revenue and costs, including allowances for technical and other risks, which are reliant on the knowledge and experience of the Group's project managers, engineers and finance and commercial professionals. Material changes in these estimates could affect the profitability of individual contracts. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events or circumstances.	1
Carrying value of goodwill	Goodwill is not amortised, but is tested annually for impairment and carried at cost less accumulated impairment losses. For the purposes of impairment testing, goodwill is allocated to Cash-Generating Units on a consistent basis. The impairment review calculations require the use of estimates of the future profitability and cash-generating ability of the acquired businesses based on the Group's five-year Integrated Business Plan and the pre-tax discount rate used in discounting these projected cash flows.	8
Deferred tax asset on retirement benefit obligations	The Group has recognised a deferred tax asset in respect of the deficits in its pension/retirement schemes. It is management's judgement that the Group will generate sufficient taxable profits to recover the net deferred tax asset recognised. This judgement requires the use of estimates of future taxable profits based on the Group's Integrated Business Plan.	14
Tax provisions	Provision is made for known issues based on management's interpretation of country-specific legislation and management's assessment of the likely outcome of negotiations or litigation. The Group's approach is to consider each uncertain tax position separately. Where management considers it is probable that there will be a future outflow of funds to a tax authority, a provision is recognised. The position is reviewed on an ongoing basis. Provisions are measured using management's best estimate of the most likely amount, being the single most likely amount in a range of possible outcomes. The Group discloses any significant uncertainties in relation to tax matters to the relevant tax authority. The resolution of tax positions taken by the Group can take a considerable period of time to conclude and, in some cases, it is difficult to predict the outcome.	16
Valuation of retirement benefit obligations	Defined benefit pension scheme accounting valuations are prepared by independent actuaries. The liabilities of the pension schemes are valued based on a number of actuarial assumptions. For each of the actuarial assumptions used there is a range of possible values and management estimates the point within that range that most appropriately reflects the Group's circumstances. Small changes in these assumptions can have a significant impact on the size of the deficit.	22

Judgements made in applying accounting policies

In the course of preparing the financial statements, no judgements have been made in the process of applying the Group's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

Preparation continued

Sources of estimation uncertainty

The application of the Group's accounting policies requires the use of estimates. In the event that these estimates prove to be incorrect, there may be an adjustment to the carrying amounts of assets and liabilities within the next financial year. The key significant risks of a material adjustment to the carrying amounts of assets and liabilities during 2019 have been considered and assessed as relating to the following:

– The determination of the discount rate and inflation assumptions underpinning the valuation of the liabilities of the Group's defined benefit pension schemes, where there is a range of possible values for each of the actuarial assumptions and small changes in assumptions may have a significant impact on the size of the deficit. Note 22 provides information on the key assumptions and analysis of their sensitivities.

– The consideration of the carrying value of goodwill for impairment requires an assessment of future cash flows expected to be generated from the associated cash-generating unit, as well as the appropriate discount rate to apply to these projections. Note 8 provides information on the key assumptions adopted by the Group and associated sensitivity analysis.

– Revenue and profit recognition on contracts is based on estimates of future costs as well as an assessment of contingencies for technical and other risks, such as the Group's inability to obtain or maintain the necessary export licences. Note 1 includes information on revenue recognised in the year in respect of performance obligations satisfied or partially satisfied in previous periods providing an indication of the range of outcomes relating to these estimates.

– Tax provisioning is based on estimates of the potential outcomes of tax litigation or negotiations, the amount recorded being the single most likely amount in a range of possible outcomes. Such provisions can be difficult to estimate due to the complexity involved and the uncertainty in the process for their resolution. Note 16 provides information relating to potential material changes regarding tax provisions in the next financial year.

Changes in accounting policies

IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers became effective on 1 January 2018. The impact of adoption is set out in note 37.

IFRS 16 Leases will be effective from 1 January 2019. The expected impact of adoption is set out in note 38.

The following other standards, interpretations and amendments to existing standards became effective on 1 January 2018 and have not had a material impact on the Group:

– Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions;

– Amendments to IAS 40: Transfers of Investment Property;

– IFRIC 22 Foreign Currency Transactions and Advance Consideration; and

– Annual Improvements to IFRS Standards 2014–2016 Cycle.

The following other standards, interpretations and amendments to existing standards have been issued but were not mandatory for accounting periods beginning on 1 January 2018 and are not expected to have a material impact on the Group:

– IFRIC 23 Uncertainty over Income Tax Treatments, effective from 1 January 2019;

– Amendments to IFRS 9: Prepayment Features with Negative Compensation, effective from 1 January 2019;

– Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures, effective from 1 January 2019;

– Amendments to IAS 19: Plan Amendment, Curtailment or Settlement, effective from 1 January 2019 (not yet endorsed by the EU);

– Annual Improvements to IFRS Standards 2015–2017 Cycle, effective from 1 January 2019 (not yet endorsed by the EU);

– Amendments to IFRS 3: Definition of a Business, effective from 1 January 2020 (not yet endorsed by the EU);

– Amendments to References to the Conceptual Framework in IFRS Standards, effective 1 January 2020 (not yet endorsed by the EU);

– Amends to IAS 1 and IAS 8: Definition of Material, effective from 1 January 2020 (not yet endorsed by the EU);

– IFRS 17 Insurance Contracts, effective from 1 January 2021; and

– Amendments to IFRS 10 and IAS 28: Sale or contribution of assets between an investor and its associate or joint venture, effective date deferred indefinitely.

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	2018 £m	2018 Total £m	2017 (restated)[1] £m	2017 (restated)[1] Total £m
Continuing operations					
Sales	1	**18,407**		18,487	
Deduct Share of sales by equity accounted investments	1	**(2,812)**		(2,534)	
Add Sales to equity accounted investments	1	**1,226**		1,271	
Revenue	1		**16,821**		17,224
Operating costs	2		**(15,514)**		(16,043)
Other income	4		**158**		131
Group operating profit			**1,465**		1,312
Share of results of equity accounted investments	1		**140**		107
Underlying EBITA	1	**1,928**		1,974	
Non-recurring items	1	**(154)**		(13)	
EBITA		**1,774**		1,961	
Amortisation of intangible assets	1	**(85)**		(86)	
Impairment of intangible assets	1	**(33)**		(384)	
Financial expense of equity accounted investments	5	**(13)**		(34)	
Taxation expense of equity accounted investments	6	**(38)**		(38)	
Operating profit	1		**1,605**		1,419
Financial income		**228**		416	
Financial expense		**(609)**		(762)	
Net finance costs	5		**(381)**		(346)
Profit before taxation			**1,224**		1,073
Taxation expense	6		**(191)**		(216)
Profit for the year			**1,033**		857
Attributable to:					
Equity shareholders			**1,000**		827
Non-controlling interests			**33**		30
			1,033		857
Earnings per share	7				
Basic earnings per share			**31.3p**		26.0p
Diluted earnings per share			**31.2p**		25.9p

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

Consolidated statement of comprehensive income for the year ended 31 December

	Notes	2018 Other reserves[2] £m	2018 Retained earnings £m	2018 Total £m	2017 (restated)[1] Other reserves[2] £m	2017 (restated)[1] Retained earnings £m	2017 (restated)[1] Total £m
Profit for the year		**–**	**1,033**	**1,033**	–	857	857
Other comprehensive income							
Items that will not be reclassified to the income statement:							
Subsidiaries:							
Remeasurements on retirement benefit schemes		**–**	**74**	**74**	–	2,056	2,056
Tax on items that will not be reclassified to the income statement	6	**–**	**5**	**5**	–	(481)	(481)
Equity accounted investments (net of tax)		**–**	**6**	**6**	–	52	52
Items that may be reclassified to the income statement:							
Subsidiaries:							
Currency translation on foreign currency net investments		**400**	**–**	**400**	(630)	–	(630)
Amounts (charged)/credited to hedging reserve		**(25)**	**–**	**(25)**	59	–	59
Tax on items that may be reclassified to the income statement	6	**5**	**–**	**5**	(11)	–	(11)
Equity accounted investments (net of tax)		**15**	**–**	**15**	(18)	–	(18)
Total other comprehensive income for the year (net of tax)		**395**	**85**	**480**	(600)	1,627	1,027
Total comprehensive income for the year		**395**	**1,118**	**1,513**	(600)	2,484	1,884
Attributable to:							
Equity shareholders		**391**	**1,085**	**1,476**	(595)	2,454	1,859
Non-controlling interests		**4**	**33**	**37**	(5)	30	25
		395	**1,118**	**1,513**	(600)	2,484	1,884

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[2] £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
Balance at 1 January 2018 as originally presented		87	1,249	6,098	(2,693)	4,741	43	4,784
Restatement[1]		–	–	(8)	(21)	(29)	–	(29)
Restated total equity at 1 January 2018		87	1,249	6,090	(2,714)	4,712	43	4,755
Profit for the year		–	–	–	1,000	1,000	33	1,033
Total other comprehensive income for the year		–	–	391	85	476	4	480
Total comprehensive income for the year		–	–	391	1,085	1,476	37	1,513
Share-based payments (inclusive of tax)	30	–	–	–	63	63	–	63
Net sale of own shares		–	–	–	1	1	–	1
Ordinary share dividends	24	–	–	–	(703)	(703)	(28)	(731)
Partial disposal of shareholding in subsidiary undertaking		–	–	–	(3)	(3)	20	17
At 31 December 2018		**87**	**1,249**	**6,481**	**(2,271)**	**5,546**	**72**	**5,618**
Balance at 1 January 2017 as originally presented		87	1,249	6,685	(4,583)	3,438	26	3,464
Restatement[1]		–	–	–	47	47	–	47
Restated total equity at 1 January 2017		87	1,249	6,685	(4,536)	3,485	26	3,511
Profit for the year		–	–	–	827	827	30	857
Total other comprehensive income for the year		–	–	(595)	1,627	1,032	(5)	1,027
Total comprehensive income for the year		–	–	(595)	2,454	1,859	25	1,884
Share-based payments (inclusive of tax)	30	–	–	–	53	53	–	53
Net purchase of own shares		–	–	–	(1)	(1)	–	(1)
Ordinary share dividends	24	–	–	–	(684)	(684)	(8)	(692)
At 31 December 2017		87	1,249	6,090	(2,714)	4,712	43	4,755

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers and to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.
2. An analysis of other reserves is provided in note 24.

Consolidated balance sheet as at 31 December

	Notes	2018 £m	2017 (restated)[1] £m	2016 (restated)[1] £m
Non-current assets				
Intangible assets	8	**10,658**	10,378	11,264
Property, plant and equipment	9	**2,365**	2,230	2,098
Investment property	10	**98**	101	110
Equity accounted investments	11	**429**	322	250
Other investments		**13**	6	6
Other receivables	12	**352**	387	351
Retirement benefit surpluses	22	**308**	302	223
Other financial assets	13	**245**	226	345
Deferred tax assets	14	**702**	702	1,181
		15,170	14,654	15,828
Current assets				
Inventories	15	**774**	733	776
Trade, other and contract receivables	12	**5,177**	4,244	3,959
Current tax	16	**81**	20	5
Other financial assets	13	**166**	89	204
Cash and cash equivalents	17	**3,232**	3,271	2,769
Assets held for sale	18	**146**	26	2
		9,576	8,383	7,715
Total assets	19	**24,746**	23,037	23,543
Non-current liabilities				
Loans	20	**(3,514)**	(4,069)	(4,425)
Other payables	21	**(1,536)**	(1,723)	(1,040)
Retirement benefit obligations	22	**(4,240)**	(4,324)	(6,330)
Other financial liabilities	13	**(104)**	(133)	(102)
Deferred tax liabilities	14	**–**	(4)	(10)
Provisions	23	**(427)**	(435)	(392)
		(9,821)	(10,688)	(12,299)
Current liabilities				
Loans and overdrafts	20	**(785)**	(14)	–
Trade and other payables	21	**(7,740)**	(6,755)	(6,917)
Other financial liabilities	13	**(74)**	(104)	(212)
Current tax	16	**(334)**	(305)	(311)
Provisions	23	**(334)**	(400)	(291)
Liabilities held for sale	18	**(40)**	(16)	(2)
		(9,307)	(7,594)	(7,733)
Total liabilities		**(19,128)**	(18,282)	(20,032)
Net assets		**5,618**	4,755	3,511
Capital and reserves				
Issued share capital	24	**87**	87	87
Share premium		**1,249**	1,249	1,249
Other reserves	24	**6,481**	6,090	6,685
Retained earnings – deficit		**(2,271)**	(2,714)	(4,536)
Total equity attributable to equity holders of BAE Systems plc		**5,546**	4,712	3,485
Non-controlling interests		**72**	43	26
Total equity		**5,618**	4,755	3,511

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers and to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.

Approved by the Board on 20 February 2019 and signed on its behalf by:

C N Woodburn
Chief Executive

P J Lynas
Group Finance Director

Consolidated cash flow statement for the year ended 31 December

	Notes	2018 £m	2017 (restated)[1] £m
Profit for the year		**1,033**	857
Taxation expense	6	**191**	216
Research and development expenditure credits	4	**(27)**	(20)
Share of results of equity accounted investments	1	**(140)**	(107)
Net finance costs	5	**381**	346
Depreciation, amortisation and impairment	2	**411**	728
Gain on investment revaluation		**(7)**	–
Profit on disposal of property, plant and equipment, and investment property	2,4	**(18)**	(10)
Loss in respect of held for sale assets and business disposals	2	**9**	13
Cost of equity-settled employee share schemes		**64**	61
Movements in provisions		**(101)**	150
Decrease in liabilities for retirement benefit obligations		**(153)**	(138)
(Increase)/decrease in working capital:			
Inventories		**(16)**	(29)
Trade, other and contract receivables		**(757)**	(397)
Trade and other payables		**530**	454
Taxation paid		**(200)**	(227)
Net cash flow from operating activities		**1,200**	1,897
Dividends received from equity accounted investments	11	**57**	72
Interest received		**25**	23
Purchase of property, plant and equipment, and investment property		**(358)**	(389)
Purchase of intangible assets		**(139)**	(87)
Proceeds from sale of property, plant and equipment, and investment property		**34**	34
Proceeds from sale of intangible assets		**–**	1
Purchase of subsidiary undertakings		**–**	(3)
Purchase of equity accounted investment		**(2)**	–
Partial disposal of shareholding in subsidiary undertaking		**17**	–
Equity accounted investment funding	11	**(1)**	(3)
Cash and cash equivalents acquired with subsidiary undertakings	34	**14**	–
Cash flow in respect of held for sale assets and business disposals		**12**	(6)
Cash and cash equivalents disposed of with subsidiary undertakings		**–**	(2)
Net cash flow from investing activities		**(341)**	(360)
Interest paid		**(203)**	(204)
Net sale/(purchase) of own shares		**1**	(1)
Equity dividends paid	24	**(703)**	(684)
Dividends paid to non-controlling interests		**(28)**	(8)
Cash flow from matured derivative financial instruments (excluding cash flow hedges)		**6**	(83)
Cash flow from movement in cash collateral		**2**	(15)
Cash flow from repayment of loans		**(7)**	–
Net cash flow from financing activities	26	**(932)**	(995)
Net (decrease)/increase in cash and cash equivalents		**(73)**	542
Cash and cash equivalents at 1 January		**3,264**	2,771
Effect of foreign exchange rate changes on cash and cash equivalents		**41**	(49)
Cash and cash equivalents at 31 December		**3,232**	3,264
Comprising:			
Cash and cash equivalents	17	**3,232**	3,271
Overdrafts	20	**–**	(7)
Cash and cash equivalents at 31 December		**3,232**	3,264

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

1. Segmental analysis

Revenue and profit recognition

Revenue represents income derived from contracts for the provision of goods and services, over time or at a point in time, by the Group to customers in exchange for consideration in the ordinary course of the Group's activities.

Performance obligations

Upon approval by the parties to a contract, the contract is assessed to identify each promise to transfer either a distinct good or service or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Goods and services are distinct and accounted for as separate performance obligations in the contract if the customer can benefit from them either on their own or together with other resources that are readily available to the customer and they are separately identifiable in the contract.

The Group provides warranties to its customers to give them assurance that its products and services will function in line with agreed-upon specifications. Warranties are not provided separately and, therefore, do not represent separate performance obligations.

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 price escalation, is included based on the expected value or most likely amount only to the extent that it is highly probable that there will not be a reversal in the amount of cumulative revenue recognised. The transaction price does not include estimates of consideration resulting from contract modifications, such as change orders, until they have been approved by the parties to the contract. The total transaction price is allocated to the performance obligations identified in the contract in proportion to their relative stand-alone selling prices. Given the bespoke nature of many of the Group's products and services, which are designed and/or manufactured under contract to the customer's individual specifications, there are typically no observable stand-alone selling prices. Instead, stand-alone selling prices are typically estimated based on expected costs plus contract margin consistent with the Group's pricing principles.

Whilst payment terms vary from contract to contract, on many of the Group's contracts, an element of the transaction price is received in advance of delivery. The Group therefore has significant contract liabilities (note 21). The Group's contracts are not considered to include significant financing components on the basis that there is no difference between the consideration and the cash selling price. UK Ministry of Defence contracting rules prohibit the inclusion of financing in the sales price. Negotiations on competitive international export contracts do not make allowance for the cash payment profile.

Revenue and profit recognition

Revenue is recognised as performance obligations are satisfied as control of the goods and services is transferred to the customer.

For each performance obligation within a contract, the Group determines whether it is satisfied over time or at a point in time. Performance obligations are satisfied over time if one of the following criteria is satisfied:

- the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs;
- the Group's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date.

The Group has determined that most of its contracts satisfy the over time criteria, either because the customer simultaneously receives and consumes the benefits provided by the Group's performance as it performs (typically services or support contracts) 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).

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.

If the over time criteria for revenue recognition are not met, revenue is recognised at the point in time that control is transferred to the customer, which is usually when legal title passes to the customer and the business has the right to payment, for example, on delivery.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

1. Segmental analysis continued

Software licences

The Group sells software licences either separately or together with other goods and services, including computer hardware and implementation, hosting and support. Revenue recognition in respect of software licences sold as part of a bundle of goods and services is considered separately when the licence is determined to be a separate performance obligation. Software licences either represent a right to access the Group's intellectual property as it exists throughout the licence period or a right to use the Group's intellectual property as it exists at the point in time at which the licence is granted. Revenue in respect of right to access licences is recognised over the licence term or, in relation to perpetual licences, over the related customer relationship and revenue in respect of right to use licences is recognised upfront on delivery to the customer. A software licence is considered to be a right to access the Group's intellectual property as it exists throughout the licence period if all of the following criteria are satisfied:

– the contract requires, or the customer reasonably expects, that the Group will undertake activities that significantly affect the intellectual property; and

– the licence directly exposes the customer to the effects of those activities; and

– those activities do not result in the transfer of a good or service to the customer.

Contract modifications

The Group's contracts are often amended for changes in customers' requirements and specifications. A contract modification exists when the parties to the contract approve a modification that either changes existing or creates new enforceable rights and obligations. The effect of a contract modification on the transaction price and the Group's measure of progress towards the satisfaction of the performance obligation to which it relates is recognised in one of the following ways:

1. prospectively, as an additional, separate contract;
2. prospectively, as a termination of the existing contract and creation of a new contract; or
3. as part of the original contract using a cumulative catch-up.

The majority of the Group's contract modifications are treated under either 1 (for example, the requirement for additional distinct goods or services) or 3 (for example, a change in the specification of the distinct goods or services for a partially completed contract), although the facts and circumstances of any contract modification are considered individually as the types of modifications will vary contract-by-contract and may result in different accounting outcomes.

Costs to obtain a contract

The Group expenses pre-contract bidding costs which are incurred regardless of whether a contract is awarded. The Group does not typically incur costs to obtain contracts that it would not have incurred had the contracts not been awarded, such as sales commission.

Costs to fulfil a contract

Contract fulfilment costs in respect of over time contracts are expensed as incurred. Contract fulfilment costs in respect of point in time contracts are accounted for under IAS 2 Inventories.

Reporting segments

With effect from 1 January 2018, the Group revised its reporting segments to reflect the organisational changes announced in 2017. The five principal reporting segments are Electronic Systems; Cyber & Intelligence; Platforms & Services (US); Air; and Maritime. These align with the strategic direction of the Group. Financial information for 2017 has been re-presented to reflect these new reporting segments.

– **Electronic Systems** comprises the US- and UK-based electronics activities, including electronic warfare 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, and hybrid electric drive systems;

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

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

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

– **Maritime** comprises the Group's UK-based maritime and land activities; and

– **HQ** comprises the Group's head office and UK-based shared services activities, together with a 49% interest in Air Astana.

The Board (the chief operating decision maker as defined by IFRS 8 Operating Segments) monitors the results of these reporting segments to assess performance and make decisions about the allocation of resources. Segmental performance is evaluated based on Key Performance Indicators – sales (see page 150) and underlying EBITA (see page 151). Finance costs and taxation expense are managed on a Group basis.

1. Segmental analysis continued

Key Performance Indicator – Sales
Definition Revenue plus the Group's share of revenue of equity accounted investments.

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

Sales and revenue by reporting segment[1]

	Sales		Deduct Share of sales by equity accounted investments		Add Sales to equity accounted investments		Revenue	
	2018 £m	2017 (restated)[2] £m	2018 £m	2017 (restated)[2] £m	2018 £m	2017 (restated)[2] £m	2018 £m	2017 (restated)[2] £m
Electronic Systems	**3,965**	3,598	**(101)**	(95)	**101**	95	**3,965**	3,598
Cyber & Intelligence	**1,678**	1,818	**–**	–	**–**	–	**1,678**	1,818
Platforms & Services (US)	**3,005**	2,951	**(141)**	(103)	**–**	–	**2,864**	2,848
Air	**6,712**	7,210	**(2,224)**	(2,006)	**1,091**	1,108	**5,579**	6,312
Maritime	**2,975**	2,877	**(37)**	(41)	**2**	9	**2,940**	2,845
HQ	**350**	336	**(309)**	(289)	**–**	–	**41**	47
	18,685	18,790	**(2,812)**	(2,534)	**1,194**	1,212	**17,067**	17,468
Intra-group sales/revenue	**(278)**	(303)	**–**	–	**32**	59	**(246)**	(244)
	18,407	18,487	**(2,812)**	(2,534)	**1,226**	1,271	**16,821**	17,224

	Intra-group revenue		Revenue from external customers	
	2018 £m	2017 (restated)[2] £m	2018 £m	2017 (restated)[2] £m
Electronic Systems	**54**	73	**3,911**	3,525
Cyber & Intelligence	**91**	88	**1,587**	1,730
Platforms & Services (US)	**39**	23	**2,825**	2,825
Air	**10**	9	**5,569**	6,303
Maritime	**40**	40	**2,900**	2,805
HQ	**12**	11	**29**	36
	246	244	**16,821**	17,224

1. Reporting segments have been re-presented to reflect the organisational changes which took effect on 1 January 2018.
2. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

Sales and revenue by customer location

	Sales		Revenue	
	2018 £m	2017 (restated)[1] £m	2018 £m	2017 (restated)[1] £m
UK	**3,819**	3,623	**3,622**	3,390
Rest of Europe[2]	**2,007**	2,046	**1,176**	1,472
US	**7,729**	7,460	**7,713**	7,457
Canada	**115**	100	**115**	100
Saudi Arabia	**2,593**	3,085	**2,464**	2,964
Rest of Middle East	**801**	912	**694**	826
Australia	**562**	608	**560**	607
Rest of Asia and Pacific	**636**	503	**430**	314
Africa, and Central and South America	**145**	150	**47**	94
	18,407	18,487	**16,821**	17,224

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.
2. Includes £0.7bn (2017 £0.9bn) generated under the Typhoon workshare agreement with Eurofighter Jagdflugzeug GmbH.

1. Segmental analysis continued

Revenue by major customer

Revenue from the Group's three principal customers, which individually represent over 10% of total revenue, is as follows:

	2018 £m	2017 (restated)[1] £m
US Department of Defense	**5,148**	4,543
UK Ministry of Defence[2]	**3,848**	3,933
Kingdom of Saudi Arabia Ministry of Defence and Aviation	**2,366**	2,799

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.
2. Includes £0.7bn (2017 £0.9bn) generated under the Typhoon workshare agreement with Eurofighter Jagdflugzeug GmbH.

Revenue from the UK Ministry of Defence and the US Department of Defense was generated by the five principal reporting segments. Revenue from the Kingdom of Saudi Arabia Ministry of Defence and Aviation was generated by the Air and Maritime reporting segments.

Key Performance Indicator – Underlying EBITA

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

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

Amortisation and impairment of intangible assets are excluded because they are not related to the in-year operational performance of the business, being driven by the timing and amount of investment in acquired businesses and software.

Finance costs and taxation expense of equity accounted investments are excluded for consistency with pre-interest, pre-tax business performance.

Non-recurring items are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying business performance. The Group's definition of non-recurring items includes profit or loss on business transactions, and costs incurred which are one-off in nature, for example non-routine costs or income relating to post-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.

2018

The non-recurring loss of £154m represents a Guaranteed Minimum Pension equalisation charge of £114m (see note 22), and a loss on disposal of the Mobile, Alabama, shipyard of £40m.

2017

The non-recurring loss of £13m represented the loss on disposal of the BAE Systems San Francisco Ship Repair business.

Operating profit/(loss) by reporting segment[1]

	Underlying EBITA		Non-recurring items		Amortisation and impairment of intangible assets		Financial and taxation expense of equity accounted investments		Operating profit/(loss)	
	2018 £m	2017 (restated)[2] £m	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 (restated)[2] £m	2018 £m	2017 (restated)[2] £m
Electronic Systems	**606**	541	**–**	–	**(16)**	(20)	**–**	–	**590**	521
Cyber & Intelligence	**111**	58	**–**	–	**(52)**	(419)	**–**	–	**59**	(361)
Platforms & Services (US)	**210**	237	**(40)**	(13)	**(8)**	(9)	**(1)**	(2)	**161**	213
Air	**859**	967	**–**	–	**(12)**	(8)	**(37)**	(41)	**810**	918
Maritime	**209**	251	**–**	–	**(16)**	(8)	**(2)**	(3)	**191**	240
HQ	**(67)**	(80)	**(114)**	–	**(14)**	(6)	**(11)**	(26)	**(206)**	(112)
	1,928	1,974	**(154)**	(13)	**(118)**	(470)	**(51)**	(72)	**1,605**	1,419
Net finance costs									**(381)**	(346)
Profit before taxation									**1,224**	1,073
Taxation expense									**(191)**	(216)
Profit for the year									**1,033**	857

1. Reporting segments have been re-presented to reflect the organisational changes which took effect on 1 January 2018.
2. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

1. Segmental analysis continued

Share of results of equity accounted investments within reporting segments[1]

	Underlying EBITA		Non-recurring items		Amortisation of intangible assets		Financial and taxation expense		Share of results of equity accounted investments	
	2018 £m	2017 (restated)[2] £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 (restated)[2] £m	**2018 £m**	2017 (restated)[2] £m
Electronic Systems	**9**	6	**–**	–	**–**	–	**–**	–	**9**	6
Platforms & Services (US)	**23**	13	**–**	–	**–**	–	**(1)**	(2)	**22**	11
Air	**150**	132	**–**	–	**(7)**	(4)	**(37)**	(41)	**106**	87
Maritime	**7**	8	**–**	–	**–**	–	**(2)**	(3)	**5**	5
HQ	**13**	24	**(4)**	–	**–**	–	**(11)**	(26)	**(2)**	(2)
	202	183	**(4)**	–	**(7)**	(4)	**(51)**	(72)	**140**	107

1. Reporting segments have been re-presented to reflect the organisational changes which took effect on 1 January 2018.
2. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

Key Performance Indicator – Order backlog
Definition Funded and unfunded unexecuted customer orders including the Group's share of order backlog of equity accounted investments. Unfunded orders include the elements of US multi-year contracts for which funding has not been authorised by the customer.

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

Performance obligations
The Group's order book[1], reconciled to order backlog as defined by the Group, is shown below.

	2018 £bn
Order backlog as defined by the Group	**48.4**
Deduct Unfunded order backlog	**(2.0)**
Deduct Share of order backlog of equity accounted investments	**(9.9)**
Add Order backlog in respect of orders from equity accounted investments	**3.3**
Order book[1]	**39.8**

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. As permitted under the transitional provisions of IFRS 15, comparative information in respect of the Group's order book is not disclosed.

The Group expects that approximately 35% of the order book as at 31 December 2018 will be recognised as revenue during the next year, with the remainder largely recognised over the following 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 was recognised during the year ended 31 December 2018 in respect of performance obligations satisfied or partially satisfied in previous periods.

2. Operating costs

Leases
Lease payments made under operating leases, including any incentives granted, are recognised in the income statement on a straight-line basis over the lease term.

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.

	2018 £m	2017 (restated)[1] £m
Raw materials, subcontracts and other bought-in items used	**5,816**	6,098
Change in inventories of finished goods and work-in-progress	**44**	(74)
Staff costs (note 3)	**5,876**	5,830
Guaranteed Minimum Pension equalisation charge (note 22)	**110**	–
Depreciation	**269**	263
Amortisation	**78**	82
Impairment – property, plant and equipment (note 9), and investment property (note 10)	**31**	(1)
Impairment – intangible assets (note 8)	**33**	384
Lease expense	**287**	295
Loss on disposal of property, plant and equipment, and investment property	**1**	1
Loss in respect of held for sale assets and business disposals	**9**	13
Other operating charges	**2,960**	3,152
Operating costs	**15,514**	16,043

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

Operating costs includes research and development expenditure of £212m (2017 £238m) funded by the Group. Development investment of £10m (2017 £nil) was capitalised during the year (see note 8).

2. Operating costs continued

Fees payable to the Company's auditor and its associates included in operating costs[1]

	2018			2017		
	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	**2,000**	–	**2,000**	2,034	–	2,034
Fees payable to the Company's auditor and its associates for other services to the Group:						
The audit of the Company's subsidiaries	**2,687**	**4,091**	**6,778**	2,809	4,471	7,280
Total audit fees	**4,687**	**4,091**	**8,778**	4,843	4,471	9,314
Audit-related assurance services[2]	**690**	–	**690**	1,086	108	1,194
Tax compliance services	–	–	–	–	107	107
Tax advisory services	–	–	–	–	35	35
Other assurance services	**175**	–	**175**	–	–	–
Other services[3]	**1,776**	–	**1,776**	38	53	91
Total non-audit fees	**2,641**	–	**2,641**	1,124	303	1,427
Total fees payable to the Company's auditor and its associates	**7,328**	**4,091**	**11,419**	5,967	4,774	10,741
Fees in respect of BAE Systems pension schemes:						
Audit	–	–	–	–	292	292
Tax compliance	–	–	–	–	5	5
Tax advisory	–	–	–	–	–	–
	–	–	–	–	297	297

1. 2017 fees are payable to KPMG LLP. Deloitte LLP replaced KPMG LLP as the Company's auditor at the Annual General Meeting on 10 May 2018. 2018 fees are payable to Deloitte LLP.
2. 2018 primarily relates to the review of the half-yearly financial report. 2017 includes advice from KPMG LLP in respect of IFRS 15.
3. 2018 primarily relates to consultancy work undertaken by Deloitte LLP in relation to the Group's Submarines business (see page 83).

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	
	2018 Number '000	2017[1] Number '000	**2018 Number '000**	2017[1] Number '000
Electronic Systems	**15**	14	**16**	14
Cyber & Intelligence	**10**	11	**10**	11
Platforms & Services (US)	**11**	11	**11**	11
Air	**22**	22	**23**	22
Maritime	**16**	16	**16**	16
HQ	**2**	2	**2**	2
	76	76	**78**	76

1. Reporting segments have been re-presented to reflect the organisational changes which took effect on 1 January 2018.

The aggregate staff costs of Group employees, excluding employees of equity accounted investments, were as follows:

	2018 £m	2017 £m
Wages and salaries	**5,019**	4,972
Social security costs	**367**	360
Share-based payments (note 30)	**63**	61
Pension costs – defined contribution plans (note 22)	**203**	193
Pension costs – defined benefit plans (note 22)	**223**	242
US healthcare costs (note 22)	**1**	2
	5,876	5,830

4. Other income

Leases
Lease income under operating leases is recognised in the income statement on a straight-line basis over the lease term.

	2018 £m	2017 £m
Research and development expenditure credits	**27**	20
Rental income from operating leases – investment property	**22**	23
Rental income from operating leases – other	**15**	16
Profit on disposal of property, plant and equipment	**13**	2
Profit on disposal of investment property	**6**	9
Management recharges to equity accounted investments (note 31)	**18**	16
Royalties	**11**	9
Other[1]	**46**	36
Other income	**158**	131

1. Includes £15m for capital spend recovery in respect of Saudi Arabia Industrial Participation investments and an £8m (2017 £11m) recovery of site development costs for the Dreadnought programme in Barrow. There are no other individual amounts in excess of £10m.

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.

	2018 £m	2017 £m
Interest income	26	24
Gain on remeasurement of financial instruments at fair value through profit or loss[1]	186	54
Foreign exchange gains[2]	16	338
Financial income	228	416
Interest expense on bonds and other financial instruments	(204)	(202)
Facility fees	(4)	(4)
Net present value adjustments	(31)	(44)
Net interest expense on retirement benefit obligations (note 22)	(103)	(165)
Loss on remeasurement of financial instruments at fair value through profit or loss[1]	(40)	(317)
Foreign exchange losses[2]	(227)	(30)
Financial expense	(609)	(762)
Net finance costs	**(381)**	**(346)**

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 foreign exchange gains and losses primarily reflect exchange rate movements on US dollar-denominated borrowings.

Additional analysis

	2018 £m	2017 £m
Net finance costs:		
Group	(381)	(346)
Share of equity accounted investments	(13)	(34)
	(394)	(380)
Analysed as:		
Underlying net interest expense[1]:		
Group	(213)	(226)
Share of equity accounted investments	(2)	(19)
	(215)	(245)
Other:		
Group:		
Net interest expense on retirement benefit obligations	(103)	(165)
Fair value and foreign exchange adjustments on financial instruments and investments[2]	(65)	45
Share of equity accounted investments:		
Net interest expense on retirement benefit obligations	(3)	(8)
Fair value and foreign exchange adjustments on financial instruments and investments	(8)	(7)
	(394)	(380)

1. Underlying net interest expense is defined as finance costs for the Group and its share of equity accounted investments, excluding net interest expense on retirement benefit obligations and fair value and foreign exchange adjustments on financial instruments and investments.
2. The net loss (2017 gain) primarily reflects foreign exchange translational losses (2017 gains) on US dollar-denominated bonds held by BAE Systems plc.

6. Taxation expense

Income tax expense comprises current and deferred tax. Current and deferred tax is recognised in profit or loss except to the extent that it relates to a business combination or items recognised directly in equity or other comprehensive income.

Current tax
Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax
Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences:

- on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- related to investments in subsidiaries and equity accounted investments to the extent that it is probable that they will not reverse in the foreseeable future; and
- arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Taxation expense

	2018 £m	2017 (restated)[1] £m
Current taxation		
UK:		
Current year	**(64)**	(132)
Adjustments in respect of prior years	**(2)**	(21)
	(66)	(153)
Overseas:		
Current year	**(183)**	(160)
Adjustments in respect of prior years	**42**	40
	(141)	(120)
Total current taxation	**(207)**	(273)
Deferred taxation		
UK:		
Origination and reversal of temporary differences	**15**	52
Adjustments in respect of prior years	**15**	3
Tax rate adjustment	**–**	(1)
	30	54
Overseas:		
Origination and reversal of temporary differences	**(1)**	(42)
Adjustments in respect of prior years	**(18)**	(13)
Tax rate adjustment[2]	**5**	58
	(14)	3
Total deferred taxation	**16**	57
Taxation expense	**(191)**	(216)
UK	**(36)**	(99)
Overseas	**(155)**	(117)
Taxation expense	**(191)**	(216)

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.
2. The US federal tax rate was reduced from 35% to 21% with effect from 1 January 2018, while the estimated state tax rate increased from 5% to 6%. In line with this change, the rate applying to US deferred tax assets and liabilities at 31 December 2017 was reduced from 40% to 27%, creating a rate adjustment in 2017, which was partly reflected in the Consolidated income statement and partly in the Consolidated statement of comprehensive income. The rate applying to US deferred tax assets and liabilities has been further reduced to 25.7% at 31 December 2018, creating a rate adjustment in 2018, which is partly reflected in the Consolidated income statement and partly in the Consolidated statement of comprehensive income.

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.

	2018 £m	2017 (restated)[1] £m
Profit before taxation	**1,224**	1,073
UK corporation tax rate	**19%**	19.25%
Expected income tax expense	**(233)**	(207)
Effect of tax rates in foreign jurisdictions, including US state taxes	**(43)**	(95)
Effect of intra-group financing	**14**	15
Expenses not tax effected	**(14)**	(8)
Income not subject to tax	**18**	46
Research and development tax credits and patent box benefits	**14**	18
Non-deductible goodwill impairment	**–**	(74)
Chargeable gains	**(1)**	(2)
Utilisation of previously unrecognised tax losses	**1**	3
Adjustments in respect of prior years	**37**	9
Adjustments in respect of equity accounted investments	**27**	21
Tax rate adjustment[2]	**5**	57
Other	**(16)**	1
Taxation expense	**(191)**	(216)

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.
2. 2017 included a £58m credit in respect of US tax reform enacted in December 2017.

Calculation of the underlying effective tax rate

	2018 £m	2017 (restated)[1] £m
Profit before taxation	**1,224**	1,073
Add back:		
Taxation expense of equity accounted investments	**38**	38
Goodwill impairment (note 8)	**–**	384
Adjusted profit before taxation	**1,262**	1,495
Taxation expense	**(191)**	(216)
Taxation expense of equity accounted investments	**(38)**	(38)
Exclude: Impact of US tax reform enacted in December 2017	**–**	(58)
Adjusted taxation expense (including equity accounted investments)	**(229)**	(312)
Underlying effective tax rate	**18%**	21%

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

6. Taxation expense continued

Tax recognised in other comprehensive income

	2018			2017 (restated)[1]		
	Before tax £m	Tax benefit/ (expense) £m	Net of tax £m	Before tax £m	Tax (expense)/ benefit £m	Net of tax £m
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on retirement benefit schemes	**74**	**3**	**77**	2,056	(398)	1,658
Tax rate adjustment[2]	**–**	**2**	**2**	–	(83)	(83)
Equity accounted investments	**8**	**(2)**	**6**	65	(13)	52
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	**400**	**–**	**400**	(630)	–	(630)
Amounts (charged)/credited to hedging reserve	**(25)**	**5**	**(20)**	59	(11)	48
Equity accounted investments	**16**	**(1)**	**15**	(17)	(1)	(18)
	473	**7**	**480**	1,533	(506)	1,027

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers and to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.
2. 2017 comprised £67m in relation to the US and £16m in relation to the UK.

	2018			2017 (restated)[1]		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings £m	Total £m
Current tax						
Subsidiaries:						
Remeasurements on retirement benefit schemes	**–**	**24**	**24**	–	23	23
	–	**24**	**24**	–	23	23
Deferred tax						
Subsidiaries:						
Remeasurements on retirement benefit schemes	**–**	**(21)**	**(21)**	–	(421)	(421)
Tax rate adjustment[2]	**–**	**2**	**2**	–	(83)	(83)
Amounts charged to hedging reserve	**5**	**–**	**5**	(11)	–	(11)
Equity accounted investments	**(1)**	**(2)**	**(3)**	(1)	(13)	(14)
	4	**(21)**	**(17)**	(12)	(517)	(529)
Tax on other comprehensive income	**4**	**3**	**7**	(12)	(494)	(506)

1. Prior year comparatives have been restated to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.
2. 2017 comprised £67m in relation to the US and £16m in relation to the UK.

7. Earnings per share

Key Performance Indicator – Underlying earnings per share
Definition Basic earnings per share excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, non-recurring items and, in 2017, the impact of US tax reform enacted in December 2017.

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

Amortisation and impairment of intangible assets are excluded because they are not related to the in-year operational performance of the business, being driven by the timing and quantum of investment in acquired businesses and software.

Non-cash finance movements on pensions are excluded because they are driven by external factors, such as corporate bond yields and inflation.

Non-cash finance movements on financial derivatives are excluded because they are driven by external factors, such as foreign exchange rates and interest rates.

Non-recurring items (as defined in note 1) are items of financial performance which have been determined by management as being material by their size or incidence and not relevant to an understanding of the Group's underlying performance.

In 2017, the impact of US tax reform enacted in December 2017 was excluded because it did not reflect the Group's in-year underlying tax rate.

	2018			2017 (restated)[1]		
	£m	**Basic pence per share**	**Diluted pence per share**	£m	Basic pence per share	Diluted pence per share
Profit for the year attributable to equity shareholders	**1,000**	**31.3**	**31.2**	827	26.0	25.9
Add back/(deduct):						
Amortisation and impairment of intangible assets, post tax[2]	**97**			68		
Impairment of goodwill	**–**			384		
Non-cash movements, being net interest expense on retirement benefit obligations, post tax[2]	**87**			137		
Non-cash movements, being fair value and foreign exchange adjustments on financial instruments and investments, post tax[2]	**60**			(30)		
Non-recurring items, post tax[2]	**126**			10		
Impact of US tax reform enacted in December 2017[3]	**–**			(58)		
Underlying earnings, post tax	**1,370**	**42.9**	**42.8**	1,338	42.1	41.9
		Millions	**Millions**		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		**3,192**	**3,192**		3,182	3,182
Incremental shares in respect of employee share schemes			**9**			15
Weighted average number of shares used in calculating diluted earnings per share			**3,201**			3,197

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.
2. The tax impact is calculated using the underlying effective tax rate of 18% (2017 21%).
3. Prior year comparatives have been restated to exclude an additional £18m benefit in respect of the impact of US tax reform enacted in December 2017 resulting from the restatement of prior year comparatives upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers.

8. Intangible assets

Intangible assets are carried at cost or valuation, less accumulated amortisation and impairment losses.

Cost or valuation

Goodwill

Under the acquisition method for business combinations, goodwill is the acquisition-date fair value of the consideration transferred, less the net of the acquisition-date fair values of the identifiable assets acquired and liabilities assumed. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of joint ventures and associates is included in the carrying value of equity accounted investments. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Software

Software includes:

- Computer software licences acquired for use within the Group are capitalised as an intangible asset on the basis of the costs incurred to acquire and bring to use the specific software; and
- Software development costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Group-funded expenditure associated with enhancing or maintaining computer software programs for sale is recognised as an expense as incurred.

Development costs

Development costs funded by the Group on activities applied to a plan or design for the production of new or substantially improved products are capitalised as an internally-generated intangible asset if certain conditions are met. The costs capitalised include materials, direct labour and related overheads.

Programme and customer-related

Intangible assets recognised by the Group include those relating to ongoing programmes within businesses acquired, mainly in respect of customer relationships and order backlog. These assets are initially recognised at their fair value at the acquisition date.

Other

Other intangible assets includes patents, trademarks and licences.

Amortisation

Goodwill is not amortised. Amortisation on intangible assets, excluding goodwill, is charged to the income statement on a straight-line basis over their estimated useful lives.

For programme-related intangibles, amortisation is set on a programme-by-programme basis over the life of the individual programme. Amortisation for customer-related intangibles is also set on an individual basis.

The estimated useful lives are as follows:

Software	2 to 10 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, investment property and equity accounted investments

The carrying amounts of the Group's intangible assets (excluding goodwill), property, plant and equipment, investment property and equity accounted investments are reviewed at each balance sheet date to determine whether there is any indication of impairment as required by IAS 36 Impairment of Assets. If any such indication exists, the asset's recoverable amount is estimated. For goodwill and intangible assets that are not yet available for use, impairment testing is performed annually.

An impairment loss is recognised whenever the carrying amount of an asset or its Cash-Generating Unit (CGU) exceeds its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using an appropriate pre-tax discount rate. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs.

Impairment losses are recognised in the income statement.

An impairment loss in respect of goodwill is not reversed. An impairment loss in respect of other intangible assets, property, plant and equipment, investment property and equity accounted investments is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised or if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

8. Intangible assets continued

	Goodwill £m	Software £m	Development costs £m	Programme and customer-related £m	Other £m	Total £m
Cost or valuation						
At 1 January 2017	15,403	558	101	544	99	16,705
Additions:						
Acquired separately	–	42	–	–	–	42
Internally developed	–	45	–	–	–	45
Business acquisitions	3	–	–	–	–	3
Disposals[1]	–	(13)	–	(259)	(10)	(282)
Reclassification as held for sale	–	–	–	–	(4)	(4)
Transfer from property, plant and equipment	–	33	–	–	8	41
Foreign exchange adjustments	(684)	(18)	(11)	(20)	(4)	(737)
At 31 December 2017	14,722	647	90	265	89	15,813
Additions:						
Acquired separately	–	98	–	5	2	105
Internally developed	–	28	10	–	–	38
Disposals[1]	–	(16)	–	(43)	(2)	(61)
Reclassification as held for sale	(80)	(10)	–	–	–	(90)
Net transfer from property, plant and equipment	–	13	–	–	–	13
Foreign exchange adjustments	436	15	5	9	4	469
At 31 December 2018	**15,078**	**775**	**105**	**236**	**93**	**16,287**
Amortisation and impairment						
At 1 January 2017	4,501	298	59	496	87	5,441
Amortisation[2]	–	43	8	20	14	85
Impairment charge	384	–	–	–	–	384
Disposals[1]	–	(13)	–	(259)	(9)	(281)
Reclassification as held for sale	–	–	–	–	(4)	(4)
Transfer from property, plant and equipment	–	7	–	–	–	7
Foreign exchange adjustments	(159)	(13)	(5)	(17)	(3)	(197)
At 31 December 2017	4,726	322	62	240	85	5,435
Amortisation[2]	–	63	7	11	3	84
Impairment charge[3]	–	–	–	33	–	33
Disposals[1]	–	(16)	–	(43)	(2)	(61)
Transfer to property, plant and equipment	–	(3)	–	–	–	(3)
Reclassification as held for sale	–	(3)	–	–	–	(3)
Reclassification between categories	–	23	–	(23)	–	–
Foreign exchange adjustments	113	14	4	9	4	144
At 31 December 2018	**4,839**	**400**	**73**	**227**	**90**	**5,629**
Net book value						
At 31 December 2018	**10,239**	**375**	**32**	**9**	**3**	**10,658**
At 31 December 2017	9,996	325	28	25	4	10,378
At 1 January 2017	10,902	260	42	48	12	11,264

1. Includes intangible assets with nil net book value no longer used by the Group.
2. Amortisation of £84m (2017 £85m) includes £78m (2017 £82m) charged to the income statement as an amortisation expense and £6m (2017 £3m) recoverable on customer contracts.
3. The impairment charge in Cyber & Intelligence relates to Silversky customer-related intangible assets.

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 in the range 0% to 2% applied. The IBP process includes the use of historical experience, available government spending data and the Group's order backlog. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital of 7.24% (2017 6.60%) (adjusted for risks specific to the market in which the Cash-Generating Unit (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 £8.2bn (2017 £7.9bn) 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	**2018 £bn**	2017 £bn	**2018 %**	2017 %
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	**4.0**	3.8	**9**	8
Intelligence & Security (within Cyber & Intelligence)	Continued demand in the US for the Group's services in the areas of homeland security, law enforcement and counter-intelligence	**0.7**	0.7	**9**	8
Platforms & Services (US)	Continued demand in the Group's principal markets for existing and successor military tracked vehicles, naval guns, missile launchers, artillery systems, munitions, upgrade programmes and support, and in the US for complex infrastructure, maritime and aviation services	**3.5**	3.4	**9**	8

The headroom, calculated as the difference between net assets including allocated goodwill as at 31 December 2018 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 and a 1% and 2% increase in the discount rate 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 2% increase in the discount rate	
Cash-Generating Unit	**2018 £bn**	2017 £bn	**2018 £bn**	2017 £bn	**2018 £bn**	2017 £bn	**2018 £bn**	2017 £bn
Electronic Systems	**4.4**	5.7	**3.0**	4.0	**2.8**	3.7	**1.6**	2.4
Intelligence & Security	**0.7**	0.6	**0.5**	0.4	**0.5**	0.4	**0.4**	0.2
Platforms & Services (US)	**1.8**	3.5	**0.9**	2.2	**0.8**	2.0	**0.1**	1.0

Other CGUs

The remaining goodwill balance of £2.0bn (2017 £2.1bn) is allocated across multiple CGUs, including £0.2bn (2017 £0.2bn) in the Applied Intelligence CGU, with no individual CGU exceeding 10% of the Group's total goodwill balance. The majority of the projected cash flows within these CGUs are underpinned by expected levels of primarily UK government spending on defence, aerospace and security, and the Group's ability to capture a broadly consistent market share. In the case of Applied Intelligence, the future cash flow projections are based on the expectation of growth in cyber and intelligence, in the UK and overseas government markets, together with increasing demand for products and services in commercial markets.

Impairment

In 2017, the impairment charge of £384m reflected lower growth assumptions in the Applied Intelligence CGU. The recoverable amount of the Applied Intelligence CGU was based on value in use calculated using a pre-tax discount rate of 16%.

Software

The software intangible assets balance includes £135m (2017 £107m) relating to an Enterprise Resource Planning transformation programme currently being implemented across the Air segment. In line with the Group's amortisation policy, the intangible asset will be amortised over a period of 10 years as the programme becomes operational from 2019.

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

For certain items of plant and equipment in the Group's US businesses, depreciation is normally provided on a basis consistent with cost reimbursement profiles under US government contracts. Typically, this provides for a faster rate of depreciation than would otherwise arise on a straight-line basis.

No depreciation is provided on freehold land and assets in the course of construction.

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each balance sheet date.

Impairment
The carrying amounts of the Group's property, plant and equipment are reviewed at each balance sheet date to determine whether there is any indication of impairment in accordance with the policy shown in note 8.

9. Property, plant and equipment continued

	Land and buildings £m	Plant and machinery £m	Total £m
Cost			
At 1 January 2017	2,176	3,229	5,405
Additions[1]	218	306	524
Reclassification as held for sale	–	(16)	(16)
Transfer to other intangible assets	(2)	(39)	(41)
Reclassification between categories	(42)	42	–
Disposals	(41)	(144)	(185)
Foreign exchange adjustments	(97)	(146)	(243)
At 31 December 2017	2,212	3,232	5,444
Additions[1]	154	288	442
Reclassification as held for sale	(11)	(12)	(23)
Transfer (to)/from other intangible assets	(17)	4	(13)
Reclassification between categories	44	(60)	(16)
Disposals	(117)	(141)	(258)
Foreign exchange adjustments	50	87	137
At 31 December 2018	**2,315**	**3,398**	**5,713**
Depreciation and impairment			
At 1 January 2017	1,148	2,159	3,307
Depreciation charge for the year	66	194	260
Impairment charge for the year	–	1	1
Impairment write back	(4)	–	(4)
Reclassification as held for sale	–	(11)	(11)
Transfer to other intangible assets	–	(7)	(7)
Reclassification between categories	(33)	33	–
Disposals	(39)	(139)	(178)
Foreign exchange adjustments	(55)	(99)	(154)
At 31 December 2017	1,083	2,131	3,214
Depreciation charge for the year	84	183	267
Impairment charge for the year[2]	27	4	31
Reclassification as held for sale	(7)	(6)	(13)
Transfer from other intangible assets	–	3	3
Reclassification between categories	18	(34)	(16)
Disposals	(89)	(136)	(225)
Foreign exchange adjustments	29	58	87
At 31 December 2018	**1,145**	**2,203**	**3,348**
Net book value			
At 31 December 2018	**1,170**	**1,195**	**2,365**
At 31 December 2017	1,129	1,101	2,230
At 1 January 2017	1,028	1,070	2,098

1. Includes £70m (2017 £109m) of land and buildings, and £20m (2017 £42m) of plant and machinery at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.
2. The impairment charge in Platforms & Services (US) relates to the Mobile shipyard prior to its disposal.

9. Property, plant and equipment continued

Net impairment

	2018 £m	2017 £m
Electronic Systems	–	(4)
Platforms & Services (US)	31	–
Air	–	1
	31	(3)

2018

The impairment charge in Platforms & Services (US) relates to the Mobile shipyard prior to its disposal.

2017

The impairment write back in Electronic Systems related to the carrying value of a property in New Jersey, US.

Assets in the course of construction

	Land and buildings[1] £m	Plant and machinery £m	Total £m
At 31 December 2018	**198**	**230**	**428**
At 31 December 2017	259	296	555

1. Includes £129m (2017 £178m) at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

Operating leases

The future aggregate minimum lease income from the non-cancellable elements of operating leases for assets capitalised (including investment property – see note 10) are as follows:

	2018 £m	2017 £m
Receipts due:		
Not later than one year	24	24
Later than one year and not later than five years	95	95
Later than five years	28	51
	147	170

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.

10. 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 2017	170
Additions	15
Disposals	(24)
At 31 December 2017	161
Additions	8
Disposals	(9)
At 31 December 2018	**160**
Depreciation and impairment	
At 1 January 2017	60
Depreciation charge for the year	3
Impairment charge	2
Disposals	(5)
At 31 December 2017	60
Depreciation charge for the year	2
At 31 December 2018	**62**
Net book value	
At 31 December 2018	**98**
At 31 December 2017	101
At 1 January 2017	110

Fair value	
At 31 December 2018	**176**
At 31 December 2017	173

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.

11. 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.

	2018		2017 (restated)[1]	
	Eurofighter Jagdflugzeug £m	**MBDA £m**	Eurofighter Jagdflugzeug £m	MBDA £m
Revenue (100%)	**3,110**	**2,799**	3,011	2,614
Underlying EBITA[2] excluding depreciation	**12**	**398**	10	330
Non-recurring items	**–**	**(11)**	–	–
Depreciation and amortisation	**(1)**	**(95)**	(1)	(46)
Financial income	**–**	**(63)**	2	64
Financial expense	**–**	**60**	–	(82)
Taxation expense	**(2)**	**(86)**	(4)	(87)
Profit/(loss) for the year (100%)	**9**	**203**	7	179
Remeasurements on retirement benefit schemes, net of tax	**–**	**15**	–	139
Amounts charged to hedging reserve, net of tax	**–**	**(11)**	–	(6)
Foreign exchange adjustments	**–**	**9**	–	(8)
Total comprehensive income for the year (100%)	**9**	**216**	7	304
Group's share of total comprehensive income for the year	**3**	**81**	2	114
Non-current assets	**14**	**2,190**	12	2,065
Cash and cash equivalents	**32**	**2,324**	30	2,420
Current assets excluding cash and cash equivalents	**1,006**	**4,537**	1,144	3,807
Current assets	**1,038**	**6,861**	1,174	6,227
Non-current financial liabilities excluding trade and other payables, and provisions	**–**	**(8)**	–	(4)
Other non-current liabilities	**(33)**	**(719)**	(29)	(795)
Non-current liabilities	**(33)**	**(727)**	(29)	(799)
Current financial liabilities excluding trade and other payables, and provisions	**–**	**–**	(3)	–
Other current liabilities	**(988)**	**(7,808)**	(1,130)	(7,136)
Current liabilities	**(988)**	**(7,808)**	(1,133)	(7,136)
Net assets (100%)	**31**	**516**	24	357

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers and to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.
2. Operating profit excluding amortisation and impairment of intangible assets (EBITA), and non-recurring items.

11. Equity accounted investments continued

	2018			2017 (restated)[1]		
	Eurofighter Jagdflugzeug £m	**MBDA £m**	**Total £m**	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Group's share of net assets	**10**	**193**	**203**	8	134	142
Goodwill adjustment	**–**	**6**	**6**	–	6	6
Carrying value	**10**	**199**	**209**	8	140	148

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers and to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.

	2018			2017		
	Eurofighter Jagdflugzeug £m	**MBDA £m**	**Total £m**	Eurofighter Jagdflugzeug £m	MBDA £m	Total £m
Dividends received	**2**	**24**	**26**	–	47	47

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 2018 are as follows: Advanced Electronics Company (£70m), FADEC International (£47m), Air Astana (£33m), FNSS (£33m) and Panavia Aircraft (£20m). The following table shows a reconciliation of opening to closing carrying value for both the Group's principal and immaterial joint ventures in aggregate.

	Principal equity accounted investments[1] £m	Other £m	Total £m
At 1 January 2017	77	173	250
Group's share of profit for the year	70	37	107
Group's share of remeasurements on retirement benefit schemes	65	–	65
Tax on items that will not be reclassified to the income statement	(13)	–	(13)
Foreign exchange adjustments	(4)	(5)	(9)
Amounts (charged)/credited to hedging reserve	(2)	4	2
Tax on items that may be reclassified to the income statement	–	(1)	(1)
Group's share of total comprehensive income for the year	116	35	151
Equity accounted investment funding	–	3	3
Dividends received from equity accounted investments	(47)	(25)	(72)
Foreign exchange adjustments	2	(12)	(10)
At 31 December 2017	148	174	322
Group's share of profit for the year	79	61	140
Group's share of remeasurements on retirement benefit schemes	8	–	8
Tax on items that will not be reclassified to the income statement	(2)	–	(2)
Foreign exchange adjustments	3	–	3
Amounts (charged)/credited to hedging reserve	(4)	4	–
Tax on items that may be reclassified to the income statement	–	(1)	(1)
Group's share of total comprehensive income for the year	84	64	148
Purchase of equity accounted investments	–	2	2
Equity accounted investment funding	–	1	1
Dividends received from equity accounted investments	(26)	(31)	(57)
Foreign exchange adjustments	3	10	13
At 31 December 2018	**209**	**220**	**429**

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers and to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.

Contingent liabilities

The Group is not aware of any material contingent liabilities in respect of its equity accounted investments.

12. Trade, other and contract receivables

Trade receivables are stated at amortised cost including 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 trade 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.

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.

US deferred compensation plan assets are measured at fair value in accordance with IAS 19 Employee Benefits.

	2018 £m	2017 (restated)[1] £m
Non-current		
Prepayments and accrued income	**25**	5
US deferred compensation plan assets	**306**	302
Other receivables[2]	**21**	80
	352	387
Current		
Contract receivables	**2,331**	1,484
Trade receivables	**1,427**	1,664
Amounts owed by equity accounted investments (note 31)	**67**	86
Prepayments and accrued income	**1,025**	704
Other receivables[3]	**327**	306
	5,177	4,244

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.
2. Includes £11m (2017 £45m) which is reimbursable in respect of reorganisation costs.
3. Includes £35m (2017 £44m) which is reimbursable in respect of reorganisation costs.

Contract receivables increased in 2018, primarily as a result of build up of costs incurred on US Combat Vehicles, Electronic Systems and Saudi Arabian support programmes, ahead of invoicing customers.

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 29.

Current prepayments and accrued income increased in 2018 as a result of increased payments made into the supply chain including payments relating to the Qatar Typhoon and Hawk programme.

Disclosed as required on transition to IFRS 15 Revenue from Contracts with Customers, contract receivables as at 1 January 2017 were £1,609m.

13. Other financial assets and liabilities

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 reclassified from the hedging reserve into the cost of the underlying transaction and recognised in the income statement when the underlying transaction affects profit or loss. The ineffective portion of any change in the fair value of the instrument is recognised in the income statement 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.

Fair value hedges

Where a derivative financial instrument is designated as a fair value hedge, changes in the fair value of the underlying asset or liability attributable to the hedged risk, and gains and losses on the derivative instrument, are recognised within finance costs in the income statement for the period.

	2018		2017	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	**125**	**(95)**	147	(114)
Other foreign exchange/interest rate contracts	**33**	**(9)**	–	(19)
Debt-related derivative financial instruments	**87**	**–**	79	–
	245	**(104)**	226	(133)
Current				
Cash flow hedges – foreign exchange contracts	**79**	**(63)**	77	(48)
Other foreign exchange/interest rate contracts	**9**	**(9)**	12	(37)
Debt-related derivative financial instruments[1]	**78**	**(2)**	–	(19)
	166	**(74)**	89	(104)

1. Liabilities include fair value hedges of £2m (2017 £nil).

Debt-related derivative financial instruments

The debt-related derivative financial instruments represent the fair value of cross-currency, interest rate and foreign exchange derivatives relating to the US$500m 2.85% bond, repayable 2020, the US$800m 3.8% bond, repayable 2024, the US$750m 3.85% bond, repayable 2025, the US$500m 7.5% bond, repayable 2027, and the US$550m 4.75% bond, repayable 2044 (see note 20). These derivatives have been entered into specifically to manage the Group's exposure to foreign exchange or interest rate risk.

Additional information on the Group's financial risk management strategies and hedge accounting is provided in note 29.

14. 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/retirement schemes (see below). This is because retirement 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/retirement schemes or when retirement benefits are paid. In reviewing the probability that taxable profits will be available in the future against which such contributions/payments can be deducted, account has been taken of the deficit recovery plans agreed with the trustees of the relevant schemes in November 2017 under which the deficits are expected to be cleared between 2021 and 2026 (see note 22).

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	
	2018 £m	2017 (restated)[1] £m	**2018 £m**	2017 (restated)[1] £m	**2018 £m**	2017 (restated)[1] £m
Property, plant and equipment	**28**	16	**(85)**	(94)	**(57)**	(78)
Intangible assets	**2**	13	**(3)**	(14)	**(1)**	(1)
Provisions and accruals	**202**	205	**–**	–	**202**	205
Goodwill	**–**	–	**(283)**	(275)	**(283)**	(275)
Pension/retirement schemes:						
Deficits	**722**	728	**–**	–	**722**	728
Additional contributions and other[2]	**97**	100	**(1)**	(1)	**96**	99
Share-based payments	**12**	14	**–**	–	**12**	14
Financial instruments	**–**	–	**(12)**	(11)	**(12)**	(11)
Other items	**14**	27	**(8)**	(22)	**6**	5
Rolled over capital gains	**–**	–	**(10)**	(10)	**(10)**	(10)
Capital losses carried forward	**10**	10	**–**	–	**10**	10
Trading losses carried forward	**17**	12	**–**	–	**17**	12
Deferred tax assets/(liabilities)	**1,104**	1,125	**(402)**	(427)	**702**	698
Set off of tax	**(402)**	(423)	**402**	423	**–**	–
Net deferred tax assets/(liabilities)	**702**	702	**–**	(4)	**702**	698

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers and to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.
2. Includes deferred tax assets on US deferred compensation plans.

14. Deferred tax continued

Movement in temporary differences during the year

	At 1 January 2018 £m	Foreign exchange adjustments £m	Recognised in income £m	Recognised in equity £m	**At 31 December 2018 £m**
Property, plant and equipment	(78)	(5)	26	–	**(57)**
Intangible assets	(1)	–	–	–	**(1)**
Provisions and accruals	205	9	(12)	–	**202**
Goodwill	(275)	(16)	8	–	**(283)**
Pension/retirement schemes:					
Deficits	728	9	4	(19)	**722**
Additional contributions and other[1]	99	6	(9)	–	**96**
Share-based payments	14	–	(1)	(1)	**12**
Financial instruments	(11)	–	(6)	5	**(12)**
Other items	5	(1)	2	–	**6**
Rolled over capital gains	(10)	–	–	–	**(10)**
Capital losses carried forward	10	–	–	–	**10**
Trading losses carried forward	12	1	4	–	**17**
	698	3	16	(15)	**702**

	At 1 January 2017 £m	Foreign exchange adjustments £m	Recognised in income[2] £m	Recognised in equity[3] £m	At 31 December 2017 £m
Property, plant and equipment	(99)	9	12	–	(78)
Intangible assets	(10)	(1)	10	–	(1)
Provisions and accruals[4]	304	(19)	(80)	–	205
Goodwill	(428)	31	122	–	(275)
Pension/retirement schemes:					
Deficits[5]	1,221	(17)	28	(504)	728
Additional contributions and other[1]	149	(12)	(38)	–	99
Share-based payments	23	–	(1)	(8)	14
Financial instruments	(5)	–	5	(11)	(11)
Other items[4]	(1)	2	4	–	5
Rolled over capital gains	(11)	–	1	–	(10)
Capital losses carried forward	11	–	(1)	–	10
Trading losses carried forward	17	–	(5)	–	12
	1,171	(7)	57	(523)	698

1. Includes deferred tax assets on US deferred compensation plans.
2. Includes a credit of £57m recognised in income in respect of tax rate adjustments.
3. Includes a debit of £83m recognised in equity in respect of tax rate adjustments.
4. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.
5. Prior year comparatives have been restated to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.

Unrecognised deferred tax assets and liabilities

Deferred tax assets have not been recognised in respect of the following items:

	2018		2017	
	Gross amount £m	**Unrecognised deferred tax asset £m**	Gross amount £m	Unrecognised deferred tax asset £m
Deductible temporary differences, including tax credits	**2**	**2**	1	1
Capital losses carried forward	**233**	**41**	207	36
Trading and other losses carried forward	**217**	**26**	389	38
	452	**69**	597	75

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 £354m (2017 £237m) relating to potentially taxable unremitted earnings of overseas subsidiaries and equity accounted investments because any withholding tax due on the remittance of those earnings is expected to be insignificant.

14. Deferred tax continued

Changes in tax rates

The US federal tax rate was reduced from 35% to 21% with effect from 1 January 2018. Recognised US deferred tax balances have been calculated at a combined federal and state tax rate of 25.7% (2017 27%).

The UK current tax rate reduced from 20% to 19% with effect from 1 April 2017 and will reduce to 17% with effect from 1 April 2020. This will reduce future UK current tax charges accordingly. Both recognised and unrecognised UK deferred tax balances as at 31 December 2018 have been calculated at a blended rate of 17.5% (2017 17.5%).

15. Inventories

Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value.

	2018 £m	2017 (restated)[1] £m
Raw materials and consumables	**354**	297
Work-in-progress	**319**	350
Finished goods and goods for resale	**101**	86
	774	733

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

The Group recognised £11m (2017 £9m) as a write down of inventories to net realisable value.

16. 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.

	2018 £m	2017 £m
Tax provisions	**(361)**	(351)
Research and development expenditure credits receivable	**163**	131
Other	**(55)**	(65)
	(253)	(285)
Represented by:		
Current tax assets	**81**	20
Current tax liabilities	**(334)**	(305)
	(253)	(285)

Tax provisions of £361m (2017 £351m) are in respect of known tax issues, of which £316m (2017 £292m) relates to non-UK jurisdictions. Whilst there is inherent uncertainty regarding the timing of any resolution of tax positions, the Group considers there to be a possibility of a material change in overseas tax positions in the next financial year.

The Group continues to monitor developments in relation to the EU's State Aid investigation into the UK's Controlled Foreign Company regime. The Group has calculated its maximum potential liability relating to this issue to be around £86m as at 31 December 2018. The Group does not currently consider that any provision is required in respect of this amount.

17. 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.

	2018 £m	2017 £m
Cash	**735**	913
Money market funds	**908**	899
Short-term deposits	**1,589**	1,459
	3,232	3,271

Cash and cash equivalents includes £278m (2017 £228m) which is subject to regulatory restrictions and is therefore not available for general use by other entities within the Group.

18. Assets and liabilities of disposal groups classified as held for sale

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.

UK-based combat vehicles

In January 2019, the Group announced an agreement with Rheinmetall to create a joint UK-based military land vehicle design, manufacturing and support business. Rheinmetall will purchase a 55% stake in the existing BAE Systems UK-based combat vehicles business, with BAE Systems retaining 45%. The establishment of the new joint venture is subject to regulatory approvals which are anticipated to be completed in the first half of 2019. Accordingly, the UK-based combat vehicles business is presented as held for sale at 31 December 2018.

The UK-based combat vehicles business is included in the Maritime segment.

AACC

As a part of a planned reorganisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia, the Group completed the disposal of its 75.6% shareholding in Aircraft Accessories and Components Company (AACC) in January 2019. Accordingly, AACC is presented as held for sale at 31 December 2018.

AACC is included in the Air segment.

	2018			2017
	UK-based combat vehicles £m	AACC £m	Total £m	AACC £m
Intangible assets	**87**	**–**	**87**	–
Property, plant and equipment	**9**	**6**	**15**	5
Inventories	**2**	**17**	**19**	16
Trade, other and contract receivables	**16**	**9**	**25**	5
Assets held for sale	**114**	**32**	**146**	26
Trade and other payables	**(19)**	**(14)**	**(33)**	(16)
Provisions	**(7)**	**–**	**(7)**	–
Liabilities held for sale	**(26)**	**(14)**	**(40)**	(16)

19. Geographical analysis of assets

Analysis of non-current assets by geographical location

Asset location	Notes	2018 £m	2017 (restated)[1] £m
UK		**3,610**	3,405
Rest of Europe		**909**	807
US		**8,466**	8,309
Saudi Arabia		**503**	439
Australia		**420**	459
Rest of Asia and Pacific		**7**	5
Non-current segment assets		**13,915**	13,424
Retirement benefit surpluses	22	**308**	302
Other financial assets	13	**411**	315
Tax	14,16	**783**	722
Inventories	15	**774**	733
Current trade, other and contract receivables	12	**5,177**	4,244
Cash and cash equivalents	17	**3,232**	3,271
Assets held for sale	18	**146**	26
Consolidated total assets		**24,746**	23,037

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers (see note 37) and to more appropriately allocate certain of the Group's non-current assets between geographical locations.

20. 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 either amortised cost or, where hedge accounting has been adopted, fair value in respect of the hedged risk. Any difference between the amount initially recognised and the redemption value is recognised in the income statement over the period of the borrowings.

	2018 £m	2017 £m
Non-current		
US$1bn 6.375% bond, repayable 2019	**–**	741
US$500m 2.85% bond, repayable 2020	**391**	368
US$500m 4.75% bond, repayable 2021	**392**	369
£400m 4.125% bond, repayable 2022	**399**	398
US$800m 3.8% bond, repayable 2024	**626**	590
US$750m 3.85% bond, repayable 2025	**583**	548
US$500m 7.5% bond, repayable 2027	**391**	368
US$400m 5.8% bond, repayable 2041	**311**	292
US$550m 4.75% bond, repayable 2044	**421**	395
	3,514	4,069
Current		
US$1bn 6.375% bond, repayable 2019	**785**	–
Albertville Hangar bond, repayable 2018	**–**	7
Overdrafts	**–**	7
	785	14

20. Loans and overdrafts continued

US$500m of the US$1bn 6.375% bond, repayable 2019, has been converted to a floating rate bond by utilising interest rate swaps that mature in June 2019 and give an effective rate during 2018 of 6.6%.

The US$500m 2.85% bond, repayable 2020, has been converted to a sterling fixed rate bond by utilising foreign exchange swaps that mature in February 2019 and give an effective rate during 2018 of 1.3%.

US$500m of the US$800m 3.8% bond, repayable 2024, has been converted to a floating rate bond by utilising interest rate swaps that mature in October 2024 and give an effective rate during 2018 of 4.0%. US$500m of the US$800m bond is measured at amortised cost as adjusted for the fair value of the interest rate risk.

US$734m of the US$750m 3.85% bond, repayable 2025, has been converted to a sterling fixed rate bond by utilising cross-currency swaps that mature in June 2019 and give an effective rate during 2018 of 3.4%.

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 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 2018 of 5.8%.

US$244m of the US$550m 4.75% bond, repayable 2044, has been converted to a sterling fixed rate bond by utilising cross-currency swaps that mature in June 2019 and give an effective rate during 2018 of 4.6%.

21. Trade and other payables

Trade and other payables are stated at amortised cost.

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.

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.

	2018 £m	2017 (restated)[1] £m
Non-current		
Contract liabilities	**560**	802
Amounts owed to equity accounted investments (note 31)	**–**	15
Accruals and deferred income[2]	**534**	469
US deferred compensation plan liabilities	**333**	318
Other payables	**109**	119
	1,536	1,723
Current		
Contract liabilities	**3,496**	2,717
Trade payables	**911**	596
Amounts owed to equity accounted investments (note 31)	**955**	912
Other taxes and social security costs	**130**	239
Accruals and deferred income	**1,993**	1,997
Other payables	**255**	294
	7,740	6,755

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.
2. Includes £439m (2017 £344m) of funding received from the UK government for property, plant and equipment at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme.

Contract liabilities increased in 2018, driven by customer advance payments in excess of contract expenditure and before advance funding into the supply chain, primarily related to the Qatar Typhoon and Hawk programme.

Revenue recognised in the year includes £2,571m (2017 £2,743m) that was included in the opening contract liabilities balance.

Disclosed as required on transition to IFRS 15 Revenue from Contracts with Customers, non-current and current contract liabilities as at 1 January 2017 were £163m and £3,624m, respectively.

22. Retirement 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 retirement 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 182. 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 2018.

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, which is consistent with prior years. 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.

22. Retirement benefits continued

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 two largest funded defined benefit schemes are the BAE Systems Pension Scheme (Main Scheme) and the BAE Systems 2000 Pension Plan (2000 Plan) which, in aggregate, represent 82% (2017 81%) of the UK IAS 19 defined benefit obligation at 31 December 2018. The schemes in other countries are primarily defined contribution schemes.

At 31 December 2018, the weighted average durations of the UK and US defined benefit pension obligations were 17 years (2017 18 years) and 11 years (2017 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, 2000 Plan and US schemes in aggregate is set out below:

	Active %	Deferred %	Pensioner %
Main Scheme[1]	35	20	45
2000 Plan[2]	16	30	54
US schemes[3]	30	17	53

1. Source: Main Scheme actuarial valuation report as at 31 March 2017.
2. Source: 2000 Plan actuarial valuation report as at 31 March 2017.
3. Source: Annual updates of the US schemes as at 1 January 2018.

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 active members of the Main Scheme and 2000 Plan 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. It is expected that the impact of GMP equalisation will be in the region of £121m based on an estimate as at 26 October 2018 for the UK schemes that were contracted out of the State Earnings Related Pension Scheme between 1990 and 1997. This has been treated for IAS 19 purposes as a plan amendment and resulted in an increase in the pension deficit in the balance sheet and a corresponding non-recurring past service cost in the income statement.

The Group has allocated a share of the past service cost to MBDA based on the relative payroll contributions of active members. The Group's share of the £121m is £110m in respect of the Group's subsidiaries, plus £4m for the Group's share of MBDA's allocation. The remaining £7m relates to the share allocated to other participating employers.

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 retirement 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.

22. Retirement benefits continued

Funding

Introduction

Disclosures in respect of pension funding are provided below. Disclosures in respect of pension accounting under IAS 19 are provided on pages 182 to 188.

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 182. The purpose of the funding valuations is to design funding plans which ensure that the schemes have sufficient funds available to meet future benefit payments.

UK valuations

Funding valuations of the Group's nine UK defined benefit pension schemes are performed every three years. The latest valuations were performed as at 31 March 2017. The next funding valuations will have an effective date of no later than 31 March 2020.

In November 2017, the triennial funding valuations and, where necessary, deficit recovery plans were agreed with the trustees and certified by the scheme actuaries after consultation with the UK Pensions Regulator.

The results of the most recent triennial valuations are shown below:

	At 31 March 2017			
	Main Scheme £bn	2000 Plan £bn	Other £bn	Total £bn
Market value of assets	12.8	4.3	4.5	21.6
Present value of liabilities	(14.4)	(4.6)	(4.7)	(23.7)
Funding deficit	(1.6)	(0.3)	(0.2)	(2.1)
Percentage of accrued benefits covered by the assets at the valuation date	89%	93%	96%	91%

The valuations were determined using the following mortality assumptions:

	2017
Life expectancy of a male currently aged 65 (years)	86 – 89
Life expectancy of a female currently aged 65 (years)	88 – 90
Life expectancy of a male currently aged 45 (years)	88 – 92
Life expectancy of a female currently aged 45 (years)	91 – 93

The discount rate assumptions used in the 2017 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.

In aggregate, the net funding deficit across the UK schemes at 31 March 2017 was £2.1bn. 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 agreements reached are underpinned by contingency plans, which include a commitment by the Group to a further £50m of deficit funding into the largest scheme prior to the next triennial valuation in the event that the scheme funding level was to fall below pre-determined parameters. In addition, the Group would be required to pay £187m across its schemes with deficits at the valuation date if the funding levels for those schemes 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 2018.

22. Retirement 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 2018, total employer contributions to the Group's pension schemes were £554m (2017 £433m), including amounts funded by equity accounted investments of £38m (2017 £31m), and included approximately £211m (2017 £209m) of deficit recovery payments in respect of the UK schemes, and £119m (2017 £62m) in respect of the US schemes.

Deficit contributions will further increase in line with any percentage growth in dividend payments made by the Group. Under the deficit recovery plans, these annual payments would subsequently fall by approximately £50m in 2022 as the deficits on certain schemes are expected to be cleared. The annual payments are expected to end in 2026 when all deficits are projected to be cleared. Under the last agreement made in 2014, all scheme deficits were projected to be cleared in 2026.

In 2019, the Group expects that contributions to its UK pension schemes will be broadly in line with 2018, whilst contributions to its US pension schemes are expected to reduce.

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 43% (2017 47%) 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 and one of the Group's other UK defined benefit pension schemes jointly have an equity option strategy protecting £1.8bn of assets against a significant fall in equity markets. In February 2019 this protection was extended to cover £2.6bn of assets.
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, some of 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 discount rate assumptions set as part of the 2017 UK funding valuations more directly reflect the expected returns on assets held by the schemes and, therefore, the liabilities are less sensitive to interest rate risk than they were in the 2014 funding valuation. Accordingly, the 2017 approach provides a more 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 2017 UK funding valuation, 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 principal 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 Group's US schemes are not indexed with inflation. The approach to the 2017 UK funding valuation provides a more natural hedge against inflation movements and, therefore, the liabilities are less sensitive to inflation risk than they were in the 2014 funding valuation. Under the 2017 UK funding valuation approach, 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.

22. Retirement 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		
	2018	2017	2016	**2018**	2017	2016
Financial assumptions						
Discount rate – past service (%)	**2.9**	2.6	2.7	**4.2**	3.7	4.2
Discount rate – future service (%)	**3.0**	2.7	2.7	**4.2**	3.7	4.2
Retail Prices Index (RPI) inflation (%)	**3.1**	3.1	3.2	**n/a**	n/a	n/a
Rate of increase in salaries (%)	**3.1**	3.1	3.2	**n/a**	n/a	n/a
Rate of increase in deferred pensions (%)	**2.1/3.1**	2.1/3.1	2.2/3.2	**n/a**	n/a	n/a
Rate of increase in pensions in payment (%)	**1.6 – 3.7**	1.6 – 3.7	1.7 – 3.7	**n/a**	n/a	n/a
Demographic assumptions						
Life expectancy of a male currently aged 65 (years)	**86 – 88**	86 – 88	86 – 89	**87**	87	87
Life expectancy of a female currently aged 65 (years)	**88 – 90**	88 – 90	89 – 90	**89**	89	89
Life expectancy of a male currently aged 45 (years)	**88 – 90**	88 – 90	88 – 91	**87**	87	87
Life expectancy of a female currently aged 45 (years)	**90 – 91**	90 – 92	91 – 92	**89**	89	89

Discount rate

The discount rate assumptions are derived through discounting the projected benefit payments using a third-party AA corporate bond yield curve to produce a single equivalent discount rate for the UK and US territories. This inherently captures the maturity profile of the expected benefit payments. For the UK territory, the discount rate used for future service differs from that used for past service as it only uses the cash flows relating to active members, which have a different duration. Further information on the duration of the schemes is detailed on page 179.

Retail Prices Index (RPI) 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. 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% (2017 RPI inflation of 3.1%), 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 Consumer Prices Index (CPI) inflation of 2.1% (2017 CPI inflation of 2.1%), with the exception of the 2000 Plan, which is based on RPI inflation of 3.1% (2017 RPI inflation of 3.1%). For all UK schemes, the rate of increase in deferred pensions is subject to inflation caps.

Rate of increase in pensions in payment

The rate of increase in pensions in payment differs between UK schemes. Different tranches of the schemes' benefits increase at rates based on either RPI or CPI inflation, and some are subject to an inflation cap. With the exception of two smaller schemes, the rate of increase in pensions in payment is based on RPI inflation.

Life expectancy

For its UK pension schemes, the Group has used the Self-Administered Pension Schemes S2 mortality tables based on year of birth (as published by the Institute of Actuaries) for both pensioner and non-pensioner members in conjunction with the results of an investigation into the actual mortality experience of scheme members and information on the demographic profile of the scheme's membership. In addition, to allow for future improvements in longevity, the Continuous Mortality Investigation 2017 tables (published by the Institute of Actuaries) have been used (in 2017, the Continuous Mortality Investigation 2016 tables were used), with an assumed long-term rate of future annual mortality improvements of 1.25% (2017 1.25%), for both pensioner and non-pensioner members.

In October 2015, the Society of Actuaries in the US released updated mortality assumptions reflecting the results of its comprehensive mortality study. For the majority of the US schemes, the mortality tables used at 31 December 2018 are a blend of the fully generational RP-2014 Aggregate table and the RP-2014 White Collar table, both projected using Scale MP-2018. The IRS have approved the new mortality tables to be adopted for funding valuation purposes from 2019.

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 2018. These valuations were rolled forward to reflect the information at 31 December 2018. The method of accounting for these is similar to that used for defined benefit pension schemes.

The assumption for long-term healthcare cost increases is 4.9% (2017 4.9%) based on the assumptions that the increases are 7.8% in 2018 reducing to 4.5% by 2026 and 4.5% each year thereafter for pre-retirement, and 8.5% in 2018 reducing to 4.5% by 2026 and 4.5% each year thereafter for post-retirement.

22. Retirement benefits continued

IAS 19 accounting continued

Summary of movements in retirement benefit obligations

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2018[1]	(3,788)	(566)	(4,354)
Actual return on assets excluding amounts included in net interest expense	(1,022)	(422)	(1,444)
Decrease in liabilities due to changes in financial assumptions	1,295	265	1,560
Decrease in liabilities due to changes in demographic assumptions	171	17	188
Experience losses	(176)	(17)	(193)
Contributions in excess of service cost	185	105	290
Past service cost – plan amendments	(131)	–	(131)
Net interest expense	(88)	(24)	(112)
Foreign exchange adjustments	–	(38)	(38)
Movement in US healthcare schemes	–	(2)	(2)
Total net IAS 19 deficit at 31 December 2018	**(3,554)**	**(682)**	**(4,236)**
Allocated to equity accounted investments	304	–	304
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 31 December 2018	**(3,250)**	**(682)**	**(3,932)**

1. Prior year comparatives have been restated to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.

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-retirement benefit schemes and the amounts recognised on the Group's balance sheet after allocation to equity accounted investments.

	2018				2017			
	UK defined benefit pension schemes £m	**US and other pension schemes £m**	**US healthcare schemes £m**	**Total £m**	UK defined benefit pension schemes[1] £m	US and other pension schemes £m	US healthcare schemes £m	Total £m
Present value of unfunded obligations	**(100)**	**(142)**	**–**	**(242)**	(49)	(146)	–	(195)
Present value of funded obligations	**(24,700)**	**(4,782)**	**(165)**	**(29,647)**	(26,071)	(4,803)	(168)	(31,042)
Fair value of scheme assets	**21,246**	**4,213**	**194**	**25,653**	22,332	4,352	199	26,883
Total net IAS 19 (deficit)/surplus	**(3,554)**	**(711)**	**29**	**(4,236)**	(3,788)	(597)	31	(4,354)
Allocated to equity accounted investments	**304**	**–**	**–**	**304**	332	–	–	332
Group's share of net IAS 19 (deficit)/surplus	**(3,250)**	**(711)**	**29**	**(3,932)**	(3,456)	(597)	31	(4,022)
Represented by:								
Retirement benefit surpluses	**219**	**48**	**41**	**308**	209	54	39	302
Retirement benefit obligations	**(3,469)**	**(759)**	**(12)**	**(4,240)**	(3,665)	(651)	(8)	(4,324)
	(3,250)	**(711)**	**29**	**(3,932)**	(3,456)	(597)	31	(4,022)
Group's share of net IAS 19 deficit of equity accounted investments	**(119)**	**–**	**–**	**(119)**	(128)	–	–	(128)

1. Prior year comparatives have been restated to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.

Total cumulative actuarial losses recognised in equity since the transition to IFRS are £4.6bn (2017 £4.7bn).

22. Retirement 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	Total £m
Value of scheme assets at 1 January 2017[1]	21,339	4,313	198	25,850
Interest income	568	169	8	745
Actual return on assets excluding amounts included in interest income[1]	1,030	444	19	1,493
Actual return on assets	1,598	613	27	2,238
Contributions by employer	352	81	2	435
Contributions by employer in respect of employee salary sacrifice arrangements	84	–	–	84
Total contributions by employer	436	81	2	519
Members' contributions	8	–	–	8
Administrative expenses	–	(16)	–	(16)
Foreign exchange translation	–	(394)	(19)	(413)
Benefits paid	(1,049)	(245)	(9)	(1,303)
Value of scheme assets at 31 December 2017[1]	22,332	4,352	199	26,883
Interest income	575	156	7	738
Actual return on assets excluding amounts included in interest income	(1,022)	(422)	(12)	(1,456)
Actual return on assets	(447)	(266)	(5)	(718)
Contributions by employer	423	131	1	555
Contributions by employer in respect of employee salary sacrifice arrangements	80	–	–	80
Total contributions by employer	503	131	1	635
Members' contributions	7	–	–	7
Administrative expenses	(14)	(14)	(1)	(29)
Foreign exchange translation	–	248	12	260
Benefits paid	(1,135)	(238)	(12)	(1,385)
Value of scheme assets at 31 December 2018	**21,246**	**4,213**	**194**	**25,653**

1. Prior year comparatives have been restated to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.

22. Retirement benefits continued

IAS 19 accounting continued

Assets of defined benefit pension schemes

	2018								
	UK[1]			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[2]	3,192	1	3,193	–	–	–	3,192	1	3,193
Overseas	1,882	12	1,894	284	–	284	2,166	12	2,178
Pooled investment vehicles[3]	1,280	3,713	4,993	659	2	661	1,939	3,715	5,654
Fixed interest securities:									
UK gilts	1,500	–	1,500	–	–	–	1,500	–	1,500
UK corporates	1,543	1,949	3,492	–	–	–	1,543	1,949	3,492
Overseas government	47	–	47	19	–	19	66	–	66
Overseas corporates	1,260	43	1,303	3,074	–	3,074	4,334	43	4,377
Index-linked securities:									
UK gilts	2,156	177	2,333	–	–	–	2,156	177	2,333
UK corporates	526	653	1,179	–	–	–	526	653	1,179
Property[4]	–	1,935	1,935	–	125	125	–	2,060	2,060
Derivatives[5]	–	(1,121)	(1,121)	–	–	–	–	(1,121)	(1,121)
Cash:									
Sterling	270	33	303	–	–	–	270	33	303
Foreign currency	10	5	15	49	–	49	59	5	64
Other	46	134	180	–	1	1	46	135	181
Total	**13,712**	**7,534**	**21,246**	**4,085**	**128**	**4,213**	**17,797**	**7,662**	**25,459**

	2017								
	UK[1]			US and other			Total		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities:									
UK[2]	4,453	1	4,454	–	–	–	4,453	1	4,454
Overseas	3,074	287	3,361	346	–	346	3,420	287	3,707
Pooled investment vehicles[3]	1,327	2,269	3,596	797	2	799	2,124	2,271	4,395
Fixed interest securities:									
UK gilts	1,556	25	1,581	–	–	–	1,556	25	1,581
UK corporates	2,214	1,213	3,427	–	–	–	2,214	1,213	3,427
Overseas government	50	–	50	97	–	97	147	–	147
Overseas corporates	1,319	8	1,327	2,953	–	2,953	4,272	8	4,280
Index-linked securities:									
UK gilts	2,164	54	2,218	–	–	–	2,164	54	2,218
UK corporates	928	375	1,303	–	–	–	928	375	1,303
Property[4]	–	1,648	1,648	–	129	129	–	1,777	1,777
Derivatives[5]	–	(1,119)	(1,119)	–	–	–	–	(1,119)	(1,119)
Cash:									
Sterling	221	46	267	–	–	–	221	46	267
Foreign currency	–	3	3	27	–	27	27	3	30
Other	138	78	216	–	1	1	138	79	217
Total	17,444	4,888	22,332	4,220	132	4,352	21,664	5,020	26,684

1. The Main Scheme and two of the Group's smaller UK defined benefit pension schemes participate in a Combined Investment Fund (CIF), covering £13.6bn (2017 £13.6bn) of assets. The purpose of the CIF is to provide economies of scale for the CIF schemes' investment administration.
2. Includes £24m (2017 £33m) of the Company's own ordinary shares.
3. Primarily invested in private markets and exchange traded funds. The amounts classified as unquoted primarily comprise investments in private markets, with the majority held in infrastructure, alternatives and direct funds, valued in accordance with International Private Equity and Venture Capital Valuation Guidelines.
4. Valued on the basis of open market value at the end of the year determined in accordance with the Royal Institution of Chartered Surveyors' Appraisal and Valuation Standards and the Practice Note contained therein. Includes £245m (2017 £243m) of property occupied by Group companies.
5. Includes equity protection options, forward foreign exchange contracts, futures, and interest rate, inflation and longevity swaps. In addition, the total derivative figures shown are net of £479m (2017 £474m) of repurchase agreements. The valuations are based on valuation techniques using underlying market data and discounted cash flows. Prior year comparatives have been restated to correct a prior year error in respect of the accounting valuation of a longevity swap held by one of the Group's defined benefit pension schemes. See note 37 for details regarding the restatement.

22. Retirement benefits continued

IAS 19 accounting continued

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	Total £m
Defined benefit obligations at 1 January 2017	(27,173)	(5,134)	(169)	(32,476)
Current service cost	(254)	(12)	(1)	(267)
Contributions by employer in respect of employee salary sacrifice arrangements	(84)	–	–	(84)
Total current service cost	(338)	(12)	(1)	(351)
Members' contributions	(8)	–	–	(8)
Past service cost – plan amendments	(2)	–	(1)	(3)
Actuarial loss due to changes in financial assumptions	(242)	(291)	(13)	(546)
Actuarial gain due to changes in mortality assumptions	971	24	1	996
Actuarial gain due to changes in other demographic assumptions	202	–	–	202
Experience gains/(losses)	136	(29)	(1)	106
Interest expense	(715)	(201)	(7)	(923)
Foreign exchange translation	–	449	14	463
Benefits paid	1,049	245	9	1,303
Defined benefit obligations at 31 December 2017	(26,120)	(4,949)	(168)	(31,237)
Current service cost	(224)	(12)	(1)	(237)
Contributions by employer in respect of employee salary sacrifice arrangements	(80)	–	–	(80)
Total current service cost	(304)	(12)	(1)	(317)
Members' contributions	(7)	–	–	(7)
Past service cost – plan amendments	(131)	–	–	(131)
Actuarial gain due to changes in financial assumptions	1,295	265	9	1,569
Actuarial gain due to changes in demographic assumptions	171	17	–	188
Experience losses	(176)	(17)	(1)	(194)
Interest expense	(663)	(180)	(6)	(849)
Foreign exchange translation	–	(286)	(10)	(296)
Benefits paid	1,135	238	12	1,385
Defined benefit obligations at 31 December 2018	**(24,800)**	**(4,924)**	**(165)**	**(29,889)**

22. Retirement benefits continued

IAS 19 accounting continued

Amounts recognised in the income statement after allocation to equity accounted investments

	2018				2017			
	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Total £m	UK defined benefit pension schemes £m	US and other pension schemes £m	US healthcare schemes £m	Total £m
Included in operating costs:								
Current service cost	**(201)**	**(12)**	**(1)**	**(214)**	(228)	(12)	(1)	(241)
Past service cost – plan amendments	**(10)**	**–**	**–**	**(10)**	(2)	–	(1)	(3)
	(211)	**(12)**	**(1)**	**(224)**	(230)	(12)	(2)	(244)
Guaranteed Minimum Pension equalisation charge	**(110)**	**–**	**–**	**(110)**	–	–	–	–
Administrative expenses	**(13)**	**(14)**	**(1)**	**(28)**	–	(16)	–	(16)
	(334)	**(26)**	**(2)**	**(362)**	(230)	(28)	(2)	(260)
Included in net finance costs:								
Net interest (expense)/income on retirement benefit obligations	**(80)**	**(24)**	**1**	**(103)**	(134)	(32)	1	(165)
Group defined benefit schemes included in share of results of equity accounted investments:								
Group's share of equity accounted investments' operating costs[1]	**(15)**	**–**	**–**	**(15)**	(12)	–	–	(12)
Group's share of equity accounted investments' finance costs	**(3)**	**–**	**–**	**(3)**	(5)	–	–	(5)

1. The 2018 Group's share of equity accounted investments' operating costs includes £4m relating to the Guaranteed Minimum Pension equalisation charge.

The Group incurred a charge of £203m (2017 £193m) in relation to defined contribution schemes for employees.

22. Retirement 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 2018 and keeping all other assumptions as set out on page 182.

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	(0.2)
0.1 percentage point decrease	(0.5)	0.2
Inflation:		
0.1 percentage point increase	(0.4)	0.2
0.1 percentage point decrease	0.4	(0.2)

1. Before allocation to equity accounted investments.

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

	(Increase)/decrease in pension obligation[1] £bn
Inflation:	
0.5 percentage point increase	(1.3)
0.5 percentage point decrease	1.3
1.0 percentage point increase	(2.8)
1.0 percentage point decrease	2.5

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 181), would have the following effect on the total net IAS 19 deficit:

	(Increase)/decrease in net deficit[1] £bn
Life expectancy:	
One-year increase	(1.1)
One-year decrease	1.1

1. Before allocation to equity accounted investments.

23. 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[1] £m	Other £m	Total £m
Non-current	51	73	281	30	435
Current	51	118	190	41	400
At 1 January 2018 (restated)[1]	102	191	471	71	835
Created	52	8	127	15	202
Utilised	(37)	(53)	(67)	(11)	(168)
Reclassified between categories	–	–	(3)	3	–
Transfer from other balance sheet categories	–	–	14	–	14
Transfer to held for sale	(5)	–	(2)	–	(7)
Released	(11)	(65)	(59)	(15)	(150)
Net present value adjustments	–	–	15	5	20
Foreign exchange adjustments	3	–	10	2	15
At 31 December 2018	**104**	**81**	**506**	**70**	**761**
Represented by:					
Non-current	46	51	294	36	427
Current	58	30	212	34	334
	104	**81**	**506**	**70**	**761**

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

Warranties and after-sales service
Warranty and after-sales service costs are generally incurred 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 costs are generally incurred 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 £46m (2017 £89m) 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 and the timing of the outflows cannot be estimated reliably.

Other
There are no individually significant provisions included within other provisions.

24. 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 2017, 31 December 2017 and 31 December 2018	**3,467**	**87**	**1**	**1**	**87**

Special Share
One Special Share of £1 in the Company is held on behalf of the Secretary of State for Business, Energy and Industrial Strategy (the Special Shareholder). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British citizens. The effect of these requirements can also be amended by regulations made by the directors and approved by the Special Shareholder.

The Special Shareholder may require the Company at any time to redeem the Special Share at par or to convert the Special Share into one ordinary voting share. The Special Shareholder is entitled to receive notice of and to attend general meetings and class meetings of the Company's shareholders, but has no voting right, nor other rights, other than to speak in relation to any business in respect of the Special Share.

Treasury shares
As at 31 December 2018, 271,650,137 (2017 281,232,739) ordinary shares of 2.5p each with an aggregate nominal value of £6,791,253 (2017 £7,030,818) were held in treasury. During 2018, 9,582,602 (2017 10,216,622) 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.

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.

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 June and November 2018.

At 31 December 2018, the ESOP held 2,299,585 (2017 1,680,035) ordinary shares of 2.5p each, with a market value of £11m (2017 £10m). 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 June and November 2018 over shares within the Company's share incentive plan trusts other than those shares owned beneficially by the participants.

Equity dividends

Equity dividends on ordinary share capital are recognised as a liability in the period in which they are declared. The interim dividend is recognised when it has been approved by the Board and the final dividend is recognised when it has been approved by the shareholders at the Annual General Meeting.

	2018 £m	2017 £m
Prior year final 13.0p dividend per ordinary share paid in the year (2017 12.7p)	**415**	404
Interim 9.0p dividend per ordinary share paid in the year (2017 8.8p)	**288**	280
	703	684

After the balance sheet date, the directors proposed a final dividend of 13.2p per ordinary share. The dividend, which is subject to shareholder approval, will be paid on 3 June 2019 to shareholders registered on 23 April 2019. The ex-dividend date is 18 April 2019.

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 10 May 2019.

24. Share capital and other reserves continued

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 2017	4,589	202	10	3	10	1,871	6,685
Subsidiaries:							
Currency translation on foreign currency net investments (restated)[1]	–	–	–	–	–	(625)	(625)
Amounts credited to hedging reserve	–	–	–	–	59	–	59
Tax on other comprehensive income	–	–	–	–	(11)	–	(11)
Equity accounted investments, net of tax (restated)[1]	–	–	–	–	1	(19)	(18)
At 1 January 2018[1]	4,589	202	10	3	59	1,227	6,090
Subsidiaries:							
Currency translation on foreign currency net investments	–	–	–	–	–	396	396
Amounts charged to hedging reserve	–	–	–	–	(25)	–	(25)
Tax on other comprehensive income	–	–	–	–	5	–	5
Equity accounted investments, net of tax	–	–	–	–	(1)	16	15
At 31 December 2018	**4,589**	**202**	**10**	**3**	**38**	**1,639**	**6,481**

1. Prior year comparatives have been restated upon the Group's adoption of IFRS 15 Revenue from Contracts with Customers. See note 37 for details regarding the restatement.

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 2018, the Group's capital was £5,580m (2017 £4,696m), which comprises total equity of £5,618m (2017 £4,755m), excluding amounts accumulated in equity relating to cash flow hedges of £38m (2017 £59m). Net debt was £904m (2017 £752m).

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;
- pursuing 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.

25. Operating business cash flow

Key Performance Indicator – Operating business cash flow
Definition Net cash flow from operating activities excluding taxation and including net capital expenditure, financial investment and dividends from equity accounted investments.

Purpose Allows management to monitor the operational cash generation of the Group.

Taxation is excluded because it is not relevant to the pre-tax operational cash generation of the Group.

Net capital expenditure and financial investment are included as a measure of the investment in the business to support the operational performance of the Group.

Dividends received from equity accounted investments are included as a measure of the operating cash generation of the Group's equity accounted investments.

Reconciliation of net cash flow from operating activities to operating business cash flow

	2018 £m	2017 £m
Net cash flow from operating activities	**1,200**	1,897
Add back Taxation paid	**200**	227
Purchase of property, plant and equipment, and investment property	**(358)**	(389)
Purchase of intangible assets	**(139)**	(87)
Proceeds from sale of property, plant and equipment, and investment property	**34**	34
Proceeds from sale of intangible assets	**–**	1
Equity accounted investment funding	**(1)**	(3)
Net capital expenditure and financial investment	**(464)**	(444)
Dividends received from equity accounted investments	**57**	72
Operating business cash flow	**993**	1,752

Reconciliation of operating business cash flow to net cash flow from operating activities by reporting segment[1]

	Operating business cash flow		Deduct Dividends received from equity accounted investments		Add back Net capital expenditure and financial investment		Net cash flow from operating activities	
	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m
Electronic Systems	**431**	450	**(7)**	(3)	**151**	122	**575**	569
Cyber & Intelligence	**85**	116	**–**	–	**11**	11	**96**	127
Platforms & Services (US)	**(30)**	222	**(7)**	(8)	**68**	72	**31**	286
Air	**666**	832	**(36)**	(57)	**89**	113	**719**	888
Maritime	**67**	278	**(3)**	(4)	**126**	122	**190**	396
HQ	**(226)**	(146)	**(4)**	–	**19**	4	**(211)**	(142)
	993	1,752	**(57)**	(72)	**464**	444	**1,400**	2,124
Taxation paid[2]							**(200)**	(227)
Net cash flow from operating activities							**1,200**	1,897

1. Reporting segments have been re-presented to reflect the organisational changes which took effect on 1 January 2018.
2. Taxation is managed on a Group-wide basis.

26. Movement in assets and liabilities arising from financing activities

	As at 1 January 2017 £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 2017 £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 2018 £m
Non-current assets									
Other financial assets[1]	**207**	–	–	(128)	**79**	–	–	41	**120**
Current assets									
Other financial assets[1]	**53**	(164)	–	123	**12**	(112)	–	187	**87**
	260	(164)	–	(5)	**91**	(112)	–	228	**207**
Non-current liabilities									
Loans	**(4,425)**	–	350	6	**(4,069)**	–	(229)	784	**(3,514)**
Other financial liabilities[1]	**–**	6	–	(25)	**(19)**	–	–	10	**(9)**
Cash collateral[2]	**(32)**	15	–	–	**(17)**	(2)	–	–	**(19)**
Current liabilities									
Loans	**–**	–	–	(7)	**(7)**	7	–	(785)	**(785)**
Other financial liabilities[1]	**(28)**	241	–	(269)	**(56)**	106	–	(61)	**(11)**
	(4,485)	262	350	(295)	**(4,168)**	111	(229)	(52)	**(4,338)**
		98				**(1)**			
Interest paid		204				203			
Net purchase/(sale) of own shares		1				(1)			
Equity dividends paid		684				703			
Dividends paid to non-controlling interests		8				28			
Net cash flow from financing activities		**995**				**932**			

1. Excluding cash flow hedges, for which the cash flow is reported within cash flow from operating activities.
2. Reported in other payables.

27. Net debt

Key Performance Indicator – Net debt
Definition Cash and cash equivalents, less loans and overdrafts (including debt-related derivative financial instruments).

Purpose Allows management to monitor the indebtedness of the Group.

Components of net debt

	Notes	2018 £m	2017 £m
Cash and cash equivalents	17	**3,232**	3,271
Debt-related derivative financial instrument assets – non-current	13	**87**	79
Debt-related derivative financial instrument assets – current	13	**78**	–
Loans – non-current	20	**(3,514)**	(4,069)
Loans and overdrafts – current	20	**(785)**	(14)
Debt-related derivative financial instrument liabilities – current	13	**(2)**	(19)
Net debt		**(904)**	(752)

28. Fair value measurement

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

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

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

- the fair values of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates;
- the fair values of both interest rate and cross-currency swaps are calculated by discounting expected future principal and interest cash flows and translating at the appropriate balance sheet rates; and
- the fair values of money market funds are calculated by multiplying the net asset value per share by the investment held at the balance sheet date.

Due to the variability of the valuation factors, the fair values presented at 31 December may not be indicative of the amounts the Group would expect to realise in the current market environment.

Fair value hierarchy
The fair value measurement hierarchy is as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

Carrying amounts and fair values of certain financial instruments

		2018		2017	
	Notes	**Carrying amount £m**	**Fair value £m**	Carrying amount £m	Fair value £m
Financial instruments measured at fair value:					
Non-current					
Available for sale		**–**	**–**	6	6
Equity investments at fair value through profit and loss		**13**	**13**	–	–
Other financial assets	13	**245**	**245**	226	226
Other financial liabilities	13	**(104)**	**(104)**	(133)	(133)
Current					
Other financial assets	13	**166**	**166**	89	89
Money market funds	17	**908**	**908**	899	899
Other financial liabilities	13	**(74)**	**(74)**	(104)	(104)
Financial instruments not measured at fair value:					
Non-current					
Loans[1]	20	**(3,514)**	**(3,597)**	(4,069)	(4,478)
Current					
Cash and cash equivalents (excluding money market funds)	17	**2,324**	**2,324**	2,372	2,372
Loans and overdrafts	20	**(785)**	**(794)**	(14)	(14)

1. US$500m of the US$800m 3.8% bond, repayable 2024, has been converted to a floating rate bond by utilising interest rate swaps. These derivatives have been designated as fair value hedges. Changes in the fair value of the bond attributable to interest rate risk, and gains and losses on the derivatives are recognised in the income statement. The bond has been included in financial instruments not measured at fair value because its carrying value has only been adjusted for the fair value attributable to interest rate risk on a portion of the bond, which has been calculated by discounting the future cash flows and translating at the appropriate balance sheet rate.

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, most of which are held at amortised cost. The fair value of loans presented in the table above is derived from market prices.

29. Financial risk management

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% (2017 50%) and a maximum of 90% (2017 90%) of gross debt is maintained at fixed interest rates. At 31 December 2018, the Group had 81% (2017 82%) of fixed rate debt and 19% (2017 18%) of floating rate debt based on a gross debt of £4.1bn, including debt-related derivative financial assets (2017 £4.0bn).

The only derivatives that have been designated as fair value hedges are the fixed-to-floating interest rate swaps converting US$500m of the US$800m 3.8% bond, repayable 2024. These derivative liabilities have a fair value of £2m (2017 £nil) and will mature in October 2019. Changes in the fair value of the bond attributable to interest rate risk, and gains and losses on the derivatives are recognised in the income statement.

The loss arising in the income statement on fair value hedging instruments was £2m (2017 £4m). The gain arising in the income statement on the fair value of the underlying hedged item was £1m (2017 £4m). The accumulated fair value loss included within the carrying amount of the hedged item is £nil (2017 £1m).

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	3,232	–	–
Loans and overdrafts	(784)	(702)	(702)

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 2018, the Group had a total of $1.0bn (2017 $1.0bn) of this type of swap outstanding with a weighted average duration of 5.8 years (2017 5.6 years). In respect of the fixed rate debt, the weighted average period in respect of which interest is fixed was 8.5 years (2017 9.5 years). Given the level of short-term interest rates during the year, the average cost of the floating rate debt was 5.5% (2017 4.6%) on US dollars. The cost of the fixed rate debt was 4.8% (2017 4.9%).

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 (2017 £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 £20m (2017 £14m).

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 2018					31 December 2017				
		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	**(4,299)**	**(971)**	**(1,742)**	**(3,301)**	**(6,014)**	(4,083)	(213)	(2,474)	(3,217)	(5,904)
Cash flow hedges – financial assets	**204**	**(3,754)**	**(2,722)**	**(376)**	**(6,852)**	224	(2,582)	(2,121)	(118)	(4,821)
Cash flow hedges – financial liabilities	**(158)**	**(3,897)**	**(3,253)**	**(345)**	**(7,495)**	(162)	(2,681)	(2,166)	(106)	(4,953)
Other foreign exchange/interest rate contracts – financial assets	**42**	**(756)**	**–**	**–**	**(756)**	12	(619)	(1)	–	(620)
Other foreign exchange/interest rate contracts – financial liabilities	**(18)**	**(816)**	**(154)**	**(36)**	**(1,006)**	(56)	(1,458)	(102)	(54)	(1,614)
Debt-related derivatives – financial assets	**165**	**(1,109)**	**(93)**	**(393)**	**(1,595)**	79	(38)	(793)	(416)	(1,247)
Debt-related derivatives – financial liabilities	**(2)**	**(14)**	**–**	**–**	**(14)**	(19)	(399)	(8)	–	(407)
Other financial assets and liabilities	**233**					78				

Contractual cash outflows in respect of all other financial liabilities are equal to the balance sheet carrying amount. Current contractual amounts relating to other non-derivative financial liabilities, such as trade payables, are settled within the normal operating cycle of the business (within one year for current liabilities and within two years for the majority of non-current liabilities).

29. Financial risk management continued

Borrowing facilities

The Group's objective is to maintain adequate undrawn committed borrowing facilities.

At 31 December 2018, the Group had a committed Revolving Credit Facility (RCF) of £2bn (2017 £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 2018, the Group had no Commercial Paper in issue (2017 £nil).

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 strong credit ratings for short periods. The cash and cash equivalents balance at 31 December 2018 of £3,232m (2017 £3,271m) was invested with 31 (2017 33) 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.

Currency risk

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

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

The currency and notional amount of the designated hedging instruments match the currency and principal amounts of the forecast transactions being hedged, therefore the hedging instruments and hedged items have values which will generally move in opposite directions because of the same hedged risk. As the critical terms of the hedging instruments match those of the hedged items, an economic relationship can be demonstrated on an ongoing basis.

The hedge ratio is 1:1 on the basis that the notional amount of the designated hedging instruments matches the principal amount of the forecast foreign currency sales/purchases designated as the hedged items.

The Group considers the potential sources of hedge ineffectiveness to be:

– valuation adjustments for credit risk made to derivative hedging instruments at each hedge effectiveness measurement date;
– foreign currency basis inherent in the ongoing re-pricing of designated foreign currency derivative hedging instruments which are not present in the ongoing re-pricing of the hedged items;
– changes in the timing of the designated hedged items;
– non-occurrence of the designated hedged items.

The effect of cash flow hedges on the Group's financial position and performance for the year ended 31 December 2018 is as follows:

	Weighted average hedged rate	Change in the value of hedging instruments since 1 January £m	Change in the value of hedged items since 1 January £m	Notional amount £m
Purchase/(sale) contracts:				
Sterling/US dollar	**1.37**	**25**	**(25)**	**(872)**
Sterling/euro	**1.17**	**6**	**(6)**	**(475)**
Other		**(17)**	**17**	**(35)**
Cash flow hedges – foreign exchange contracts		**14**	**(14)**	**(1,382)**

The Notional amount is the sterling equivalent of the net currency amount purchased or sold. For example, for designated sterling/US dollar cash flow hedges, the Group has purchased a net $1,195m at a weighted average rate of 1.37 costing £872m.

The hedged, highly probable forecast transactions denominated in foreign currency are predominantly expected to occur at various stages during the next five years.

Amounts charged to the hedging reserve in respect of cash flow hedges were £25m (2017 £61m), including a £39m charge (2017 £24m credit) on reclassification to profit and loss, and a £14m credit (2017 £37m credit) on contracts held at 31 December 2018.

Additional information on the Group's derivative financial instruments is provided in note 13.

29. Financial risk management continued

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 £56m (2017 £49m).

Credit risk

For trade receivables, contract receivables and amounts due from equity accounted investments, 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 sub-contractors 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, 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 objective evidence that individual receivables in this category are recoverable.

Excluding the UK, US and Saudi Arabian governments where credit risk is not considered an issue, no one counterparty constitutes more than 7% of the trade receivables balance (2017 2%).

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:

	2018 £m	2017 £m
At 1 January	**35**	40
Net remeasurement of loss allowance	**(3)**	(3)
Amounts written off	**(2)**	(1)
Foreign exchange gains and losses	**–**	(1)
At 31 December	**30**	35

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

The Group writes off a trade 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. 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:

	2018			2017		
	Gross £m	**Provision £m**	**Net £m**	Gross £m	Provision £m	Net £m
Not past due	**873**	**–**	**873**	1,119	–	1,119
Up to 180 days overdue	**304**	**–**	**304**	369	–	369
Past 180 days overdue	**280**	**(30)**	**250**	211	(35)	176
	1,457	**(30)**	**1,427**	1,699	(35)	1,664

Trade receivables past 180 days overdue primarily relate to contracts in Saudi Arabia. The Group has assessed the risk of default and recoverability of these receivables at the balance sheet date and the expected credit losses in respect of these balances are not considered to be material.

Offsetting financial assets and liabilities

		2018					2017				
	Notes	**Gross balances[1] £m**	**Amounts offset[2] £m**	**Balance sheet[3] £m**	**Amounts not offset[4] £m**	**Net balances[5] £m**	Gross balances[1] £m	Amounts offset[2] £m	Balance sheet[3] £m	Amounts not offset[4] £m	Net balances[5] £m
Assets											
Cash and cash equivalents	17	**3,244**	**(12)**	**3,232**	**–**	**3,232**	3,287	(16)	3,271	–	3,271
Other financial assets	13	**411**	**–**	**411**	**(172)**	**239**	315	–	315	(204)	111
Liabilities											
Overdrafts	20	**(12)**	**12**	**–**	**–**	**–**	(23)	16	(7)	–	(7)
Other financial liabilities	13	**(178)**	**–**	**(178)**	**153**	**(25)**	(237)	–	(237)	187	(50)

1. The gross amounts of the recognised financial assets and liabilities.
2. The amounts offset in accordance with paragraph 42 of IAS 32.
3. The net balances presented in the Consolidated balance sheet.
4. The amounts subject to a master netting arrangement not offset in the Consolidated balance sheet in accordance with paragraph 42 of IAS 32. Includes £153m (2017 £187m) in respect of recognised financial instruments and £19m (2017 £17m) in respect of cash collateral.
5. The net balances after deducting the amounts in (4) from (3).

30. 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 97 to 115.

Expense in year

	2018 £m	2017 £m
Executive Share Option Plan	**7**	6
Performance Share Plan	**13**	12
Restricted Share Plan	**7**	6
	27	24

The Group also incurred a charge of £36m (2017 £37m) in respect of the equity-settled all-employee Free Shares and Matching Partnership Shares elements of the Share Incentive Plan.

Executive Share Option Plan

	2018		2017	
	Number of shares '000	Weighted average exercise price £	Number of shares '000	Weighted average exercise price £
Outstanding at the beginning of the year	**32,907**	**5.28**	34,315	4.59
Granted during the year	**8,971**	**5.83**	9,816	6.48
Exercised during the year	**(3,174)**	**4.74**	(7,491)	3.92
Expired during the year	**(2,540)**	**5.60**	(3,733)	4.86
Outstanding at the end of the year	**36,164**	**5.44**	32,907	5.28
Exercisable at the end of the year	**9,482**	**4.52**	5,835	3.81

	2018	2017
Range of exercise price of outstanding options (£)	**3.01 – 6.49**	3.01 – 6.49
Weighted average remaining contracted life (years)	**7**	8
Weighted average fair value of options granted (£)	**0.86**	0.88

Performance Share Plan and Restricted Share Plan

	Performance Share Plan		Restricted Share Plan	
	2018 Number of shares '000	2017 Number of shares '000	2018 Number of shares '000	2017 Number of shares '000
Outstanding at the beginning of the year	**20,758**	22,992	**3,769**	3,328
Granted during the year	**7,851**	6,979	**1,540**	1,463
Exercised during the year	**(965)**	(456)	**(1,012)**	(766)
Expired during the year	**(5,264)**	(8,757)	**(197)**	(256)
Outstanding at the end of the year	**22,380**	20,758	**4,100**	3,769
Exercisable at the end of the year	**250**	38	**–**	–

	2018	2017	2018	2017
Weighted average remaining contracted life (years)	**5**	5	**5**	5
Weighted average fair value of awards granted (£)	**4.63**	5.36	**5.83**	6.49

The exercise price for the Performance Share Plan and Restricted Share Plan is £nil (2017 £nil).

30. 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

	2018	2017
Range of share price at date of grant (£)	**5.82 – 6.07**	6.05 – 6.49
Expected option/award life (years)	**3 – 10**	3 – 10
Volatility (%)	**19**	19
Risk free interest rate (%)	**0.8**	0.2

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 £5.89 (2017 £6.11).

31. Related party transactions

The Group has a related party relationship with its directors and key management personnel (see below), equity accounted investments (note 11) and pension schemes (note 22).

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	**2018 £m**	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Advanced Electronics Company Limited	**38**	86	**166**	158	**18**	24	**24**	5	**–**	–
CTA International SAS	**1**	8	**–**	–	**–**	3	**15**	–	**–**	–
Eurofighter Jagdflugzeug GmbH	**1,028**	1,004	**–**	–	**37**	47	**52**	49	**–**	–
FADEC International LLC	**101**	95	**–**	–	**–**	–	**–**	–	**–**	–
FAST Training Services Limited	**2**	2	**–**	–	**–**	–	**–**	–	**–**	–
MBDA SAS	**23**	28	**199**	199	**8**	9	**864**	873	**18**	16
Panavia Aircraft GmbH	**32**	48	**26**	51	**4**	3	**–**	–	**–**	–
Reaction Engines Limited	**1**	–	**–**	–	**–**	–	**–**	–	**–**	–
BAE Systems Pensions Trust Limited[2]	**–**	–	**19**	17	**4**	4	**10**	11	**–**	–
	1,226	1,271	**410**	425	**71**	90	**965**	938	**18**	16

1. Also relates to disclosures under IAS 24 Related Party Disclosures, for the parent company, BAE Systems plc. At 31 December 2018, £869m (2017 £884m) was owed by BAE Systems plc and £96m (2017 £54m) by other Group subsidiaries.
2. Transactions with BAE Systems Pensions Trust Limited represent lease arrangements for land and buildings leased by the Group.

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 97 to 115. Total emoluments for directors and key management personnel charged to the Consolidated income statement were:

	2018 £'000	2017 £'000
Short-term employee benefits	**15,140**	16,878
Post-employment benefits	**1,127**	1,661
Share-based payments	**6,578**	5,123
	22,845	23,662

32. 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 23).

The Group has no individually significant contingent liabilities.

33. Commitments

Operating lease commitments
The Group leases land, buildings, vehicles and equipment under non-cancellable operating lease agreements. 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.

The future aggregate minimum lease payments under non-cancellable operating leases and associated future minimum sublease income are as follows:

	2018 £m	2017 £m
Payments due:		
Not later than one year	**281**	251
Later than one year and not later than five years	**891**	769
Later than five years	**534**	626
	1,706	1,646
Total of future minimum sublease income under non-cancellable subleases	**93**	101

Capital commitments
Capital expenditure contracted for but not provided for in the accounts is as follows:

	2018 £m	2017 £m
Property, plant and equipment, and investment property[1]	**253**	310
Intangible assets	**21**	18
	274	328

1. Includes £83m (2017 £100m) at Barrow-in-Furness, UK, relating to the Dreadnought submarine programme funded by the UK government.

34. Acquisition of subsidiary

On 14 December 2018, the Group acquired 100% of the issued share capital of ASC Shipbuilding Pty (ASCS) for consideration of A$1. Following the acquisition, ASCS was awarded the contract for the Australian Hunter Class Future Frigate programme.

The Group has determined that it controls ASCS; therefore the acquisition has been accounted for as a business combination and its results and financial position have been consolidated from the date of acquisition.

The provisionally determined fair values of the assets and liabilities of ASCS at the date of acquisition are as follows:

	£m
Cash and cash equivalents	14
Trade and other receivables	1
Trade and other payables	(15)
Net identifiable assets acquired	–
Goodwill arising	–
Net assets acquired	**–**

Acquisition-related costs of £1m have been included in operating expenses in the Consolidated income statement in the year ending 31 December 2018.

ASCS contributed £1m to the Group's revenue and £nil to the Group's operating profit between the date of acquisition and the balance sheet date.

If ASCS had been acquired on 1 January 2018, the Group's revenue and operating profit would have been £16,904m and £1,604m, respectively, for the year ending 31 December 2018.

35. 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 2018 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
Lupin Way, Alvington, Yeovil, Somerset BA22 8UZ, United Kingdom

Alvis Limited

Alvis Pension Scheme Trustees Limited

Alvis Vickers Limited

Armstrong Whitworth Aircraft Limited[2]

ASC Shipbuilding Pty Limited
Level 2, 80 Flinders Street, Adelaide SA 5000, Australia

Australian Marine Engineering Corporation (Finance) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Avro International Aerospace Limited[2]

BAE Systems (Al Diriyah C4i) Limited[2]

BAE Systems (Aviation Services) Limited

BAE Systems (Canada) Inc.
220 Laurier Avenue West, Suite 1200, Ottawa ON K1P 5Z9, Canada

BAE Systems (Combat and Radar Systems) Limited
4th Floor, St. Paul's Gate, 22-24 New Street, St. Helier JE1 4TR, Jersey

BAE Systems (Consultancy Services) Limited

BAE Systems (Corporate Air Travel) Limited

BAE Systems (CS&SI – Qatar) Limited[2]

BAE Systems (Defence Systems) Limited

BAE Systems (Dynamics) Limited

BAE Systems (Farnborough 1) Limited

BAE Systems (Farnborough 2) Limited

BAE Systems (Farnborough 3) Limited

BAE Systems (Finance) Limited

BAE Systems (Funding Three) Limited

BAE Systems (Funding Two) Limited

BAE Systems (Gripen Overseas) Limited

BAE Systems (Hawk Synthetic Training) Limited

BAE Systems (Holdings) Limited[2]

BAE Systems (Insurance) Limited

BAE Systems (International) Limited

BAE Systems (Kazakhstan) Limited

BAE Systems (Land and Sea Systems) Limited[3]

BAE Systems (Malaysia) Sdn Bhd
16th Floor, Wisma Sime Darby, Jalan Raja Laut, 50350 Kuala Lumpur, Malaysia

BAE Systems (MEH) Limited

BAE Systems (Military Air) Overseas Limited

BAE Systems (Nominees) Limited[2]

BAE Systems (Oman) Limited

BAE Systems (Operations) Limited[4]

BAE Systems (Operations) Singapore Pte Limited
One Marina Boulevard #28-00, Singapore 018989, Singapore

BAE Systems (Overseas Holdings) Limited

BAE Systems (Poland) Sp. z o.o.
ul. Abp. A. Baraniaka 88, 61-131 Poznan, Poland

BAE Systems (Projects) Limited

BAE Systems (Property Investments) Limited

BAE Systems (Vehicles and Equipment) Limited

BAE Systems 2000 Pension Plan Trustees Limited[2]

BAE Systems AB[5]
Box 5676, SE-114 86 Stockholm, Sweden

BAE Systems Al Diriyah Programme Limited[2]

BAE Systems Applied Intelligence (Asia Pacific) Pte Limited
United Square, 101 Thomson Road, #25-03/04, 307591, Singapore

BAE Systems Applied Intelligence (Australia) Pty Limited
Level 12, 16-20 Bridge Street, Sydney NSW 2000, Australia

BAE Systems Applied Intelligence (Belgium) NV
Geldenaaksebaan 329, B-3001, Heverlee, Leuven, Belgium

BAE Systems Applied Intelligence (Connect) A/S
c/o Kromann Reumert, Sundkrogsgade 5, Copenhagen East, 2100, Denmark

BAE Systems Applied Intelligence (GCS) Limited
Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (Germany) GmbH
Mainzer Landstrasse 50, 60325 Frankfurt am Main, Germany

BAE Systems Applied Intelligence (Integration) Limited
Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (International) Limited
Priestley Road, Surrey Research Park, Guildford, Surrey GU2 7YP, United Kingdom

BAE Systems Applied Intelligence (Ireland) Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

BAE Systems Applied Intelligence (Japan) KK
12/F Ark Mori Building, 1-12-32 Akasaka, Minato-ku, Tokyo, Japan 107-6024

BAE Systems Applied Intelligence (Luxembourg) SARL
412F Route d'Esch, L-2086, Luxembourg

BAE Systems Applied Intelligence (Spain) S.A.
Paseo de la Castellana, 141, Cuzco IV, 28046 Madrid, Spain

BAE Systems Applied Intelligence (UK) Limited

BAE Systems Applied Intelligence A/S
c/o Kromann Reumert, Sundkrogsgade 5, Copenhagen East, 2100, Denmark

BAE Systems Applied Intelligence Canada Inc.
1959 Upper Water Street, Suite 900, Halifax NS B3J 2X2, Canada

BAE Systems Applied Intelligence France SAS
19 Boulevard Malesherbes, 75008, Paris, France

BAE Systems Applied Intelligence GCS Inc.[6]
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

BAE Systems Applied Intelligence Inc.[7]
5th Floor, Suite 1920, 256 Franklin Street, Boston MA 02110, 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 Applied Intelligence US Corp[6]
440 Wheelers Farms Road, Suite 202, Milford CT 06461, United States

BAE Systems Australia (Electronic Systems) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (NSW) Holdings Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (NSW) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia (Singapore) Pte Limited[8]
60 Paya Lebar Road, #08-43 Paya Lebar Square, 409051, Singapore

BAE Systems Australia Datagate Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Defence Holdings Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Defence Pty Limited[9]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Holdings Limited[2]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Logistics Pty Limited[4]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Australia Sea Sentinel Project Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Avionics Singapore Pte Limited
One Marina Boulevard, #28-00, Singapore 018989, Singapore

BAE Systems Bofors AB
SE-691 80 Karlskoga, Sweden

BAE Systems Bofors Holdings Sdn Bhd
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia

BAE Systems C-ITS AB
Box 5676, SE-114 86 Stockholm, Sweden

BAE Systems China (Exports) Limited

BAE Systems Communications Limited[2]

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.[7]
1098 Clark Street, Endicott NY 13760, United States

BAE Systems Creole Inc.[10]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Datagate Holdings Limited

BAE Systems Datagate Limited

BAE Systems Deployed Systems Limited[11]

BAE Systems Display Technologies Limited

BAE Systems do Brasil Ltda
SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil

BAE Systems Electronic Systems (Overseas) Limited

BAE Systems Electronics Limited

BAE Systems Enterprises Limited

BAE Systems Executive Pension Scheme Trustees Limited[2]

35. Information about related undertakings continued

Subsidiaries – wholly-owned continued

BAE Systems Finance (Ireland) Unlimited Company[12]
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

BAE Systems Finance B.V.
c/o SGG Netherlands N.V., Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

BAE Systems Finance Inc.[6]
1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States

BAE Systems Flight Training (Australia) Pty Limited[4]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

BAE Systems Funds Management[2,12]

BAE Systems Global Combat Systems Bridging Limited

BAE Systems Global Combat Systems Limited

BAE Systems Global Combat Systems Munitions Limited

BAE Systems Hägglunds AB
SE-691 80, Karlskoga, Sweden

BAE Systems Hawaii Shipyards Inc.[6]
3049 Ualena Street, Suite 915, Honolulu HI 96819, United States

BAE Systems Holding GmbH[13]
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 SGG Netherlands N.V., Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

BAE Systems Holdings Inc.[7]
1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States

BAE Systems Holdings International LLC[1]
1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States

BAE Systems IAP Research, Inc.[6]
CT Corporation System, 4400 Easton Commons Way, Ste 125, Columbus OH 43219, United States

BAE Systems Imaging Solutions Inc.[7]
1841 Zanker Road, Suite 50, San Jose CA 95112, United States

BAE Systems India (Homeland Security) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Services) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Technology) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems India (Ventures) Private Limited[14]
#201, 2nd Floor, World Mark 2, Asset No. 8, Aerocity, NH-8, New Delhi – 110037, India

BAE Systems Information and Electronic Systems Integration Inc.[2]
65 Spit Brook Road, Nashua NH 03061, United States

BAE Systems Insurance (Isle of Man) Limited
Tower House, Loch Promenade, Douglas, IM1 2LZ, Isle of Man, United Kingdom

BAE Systems Integrated System Technologies (KSA) Limited

BAE Systems Integrated System Technologies (Overseas) Limited

BAE Systems Integrated System Technologies GmbH[15]
Hans-Stießberger-Str. 2b, 85540 Haar, Germany

BAE Systems Integrated System Technologies Limited

BAE Systems International Inc.[7]
1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States

BAE Systems Jacksonville Ship Repair LLC[1]
8500 Heckscher Drive, Jacksonville FL 32226, United States

BAE Systems Land & Armaments Holdings LLC[6]
2000 North 15th Street, 11th Floor, Arlington VA 22201, United States

BAE Systems Land & Armaments Inc.[6]
2000 North 15th Street, 11th Floor, Arlington VA 22201, United States

BAE Systems Land & Armaments L.P.[1]
2000 North 15th Street, 11th Floor, Arlington VA 22201, United States

BAE Systems Land Systems (Finance) Limited

BAE Systems Land Systems (Investments South Africa) Limited

BAE Systems Land Systems (Investments) Limited

BAE Systems Land Systems (Logistics) Limited

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.[10]
1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States

BAE Systems Land Systems Pinzgauer (Holdings) Limited

BAE Systems Land Systems Pinzgauer Limited

BAE Systems Logistica Ltda
SCN Quadra 5 Bloco A, Ed. Brasilia Shopping, Torre Norte, Sala 426, Brasilia, DF CEP:70715-900, Brazil

BAE Systems MAI Turkey Hava Sistemleri A.Ş
Kizilimak Mahallesi, 1445. Sok No: 2, The Paragon B Blok K: 23, iç Kapi No: 113 Çukurambar, Çankaya, Ankara, Turkey

BAE Systems Marine (Holdings) Limited

BAE Systems Marine (YSL) Limited

BAE Systems Marine Limited

BAE Systems Norfolk Ship Repair Inc.[6]
750 West Berkley Avenue, Norfolk VA 23523, United States

BAE Systems Oman LLC[1]
PO Box 74, Postal Code 111, Seeb, Oman

BAE Systems Ordnance Systems Inc.[6]
4509 West Stone Drive, Kingsport TN 37660-9982, United States

BAE Systems Overseas Inc.[6]
1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States

BAE Systems Pension Funds CIF Trustees Limited[2]

BAE Systems Pension Funds Investment Management Limited[2,16]

BAE Systems Pension Funds Trustees Limited[2]

BAE Systems Project Services Limited

BAE Systems Projects (Canada) Limited

BAE Systems Properties Limited

BAE Systems Quest Limited[2]

BAE Systems Regional Aircraft (Japan) KK[6]
Minami Azabu T&F Building 8th Floor, 4-11-22 Minami Azabu, Minato-ku, Tokyo, Japan

BAE Systems Regional Aircraft Colombia SAS
c/o Brigard & Urrutia, Calle 70 A No. 4-41, Bogota, Colombia

BAE Systems Resolution Inc.[10]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Rokar International Limited
PO Box 45059, 11 Hartom Street, Mount Hotzvim, 91450 Jerusalem, Israel

BAE Systems S&S Operations Inc.[6]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems San Diego Ship Repair Inc.[6]
2205 East Belt Street, Foot of Sampson Street, San Diego CA 92113, United States

BAE Systems Saudi America Limited
Business Gate Building 7, Floor 1, Riyadh 11482, Saudi Arabia

BAE Systems Saudi Arabia (Maintenance and Equipment Services) Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

BAE Systems Saudi Arabia (Vehicles and Equipment Holdings) Limited[2]

BAE Systems Saudi Arabia (Vehicles and Equipment Nominees) Limited[2]

BAE Systems Saudi Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

BAE Systems Serviços de Aviônicos Ltda.
Rua Boa Vista, No. 254, 13th Floor, Suite 15, Centro, São Paulo, São Paulo 01014-907, Brazil

BAE Systems Share Plans Trustee Limited[2]

BAE Systems Shared Services (Overseas) Limited

BAE Systems Shared Services Inc.[6]
11215 Rushmore Drive, Charlotte NC 28277, United States

BAE Systems Ship Repair Inc.[6]
750 West Berkley Ave., Norfolk VA 23523, United States

BAE Systems Southeast Shipyards AMHC Inc.[1,6]
8500 Heckscher Drive, Jacksonville FL 32226, United States

BAE Systems Surface Ships (Holdings) Limited

BAE Systems Surface Ships (Overseas) Limited

BAE Systems Surface Ships (Projects) Limited

BAE Systems Surface Ships Integrated Support Limited

BAE Systems Surface Ships Intermediate Holdings Limited

BAE Systems Surface Ships International Limited[5]

BAE Systems Surface Ships Limited

BAE Systems Surface Ships Maritime Limited

BAE Systems Surface Ships Portsmouth Limited[5]

BAE Systems Surface Ships Projects (Malaysia) Sdn Bhd
Level 14, West Block, Wisma Golden Eagle Realty, 142-C, Jalan Ampang, 50450 Kuala Lumpur, Malaysia

BAE Systems Surface Ships Property Services Limited

BAE Systems Surface Ships Support Limited[4]

BAE Systems SWS Defence AB
SE-691 80 Karlskoga, Sweden

BAE Systems Tactical Vehicle Systems LP[1]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Technology Solutions & Services Inc.[6]
520 Gaither Road, Rockville, MD 20850, United States

BAE Systems Training Services Limited

BAE Systems TVS Holdings Inc.[6]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems TVS Holdings LLC[1]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems TVS Inc.[10]
3701 Outlet Ctr. Drive, Suite 15, Sealy TX 77474-4904, United States

BAE Systems Zephyr Corporation[7]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Fifth Corporation[7]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Fourth Corporation[7]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Second Corporation[7]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems Zephyr Third Corporation[7]
c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle DE 19801, United States

BAE Systems, Inc.[6]
1101 Wilson Blvd, Ste 2000, Arlington VA 22209, United States

35. Information about related undertakings continued

Subsidiaries – wholly-owned continued

Brabazon Limited

British Aerospace (Far East) Limited[17]
Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong

British Aerospace (Malaysia) Sdn Bhd[17]
Unit 30-01, Level 30, Tower A, Vertical Business Suite, Avenue 3, Bangsar South, No.8, Jalan Kerinchi, 59200 Kuala Lumpur, Malaysia

British Aircraft Corporation (Pension Fund Trustees) Limited[2]

British Aircraft Corporation Limited[2]

Buckfield Properties Limited

Cashhold Limited[2,4]

CPS International, Inc.[10]
c/o Benedetti & Benedetti, Comosa Building, 21st Floor, Ave. Samuel Lewis, PO Box 850120, Panama 5, Panama

Creole (Nigeria) Limited[4]
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[5]
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Mexico S. de R.L. de C.V.
Torre Esmeralda II, Blvd Manuel Avila Camacho No. 36 Piso 18, Lomas de Chapultepec, 11000 D.F., Mexico

Detica Patent Limited
Level 5, Block 4, Dundrum Town Centre, Sandyford Road, Dundrum, Dublin 16, D16 A4W6, Ireland

Detica Services, Inc.
5th Floor, Suite 1920, 256 Franklin Street, Boston MA 02110, United States

ETI Engineering, Inc.[6]
1676 International Drive, 10th Floor, Suite 1000, McLean VA 22102, United States

Gloster Aircraft Limited[2]

Granada Enterprises Limited
PO Box 1732, Riyadh 11441, Saudi Arabia

H-B Utveckling, H-B Development AB
Nybrogatan 7, SE-114 34 Stockholm, Sweden

Hadrian Holdings, Inc.[14]
521 Fifth Avenue, New York NY 101075, United States

Hadrian Trustees Limited[2,14]

Hägglunds Vehicle GmbH
Ernst-Grote Strasse 13, 30916 Isernhagen, Germany

Hawker Siddeley Aviation Limited[2]

Hawker Siddeley Dynamics Limited[2]

Hertfordshire Estates Limited[4]

HSA/HSD Pension Fund Trustees Limited[2]

Hunter Aerospace Corporation Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

International Military Sales Limited

Jetstream Aircraft Limited[2]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Kalamind Limited[18]

Lemacrown Limited[19]

MES Holdco Limited
4th Floor, St. Paul's Gate, 22-24 New Street, St. Helier JE1 4TR, Jersey

MES Interco[12]

Meslink Limited

Newcombe Properties Limited

Piper Group plc

Pitch Technologies AB
Repslagaregatan 25, SE-582 22 Linköping, Sweden

Pitch Technologies Limited
Sweden House, 5 Upper Montagu Street, London W1H 2AG, United Kingdom

Port Solent Limited

Port Solent Marina Limited

PT. BAE Systems Services[6]
Wisma 46, Kota BNI, 34th Floor, Suite 34.01.A, Jl. Jenderal Sudirman Kavling 71, Jakarta 10220, Indonesia

Representaciones SSTS, CA[10]
Ave Francisco de Miranda, Centro Lido El Rosal Oficina 71B, Caracas, Venezuela

Royal Ordnance (Crown Service) Pension Scheme Trustees Limited

Royal Ordnance B.V.
c/o SGG Netherlands N.V., Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands

Royal Ordnance Senior Staff Pension Scheme Trustees Limited

Royal Ordnance Speciality Metals Limited[2]

RWT Limited[2]

Salford Electrical Instruments Limited

Scentcivil Limited

Scottish Aviation Limited[2]
Prestwick International Airport, Prestwick, Ayrshire KA9 2RW, United Kingdom

Sepia, LLC[1]
4219 Lafayette Center Drive, Chantilly VA 20151, United States

Shipbuilding (MSF) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Shipbuilding (VIC) Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

Stephen Howe Systems Limited[18]
Alvington, Yeovil, Somerset BA22 8UZ, United Kingdom

Stewart & Stevenson Operations (Nigeria) Limited[10]
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[1,13]
House No. 145, Street No. 1, Qtr. 611, Al Andulous Area, Al Mansour, Baghdad, Iraq

TDS International Holdings Pty Limited[20]
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

TDS International Pty Limited
Evans Building, Taranaki Road, Edinburgh Parks, Edinburgh SA 5111, Australia

The Blackburn Aeroplane & Motor Co Limited[2]

The Bristol Aviation Company Limited[2]

The British & Colonial Aeroplane Co. Limited[2]

The Leeds Partnership Limited[4]

The Supermarine Aviation Works Limited[2,3]

Thomas Sopwith Aviation Company Limited[2]

VSEL Birkenhead Limited

Warship Design Services Limited

Westover Controls Incorporated[6]
1098 Clark Street, Endicott NY 13760, United States

35. Information about related undertakings continued

Subsidiaries – not wholly-owned

Advanced National Company for Aircraft Maintenance Limited (88.1%)
PO Box 1732, Riyadh 11441, Saudi Arabia

Aircraft Accessories & Components Co Limited (75.6%)
PO Box 13532, Jeddah 21434, Saudi Arabia

Aircraft Research Association Limited (87.1%)[2]
Manton Lane, Bedford MK41 7PF, United Kingdom

ARA Pension Fund Trustees Limited (87.1%)
Manton Lane, Bedford MK41 7PF, United Kingdom

BAE Systems Saudi Development and Training Company Limited (87.3%)[21]
PO Box 67775, Riyadh 11517, Saudi Arabia

BAE Systems SDT (UK) Limited (87.3%)

Flight Control System Management GmbH (66.6%)[22]
PO Box 801109, 81663 Munich, Germany

Hadrian Properties, Inc. (95%)[14]
521 Fifth Avenue, New York NY 101075, United States

International Systems Engineering Company Limited (79.9%)
PO Box 54002, Riyadh 11514, Saudi Arabia

Overhaul and Maintenance Company Holding (88.1%)
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%)[2]
PO Box 1732, Riyadh 11441, Saudi Arabia

SMSCMC (UK) Limited (51%)

Equity accounted investments

Abercromby Property International (20.42%)
521 Fifth Avenue, New York NY 101075, United States

Advanced Electronics Company Limited (44%)
PO Box 90916, Riyadh 11623, Saudi Arabia

Air Astana (49%)[7]
Zakarpatskaya Str 4A, 050039 Almaty, Kazakhstan

AMSH B.V. (50%)[23]
Weena 210-212, 3012 NJ Rotterdam, Netherlands

BAeHAL Software Limited (40%)[2,14]
Airport Lane, HAL Estate, Bangalore 560010, India

BHIC Bofors Defense Asia Sdn Bhd (49%)
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley City, Lingkaran Syed Putra, 59200 Kuala Lumpur, Malaysia

Canadian Naval Support Limited (50%)[24]
3099 Barrington Street, Halifax NS B3K 5M7, Canada

CTA International SAS (50%)
13 Route De La Miniere, 78034 Versailles Cedex, France

Data Link Solutions L.L.C. (50%)[1,17]
400 Collins Ave, Cedar Rapids IA 52498, United States

Eurofighter Aircraft Management GmbH (33%)[2,13]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

Eurofighter Jagdflugzeug GmbH (33%)[2]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

European Aerosystems Limited (50%)[2,20]

FADEC International LLC (50%)[1]
1098 Clark Street, Endicott NY 13760, United States

FAST Holdings Limited (50%)[14,20]

FAST Training Services Limited (50%)[14]

FNSS Savunma Sistemleri A.S (49%)[20]
PK 37, Golbasi 06830, Ankara, Turkey

Gripen International KB (50%)[1,13]
SE-581 88 Linköping, Sweden

MBDA Holdings SAS (25%)
1 Avenue Réaumur, 92350 Le Plessis-Robinson, France

Nobeli Business Support AB (34%)
SE-691 80 Karlskoga, Sweden

Nurol BAE Systems Hava Sistemleri Anonim Şirketi (49%)[23]
Üniversiteler Mah, 1605.Cad, No:3/1-3, 06800, Ankara, Turkey

Panavia Aircraft GmbH (42.5%)[2]
Am Soldnermoos 17, 85399 Hallbergmoos, Germany

Reaction Engines Limited (18%)[23]
Hill House, 1 Little New Street, London EC4A 3TR, United Kingdom

Saab Bofors Test Center AB (30%)
SE-691 80 Karlskoga, Sweden

Saab-BAe Systems Gripen AB (50%)[2]
SE-581 88 Linköping, Sweden

Sealand Support Services Limited (33.3%)[9]
MoD Sealand, Welsh Road, Sealand, Deeside, Flintshire CH5 2LS, United Kingdom

Seele-Alvis Fenestration Limited (43.5%)[8,20]
Unit A44, Jack's Place, 6 Corbett Place, London E1 6NN, United Kingdom

SIKA International Limited (50%)[15,20]

Spectrum Technologies Limited (20%)[2,14]
Western Avenue, Bridgend Industrial Estate, Bridgend, Mid Glamorgan CF31 3RT, United Kingdom

Winner Developments Limited (33.3%)

Notes

1. Unincorporated entity for which the address given is the principal place of business.
2. Directly owned by BAE Systems plc.
3. Ownership held in class of A shares, B shares and preference shares.
4. Ownership held in class of A shares and B shares.
5. Ownership held in ordinary shares and preference shares.
6. Ownership held in common shares.
7. Ownership held in common stock.
8. Year end 30 June.
9. Ownership held in ordinary shares and redeemable preference shares.
10. Ownership held in authorized shares.
11. 40% owned by BAE Systems plc.
12. Unlimited company.
13. In liquidation.
14. Year end 31 March.
15. In members' voluntary liquidation.
16. Year end 5 April.
17. Year end 30 September.
18. In strike off.
19. Ownership held in ordinary shares and class of A shares.
20. Ownership held in class of A shares.
21. 1% owned by BAE Systems plc.
22. 33.3% owned by BAE Systems plc.
23. Ownership held in class of B shares.
24. Ownership held in common shares and B Preferred shares.

36. Events after the reporting period

In January 2019, the Group announced an agreement with Rheinmetall to create a joint UK-based military land vehicle design, manufacturing and support business. Rheinmetall will purchase a 55% stake in the existing BAE Systems UK-based combat vehicles business, with BAE Systems retaining 45%. The establishment of the new joint venture is subject to regulatory approvals which are anticipated to be completed in the first half of 2019. Once the approvals have been completed, the joint venture will be known as Rheinmetall BAE Systems Land (RBSL). The UK-based combat vehicles business is presented as held for sale at 31 December 2018 (see note 18).

As a part of a planned reorganisation of the Group's portfolio of interests in a number of industrial companies in Saudi Arabia, the Group completed the disposal of its 75.6% shareholding in Aircraft Accessories and Components Company (AACC) in January 2019. AACC is presented as held for sale at 31 December 2018 (see note 18).

37. Changes in accounting policies and restatements

This note explains the impact of changes in accounting policies and the correction of a prior year error on the Group's financial statements.

Impact on financial statements

As a result of changes in the Group's accounting policies, prior year comparative information has been restated for the adoption of IFRS 15 Revenue from Contracts with Customers. As explained below, IFRS 9 Financial Instruments was adopted without restating comparative information.

Following an internal review of the third-party accounting valuation of a longevity swap held by one of the Group's pension schemes, the Group became aware of an error in respect of the treatment of experience collateral in the accounting valuation. This resulted in a material error in the value of pension scheme assets included in the financial statements for the years ended 31 December 2017 and 31 December 2016. This error has been corrected retrospectively by restating the comparative amounts presented in these financial statements.

The following tables show the adjustments recognised for each individual line item. Line items that are not affected by the changes have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided.

Consolidated balance sheet (extract)

	As at 31 December 2017			
	As previously reported £m	Impact of IFRS 15 £m	Valuation of longevity swap £m	Restated £m
Non-current assets				
Equity accounted investments	384	(60)	(2)	322
Deferred tax assets	724	(40)	18	702
	14,738	**(100)**	**16**	**14,654**
Current assets				
Inventories	723	10	–	733
Trade and other receivables including amounts due from customers for contract work	3,586	(3,586)	–	–
Trade, other and contract receivables	–	4,244	–	4,244
	7,715	**668**	**–**	**8,383**
Total assets	**22,453**	**568**	**16**	**23,037**
Non-current liabilities				
Trade and other payables	(1,722)	(1)	–	(1,723)
Retirement benefit obligations	(4,222)	–	(102)	(4,324)
Provisions	(413)	(22)	–	(435)
	(10,563)	**(23)**	**(102)**	**(10,688)**
Current liabilities				
Trade and other payables	(6,322)	(433)	–	(6,755)
Provisions	(345)	(55)	–	(400)
	(7,106)	**(488)**	**–**	**(7,594)**
Total liabilities	**(17,669)**	**(511)**	**(102)**	**(18,282)**
Net assets	**4,784**	**57**	**(86)**	**4,755**
Capital and reserves				
Other reserves	6,098	(8)	–	6,090
Retained earnings	(2,693)	65	(86)	(2,714)
Total equity attributable to equity holders of BAE Systems plc	**4,741**	**57**	**(86)**	**4,712**
Non-controlling interests	**43**	**–**	**–**	**43**
Total equity	**4,784**	**57**	**(86)**	**4,755**

37. Changes in accounting policies and restatements continued

Consolidated balance sheet (extract)

	As at 31 December 2016			
	As previously reported £m	Impact of IFRS 15 £m	Valuation of longevity swap £m	Restated £m
Non-current assets				
Equity accounted investments	299	(48)	(1)	250
Deferred tax assets	1,251	(79)	9	1,181
	15,947	**(127)**	**8**	**15,828**
Current assets				
Inventories	744	32	–	776
Trade and other receivables including amounts due from customers for contract work	3,305	(3,305)	–	–
Trade, other and contract receivables	–	3,959	–	3,959
	7,029	**686**	**–**	**7,715**
Total assets	**22,976**	**559**	**8**	**23,543**
Non-current liabilities				
Trade and other payables	(1,027)	(13)	–	(1,040)
Retirement benefit obligations	(6,277)	–	(53)	(6,330)
Provisions	(372)	(20)	–	(392)
	(12,213)	**(33)**	**(53)**	**(12,299)**
Current liabilities				
Trade and other payables	(6,540)	(377)	–	(6,917)
Provisions	(234)	(57)	–	(291)
	(7,299)	**(434)**	**–**	**(7,733)**
Total liabilities	**(19,512)**	**(467)**	**(53)**	**(20,032)**
Net assets	**3,464**	**92**	**(45)**	**3,511**
Capital and reserves				
Retained earnings	(4,583)	92	(45)	(4,536)
Total equity attributable to equity holders of BAE Systems plc	**3,438**	**92**	**(45)**	**3,485**
Non-controlling interests	**26**	**–**	**–**	**26**
Total equity	**3,464**	**92**	**(45)**	**3,511**

37. Changes in accounting policies and restatements continued

Consolidated income statement

	Year ended 31 December 2017		
	As previously reported £m	Impact of IFRS 15 £m	Restated on adoption of IFRS 15 £m
Continuing operations			
Sales	19,626	(1,139)	**18,487**
Deduct Share of sales by equity accounted investments	(2,575)	41	**(2,534)**
Add Sales to equity accounted investments	1,271	–	**1,271**
Revenue	18,322	(1,098)	**17,224**
Operating costs	(17,089)	1,046	**(16,043)**
Other income	131	–	**131**
Group operating profit	1,364	(52)	**1,312**
Share of results of equity accounted investments	116	(9)	**107**
Underlying EBITA	2,034	(60)	**1,974**
Non-recurring items	(13)	–	**(13)**
EBITA	2,021	(60)	**1,961**
Amortisation of intangible assets	(86)	–	**(86)**
Impairment of intangible assets	(384)	–	**(384)**
Financial expense of equity accounted investments	(34)	–	**(34)**
Taxation expense of equity accounted investments	(37)	(1)	**(38)**
Operating profit	1,480	(61)	**1,419**
Financial income	416	–	**416**
Financial expense	(762)	–	**(762)**
Net finance costs	(346)	–	**(346)**
Profit before taxation	1,134	(61)	**1,073**
Taxation expense	(250)	34	**(216)**
Profit for the year	884	(27)	**857**
Attributable to:			
Equity shareholders	854	(27)	**827**
Non-controlling interests	30	–	**30**
	884	(27)	**857**
Earnings per share			
Basic earnings per share	26.8p	(0.8)p	**26.0p**
Diluted earnings per share	26.7p	(0.8)p	**25.9p**
Underlying earnings per share[1]	43.5p	(1.4)p	**42.1p**

1. Restated underlying earnings per share excludes an additional £18m benefit in respect of the impact of US tax reform enacted in December 2017 included in the restated taxation expense above.

37. Changes in accounting policies and restatements continued

Consolidated statement of comprehensive income

	Year ended 31 December 2017			
	As previously reported £m	Impact of IFRS 15 £m	Valuation of longevity swap £m	Restated £m
Profit for the year	**884**	**(27)**	**–**	**857**
Other comprehensive income				
Items that will not be reclassified to the income statement:				
Subsidiaries:				
Remeasurements on retirement benefit schemes	2,105	–	(49)	2,056
Tax on items that will not be reclassified to the income statement	(490)	–	9	(481)
Equity accounted investments (net of tax)	53	–	(1)	52
Items that may be reclassified to the income statement:				
Subsidiaries:				
Currency translation on foreign currency net investments	(625)	(5)	–	(630)
Amounts credited to hedging reserve	59	–	–	59
Tax on items that may be reclassified to the income statement	(11)	–	–	(11)
Equity accounted investments (net of tax)	(15)	(3)	–	(18)
Other comprehensive income for the year (net of tax)	**1,076**	**(8)**	**(41)**	**1,027**
Total comprehensive income for the year	**1,960**	**(35)**	**(41)**	**1,884**
Attributable to:				
Equity shareholders	1,935	(35)	(41)	1,859
Non-controlling interests	25	–	–	25
	1,960	**(35)**	**(41)**	**1,884**

IFRS 9 Financial instruments – impact of adoption
IFRS 9 replaces the provisions of IAS 39 that relate to recognition, classification and measurement of financial assets and financial liabilities, de-recognition of financial instruments, impairment of financial assets and hedge accounting. The adoption of IFRS 9 Financial Instruments from 1 January 2018 resulted in changes in accounting policies; however, no adjustments were required to the amounts recognised in the financial statements in previous periods. The accounting policies applied from 1 January 2018 are set out in the relevant notes.

Classification and measurement
On 1 January 2018, the Group has classified its financial instruments in the appropriate IFRS 9 categories.

The derivative financial instruments designated as cash flow hedges and fair values hedges under IAS 39 at 31 December 2017 continue to qualify for hedge accounting under IFRS 9 at 1 January 2018 and are therefore treated as continuing hedges.

Derivative financial instruments that were not designated as hedges under IAS 39 were classified in the fair value through profit or loss category and gains and losses were recognised in the income statement in the period. There is no change to the classification of these financial instruments under IFRS 9 as they fail the contractual cash flow characteristics test in IFRS 9 (4.1.2(b)) and (4.1.2A(b)).

Trade receivables and amounts owed by equity accounted investments, previously classified in the loans and receivables category and measured at amortised cost under IAS 39, continue to be classified in the amortised cost category under IFRS 9 as they are held within a business model to collect contracted cash flows and these cash flows consist solely of payments of principal and interest.

Money market funds previously classified in the available for sale category under IAS 39 were previously measured at fair value with any change in fair value recognised in other comprehensive income. Under IFRS 9, money market funds are measured at fair value through profit and loss. However, fair value approximates to amortised cost for these financial assets; therefore the impact on transition to IFRS 9 is immaterial. Money market funds continue to be presented within cash and cash equivalents in the Consolidated balance sheet.

Equity investments previously classified in the available for sale category under IAS 39 were previously measured at fair value with any change in fair value recognised in other comprehensive income. Under IFRS 9, equity investments are measured at fair value through profit and loss.

Impairment of financial assets
The Group has three types of financial asset that are subject to IFRS 9's new expected credit loss model: trade receivables; contract receivables; and amounts owed by equity accounted investments.

Trade receivables and contract receivables do not contain a significant financing element and therefore expected credit losses are measured using the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from the initial recognition of the receivables.

The Group has assessed credit risk in relation to defence-related sales to government customers or sub-contractors to governments and believes it to be 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. The Group considers expected credit losses for non-government commercial customers, however this risk is not material to the financial statements.

Amounts due from equity accounted investments primarily relate to trading balances with no significant financing element, in accordance with IFRS 15. The simplified approach is therefore used for these balances. The identified impairment loss was immaterial.

While cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial.

There was minimal IFRS 9 impact on retained earnings at 1 January 2018 and therefore no restatement was required.

37. Changes in accounting policies and restatements continued

IFRS 15 Revenue from Contracts with Customers – impact of adoption
The Group has adopted IFRS 15 fully retrospectively in accordance with paragraph C3(a). Comparatives for the year ended 31 December 2017 have been restated. The following expedients have been used in accordance with paragraph C5:

- revenue in respect of completed contracts that begin and end in the same accounting period has not been restated;
- revenue in respect of completed contracts with variable consideration reflects the transaction price at the date the contracts were completed; and
- the transaction price allocated to unsatisfied and partially unsatisfied performance obligations as at 31 December 2017 is not disclosed.

The accounting policy in respect of revenue applied from 1 January 2018 is set out in note 1.

As a result of the adoption of IFRS 15 Revenue from Contracts with Customers from 1 January 2018, the following adjustments were made to restate the amounts recognised in the balance sheet at 31 December 2017:

	As at 31 December 2017			
	As previously reported £m	Reclassification £m	Remeasurement £m	Restated on adoption of IFRS 15 £m
Equity accounted investments	384	–	(60)	324
Deferred tax assets	724	–	(40)	684
Inventories	723	10	–	733
Trade and other receivables including amounts due from customers for contract work	3,586	(3,586)	–	–
Trade, other and contract receivables	–	4,055	189	4,244
Non-current other payables	(1,722)	22	(23)	(1,723)
Current trade and other payables	(6,322)	(424)	(9)	(6,755)
Non-current provisions	(413)	(22)	–	(435)
Current provisions	(345)	(55)	–	(400)

The impact of adoption on the Group's retained earnings at 31 December 2017 and 31 December 2016 is as follows:

	2017 £m	2016 £m
Retained earnings – as previously reported	**(2,693)**	**(4,583)**
Recognition of revenue for over time contracts based on costs incurred and including attributable margin	201	259
Equity accounted investments – separation of development and production margin, net of tax	(59)	(48)
Licence revenue – deferral of revenue over the licence term	(32)	(39)
Deferred tax	(45)	(80)
Adjustment to retained earnings upon adoption of IFRS 15	65	92
Retained earnings – IFRS 15 (restated)	**(2,628)**	**(4,491)**

38. Adoption of IFRS 16 Leases

IFRS 16 is effective from 1 January 2019 and replaces IAS 17 Leases and related interpretations. It will result in almost all leases being recognised on the balance sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, a right-of-use asset and a financial liability for future lease payments are recognised. The only exceptions are short-term leases, low-value leases and leases of intangible assets.

The Group will apply the Standard from 1 January 2019. The Group has applied the modified retrospective transition approach and will not restate comparative amounts for the year ended 31 December 2018. In the majority of cases the Group has elected to measure right-of-use assets at the amount of the lease liability on adoption (adjusted for any lease prepayments or accrued lease expenses, onerous lease provisions, and leased assets which have subsequently been sub-leased). For a number of property leases the Group has elected to measure the right-of-use asset as if IFRS 16 had been applied since the start of the lease, but using the incremental borrowing rate at 1 January 2019, with the difference between the right-of-use asset and the lease liability taken to retained earnings.

The Group has elected to adopt the following practical expedients on transition:

- not to capitalise a right-of-use lease asset or related lease liability where the lease expires before 31 December 2019;
- not to reassess contracts to determine if the contract contains a lease and not to separate lease and non-lease elements;
- where an onerous lease provision is in existence, to utilise this provision to reduce the right-of-use asset value rather than undertaking an impairment review;
- to use hindsight in determining the lease term;
- to exclude initial direct costs from the measurement of the right-of-use asset; and
- to apply the portfolio approach where a group of leases has similar characteristics.

Impact of adoption of IFRS 16 Leases

Balance sheet

Upon transition on 1 January 2019, the Group will recognise a right-of-use lease asset of £1,300m (after adjustments for onerous lease provisions, lease prepayments and accrued lease expenses at 31 December 2018), and lease liabilities of £1,486m (non-current £1,270m; current £216m), along with a deferred tax asset of £2m. A sub-lease finance receivable of £70m will also be recognised. A transition adjustment of £92m will be recognised as a debit to retained earnings. The Group will not capitalise low-value leases on transition, or those which expire before 31 December 2019, and has opted not to apply IFRS 16 to leases relating to intangible assets. The right-of-use lease asset principally consists of property.

Income statement

Under IFRS 16 the Group will see a different pattern of expense within the income statement, as the IAS 17 operating lease expense is replaced by depreciation and interest charges. In 2019, the Group's EBITA metric will improve by an estimated £50m under IFRS 16 as the new depreciation expense is expected to be lower than the IAS 17 operating lease charge; however the new finance costs are expected to broadly offset this, such that net profit after tax and the underlying earnings metric are not expected to be materially different compared to the previous IAS 17 reporting basis.

Cash flow statement

The change in presentation as a result of the adoption of IFRS 16 will see an improvement in 2019 of an estimated £46m in cash flow generated from operating activities, offset by a corresponding decline in cash flow from financing activities. There is no overall cash flow impact from the adoption of the new Standard.

Lessor accounting under IFRS 16 is largely unchanged from IAS 17.

Estimated 2019 IFRS 16 Leases impact on underlying EBITA by segment

	£m
Electronic Systems	4
Cyber & Intelligence	3
Platforms & Services (US)	3
Air	19
Maritime	2
HQ	19
Group	**50**

38. Adoption of IFRS 16 Leases continued

Impact on Consolidated balance sheet at 1 January 2019 (extract)

The following table shows the effect of adopting IFRS 16 on the Consolidated balance sheet at 1 January 2019.

	£m
Non-current assets	
Right-of-use assets	1,255
Investment property	45
Equity accounted investments	(11)
Finance lease receivable	61
Deferred tax assets	2
	1,352
Current assets	
Finance lease receivable	9
Trade, other and contract receivables	(26)
	(17)
Total assets	**1,335**
Non-current liabilities	
Lease liabilities	(1,270)
Provisions	24
	(1,246)
Current liabilities	
Lease liabilities	(216)
Trade and other payables	28
Provisions	7
	(181)
Total liabilities	**(1,427)**
Net assets	**(92)**
Capital and reserves	
Retained earnings	(92)
Total equity attributable to equity holders of BAE Systems plc	**(92)**
Non-controlling interests	**–**
Total equity	**(92)**

The weighted average incremental borrowing rate applied to lease liabilities was 3.43%.

Reconciliation between operating lease commitments and lease liability

The following table explains the difference between the operating lease commitments disclosed applying IAS 17 at 31 December 2018 and the lease liability recognised on adoption of IFRS 16 at 1 January 2019.

	£m
Total minimum lease payments reported at 31 December 2018 under IAS 17 (note 33)	1,706
Change in assessment of lease term under IFRS 16	107
Leases outside the scope of IFRS 16	(81)
Impact of discounting lease liability under IFRS 16	(246)
Lease liability recognised on transition to IFRS 16 at 1 January 2019	**1,486**

Independent review report to BAE Systems plc

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 2020 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 1-14. 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 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 Financial Reporting Council. Our work has been undertaken so that we might state to the company those matters we are required to state to it in an independent review 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 formed.

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 Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" as adopted by the European Union.

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 Financial Reporting Council for use in the United Kingdom. A review of interim financial information consists of making inquiries, 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 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 2020 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Deloitte LLP
Statutory Auditor
London
United Kingdom

29 July 2020

Condensed consolidated income statement (unaudited)

	Notes	**Six months ended 30 June 2020** £m	**Six months ended 30 June 2020** £m	Six months ended 30 June 2019 £m	Six months ended 30 June 2019 £m
Continuing operations					
Sales	2	**9,871**		9,416	
Deduct Share of revenue of equity accounted investments		**(1,208)**		(1,271)	
Add Subsidiaries' revenue from equity accounted investments		**517**		529	
Revenue	2		**9,180**		8,674
Operating costs			**(8,452)**		(7,896)
Other income			**73**		58
Group operating profit			**801**		836
Share of results of equity accounted investments			**7**		60
Underlying EBITA	2	**895**		999	
Non-recurring items	2	**(21)**		(28)	
EBITA		**874**		971	
Amortisation of intangible assets		**(49)**		(49)	
Financial expense of equity accounted investments		**(15)**		(10)	
Taxation expense of equity accounted investments		**(2)**		(16)	
Operating profit	2		**808**		896
Financial income[1]		**12**		16	
Financial expense[1]		**(131)**		(136)	
Net finance costs	3		**(119)**		(120)
Profit before taxation			**689**		776
Taxation (expense) / credit	4		**(130)**		41
Profit for the period			**559**		817
Attributable to:					
Equity shareholders			**532**		795
Non-controlling interests			**27**		22
			559		817
Earnings per share	5				
Basic earnings per share			**16.7p**		25.0p
Diluted earnings per share			**16.6p**		24.9p

1. Gains on remeasurement of financial instruments at fair value through profit or loss of £82m and foreign exchange gains of £15m were previously presented within financial income in 2019. The Group believes it is more representative to present these items net within financial expense, since the gains and losses relate to the same underlying transactions. Accordingly, amounts previously included within financial income in 2019 have been reclassified to financial expense.

Condensed consolidated statement of comprehensive income (unaudited)

	Six months ended 30 June 2020			Six months ended 30 June 2019		
	Other reserves £m	**Retained earnings £m**	**Total £m**	Other reserves £m	Retained earnings £m	Total £m
Profit for the period	**–**	**559**	**559**	–	817	817
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Subsidiaries:						
Remeasurements on post-employment benefit schemes	**–**	**(2,510)**	**(2,510)**	–	(487)	(487)
Tax on items that will not be reclassified to the income statement	**–**	**575**	**575**	–	56	56
Equity accounted investments (net of tax)	**–**	**(68)**	**(68)**	–	(16)	(16)
Items that may be reclassified to the income statement:						
Subsidiaries:						
Currency translation on foreign currency net investments	**582**	**–**	**582**	18	–	18
Reclassification of cumulative currency translation reserve on disposal	**–**	**–**	**–**	(8)	–	(8)
Fair value gain arising on hedging instruments during the period	**23**	**–**	**23**	13	–	13
Cumulative fair value gain on hedging instruments reclassified to the income statement	**(10)**	**–**	**(10)**	(57)	–	(57)
Tax on items that may be reclassified to the income statement	**–**	**–**	**–**	8	–	8
Equity accounted investments (net of tax)	**28**	**–**	**28**	8	–	8
Total other comprehensive income for the period (net of tax)	**623**	**(2,003)**	**(1,380)**	(18)	(447)	(465)
Total comprehensive income for the period	**623**	**(1,444)**	**(821)**	(18)	370	352
Attributable to:						
Equity shareholders	**615**	**(1,471)**	**(856)**	(18)	348	330
Non-controlling interests	**8**	**27**	**35**	–	22	22
	623	**(1,444)**	**(821)**	(18)	370	352

Condensed consolidated statement of changes in equity (unaudited)

	Attributable to equity holders of BAE Systems plc						
	Issued share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
Balance at 1 January 2020	87	1,249	6,156	(2,085)	5,407	104	5,511
Profit for the period	–	–	–	532	532	27	559
Total other comprehensive income for the period	–	–	615	(2,003)	(1,388)	8	(1,380)
Total comprehensive income for the period	–	–	615	(1,471)	(856)	35	(821)
Share-based payments (inclusive of tax)	–	–	–	28	28	–	28
Partial disposal of shareholding in subsidiary undertaking	–	–	–	(6)	(6)	12	6
Cumulative fair value gain on hedging instruments transferred to the balance sheet (net of tax)	–	–	(23)	–	(23)	–	(23)
Ordinary share dividends	–	–	–	–	–	(3)	(3)
At 30 June 2020	**87**	**1,249**	**6,748**	**(3,534)**	**4,550**	**148**	**4,698**
Balance at 1 January 2019 (post-IFRS 16 transition)	87	1,249	6,481	(2,363)	5,454	72	5,526
Profit for the period	–	–	–	795	795	22	817
Total other comprehensive income for the period	–	–	(18)	(447)	(465)	–	(465)
Total comprehensive income for the period	–	–	(18)	348	330	22	352
Share-based payments (inclusive of tax)	–	–	–	37	37	–	37
Partial disposal of shareholding in subsidiary undertaking	–	–	–	(6)	(6)	20	14
Cumulative fair value loss on hedging instruments transferred to the balance sheet (net of tax)	–	–	34	–	34	–	34
Ordinary share dividends	–	–	–	(423)	(423)	(26)	(449)
At 30 June 2019	87	1,249	6,497	(2,407)	5,426	88	5,514

Condensed consolidated balance sheet (unaudited)

	Notes	**30 June 2020 £m**	31 December 2019 £m
Non-current assets			
Intangible assets		**10,992**	10,371
Property, plant and equipment		**2,611**	2,437
Right-of-use assets		**1,144**	1,138
Investment property		**137**	137
Equity accounted investments		**362**	428
Other investments		**18**	13
Other receivables		**520**	484
Post-employment benefit surpluses	6	**253**	302
Other financial assets		**497**	350
Deferred tax assets		**1,274**	726
		17,808	16,386
Current assets			
Inventories		**951**	835
Trade, other and contract receivables		**5,737**	5,458
Current tax		**5**	19
Other financial assets		**230**	210
Cash and cash equivalents		**2,523**	2,587
Assets held for sale		**148**	135
		9,594	9,244
Total assets		**27,402**	25,630
Non-current liabilities			
Loans		**(4,251)**	(3,020)
Lease liabilities		**(1,106)**	(1,116)
Other payables		**(1,578)**	(1,481)
Post-employment benefit obligations	6	**(6,223)**	(4,757)
Other financial liabilities		**(183)**	(227)
Provisions		**(391)**	(385)
		(13,732)	(10,986)
Current liabilities			
Loans and overdrafts		**(525)**	(377)
Lease liabilities		**(257)**	(238)
Trade and other payables		**(7,527)**	(7,926)
Other financial liabilities		**(153)**	(232)
Current tax		**(170)**	(55)
Provisions		**(334)**	(300)
Liabilities held for sale		**(6)**	(5)
		(8,972)	(9,133)
Total liabilities		**(22,704)**	(20,119)
Net assets		**4,698**	5,511
Capital and reserves			
Issued share capital		**87**	87
Share premium		**1,249**	1,249
Other reserves		**6,748**	6,156
Retained earnings – deficit		**(3,534)**	(2,085)
Total equity attributable to equity holders of BAE Systems plc		**4,550**	5,407
Non-controlling interests		**148**	104
Total equity		**4,698**	5,511

Condensed consolidated cash flow statement (unaudited)

	Notes	Six months ended 30 June 2020 £m	Six months ended 30 June 2019[1] £m
Profit for the period		**559**	817
Taxation expense / (credit)		**130**	(41)
Adjustment in respect of research and development expenditure credits		**150**	(8)
Share of results of equity accounted investments		**(7)**	(60)
Net finance costs		**119**	120
Depreciation, amortisation, impairment and derecognition		**312**	330
Profit on disposal of property, plant and equipment, and investment property		**(5)**	(3)
Gain on investment revaluation		**(5)**	–
Gain on disposal of businesses		**–**	(8)
Cost of equity-settled employee share schemes		**29**	38
Movements in provisions		**8**	(38)
Contributions to post-employment benefit schemes in excess of service cost		**(1,086)**	(169)
Increase in working capital:			
Inventories		**(72)**	(70)
Trade, other and contract receivables		**(46)**	(885)
Trade and other payables		**(685)**	(107)
Taxation paid		**(128)**	(148)
Net cash flow from operating activities		**(727)**	(232)
Dividends received from equity accounted investments		**24**	90
Interest received		**12**	17
Principal element of finance lease receipts		**4**	5
Purchases of property, plant and equipment, and investment property		**(159)**	(142)
Purchases of intangible assets		**(42)**	(58)
Proceeds from sale of property, plant and equipment, and investment property		**12**	4
Acquisition of subsidiaries		**(217)**	(9)
Proceeds from sale of subsidiary undertakings		**–**	26
Equity accounted investment funding		**–**	(5)
Net cash flow from investing activities		**(366)**	(72)
Interest paid		**(114)**	(134)
Equity dividends paid	7	**–**	(423)
Dividends paid to non-controlling interests		**(3)**	(26)
Partial disposal of shareholding in subsidiary undertaking		**–**	14
Principal element of lease payments		**(120)**	(119)
Cash flow from matured derivative financial instruments		**72**	47
Cash flow from cash collateral		**14**	4
Cash inflow from loans		**1,136**	463
Cash outflow from repayment of loans		**–**	(1,236)
Net cash flow from financing activities		**985**	(1,410)
Net decrease in cash and cash equivalents		**(108)**	(1,714)
Cash and cash equivalents at 1 January		**2,587**	3,232
Effect of foreign exchange rate changes on cash and cash equivalents		**44**	(17)
Cash and cash equivalents at end of period		**2,523**	1,501

1. 2019 comparatives have been reclassified to present a cash inflow of £14m in respect of a partial disposal of the Group's shareholding in a subsidiary undertaking within financing activities. This cash flow was previously presented in investing activities.

Notes to the condensed half-yearly financial statements

1. Preparation

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 in accordance with EU-endorsed International Financial Reporting Standards (IFRSs). 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 2019. The comparative figures for the year ended 31 December 2019 are not the Group's statutory accounts for that financial year. Those financial statements have been reported upon by the Group's auditor and delivered to the registrar of companies. The report of the auditor was unqualified, did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and did not contain statements under Section 498 (2) or (3) of the Companies Act 2006.

The accounting policies adopted in the preparation of these condensed consolidated half-yearly financial statements to 30 June 2020 are consistent with the accounting policies applied by the Group in its consolidated financial statements as at, and for the year ended, 31 December 2019 as required by the Disclosure Guidance and Transparency Rules of the UK's Financial Conduct Authority, with the exception of income tax and the adoption of new and amended standards as set out below.

New and amended standards adopted by the Group

No new or amended standards which became applicable for the current reporting period had a material impact on the Group or required the Group to change its accounting policies.

Sources of estimation uncertainty

The full impact of the COVID-19 pandemic on medium- and long-term economic activity is not yet known, although could be significant. The Group continues to monitor the impact on its business and conduct ongoing risk assessments which consider a range of potential outcomes, however while the uncertainty continues, the Group will need to consider a range of estimates and assumptions in the application of its accounting policies and management's assessment of the carrying values of assets and liabilities. In the event that these estimates or assumptions prove to be incorrect, there may be an adjustment to the carrying values of assets and liabilities within the next year. Potential areas of the Group's financial statements which could be materially impacted may include, but are not limited to:

– Revenue and margin recognition on contracts. These are based on constraints on variable consideration, estimates of future costs and an assessment of technical and other risks. The long-term nature of many of the Group's contracts means that judgements are made in estimating future costs on a contract as well as when risks will be mitigated or retired. The impact of the COVID-19 pandemic may increase uncertainty in relation to these judgements and estimates. The Group continues to work closely and collaboratively with its key customers 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. The Group's estimates and assumptions relating to revenue could be impacted by issues such as reduced productivity as a result of altered working practices to comply with safety and social distancing requirements, or production delays and increased costs as a result of disruption to the supply chain. In the 2019 Annual Report, note 1 provided a sensitivity indicator regarding revenue recognised in respect of performance obligations satisfied or partially satisfied in previous periods. This continues to provide an approximation of the potential revenue sensitivity arising as a result of management's estimates and assumptions for variable consideration, future costs, and technical and other risks, although given its inherent uncertainty, it may not reflect the full potential impact of the pandemic;

– The valuation of post-retirement benefit obligations and related deferred tax balances, if estimates relating to actuarial assumptions (including discount rate, inflation rate assumptions) are no longer valid or change significantly as the economic impact of the pandemic develops. Discount and inflation rates could change significantly as a result of an economic downturn, monetary policy decisions and interventions or other macro-economic issues resulting from the pandemic. Note 6 provides information on the key assumptions and analysis of their sensitivities. Pension asset values could also be impacted by the economic uncertainty, for example if there is a longer term impact on equity market returns, or in relation to the valuation of assets for which there is no observable market value;

- The carrying value of goodwill, if areas of estimation and judgement detailed under revenue and margin recognition on contracts above crystallise, or if there are changes in customer demand as a result of potential reductions in defence budgets or lower demand in areas such as commercial aerospace. These may impact upon estimated future cash flows for value-in-use assessments and therefore potentially lead to the impairment of goodwill. Note 8 of the 2019 Annual Report provides information on the sensitivity of impairment to changes in assumptions, although given its inherent uncertainty, this range of assumptions may not reflect the potential impact of the pandemic; and
- The carrying value of property, plant and equipment, right-of-use assets, investment property and equity accounted investments could potentially be impacted in the event of a prolonged economic downturn, significant reductions in customer defence spending and orders, or fundamental and enduring changes in working practices.

As the potential range of impacts of the pandemic is inherently uncertain and could be significant, it is not practicable at this time to assign a range of sensitivities relating to the pandemic to some of these potential sources of estimation uncertainty.

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 its assessment of customers' ongoing requirements, as well as how the Group will continue to be able to operate in response to the limitations imposed upon the business and its operations by the COVID-19 pandemic. As noted in the 2019 Annual Report, no judgements have been made in the process of applying the Group's accounting policies, other than those involving estimates, that have had a significant effect on the amounts recognised in the financial statements.

Separate from accounting policy judgements, assessments have been made by each business sector to consider the potential timing and extent of their return to normal operations. These judgements are based on considerations such as, but not limited to: local operational restrictions and the ability of sites and facilities to adopt safe and socially distanced working practices; customer instructions, requirements and guidance on progression of essential programmes; potential disruption to elements of the Group's supply chain; and possible changes in customer demand in commercial lines of business.

It should be noted that these assessments are part of a broader range of scenario planning undertaken by the business in the face of the COVID-19 pandemic, rather than as a formal forecasting process. The pandemic is an inherently uncertain event with future developments which cannot be predicted, and the Group will therefore continue to monitor its impact on the business, undertake risk assessments, and amend these judgements as required.

2. Segmental analysis

Sales and revenue by reporting segment

	Sales[1]		Deduct: Share of revenue of equity accounted investments		Add: Subsidiaries' revenue from equity accounted investments		Revenue	
	Six months ended 30 June 2020 £m	Six months ended 30 June 2019 £m	**Six months ended 30 June 2020 £m**	Six months ended 30 June 2019 £m	**Six months ended 30 June 2020 £m**	Six months ended 30 June 2019 £m	**Six months ended 30 June 2020 £m**	Six months ended 30 June 2019 £m
Electronic Systems	**2,203**	2,142	**(18)**	(61)	**18**	61	**2,203**	2,142
Cyber & Intelligence	**913**	853	**–**	–	**–**	–	**913**	853
Platforms & Services (US)	**1,718**	1,522	**(33)**	(63)	**3**	–	**1,688**	1,459
Air	**3,610**	3,366	**(1,056)**	(994)	**475**	452	**3,029**	2,824
Maritime	**1,505**	1,525	**(28)**	(13)	**1**	–	**1,478**	1,512
HQ	**102**	163	**(76)**	(140)	**–**	–	**26**	23
	10,051	9,571	**(1,211)**	(1,271)	**497**	513	**9,337**	8,813
Intra-group sales / revenue	**(180)**	(155)	**3**	–	**20**	16	**(157)**	(139)
	9,871	9,416	**(1,208)**	(1,271)	**517**	529	**9,180**	8,674

Underlying EBITA and operating profit / (loss) by reporting segment

	Underlying EBITA[1]		Non-recurring items[2]		Amortisation of intangible assets		Financial and taxation expense of equity accounted investments		Operating profit / (loss)	
	Six months ended 30 June 2020 £m	Six months ended 30 June 2019 £m	**Six months ended 30 June 2020 £m**	Six months ended 30 June 2019 £m	**Six months ended 30 June 2020 £m**	Six months ended 30 June 2019 £m	**Six months ended 30 June 2020 £m**	Six months ended 30 June 2019 £m	**Six months ended 30 June 2020 £m**	Six months ended 30 June 2019 £m
Electronic Systems	**291**	316	**(3)**	–	**(7)**	(8)	**–**	–	**281**	308
Cyber & Intelligence	**59**	25	**(2)**	–	**(1)**	(3)	**–**	–	**56**	22
Platforms & Services (US)	**121**	135	**(14)**	–	**(3)**	(5)	**1**	–	**105**	130
Air	**356**	438	**–**	(28)	**(16)**	(14)	**(16)**	(17)	**324**	379
Maritime	**122**	133	**–**	–	**(13)**	(12)	**(1)**	(1)	**108**	120
HQ	**(54)**	(48)	**(2)**	–	**(9)**	(7)	**(1)**	(8)	**(66)**	(63)
	895	999	**(21)**	(28)	**(49)**	(49)	**(17)**	(26)	**808**	896
Net finance costs									**(119)**	(120)
Profit before taxation									**689**	776
Taxation (expense) / credit									**(130)**	41
Profit for the period									**559**	817

1. The totals of these measures are not defined in International Financial Reporting Standards (IFRS) and, therefore, are considered to be non-GAAP (Generally Accepted Accounting Principles) measures. For alternative performance measure definitions see glossary on page 10.
2. Non-recurring items in 2020 comprises a £14m impairment charge relating to Platform & Services' legacy Commercial Shipbuilding business which the business exited in 2018, and advisory fees of £7m relating to the Group's acquisition and disposal activities (2019 comprises a £36m charge relating to the derecognition of Enterprise Resource Planning software intangible assets in the Air sector and an £8m gain on disposal of Aircraft Accessories and Components Company).

Underlying EBITA is the Group's measure of profit / (loss) for each reportable segment. The table above is provided to reconcile the total of the reportable segments' underlying EBITA to the Group's profit for the period.

3. Net finance costs

	Six months ended 30 June 2020 £m	Six months ended 30 June 2019 £m
Net finance costs:		
Group	**(119)**	(120)
Share of equity accounted investments	**(15)**	(10)
	(134)	(130)
Analysed as:		
Underlying interest expense:		
Group	**(118)**	(123)
Share of equity accounted investments	**(9)**	(7)
	(127)	(130)
Other:		
Group:		
Net interest expense on post-employment benefit obligations	**(43)**	(58)
Fair value and foreign exchange adjustments on financial instruments and investments	**42**	61
Share of equity accounted investments:		
Net interest expense on post-employment benefit obligations	**(1)**	(2)
Fair value and foreign exchange adjustments on financial instruments and investments	**(5)**	(1)
	(134)	(130)

4. Taxation

Taxation (expense) / credit

	Six months ended 30 June 2020 £m	Six months ended 30 June 2019 £m
Taxation expense excluding one-off items	**(130)**	(120)
One-off tax benefit	**–**	161
Taxation (expense) / credit	**(130)**	41

Calculation of the underlying effective tax rate

	Six months ended 30 June 2020 £m	Six months ended 30 June 2019 £m
Profit before taxation	**689**	776
Add back: Taxation expense of equity accounted investments	**2**	16
Add back / (deduct): Non-taxable non-recurring items	**7**	(8)
Adjusted profit before tax	**698**	784
Taxation (expense) / credit	**(130)**	41
Taxation expense of equity accounted investments	**(2)**	(16)
Exclude: One-off tax benefit	**–**	(161)
Adjusted taxation expense (including equity accounted investments)	**(132)**	(136)
Underlying effective tax rate	**19%**	17%

5. Earnings per share

	Six months ended 30 June 2020			Six months ended 30 June 2019		
	£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	**532**	**16.7**	**16.6**	795	25.0	24.9
Add back / (deduct):						
Non-recurring items, post tax[1]	**18**			22		
Amortisation of intangible assets, post tax[1]	**40**			40		
Net interest expense on post-employment benefit obligations, post tax[1]	**35**			50		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax[1]	**(30)**			(50)		
Underlying earnings, post tax	**595**	**18.7**	**18.5**	857	26.9	26.8
One-off tax benefit	**–**			(161)		
Underlying earnings, excluding one-off tax benefit	**595**	**18.7**	**18.5**	696	21.9	21.8

		Millions	Millions		Millions	Millions
Weighted average number of shares used in calculating basic earnings per share		**3,189**	**3,189**		3,180	3,180
Incremental shares in respect of employee share schemes			**19**			14
Weighted average number of shares used in calculating diluted earnings per share			**3,208**			3,194

1. The tax impact, where applicable, is calculated using the underlying effective tax rate of 19% (2019 17%).

6. Post-employment benefits

	UK £m	US and other £m	Total £m
Total net IAS 19 deficit at 1 January 2020	(4,111)	(668)	(4,779)
Actual return on assets excluding amounts included in net interest expense	126	132	258
Increase in liabilities due to changes in assumptions and experience	(2,607)	(348)	(2,955)
Contributions in excess of / (below) service cost	1,202	(6)	1,196
Past service cost – plan amendments	(2)	–	(2)
Net interest expense	(36)	(10)	(46)
Foreign exchange adjustments	–	(52)	(52)
Movement in other schemes	–	(30)	(30)
Total net IAS 19 deficit at 30 June 2020	**(5,428)**	**(982)**	**(6,410)**
Allocated to equity accounted investments	440	–	440
Group's share of net IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments at 30 June 2020	**(4,988)**	**(982)**	**(5,970)**
Represented by:			
Post-employment benefit surpluses	202	51	253
Post-employment benefit obligations	(5,190)	(1,033)	(6,223)
	(4,988)	**(982)**	**(5,970)**

Contributions in excess of service cost for the UK above include a £1bn payment as part of the new deficit recovery plan.

Deficit allocation

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.

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	
	30 June 2020	31 December 2019	**30 June 2020**	31 December 2019
Financial assumptions				
Discount rate – past service (%)	**1.5**	2.1	**2.6**	3.1
Discount rate – future service (%)	**1.6**	2.2	**2.6**	3.1
Retail Prices Index (RPI) inflation (%)	**2.7**	2.8	**n/a**	n/a
Rate of increase in salaries (%)	**2.7**	2.8	**n/a**	n/a
Rate of increase in deferred pensions (%)	**1.9/2.7**	2.0/2.8	**n/a**	n/a
Rate of increase in pensions in payment (%)	**1.5-3.5**	1.5-3.6	**n/a**	n/a
Demographic assumptions				
Life expectancy of a male currently aged 65 (years)	**87-88**	87-88	**87**	87
Life expectancy of a female currently aged 65 (years)	**88-90**	88-90	**89**	89
Life expectancy of a male currently aged 45 (years)	**88-89**	88-89	**87**	87
Life expectancy of a female currently aged 45 (years)	**89-91**	89-91	**89**	89

The Group has continued to use the Continuous Mortality Investigation (CMI) 2018 data for the UK demographic assumptions at 30 June 2020, reflecting the Group's best estimate of mortality at this time. This will be reviewed for the year end.

Sensitivity analysis

The sensitivity information has been derived using scenario analysis from the actuarial assumptions as at 30 June 2020 and keeping all other assumptions the same.

Financial assumptions

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

	(Increase)/ decrease in pension obligation[1] £bn	Increase/ (decrease) in scheme assets[1] £bn
Discount rate:		
0.1 percentage point increase	0.6	(0.3)
0.1 percentage point decrease	(0.6)	0.3
Inflation:		
0.1 percentage point increase	(0.5)	0.2
0.1 percentage point decrease	0.5	(0.2)

1. Before allocation to equity accounted investments.

The sensitivity of the valuation of the liabilities to changes in the inflation assumption presented above assumes that a 0.1 percentage point change to expectations of future inflation results in a 0.1 percentage point change to all inflation-related assumptions (rate of increase in salaries, rate of increase in deferred pensions and rate of increase in pensions in payment) used to value the liabilities. However, upper and lower limits exist on the majority of inflation-related benefits such that a change in expectations of future inflation may not have the same impact on the inflation-related benefits, and hence will result in a smaller change to the valuation of the liabilities. Accordingly, extrapolation of the above results beyond the specific sensitivity figures shown may not be appropriate. To illustrate this, the (increase) / decrease in the defined benefit pension obligation before allocation to equity accounted investments resulting from larger changes in the inflation assumption would be as follows:

	(Increase)/ decrease in pension obligation[1] £bn
Inflation:	
0.5 percentage point increase	(1.8)
0.5 percentage point decrease	1.5
1.0 percentage point increase	(3.6)
1.0 percentage point decrease	3.0

1. Before allocation to equity accounted investments.

Demographic assumptions

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

	(Increase)/ decrease in net deficit[1] £bn
Life expectancy:	
One-year increase	(1.5)
One-year decrease	1.4

1. Before allocation to equity accounted investments.

7. Equity dividends

	Six months ended 30 June 2020 £m	Six months ended 30 June 2019 £m
Prior year final dividend per ordinary share paid in the period (2019 13.2p)	**–**	423

The directors have declared an interim dividend of 13.8p per ordinary share in respect of the year ended 31 December 2019, totalling approximately £444m – that being the value of the dividend per share proposed but subsequently deferred earlier in the year. The dividend will be paid on 14 September 2020 to shareholders registered on 7 August 2020. The ex-dividend date is 6 August 2020.

In addition the directors have also declared an interim dividend of 9.4p per ordinary share in respect of the period ended 30 June 2020, totalling approximately £302m. This will be paid on 30 November 2020 to shareholders registered on 23 October 2020, assuming that there are no major additional or unforeseen pandemic-related disruptions. The ex-dividend date is 22 October 2020. This is in line with our usual dividend timetable.

The 2019 interim dividend was 9.4p per ordinary share, totalling £301m.

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 for receipt no later than 21 August for the first interim dividend, and no later than 9 November 2020 for the second interim dividend.

8. Fair value measurement

Fair value of financial instruments

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

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

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

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

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

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

Due to the variability of the valuation factors, the fair values presented at 30 June may not be indicative of the amounts the Group would expect to realise in the current market environment.

Fair value hierarchy

The fair value measurement hierarchy is as follows:

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

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

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

Carrying amounts and fair values of certain financial instruments

	30 June 2020 Carrying amount £m	30 June 2020 Fair value £m	31 December 2019 Carrying amount £m	31 December 2019 Fair value £m
Financial instruments measured at fair value:				
Non-current				
Equity investments at fair value through profit and loss	**18**	**18**	13	13
Other financial assets	**497**	**497**	350	350
Other financial liabilities	**(183)**	**(183)**	(227)	(227)
Current				
Other financial assets	**230**	**230**	210	210
Money market funds	**903**	**903**	680	680
Other financial liabilities	**(153)**	**(153)**	(232)	(232)
Financial instruments not measured at fair value:				
Non-current				
Loans	**(4,251)**	**(4,911)**	(3,020)	(3,315)
Current				
Cash and cash equivalents (excluding money market funds)	**1,620**	**1,620**	1,907	1,907
Loans and overdrafts	**(525)**	**(530)**	(377)	(380)

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

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

9. Financial risk management

Currency risk

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

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

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

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.

Despite the COVID-19 pandemic, the Group's assessment is that credit risk in relation to defence-related sales to government customers or sub-contractors 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 customers, the Group assesses expected credit losses, 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 objective evidence that individual receivables in this category are recoverable. For contract receivables, amounts due from equity accounted investments and finance lease receivables the expected credit loss provision is immaterial as the probability of default is insignificant.

Cash management and borrowing facilities

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.

The Group aims to maintain adequate undrawn committed borrowing facilities. At 30 June 2020, the Group had a committed Revolving Credit Facility (RCF) of £2bn (31 December 2019 £2bn). The RCF was undrawn throughout the period. The RCF also acts as a backstop to Commercial Paper issued by the Group. At 30 June 2020, the Group had £123m of Commercial Paper in issue (31 December 2019 £nil), which matures in September 2020.

10. Related party transactions

Transactions with related parties are shown on page 218 of the Annual Report 2019.

	Six months ended 30 June 2020 £m	Six months ended 30 June 2019 £m
Sales to related parties	**517**	529
Purchases from related parties[1]	**423**	235

	30 June 2020 £m	31 December 2019 £m
Amounts owed by related parties	**142**	53
Amounts owed to related parties	**1,450**	1,359

1. 2019 purchases from related parties have been restated to include £119m of purchases from Eurofighter Jagdflugzeug GmbH.

11. Acquisitions

On 4 May 2020, the Group completed the acquisition of the assets and liabilities of Raytheon Technologies Corporation's Airborne Tactical Radios business for consideration of £217m. The acquisition is expected to augment the Group's portfolio in airborne communications with broad-spectrum, multi-band, multi-channel radios that feature robust anti-jamming and encryption capabilities.

The assets, liabilities, workforce and ongoing trade of the Airborne Tactical Radios business were legally transferred in full to the Group as of 4 May 2020 and this was the point at which control of the business was established. The acquisition of this business has therefore been accounted for as a business combination and its results and financial position have been consolidated from the date of acquisition.

Purchase consideration and fair value of net assets acquired

The consideration transferred of £217m consisted entirely of cash.

The fair values of the assets and liabilities of the Airborne Radios business at the date of acquisition remain under review and have not yet been finalised, in part as a result of limitations arising from the COVID-19 pandemic, however the provisionally determined fair values are as follows:

	£m
Identifiable intangible assets	84
Property, plant and equipment	8
Right-of-use assets	3
Inventories	5
Trade, other and contract receivables	47
Lease liabilities	(3)
Trade and other payables	(42)
Net identifiable assets acquired	**102**
Add: goodwill	115
Net assets acquired	**217**

The goodwill recognised 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.

Goodwill of at least £74m is expected to be deductible for tax purposes.

No impairment losses have been recognised in respect of goodwill in the period ending 30 June 2020.

Since the acquisition date, revenue of £12m and an EBITA loss of £1m have been recognised in relation to the Airborne Tactical Radios business in the reporting period.

If the Airborne Tactical Radios business had been acquired at 1 January 2020, the Group's revenue and EBITA would have been £9,214m and £903m, respectively, for the period ending 30 June 2020.

Acquisition-related costs of £5m have been included in operating costs in the income statement for the period ending 30 June 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 this business acquisition.

12. Contingent liabilities

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. From time to time various Group undertakings are parties to legal actions, investigations and claims which arise in the normal course of business. Provision is made for any amounts that the directors consider may become payable. The Group takes legal advice as to the likelihood of success of claims and actions and no provision is made where the directors consider, based on that advice, that the action is unlikely to succeed, or that the Group cannot make a sufficiently reliable estimate of the potential obligation.

13. Events after the reporting period

There were no material events after the balance sheet date requiring disclosure.

14. Shareholder information

The Annual General Meeting of BAE Systems plc will be held on 6 May 2021.

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Cautionary statement:

All statements other than statements of historical fact included in this document, including, without limitation, those regarding the financial condition, results, operations and businesses of BAE Systems and its strategy, plans and objectives and the markets and economies in which it operates, are forward-looking statements. Such forward-looking statements which reflect management's assumptions made on the basis of information available to it at this time, involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of BAE Systems or the markets and economies in which BAE Systems operates to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. BAE Systems plc and its directors accept no liability to third parties in respect of this report save as would arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with Schedule 10A of the Financial Services and Markets Act 2000. It should be noted that Schedule 10A contains limits on the liability of the directors of BAE Systems plc so that their liability is solely to BAE Systems plc.

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