ANNUAL REPORT
2011

BAE SYSTEMS

BAE Systems continues to build on its position as one of the world's largest and most geographically diverse defence, aerospace and security companies.

BAE Systems is focused on delivering sustainable growth in shareholder value through its commitment to Total Performance.

For BAE Systems at a glance see overleaf ▶

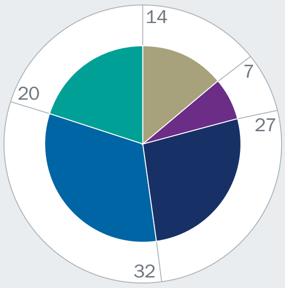
Detica Treidan® protects business-critical information, operations and services from the threat of sophisticated and targeted cyber attacks.

Cautionary statement: All statements other than statements of historical fact included in this document, including, without limitation, those regarding the financial condition, results, operations and businesses of BAE Systems and its strategy, plans and objectives and the markets and economies in which it operates, are forward-looking statements. Such forward-looking statements which reflect management's assumptions made on the basis of information available to it at this time, involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of BAE Systems or the markets and economies in which BAE Systems operates to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. BAE Systems plc and its directors accept no liability to third parties in respect of this report save as would arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with schedule 10A of the Financial Services and Markets Act 2000. It should be noted that schedule 10A and section 463 Companies Act 2006 contain limits on the liability of the directors of BAE Systems plc so that their liability is solely to BAE Systems plc.

BAE SYSTEMS AT A GLANCE

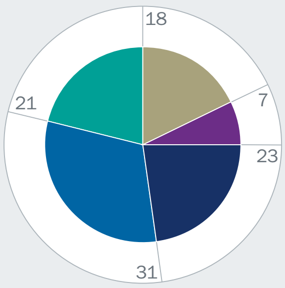
BAE Systems is a global defence, aerospace and security company with approximately 93,500 employees[1] worldwide. The Group delivers a full range of products and services for air, land and naval forces, as well as advanced electronics, security, information technology solutions and support services.

Sales[1,2,3] by reporting segment (%) KPI



- Electronic Systems
- Cyber & Intelligence
- Platforms & Services (US)
- Platforms & Services (UK)
- Platforms & Services (International)

Underlying EBITA[1,3,4] by reporting segment (%) KPI



- Electronic Systems
- Cyber & Intelligence
- Platforms & Services (US)
- Platforms & Services (UK)
- Platforms & Services (International)

20 For more information on the Group's reporting segments

For more information visit www.baesystems.com/businesses

Electronic Systems

Principal operations

Electronic Systems comprises the US- and UK-based electronics activities, including electronic warfare systems and electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

Principal markets

US
UK

Operational key points

- Sustained a leadership position in the electronic warfare market
- Increasing position in high growth commercial aircraft electronics market
- Winning key development contracts in the airborne persistent surveillance market
- Integration of the acquired Fairchild Imaging and OASYS businesses
- Continued focus on increasing productivity and efficiency
- Business recovery in process following disruption due to flood damage at the Johnson City facility

Sales[1,2] £2,645m

Number of employees[1] 13,400

Cyber & Intelligence

Principal operations

Cyber & Intelligence comprises the Group's cyber, secure government, and commercial and financial security activities within the US-based Intelligence & Security business, and the UK-headquartered BAE Systems Detica business.

Principal markets

US
UK

Operational key points

- The US-based business continues to perform well on legacy programmes while securing strategic contract awards with existing customers
- The US-based business continues to invest in differentiating technologies, such as activity-based intelligence and cybersecurity, including a leading edge network, operations and security centre environment, to maintain the relevance of its service offerings
- Successful integration of acquired L-1 Intelligence Services Group, Norkom and ETI businesses
- Growth of commercial sales in Detica offsetting lower UK government volume
- Investment in UK Security Operations Centre

Sales[1,2] £1,399m

Number of employees[1] 8,900

1 Including share of equity accounted investments.
2 Before elimination of intra-group sales.
3 Excluding HQ.
4 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).

Platforms & Services (US)

Platforms & Services (US) comprises the US-headquartered Land & Armaments business, with operations in the US, UK, Sweden and South Africa, together with US-based services and sustainment activities, including ship repair and modernisation services.

US
UK

- Increases in orders and sales in the Support Solutions business
- Support business awarded a ten-year contract to manage, operate and maintain the US Army's Radford Army Ammunition Plant
- Sales reduction in the land business due to lower Bradley reset/remanufacturing activity and completed Family of Medium Tactical Vehicles programme
- Continued restructuring and efficiency activity in the land business
- Participating in the technology development phase of the US Army's Ground Combat Vehicle programme
- Business disposals of Swiss-Photonics, Advanced Ceramics and Composite Structures complete, and Safety Products disposal announced

£5,305m

24,100

Platforms & Services (UK)

Platforms & Services (UK) comprises the Group's UK-based air and maritime activities, and certain shared services activities, including the UK-based Advanced Technology Centre.

UK

- Settlements reached on terminated Nimrod and Harrier programmes
- Rationalisation and efficiency activity ongoing within Military Air & Information
- 45 Typhoon Tranche 2 aircraft delivered to partner nations and first F-35 production aircraft accepted by the US Air Force
- Block construction continued on the first aircraft carrier and first steel cut on the second
- Fourth Type 45 destroyer accepted off contract
- Brazilian Navy to acquire the three cancelled Trinidad and Tobago Offshore Patrol Vessels (OPVs)
- Higher than planned costs to complete the Omani OPVs
- Ambush, the second Astute-class submarine, undertaking commissioning

£6,258m

29,000

Platforms & Services (International)

Platforms & Services (International) comprises the Group's businesses in Saudi Arabia, Australia, India and Oman, together with its 37.5% interest in the pan-European MBDA joint venture.

Saudi Arabia
Australia
India

- Additional budgets approved on the Salam Typhoon programme
- Salam price escalation negotiations continue into 2012
- Customer budgets established for the next five years of support on the Saudi British Defence Co-operation Programme
- First Saudi Typhoon squadron operational
- First Royal Australian Navy Landing Helicopter Dock hull launched
- New UK missile development order received by MBDA
- Typhoon not selected as lowest priced compliant bid for India
- Request for proposal from Oman for Typhoon and associated support

£3,794m

15,900

CONTENTS

STRATEGIC REVIEW

REPORTING SEGMENTS PERFORMANCE REVIEW

GROUP PERFORMANCE REVIEW

GOVERNANCE

The above sections make up the Directors' Report in accordance with the Companies Act 2006.

FINANCIAL STATEMENTS

Further information:
www.baesystems.com

Throughout the report we have used the following icons to help navigate to further information.

Links to pages within this report

Links to pages within our website

If you would like to give us any feedback on this year's Annual Report, please send your written comments to our investor relations team by e-mail to: **investors@baesystems.com**

Further information on corporate responsibility:
www.baesystems.com/corporateresponsibility

This report includes a summary of the Group's corporate responsibility (CR) activities during 2011. It focuses on our strategy, and performance in the key areas of business conduct, safety, diversity and inclusion, and environment.

Our website contains the following information: our approach to CR; managing CR; reporting and assurance; and support for charities and local communities.

2011 SUMMARY AND OUTLOOK

RESULTS IN BRIEF

Results from continuing operations		2011	Restated[1] 2010
Sales[2]	KPI	**£19,154m**	£22,275m
Underlying EBITA[3]	KPI	**£2,025m**	£2,179m
Operating profit		**£1,580m**	£1,601m
Underlying earnings[4] per share:	KPI		
– including R&D tax benefit		**45.6p**	39.8p
– excluding R&D tax benefit		**39.7p**	39.8p
Basic earnings per share[5]		**37.0p**	27.9p
Order book[6]		**£36.2bn**	£39.5bn

Other results including discontinued operations	2011	2010
Dividend per share	**18.8p**	17.5p
Operating business cash flow[7]	**£634m**	£1,187m
Net debt (as defined by the Group)[8]	**£(1,439)m**	£(242)m

KEY POINTS – FINANCIAL

- Headline sales[2] reduced by 14%
- Underlying EBITA[3] of £2,025m (2010 £2,179m) impacted by:
  - a £160m charge in the first half on the Omani Offshore Patrol Vessel (OPV) programme
  - a £125m benefit from a UK Ministry of Defence settlement agreement
  - a £60m benefit from the increase in the carrying value of the Trinidad and Tobago OPVs upon agreement of a sale to the Brazilian Navy
  - deferred recognition of sales and profit relating to the formalisation of price escalation on the Salam Typhoon programme
- Benefit of 5.9p per share from an agreement with the UK tax authorities
- Underlying earnings[4] per share broadly in line with 2010, excluding the tax agreement benefit
- Total dividend increased by 7.4% to 18.8p
- £500m market purchase of shares completed
- $1.25bn (£0.8bn) debt financing completed

KEY POINTS – NON-FINANCIAL

- The implementation programme to address the 23 recommendations of the Woolf Committee has been completed
- The number of injuries resulting in days lost per 100,000 employees has reduced by 11%
- Board diversity target of 25% women achieved

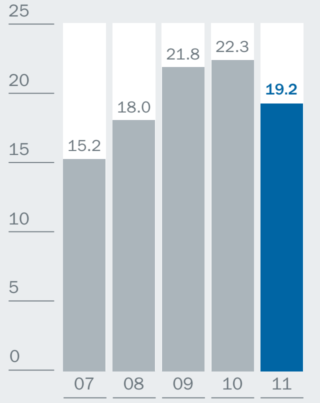
14 For more information on the Group's financial KPIs

46 For more information on the Group's financial performance

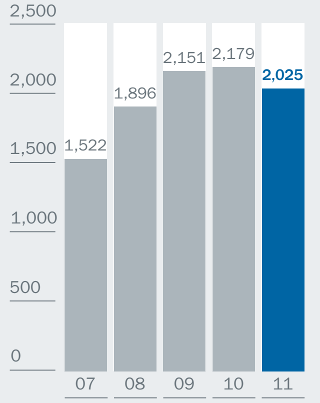
16 For more information on the Group's non-financial KPIs

55 For more information on the Group's corporate responsibility performance

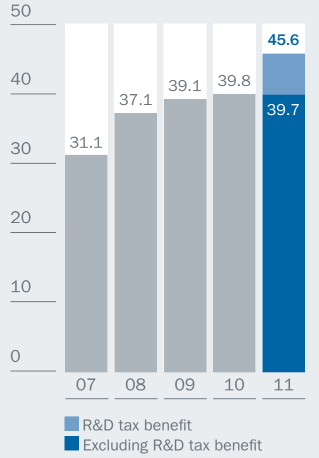
Sales[1,2] (£bn) KPI



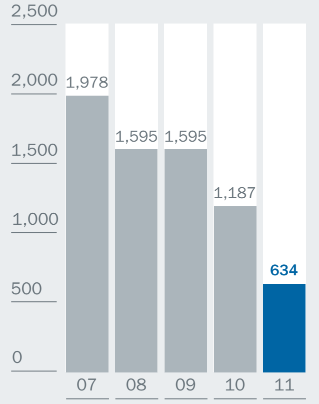
Underlying EBITA[1,3] (£m) KPI



Underlying earnings[1,4] per share (pence) KPI



Operating business cash flow[7] (£m) KPI



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

14 For more information on the Group's KPIs

OUTLOOK

Whilst little sales[2] growth can be expected for the Group in 2012 in the current market conditions, modest growth in underlying earnings[4] per share is anticipated, assuming a satisfactory conclusion to Salam negotiations in 2012 and excluding the benefit of the 2011 Research & Development tax settlement.

- Electronic Systems sales[2] in 2012 are expected to be broadly similar to those in 2011 with margins expected to be within a range of 12% to 14%.
- Mid-single digit sales[2] growth is expected for Cyber & Intelligence in 2012 with margins expected to be in the 8.5% to 9.5% range.
- In Platforms & Services (US), Land & Armaments sales[2] of around \$5bn (£3.1bn) are anticipated with margins approaching 10%. Sales[2] in Support Solutions are anticipated to be similar to the 2011 level with slightly lower margins.
- Sales[2] for Platforms & Services (UK) are expected to remain broadly similar to last year's with margins anticipated to be within a 10% to 12% range.
- Significant growth in sales[2] for Platforms & Services (International) is anticipated with margins expected around the 10% level.
- HQ costs are expected to be broadly similar to 2011 and Group earnings are expected to reflect lower finance costs. An effective tax rate within a 26% to 28% range is now expected.

A higher level of operating business cash inflow[7] is planned for the Group with the anticipated benefit of cash payments related to the Salam programme in 2012.

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7 to the Group accounts).
2 Including share of equity accounted investments.
3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
4 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 8 to the Group accounts).
5 Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.
6 Including share of equity accounted investments' order books and after the elimination of intra-group orders of £1.3bn (2010 £1.4bn).
7 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.
8 See page 48 and note 10 to the Group accounts.

CHAIRMAN'S LETTER

Dick Olver
Chairman

BAE Systems maintains a well-defined strategy with a defence focus at its core, but with the flexibility to adapt to changes in the business landscape. As markets have evolved, with changing customer priorities, the Group's strategy has also evolved to good effect.

There were three essential elements to the Group's strategy in 2011, each of which progressed in the year. Firstly, the Group targeted development of export business to sustain and, over time, build on its established Platforms business. Secondly, it sought to build on the geographic footprint which is a differentiating characteristic of the Group. Thirdly, the Group targeted growth in the cybersecurity market. As a consequence of the actions taken to support this strategy, BAE Systems has developed significant capability in the field of cybersecurity.

With budget pressures now prevalent in many markets, and expected to continue, sales growth has become more challenging. Recognising the significant changes taking place in its markets, the Group will continue to develop within this strategic framework, driving from its established core defence capabilities to address the emergent demand for cybersecurity and intelligence capabilities, to address higher growth segments of the electronics markets, and build on its successes in international markets.

Agility at all levels of the Group is becoming ever more important whether it be responding to meet urgent customer requirements or moving to re-position the Group's business portfolio to address changes in markets. BAE Systems will continue to keep its strategy under review and will move to adjust its portfolio of businesses where it is in the interests of shareholders to do so.

> **"Agility at all levels of the Group is becoming ever more important."**

BAE Systems has been successful in its drive for cost efficiencies to enhance competitiveness, and generate value through higher return on sales and the generation of cash flow. With the benefit of that cash flow, the Group's allocation of capital aims to address pension obligations, organic investment in the business, pay dividends, generate accelerated returns to shareholders when the balance sheet allows and fund business development for the longer term. Capital allocation in 2011 addressed all these items, including a £500m repurchase of the Group's shares.

BAE Systems is a results-focused business, but great importance is also attached to the way it conducts its business. The Group continues to pursue an integrated approach to performance in all aspects of its business life. This Total Performance approach includes the setting of financial and non-financial objectives for management. Further details of this Total Performance approach, and the way it embraces all employees, can be found on page 9 of this report.

BAE Systems is committed to maintaining a work environment in which a diverse range of talented people work together to improve business performance and competitive advantage. A diverse workforce, with employees drawn from all backgrounds, encourages innovation, improves productivity and brings the Group closer to its customers.

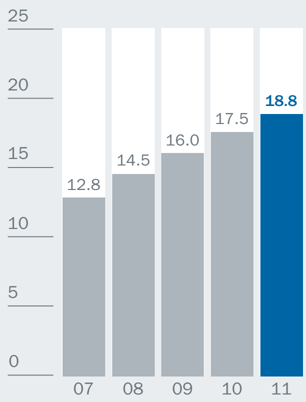
Consistent with this commitment to improve the diversity of its workforce, the Group currently meets its aspirational target of having at least 25% of the Board consisting of women.

Following the publication of the report by the Woolf Committee in 2008, the Group initiated an extensive programme to address the 23 recommendations of the Committee. Implementation of that programme was completed in May 2011. This has established a firm platform on which we continue to build. The Group remains committed to a programme of continuous improvement to position BAE Systems in the vanguard of best practice in the area of responsible business conduct.

7.4%

increase in dividend on 2010

Dividend (pence per share)



The Board has recommended a final dividend of 11.3p per share making a total of 18.8p per share for the year.

In May 2011, the Company and the US Department of State reached a civil settlement in connection with violations of the US defence export control regulations that were the subject of the earlier settlement with the US Justice Department announced by the Company in 2010. Under the agreement with the Department of State, the Company agreed to pay a fine of up to $79m (£49m) in respect of alleged civil violations. The fine is payable over a period of three years, subject to a reduction of up to $10m (£6m) in respect of the cost of enhanced export control compliance measures already implemented by the Company and planned for implementation during the four-year period from the settlement date. In addition, a limited number of the Company's UK-originated export programmes will be subjected to enhanced administrative review, which is not expected to adversely impact the Company's current or future export programmes. The Company also agreed to make additional commitments concerning its ongoing compliance and, pursuant to those commitments, appointed a Special Compliance Official for a period of up to three years to monitor compliance with such commitments.

The success of the business is built on the hard work, creativity and commitment of our workforce. I am pleased to be able to recognise formally many of their achievements through the annual Chairman's Awards. We were delighted to also see external recognition. Joe Murphy, Training Co-ordinator – Structural Welding, and Philip Burns, Engineering Manager, for Submarine Solutions, were made Members of the Order of the British Empire (MBE) for services to the defence industry.

Directors and management

George Rose, Group Finance Director, retired from the Board on 31 March 2011 after 19 years with the Group. Peter Lynas, previously Director, Financial Control, Reporting and Treasury, was appointed Group Finance Director with effect from 1 April 2011, and joined the Board and Executive Committee on that date.

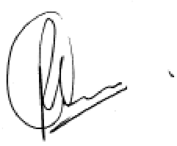
Also with effect from 1 April 2011, Ravi Uppal, a non-executive director, stood down from the Board and Paula Rosput Reynolds was appointed a non-executive director of the Company. On 1 June 2011, Lee McIntire was appointed a non-executive director. Having completed a second term of three years as a non-executive director, Roberto Quarta stood down from the Board at the end of 2011. Also, after nearly nine years on the Board, Michael Hartnall will stand down at the Annual General Meeting on 2 May 2012. I would like to record my thanks and appreciation for the contributions that both Roberto and Michael have made to the working of the Board and its committees.

Summary

In the current challenging business environment, the Group continues to take the actions the Board believes are necessary to remain competitive and to deliver value for shareholders.

In addition to its well established positions on priority programmes, providing key capabilities to support the needs of defence and security customers, the Group has strong positions in electronic systems and cybersecurity, together with significant international presence. These strengths provide a good base of activity which, with a continued focus on cost, is expected to result in a resilient business performance.

The Board has recommended a final dividend of 11.3p per share making a total of 18.8p per share for the year, an increase of 7.4% over 2010. At this level, the annual dividend is covered 2.1 times by underlying earnings from continuing operations excluding the R&D tax benefit (2010 2.3 times). Subject to shareholder approval at the 2012 Annual General Meeting, the dividend will be paid on 1 June 2012 to holders of ordinary shares registered on 20 April 2012.



Dick Olver
Chairman

STRATEGY

The Executive Committee focuses on evolving and delivering the Group's strategy. For 2012, the Group Strategic Framework has been refreshed.

Our Vision is to be the premier global defence, aerospace and security company

Our Mission is to deliver sustainable growth in shareholder value through our commitment to Total Performance

Customer Focus | Programme Execution | Financial Performance | Responsible Behaviour

Our Values are Trusted, Innovative and Bold

Our Strategy

– Support our customers in safeguarding their vital interests

– Drive shareholder value by improving financial performance and competitive positions across the business

Strategic Actions

- **Improve profit and cash generation**
- **Grow our Cyber, Intelligence and Security business**
- **Grow Electronic Systems**
- **Drive value from our Platforms and Services positions**
- **Increase our international business**

Integrated Business Plans

Executive Committee Key Objectives

1. Financial Performance	Meet 2012 financial targets
2. Electronic Systems	Be agile, sustain revenues and deliver strong bottom line performance
3. Cyber, Intelligence and Security	Establish a leading position in Cyber, Intelligence and Security
4. Platforms & Services (US)	Drive value from our land portfolio and deliver sustainable, profitable growth in the Services sector
5. Platforms & Services (UK)	Deliver in the UK sustainably profitable through-life businesses in the air and maritime sectors
6. Platforms & Services (International)	Increase our Platforms & Services (International) business
7. Customer Focus and Programme Execution	Continued focus on improving customer satisfaction and programme execution
8. Responsible Behaviour	Progress towards recognised leading positions

Vision

BAE Systems' Vision provides a clear definition of the future state we wish to attain. Given the significant changes we see in our core defence markets and upon reviewing our strategic options, we made a decision to develop our growing commercial aerospace electronics business, as part of our portfolio.

Whilst the Vision defines the destination, a commitment to Total Performance guides the actions for the benefit of all of the Group's stakeholders. This is embedded in the Group's Mission.

Mission

The Group's Mission describes the overall goal and philosophy that underpins our activities. Meeting the Mission is key to achieving the Vision.

Shareholder value is defined as share price appreciation and dividend growth, driven by increased earnings per share and strong cash generation.

Total Performance is demonstrated in every aspect of the way the Group does business – Customer Focus, Programme Execution, Financial Performance and Responsible Behaviour.

We believe that by embodying the four elements of Total Performance wherever we operate, we will deliver growth in shareholder value, and become the premier global defence, aerospace and security company.

Strategy

The Strategy provides the framework which defines the direction and shape of the Group over the long term. This enables us to prioritise the deployment of our resources in an increasingly challenging environment.

We anticipate that defence budgets in certain of our major markets will experience a significant reduction. As governments seek to reduce fiscal deficits, we have reviewed and adjusted the Strategy to ensure we continue to perform well.

The key elements of the Group's Strategy are as follows:

Support our customers in safeguarding their vital interests
We operate in the defence, aerospace and security markets, which in turn have their own unique market drivers. The Group's Strategy is to deeply understand the needs of our customers in each of these markets and recognise that their needs will be subject to rapid changes. We need to be agile as an organisation, to enable us to identify our customers' vital needs, and prioritise capabilities which support their vital interests, creating demand for our products and services.

Drive shareholder value by improving financial performance and competitive positions across the business
The current environment is increasingly competitive and, to deliver growth in shareholder value, the Group will focus on generating strong cash flows and profits. Improving efficiency in the Group's operations will also make it more competitive to win future business. All the Group's operations in the defence, aerospace and security markets must strive to increase value and eliminate non-value-added activity, whilst maintaining a commitment to Total Performance. We have already demonstrated good performance in terms of reliable programme delivery, customer focus and efficiency, including determined steps on cost reduction. This must continue in 2012 and beyond.

Integrated Business Plans

The Integrated Business Planning process is an annual, two-stage process that culminates in a BAE Systems Board and Executive Committee approved five-year strategic and financial plan, which is used to shape the Strategic Actions. For more information on the process see page 105.

Strategic Actions

The Group Strategic Framework contains five Strategic Actions. These flow directly from the Group's Vision, Mission and Strategy, and are designed to shape the business portfolio and strengthen performance over the long term. These actions translate the Group's overarching strategy into operational plans that are delivered through our lines of business.

Executive Committee Key Objectives

The Executive Committee Key Objectives focus on specific deliverables in support of delivery of short-term results and the overall strategy.

The Executive Committee has set the objectives shown opposite for 2012. The aim of these objectives is to provide focus for the leadership and engagement of people at all levels of the Group. A review of performance against these objectives will be contained in the 2012 Annual Report. Performance against the 2011 objectives is summarised on page 13.

20 For more information on the performance of the Group's reporting segments

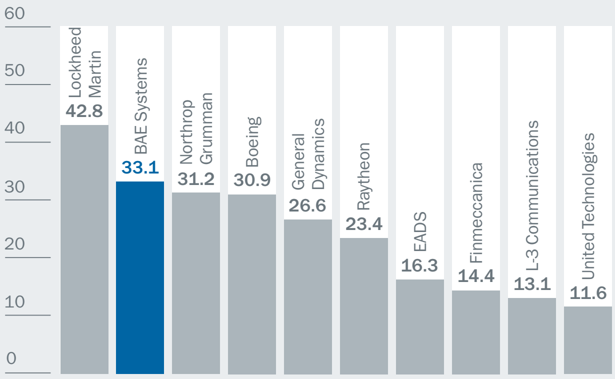
BUSINESS MODEL

Who we are

BAE Systems is a global defence, aerospace and security company. The Group's business model is to deliver sustainable growth in shareholder value through Total Performance. This guides actions for the benefit of all its stakeholders.

OUR GLOBAL DEFENCE MARKET POSITION ($BN)

In 2010, BAE Systems was the second largest global defence supplier. This represented a continuation of the Group's strong position in its domestic and international markets overall.



Top ten global defence companies (based on 2010 defence revenue)
Source: Defense News

What we do

BAE Systems delivers a full range of products and services for air, land and naval forces, as well as advanced electronics, security, information technology solutions and support services.

OUR REPORTING SEGMENTS

The business is reported through five principal reporting segments, recognising the focus on the services nature of the Group's business and the broad geographic base of its operations.

Electronic Systems	Cyber & Intelligence	Platforms & Services (US)	Platforms & Services (UK)	Platforms & Services (International)

20 For more information on the activities of the Group's reporting segments

How we do it

BAE Systems is committed to developing a culture of Total Performance, which encompasses Customer Focus, Programme Execution, Financial Performance and Responsible Behaviour.

Customer Focus

The Group's priority to all its customers is to understand their needs and expectations, and deliver on its commitments throughout the life of the products and services it delivers. Schedule adherence metrics, relating to milestone performance across the Group's major contracts, together with customer satisfaction, are key indicators of Customer Focus.

Programme Execution

The Group's performance is dependent on the successful execution of its projects. It is important that the Group wins and contracts for high quality new programmes, and delivers on those projects within tight tolerances of quality, time and cost performance in a reliable, predictable and repeatable manner. Key indicators of performance include outturn projections of, and movements in, margin of key customer-funded projects, and customer satisfaction.

Financial Performance

The Group sets itself challenging financial targets through its Integrated Business Planning process. Financial Performance is measured through a range of key financial salients derived from the Group's consolidated financial statements, including order intake[1], sales[1], underlying EBITA[2], underlying earnings[3] per share and operating business cash flow[4].

Responsible Behaviour

Responsible Behaviour is embedded within the business. The Group's Code of Conduct is a summary of the principles and standards of business conduct expected of all employees. Together with the Group's Responsible Trading Principles, the Code of Conduct underpins its business activities. Metrics exist to measure safety, diversity and inclusion, and environment.

14 For more information on the Group's KPIs

OUR OPERATIONAL FRAMEWORK

The Operational Framework sets out how the Group does business, wherever it operates in the world. The Operational Framework is based on principles of good governance, and outlines the Group's values, policies and processes.

105 For more information on the Group's Operational Framework

OUR APPROACH TO RISK MANAGEMENT

Effective management of risks and opportunities is essential to the delivery of the Group's strategic objectives, achievement of sustainable shareholder value, protection of its reputation and meeting the requirements of good corporate governance. The Group's risk management policy is set out in the Operational Framework.

60 For more information on the Group's approach to risk management and principal risks

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
3 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 8 to the Group accounts).
4 Net cash flow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

CHIEF EXECUTIVE'S REVIEW

Ian King
Chief Executive

BAE Systems is operating in a difficult business environment as defence spending reduces in its largest markets, the US and UK. These market pressures have been apparent for some time. BAE Systems has moved quickly to take strategic actions it believes necessary to sustain and position the business for the future.

BAE Systems has been driving down its cost base and improving efficiencies. At the same time, the Group is developing its Services positions, investing in growth streams of business and developing international markets. The high number of export campaigns in the Group is at a level unprecedented in recent years.

In October 2011, the Group announced changes to its external reporting segments. The changes provide improved visibility of the performance of its Electronic Systems and Cyber & Intelligence businesses, and align with the Group's strategic direction.

Services-related activities represented approximately 49% of sales in 2011. These activities include the provision of Cyber & Intelligence and Military & Technical Services, the latter delivering enhanced capabilities, whilst reducing costs for its customers in the air, land and maritime defence domains.

During the year, the Group has invested in cyber and intelligence through both organic development and through a series of small, high quality acquisitions. These acquisitions included, in February 2011, L-1 Identity Solutions, Inc.'s Intelligence Services Group, a leading provider of security and counter threat capabilities to the US government, and Norkom Group plc, a market-leading provider of innovative anti-money laundering solutions to counter financial crime to the global financial services industry. ETI A/S, a recognised provider of advanced security products and services to government and commercial clients worldwide, was acquired in March 2011, and stratsec.net Pty Limited, an information security company with offices in Australia, Malaysia and Singapore, was acquired in January 2011.

> **"BAE Systems has moved quickly to take strategic actions it believes necessary to sustain and position the business for the future."**

Growth opportunities in the cyber domain arise from both the increasing priority of governments addressing cyber threats and the rapid increase in requirements within the commercial sector.

BAE Systems also identifies and prioritises fast growth lanes within the electronics market. The Group is an industry leader in key areas of high technology electronics for both defence and commercial aerospace activities. It continues to see growth opportunities in both its commercial avionics activities and parts of its defence product portfolio. In April 2011, BAE Systems acquired the 91.3% of outstanding equity of Fairchild Imaging, Inc. not already held by the Group. Fairchild is a provider of solid-state electronic imaging components, cameras and systems.

The Group has continued to review its business portfolio and has undertaken a number of non-core business disposals. In January 2011, the Group sold its Swiss-Photonics AG group. In June 2011, the Group sold its remaining shareholding in Saab AB. In July 2011, BAE Systems sold its Regional Aircraft Asset Management and US-based Composite Structures businesses. In September 2011, the Advanced Ceramics business in California was sold. In December 2011, the Group announced an agreement for the sale of its Safety Products businesses, which is expected to complete in the first quarter of 2012.

In aggregate, approximately £0.3bn was invested in business acquisitions, net of disposals, during the year.

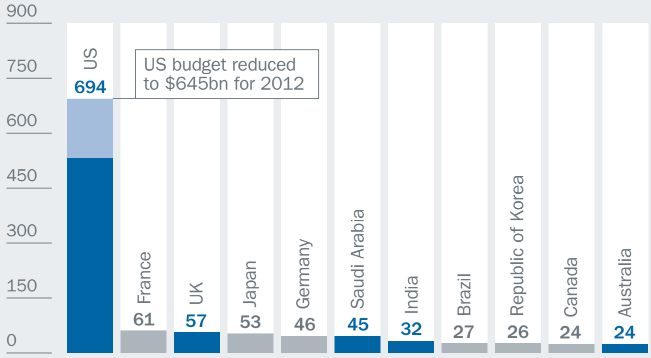
HOME MARKETS

US
BAE Systems is a major supplier to the US Department of Defense, offering a balanced portfolio of products and services across defence and security domains, including the operational support of equipment used around the world by US forces and their allies. Whilst the US continues to lead global defence expenditure, investment spending is expected to decline as the government seeks to reduce its deficit. As a major supplier in the US market, BAE Systems is focusing on competitiveness and affordability to improve profit and cash generation.

UK
The Group plays an important role in the UK's defence capabilities across air, maritime and land platforms, including military and technical service contracts. BAE Systems also operates in the security and intelligence domain, with customers in both government and commercial markets. The UK has benefited from better clarity on spending priorities following the publication of the Strategic Defence and Security Review in 2010, and BAE Systems is working with its customer to ensure their vital interests are secured.

Kingdom of Saudi Arabia
BAE Systems is a leading in-country defence supplier, supporting the operational capability of the Saudi air, land and naval forces, and investing in the development of Saudi indigenous defence capabilities. This established position continues to provide the Group with opportunities to capture returns from this key market.

Top 11 defence markets accessible for business by the Group ($bn)



Home markets   Overseas Contingency Operations budget

Source: BAE Systems' internal analysis (based on 2010 total defence expenditure)

Australia
The Group is the largest defence supplier, providing leading capability across air defence, land combat systems, maritime systems and security.

India
India continues to develop as a home market. BAE Systems is investing in its presence through technology sharing and inward investment in this growing defence and security market.

BAE Systems is well positioned on a number of key platforms programmes, such as Typhoon and F-35 combat aircraft, as well as in the areas of naval ships and fighting vehicles. These programmes form a large core of business with good, multi-year order book visibility. Additionally, such programmes can generate substantial Services business throughout the in-service life of the product.

The development of business across a broad international base of operations provides a robust portfolio of activity and contributes to the resilience of the business at a time when defence spending is under pressure in the US and UK markets.

The Group has also moved to capture business in non-defence markets, including commercial aerospace electronics. BAE Systems' strategy to grow its presence in the cyber and intelligence markets is proving successful, with around 7% of its business now generated in this area of activity.

BAE Systems has been quick to recognise that affordability is a priority for customers and has cut costs and improved efficiency to address reducing demand in some activities and to ensure continued value for customers. Cost reduction and efficiency actions have been underway since 2009 and, as part of these actions, there has been a need to reduce workforce across the Group. Excluding M&A activity, there has been a net headcount reduction of approximately 22,000 (including contractors) in the past three years. These cost reduction programmes will assist the Group in winning new business, managing workloads and delivering value for customers, and be of sustained benefit to the Group's performance.

The Group's customers in its home markets of the US, UK, Saudi Arabia, Australia and India have a significant and sustained commitment to defence and security budgets across multiple domains, welcome foreign investment, and sustain a domestic industrial capability.

US
BAE Systems' US-led businesses contributed 47% of the Group's sales in 2011.

As anticipated, vehicle production and reset activity reduced significantly in the US land vehicles business reflecting the drawdown of US overseas military operations.

Delays in approving Department of Defense budgets resulted in the Group's US defence businesses operating under Continuing Resolution limitations for seven months of 2011. BAE Systems' business remained resilient through this period, with only a modest amount of sales lost or deferred as a consequence.

The Group's US-based electronics business was impacted by serious flood damage at its Johnson City facility resulting in some sales deferral to 2012.

The Group had success in winning new business in 2011, but several large contract starts were delayed due to bid protests by competitors. A contract, worth approximately $850m (£547m) over ten years, to manage, operate and maintain the Radford Army Ammunition Plant in the US was awarded to the Group in May 2011, but the programme start was delayed into early 2012 with the US Army confirming the award in January 2012. Similarly, in August 2011, the Group was one of two successful teams selected to participate in the 24-month technology development phase of the US Army's Ground Combat Vehicle programme. BAE Systems, together with Northrop Grumman, was awarded a $450m (£290m) contract, but the programme start was delayed until December 2011 while a protest by SAIC was evaluated and rejected by the General Accounting Office.

Whilst the near-term US budgetary and procurement issues have had only modest impacts on the business, there remains significant uncertainty as to the impact of both planned and potential additional deficit reduction actions on US defence budgets over coming years.

UK
Pressure on UK budgets remains, but following publication of the Strategic Defence and Security Review (SDSR) in October 2010 and resulting actions, there is now greater programme stability and alignment of funding with government defence programme commitments. The post-SDSR programme changes have reduced the

CHIEF EXECUTIVE'S REVIEW *(continued)*

Group's annual sales by some £500m. Actions were taken to mitigate the impact of these changes, including workforce reductions, facility rationalisation and contract settlement agreements.

The Group continues to work with its UK customer to help to identify further efficiency improvements.

Other home markets
In addition to its US and UK operations, BAE Systems has established leading market positions in Saudi Arabia and Australia. In addition, the Group is pursuing its strategy, establishing India as a home market.

In the Kingdom of Saudi Arabia, where defence spending remains a high priority and is growing, the Group is working to deliver a broad range of capabilities. The established core business, including support to Tornado aircraft in service with the Royal Saudi Air Force under the Saudi British Defence Co-operation Programme (SBDCP), continues to deliver good performance, and 24 Typhoon aircraft have been successfully introduced into service under the first phase of the Salam programme.

BAE Systems has been in discussions with its customer regarding changes to the Salam programme. The proposed changes relate to final assembly of the last 48 of the 72 Typhoon aircraft, the creation of a maintenance and upgrade facility in the Kingdom of Saudi Arabia, initial provisioning for subsequent insertion of Tranche 3 capability in respect of the last 24 aircraft of this order and formalisation of price escalation.

Good progress on these discussions has been made in 2011, with budgets approved in the Kingdom in December on all items other than the price escalation where negotiations will now continue into 2012. Budgets have also been established for the next five years of support on the core SBDCP, including an upgrade of the training environment. Formal contracts under these budgets are being progressed.

These budget approvals underpin both the Salam and SBDCP programmes.

In Australia, the Group has continued to build on its position as the leading in-country provider of equipment and support to the Australian armed forces, working with the Australian government to deliver against a clearly laid out multi-year defence and security plan.

Defence spending in India is also expected to grow substantially. The supply of Hawk aircraft continues with local assembly by Hindustan Aeronautics. A land systems joint venture with Mahindra & Mahindra has been established with significant armoured vehicle and artillery opportunities being pursued. In January 2012, the Group was notified that Typhoon had not been selected as the lowest priced compliant bid to meet the requirement for a Medium Multi-Role Combat Aircraft. The programme has a long way to go before a contract is awarded and we continue to actively support the bid.

Pension funding
In April 2011, the trustees of the Group's two largest UK pension schemes, the BAE Systems Pension Scheme and the BAE Systems 2000 Pension Plan, commenced triennial funding valuations. These have been concluded and revised funding profiles agreed.

Balance sheet and capital allocation
Pension funding is a significant obligation for BAE Systems, but it remains only a part of the allocation of capital. In addition to meeting its pension obligations, the Group expects to continue organic investment in its businesses, plans to continue to pay dividends in line with its policy of a long-term sustainable cover of around two times earnings and to make accelerated returns to shareholders when the balance sheet allows. Investment in value enhancing acquisitions will continue to be considered where market conditions are right and where they deliver on the Group's strategy.

The Group's balance sheet will continue to be managed conservatively, in line with the Group's policy to retain its investment grade credit rating, and to ensure operating flexibility.

Total Performance
Total Performance is not just about what the Group does, but also about how it does it. Building a culture of Total Performance means focusing on delivering shareholder value, on meeting the needs of the Group's customers and acting responsibly at all times.

Embedding the importance of non-financial performance measures in the culture of the Group, through the drive for a more integrated, Total Performance, approach, is an important part of the Group's development.

BAE Systems is committed to becoming recognised as a leader in business conduct. The Group continues to reinforce a culture of Responsible Behaviour across the business. Mandated policies and processes within the Operational Framework are reviewed and, where appropriate, updated to ensure they best reflect the Group's Responsible Trading Principles. Employees in all markets receive training to help them apply the Group's global Code of Conduct. The Group-wide rollout of this training was completed as scheduled in May 2011 and refresher training continues.

BAE Systems continues to drive high standards of safety across the business. This year, the Group achieved an 11% improvement against its targeted metric and progressed the implementation of the safety maturity programme. Looking forward, the Group will be focusing on a broader set of metrics, whilst ensuring that safety remains a priority.

Maintaining and developing the skills and capabilities of its employees is a key factor in the sustained success of the Group. As well as Total Performance Leadership programmes, the Group provides appropriately tailored leadership and competency frameworks in each of its principal markets. The Group's 'Developing You' programme continued to deliver training across a number of functional specialities, and a diversity and inclusion strategy was adopted to better support the recruitment, retention and engagement of talented employees from all backgrounds.

Although we are operating in a challenging business environment, BAE Systems' continued focus on cost efficiency, together with its broad geographic base, and strong positions in defence, aerospace and security markets, are expected to sustain this resilient business.

Ian King
Chief Executive

EXECUTIVE COMMITTEE KEY OBJECTIVES – 2011 PERFORMANCE

The Board reviews and updates the Group's strategy annually. The Chief Executive and Executive Committee agree the Group's Strategy, Strategic Actions and Integrated Business Plans. In addition, there are annual objectives agreed by the Chief Executive and Executive Committee with the Board which focus on specific deliverables in support of both delivery of short-term results and overall strategy. The specific in-year performance indicators used to measure performance against the Executive Committee's key objectives are discussed below.

	Objective	2011 performance	
1	**Financial Performance** Meet 2011 financial targets and deliver sustainable growth in shareholder value	The Group's targets for underlying earnings[1] per share, and average and year-end net debt were exceeded.	46
2	Grow our International presence through implementation of our home market strategy	In Saudi Arabia, budgets were approved on the Saudi British Defence Co-operation Programme and Salam Typhoon programme, other than for price escalation. In Australia, stratsec.net, an information security company, was acquired, construction of two Landing Helicopter Docks progressed, with the first hull launched, and the business has been awarded a A$267m (£176m) Royal Australian Navy frigate upgrade contract. In India, the land systems joint venture commenced sales of its first new vehicle.	40
3	US product businesses: Deliver actions to drive increased shareholder value	Efforts to align the cost base to the reduced activity in the Land & Armaments business continued and a number of strategic business disposals were completed. The business was awarded a $450m (£290m) contract to participate in the technology development phase of the US Army's Ground Combat Vehicle programme. At Electronic Systems, Fairchild Imaging was acquired, and the business strengthened its positions in growth areas, such as commercial aerospace electronics.	24 32
4	Deliver in the UK sustainably profitable through-life business in the air and maritime sectors, and grow our security business	In air, settlement agreements were reached on the terminated Nimrod and Harrier programmes, and there was a continued focus on rationalisation and efficiency, with approximately 2,700 further potential job losses announced. In maritime, whilst there were delays on the Oman OPV programme, aggregate schedule adherence metrics improved and a £120m contract for the sale of the Trinidad and Tobago OPVs to Brazil was signed. In Cyber & Intelligence, the Group's Detica business acquired Norkom and ETI.	28 36
5	US Services businesses: Build a foundation for sustained profitable growth	The Support Solutions business increased its in-year order intake, with good performance in ship repair. Business was taken from its competitors, including the $850m (£547m) Radford Army Ammunition Plant management contract. In Cyber & Intelligence, the Group's Intelligence & Security business acquired L-1's Intelligence Services Group.	28 32
6	Implement our global initiatives within the five-year plan	There has been collaboration across the Group's security businesses. For example, Detica's products will be amongst the first to be brought to market by the Group's new security business in India. In military and technical services, the pipeline of major strategic opportunities identified increased from less than ten to more than 30.	20
7	Continue to develop and deliver business within export markets	The Group secured orders from over 90 countries, including the OPVs, M113 upgrades and flight controls to Brazil, Hawk support to India, and RG31/32 vehicles to Spain, Sweden, Finland and the United Arab Emirates.	20
8	**Customer Focus** Focus on our commitments to our customers through schedule performance	The Group has continued to deliver on its commitments to customers, delivering an aggregated improvement in schedule adherence on milestones across major projects.	16
9	**Programme Execution** Further enhance programme execution through cost performance	Programme execution has been good with the Group delivering an aggregated improvement in outturn margin across its major programmes.	17
10	**Responsible Behaviour** Progress towards recognised leadership position	Management has continued to embed its corporate responsibility agenda as part of the Group's Total Performance drive. Objectives in respect of business conduct, safety, diversity and inclusion, and environment have been achieved.	55

14 For more information on the Group's KPIs

60 For more information on the Group's approach to risk management

1 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 8 to the Group accounts).

KEY PERFORMANCE INDICATORS (KPIs)

The Board uses a range of quantitative financial and non-financial performance indicators, reported on a periodic basis, to monitor the Group's performance against its Total Performance and Executive Committee key objectives. Executive directors' remuneration is linked to certain of these measures.

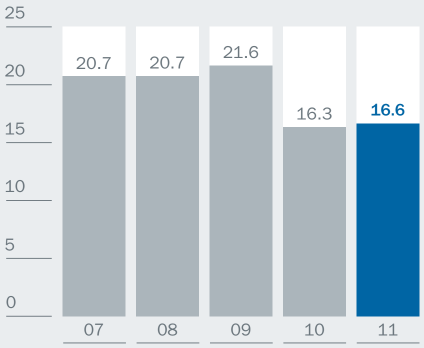
Financial Performance

The Group sets itself challenging financial targets through the Integrated Business Planning process to improve financial performance and drive shareholder value.

13 2011 Executive Committee key objectives
62 Principal risks

Order intake[1,2] (£bn)

£16.6bn
2010: £16.3bn



Target[6] not achieved

Part of the executive directors' 2011 annual incentive

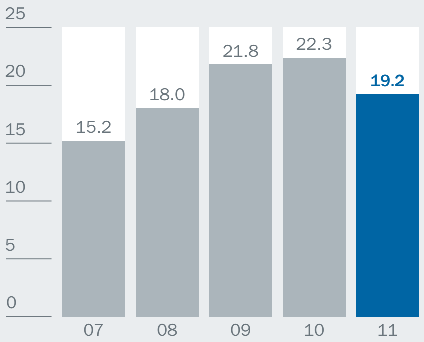
Definition
Order intake represents the value of funded orders received from customers in the year. It is a measure of in-year performance and supports future years' sales performance.

Comment
Whilst order intake[2] is marginally above the prior year, the target assumed significant contract awards for changes to the Salam Typhoon programme and the next phase of support on the Saudi British Defence Co-operation Programme (SBDCP), and for the supply of Typhoon aircraft to Oman.

Budgets were approved in 2011 on SBDCP and Salam Typhoon, with the exception of price escalation, and formal contracts under these budgets are being progressed. Contract award on Typhoon for Oman is expected during 2012 following receipt of the formal request for proposal.

Sales[1,2] (£bn)

£19.2bn **-14%**
2010: £22.3bn



Definition
Sales represents the amounts derived from the provision of goods and services, and includes the Group's share of sales of its equity accounted investments.

Comment
The 15% like-for-like decrease in sales[2] this year has primarily been driven by the lower level of Bradley reset/remanufacturing activity and completed Family of Medium Tactical Vehicles programme in the Land & Armaments business, and the impacts of the Strategic Defence and Security Review on the UK business.

Sales[2] in 2011 have been impacted by the deferral of trading relating to the formalisation of price escalation on the Salam Typhoon programme.

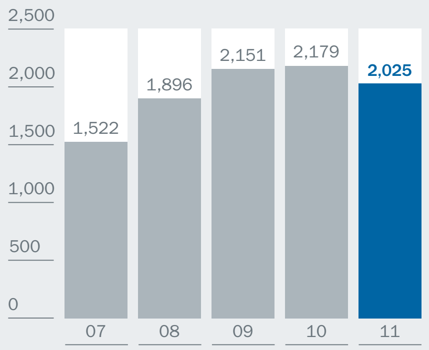
47 Sales[2] bridge chart

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7 to the Group accounts).
2 Including share of equity accounted investments.
3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).

Underlying EBITA[1,3] (£m)

£2,025m **-7%**

2010: £2,179m



Definition

Underlying EBITA is used by the Group for internal performance analysis as a measure of operating profitability that is comparable over time. It excludes amortisation and impairment of intangible assets, finance costs and taxation expense, and non-recurring items (these are profit/loss on disposal of businesses, pension accounting gains and regulatory penalties).

Comment

Underlying EBITA[3] in 2011 includes:

- a £160m charge in the first half on the Omani Offshore Patrol Vessel (OPV) programme;
- a £125m benefit from a UK Ministry of Defence settlement agreement relating to the recovery of rationalisation costs charged to the income statement in prior years; and
- a £60m benefit from the increase in the carrying value of the Trinidad and Tobago OPVs upon agreement of a sale to the Brazilian Navy.

Underlying EBITA[3] in the prior year included a charge of £100m taken in respect of the terminated Trinidad and Tobago OPV contract.

Underlying EBITA[3] in 2011 has been impacted by the deferral of trading relating to the formalisation of price escalation on the Salam Typhoon programme.

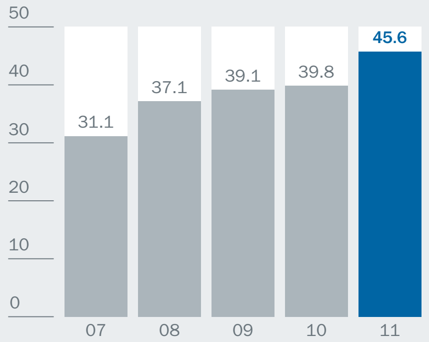
Return on sales increased to 10.6% (2010 9.8%).

47 Underlying EBITA[3] bridge chart

Underlying earnings[1,4] per share (pence)

45.6p **+15%**

2010: 39.8p



Target[6] achieved

Part of the executive directors' 2011 annual incentive

Definition

Underlying earnings represent profit for the year attributable to equity shareholders excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 8 to the Group accounts). Underlying earnings per share provides a measure of shareholder return that is comparable over time.

Comment

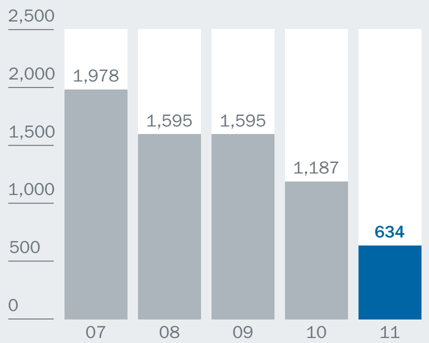
The 5.8p increase in underlying earnings[4] per share includes a 5.9p tax benefit arising as a result of an agreement with the UK tax authorities addressing a number of items, including research and development tax credits.

48 Underlying earnings[4] per share bridge chart

Operating business cash flow[5] (£m)

£634m

2010: £1,187m



Target[6] achieved

Part of the executive directors' 2011 annual incentive

Definition

Operating business cash flow represents net cash flow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

Comment

The reduction in operating business cash flow[5] reflects the lower activity in the Land & Armaments business, and utilisation of advance funding in Platforms & Services (UK) and Platforms & Services (International). A significant cash receipt expected on the Salam Typhoon programme has been deferred until ongoing negotiations regarding price escalation have been concluded.

4 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 8 to the Group accounts).
5 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.
6 The target is the Group's budget for the year, which represents the first year of the five-year Integrated Business Plan (see page 7).

KEY PERFORMANCE INDICATORS *(continued)*

Customer Focus

The Group's priority is to understand its customers' needs and expectations, and deliver on its commitments throughout the life of its products and services.

13 2011 Executive Committee key objectives
62 Principal risks
105 Lifecycle Management

Schedule adherence

Performance

The Group targets an aggregated improvement in schedule adherence metrics relating to milestones across its major contracts.

Schedule adherence metrics can only be fully interpreted and understood on a contract-by-contract basis and, therefore, aggregated data is not presented.

Target achieved

Part of the executive directors' 2011 annual incentive

Definition

Schedule adherence measures the timing of achievement of key milestones. It shows how well the Group is performing against key contract commitments to its customers.

Comment

The data for the schedule adherence metric included 100 (2010 91) contracts reported in Contract Reviews prepared under Lifecycle Management (LCM).

The year's target was achieved.

Customer satisfaction

Performance

The Group targets an aggregated year-on-year improvement in customer satisfaction across its major contracts.

Customer satisfaction metrics can only be fully interpreted and understood on a contract-by-contract basis and, therefore, aggregated data is not presented.

Target achieved

Part of the executive directors' 2011 annual incentive

Definition

Customer satisfaction surveys are used to collect customer opinions on key customer-funded projects. This provides an opportunity for customers to share information on perceived performance levels, and identify areas of strength and weakness.

Comment

The data for the customer satisfaction metric included 89 (2010 90) contracts reported in Contract Reviews prepared under LCM.

The year's target was achieved.

Programme Execution

The Group's performance is dependent on the successful execution of projects. It is important that the Group wins and contracts for high quality new programmes, and delivers on its projects within tight tolerances of quality, time and cost performance.

13 2011 Executive Committee key objectives

62 Principal risks

Programme margin variation

Performance

The Group targets an aggregated year-on-year improvement in programme margin across its major contracts.

Programme margin variation metrics can only be fully interpreted and understood on a contract-by-contract basis and, therefore, aggregated data is not presented.

Target achieved

Part of the executive directors' 2011 annual incentive

Definition

Programme margin variation measures outturn projections of, and movements in, margin of key customer-funded projects. It provides an indicator of the Group's ability to effectively manage major programmes.

Comment

The data for the programme margin variation metric included 101 (2010 105) contracts reported in Contract Reviews prepared under LCM, representing over 66% of the Group's order book.

The year's target was achieved.

Responsible Behaviour[1]

High standards of business conduct are essential to the Group's mission to deliver sustainable growth.

13 2011 Executive Committee key objectives

62 Principal risks

55 Corporate responsibility review

Safety

Performance

In 2011, the Group continued to demonstrate year-on-year improvement in the Lost Work Day Case Rate. The number of injuries resulting in days lost per 100,000 employees reduced by 11%.

24 Performance by reporting segment

Target achieved

Part of the executive directors' 2011 annual incentive[2]

Definition

The number of injuries resulting in days lost per 100,000 employees is monitored, and actions taken to minimise the risk to the Group's employees and its operations, and drive continual performance improvement.

Comment

The Lost Work Day Case Rate is one of the metrics used across the Group to monitor performance in safety. The Group also uses a five-level Safety Maturity Matrix to help its businesses around the world work towards consistently high safety standards and to improve their performance.

1 In the Annual Report 2010, a KPI was presented relating to the Group's target to provide Responsible Business Conduct Awareness Training to all employees during the period May 2010 to May 2011. More than 50% of employees were trained by 31 December 2010 and all employees were trained by the targeted date of 31 May 2011.

2 Whilst the Group met its target of year-on-year improvement in the Lost Work Day Case Rate, it did not meet the executive directors' annual incentive-related reduction target of 20% set by the Corporate Responsibility Committee (see page 87).

REPORTING SEGMENTS PERFORMANCE REVIEW

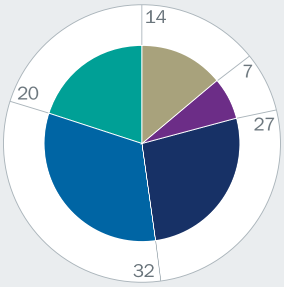
In support of the Mine Resistant Ambush Protected (MRAP) vehicles supplied to the US armed forces, BAE Systems has established field service centres for vehicle reset and upgrade.


US ARMY
NZ1TXG
CLOSE

REPORTING SEGMENTS OVERVIEW

The Group has revised its reporting segments to align with the Group's strategic direction and improve visibility in areas of recent development of the business. BAE Systems now has five principal reporting segments.

Sales[1,2,3] by reporting segment (%) KPI



- Electronic Systems
- Cyber & Intelligence
- Platforms & Services (US)
- Platforms & Services (UK)
- Platforms & Services (International)

Electronic Systems

Electronic Systems has advanced technology, high integrity, electronics capabilities. The business comprises a large number of relatively small, short-cycle contracts. Production activity is typically contracted on a fixed-price basis.

Electronic Combat combines the Electronic Protection, Electronic Warfare and Electronic Attack product lines, and provides a depth of capability in integrated electromagnetic systems for airborne applications.

Survivability & Targeting includes situational awareness, targeting and survivability systems, such as electro-optic sensor products, guidance systems, handheld targeting and infrared countermeasures systems for soldiers and vehicles.

Communications & Control has a strong footing in radio frequency communication and datalinks, and provides military aircraft controls and displays, together with platform integration capabilities.

Intelligence, Surveillance & Reconnaissance (ISR) addresses the market for airborne persistent surveillance, identification systems, signals intelligence and space products.

Commercial Aircraft avionics addresses the commercial aircraft electronics market, including fly-by-wire flight controls, full authority digital engine controls, cockpit controls, head-up displays, cabin management systems and power management systems.

HybriDrive® delivers power and energy management solutions, including vehicle hybrid drive systems.

Cyber & Intelligence

Cyber & Intelligence comprises the Group's US- and UK-based cybersecurity activities. The businesses comprise short-cycle and multi-year man-hour-based consulting arrangements, including Indefinite Delivery, Indefinite Quantity (IDIQ) contracts and sales of software licences.

Intelligence & Security has four businesses:
– Information Technology & Cybersecurity Solutions develops, deploys and maintains mission applications focused on information sharing, knowledge management and enhanced enterprise mission IT solutions for the US federal, civilian and defence intelligence communities.
– GEOINT-ISR develops and supports software systems for geospatial analysis, mission planning, ISR, precision targeting, and command and control for the defence and intelligence communities.
– Global Analysis provides mission-enabling analytic solutions and support to operations across the US homeland security, law enforcement, defence, intelligence and counterintelligence communities.
– SpecTal provides government customers with specialised security and intelligence mission support.

BAE Systems Detica collects, manages and exploits information to enable government and commercial clients to reveal intelligence, maintain security, manage risk and strengthen resilience. It provides a range of specialist services and products, including development, delivery and support of both hardware technology and sophisticated software products. Alongside its secure government-focused business, Detica is a major supplier of information assurance capabilities to the financial services sector.

HQ

HQ comprises the Group's head office activities, together with a 49% interest in Air Astana.

For more information visit www.baesystems.com/businesses

1 Including share of equity accounted investments.
2 Before elimination of intra-group sales.
3 Excluding HQ.

Platforms & Services (US)

Platforms & Services (US) comprises the US-headquartered Land & Armaments business and the US-based services and sustainment activities. The Land & Armaments business typically includes funded development activity and medium-term fixed price production contracts. Support activities may be contracted over multi-year arrangements, including IDIQ contracts.

BAE Systems has a strong position as a major supplier of ship sustainment services to the US Navy. The business also provides fixed and rotary wing aircraft support services to US special operations forces. Other support activities in the US include complex facilities management, such as for the Holston explosives facility.

Land & Armaments is engaged in the design, development, production, support and upgrade of armoured combat vehicles, tactical wheeled vehicles, missile launchers, artillery systems and munitions.

Tracked vehicle programmes include reset and upgrade of Bradley fighting vehicles in the US, and manufacture of CV90 combat vehicles in Sweden. Wheeled vehicle programmes include Mine Resistant Ambush Protected (MRAP) vehicles. Artillery & Munitions includes the manufacture of artillery systems, such as the M777 howitzer, naval guns, where the business is the leading supplier to the US Navy, and munitions, where the business is the principal supplier to the UK's armed forces. Individual Protection includes the provision of protective products, such as body armour, for military, law enforcement and security personnel.

Platforms & Services (UK)

Platforms & Services (UK) is the focus for the Group's large prime contracting platform contracts with a large order book of typically multi-year contracts.

Military Air & Information includes programmes for the production of the Typhoon combat aircraft, support for Tornado and Hawk aircraft, and development of new generation Unmanned Aircraft Systems.

Maritime programmes include the Type 45 anti-air warfare destroyers, the Astute class nuclear-powered attack submarines and the two new Queen Elizabeth class aircraft carriers for the Royal Navy.

To mitigate risk on substantial UK Ministry of Defence programmes, development programmes are normally contracted with appropriate levels of risk being initially held by the customer due to the customer's involvement in agreeing requirements at this stage. Subsequent production programmes are priced when a platform's development has reached sufficient maturity for specifications to be stabilised and costs known to a high degree of certainty. When entering production contracts, a variety of contract structures are used to mitigate risk, such as, incentive arrangements, whereby the customer and contractor share cost savings and cost overruns against agreed target prices.

The significant Military & Technical Services business for air and maritime programmes is also usually contracted over multi-year periods, and includes business where the Group's service offering underpins the availability and capability of customers' equipment. These contracts may also have incentivised profitability, the customer and contractor sharing cost savings.

Platforms & Services (International)

Platforms & Services (International) has businesses in Saudi Arabia and Australia, as well as shareholdings in MBDA and Indian businesses.

In Saudi Arabia, the business provides operational capability support to the country's air and naval forces on UK/Saudi government-to-government contracts. Services contracts, such as the Saudi British Defence Co-operation Programme and Typhoon support, tend to be multi-year, including fixed price elements. Platforms business includes multi-year, fixed-price contracts, often with price variation formulae, such as the Salam Typhoon contract in Saudi Arabia.

In Australia, the business delivers production, upgrade and support programmes for the Australian government across the air, maritime, land and security domains. Services contracts include the provision of support and upgrades. Platforms contracts include naval ships, such as the Landing Helicopter Dock programme for the Navy and land vehicle programmes. Contracts are often multi-year and fixed price with price variation formulae applied.

In India, the Group continues to develop its land systems and software joint ventures, and build on its long-standing relationship with Hindustan Aeronautics Limited, which is manufacturing Hawk aircraft under licence in India.

The business is developing its position in Oman, building on a long history of relationships with the Omani armed forces, with significant current and new business being progressed.

REPORTING SEGMENTS OVERVIEW *(continued)*

REPORTING SEGMENTS FINANCIAL PERFORMANCE SUMMARY

2011		KPI Order intake[1] £m	Order book[1] £bn	KPI Sales[1] £m	KPI Underlying EBITA[2] £m	Return on sales %	KPI Cash flow[3] £m
Electronic Systems	p24	2,620	3.2	2,645	386	14.6	268
Cyber & Intelligence	p28	1,443	0.8	1,399	136	9.7	123
Platforms & Services (US)	p32	5,077	6.5	5,305	478	9.0	410
Platforms & Services (UK)	p36	4,355	18.7	6,258	658	10.5	69
Platforms & Services (International)	p40	3,319	8.3	3,794	449	11.8	80
HQ		236	–	233	(82)		(308)
Discontinued operations		–	–	–	–		(8)
		17,050	37.5	19,634	2,025		634
Less: Intra-group		(403)	(1.3)	(480)	–		–
Total		16,647	36.2	19,154	2,025	10.6	634

2010 (restated[4])	KPI Order intake[1] £m	Order book[1] £bn	KPI Sales[1] £m	KPI Underlying EBITA[2] £m	Return on sales %	KPI Cash flow[3] £m
Electronic Systems	2,894	3.2	2,969	455	15.3	367
Cyber & Intelligence	1,300	0.6	1,201	108	9.0	89
Platforms & Services (US)	5,605	7.0	7,671	728	9.5	967
Platforms & Services (UK)	3,968	21.0	6,529	522	8.0	191
Platforms & Services (International)	2,694	9.1	4,325	449	10.4	190
HQ	214	–	209	(83)		(671)
Discontinued operations	–	–	–	–		54
	16,675	40.9	22,904	2,179		1,187
Less: Intra-group	(363)	(1.4)	(629)	–		–
Total	16,312	39.5	22,275	2,179	9.8	1,187

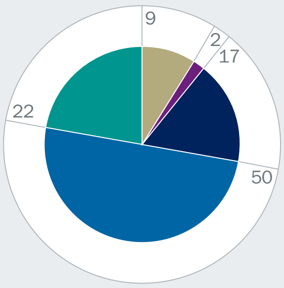
1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
3 Net cash inflow/(outflow) from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.
4 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7 to the Group accounts) and changes to the Group's reporting segments.

46 For more information on the Group's financial performance

ORDER BOOK

Order book[5,6] by reporting segment (%)

The Group has a £36.2bn order book[1].

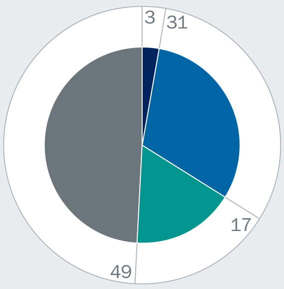


Electronic Systems
Cyber & Intelligence
Platforms & Services (US)
Platforms & Services (UK)
Platforms & Services (International)

£36.2bn
total order book[1]

Top 15 orders in the order book[5,6] (%)

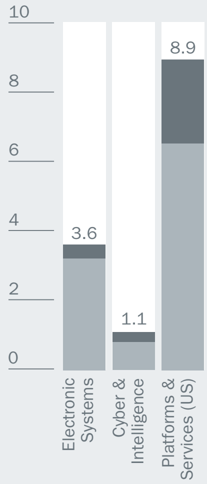
51% of the order book[5,6] is represented by the Group's top 15 programmes with the remaining 49% spread across the five reporting segments.



Munitions Acquisition Supply Solution
Queen Elizabeth Class Aircraft Carriers
Astute Class Submarines
Type 45 Destroyers
Typhoon Tranche 3A Aircraft
Typhoon Tranche 2 Aircraft
Tornado ATTAC
Hawk India Aircraft
Typhoon Support
F-35
Saudi Typhoon Aircraft[7]
Saudi British Defence Co-operation Programme
Landing Helicopter Dock
Saudi Tornado Role Equipment
Saudi Tornado Upgrade
Remaining order book

ORDER BACKLOG

Order backlog[6,8] by reporting segment (£bn)



Order book
Unfunded customer orders

£39.3bn
total order backlog[1,8]

The Group's US businesses are engaged in significant multi-year contracts. Performance on many contracts beyond the first year is contingent upon the receipt of funding, which the US government typically authorises on an annual basis. The Group's order book excludes the unfunded element of these multi-year contracts. At the 2011 half-year, the Group introduced a new performance metric, order backlog, to provide visibility of the total value of contracts won, not just the funded value as recorded in the order book. In the US businesses, this metric gives a more meaningful measure of the sustaining business levels. An example of order backlog is the ship repair business within Platforms & Services (US). Multi-Ship, Multi-Option contracts for five years are secured, but then only funded by the customer incrementally. The order backlog recognises the remaining period of the contracts awarded, but yet to be funded.

From 2012, the order backlog metric will be formally reported to the Board.

5 Excluding HQ.
6 Including share of equity accounted investments' order books and before the elimination of intra-group orders.
7 The appropriate work share of the Saudi Typhoon Aircraft contract is reported within Platforms & Services (UK).
8 Order backlog comprises both the order book, which includes unexecuted, funded customer orders only, and unfunded customer orders.

REPORTING SEGMENTS *(continued)*

Electronic Systems

Electronic Systems comprises the US- and UK-based electronics activities, including electronic warfare systems and electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

KEY CHARACTERISTICS

- Broad base of programmes, with more than 5,000 active contracts
- No programme greater than 5% of sales
- Over 65% of 2011 sales were fixed price-based
- Cutting edge technology and capabilities, with significant Group-funded research and development invested in the business
- 14% of total sales are to commercial customers

OPERATIONAL KEY POINTS

- Sustained a leadership position in the electronic warfare market
- Increasing position in high growth commercial aircraft electronics market
- Winning key development contracts in the airborne persistent surveillance market
- Integration of the acquired Fairchild Imaging and OASYS businesses
- Continued focus on increasing productivity and efficiency
- Business recovery in process following disruption due to flood damage at the Johnson City facility

Electronic Combat: BAE Systems is responsible for a number of subsystems and equipment on the F-35 Joint Strike Fighter, including the electronic warfare suite.

Survivability & Targeting: High technology electronic systems and sensors include the Group's capabilities in electronic warning and countermeasures.

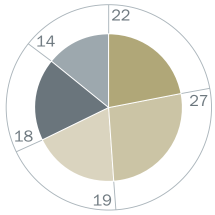
Survivability & Targeting: The Group produces a range of advanced electro-optical systems and sensors, including Thermal Weapon Sights for the US armed forces.

Communications & Control: Electronic Systems has developed the helmet-mounted display and targeting system for Typhoon. The Group's helmet technology is being adapted for the F-35.

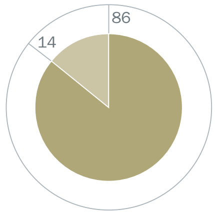
Intelligence, Surveillance & Reconnaissance (ISR): BAE Systems is a leading provider of ISR capability producing tactical identification, sensing and intelligence exploitation systems for airborne, maritime, land and space-based applications.

Commercial Aircraft avionics: Many of the world's commercial aircraft employ BAE Systems' engine and flight controls.

Sales analysis: activity (%)



Sales analysis: defence and commercial (%)



FINANCIAL KEY POINTS

- **Order backlog[1,4] slightly increased in challenging business environment**
- **Sales[1] performance impacted by programme award delays due to the extended period of Continuing Resolution and Johnson City flood**
- **Return on sales reduced on completion of certain production programmes**
- **Cash flow[3] conversion of underlying EBITA[2] at 80%, before pension deficit funding**

		2011	2010	2009
Order intake[1]	KPI	**£2,620m**	£2,894m	£2,811m
Order book[1]		**£3.2bn**	£3.2bn	£3.1bn
Order backlog[1,4]		**£3.6bn**	£3.5bn	n/a
Sales[1]	KPI	**£2,645m**	£2,969m	£2,899m
Underlying EBITA[2]	KPI	**£386m**	£455m	£348m
Return on sales		**14.6%**	15.3%	12.0%
Cash inflow[3]	KPI	**£268m**	£367m	£226m

Order backlog[1,4] increased to £3.6bn (2010 £3.5bn) despite some impact of contracting delays as the US administration operated federal budgets under Continuing Resolution limitations for seven months of 2011.

On a like-for-like basis, sales[1] reduced by 10% on 2010 reflecting the completed F-22 and Advanced Threat Infrared Countermeasures (ATIRCM) production programmes, the impact of the delayed programme awards, and the disruption caused by the Johnson City flood.

Underlying EBITA[2] was £386m (2010 £455m). Return on sales reduced to 14.6% (2010 15.3%) reflecting risk retirement on completion of the F-22 and ATIRCM programmes.

Operating cash inflow[3] was £268m (2010 £367m) reflecting a conversion of underlying EBITA[2] to cash flow[3] of 80%, before pension deficit funding.

In July 2011, the US-headquartered Electronic Systems business was created by combining the Electronic Solutions and Platform Solutions businesses. The new reporting segment spans the commercial and defence electronics markets, and brings together a strong portfolio of products, technology and know-how to serve its customers.

In April 2011, BAE Systems completed the acquisition of Fairchild Imaging, a company that designs and manufactures solid-state electronic imaging components, cameras and systems. The components have potential uses across diverse aerospace, industrial, medical and scientific imaging applications, including night vision systems, aerial mapping, electron microscopy and DNA mapping.

During the year, operations at two US sites were consolidated into larger facilities in order to maximise efficiencies and performance. Work at the affected sites, in Ontario, California, and Irving, Texas, is being transitioned to other locations.

Electronic Combat The business maintains its leadership position in electronic warfare primarily through its involvement in the F-35 Joint Strike Fighter programme as the provider of the electronic warfare suite. The F-35 programme has been aligned to support the US Defense Secretary's programme restructuring announcement in January 2011. In 2011, the business met its key milestones on the Systems Design and Development programme and was awarded a contract for Low-Rate Initial Production (LRIP) Lot 6 on the F-35 Production programme.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.
4 Order backlog comprises both the order book, which includes unexecuted, funded customer orders only, and unfunded customer orders (see page 23).

REPORTING SEGMENTS: ELECTRONIC SYSTEMS *(continued)*

13,400
employees[1]

£169m
of research and development expenditure[2] in 2011

The US Navy has requested a proposal to extend the current technology maturation contract for the Next Generation Jammer (NGJ) until 2012. BAE Systems is one of four competitors bidding for the technology development contract to be awarded later in 2012. The NGJ will replace the ageing ALQ-99 jammer currently on certain US Navy aircraft.

In December, the Kingdom of Saudi Arabia reached agreement with the US government to purchase 84 new F-15SA aircraft and upgrade its existing fleet of 70 aircraft. Good progress has been made in the development of the Group's digital electronic warfare system for the aircraft.

Survivability & Targeting Using its Boldstroke® system technology, the business provided the US Army with a proposal for the Common Infrared Countermeasures (CIRCM) programme. The Boldstroke® system is an integrated aircraft survivability system for protecting aircraft from infrared-guided missiles and other threats. It provides increased system capability in a smaller and more energy efficient package. In early 2012, the US Army awarded the business one of two contracts to develop the CIRCM capability. The contract is worth $38m (£24m) over two years. The award is under protest and the Group is awaiting further direction from the US government.

BAE Systems, as a subcontractor to Alliant Techsystems, is supporting a $109m (£70m) US Navy contract for the engineering and manufacturing development of the Joint and Allied Threat Awareness System (JATAS), the next-generation warning system designed to enhance aircraft survivability against man-portable air-defence systems, small-calibre weapons and rocket-propelled grenades.

In 2011, Electronic Systems was awarded a $17m (£11m) US Navy follow-on LRIP contract for an additional 600 Advanced Precision Kill Weapon Systems, bringing the total to 925 units under contract. Deliveries continue in 2012.

The 100,000th Thermal Weapon Sight was delivered to the US Army in support of military operations in Iraq and Afghanistan. Orders received in 2011 exceeded $60m (£39m). The business has been producing the sights since 2004 under contracts valued at more than $1bn (£0.6bn). The technology enables soldiers to see deep into the battlefield, and enhances their situational awareness by allowing them to see in darkness, and through smoke and fog.

The business delivered 4,000 units of the StalkIR® night vision product, a clip-on or hand-held thermal viewer device featuring a dual-band aiming laser, module rail interface and one-touch menu options. The product was developed by the OASYS Technology business acquired in 2010.

Communications & Control In defence avionics, Lockheed Martin has selected the Group's Fighter Helmet-Mounted Display, using BAE Systems' Q-Sight waveguide technology, for the F-35's Night Vision Goggle Helmet programme. This initial award continues the Group's success in helmet-mounted displays.

The contract awarded in 2010 to provide the Slovak Ministry of Defence with a mobile military communications system (MOKYS) that enables secure voice, data and internet protocol communication is nearing successful completion.

The business continues to pursue significant opportunities in the tactical radios and networking markets to meet the need for the modernisation of battlefield communication systems.

Intelligence, Surveillance & Reconnaissance The business has been selected to provide Wide Area Airborne Surveillance capability on several key development programmes for multiple US Air Force and US Army airframes, based on two wide-area, high-resolution imaging sensor systems. The Autonomous Real-time Ground Ubiquitous Surveillance – Imaging System (ARGUS-IS) was recognised by Aviation Week and Space Technology as one of the top ten new technologies for 2011. The Airborne Wide Area Persistent Surveillance System (AWAPSS) received an Army Research and Development Award in 2010. These systems provide the war fighter with the ability to observe very wide areas of interest with sufficient imagery resolution to meet intelligence and surveillance needs.

Commercial Aircraft avionics Key wins have been secured on new programmes, including high integrity flight controls for regional and transport aircraft, such as the Bombardier CSeries and Embraer KC-390. The business is well positioned to support the growth in demand for commercial aircraft.

In the year, the business has successfully renewed long-term supplier agreements with aftermarket airline customers.

General Electric has signed a memorandum of understanding with the business's joint venture, FADEC International, to develop and produce the Full-Authority Digital Electronic Control (FADEC) for CFM International's next generation engine, the LEAP-X. The fuel-efficient LEAP-X turbofan engine is designed to power future narrow body commercial aircraft. The engine has been selected for the Boeing 737 MAX, Airbus A320neo and Comac C919 aircraft.

HybriDrive® Buses powered by the HybriDrive® Series hybrid electric propulsion system have recently driven their one millionth mile of clean, reliable revenue service. Since the first of these vehicles entered service in late 2008, the environmentally friendly propulsion provided by BAE Systems has saved operators well over 126 million litres of diesel fuel and prevented the release of more than 420 tonnes of CO_2.

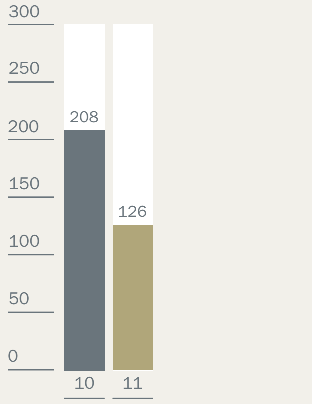
In September 2011, the electronics facility at Johnson City, New York, experienced severe flood damage to offices, laboratories and equipment. Whilst critical business operations have been re-established, some sales have been deferred and recovery efforts continue in 2012.

1 Including share of equity accounted investments.
2 Includes both Group-funded and customer-funded expenditure.

NON-FINANCIAL PERFORMANCE

Safety
During 2011, safety remained a priority across Electronic Systems. The business continued to make progress regarding external assessments of safety operations, and against the Safety Maturity Matrix. The business achieved a 39% reduction in its Lost Work Day Case Rate.

Lost Work Day Case Rate (per 100,000 employees) KPI



59 For more information on the corporate responsibility matrices

Diversity and inclusion
Electronic Systems supported US-wide activities on diversity and inclusion, including supporting the diversity and inclusion champions network. Senior leaders continue to advocate diversity as one of the keys to unlocking innovation and driving employee engagement.

A Diversity Council has been established which is responsible for developing and driving objectives in diversity and inclusion. Activities in 2011 included the roll-out and launch of leadership training and manager training kits to help increase the awareness of employees across the business.

Environmental sustainability
Initial environmental objectives have been met, with reduction targets set in energy, water and waste.

People
Electronic Systems continued to invest in the capability development of its employees. An Engineering Talent Database was launched, containing engineering skills and competencies linked to learning and development opportunities. A component of this is the Engineering University Portal, which includes internal courses, links to programmes offered through collaborations with colleges and universities, and access to resources for self-directed learning.

Within the former Electronic Solutions business, a Global Business Culture training programme was launched to further develop and support cultural understanding.

55 For more information on the Group's corporate responsibility activities

LOOKING FORWARD

Efforts to reduce the US government's budget deficit are likely to require reductions across all areas of government spend. Whilst likely funding reductions and the resultant slow-down or cancellation of ongoing and new programmes could impact the business, Electronic Systems remains well positioned with a balanced electronics portfolio that will enable it to respond to changing customer priorities.

The business expects to benefit from its incumbent positions on core platforms and from positions in areas that are forecast to grow faster than the overall market, such as Intelligence, Surveillance and Reconnaissance, commercial avionics, and electronic warfare.

The business is well positioned to benefit from the growth in commercial aviation through its engine and flight controls activities.

REPORTING SEGMENTS *(continued)*

Cyber & Intelligence

Cyber & Intelligence comprises the Group's cyber, secure government, and commercial and financial security activities within the US-based Intelligence & Security business, and the UK-headquartered BAE Systems Detica business.

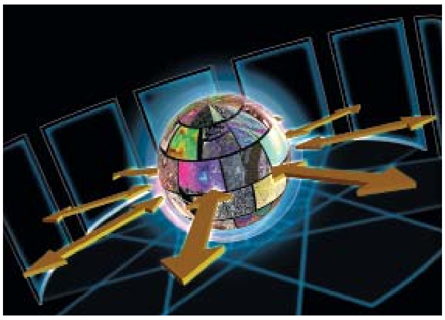
KEY CHARACTERISTICS

- Multiple, fast-execution contracts
- Excellent customer intimacy
- Building strong positions in cyber capabilities and network protection
- Large and diverse US customer base
- Detica repositioning towards solutions integration and managed services
- Detica expanding into growing commercial markets

OPERATIONAL KEY POINTS

- The US-based business continues to perform well on legacy programmes while securing strategic contract awards with existing customers
- The US-based business continues to invest in differentiating technologies, such as activity-based intelligence and cybersecurity, including a leading edge network, operations and security centre environment, to maintain the relevance of its service offerings
- Successful integration of acquired L-1 Intelligence Services Group, Norkom and ETI businesses
- Growth of commercial sales in Detica offsetting lower UK government volume
- Investment in UK Security Operations Centre

Information Technology & Cybersecurity Solutions: BAE Systems provides critical cybersecurity and network defence solutions in support of the US government.



GEOINT-ISR: The Group develops geospatial and ISR hardware and software platforms, and mission applications for the defence and intelligence communities.

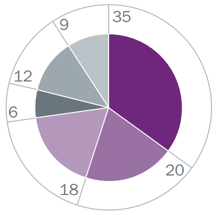
Global Analysis: The business provides mission-enabling analytic solutions supporting a number of government departments in the US.

SpecTal: The business provides specialised security and intelligence consulting services to the US government.

Detica: The UK-based Detica business provides a range of cyber, security software and consulting services to the UK government.

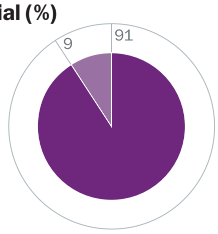
Detica: Detica manufactures specialist equipment for telecommunications security applications.

Sales analysis: activity (%)



- Information Technology & Cybersecurity Solutions
- GEOINT-ISR
- Global Analysis
- SpecTal
- Detica government
- Detica commercial

Sales analysis: government and commercial (%)



- Government
- Commercial

FINANCIAL KEY POINTS

- **Order backlog[1,4] grown**
- **Increase in sales[1] of 16%**
- **Margin increased to 9.7%**
- **US sales[1] growth of 13%**
- **Detica decline in government business largely offset by growth in commercial**
- **Cash flow[3] conversion of underlying EBITA[2] at 90%**

		2011	2010	2009
Order intake[1]	KPI	**£1,443m**	£1,300m	£1,286m
Order book[1]		**£0.8bn**	£0.6bn	£0.6bn
Order backlog[1,4]		**£1.1bn**	£0.9bn	n/a
Sales[1]	KPI	**£1,399m**	£1,201m	£1,302m
Underlying EBITA[2]	KPI	**£136m**	£108m	£107m
Return on sales		**9.7%**	9.0%	8.2%
Cash inflow[3]	KPI	**£123m**	£89m	£74m

Order backlog[1,4] increased to £1.1bn (2010 £0.9bn) mainly reflecting the impact of business acquisitions during the year.

Like-for-like sales[1] increased by 4% primarily reflecting higher volumes on legacy programmes in the US Global Analysis business.

Underlying EBITA[2] was £136m (2010 £108m). Return on sales increased to 9.7% (2010 9.0%), after expensing costs of integrating acquired businesses and Security Operations Centre investment.

Operating cash inflow[3] increased to £123m (2010 £89m).

Intelligence & Security

The US-based Intelligence & Security business is structured into four key business areas that each provide specific domain expertise, whilst working closely together to provide enterprise-wide support to a range of customers, and key agencies in the intelligence, defence, homeland security and civilian markets. This enables the business to provide products, people and expertise to meet customers' needs in a cost-effective way.

Information Technology & Cybersecurity Solutions develops, deploys and maintains mission applications focused on information sharing, knowledge management and enhanced enterprise mission IT solutions for the federal, civilian and defence intelligence communities. The business also provides analytics, cyber analysis and real-time network forensics.

In 2011, the business was awarded three competitive task orders under the Solutions for the Information Technology Enterprise programme Indefinite Delivery, Indefinite Quantity (IDIQ) contract worth $466m (£300m) over a five-year period. These task orders for the US Defense Intelligence Agency address requirements to transform IT service delivery worldwide. Orders totalling $122m (£78m) were received in the year under these contracts.

The business was awarded an initial task order over 18 months under the Next Generation Desktop Environment Programme IDIQ contract. This task order for the US Defense Intelligence Agency is to deploy over 12,000 analyst workstations across the intelligence community, with over 6,000 workstations successfully installed at 31 December 2011.

GEOINT-ISR develops and supports software platforms and mission applications for geospatial tasking, collection, processing, exploitation and dissemination, as well as mission planning, Intelligence Surveillance and Reconnaissance (ISR), precision targeting, and command and control for the defence and intelligence communities.

The business was awarded several key task orders under the Total Application Services for Enterprise Requirements IDIQ contract with the US National Geospatial Agency. These task orders have an awarded value of $123m (£79m) for the provision of engineering services. Programme performance is meeting the customer's expectations.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.
4 Order backlog comprises both the order book, which includes unexecuted, funded customer orders only, and unfunded customer orders (see page 23).

REPORTING SEGMENTS: CYBER & INTELLIGENCE *(continued)*

8,900
employees[1]

Other sensitive programmes with the National Geospatial Agency continue to provide value to this important customer.

Global Analysis provides mission-enabling analytic solutions and support to operations across the homeland security, law enforcement, defence, intelligence and counterintelligence communities.

The business has experienced significant sales growth driven by the Counter Improvised Explosive Device (C-IED) programme awarded in 2010. The C-IED programme provides mission analytical support to forward deployed defence personnel. Performance on this programme has exceeded customer criteria, with a highly skilled team of approximately 450 analysts deployed in Afghanistan. A follow-on option award on the C-IED programme for approximately $200m (£129m) was secured during the year.

In 2011, the business was awarded two US government IDIQ contracts for full-motion video and geospatial imagery analysis. Multiple task orders under these contracts have been awarded for a total contract value, including options, of $391m (£252m) over various performance periods, the longest being for five years. In 2011, funding of $48m (£31m) was received for these task orders.

SpecTal provides government customers with specialised security and intelligence mission support, including intelligence analysis, engineering, operations support, training and information technology development.

SpecTal was a business unit within L-1 Identity Solutions, Inc.'s Intelligence Services Group (L-1 ISG), which was acquired in February 2011.

The acquisition of L-1 ISG expands and complements the business's existing presence in the US intelligence community, and provides a greater capability base to secure upcoming re-competed contracts, whilst providing a broader, more attractive offering to meet the needs of customer missions.

The business continues to invest in capability development to ensure a market-focused evolution of its portfolio of offerings, and is advancing several core and discriminating capabilities, including:

Activity-based intelligence: Capability within GEOINT-ISR which focuses on developing solutions to predict when and where threats will strike with a high degree of probability.

Cybersecurity: A leading edge network, operations and security centre environment deployed at the gateway of BAE Systems' own 50,000 node North American network. This offers a real-time forensics toolset that places current and historical information at an analyst's fingertips, providing clarity regarding what is happening in the network.

These initiatives have contributed towards strengthening the bid pipeline and potential level of future contract awards.

BAE Systems Detica
The business continues to develop and deliver information intelligence solutions to government and commercial customers, and grow its business in the areas of cybersecurity, information assurance and information intelligence products.

The acquisitions of Norkom and ETI have strengthened the product portfolio for tackling fraud and delivering intelligence. The integration of these businesses has progressed well. Detica now has primary operations in the UK, Denmark and Ireland, and has an international reach.

Financial Crime and Compliance The Detica NetReveal® business, which has been combined with Norkom's market-leading anti-money laundering products, provides solutions used globally to reduce financial loss, fight crime, and manage risk and compliance, and received orders of £69m during the year.

Global Communications Solutions Detica has established a Global Communications Solutions business, combining ETI software products with existing products, to provide a range of communications monitoring and intercept solutions for the law enforcement communities. During the year, orders of £42m were received from customers in 22 countries for these products and services.

Cybersecurity Detica continues to build a portfolio of offerings, including specialist cybersecurity and secure communications solutions. Detica's cyber business is growing rapidly across both government and commercial sectors with a range of new clients and contracts in 2011. Detica is also investing in a state-of-the-art Security Operations Centre, building on Detica Treidan®, that can detect and remediate advanced cyber attacks for both government and business. Orders were received from two customers in the UK for this service during 2011.

UK Core Mission The UK business continues to be repositioned. As the volume of consulting activity with the UK government customer declines, so growth is being generated in commercial sales from systems integration and managed services, and security solutions to the financial services, retail, energy and telecommunications sectors.

The business is investing in a new Delivery Centre to provide customers with a highly secure environment to deliver their critical business services more effectively and economically.

International Secure Government Detica has continued to develop an international consultancy, system integration and managed services business, initially focusing on the Middle East region. Detica has seen a positive response, winning its first orders in two countries.

1 Including share of equity accounted investments.

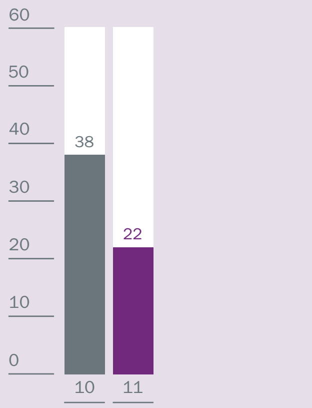
NON-FINANCIAL PERFORMANCE

Safety
During the year, Cyber & Intelligence continued to progress against global safety objectives. The reporting segment achieved a 42% reduction in its Lost Work Day Case Rate.

In the Intelligence & Security business, progress has been made against the Safety Maturity Matrix (SMM), with one site achieving Level 5 during 2011.

Detica has been working towards achieving SMM Level 5 in the UK in 2012, with a number of new initiatives to engage staff with the 'safety first' message.

Lost Work Day Case Rate (per 100,000 employees) KPI



Changes have taken place to give health and safety sufficient priority within the recently acquired businesses to ensure they reach the target of achieving SMM Level 4 by the end of 2012.

Diversity and inclusion
During 2011, Intelligence & Security launched a diversity and inclusion steering group which developed and implemented a diversity and inclusion strategy. This strategy is directly linked to the overall business strategy, and its principles and tactical actions are embedded across executives' personal development plans and objectives for the year.

To support diversity and inclusion, Detica has appointed a Detica board sponsor and set up a working group to define an action plan to promote and improve diversity and inclusion with a view to achieving a good level of awareness across the business by the end of 2012. Initiatives include reviewing mentors for senior women, gathering detailed recruitment statistics for analysis and review, and embedding diversity and inclusion concepts into management training.

Environmental sustainability
Initial environmental objectives have been met, with reduction targets set in energy, water and waste.

People
To support the talent pipeline for the US business, Intelligence & Security embarked on a focused, month-long cyber jobs campaign that integrated radio and social media recruiting channels. The programme resulted in successful recruitment in this very competitive talent market.

To support the continued growth and expansion of its cybersecurity business, Detica invested in a Security Operations Centre within the new UK Delivery Centre. A focused recruitment drive was initiated to boost and increase capability around Information Security Assurance, for which the business sees significant customer demand.

59 For more information on the corporate responsibility matrices

55 For more information on the Group's corporate responsibility activities

LOOKING FORWARD

Intelligence & Security
Whilst efforts to reduce the US government's budget deficit are likely to require reductions across all areas of government spend, cybersecurity is expected to remain a priority.

Growth opportunities remain, particularly in critical, mission-focused areas, such as Full Motion Video, Multi-INT fusion (the seamless synthesis of the individual intelligence disciplines to enable more complete situational awareness), enterprise solutions for big data problems and cybersecurity.

The business seeks to grow market share in 2012 with fewer new programmes expected through its positioning to compete as a result of the structural, cost and investment actions previously taken. The Intelligence & Security market is experiencing delays in procurement awards and de-scoping of existing contracts as US government agencies look for cuts in their IT budgets. The business expects a competitive and price-sensitive market. Based on its customer intimacy, increased innovation and the ability to offer a competitive price, the business is well positioned in this challenging environment.

BAE Systems Detica
Detica expects continued demand for its intelligence and cybersecurity capabilities. In particular, Detica targets opportunities to grow in commercial markets through its cross selling of software and capability to its expanded customer base following the Norkom and ETI acquisitions.

REPORTING SEGMENTS *(continued)*

Platforms & Services (US)

Platforms & Services (US) comprises the US-headquartered Land & Armaments business, with operations in the US, UK, Sweden and South Africa, together with US-based services and sustainment activities, including ship repair and modernisation services.

KEY CHARACTERISTICS

Support Solutions combines positions in:
- US naval ship repair and modernisation
- Operations support
- Complex infrastructure services
- Fixed and rotary wing military aircraft modification

Land & Armaments combines positions in:
- Tracked combat vehicles
- Tactical wheeled vehicles
- Artillery, ammunition and naval armaments
- Soldier survivability products

OPERATIONAL KEY POINTS

- Increases in orders and sales in the Support Solutions business
- Support business awarded a ten-year contract to manage, operate and maintain the US Army's Radford Army Ammunition Plant
- Sales reduction in the land business due to lower Bradley reset/remanufacturing activity and completed Family of Medium Tactical Vehicles programme
- Continued restructuring and efficiency activity in the land business
- Participating in the technology development phase of the US Army's Ground Combat Vehicle programme
- Business disposals of Swiss-Photonics, Advanced Ceramics and Composite Structures complete, and Safety Products disposal announced

Services: BAE Systems is a leading provider of ship repair and modernisation services to the US Navy.

Services: The Group undertakes aircraft modernisation services at its Albertville, Alabama, facility in the US.

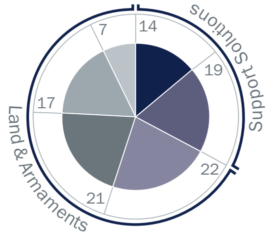
Tracked Vehicles: The CV90 family of vehicles, manufactured in Sweden, is in service with six nations.

Wheeled Vehicles: Deliveries of Caiman vehicles continued in 2011, with upgrades to the Multi-Terrain Vehicle standard.

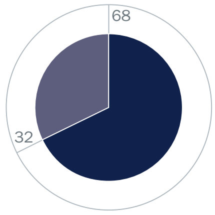
Artillery & Munitions: The M777 howitzer is in service with US, Canadian and Australian armed forces. Production continues and further orders are anticipated.

Individual Protection: In addition to its large land systems platform programmes, BAE Systems supplies a range of individual soldier protection products.

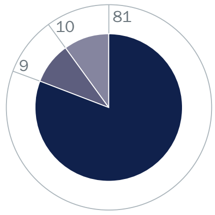
Sales analysis: activity (%)



Sales analysis: Platforms and Services (%)



Sales analysis: markets (%)



FINANCIAL KEY POINTS

- **Sales[1] in:**
  - **Land & Armaments business decreased 40% to £3.5bn**
  - **Support Solutions business increased 1% to £1.8bn**
- **Return on sales in:**
  - **Land & Armaments business reduced to 9.3%**
  - **Support Solutions business increased to 8.4%**
- **Support business delivered an increase in order backlog[1,4] and strong operating cash flow[3]**

		2011	2010	2009
Order intake[1]	KPI	**£5,077m**	£5,605m	£5,493m
Order book[1]		**£6.5bn**	£7.0bn	£8.7bn
Order backlog[1,4]		**£8.9bn**	£9.1bn	n/a
Sales[1]	KPI	**£5,305m**	£7,671m	£8,414m
Underlying EBITA[2]	KPI	**£478m**	£728m	£747m
Return on sales		**9.0%**	9.5%	8.9%
Cash inflow[3]	KPI	**£410m**	£967m	£566m

Like-for-like sales[1] reduced by 30%. At Land & Armaments, sales[1] reduced to £3.5bn ($5.7bn), primarily reflecting the anticipated lower level of Bradley reset/remanufacturing activity on a reduced level of military operations, and the completed Family of Medium Tactical Vehicles (FMTV) programme. Sales[1] at Support Solutions increased by 1%.

Underlying EBITA[2] was £478m (2010 £728m). Return on sales reduced to 9.0% (2010 9.5%). Return on sales at Land & Armaments was 9.3% (2010 10.2%) reflecting self-funding of the costs on the Ground Combat Vehicle (GCV) team during the award protest, and a short-term under-recovery of overheads from the delayed placement of Caiman and GCV contracts. The rationalisation programme in Land & Armaments, which commenced in 2009, has reduced net headcount (including contractors) by some 47% to date. Efforts to align the cost base to the reduced activity at Land & Armaments continue. Return on sales at the Support Solutions business increased from 7.1% to 8.4%.

Cash flow[3] conversion of underlying EBITA[2] at Land & Armaments was 84%. Conversion of underlying EBITA[2] at Support Solutions was 91%.

Support Solutions

In the maritime environment, the US Navy awarded the business $1.5bn (£1.0bn) in follow-on Multi-Ship, Multi-Option (MSMO) contracts for the planning, modernisation, maintenance and repair of vessels at Norfolk, Virginia and San Diego, California. These contracts bring the total value to approximately $3bn (£1.9bn) over five years and represent a 100% re-compete MSMO win rate for the ship repair business.

The business was selected by the US Navy under a contract valued at $148m (£95m) to provide the external communications systems for ten additional Littoral Combat Ships to be built by an Austal US-led team. The fleet will be a new generation of high-speed warships, designed to carry out a range of operations in shallow waters close to shore. The win further demonstrates the Group's position as an industry leader in systems development and integration for US Navy ships.

In April 2011, the Mobile, Alabama shipyard was contracted to finish the construction of the American Phoenix, a product chemical tanker and, in August 2011, Weeks Marine, Inc. selected BAE Systems to build an 8,500 cubic-yard capacity twin screw trailing suction hopper dredge at the shipyard.

Building on C4ISR (Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance) work that BAE Systems has been performing for more than 25 years, often deploying with military units overseas to ensure their readiness, the US Navy awarded the business a $132m (£85m) task order to provide C4ISR technical services for military operations around the world. This order covers the provision of maintenance, upgrades, logistics and other services for military structures, vehicles, ships and small boats.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.
4 Order backlog comprises both the order book, which includes unexecuted, funded customer orders only, and unfunded customer orders (see page 23).

REPORTING SEGMENTS: PLATFORMS & SERVICES (US) *(continued)*

24,100
employees[1]

£183m
of research and development expenditure[2] in 2011

The US Army awarded the business the contract to manage, operate and maintain the Radford Army Ammunition Plant in southwest Virginia. Valued at approximately $850m (£547m) over ten years, with an additional three five-year options, the contract represents a significant win. Following an unsuccessful protest, the US Army confirmed its award to BAE Systems in January 2012.

The Group has been selected by the US Department of Defense's Joint Improvised Explosive Device Defeat Organization to compete for task orders worth a total of $900m (£579m) for all awardees over five years on a new Indefinite Delivery, Indefinite Quantity contract for research, analysis, training, operations support and sustainment of information technology to aid its efforts to counter the use of improvised explosive devices.

Land & Armaments

US

In August 2011, the business was awarded a $450m (£290m) contract to participate in the 24-month technology development phase of the US Army's Ground Combat Vehicle programme. An award protest by competitor SAIC, which was subsequently rejected by the US government, resulted in a temporary funded work stoppage in 2011. The programme is now moving forward.

The business advanced its Heavy Brigade Combat Team positions, supporting customer requirements across the Bradley and Paladin Integrated Management (PIM) programmes. In 2011, the business received several contracts worth $677m (£436m) to provide vehicle and survivability upgrades, and field support for the Bradley family of vehicles. The business delivered seven test vehicles on or ahead of schedule for the PIM programme and, in January 2012, received a $313m (£201m) contract modification for additional engineering design, logistics development and test evaluation support to complete the engineering and manufacturing development phase.

The business is continuing to prepare its response to a US Marine Corps Assault Amphibious Vehicle upgrade request for proposal. Submission is expected in the last quarter of 2012, with contract award in the first quarter of 2013.

In May 2011, the business's two teams completed the technology development phase of the US Army's Joint Light Tactical Vehicle programme. Both teams plan to compete for the engineering and manufacturing development phase.

The upgrade of 1,700 Caiman Multi-Terrain Vehicles under the $629m (£405m) contract awarded in 2010 continues.

The business completed its last chassis under the US Army FMTV contract in May 2011.

The business was awarded a $42m (£27m) contract to work with its Brazilian Army customer to upgrade 150 M113 armoured personnel carriers.

The business is progressing a major competitive pursuit in Canada, the Tactical Armoured Patrol Vehicle. Testing on this vehicle is complete and contract award is expected in 2012.

In naval armaments, the business received a one-year, $32m (£21m) contract to deliver 40 Mk 38 Mod 2 gun systems as part of a larger effort to secure a four-year contract, worth over $176m (£113m) for mounts, spares, and technical and professional services. The US Navy awarded four additional contracts for over $63m (£41m) to upgrade seven Mk 45 gun systems.

During the year, the business sold its Swiss-Photonics, Advanced Ceramics and Composite Structures businesses for an aggregate consideration of £30m.

UK

A new high-technology production facility was opened in Washington, UK, and the first 150 105mm forgings were successfully produced during September. In March, a new laboratory complex opened at Glascoed and a new small arms ammunition facility was completed at Radway Green in September. The business continued to perform well under its 15-year partnership with the UK Ministry of Defence (MoD) to deliver small arms ammunition.

An amendment to the Terrier armoured engineer vehicle contract was agreed with the UK MoD in March, and deliveries of production vehicles commenced in late 2011.

The US Army placed two additional M777 howitzer orders for 116 guns, bringing the total orders since product launch to 1,071 systems, worth in excess of £1.2bn.

Other markets and joint ventures

The business won a competitive selection to provide the Swedish Defence Materiel Administration, FMV, with armoured all-terrain vehicles. The initial £65m contract for 48 BvS10 vehicles and support, together with options for additional vehicles and enhanced support, was awarded in January 2012.

The contract for the supply of new and upgraded CV90 vehicles to Norway was delayed from 2011 to 2012.

The business is progressing a Canadian combat competitive pursuit, the Close Combat Vehicle. Testing is complete and contract awards are expected in 2012.

The development of the Archer 155mm self-propelled artillery gun systems for the Swedish and Norwegian armed forces has progressed through qualification testing, with production commencing in 2012.

The Sweden-based weapons business was selected to supply 57mm Mk 110 naval gun systems for the US Navy Littoral Combat Ships programme. Further options are expected through to 2015.

In South Africa, the business received mobility upgrade contracts for a total value of $193m (£124m) in support of the RG31 Mine Resistant Ambush Protected vehicle programme. The business received several contracts for RG31 and RG32M vehicles for customers in Spain, Sweden, Finland and the United Arab Emirates for a total value of $200m (£129m).

In June 2011, FNSS, a 49% owned joint venture with Nurol Group of Turkey, received and signed a $559m (£360m) agreement with DEFTECH of Malaysia for the design, development and manufacture of 257 wheeled armoured vehicles and integrated logistics support for the Malaysian armed forces.

1 Including share of equity accounted investments.
2 Includes both Group-funded and customer-funded expenditure.

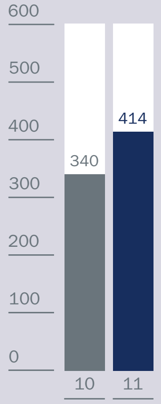
NON-FINANCIAL PERFORMANCE

Safety
Focused safety programmes in Platforms & Services (US) businesses supported continued progress against performance on the Safety Maturity Matrix.

There was an increase in the Lost Work Day Case Rate of 22% reflecting a change in profile of operational facilities and activities. The Group is working hard to bring standards of safety in acquired businesses up to those expected by BAE Systems.

The 'Anchored in Safety' programme in the ship repair business is helping to embed a culture of safety throughout the business. The Jacksonville and Mayport shipyards celebrated their one-millionth man-hour without a lost-time injury.

Lost Work Day Case Rate (per 100,000 employees) KPI



59 For more information on the corporate responsibility matrices

Diversity and inclusion
During 2011, Platforms & Services (US) continued to support US-wide diversity and inclusion activities, including supporting the diversity and inclusion champions network across its business and the development of a US-wide diversity and inclusion strategy.

At Support Solutions, activities focused on developing strategies for increasing female and minority representation in senior leadership positions. Another priority was improving the pipeline of females and minorities for leadership positions by extending supervisory responsibilities and tactical development plans for the next tier of management. In the ship repair business, a highlight was the implementation of an accredited apprenticeship programme with a focus on under-represented groups.

In Land & Armaments, there were targeted activities, including training sessions on unconscious bias, and the business took the lead for a cross-sector, two-day Diversity and Inclusion Symposium that provided internal and external expertise on multiple dimensions of diversity, and lessons on resiliency in leadership and driving innovation through diversity.

Environmental sustainability
Initial environmental objectives have been met, with reduction targets set in energy, water and waste.

People
To support development of leadership capability, both Support Solutions and Land & Armaments launched new leadership programmes. To meet the leadership development needs in the services market, Support Solutions launched a new programme targeted at supervisors and managers. At Land & Armaments, training was introduced placing emphasis on programmes to develop capabilities needed for success in a challenging market.

In the UK, the Radway Green munitions facility received the North West Health Work and Wellbeing Excellence award for wellbeing.

55 For more information on the Group's corporate responsibility activities

LOOKING FORWARD

Efforts to reduce the US government's budget deficit are likely to require reductions across all areas of government spend.

In the near term, the Land & Armaments business faces a challenging market environment and a further decline in sales, specifically for completing FMTV and Caiman contracts, and lower Bradley volume. It is expected that pressures on defence budgets and shifting national priorities, combined with a reduction in military operations, will continue.

In order to offset these pressures, increased focus is placed on capturing export opportunities and key new domestic programmes. Simultaneously, the business continues to drive rationalisation, efficiencies and cost reductions in order to adapt and remain competitive.

Although budget cutbacks continue to exert downward pressure on the services market as a whole, the increasing age of US and allied government equipment is expected to lead to opportunities in the near term for lifecycle support services.

REPORTING SEGMENTS *(continued)*

Platforms & Services (UK)

Platforms & Services (UK) comprises the Group's UK-based air and maritime activities, and certain shared services activities, including the UK-based Advanced Technology Centre.

KEY CHARACTERISTICS

- Multi-year prime contracting and support programmes
- Full spectrum of military aircraft capabilities, including:
  - Design, development, manufacture and support
  - Combat aircraft
  - Trainer aircraft
  - Unmanned Aircraft Systems
- Full spectrum of maritime systems capabilities, including:
  - Naval ships
  - Submarines
  - Radar and combat management systems
  - Underwater systems

OPERATIONAL KEY POINTS

- Settlements reached on terminated Nimrod and Harrier programmes
- Rationalisation and efficiency activity ongoing within Military Air & Information
- 45 Typhoon Tranche 2 aircraft delivered to partner nations and first F-35 production aircraft accepted by the US Air Force
- Block construction continued on the first aircraft carrier and first steel cut on the second
- Fourth Type 45 destroyer accepted off contract
- Brazilian Navy to acquire the three cancelled Trinidad and Tobago Offshore Patrol Vessels (OPVs)
- Higher than planned costs to complete the Omani OPVs
- Ambush, the second Astute-class submarine, undertaking commissioning

Platforms and Services: BAE Systems has delivered more than 100 Typhoon aircraft of the 300+ aircraft now in service with six air forces, and provides availability and in-service support services.

Platforms: BAE Systems has a significant airframe and electronics production content on the F-35 Joint Strike Fighter combat aircraft.

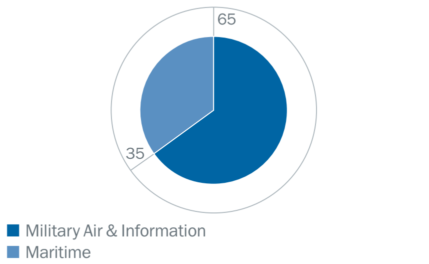
Platforms: The Group's Military Air & Information business is developing next generation autonomous Unmanned Aircraft Systems.

Platforms: Major block assemblies are in-build for the Royal Navy's new Queen Elizabeth class aircraft carriers.

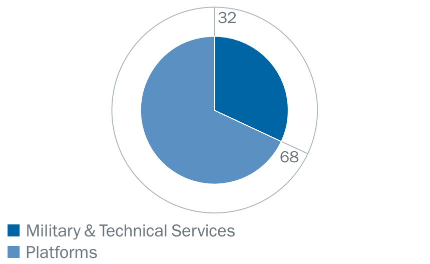
Platforms: Production of the Royal Navy's Astute-class nuclear-powered submarines continues, with the second of class, Ambush, undertaking commissioning, and boats three, four and five under construction.

Services: In 2011, BAE Systems opened the Maritime Composite Training System, a shore-based training system for the Royal Navy.

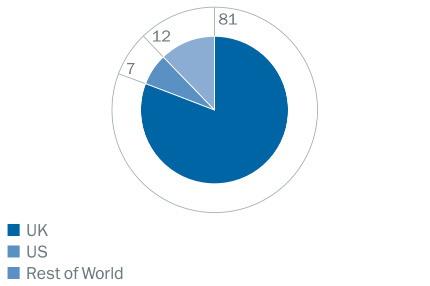
Sales analysis: activity (%)



Sales analysis: Platforms and Services (%)



Sales analysis: markets (%)



FINANCIAL KEY POINTS

- **Order book[1] reduced reflecting the continuing high level of trading on Typhoon against orders received in prior years**
- **4% like-for-like reduction in sales[1] reflects the impact of the terminated Nimrod MRA4 and Harrier programmes**
- **Return on sales improved to 10.5%**
- **Cash inflow[3] of £69m in 2011 includes the anticipated utilisation of programme advances**

		2011	2010	2009
Order intake[1]	KPI	**£4,355m**	£3,968m	£8,633m
Order book[1]		**£18.7bn**	£21.0bn	£24.3bn
Sales[1]	KPI	**£6,258m**	£6,529m	£6,153m
Underlying EBITA[2]	KPI	**£658m**	£522m	£661m
Return on sales		**10.5%**	8.0%	10.7%
Cash inflow[3]	KPI	**£69m**	£191m	£251m

Order intake[1] in the year of £4.4bn (2010 £4.0bn) includes a £0.9bn contract amendment on the aircraft carrier contract.

Sales[1] in 2011 were £6.3bn, which, on a like-for-like basis, were 4% below 2010 reflecting the impact of the terminated Nimrod MRA4 and Harrier programmes following the Strategic Defence and Security Review (SDSR).

Underlying EBITA[2] of £658m (2010 £522m) includes:

- a £160m charge in the first half on the Omani Offshore Patrol Vessel (OPV) programme;
- a £125m benefit from a UK Ministry of Defence (MoD) settlement agreement; and
- a £60m benefit from the increase in the carrying value of the Trinidad and Tobago OPVs upon signature of a contract for sale of these vessels to the Brazilian Navy.

Underlying EBITA[2] in the prior year included a charge of £100m taken in respect of the terminated Trinidad and Tobago OPV contract.

There was an operating cash inflow[3] of £69m (2010 £191m), which includes the anticipated utilisation of programme advances.

Military Air & Information

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

In line with the continuing focus on cost reduction and efficiency, there was a net headcount reduction of 2,400 during the year. In addition, as part of these efficiency improvements, and to address programme changes, including a planned reduction in the Typhoon production rate, the business announced in September 2011 approximately 2,700 further potential job losses.

Deliveries of Typhoon Tranche 2 aircraft to the four partner nations totalled 45. The global Typhoon fleet achieved the significant milestone of 100,000 flying hours during the year.

The Group continues to support its UK customer's Typhoon aircraft and their operational commitments through the Typhoon Availability Service contract with £89m of sales in the year.

The business continued to support the operational requirements of the UK Tornado fleet under an availability-based support contract. Flying hours across the Tornado fleet are expected to reduce as additional Typhoon aircraft enter service.

During the year, Typhoon and Tornado GR4 aircraft conducted in excess of 1,000 sorties as part of Operation Ellamy in support of UNSCR 1973 authorising the use of military force to protect civilians in Libya.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

REPORTING SEGMENTS: PLATFORMS & SERVICES (UK) *(continued)*

29,000
employees[1]

862
apprentices employed in the business

£755m
of research and development expenditure[2] in 2011

Lockheed Martin, the Group's customer, delivered the first production standard F-35 aircraft to the US Air Force. The Group has delivered 21 development and production aircraft fuselage assemblies to Lockheed Martin. Funding of £162m for the fourth Low-Rate Initial Production (LRIP) contract was secured in the year and negotiations with the customer continue in respect of funding for the fifth LRIP contract.

Support continues to be provided to users of Hawk aircraft across the world and orders for Indian Hawk packages worth £133m were received in the year. The contract to supply products and services to enable 57 Hawk aircraft to be built under licence in India awarded in 2010 is now fully mobilised, with material deliveries commencing in December 2011. Initial discussions have now commenced on the technical requirements for an additional 20 aircraft.

In March, a Memorandum of Understanding was signed with Dassault Aviation to bid jointly for new Unmanned Aircraft Systems (UAS) for the UK and French Ministries of Defence in response to the UK-French Defence Co-operation Treaty announced in 2010. Negotiations are anticipated in 2012 regarding the initial technology requirements for a Medium-Altitude Long-Endurance UAS.

In December, the Group signed a four-year, £40m Future Combat Air System research contract with the MoD to sustain and develop the UK's critical technology and skills in UAS.

In the defence information domain, the Group was one of three companies down selected to bid for the UK's Joint Military Air Traffic Services contract and, in December, the FALCON secure deployable communication system programme for the British Army and RAF achieved an important milestone by concluding a network build-up over a planned number of customer sites.

Maritime

The construction of the Royal Navy's new aircraft carriers continued. A number of blocks for the first ship, Queen Elizabeth, arrived at the Rosyth dockyard, and the first steel was cut in May for the second ship, Prince of Wales. A £0.9bn contract amendment was received reflecting the revised programme schedule and final pricing arrangements.

The fourth Type 45 destroyer, HMS Dragon, was accepted off contract by the Royal Navy in August and the support contract is delivering availability of the four ships now in service.

Cumulative savings to March 2011 of £194m have been reported to the MoD against commitments made under the Terms of Business Agreement (ToBA).

The arbitration process between the Group and the Government of the Republic of Trinidad and Tobago, in respect of the cancelled OPV programme, continues and the tribunal hearing is scheduled for the first half of 2012. In December 2011, the Brazilian Navy signed a contract worth £120m with BAE Systems to purchase the three OPVs. The contract also contains a Manufacturing Licence to enable further vessels of the same class to be constructed in Brazil.

Following sea trials, engineering reviews and customer discussions, the Group expects to incur significantly higher than planned costs to complete the Omani OPV programme, and took a pre-tax charge of £160m in the first half of the year. Progress is being made on the re-baselined schedule, and deliveries to the customer are expected in 2012 and 2013.

The Maritime Composite Training System (MCTS), a shore-based warfare operator training solution, was opened by the Royal Navy in August.

HMS Astute, the first of class attack submarine for the Royal Navy, continues to undertake sea trials and is making good progress, including the demonstration of Tomahawk Land Attack Missile capability. Ambush, the second of class, was launched in January 2011 and is progressing through the commissioning phase. Construction continues on the third and fourth boats, and construction of the fifth boat is now underway. Long lead procurement has commenced on the sixth boat in the anticipated seven boat programme.

The UK government has formally announced the approval to develop the Vanguard class replacement submarine. The business has agreed a contract with the UK MoD for the design and development phase.

The Advanced Radar Target Indication Situational Awareness Navigation (ARTISAN) 3D radar successfully achieved the demonstration of antenna technology progression milestone. The programme continues towards full production.

A number of combat system support contracts have been secured in the year, including a £46m long-term contract to provide in-service support to the Sampson multi-function radar. The major long-term in-service support contracts for ships, radar, torpedoes and combat mission systems continue to meet or exceed contracted performance.

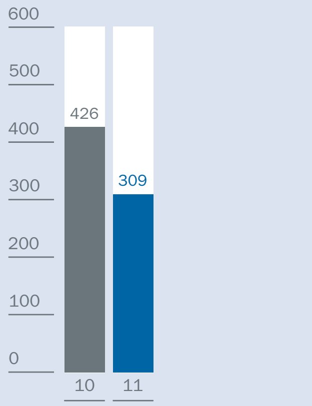
The Sting Ray lightweight torpedo delivery contract for the Norwegian government is ahead of schedule with three of five batches delivered. The remaining two batches are to be delivered in 2012.

1 Including share of equity accounted investments.
2 Includes both Group-funded and customer-funded expenditure.

NON-FINANCIAL PERFORMANCE

Safety
Performance in safety across the businesses has improved against 2010. This is reflected in a 27% decrease in the Lost Work Day Case Rate. Ongoing proactive employee safety campaigns have supported the 'safety first' approach across the business.

Lost Work Day Case Rate (per 100,000 employees) KPI



59 For more information on the corporate responsibility matrices

Diversity and inclusion
In 2011, a five-year diversity and inclusion strategy was launched, and each business has initiated activities to address talent diversity from a local and business perspective. Initiatives include mentoring, awareness briefings, executive sponsors with a supporting steering group, enhanced learning facilities, creating baseline information and an intranet site, and establishing networks and forums.

Environmental sustainability
Initial environmental objectives have been met, with reduction targets set in energy, water and waste.

During 2011, the business participated in the Carbon Reduction Commitment (CRC) and was ranked in the top half of UK listed companies in the CRC ratings.

People
The business continues to develop the capability of employees through 'Developing You' schemes and e-learning modules. Leadership development programmes and assessment centres support succession and development planning, together with an annual 360° feedback for the management population.

The business provides over 500 work experience placements throughout the UK, and is committed to continuing and expanding its substantial apprenticeship programme. Employee engagement initiatives in 2011 included an employee opinion survey, business-specific recognition schemes, leadership briefings and the launch of a leadership engagement programme.

Acknowledging the level of rationalisation activity in the business, a best practice rationalisation guide and UK redeployment site were launched during the year.

55 For more information on the Group's corporate responsibility activities

LOOKING FORWARD

Platforms & Services (UK) has a strong order book of long-term committed programmes, an enduring support business and cost reduction programmes in place.

In Military Air & Information, sales are underpinned by combat aircraft production on Typhoon and F-35, and in-service support in the UK and on export programmes for existing and legacy combat and Hawk trainer aircraft. There are a number of significant opportunities to secure future Typhoon export sales, including to Oman and Saudi Arabia.

In Maritime, sales are underpinned by the Type 45 destroyer, Queen Elizabeth class carrier and Astute class submarine manufacturing programmes, the 15-year ToBA, and the design of the Vanguard class successor submarine and Type 26 global combat ship. Additionally, such programmes can generate Services business throughout the the in-service life.

REPORTING SEGMENTS *(continued)*

Platforms & Services (International)

Platforms & Services (International) comprises the Group's businesses in Saudi Arabia, Australia, India and Oman, together with its 37.5% interest in the pan-European MBDA joint venture.

KEY CHARACTERISTICS

Saudi Arabia:
– Royal Saudi Air Force equipment, training and support
– Support for Royal Saudi Navy minehunter
– Land vehicles

Australia:
– Shipbuilding and electronics capability
– Land, sea and air support, and defence logistics provision
– Cyber and security

India:
– Long-standing military aircraft programme relationships
– Recently established land joint venture with Mahindra & Mahindra

MBDA:
– Pan-European guided weapons joint venture

Oman:
– Strong in-service base across air and land products

OPERATIONAL KEY POINTS

– Additional budgets approved on the Salam Typhoon programme

– Salam price escalation negotiations continue into 2012

– Customer budgets established for the next five years of support on the Saudi British Defence Co-operation Programme

– First Saudi Typhoon squadron operational

– First Royal Australian Navy Landing Helicopter Dock hull launched

– New UK missile development order received by MBDA

– Typhoon not selected as lowest priced compliant bid for India

– Request for proposal from Oman for Typhoon and associated support

Saudi Arabia: Services – Tornado maintenance and upgrade. As part of the Saudi British Defence Co-operation Programme, BAE Systems has substantial training and support activities in Saudi Arabia.

Saudi Arabia: Platforms – Typhoon training and support. The first 24 Typhoon aircraft of an order for 72 have been delivered to the Royal Saudi Air Force.

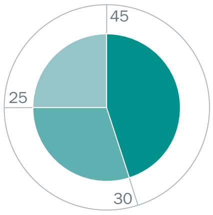
Australia: Services – Sea Hawk maintenance and logistics support. Support services activities in Australia include maintenance and logistics support for both fixed and rotary wing aircraft.

Australia: Platforms – Landing Helicopter Dock. Manufacture of major blocks for the two Royal Australian Navy Landing Helicopter Dock ships is progressing well.

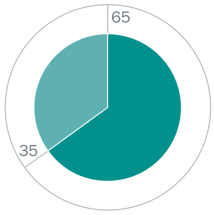
India: Defence Land Systems India – Mine Protected Vehicle manufacturing. With the establishment of a joint venture with Mahindra & Mahindra in India, the business is building on a number of new land opportunities.

MBDA: BAE Systems is a 37.5% participant in MBDA, now the world's largest guided weapons business.

Sales analysis (%)



Sales analysis: Platforms and Services (%)



FINANCIAL KEY POINTS

– **Order book[1] reduced pending multi-year awards in 2012**

– **Sales[1] reduced by 12% on maturing Tornado upgrade and core support programmes, and completed contract for Tactica vehicles**

– **Return on sales increased to 11.8%**

– **Low cash inflow[3] pending contract amendment for Salam Typhoon price escalation**

		2011	2010	2009
Order intake[1]	KPI	**£3,319m**	£2,694m	£4,395m
Order book[1]		**£8.3bn**	£9.1bn	£11.0bn
Sales[1]	KPI	**£3,794m**	£4,325m	£3,658m
Underlying EBITA[2]	KPI	**£449m**	£449m	£402m
Return on sales		**11.8%**	10.4%	11.0%
Cash inflow[3]	KPI	**£80m**	£190m	£812m

Order book[1] reduced to £8.3bn (2010 £9.1bn) pending award of contracts for changes to the Salam Typhoon programme, including price escalation, and the next phase of support on the Saudi British Defence Co-operation Programme (SBDCP).

Sales[1] in 2011 were £3.8bn, which, on a like-for-like basis, were 14% lower reflecting the maturing Tornado upgrade and core support programmes, and the completed contract for Tactica vehicles.

Underlying EBITA[2] was £449m (2010 £449m). Return on sales increased to 11.8% (2010 10.4%) on strong performance and risk reduction on the Tornado upgrade and core support programmes.

Operating cash inflow[3] of £80m (2010 £190m) includes the anticipated utilisation of programme advances. A significant cash receipt expected on the Salam Typhoon programme has been deferred until ongoing negotiations regarding price escalation have been concluded.

Saudi Arabia

The business continues to develop its presence in Saudi Arabia and remains committed to developing a greater indigenous capability in the Kingdom. This strategy is being enhanced by the entry into service of Typhoon aircraft and the subsequent development of the Typhoon in-country industrial base.

Of the 72 Typhoon aircraft contracted under the Salam programme, the first squadron of 24 aircraft has now been delivered to the Royal Saudi Air Force (RSAF), including six twin-seat aircraft to allow the RSAF to conduct their own training missions. The three-year Typhoon support contract is providing increased levels of capability to the RSAF.

BAE Systems has been in discussions with its customer regarding changes to the Salam programme. The proposed changes relate to final assembly of the last 48 of the 72 Typhoon aircraft, the creation of a maintenance and upgrade facility in the Kingdom of Saudi Arabia, initial provisioning for subsequent insertion of Tranche 3 capability in respect of the last 24 aircraft of this order and formalisation of price escalation.

Good progress on these discussions has been made in 2011 with budgets approved in the Kingdom in December on all items other than the price escalation where negotiations will now continue into 2012. Customer budgets have also been established for the next five years of support on the core SBDCP, including an upgrade of the training environment. Formal contracts under these budgets are being progressed.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

REPORTING SEGMENTS: PLATFORMS & SERVICES (INTERNATIONAL) *(continued)*

15,900
employees[1]

57%
of positions in Saudi Arabia filled by Saudi nationals

These budget approvals underpin both the Salam and SBDCP programmes. Salam trading performance, originally planned for 2011, relating to the formalisation of price escalation, including significant cash payment, has been deferred until ongoing negotiations have been concluded.

The upgrade of the RSAF Tornado fleet under the Tornado Sustainment Programme is currently performing ahead of schedule. A total of 61 of the contracted 81 aircraft had been delivered back into the fleet at 31 December 2011. The delivery of weapons capability under the programme, including associated storage facilities, is performing in line with expectations.

The first of the Royal Saudi Navy Al Jawf class ships entered the Naval Minehunter Mid-Life Update programme for re-fit as planned during the year.

All 200 Tactica vehicles have been accepted by the Saudi Arabia National Guard. The separate support contract for these vehicles continues to perform to plan.

As at the end of 2011, the customer had instructed BAE Systems to stop implementing work under the existing C4i (Command, Control, Communications, Computers and Intelligence) programme. Discussions to agree a mutually acceptable way forward are ongoing.

Australia

Construction of the superstructure blocks for the first of two Landing Helicopter Docks is now well advanced at the Williamstown shipyard, with subcontractor Navantia launching the first completed hull in Spain ahead of schedule. During the year, the business was awarded a A$115m (£76m) capability training contract.

On the Air Warfare Destroyer programme, the business has reached agreement in principle with the prime contractor for a reduction in the Group's work share of hull block construction and orders have been received for construction work on the second ship.

In November, it was announced that the business was to be awarded a A$267m (£176m) contract to upgrade seven Royal Australian Navy ANZAC class frigates with anti-ship missile defence capability. The contract was signed in January 2012.

During the year, the business was awarded contract extensions for A$116m (£77m) on the Over-The-Horizon Radar system for five years and A$135m (£89m) for Hawk Lead-In Fighter support for two years. The business was also selected to provide interim basic flying training for a further six years under an A$87m (£57m) contract. These awards demonstrate the Group's success in identifying efficiencies in response to the Australian Strategic Reform Programme (SRP). The Over-The-Horizon Radar system contract was the first new performance-based contract negotiated under the SRP.

In adjacent markets, the business successfully secured a position as one of the Department of Defense Chief Information Officer's Group (CIOG) Preferred Industry Partners on the Applications Managed Services Partnership Arrangement (AMSPA) panel. The business will act as lead for the Warfighter and Intelligence domain. The AMSPA arrangement is for at least five years, with potential extensions to 15 years, and represents a key change in the way CIOG will engage with industry to fast track the delivery of Information Communications Technology projects.

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

MBDA

Order intake with domestic customers was strong with new development orders received, including for the Future Local Area Air Defence System in the UK air defence sector and for the Milan successor programme in the combat surface sector. However, there was disappointment on the MEADS air-defence programme with the decision in the US not to pursue the development order beyond the Memorandum of Understanding ending in 2014. In the export market, a significant order was received from India in early 2012 for MICA air-to-air missiles as part of their Mirage 2000 upgrade.

Key deliveries during the year included Aster surface-to-air missiles, Mistral short-range ground-to-air missiles, Eryx anti-armour missiles, Exocet anti-ship missiles, Dual-Mode Brimstone air-to-ground missiles and Spada air defence systems.

Development programmes continue to progress well, with key milestones being passed on the MEADS air-defence programme, MdCN-Scalp naval stand-off missile programme, Meteor beyond visual range air-to-air missile and Aster air-defence programme, with six successful firings on the Aster programme, including one against a ballistic missile target.

India

Typhoon was down selected in 2011 by the Indian government as one of two remaining competitors for the Medium Multi-Role Combat Aircraft programme. Subsequently, the Group's competitor has been advised that it is the lowest priced compliant bidder and, on this basis, it is expected that contract negotiations will be initiated with that bidder. The Group is continuing to support the Indian customer and its evaluation process which is expected to take some time to complete.

In Defence Land Systems India, the Group's 26% joint venture with Mahindra & Mahindra, sales of the first new vehicle, the Mine Protected Vehicle India, commenced in 2011. The joint venture awaits the results of the competition to be one of the design authorities for the Future Infantry Combat Vehicle programme.

The Group continues to pursue an opportunity to supply M777 howitzers to the Indian Army.

During the year, the Group commenced the establishment of homeland security and technology operations in India to expand local capability, and support indigenous research and development activity. These operations are expected to develop during 2012.

Oman

Activity continues towards securing a contract award for the supply of Typhoon aircraft and associated support to the Royal Air Force of Oman. A request for proposal was received in January 2012 and contract award is expected during 2012.

1 Including share of equity accounted investments.

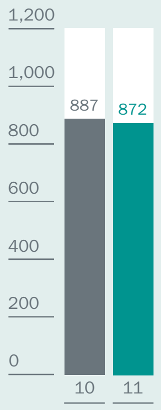
NON-FINANCIAL PERFORMANCE

Safety
Performance in safety across the business has improved against 2010. This is reflected in a marginal decrease in the Lost Work Day Case Rate. Safety improvement plans are in place to help support continued progress against the Safety Maturity Matrix (SMM) and factor in safety risks associated with the fulfilment of new contracts.

An engagement programme has been launched in Saudi Arabia to facilitate greater co-operation with the customer regarding on-base safety programmes.

To support continued progress on the SMM, the Australian management team has introduced safety, health and environmental metrics, focused on risk mitigation, and injury prevention and reduction.

Lost Work Day Case Rate (per 100,000 employees) KPI



59 For more information on the corporate responsibility matrices

Diversity and inclusion
Diversity and inclusion has progressed with the businesses implementing programmes that reflect their individual starting points and cultural context.

Female employment within the Saudi business is low due to regulatory and security clearance requirements currently restricting opportunities for the recruitment of females within military-related fields. To progress support in this area, the business has established its first female office in Riyadh.

In Australia, work has been done to create a flexible and inclusive workplace culture in line with feedback from the annual flexibility survey and work-life balance focus groups. To help improve gender diversity, targets have been set for the executive population. These 2015 targets will help to increase women's representation at senior levels.

The Indian business has focused on developing a pipeline of leadership within its local resource pool to increase the number of local nationals and females that it employs.

Environmental sustainability
Initial environmental objectives have been met, with reduction targets set in energy, water and waste.

People
The business's Saudisation programme is crucial to the long-term sustainability of its business. The business remains committed to recruiting and training local nationals. Local employees currently fill 57% of positions in-Kingdom, significantly ahead of the government interim requirement of 30%.

During 2011, the Australian business continued to invest in the development of its employees, including training to support its 'employee talent pipeline', and the introduction of mentoring and coaching frameworks.

55 For more information on the Group's corporate responsibility activities

LOOKING FORWARD

In the Kingdom of Saudi Arabia, the Group seeks to sustain its long-term presence through delivering current programmes and industrialisation, and developing new business in support of the Saudi military and paramilitary forces. The budgets approved in the Kingdom in December 2011 underpin both the SBDCP and Salam programmes.

In Australia, the Group will continue to support the Department of Defense in its efforts to achieve its Strategic Reform Programme by delivering cost and service improvements across all contracts as well as targeting further growth opportunities in the security services market. It is also exploring expansion into adjacent maritime markets, including commercial sustainment, and offshore oil and gas industry support and fabrication services.

In India, significant armoured vehicle and artillery opportunities are being pursued.

In Oman, the Group is making good progress towards capturing significant opportunities to address the future requirements of customers, in new product and support activities.

In MBDA, whilst domestic budgetary pressures continue, export markets are anticipated to grow, potentially benefiting from significant platform procurements.

GROUP PERFORMANCE REVIEW

Agile, adaptable and capable, Typhoon is the complete combat aircraft. Currently in service with the Royal Air Force, and the air forces of Germany, Italy, Spain, Austria and the Kingdom of Saudi Arabia, Typhoon's unrivalled combat capability, coupled with improved situation awareness, high survivability and the most advanced array of integrated sensors, make Typhoon a total solution for the modern air force.

Image taken over Abu Dhabi. Photographer: K. Tokunaga.

FINANCIAL REVIEW

Peter Lynas
Group Finance Director

FINANCIAL HIGHLIGHTS

- Headline sales[2] reduced by 14%
- Underlying EBITA[3] of £2,025m (2010 £2,179m) impacted by:
  - a £160m charge in the first half on the Omani Offshore Patrol Vessel (OPV) programme
  - a £125m benefit from a UK Ministry of Defence settlement agreement
  - a £60m benefit from the increase in the carrying value of the Trinidad and Tobago OPVs upon agreement of a sale to the Brazilian Navy
  - deferred recognition of sales and profit relating to the formalisation of price escalation on the Salam Typhoon programme
- Benefit of 5.9p per share from an agreement with the UK tax authorities
- Underlying earnings[4] per share broadly in line with 2010, excluding the tax agreement benefit
- Total dividend increased by 7.4% to 18.8p
- £500m market purchase of shares completed
- $1.25bn (£0.8bn) debt financing completed

INCOME STATEMENT – CONTINUING OPERATIONS

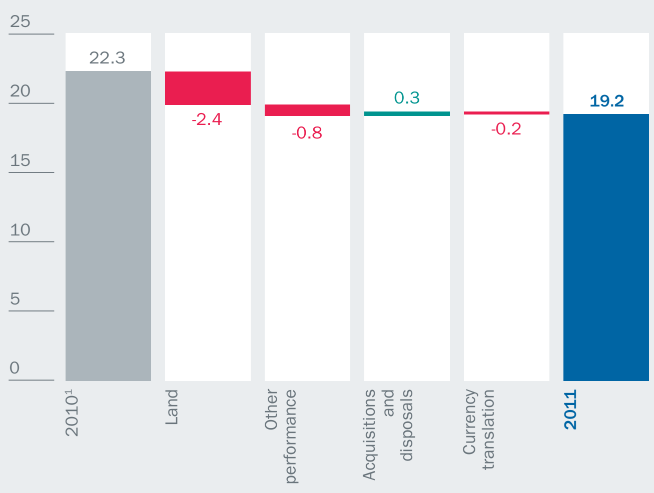
		2011 £m	Restated[1] 2010 £m
Sales[2]	KPI	**19,154**	22,275
Underlying EBITA[3]	KPI	**2,025**	2,179
Return on sales		**10.6%**	9.8%
(Loss)/profit on disposal of businesses		**(29)**	1
Pension accounting gains		**–**	2
Regulatory penalties		**(49)**	(18)
EBITA		**1,947**	2,164
Amortisation of intangible assets		**(239)**	(392)
Impairment of intangible assets		**(109)**	(125)
Finance costs[2]		**(106)**	(194)
Taxation expense[2]		**(233)**	(462)
Profit for the year		**1,260**	991

Exchange rates – average

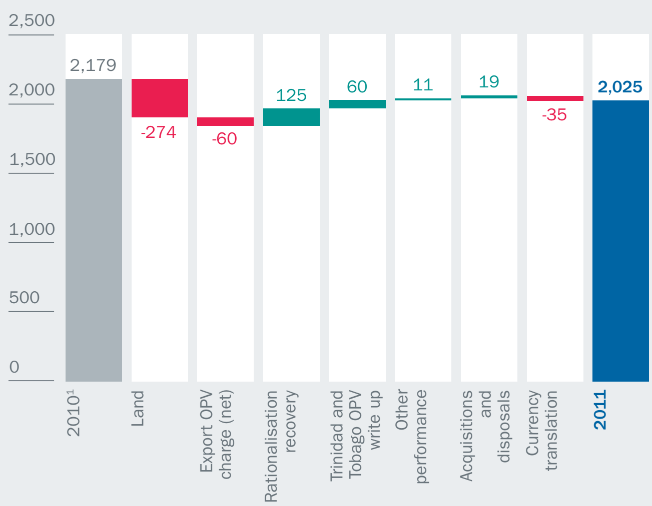
	2011	2010
£/$	**1.604**	1.545
£/€	**1.153**	1.166
£/A$	**1.553**	1.682

The results of the Regional Aircraft line of business and the Group's share of the results of Saab AB to the date of disposal of half of its 20.5% shareholding in June 2010 are shown within discontinued operations (see note 7 to the Group accounts).

Sales[2] bridge (£bn)



Underlying EBITA[3] bridge (£m)



Sales[2] reduced by 15% on a like-for-like basis primarily driven by the lower level of Bradley reset/remanufacturing activity and completed Family of Medium Tactical Vehicles (FMTV) programme in the Land & Armaments business, the impacts of the SDSR on the UK business and delay in securing some of the contract changes to the Saudi Typhoon programme. The Group's sales[2] performance is illustrated in the bridge chart above.

Underlying EBITA[3] Management uses an underlying profit measure to monitor the year-on-year profitability of the Group defined as earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

Underlying EBITA[3], which has reduced by 6% on a like-for-like basis, includes:

- a £160m charge in the first half on the Omani Offshore Patrol Vessel (OPV) programme;
- a £125m benefit from a UK Ministry of Defence settlement agreement; and
- a £60m benefit from the increase in the carrying value of the Trinidad and Tobago OPVs upon agreement of a sale to the Brazilian Navy.

Underlying EBITA[3] in the prior year included a charge of £100m taken in respect of the terminated Trinidad and Tobago OPV contract.

The reduction in underlying EBITA[3] is illustrated in the bridge chart above.

Non-recurring items are defined as items that are relevant to an understanding of the Group's performance with reference to their materiality and nature. The non-recurring items, which are unchanged from the prior year, are as follows:

Loss on disposal of businesses of £29m mainly comprises losses on the disposals of the Advanced Ceramics and Swiss-Photonics businesses.

Regulatory penalties of £49m reflect the US Department of State fine. The prior year charge reflects the exchange rate movement on payment of the global settlement with the US Department of Justice.

Amortisation of intangible assets is £153m lower at £239m mainly reflecting the alignment of amortisation to the profile of vehicle deliveries under the completed FMTV contract.

Impairment of intangible assets of £109m includes charges taken for goodwill impairment on the Safety Products business within Land & Armaments (£60m) and the Surface Ships business within Platforms & Services (UK) (£34m).

Finance costs[2] were £106m (2010 £194m). The underlying interest charge, excluding pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements, was £212m (2010 £191m). In 2011, the underlying interest charge includes £41m relating to the early redemption of debt in June in connection with the disposal of the Regional Aircraft Asset Management business, £28m of which would have been incurred in future years.

Taxation expense[2] reflects an effective tax rate of 14%. Excluding the benefit of an agreement with the UK tax authorities addressing a number of items, including the interpretation of the complex tax rules relating to research and development tax credits, the effective tax rate for 2011 is 26%, which is lower than the prior year rate of 30%. The calculation of the effective tax rate is shown below.

Calculation of the effective tax rate

	2011 £m	Restated[1] 2010 £m
Profit before taxation	**1,493**	1,453
Add back/(deduct):		
Loss/(profit) on disposal of businesses	**29**	(1)
Regulatory penalties	**49**	18
Goodwill impairment	**94**	84
	1,665	1,554
Taxation expense[2] (excluding UK tax agreement)	**430**	462
UK tax agreement	**(197)**	–
Taxation expense[2]	**233**	462
Effective tax rate	**14%**	30%

The underlying tax rate for 2012 is expected to be between 26% and 28%, with the final number dependent on the mix of profits between the UK and US.

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7 to the Group accounts).
2 Including share of equity accounted investments.
3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
4 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 8 to the Group accounts).

FINANCIAL REVIEW *(continued)*

EARNINGS PER SHARE – CONTINUING OPERATIONS

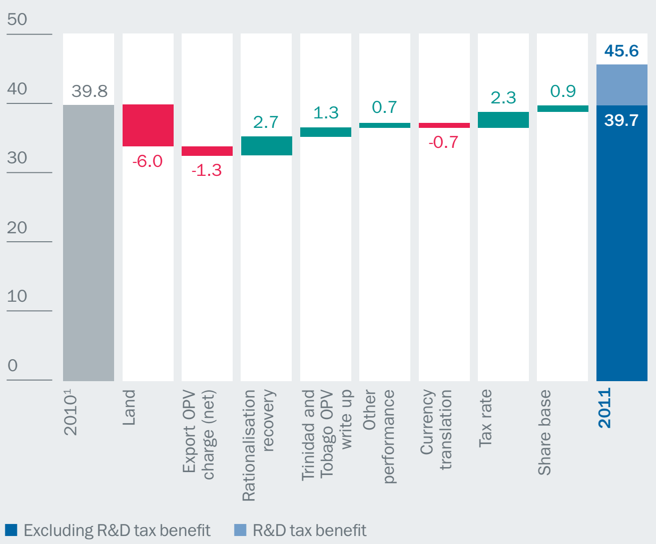
Reconciliation from underlying EBITA[3] to underlying earnings[4] – continuing operations

		2011 £m	Restated[1] 2010 £m
Underlying EBITA[3]	KPI	**2,025**	2,179
Finance costs excluding non-cash finance movements on pensions and financial derivatives (see note 5 to the Group accounts)		**(212)**	(191)
Add back: Finance charges relating to early redemption of debt		**13**	–
		1,826	1,988
Taxation		**(472)**	(588)
UK tax agreement		**197**	–
Non-controlling interests		**(16)**	(29)
Underlying earnings[4]		**1,535**	1,371
Weighted average number of shares		**3,365m**	3,451m
Underlying earnings[4] per share	KPI	**45.6p**	39.8p

Underlying earnings[4] per share was 45.6p (2010 39.8p), an increase of 15% (see underlying earnings[4] per share KPI on page 15). The increase in underlying earnings[4] per share, which is illustrated in the bridge chart below, includes a 5.9p benefit relating to the tax agreement referred to above. Excluding the tax agreement benefit, underlying earnings[4] per share was 39.7p.

Basic earnings per share, in accordance with International Accounting Standard (IAS) 33, Earnings per Share, increased to 37.0p compared with 27.9p in 2010.

Underlying earnings[4] per share bridge (pence)



DIVIDENDS

The Board is recommending a final dividend of 11.3p per share (2010 10.5p), bringing the total dividend for the year to 18.8p per share (2010 17.5p), an increase of 7.4%.

The total dividend for the year is covered 2.1 times by underlying earnings[4] from continuing operations excluding the R&D tax benefit (2010 2.3 times).

CASH FLOW

Reconciliation of cash inflow from operating activities to net debt (as defined by the Group)[5]

		2011 £m	2010 £m
Cash inflow from operating activities		**951**	1,535
Capital expenditure (net) and financial investment		**(268)**	(364)
Dividends received from equity accounted investments		**88**	71
Assets contributed to Trust		**(137)**	(25)
Cash held for charitable contribution to Tanzania		**–**	(30)
Operating business cash flow[6]	KPI	**634**	1,187
Interest		**(180)**	(173)
Income from financial assets at fair value through profit or loss		**4**	–
Taxation		**(257)**	(352)
Free cash flow		**201**	662
Acquisitions and disposals		**(256)**	(88)
Purchase of equity shares (net)		**(509)**	(520)
Equity dividends paid		**(606)**	(574)
Dividends paid to non-controlling interests		**(22)**	(32)
Cash flow from matured derivative financial instruments		**(34)**	(123)
Movement in cash collateral		**–**	11
Movement in cash received on customers' account[7]		**13**	7
Foreign exchange translation		**(20)**	(20)
Other non-cash movements		**36**	32
Total cash outflow		**(1,197)**	(645)
Opening net (debt)/cash (as defined by the Group)[5]		**(242)**	403
Closing net debt (as defined by the Group)[5]		**(1,439)**	(242)

Components of net debt (as defined by the Group)[5]

	2011 £m	2010 £m
Debt-related derivative financial assets	**56**	45
Other investments – current	**–**	260
Cash and cash equivalents	**2,141**	2,813
Loans – non-current	**(2,682)**	(2,133)
Loans and overdrafts – current	**(518)**	(920)
Less: Cash received on customers' account[7]	**(3)**	(16)
Less: Assets held in Trust	**(403)**	(261)
Less: Cash held for charitable contribution to Tanzania	**(30)**	(30)
Net debt (as defined by the Group)[5]	**(1,439)**	(242)

Cash inflow from operating activities was £951m (2010 £1,535m), which includes contributions in excess of service costs for the UK and US pension schemes totalling £375m (2010 £554m).

The outflow from **net capital expenditure and financial investment** reduced to £268m (2010 £364m) mainly reflecting the proceeds from a number of investment property disposals.

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7 to the Group accounts).
2 Including share of equity accounted investments.
3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
4 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 8 to the Group accounts).

Dividends received from equity accounted investments, primarily MBDA, Panavia and Air Astana, totalled £88m (2010 £71m).

Assets contributed to Trust comprise payments made for the benefit of the Group's main pension scheme totalling £137m (2010 £25m), including £112m following the £500m share buyback programme completed in December 2011.

Cash held for charitable contribution to Tanzania The £29.5m charitable contribution for the benefit of the people of Tanzania in connection with the global settlement of regulatory investigations with the UK's Serious Fraud Office was deducted from the Group's net debt at 31 December 2010. The amount (including interest) will be applied by the Company for the benefit of the people of Tanzania in accordance with applicable Company policies.

Taxation payments were £257m (2010 £352m). The reduction primarily reflects timing differences on US tax payments in the prior year.

Net cash outflow in respect of **acquisitions and disposals** of £256m mainly comprises the acquisition of L-1 Identity Solutions, Inc.'s Intelligence Services Group, Norkom Group plc, ETI A/S, Fairchild Imaging, Inc. and stratsec.net Pty Limited (£524m), less the net proceeds from the disposal of the Regional Aircraft Asset Management business (£98m) and the Group's residual shareholding in Saab AB (£152m). The prior year outflow of £88m mainly comprises the acquisition of Atlantic Marine and OASYS Technology (£260m), less the disposal of half of the Group's 20.5% Saab AB shareholding (£92m) and an initial payment from the former owners of the Tenix Defence business relating to the resolution of outstanding issues from the 2008 acquisition (£65m).

The **net purchase of equity shares** of £509m (2010 £520m) includes 184 million shares purchased under the buyback programme at a cost of £500m (excluding transaction costs of £3m).

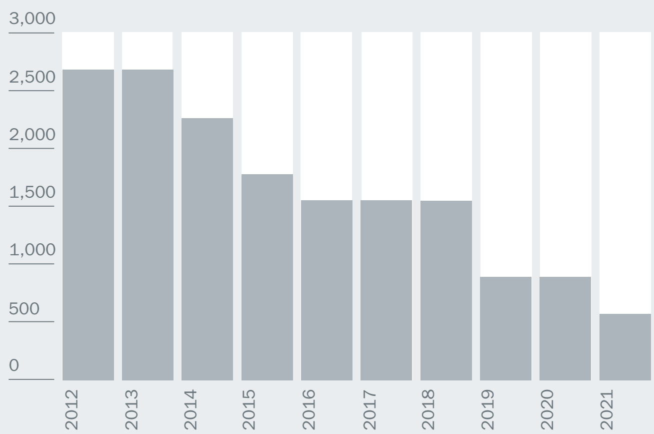
As a consequence of movements in the US dollar and Euro exchange rates during the year, there has been a **cash outflow from matured derivative financial instruments** of £34m (2010 £123m) from rolling hedges on balances with the Group's subsidiaries and equity accounted investments.

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

In October 2011, the Group raised $1.25bn (£0.8bn) in the US bond market. A $1bn (£0.6bn) 6.4% bond was repaid in December 2011.

The maturity profile of the borrowings component of net debt (as defined by the Group)[5] is illustrated in the chart below. Details on the Group's objectives and policies regarding net debt (as defined by the Group)[5] are provided on page 52.

Maturity profile of the Group's borrowings (£m)



BALANCE SHEET

Summary balance sheet

	2011 £m	2010 £m
Intangible assets	**11,465**	11,216
Property, plant and equipment, and investment property	**2,626**	2,848
Equity accounted investments and other investments	**788**	798
Other financial assets and liabilities (net)	**(219)**	(10)
Tax assets and liabilities (net)	**975**	580
Pension deficit (as defined by the Group)	**(4,217)**	(3,146)
Working capital	**(5,677)**	(6,641)
Net debt (as defined by the Group)[5]	**(1,439)**	(242)
Net liabilities of disposal group held for sale	**(3)**	–
Net assets	**4,299**	5,403

Exchange rates – year end

	2011	2010
£/$	**1.554**	1.565
£/€	**1.197**	1.166
£/A$	**1.516**	1.526

The £249m increase in **intangible assets** to £11.5bn (2010 £11.2bn) mainly reflects acquisitions (£561m), partly offset by amortisation and impairments (£348m).

The movement in the **pension deficit (as defined by the Group)** during the year was as follows:

Movement in the pension deficit (as defined by the Group)

	£m
Total IAS 19 deficit at 1 January 2011	**(4,103)**
Actual return on assets below expected return	**(422)**
Increase in liabilities due to changes in assumptions	**(1,405)**
Contributions in excess of service cost	**375**
Past service cost	**(47)**
Net financing credit	**22**
Exchange translation	**(10)**
Movement in US healthcare plans	**5**
Total IAS 19 deficit at 31 December 2011	**(5,585)**
Allocated to equity accounted investments and other participating employers	**965**
Group's share of IAS 19 deficit at 31 December 2011	**(4,620)**
Assets held in Trust	**403**
Pension deficit (as defined by the Group)	**(4,217)**

The increase in liabilities due to changes in assumptions of £1.4bn mainly reflects a 0.2 percentage point reduction in real UK discount rates and updated mortality assumptions in respect of the UK schemes.

A net deferred tax asset of £1.2bn (2010 £1.0bn) relating to the Group's pension deficit is included within net tax assets and liabilities, and disclosed in note 18 to the Group accounts.

The Group's pension schemes are discussed in more detail overleaf.

There was a £1.0bn increase in **working capital** mainly reflecting the utilisation of advance contract funding.

5 See note 10 to the Group accounts.
6 See note 9 to the Group accounts.
7 Cash received on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance. It is included within trade and other payables in the consolidated balance sheet.

FINANCIAL REVIEW *(continued)*

PENSION SCHEMES

The Group's principal pension schemes are funded defined benefit schemes. The two largest schemes are the BAE Systems Pensions Scheme (Main Scheme) and the BAE Systems 2000 Pension Plan (2000 Plan). In aggregate, these two schemes represent 73% (2010 73%) of the total IAS 19, Employee Benefits, deficit at 31 December 2011.

Investment strategy
In aggregate, some 51% of the Group's pension scheme assets are held in equities due to the higher expected level of return over the long term. The investment portfolios are highly diversified in order to provide reasonable assurance that no single security or type of security could have a materially adverse impact on the total portfolio. Some of the Group's pension schemes use derivative financial instruments as part of their investment strategy to manage the level of risk.

An analysis of pension scheme assets split between equities, bonds, property and other investments, together with the expected returns on those investments, is shown in note 23 to the Group accounts.

Valuation
Pension plan valuations are performed by independent actuaries for both IAS 19 accounting and funding purposes.

Accounting valuations
A summary of the Group's pension scheme assets and liabilities is shown below:

Pension scheme assets and liabilities

	2011 £m	2010 £m
Fair value of plan assets	17,707	17,203
Present value of obligations	(23,292)	(21,306)
Total IAS 19 deficit, net	**(5,585)**	(4,103)
Allocated to equity accounted investments and other participating employers	965	696
Group's share of IAS 19 deficit, net	**(4,620)**	(3,407)
Assets held in Trust	403	261
Pension deficit (as defined by the Group)	**(4,217)**	(3,146)

Pension scheme assets are included in the valuation at bid value.

The key assumptions used to calculate pension scheme liabilities for the principal schemes are shown below:

Principal pension accounting valuation assumptions

	UK		US	
	2011	2010	2011	2010
Real discount rate[8] (%)	1.9	2.1	2.5	2.5
Rate of increase in salaries (%)	3.4	4.4	4.5	4.5
Rate of increase in pensions in payment (%)	1.9–3.4	2.3–3.6	n/a	n/a
Rate of increase in deferred pensions (%)	2.0/2.9	2.8/3.4	n/a	n/a
Life expectancy of a male currently aged 65 (years)	22–24	19–23	19	19
Life expectancy of a female currently aged 65 (years)	24–25	22–26	21	21

The discount rate assumptions are based on third party AA corporate bond indices using yields that reflect the maturity profile of the expected benefit payments.

The valuation of the Group's pension liabilities is highly sensitive to movements in discount rates. A ten basis point movement in the rate changes the total pre-tax liability by some £0.4bn.

The rate of increase in salaries for the UK schemes is assumed to be 0.5% (2010 1.0%) above Retail Prices Index (RPI) inflation of 2.9% (2010 3.4%).

The rate of increase in pensions in payment differs between schemes. Different tranches of the schemes increase at rates based on either RPI or Consumer Prices Index (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.

The rate of increase in deferred pensions is based on CPI inflation of 2.0% (2010 2.8%), with the exception of the 2000 Plan, which is based on RPI inflation of 2.9% (2010 3.4%).

Assumptions in respect of the levels of both RPI and CPI inflation over the duration of the Group's pension scheme liabilities have reduced during the year.

Certain of the Group's equity accounted investments participate in the Group's defined benefit pension schemes as well as Airbus SAS, the Group's share of which was sold in 2006. As these are multi-employer schemes, the Group allocates an appropriate share of the IAS 19 pension deficit to those equity accounted investments and Airbus SAS.

Following the 2011 share buyback programme, the Group made contributions into Trust in respect of the Main Scheme of £112m. Contributions of £20m were also made to other UK pension schemes and an additional £25m will be paid into Trust in respect of the 2000 Plan in 2012.

The Group contributed a total of £137m into Trust in 2011. The cumulative contributions into Trust of £387m, plus fair value gains of £16m, are reported within cash and cash equivalents (£403m) at 31 December 2011. The use of these assets is restricted under the terms of the Trust. The Group considers these contributions to be equivalent to other lump sum contributions it makes into the Group's pension schemes and, accordingly, presents a definition of the pension deficit including them.

Funding valuations
Pension scheme assets are included in the valuation at market value, whilst the liabilities are determined based on prudent assumptions set by the trustees following consultation with scheme actuaries.

Triennial funding valuations of the Group's two largest pension schemes, the Main Scheme and 2000 Plan, were performed as at 31 March 2011. Whilst asset returns were marginally above previous expectations, the funding deficit is £3bn, some £1bn higher than the estimated position at the time of the previous valuations. This is primarily due to lower discount rates and further movements in mortality assumptions.

Revised deficit recovery plans have been agreed with the trustees of both the Main Scheme and 2000 Plan, which run until 2026.

The expected level of pension deficit funding across all Group schemes, in excess of service cost, is approximately £400m in 2012.

The results of future triennial valuations and associated funding requirements will be impacted by the future performance of investment markets, and interest and inflation rates.

8 Discount rate net of inflation.

CAPITAL

Objectives	Policies	Performance
Maintain the Group's investment grade credit rating and ensure operating flexibility, whilst: **– meeting its pension obligations;** **– continuing to pursue organic investment opportunities;** **– paying dividends in line with the Group's policy of long-term sustainable cover of around two times;** **– making accelerated returns of capital to shareholders when the balance sheet allows; and** **– investing in value enhancing acquisitions, where market conditions are right and where they deliver on the Group's strategy.** 158 For more information see note 25 to the Group accounts	The Group funds its operations through a mixture of equity funding and debt financing, including bank and capital market borrowings. The capital structure of the Group reflects the judgement of the directors of an appropriate balance of funding required.	At 31 December 2011, the Group's capital was £4,291m (2010 £5,356m), which comprises total equity of £4,299m (2010 £5,403m), less amounts in equity relating to cash flow hedges of £8m (2010 £47m). Net debt (as defined by the Group)[5] was £1,439m (2010 £242m). During the year, the Group returned a total of £1,106m to shareholders in dividends and share buybacks (2010 £1,074m).

TAX

Objectives	Policies	Performance
The Group's tax strategy aims to: **– ensure compliance with all relevant statutory obligations; and** **– mitigate the tax charge to a level that is consistent with the Group's legal obligations in all relevant jurisdictions.** 126 145 For more information see notes 6 and 18 to the Group accounts	The Group seeks to build constructive, open working relationships with tax authorities through full disclosure, and actively considers the implications of tax planning for the Group's wider corporate reputation. Whilst the Group aims to maximise the tax efficiency of its business transactions, it does not use artificial structures in its tax planning, nor does it engage in tax evasion. Arm's length principles are applied in the pricing of all intra-group transactions in accordance with OECD guidelines. Where appropriate, the Group consults with tax authorities to help shape proposed legislation and tax policy. BAE Systems operates internationally and is subject to tax in many different jurisdictions. The Group employs professional tax managers and takes appropriate advice from reputable professional firms. The Group is routinely subject to tax audits and reviews which can take a considerable period of time to conclude. Provision is made for known issues based on management's interpretation of country-specific legislation and the likely outcome of negotiations or litigation.	During the year, the Group concluded an agreement with the UK tax authorities addressing a number of outstanding items, including the interpretation of complex rules relating to research and development tax credits. The Group's tax affairs are broadly up to date in the jurisdictions in which it operates.

5 See note 10 to the Group accounts.

FINANCIAL REVIEW *(continued)*

TREASURY

The Group's treasury activities are overseen by the Treasury Review Management Committee (TRMC). Two executive directors are members of the TRMC, including the Group Finance Director who chairs the Committee. The TRMC also has representatives with legal and tax expertise.

The Group operates a centralised treasury department that is accountable to the TRMC for managing treasury activities in accordance with the treasury policies approved by the Board.

It is an overriding policy that trading in financial instruments for the purpose of profit generation is prohibited, with all financial instruments being used solely for risk management purposes.

Compliance against treasury policies is monitored and any exceptions found are reported to the TRMC.

All treasury policies remain under close review given the continuing volatility in the financial markets.

Objectives	Policies	Performance
Net debt (as defined by the Group)[5]		
Maintain a balance between the continuity, flexibility and cost of debt funding through the use of borrowings from a range of markets with a range of maturities, currencies and interest rates, reflecting the Group's risk profile. 133 For more information see note 10 to the Group accounts	Material borrowings are arranged by the central treasury department. Funds raised are lent onward to operating subsidiaries as required and any surplus funds are lent back where appropriate. The Group intends to continue to fund the business conservatively through proactive use of bank and capital markets.	In October 2011, the Group raised \$1.25bn (£0.8bn) in the US bond market. Three tranches of notes were issued, \$350m (£224m) due in 2016 with a coupon of 3.5%, \$500m (£321m) due in 2021 with a coupon of 4.75% and \$400m (£257m) due in 2041 with a coupon of 5.8%. A \$1bn (£0.6bn) 6.4% bond was repaid in December 2011. Excluding acquisition or disposal financing and share buybacks, net debt (as defined by the Group)[5] is driven by the Group's operational performance and receipts on major contracts. As in previous years, the net debt position of the Group is generally best at the end of the year.
Interest rates		
Mitigate the Group's exposure to interest rate fluctuations on borrowings through varying the proportion of fixed rate debt relative to floating rate debt with derivative instruments, mainly interest rate swaps. 163 For more information see note 27 to the Group accounts	A minimum of 50% and a maximum of 75% of gross debt is maintained at fixed interest rates.	At 31 December 2011, the Group had 63% (2010 65%) of fixed rate debt and 37% (2010 35%) of floating rate debt based on a gross debt of £3.1bn, including debt-related derivative financial assets (2010 £3.0bn).
Liquidity		
Maintain adequate undrawn committed borrowing facilities. 163 For more information see note 27 to the Group accounts	The Group's committed Revolving Credit Facility (RCF) is £2bn (2010 £2bn). The RCF, which is contracted until 2015, is syndicated amongst the Group's core relationship banks and is available to meet expected general corporate funding requirements. The RCF also acts as a back stop to Commercial Paper issued by the Group. 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 RCF was undrawn throughout the year. The Group had £513m of Commercial Paper in issue at 31 December 2011 (2010 £144m).

5 See note 10 to the Group accounts.

Objectives	Policies	Performance
Liquidity *(continued)*		
Monitor and control counterparty credit risk and credit limit utilisation. 163 For more information see note 27 to the Group accounts	The Group 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 capitalisation, credit rating and credit default swap price.	The Group had cash and cash equivalents at 31 December 2011 of £2,141m (2010 £2,813m), which was invested with 24 financial institutions (2010 24). The maximum amount deposited with any individual bank as at 31 December 2011 was less than £200m (2010 £225m). The Group has no exposure to Greek, Irish, Italian, Portuguese or Spanish banks. Additionally, the Group monitors its exposure to banks which have exposure to these countries.
Currency		
Reduce the Group's exposure to volatility in earnings and cash flows from movements in foreign currency exchange rates, mainly the US dollar, Euro and Saudi Arabian riyal. 163 For more information see note 27 to the Group accounts	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, unless otherwise approved as exceptions by the TRMC, 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 the 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 statement or balance sheet of foreign subsidiaries and equity accounted investments it regards as long-term investments. Hedges are, however, undertaken in respect of investments that are not considered long term or core to the Group.	There was a net credit of £85m in the income statement for the year (2010 £84m) in respect of market value and foreign exchange movements on financial instruments and investments.
Credit quality		
Maintain an investment grade rating in order to ensure access to the widest possible sources of finance and minimise the cost of debt funding to support the efficient operation of the Group's activities.	The Group aims to deliver its planned operating cash flows, and manage its relationships with debt capital market investors, banks and rating agencies.	Three credit rating agencies publish credit ratings for the Group: Moody's Investors Service (Baa2), Standard & Poor's Ratings Services (BBB+) and Fitch's Investors Service (BBB+). During the year, all three maintained their categories and outlooks for the Group as investment grade and stable, respectively.

INSURANCE

Objectives	Policies	Performance
Maintain an understanding of the current and future risk profile of the Group, offer tailored risk mitigation solutions, and ensure the Group insurance protection reflects current exposures.	The Group operates a policy of partial self-insurance, with the majority of cover placed in the external market. The Group insures its export contracts, and associated on-demand bank guarantees against political and corporate risks. All of the Group's insurers must have a minimum credit rating of A-.	The Group continues to monitor its insurance arrangements to ensure the quality and adequacy of cover. During 2011, the Group again sought external validation of the credit rating of those insurers who have a significant proportion of the insurance portfolio. The views of a number of rating agencies and insurance intermediaries were considered to assess the long-term stability of the Group's insurers.

FINANCIAL REVIEW *(continued)*

CRITICAL ACCOUNTING POLICIES

Certain of the Group's 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 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. The critical accounting policies are listed below and explained in more detail in note 32 to the Group accounts. References to the relevant individual notes to the Group accounts are also provided.

Recognition of profit on long-term contracts (IAS 11, Construction Contracts)
Revenue on long-term contracts is recognised in the Group's income statement when performance milestones have been completed.

The ultimate profitability of the contract is estimated 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.

In 2011, a significant proportion of the Group's £17.8bn of revenue was accounted for under IAS 11.

120 For more information
see note 1 to the Group accounts

Valuation of retirement benefit obligations for defined benefit pension schemes (IAS 19, Employee Benefits)
The retirement benefit obligation recognised in the Group's balance sheet represents the present value of the defined benefit obligations as adjusted for unrecognised past service cost and as reduced by the fair value of scheme assets.

For each of the assumptions used to measure the Group's pension scheme liabilities (summarised on page 50), there is a range of possible values and management exercises judgement in deciding 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. Pension scheme accounting valuations are prepared by independent actuaries as at 30 June and 31 December each year.

The Group has allocated a share of the pension deficit to its equity accounted investments and other participating employers using a consistent method of allocation, which represents the directors' best estimate of the deficit anticipated to be funded by these entities.

At 31 December 2011, the Group's share of the IAS 19 pension deficit was £4.6bn, excluding amounts allocated to equity accounted investments and other participating employers.

151 For more information
see note 23 to the Group accounts

Valuation of acquired intangible assets (IFRS 3, Business Combinations) and ongoing impairment testing (IAS 36, Impairment of Assets)
Acquired intangible assets, excluding goodwill, are valued in line with internationally used models, which require the use of estimates that may differ from actual outcomes. These intangible assets are amortised over their estimated useful lives. Future results are impacted by the amortisation periods adopted and, potentially, any differences between estimated and actual circumstances related to individual intangible assets.

Goodwill is not amortised, but is tested annually for impairment and carried at cost less accumulated impairment losses. The impairment review calculations require the use of estimates related to the future profitability and cash-generating ability of the acquired businesses.

The Group recognised intangible assets totalling £561m in respect of acquisitions made during 2011, including £291m of goodwill. At 31 December 2011, total intangible assets were £11.5bn, including £10.7bn of goodwill.

136 160 For more information
see notes 11 and 26 to the Group accounts

CORPORATE RESPONSIBILITY REVIEW

Overview

Creating a successful and sustainable business requires more than financial results. The Group places great importance not just on what we do, but how we do it. Responsible business is embedded within the Group's strategy.

The Corporate Responsibility (CR) objectives support the Group in progressing towards recognised leading positions in ethics and safety. The Group also has programmes in place to progress diversity and inclusion, and environmental sustainability.

The Group's CR agenda covers the issues that have been identified as having the most potential to affect the long-term sustainability of the Group, by directly impacting the Group's reputation or ability to operate. The Group has four priorities, outlined below, that are material to its long-term performance, and which are supplemented at a local level by CR programmes to address specific local issues (see pages 24 to 43).

The four corporate responsibility priorities are addressed by...

Ethics

...continuing to engage employees and develop the Group's ethics programme in support of Responsible Behaviour.

Highlights include:

- **Continued to develop and evolve the Group's business conduct programme**
- **Woolf Committee implementation programme completed**

1,011

2011 employee enquiries to Ethics Helpline

56 For more information on ethics

Safety

...embedding a safety first approach to the Group's operations so that all employees understand the importance of a safe workplace.

Highlights include:

- **Year-on-year improvement in the Lost Work Day Case Rate**
- **Good progress made in embedding safety awareness and culture across the Group**

11%

reduction in Lost Work Day Case Rate

57 For more information on safety

Diversity and inclusion

...developing a diverse and inclusive environment which encourages innovation and enhances productivity by helping to recruit and retain the best people.

Highlights include:

- **Executive Committee agreed actions on growing the female leadership pipeline**
- **The Chief Executive's leadership team participated in Inclusive Leadership/ Unconscious Bias training**

25%

of the BAE Systems Board are women at 31 December 2011

58 For more information on diversity and inclusion

Environmental sustainability

...managing the operational efficiency of the Group's sites so that its environmental impact is reduced.

Highlights include:

- **Reduction targets agreed for energy, waste and water**
- **Progress achieved against Environmental Sustainability Maturity Matrix**

6%

reduction in CO_2 emissions in 2010

1.286

million tonnes of CO_2 emissions in 2010

59 For more information on environmental sustainability

In addition to the four priorities above, the Group continues to support the communities in which it operates.

Highlights include:

- Over £1.4m raised for armed forces charities
- Over £1m raised to support Science, Technology, Engineering and Mathematics (STEM) agenda

Over £4m*

total fundraising in 2011

For more information on the Group's community programme: www.baesystems.com/corporateresponsibility

* See assurance statement on www.baesystems.com/deloitteassurancestatement

CORPORATE RESPONSIBILITY REVIEW *(continued)*

Ethics

2011 objectives

– Implementation of the Group's programme to address the Woolf recommendations to be complete by May 2011 and confirmed through external assurance at the end of 2011.

Progress

– The implementation programme to address the 23 recommendations of the Woolf Committee was completed in May 2011. Deloitte has assured BAE Systems' statements on 'Progress against Recommendations' on the Group's website.

2012 objectives

– Continue to improve and evolve the Group's business conduct programme.

Ethics programme

The Group remains committed to achieving and sustaining a leadership role in business conduct.

The Group's global Code of Conduct sets out clear expectations for employees, and regular training on the Code and ethical standards is helping it to embed a culture of responsible business conduct throughout the businesses. It includes practical guidance to help employees deal with ethical issues and where to go for advice or to report concerns, including the Ethics Helpline. During 2011, 1,011 calls were made to the helpline.

The Group has continued to strengthen its policies and processes to ensure employees have the clear guidance they need to make ethical choices and understand the due diligence required in the Group's business decisions. The Code and key policies on ethical conduct are integrated into the processes that govern all aspects of the Group's day-to-day business.

Any employee found to be in breach of the Code, or any other relevant policies, is subject to appropriate disciplinary action. In 2011, 298 employees were dismissed for reasons relating to breaches of the Group's standards and policies, primarily for personnel and work place issues.

In 2007, the Board set up the Woolf Committee, which was asked to examine the ethical principles and practices underlying the Group's business, and identify areas for further improvement that the Group should address in order to be recognised as a global leader in ethical business conduct. Following the publication of the Committee's report in 2008, the Group initiated an extensive three-year programme to address the 23 recommendations of the Committee. Implementation of that programme was completed in May 2011. The Group remains committed to a programme of continuous improvement to position BAE Systems in the vanguard of best practice in this regard.

Following the Woolf implementation programme, the Ethical Leadership Group (ELG) independently reviewed the Group's progress and concluded that BAE Systems has a solid business conduct programme that includes many best practice elements. ELG identified some opportunities for improvement and these have been incorporated into the Group's ongoing business conduct programme to ensure continuous improvement.

Improving industry standards

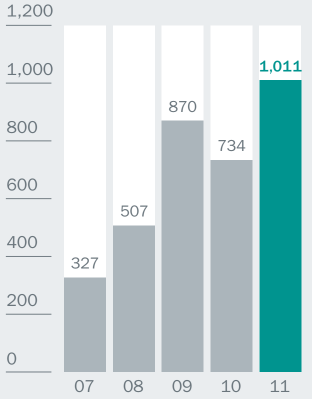
BAE Systems continues to play an important role in helping to raise standards of ethical conduct, sharing what it has learnt and encouraging best practice. The Group is working with other major companies, and the UK, European and US trade associations for the Aerospace and Defence industry, and is a Task Force member of the International Forum on Business Ethical Conduct. The Group played a key role in the creation of Global Principles of Business Ethics for the industry. The Group, as part of the UK defence industry, is supporting the development of the United Nations Arms Trade Treaty.

Suppliers

Supplier management is important to the Group as it depends on its suppliers to help to deliver the products and systems its customers need, on time and to the quality they expect. Poor performance or unethical conduct by a supplier could affect the Group's reputation or its ability to operate effectively.

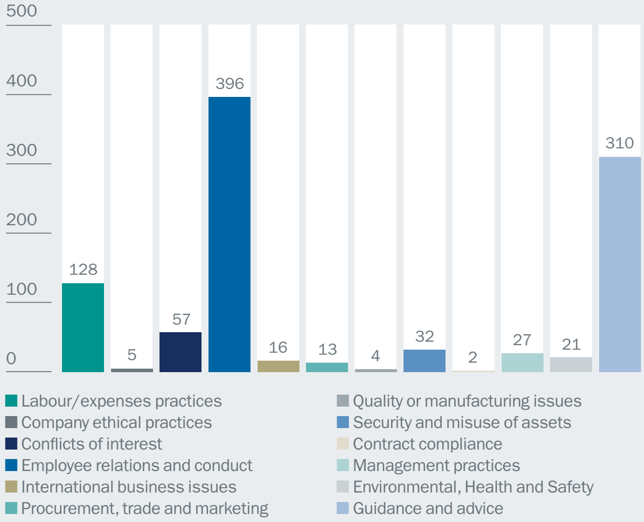
The Group expects its suppliers to comply with local legislation, and to have and meet equivalent standards on issues such as ethical conduct, health and safety, product safety, the environment, civil liberties and human rights. The Group also expects them to apply these standards in their own supply chains, and assesses compliance during the supplier selection process and at regular project reviews.

Employee enquiries to Ethics Helpline^

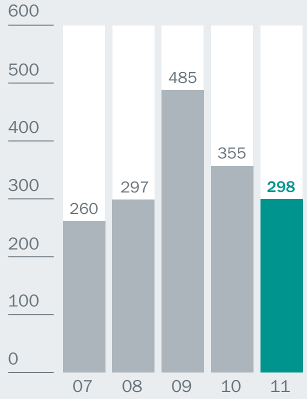


All concerns raised with the Ethics Helpline were reviewed and reported either to the Ethics Review Committee or, in BAE Systems, Inc., to the Ethics Executive Oversight Committee.

2011 employee enquiries to Ethics Helpline^



Dismissals for reasons relating to unethical behaviour*



If an employee is found to be in breach of the Group's Code of Conduct or any other relevant policies, appropriate disciplinary action, which may include dismissal, is taken.

^* See assurance statement on www.baesystems.com/deloitteassurancestatement

Safety

2011 objectives

Continue to progress towards a world class level of safety performance:

– demonstrate continued progress towards Safety Maturity Matrix (SMM) Level 5. SMM clarification:

a. Level 5 achievement: All sites at Level 4 in 2009 to achieve Level 5 by the end of 2011;

b. Level 5 progress: All sites at Level 4 at the end of 2010 to demonstrate progress to achieve Level 5 by the end of 2012;

c. Level 4 achievement: All remaining sites to achieve Level 4 by the end of 2012.

– continue to demonstrate year-on-year improvement in the Lost Work Day Case Rate.

Progress

– Sites continued to progress against the SMM and there was a year-on-year improvement in the Lost Work Day Case Rate.

2012 objectives

– Businesses to demonstrate improvement against 2011 baseline performance on recordable accidents.

– Continue to progress against the SMM.

Employee safety

The safety and well-being of the Group's employees, and those who work on its sites, is a key priority. The goal is to create a 'safety first' approach where employees take responsibility for their own safety and the safety of those around them, as well as the people using the products and services they deliver. The Group gives them the training and tools to help them do this.

The businesses manage a wide range of safety risks. For manufacturing employees, these include working at height, operating heavy equipment and dealing with hazardous, explosive or nuclear materials. In offices, risks include ergonomics, and slips, trips and falls. Employees providing maintenance and support services at customers' sites, including military bases in combat zones, face significant safety risks.

The Group uses a five-level Safety Maturity Matrix to help its businesses around the world work towards consistently high standards and to improve their performance. Ultimately, the Group wants to be among the leading companies for safety performance. Over the past three years, there has been a downward trend in days lost to work-related injuries, which demonstrates an improvement in safety performance and reflects the efforts made to embed a 'safety first' approach across the Group. However, during 2011, there was an increase in the number of major injuries. The Group considers any increase in major injuries a cause for concern and will focus on the root causes during 2012.

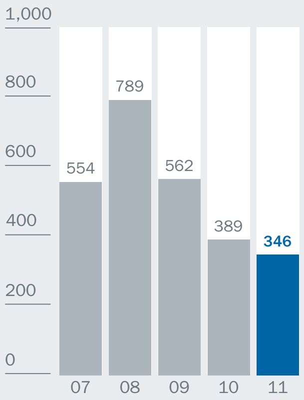
Product safety

It is critical that the Group's products do what they are designed for without unacceptable harm to any third parties or the people using them. No complex and innovative product, whether used in defence or civilian markets or both, is without risk so it is essential that the Group achieves an appropriate balance between the benefits they provide to customers and the risks associated with their use.

The Group works with its customers to agree the level of safety that is required and the risks that are acceptable, and works to ensure that it delivers products that meet that level. The Group will not agree to a level of safety that is unethical or unlawful.

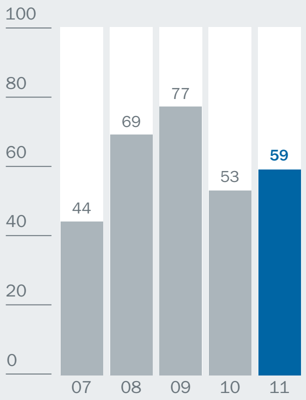
The Group's Product Safety Policy and practices are built on a set of product safety principles that apply throughout a product's life from concept and manufacturing through to use and disposal. The safety of the Group's products relies on the application of its safety policies and processes, and on the behaviours and attitudes of the employees working on them. The Group's policies require accountability to be established to ensure that the products the Group delivers meet both design requirements and agreed levels of safety. Across the Group's global businesses, there are a number of working groups that ensure a consistent approach to product safety by sharing ideas and best practice.

Lost Work Day Case Rate (per 100,000 employees)*



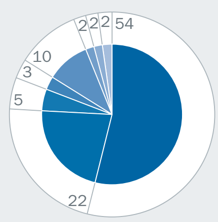
The Lost Work Day Case Rate decreased by 11% in line with the Group's objective to continue to demonstrate year-on-year improvement in safety performance.

Major injuries recorded*



The increase in 2011 reflects a change in profile of operational facilities and activities, but the Group considers any increase in major injuries a cause for concern and will focus on root causes during 2012.

2011 causes of major injuries recorded (% of total causes)



- Slips, trips or falls on the same level
- Fall from height
- Injured while handling, lifting or carrying
- Contact with moving machinery
- Struck by moving, including flying/ falling, object
- Strike against something fixed or stationary
- Trapped by something collapsing/ overturning
- Exposure to, or contact with, a harmful substance

* See assurance statement on www.baesystems.com/deloitteassurancestatement

CORPORATE RESPONSIBILITY REVIEW *(continued)*

Diversity and inclusion

2011 objectives

– Continue to utilise the global Diversity & Inclusion Maturity Matrix (D&IMM) to achieve an improved level of performance for 2011.

Progress

– The Executive Committee has agreed a programme to improve gender diversity in leadership positions. At 31 December 2011, 25% of the Board are women.

2012 objectives

– Demonstrate continued progress against the D&IMM and establish milestones/targets to underpin delivery of the stated 2015 position.

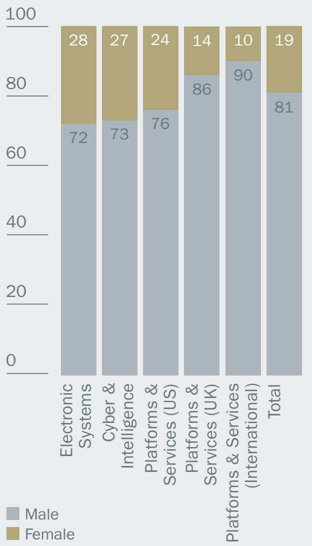
The Group is committed to maintaining a work environment in which a diverse range of talented people work together to improve business performance and competitive advantage. To support this commitment, the Group adopted a diversity and inclusion strategy in 2010, with businesses setting milestones to develop a diverse and inclusive workplace by 2015. Businesses monitor their progress against the Group's five-level D&IMM. This approach reflects each business's starting point and cultural context (see pages 24 to 43). The strategy will help the Group to build a workforce that more closely reflects the diversity of the local population in each of the Group's markets and will underpin the future sustainability of the business.

A diverse workforce, with employees drawn from all backgrounds, encourages innovation, improves productivity and brings the Group closer to its customers.

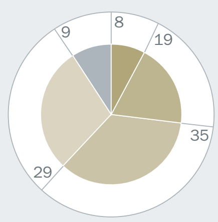
The Group focuses on attracting and retaining talented people from diverse backgrounds, and helping them to develop their skills and build a successful career with BAE Systems.

The Group aims to create an inclusive environment where a diverse workforce can flourish, and where every one of its employees is valued and has the opportunity to fulfil their potential and contribute to the Group's business success.

2011 gender diversity (%)*



2011 age diversity (%)*



- 25 years and younger
- 26 – 35 years
- 36 – 49 years
- 50 – 59 years
- 60 years and older

Diversity data for both gender and age remained consistent with 2010. During 2011, the Group continued to embed a diversity and inclusion strategy to support the recruitment, engagement and retention of talented employees from all backgrounds.

Diversity and inclusion helps the Group create a positive employment experience and to be known as an employer of choice.

At the end of 2011, 25% and 17% of Board and Executive Committee members, respectively, were female. Globally, 19% of the Group's workforce are women.

Consistent with the Group's commitment to improve the diversity of its workforce, the Executive Committee has approved the following actions to grow the female talent pipeline at senior executive levels and to support the achievement of the aspirational target of 25% female membership of the Executive Committee:

Fostering a culture of inclusion:
– by investing in inclusive leadership education; and

– establishing a flexible work culture.

Accelerating the development of high potential women:
– through mentoring by Executive Committee members; and

– increasing participation in global high potential programmes.

Hiring and selecting the top performing diverse talent:
– by ensuring leadership jobs have diverse candidate lists.

Measuring performance:
– through each business developing aspirational targets to increase significantly gender diversity in leadership ranks.

The Group has also taken additional actions to increase the diversity of its workforce, including the development of a Board Diversity Charter and the revision of the Nomination Committee's Terms of Reference.

Programmes are also in place to address ethnic diversity. This is undertaken at a business level to help the Group to build a workforce that more closely reflects the diversity of the local population in each of the Group's markets.

* See assurance statement on www.baesystems.com/deloitteassurancestatement

Environmental sustainability

2011 objectives

Develop and launch an environmental sustainability programme:

– agree and implement an Environmental Sustainability Maturity Matrix (ESMM).

– businesses to confirm a 2010 baseline, and set 2011 targets for energy, waste and water.

Progress

– Businesses have put in place plans to progress against the ESMM, and have also set 2012 reduction targets for energy, waste and water.

2012 objectives

– Continued progression against the ESMM – businesses to meet 2012 targets for energy, waste and water.

Operational environment
The goal is to reduce the environmental impact of the Group's operations and products by driving efficiencies in the management of energy, waste and water.

The Group has developed an environmental sustainability programme, which includes an Environmental Sustainability Maturity Matrix (ESMM) that provides a road map for the businesses to improve their environmental performance. It covers impacts throughout the product lifecycle from supply to manufacturing and end use. Each business has conducted a self-assessment against the matrix to determine their current position and set targets for where they would like to be in each area.

The ESMM is supported by reduction targets in energy, waste and water. During 2011, each business baselined its energy, waste and water use, and put in place reduction targets for each to be achieved during 2012.

Product environment
Environmental considerations are taken into account throughout a product's lifecycle via the Lifecycle Management process, including reducing the environmental impacts of the Group's products during research and development, minimising waste materials during manufacturing, and helping to reduce product impacts when being used, upgraded and disposed.

The Group works with suppliers to reduce the environmental impact of the products and services they supply by, for example, using resources more efficiently and reducing waste. This helps to reduce costs and cut the Group's environmental footprint and that of its products. To support this, the Group has introduced a Sustainable Procurement handbook to help purchasing teams to understand and embed environmental standards into the supplier management process.

The Group works with customers to help them to understand the environmental impacts of products and supports them on their environmental programmes. For example, the Group works with the UK Ministry of Defence on their Sustainable Procurement Strategy.

HOW THE GROUP MEASURES PROGRESS IN CORPORATE RESPONSIBILITY

To help businesses across the Group progress the CR agenda, and improve performance in diversity and inclusion, safety, and environmental sustainability, the Group has introduced maturity matrices for each area. Each matrix provides a road map of how to improve performance across each area to help drive consistent standards across the Group and deliver against the Group's CR objectives.

Each matrix includes clearly defined levels that each business needs to aspire to or meet via targets over a set period of time.

Safety – a five-level matrix aimed at embedding a proactive approach to safety across the Group, so that safety is a precondition of how employees work.

Diversity and inclusion – the five-level matrix aims to embed diversity and inclusion into day-to-day activities to enhance the Group's competitive edge. At an operational level, the matrix reflects each business's start point and cultural context.

Environment – a four-level matrix aimed at improving environmental performance across the Group, resulting in a sustainable approach to how the Group does business.

DELOITTE ASSURANCE STATEMENT

This year, Deloitte has assured the following performance indicators:

Ethics – employee enquiries to Ethics Helpline (total number and number by category) and dismissals for reasons relating to unethical behaviour;

Safety – Lost Work Day Case Rate and the number of major injuries recorded;

Diversity and inclusion – employees split by gender and age; and

Community – total Company Giving and Charity Challenge donations.

Deloitte has provided limited assurance on performance indicators marked with a * and reasonable assurance on performance indicators marked with a ^.

To see Deloitte's assurance statement go to:
www.baesystems.com/deloitteassurancestatement

For more information on the Group's corporate responsibility performance: www.baesystems.com/corporateresponsibility

– CR Committee statements

– Deloitte assurance statement

– How the Group manages CR

– More information on the maturity matrices

– Support for charities and local communities

RISK MANAGEMENT

Effective management of risks and opportunities is essential to the delivery of the Group's strategic objectives, achievement of sustainable shareholder value, protection of its reputation and meeting the requirements of good corporate governance.

HOW BAE SYSTEMS MANAGES RISK

Board

The Board has overall responsibility for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives, and ensuring that risks are managed effectively across the Group.

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

The Board delegates certain risk management activities to the Audit and Corporate Responsibility committees as follows.

Audit Committee

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

Corporate Responsibility Committee

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

Approach

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

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

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

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

Financial and non-financial risks

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

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

Process

Businesses

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

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

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

Project risks are reported and monitored in Group-mandated format Contract Review Packs, which are reviewed by management at monthly Contract Reviews. The financial performance of projects is reported and monitored using Contract Status Reports, which form part of the Contract Review Pack. These include programme margin variation metrics, which are reviewed regularly by the Executive Committee and Board (see KPI on page 17). Project margin is recognised after making suitable allowances for technical and other risks related to performance milestones yet to be achieved.

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

Executive Committee

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

Management responsibility for the management of the Group's most significant non-financial risks is allocated at the Executive Committee's risk workshops. The OAS and Non-financial Risk registers are reviewed regularly by the Executive Committee to monitor the status and progression of mitigation plans, and these key risks are reported to the Board on a regular basis.

Principal risks

The principal risks identified by the Group using the policies and processes explained above during the year are shown on pages 62 to 67. This year, the Group has included cybersecurity as a principal risk (see page 67).

72 For more information on the activities of the Board and its committees

105 For more information on the Group's business processes and mandated policies

BOARD
– Overall responsibility for risk management

Monitoring

AUDIT COMMITTEE
– Operational Assurance Statement Risk Register
– Non-financial Risk Register

CORPORATE RESPONSIBILITY COMMITTEE
– Non-financial Risk Register

Monitoring and reporting

Monitoring and reporting

Monitoring and reporting

EXECUTIVE COMMITTEE
– Operational Assurance Statement Risk Register
– Non-financial Risk Register

Monitoring and reporting

BUSINESSES

Integrated Business Plan – Core Business Process*
Annual Board-approved long-term strategy and five-year plan for each business

Operational Assurance Statement – Mandated Policy*
Six-monthly management self-assessment of compliance with the Operational Framework and summary of key risks

Chief Executive's Business Review – Core Business Process*
Quarterly top-level review of the key operational and financial performance issues within the business, and significant forthcoming events

Quarterly Business Review – Core Business Process*
Quarterly management review of the performance of each of the Group's businesses against their objectives, measures and milestones

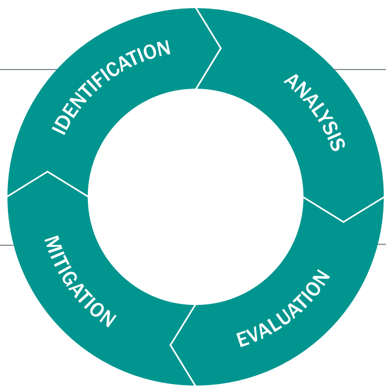
Lifecycle Management Contract Review – Core Business Process*
Monthly management review of project performance and issues to ensure that appropriate decisions and actions are taken

Monitoring and reporting

BUSINESS RISK

Risk Management Policy – Mandated Policy*

1. IDENTIFICATION
– Financial and non-financial risks recorded in controlled risk registers



2. ANALYSIS
– Risks analysed for impact and probability to determine gross exposure

3. EVALUATION
– Risk exposure reviewed and risks prioritised

4. MITIGATION
– Risk owners identified and action plans implemented
– Robust mitigation strategy subject to regular and rigorous review

* As defined in the Group's Operational Framework

105 For more information on the Group's Operational Framework

PRINCIPAL RISKS

Summary of principal risks

The Group's principal risks are identified below, together with a description of how the Group mitigates those risks.

Link to Total Performance	Financial Performance			
	Customer Focus	Programme Execution	Responsible Behaviour	Other
High impact	Defence spending **p62** Government customers **p63** Global market **p63**	Large contracts **p64** Fixed-price contracts **p64**	Laws and regulations **p65**	Competition **p65** Pension funding **p66** Export controls and other restrictions **p66** Acquisitions **p66**
Medium impact	Contract award timing **p63**	Component availability, subcontractor performance and key suppliers **p64**		Consortia and joint ventures **p67** Exchange rates **p67** Cybersecurity **p67**

Defence spending

The Group is dependent on defence spending.

Description
The Group's core businesses are primarily defence-related, selling products and services directly and indirectly, mainly to the US, UK, Saudi Arabian, and other national governments. Defence spending depends on a complex mix of political considerations, budgetary constraints, and the ability of the armed forces to meet specific threats and perform certain missions, and, as such, may be subject to significant fluctuations from year to year. With constraints on government expenditure in a number of the Group's markets and countries in the Eurozone area currently experiencing serious financial difficulties, affordability continues to be a key focus for customers.

Impact
A decrease in defence spending by the Group's major customers could have a material adverse effect on the Group's future results and financial condition.

Mitigation
The Group's business is geographically spread across five home markets, and its products are marketed across a range of defence markets. The Group has a highly sustainable Services business, which is an area for growth as customers' operations and maintenance budgets come under pressure. Significant cost reductions have already been made to address increased budgetary pressures in the US and UK. The Group continues to use realistic assumptions to underpin its financial and operational planning.

Despite significant budgetary pressures, the US government remains committed to protecting the size, reach and fighting strength of its military, and has committed to substantial investments in high priority capabilities and programmes.

In the UK, the 2010 Strategic Defence and Security Review defined the areas of future spend in defence and confirmed that the Group's strategy is focused on the appropriate areas.

In Saudi Arabia, regional tensions continue to dictate that defence remains a high priority.

11 For more information on the Group's five home markets

Government customers

The Group's largest customers are governments.

Description
Companies engaged in the supply of defence and security related equipment and services to government agencies are subject to certain business risks particular to the defence and security industries. These governments could modify contracts or terminate them at short notice and at their convenience. For example, long-term US government contracts are normally funded annually and are subject to cancellation or delay if funding appropriations for subsequent performance periods are not made. Terms and risk sharing agreements can also be amended. In addition, the Group, as a government contractor, is subject to financial audits and other reviews by some of its governmental customers with respect to the performance of, and the accounting and general practices relating to, government contracts. As a result of these audits and reviews, costs and prices under these contracts may be subject to adjustment.

Impact
The termination of one or more of the contracts for the Group's programmes by governments; the failure of the relevant agencies to obtain expected funding appropriations for the Group's programmes; or a deterioration in the Group's relationship with any of its key government customers and corresponding reduction in contract awards, could have a material adverse effect on the Group's future results and financial condition.

Mitigation
The Board regularly reviews the Group's performance in its markets, and the Executive Committee continues to work closely with the government customers in these markets to ensure the Group's strategy is aligned with theirs. In the event of a customer termination for convenience, the Group would typically be paid for work done and commitments made at the time of termination. Having sovereign governments as major customers offers the benefits of dealing with mature procurement organisations with which the Group can have long-standing business relationships, and well established and understood terms of trade.

6 For more information on the Group's strategy

Global market

The Group operates in a global market.

Description
BAE Systems is a global company which conducts business in a number of regions, including the Middle East, and, as a result, assumes certain risks associated with businesses with a broad geographical reach. In some countries, these risks include, and are not limited to, the following: political changes could lead to changes in the business environment in which the Group operates; economic downturns, political instability and civil disturbances could disrupt the Group's business activities; government regulations and administrative policies could change quickly and restraints on the movement of capital could be imposed; governments could expropriate the Group's assets; and burdensome taxes or tariffs could be introduced.

Impact
The occurrence of any such events could have a material adverse effect on the Group's future results and financial condition.

Mitigation
The Group has a balanced portfolio of businesses across its markets.

11 For more information on the Group's five home markets

Contract award timing

The Group is dependent on the timing of award of defence contracts.

Description
The Group's profits and cash flows are dependent, to a significant extent, on the timing of award of defence contracts.

Impact
Amounts receivable under the Group's defence contracts can be substantial and, therefore, the timing of awards, or failure to receive anticipated awards, could materially affect the Group's profits and cash flows for the periods affected.

In 2011, the Group's financial performance was impacted by a delay in the award of a contract from the Kingdom of Saudi Arabia relating to price escalation on the Salam Typhoon programme. Negotiations on the contract continue in 2012.

Mitigation
The Board regularly reviews the Group's performance with regard to contract awards, and the Executive Committee actively manages the assets and resources of the Group in line with the timing of awards.

105 For more information on Lifecycle Management (LCM) which mandates project management processes

PRINCIPAL RISKS *(continued)*

Large contracts

Certain of the Group's businesses are dependent on a small number of large contracts.

Description
A significant proportion of the Group's revenue comes from a small number of large contracts. Each of these contracts, which are primarily in the Platforms & Services (UK) and Platforms & Services (International) reporting segments, is typically worth or potentially worth over £1bn.

Impact
The loss, expiration, suspension, cancellation or termination of any one of these large contracts, for any reason, could have a material adverse effect on the Group's future results and financial condition.

Mitigation
The Group has a well-balanced spread of programmes and a large forward order book, which provides long-term visibility. The Board regularly reviews the Group's performance on these large contracts, and the Executive Committee continues to work closely with these customers to ensure the Group's strategy is aligned with theirs.

23 For more information on the Group's order book by major programme and reporting segment

Fixed-price contracts

The Group has fixed-price contracts.

Description
A significant portion of the Group's revenue is derived from fixed-price contracts. An inherent risk in these fixed-price contracts is that actual performance costs may exceed the projected costs on which the fixed prices for such contracts are agreed. These contracts can extend over many years and it can be difficult to predict the ultimate outturn costs associated with the terms on which they are based.

Impact
The Group's failure to anticipate technical problems, estimate costs accurately or control costs during performance of a fixed-price contract may reduce the profitability of such a contract or result in a loss.

Mitigation
The Group has reduced its exposure to fixed-price design and development activity which is in general more risk intensive than fixed-price production activity. To manage contract-related risks and uncertainties, contracts are managed under LCM at the operational level. Robust bid preparation and approvals processes are well established throughout the Group, with decisions required to be taken at the appropriate level in line with clear delegations of authority. The consistent application of metrics is used to support the review of individual contract performance.

16 For KPIs relating to schedule adherence and programme margin variation

Component availability, subcontractor performance and key suppliers

The Group is dependent upon component availability, subcontractor performance and key suppliers.

Description
The Group is dependent upon the delivery of materials by suppliers, and the assembly of components and subsystems by subcontractors used in its products in a timely and satisfactory manner, and in full compliance with applicable terms and conditions.

Impact
Some of the Group's suppliers or subcontractors may be impacted by the economic environment and constraints on available financing, which could impair their ability to meet their obligations to the Group. In addition, some products require relatively scarce raw materials. The Group is generally subject to specific procurement requirements which may, in effect, limit the suppliers and subcontractors it may utilise. In some instances, the Group is dependent on one or a limited number of suppliers. If any of these suppliers or subcontractors fails to meet the Group's needs, the Group may not, in the short term, have readily available alternatives, thereby impacting its ability to complete its customer obligations satisfactorily and in a timely manner, which could have a negative impact on the Group's future results and financial condition.

Mitigation
The Group's procurement function, which is led by a member of the Executive Committee, is responsible for establishing and managing end-to-end integrated supplier arrangements. The Executive Committee continues to monitor this risk and the Group has experienced no material negative impact to date. The Group reviews the financial health of strategically important suppliers globally on an ongoing basis.

56 For more information on suppliers

Laws and regulations

The Group is subject to risk from a failure to comply with laws and regulations.

Description
The Group has contracts and operations in many parts of the world, operates in a highly regulated environment, and is subject to applicable laws and regulations of many jurisdictions. These include, without limitation, regulations relating to import-export controls, money laundering, false accounting, anti-bribery and anti-boycott provisions. Non-compliance could expose the Group to fines, penalties, suspension or debarment, which could have a material adverse effect on the Group. From time to time, the Group is subject to government investigations relating to its operations.

Impact
Failure by the Group or its sales representatives, marketing advisers or others acting on its behalf to comply with these laws and regulations could result in administrative, civil or criminal liabilities resulting in significant fines and penalties, and/or result in the suspension or debarment of the Group from government contracts for some period of time or suspension of the Group's export privileges.

Mitigation
During the year, the Group has continued to add resources dedicated to legal and regulatory compliance in order to enhance further its capability to identify and manage the risk of compliance failure. Internal and external market risk assessments form an important element of the ongoing corporate development and training processes.

A uniform global policy and process for the appointment of advisers engaged in business development is in effect.

Pursuant to its commitments concerning ongoing regulatory compliance made in the course of the 2010 settlement with the US Department of Justice and the consequent 2011 settlement with the US Department of State, the Group appointed, respectively, an independent monitor in 2010 and a Special Compliance Official in 2011, in each case for a period of up to three years, to monitor the Group's compliance with its respective commitments under those settlements and its compliance obligations going forward.

56 For more information on the Group's approach to business conduct

Competition

The Group's business is subject to significant competition.

Description
The Group's businesses are subject to competition from national and multi-national firms with substantial resources and capital, and many contracts are obtained through a competitive bidding process.

The Group's ability to compete for contracts depends to a large extent on the strength of its intellectual property rights and technical know-how, together with the effectiveness and innovation of its research and development programmes, its ability to offer better programme performance than its competitors at a lower cost to its customers, and the readiness of its facilities, equipment and personnel to undertake the programmes for which it competes.

In some instances, governments direct to a single supplier all work for a particular programme, commonly known as sole-source programmes. Although governments have historically awarded certain programmes to the Group on a sole-source basis, they may in the future determine to open such programmes to a competitive bidding process. Government contracts for defence-related products can, in certain countries, be awarded on the basis of home country preference.

Impact
In the event that the Group is unable adequately to compete in the markets in which it operates, the Group's business and future results may be adversely impacted.

Mitigation
The Group's global, multi-market presence, balanced portfolio of businesses, leading capabilities and performance continue to address this risk. In particular, the Group invests in research and development, and innovation, and continues to reduce its cost base and improve efficiencies.

11 For more information on the Group's five home markets

PRINCIPAL RISKS *(continued)*

Pension funding

The Group has an aggregate funding deficit in its defined benefit pension schemes.

Description
The Group operates certain defined benefit pension schemes. At present, in aggregate, there is an actuarial deficit between the value of the projected liabilities of these schemes and the assets they hold.

Impact
The amount of the deficits may be adversely affected by changes in a number of factors, including investment returns, long-term interest rate and price inflation expectations, and anticipated members' longevity. Further increases in pension scheme deficits may require the Group to increase the amount of cash contributions payable to these schemes, thereby reducing cash available to meet the Group's other operating, investing and financing requirements.

Mitigation
Following triennial funding valuations of the Group's two largest UK pension schemes in 2011, revised deficit recovery plans have been agreed. The performance of the Group's pension schemes and deficit recovery plans are regularly reviewed by both the Group and the trustees of the schemes taking actuarial and investment advice as appropriate. The results of these reviews are discussed with the Board and appropriate action taken.

In future, the growth of the defined benefit liabilities is expected to be curtailed as new employees in the UK will be offered membership of a defined contribution pension scheme with effect from 1 April 2012, rather than the current defined benefit/defined contribution hybrid scheme. Current members of the Group's legacy plans will be unaffected by this change.

50 For more information on the Group's pension accounting and funding valuations, and deficit recovery plans

Export controls and other restrictions

The Group is subject to export controls and other restrictions.

Description
A portion of the Group's sales is derived from the export of its products. The export of defence and security products outside the jurisdictions in which they are produced is subject to licensing and export controls, and other restrictions. No assurance can be given that the export controls to which the Group is subject will not become more restrictive, that new generations of the Group's products will not also be subject to similar or more stringent controls, or that political factors or changing international circumstances will not result in the Group being unable to obtain necessary export licences.

Impact
Reduced access to export markets could have a material adverse effect on the Group's future results and financial condition. Failure to comply with export controls and wider regulations could expose the Group to fines, penalties, suspension or debarment, which could have a material adverse effect on the Group.

Mitigation
The Group has formal systems and policies in place which are mandated under the Operational Framework to ensure adherence to regulatory requirements and identify any restrictions that could adversely impact the Group's activities.

13 For more information on exports

Acquisitions

The anticipated benefits of acquisitions may not be achieved.

Description
The Group has experienced growth through acquisitions and continues to pursue acquisitions in order to meet its strategic objectives. Whether the Group realises the anticipated benefits from these transactions depends upon the successful integration of the acquired businesses, as well as their performance.

Impact
The diversion of management attention to integration efforts and the performance of the acquired businesses below expectations could adversely affect the Group's business, and create the risk of impairments arising on goodwill and other intangible assets.

Mitigation
The Group has established policies in place to manage the acquisition process, monitor the integration and performance of acquired businesses, and identify potential impairments.

10 For more information on the Group's M&A activity during the year

Consortia and joint ventures

The Group is involved in consortia, joint ventures and equity holdings where it does not have control.

Description
The Group participates in various consortia, joint ventures and equity holdings, exercising varying degrees of control. The risk of failure or the risk of disagreement, particularly in those that require the unanimous consent of all members with regard to major decisions, is inherent in any jointly controlled entity.

Impact
In the event of failure or disagreement within a consortium, joint venture or equity holding and the business arrangement failing to meet its strategic objectives or expected benefits, the Group's business and future results may be adversely affected.

Mitigation
The Group seeks to participate only in ventures in which its interests are complementary to those of its partners, and has formal systems and procedures in place to monitor the performance of such business arrangements.

141 For more information on the Group's principal joint ventures

Exchange rates

The Group is exposed to volatility in currency exchange rates.

Description
The global nature of the Group's business means it is exposed to volatility in currency exchange rates in respect of foreign currency denominated transactions, and the translation of net assets and income statements of foreign subsidiaries and equity accounted investments. The Group is exposed to a number of foreign currencies, the most significant being the US dollar, Euro and Saudi Arabian riyal.

Impact
Significant fluctuations in exchange rates to which the Group is exposed could have a material adverse effect on the Group's future results and financial condition.

Mitigation
In order to protect itself against currency fluctuations, the Group's policy is to hedge all material firm transactional exposures, unless otherwise approved as exceptions by the Treasury Review Management Committee. The Group does not hedge the translation effect of exchange rate movements on the income statement or balance sheet of foreign subsidiaries and equity accounted investments it regards as long-term investments. Hedges are, however, undertaken in respect of investments that are not considered long term or core to the Group.

52 For more information on the Group's treasury policies

Cybersecurity

The Group could be negatively impacted by information technology security threats.

Description
As a defence, aerospace and security company, the security threats faced by the Group include threats to its information technology infrastructure, unlawful attempts to gain access to its proprietary or classified information and the potential for business disruptions associated with information technology failures.

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

Mitigation
The Group has a broad range of measures in place, including appropriate tools and techniques, to monitor and mitigate this risk.

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

GOVERNANCE

Surface Ships is part of BAE Systems Maritime. Founded on almost 150 years' experience in the delivery of complex warships, Surface Ships is a through-life enterprise that crosses the traditional boundaries of shipbuilder and support services provider.

BOARD OF DIRECTORS

1. Dick Olver
Chairman

Appointed to the Board: 2004

Nationality: British

Skills and experience: A chartered civil engineer with extensive experience of managing complex international engineering projects, he held a variety of senior management positions in the oil industry culminating in his appointment to the board of BP p.l.c. as CEO of Exploration and Production in 1998. Subsequently appointed Deputy Group Chief Executive of BP in 2003, stepping down from that role when he assumed the chairmanship of BAE Systems.

Other appointments: Member of the Prime Minister's Business Advisory Group, Business Ambassador for UK Trade & Investment, and member of the Prime Minister's India/UK CEO Forum. Also a member of the Multinational Chairman's Group and the Trilateral Commission, a Fellow of the Royal Academy of Engineering, Chairman of the Education for Engineering (E4E) Policy Group, and adviser to HSBC and Clayton, Dubilier & Rice.

Past appointments: Non-executive director of Thomson Reuters plc.

Committee membership: Chairman of the Nominations Committee and member of the Non-Executive Directors' Fees Committee

2. Ian King
Chief Executive

Appointed to the Board: 2007

Nationality: British

Skills and experience: Appointed as Chief Executive in 2008 having been originally appointed to the Board as Chief Operating Officer, UK and Rest of the World. He was previously Group Managing Director of the Company's Customer Solutions & Support business and, prior to that, Group Strategy and Planning Director. Prior to the BAe/MES merger he was Chief Executive of Alenia Marconi Systems, having previously served as Finance Director of Marconi Electronic Systems.

Other appointments: Non-executive director and Senior Independent Director of Rotork plc.

Committee membership: Non-Executive Directors' Fees Committee

3. Linda Hudson
President and Chief Executive Officer of BAE Systems, Inc.

Appointed to the Board: 2009

Nationality: US

Skills and experience: Appointed to the Board as President and Chief Executive Officer of BAE Systems, Inc., Linda Hudson was previously President of the Company's US-based Land & Armaments business. She joined the Company in 2006 from General Dynamics where she had worked since 1992 in a variety of roles culminating in her appointment as Corporate Vice President and President, Armament and Technical Products.

Other appointments: Member of the United Service Organization's Worldwide Board of Governors, the Blue Star Families Board of Directors, the Executive Committee of Aerospace Industries Association, and engineering advisory boards for engineering programmes at the universities of Maryland and Florida.

Committee membership: Non-Executive Directors' Fees Committee

4. Peter Lynas
Group Finance Director

Appointed to the Board: 2011

Nationality: British

Skills and experience: Peter Lynas, a qualified accountant, was appointed to the Board as Group Finance Director in April 2011. He previously served for a number of years as Director, Financial Control, Reporting & Treasury. He joined GEC-Marconi in 1985 having previously worked for other companies in the UK and Europe. After progressing through a number of positions he was appointed Finance Director of GEC's Marconi Electronic Systems business, which was subsequently acquired by British Aerospace in 1999 to become BAE Systems.

5. Paul Anderson
Non-executive director

Appointed to the Board: 2009

Nationality: US

Skills and experience: Paul Anderson has extensive global business experience in the energy and mining sectors. He spent more than 20 years in two spells at Duke Energy Corporation and its predecessor companies, culminating in his appointment as Chairman, President and Chief Executive Officer. He was subsequently Chairman of Spectra Energy Corporation until 2009 and in the intervening period he served as Managing Director and Chief Executive Officer of BHP and, subsequently, of the newly merged BHP Billiton.

Other appointments: Non-executive director of Spectra Energy Corporation and BP p.l.c.

Past appointments: Non-executive director of BHP Billiton plc and Qantas Airways Limited.

Committee membership: Chairman of the Corporate Responsibility Committee and member of the Nominations Committee

6. Harriet Green OBE
Non-executive director

Appointed to the Board: 2010

Nationality: British

Skills and experience: Currently Chief Executive Officer and executive director of Premier Farnell plc, a leading, high service, multi-channel technology distribution group, Harriet Green has significant global business experience having run volume distribution businesses in four continents including Asia Pacific for Arrow Electronics as well as having functional responsibility for worldwide marketing, suppliers and strategy.

Other appointments: Non-executive director of Emerson Electric Co.

Committee membership: Corporate Responsibility Committee

7. Michael Hartnall
Non-executive director

Appointed to the Board: 2003

Nationality: British

Skills and experience: A Fellow of the Institute of Chartered Accountants in England and Wales, Michael Hartnall is a former Finance Director of Rexam PLC where, in addition to his finance responsibilities, he gained considerable exposure to mergers and acquisitions activity. Prior to that he held senior finance and operational positions with a number of manufacturing companies. He served as Chairman of the Company's Audit Committee for a number of years, stepping down from that committee in July 2011.

Past appointments: Non-executive director of Lonmin plc and Elementis plc.

8. Lee McIntire
Non-executive director

Appointed to the Board: 2011

Nationality: US

Skills and experience: Lee McIntire is Chairman and Chief Executive of CH2M HILL, a leader in consulting, design, design-build, operations, risk management and programme management for public and private clients. Prior to joining CH2M HILL, he was an executive at Bechtel Group Inc., where he served on the board of directors and was Executive Vice President for the parent company.

Committee membership: Remuneration Committee

9. Sir Peter Mason KBE
Non-executive director and Senior Independent Director

Appointed to the Board: 2003

Nationality: British

Skills and experience: Chairman of Thames Water and Senior Independent Director of Subsea 7 S.A., an international offshore engineering, construction and services contractor. Formerly Chairman and Chief Executive of Balfour Beatty Limited, and Chief Executive of AMEC plc, Sir Peter has extensive experience in engineering, construction and long-term contracting.

Past appointments: Executive director of BICC plc and Chief Executive of Norwest Holst Group PLC.

Committee membership: Audit Committee, Corporate Responsibility Committee and Nominations Committee

10. Paula Rosput Reynolds
Non-executive director

Appointed to the Board: 2011

Nationality: US

Skills and experience: Paula 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, an insurance company located in Seattle, Washington, until its acquisition by Liberty Mutual Group in 2008. She was then appointed as Vice Chairman and Chief Restructuring Officer of American International Group Inc. (AIG) from October 2008 to September 2009, overseeing AIG's divestiture of assets and serving as chief liaison with the Federal Reserve Bank of New York.

Other appointments: Non-executive director of Delta Air Lines, Inc.

Past appointments: Non-executive director of Coca-Cola Enterprises, Inc., and Air Products and Chemicals, Inc.

Committee membership: Audit Committee

11. Nick Rose
Non-executive director

Appointed to the Board: 2010

Nationality: British

Skills and experience: Nick Rose was, until October 2010, Chief Financial Officer of Diageo plc. He held the position for over ten years and, in addition to his finance responsibilities, he was also responsible for supply, procurement, strategy and IT on a global basis. His financial experience has encompassed a number of roles since joining Diageo's predecessor company, Grand Metropolitan, in 1992, including group treasurer and group controller, having spent his earlier career with Ford Finance. He assumed the chairmanship of the Company's Audit Committee in August 2011.

Other appointments: Non-executive director of BT Group plc and Williams Grand Prix Holdings plc.

Past appointments: Non-executive director of Moët Hennessy SNC and Scottish Power plc.

Committee membership: Chairman of the Audit Committee and member of the Remuneration Committee

12. Carl Symon
Non-executive director

Appointed to the Board: 2008

Nationality: US/British

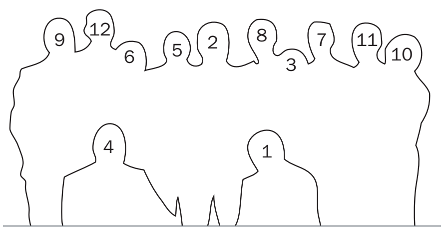
Skills and experience: Carl Symon has an extensive background in global business operations and management, retiring in 2001 after a long career at IBM during which he held senior executive positions in the US, Canada, Latin America, Asia and Europe, including that of Chairman and Chief Executive Officer of IBM UK.

Past appointments: Non-executive director of BT Group plc, Rexam PLC and Rolls-Royce Group plc, and Chairman of HMV Group plc.

Committee membership: Chairman of the Remuneration Committee

Company Secretary

David Parkes



CORPORATE GOVERNANCE

Dick Olver
Chairman

> **"We continue to evaluate our governance arrangements against our own experiences and changes in best practice."**

Dear Shareholders,

These governance reports deal with how the Board discharged its governance duties in 2011. Being mindful of the different requirements that the users of these reports have, this section has been structured so that we begin with relatively short sections from myself and the chairmen of the Board committees highlighting some of the key issues and activities in 2011. Thereafter, we provide more detailed reporting that explains how we have applied the principles of the UK Corporate Governance Code, and also provides other information required by the provisions of the Code and the statutory and regulatory requirements for the reporting of directors' remuneration.

There are three specific areas of governance that I would like to address: how we achieve effective board committees, boardroom diversity and business conduct.

Effective board committees

Executive remuneration has been subject to widespread debate recently, and part of this has focused on the role of remuneration committees and whether current UK governance structures, based on a unitary board, are effective in managing potential conflicts of interest.

With a unitary board, one group of individuals is collectively responsible for promoting the success of the company. All chairmen are aware of the merits and challenges of operating a unitary board. Many of us value the significant advantages that a unitary board has over a two-tier board structure. A unitary board can engage more effectively with executive management in providing strategic direction and entrepreneurial leadership for a company. However, in order to exercise effective oversight in situations when there are potential conflicts of interest, much reliance is placed on board committees formed of independent non-executive directors. These committees, and the associated corporate governance practice that has evolved over the last two decades, enables the unitary board to manage robustly the tension between having a single group of individuals capable of driving the business commercially and the need for oversight of executive performance and associated rewards.

Effective board committees are a core part of corporate governance and therefore it is worth analysing the checks and balances our governance regime provides:

– **Membership** – in compliance with the UK Corporate Governance Code, our Remuneration and Audit committees are formed exclusively of independent non-executive directors. Also, when we created our Corporate Responsibility Committee we wanted it to have the same governance standards as these committees, and consequently all of its members are independent non-executive directors. An important part of our Board's succession planning involves the membership of the committees and ensuring that we have individuals with the rights skills and knowledge to make sure the committees are effective. This is particularly important when it comes to committee chairmen, and by way of example, in 2010, we recruited Nick Rose (a former FTSE 30 finance director) to the Board in anticipation that he would succeed Michael Hartnall as chairman of the Audit Committee, which he duly did in August 2011. The Nominations Committee regularly reviews the composition of the Board's committees and makes nominations to the Board on their membership and chairmanship.

– **Law and regulation** – the basic duties of directors are an important element of the UK's governance framework. The general legal duties that directors owe to a company provide all directors with a common set of legal obligations that underpins the important role they perform. Managing conflicts of interest is a core element of a director's legal duties under UK company law. Training on the management of conflicts forms part of our induction programme for directors. Also, on an annual basis, supported by our board effectiveness review, the Board and Nominations Committee review potential conflicts and the independence of the non-executive directors. On pages 104 and 105 of these reports you will find the formal report of the review of director independence, which is provided to shareholders to assist them when voting on the annual re-election of directors.

– **Disclosure and shareholder stewardship** – UK companies are required to report to shareholders each year on governance arrangements and other disclosure requirements either mandated by law or covered by the UK Corporate Governance Code. On the basis of those reports, shareholders are in a position to exercise their stewardship responsibilities and make informed decisions when voting on the resolutions put to shareholders at the Annual General Meeting (AGM) (including specific resolutions on remuneration and the re-appointment of directors). In these reports you will find 20 pages of information on directors' remuneration. The statutory requirements for remuneration reporting are lengthy and detailed, plus we provide additional information requested by shareholder bodies, and we review regularly best practice in this area and endeavour to evolve our reporting in line with this. Such transparency is at the heart of how we as directors account to shareholders for our stewardship of the Company and allow them to exercise their stewardship when voting on matters such as directors' remuneration and re-election.

– **Effectiveness review** – all of our committees are included in the Board's annual effectiveness review. Such reviews are externally facilitated with all committee chairmen receiving feedback on the performance of their committee based on interviews conducted with all Board members. These reviews provide regular and constructive feedback to the committees to help them perform effectively. High performing individuals welcome constructive feedback from their peers as it is an essential part of achieving high performance. Over the last six years we have refined our externally facilitated evaluation process, and I believe that it is not only a useful performance management tool but also an important part of the checks and balances in our governance structure – allowing directors to raise concerns so that they can be dealt with in a timely manner.

Diversity

In last year's report and accounts, I commented at length on the benefits of diversity in the boardroom and the steps we were taking to ensure that we have visibility of suitable candidates for appointment to the Board, regardless of gender. Since then, Lord Davies' report, Women on Boards, has heightened awareness of this issue and ensured that it was an agenda item for many boards and nomination committees in 2011. That was the case in BAE Systems and we were one of the first companies to make a public statement about our aspirational target and the modest success we have had to date in increasing the diversity of our board.

This is an area where board chairmen can drive change and one that I am happy to support. However, the timescale over which change can be achieved must be realistic. Change will need to be dictated by the natural pace of board succession. As with any board, ours needs to be of a certain size to be effective, beyond which it will start to lose its effectiveness. Likewise, the performance of the Board would be compromised if we were to simply force vacancies so as to provide scope for greater diversity. Good succession planning requires that change in board composition is managed so that a board is refreshed progressively, with the fresh insight that new members bring being complemented by the accumulated company knowledge and understanding that longer serving directors provide. That said, there is much that can be done to facilitate progress in this important area and Lord Davies' report has provided impetus for change.

Three of the current members of the Board are women, including one executive director, Linda Hudson, who runs our US business. With the appointment of Paula Rosput Reynolds to the Board in 2011, 25% of the Board are women. Chairmen and boards can provide leadership in championing the benefits of greater diversity within businesses. To achieve real change we need to focus on the senior executive 'pipeline' that ultimately leads to the Board and from which executive directors can be drawn. Importantly, it is from this pipeline, and those of many other companies, that the majority of our future non-executives will also be drawn.

BAE Systems is fostering a culture of inclusion by investing in inclusive leadership education and establishing a more flexible work environment for all employees. We recognise that we can do more, particularly at the more senior levels, and to help achieve this members of our Executive Committee are mentoring high potential women executives and increasing the diversity of participants in our global high potential development programmes. In addition, when hiring and selecting for senior positions within the Company, we are ensuring that candidate lists are appropriately diverse. Finally, we are measuring our performance, with each business developing aspirational targets to increase gender diversity in their leadership ranks. We undertake to report on progress against targets and action taken in future years.

How we manage our long-term management resources to meet our future senior executive requirements is an area of activity that our Nominations Committee has overseen for a number of years. Diversity is an important part of this process and one that is reviewed by the committee on an annual basis. In addition, our Corporate Responsibility Committee is overseeing what we are doing to embed diversity and inclusion at other levels within the workforce. Progress

CORPORATE GOVERNANCE *(continued)*

against diversity and inclusion objectives will form part of the annual incentive plan for senior executives in 2012. As with all corporate responsibility objectives, the Committee sets the targets and, based on performance during the year, makes recommendations on award levels to the Remuneration Committee.

Recognising the role that the Nominations Committee is required to play in facilitating progress in the area of diversity, the Board agreed during 2011 that the Committee's terms of reference should be changed to make specific reference to diversity.

Extract from the Terms of Reference of the Nominations Committee, as amended November 2011

Duties

– Review regularly the balance of skills, experience, diversity (including gender), knowledge and independence, and make recommendations to the Board with regards to any changes that it believes are necessary or desirable.

– Prepare a description of the role and capabilities required for particular Board appointments having regard to the balance of experience, diversity (including gender), knowledge and independence of the Board.

The Board has also agreed the following statement of its approach to diversity:

Statement approved at a meeting of the board of directors held on 15 November 2011

Board diversity
BAE Systems is committed to maintaining a work environment in which a diverse range of talented people work together to improve business performance and competitive advantage. The Board seeks to maximise its effectiveness by bringing together people with the right mix of skills, knowledge and experience. Diversity, in all its aspects, is an important element in the composition of a board.

Appointments shall always be made on the basis of merit and seek to leverage the benefits of diverse talent. With regard to gender diversity the Board has agreed the following:

– In seeking candidates for appointment to the Board, the Nominations Committee shall only engage the services of search consultants who have open and inclusive recruitment processes that draw from an appropriately diverse pool of candidates.

– It shall have an aspirational target of at least 25% of the Board being women by 2015.

– Through its regular reviews of management resources it shall oversee the effectiveness of the actions being taken by management to ensure that the composition of the executive leadership team reflects the entirety of the management talent pool available within the Company and the wider market.

– It shall support external programmes that seek to improve gender balance at board level.

– It shall report progress against targets and action taken in the Annual Report and Accounts.

The Group supports management and educational programmes that are intended to increase diversity within the specialised technical fields from which senior leadership is selected.

Business conduct
In 2007, the BAE Systems Board set up the Woolf Committee, which was asked to examine the ethical principles and practices underlying the Company's business and identify areas for further improvement that the Company should address in order to be recognised as a global leader in ethical business conduct. The Committee, chaired by Lord Woolf, issued its report in 2008 and the Board agreed to implement all 23 recommendations contained in the report. Over a three-year period the Company undertook a major programme to embed responsible business conduct into all aspects of the way it operates. From a governance perspective, the Board's Corporate Responsibility Committee has played an important role in overseeing progress in implementing the recommendations in the Woolf report.

During 2011, the Corporate Responsibility Committee reviewed in detail a report produced by Ethical Leadership Group, a leading global compliance adviser, on its independent audit of our business conduct programme and assessment of our progress to date in meeting the Woolf recommendations. Its report was based on a six-month in-depth review, including focus groups involving over 600 employees. The report concluded that BAE Systems has a solid ethical business programme including many best practice elements and some opportunities for improvement. It also recognised that substantial progress has been made against the Woolf recommendations with well designed processes to ensure continuous improvement.

Boards set the values and standards expected by everyone involved with a company and, once set, they need to be diligent in ensuring that they are robustly applied. This was recognised when the BAE Systems Board looked at what it needed to do for its part in implementing the Woolf Committee recommendations and the results of this can be seen in the various documents formally adopted by the Board. A key element of this was ensuring that clear expectations are set with regard to the responsible business standards expected of everyone and, in recognising this, we added the following to our Board Charter:

Extract from the Board Charter, as amended 18 November 2009

Standards and values
The Board shall set global principles, values and standards and agree policies and processes to guide the affairs of the Company in pursuing its strategic intention to become a leader in standards of responsible business conduct among global companies.

Board members shall be exemplars of the Company's values, principles and standards.

The Company's Code of Conduct, as agreed with the Board, is provided to all employees and sets out the principles of business conduct that all employees are expected to follow.

Extract from the BAE Systems Code of Conduct, section 1.1, adopted 1 January 2010

As a company and as individuals we are committed to behaving ethically in all aspects of our business. Success depends on us maintaining our corporate reputation and every employee has an important role to play.

Paragraph 3.2.2 of the BAE Systems Operational Framework

We have a Code of Conduct that sets out the standards to which every employee is required to work. Code of Conduct training for all employees shall be conducted on a regular basis. All new employees shall receive a copy of the Code of Conduct and introductory training during their induction period. All employees shall have access to an independent method of raising an issue or concern through the Ethics Helpline and Ethics Officer network.

The Code of Conduct shall be regularly reviewed to ensure it remains aligned with leading practice, at least every three years.

Responsible business behaviour starts with the people who run the company and therefore board succession planning has an important part to play in being a responsible business. Again, this is captured in our Board Charter:

Extract from the Board Charter, as amended 18 November 2009

People
The Board shall be responsible for ensuring that the Company is managed by people with the necessary skills, experience and knowledge to deliver the Company's agreed business strategy and who demonstrate high standards of responsible business conduct.

The BAE Systems Board requires the Chief Executive to provide clear and visible leadership in responsible business conduct. Ian King led the Woolf implementation process that has provided the Company with a solid business conduct programme, and the Board and the Corporate Responsibility Committee will be diligent in its ongoing oversight of this.

Further details of the matters discussed above and our full governance report can be found on pages 101 to 109.

Dick Olver
Chairman

BOARD PERFORMANCE – 2011 OBJECTIVES AND ACHIEVEMENTS

2011 objectives	2011 summary of achievements
Strategy Develop further the process by which the Board engages in the development of strategy.	– For the Company to be able to respond to changing market conditions and an ever-evolving business environment, its longer-term strategy must be a topic of recurring examination, discussion and consultation. In 2011, the Board held detailed strategy discussions at five Board meetings and it agreed that at all future sessions it will include strategy as a standing item for consideration.
Succession planning and implementation Prioritise support for new Board members and long-term succession planning for key executive roles.	– The Board engaged with the Chief Executive in reviewing the development of senior executives and appointments to key Group leadership roles. The Board was closely involved in the process that led to the appointment during the year of the new Group Finance Director, Peter Lynas. The Board adopted a policy regarding diversity and it will continue to monitor progress against this.
Operational performance monitoring Develop the programme of 'Deep Dives' to complement and validate KPIs and deepen directors' understanding of the Group's operations and performance.	– During 2011, the Board continued to benefit from senior operational executives attending meetings on a regular basis, thereby providing directors with a deeper understanding of the Group's operations and performance. In addition, directors made visits to various facilities and operations.
Risk and risk management Monitor the development of crisis management planning and the role of the Board in such plans. Establish future milestones after completion of the Woolf Report three-year implementation review.	– The Board was briefed regularly on the work led by the Chief Executive reviewing the Company's Crisis Management Procedures, which included the use of a simulation exercise to evaluate their effectiveness. – The Board, with the assistance of the Corporate Responsibility Committee, continues to provide oversight of responsible business conduct within the Company. This includes the implementation of the recommendations in the report issued by the Ethical Leadership Group on its review of the implementation of the Woolf Committee recommendations.
Stewardship and UK Corporate Governance codes Engage with shareholders as they implement the Stewardship Code and find ways to expose non-executive directors more directly to shareholders' views.	– The Chairman and certain non-executive directors participated in meetings with major shareholders during the year. In addition, the directors are provided with analysts' reports and the results of an annual survey of shareholder sentiment.
Brand Think about 'Brand' in the context of the evolving nature of the business.	– Work has started on the Company's brand narrative and will continue in 2012. Given the changing dynamics of defence budgets worldwide and the evolving nature of the strategic planning work outlined above, the Board will continue its discussions on brand in 2012.

BOARD PERFORMANCE – 2012 OBJECTIVES

Strategy	Continue to keep strategy under review and support moves to adjust the portfolio of businesses where it is in the interests of shareholders to do so.
Succession planning	Increase focus on matching succession and development to the strategic challenges of internationalisation, and the next decade of change in the business environment.
Performance monitoring	Extract insight from the new segmentation of business results.
Culture and behaviour	Implement improvements and observations identified in the Ethical Leadership Group report and the US monitors' reports, and oversee progress against these at Board meetings.
Risk and risk management	Continue to review the corporate risk register, including major programme risks and crisis management plans.
Board development	Use deep dives to improve understanding of principal markets and other major business issues.

CORPORATE GOVERNANCE *(continued)*

Audit Committee report

Nick Rose, Chairman

Sir Peter Mason

Paula Rosput Reynolds

Overview

The Committee is responsible for reviewing the effectiveness of the Group's financial reporting, internal control policies, and procedures for the identification, assessment and reporting of risk. It also monitors the integrity of the Group's financial statements, keeps the relationship with the Auditors under review, including the scope, level and cost of non-audit services undertaken by them, and monitors the role and effectiveness of the Internal Audit function.

The Group's internal control framework, which is based on a set of core processes developed over the years, is documented in the Operational Framework and forms the bedrock of the Group's governance processes. The Committee reviewed, twice during the year, the results of the Group's Operational Assurance Statement (OAS) process, through which senior managers across the Group report on the quality of their businesses' implementation of, and compliance with, the policies mandated in the Operational Framework. As part of this process, the Committee also reviewed the output from the OAS process that requires senior managers to evaluate, identify and report on significant risks to the delivery of their business plans, and to report on the status of plans to mitigate such risks.

The Committee derives value from discussing issues directly with operational management, as well as seeing at first hand a practical demonstration of the Group's core control processes, and risk identification and risk mitigation processes. To this end, the Committee met with senior management in the Group's Electronic Systems business as part of a US site visit undertaken by the Committee in 2011.

Audit – both internal and external – is naturally central to assessing the effectiveness of financial reporting and internal controls, and in turn, the effectiveness and quality of audit is of key importance. During the year, the Committee undertook a comprehensive review of the Auditors' effectiveness and performance, including management performance evaluation, independent client service review, future audit strategy and fee benchmarking. Having considered the output of this review, the Committee has recommended to the Board that it recommend that shareholders support the re-appointment of the Auditors at the 2012 AGM.

The Committee also reviewed the effectiveness of the Internal Audit function during the year, seeking input from key stakeholders within the Group, as well as the views of the external Auditors, and has concluded that the Internal Audit function continues to remain effective. The Committee has agreed the appointment of a new head of Internal Audit who will succeed the current incumbent when he retires at the end of the first quarter of 2012.

Nick Rose, Audit Committee Chairman

Principal activities

Internal controls and risk

– Considered reports from the Group's auditors, KPMG Audit Plc, and the Group's Internal Audit function on work undertaken in reviewing and auditing the control environment, to assess the quality and effectiveness of the internal control system.
– Reviewed, twice in the year, the results of the Group's OAS process, the Group's internal controls framework.
– Reviewed the output from the OAS process that requires managers to evaluate, identify and report on significant risks to the delivery of their business plans, and to report on the status of plans to mitigate such risks.
– Assessed the effectiveness of the Group's internal controls and reviewed the related disclosures in the Annual Report.

Financial reporting

– Reviewed the financial statements and the significant financial reporting judgements contained within them.
– Reviewed liquidity risk and the basis for preparing the Group accounts on a going concern basis.
– Reviewed the financial statements in the 2010 and 2011 Annual Reports, and the 2011 Half-yearly Report, and received a report from the Auditors on the statements.

Internal audit

– Agreed with the Corporate Responsibility Committee a programme of internal audit work aimed at assessing the effectiveness of policies and processes relating to key areas of ethical and reputational risk.
– Agreed the internal audit programme for 2011.
– Appointed a successor to the current head of Internal Audit.
– Reviewed output from, and considered progress against, the internal audit programme twice during the year.
– Reviewed the effectiveness of the Group's Internal Audit function.

The Auditors

– Agreed the approach and scope of the audit work to be undertaken by the Auditors.
– Reviewed with the Auditors the findings of their work.
– Reviewed the Group's processes for disclosing information to the Auditors and the related statement in the Annual Report.
– Agreed the fees payable in respect of the 2011 audit work.
– Reviewed the nature and cost of non-audit work undertaken in 2011.
– Undertook a review of the effectiveness and performance of the Auditors which formed part of a wider review of external audit performance and effectiveness undertaken by the Committee on a triennial basis.
– Received confirmation from the Auditors regarding their independence.

107 For more information on the Audit Committee

105 For more information on the Operational Assurance Statement (OAS)

Corporate Responsibility Committee report


Paul Anderson, Chairman


Harriet Green


Sir Peter Mason

Overview

The Committee is responsible for overseeing the Company's activities from the perspective of corporate responsibility. As different industries have different corporate responsibility issues, it is important that the Committee ensures that the Company is focused primarily on those that have potentially the most significant impact on the current operations and long-term sustainability of its business. Our focus at present is on ethics, safety, diversity and inclusion, and environmental sustainability. During 2011, the Committee reviewed regularly the progress being made against the objectives we agreed for these areas, and it also spent time with management exploring how we develop our future approach to them.

The Committee oversees the Company's compliance with corporate responsibility-related policies and procedures. To help us in this task, we have direct access to the Company's Internal Audit function and agree its annual audit programme jointly with the Audit Committee. The head of Internal Audit usually attends a number of the Committee's meetings and briefs us on the findings of relevant audits. He also facilitates our review of the effectiveness of the Company's Ethics Helpline, and the number and nature of the issues that have been reported. In addition, the Committee oversees the work undertaken by the external assurer, Deloitte, who have been engaged by the Company to provide assurance over corporate responsibility metrics reported externally.

One of the key activities performed by the Corporate Responsibility Committee in 2011 was to review the completion of the implementation programme to address the 23 responsible business conduct recommendations contained in the Woolf Committee Report issued in 2008. The services of Ethical Leadership Group, a third-party global compliance adviser, were engaged to carry out an in-depth review to support this and reported back to the Committee on its findings. The report concluded that BAE Systems has a solid ethical business programme including many best practice elements and some opportunities for improvement. It also recognises that substantial progress has been made against the Woolf recommendations with well designed processes to ensure continuous improvement.

Members of the Committee need to develop an awareness and understanding of how corporate responsibility matters are managed across the Group. To help achieve this, Committee members participate in both individual and group visits to Company facilities. In addition, we have asked the executives responsible for the Company's principal businesses to attend meetings and explain how corporate responsibility matters are managed in their businesses, including how, given differing local conditions, they are approaching the agreed corporate responsibility objectives and their success in achieving these.

Paul Anderson, Corporate Responsibility Committee Chairman

Principal activities

Corporate responsibility objectives

- Agreed the principal areas of corporate responsibility that the Company should focus on.
- Agreed corporate responsibility-related management objectives, which the Remuneration Committee has incorporated into the objectives for 2012, and against which annual incentive payments for executive directors and other senior managers will be determined.
- Agreed actual performance against the measures set for the 2010 objectives and made a recommendation to the Remuneration Committee as to the appropriate level of pay-out for the corporate responsibility-related elements of the plan.

Risk management

- Reviewed the output from the Company's risk management processes as they relate to corporate responsibility-related risks, including the Non-financial Risk Register process.

Safety

- Considered how to evolve the Company's approach to safety management and measuring performance in this area.

Environment

- Reviewed progress in developing the Group's approach to environmental sustainability.

Responsible business conduct

- Received a presentation on the findings of an independent review on the effectiveness of the implementation of the 23 recommendations contained in the Woolf Committee Report. Considered the Company's approach to responsible business conduct and objectives for 2012.

Diversity and inclusion

- Reviewed progress in developing the Group's approach to diversity and inclusion. Considered Lord Davies' report, Women on Boards, and the Company's approach to Board diversity.

Compliance

- Met with the Chief Counsel – Compliance & Regulation and was briefed on the Company's business conduct compliance processes.
- Met with the Senior Vice President – Offset and was briefed on the Company's processes for managing commercial offset arrangements.
- Met with the head of Government Relations and was briefed on the Company's processes for managing lobbying activity.

Assurance

- Reviewed a report received from Deloitte on the activities they undertake in providing independent assurance on certain corporate responsibility matters. Agreed the scope of their activities.
- Received reports and presentations from the head of Internal Audit on the corporate responsibility-related work undertaken by the Internal Audit function and the key findings from this.

Ethics Helpline

- Reviewed the working of the Ethics Helpline, and the nature and number of contacts made.

Corporate responsibility reporting

- Reviewed and approved the corporate responsibility reporting in the 2010 Annual Report and Accounts.

108 For more information on the Corporate Responsibility Committee

CORPORATE GOVERNANCE *(continued)*

Nominations Committee report

Dick Olver, Chairman

Paul Anderson

Sir Peter Mason

Overview

The Committee is responsible for overseeing the processes for nominating individuals for appointment to the Board. In addition, it has oversight over the composition of the principal board committees and who chairs them.

As part of its executive director succession planning remit, the Committee reviews on a regular basis the Company's processes for developing its senior management resources. This includes long-term succession planning for all senior executive roles. Through its involvement in such executive development activities, the Committee has visibility of the depth and quality of the senior manager resource, from which candidates for consideration as future executive members of the Board can be drawn.

During 2011, Peter Lynas joined the Board as Group Finance Director having been nominated by the Committee after a search that considered both external and internal candidates. The Committee engaged the search consultants, Spencer Stuart, to facilitate this activity. The Company's succession planning processes were the starting point for this search and ensured that the Committee had an awareness of potential internal candidates that had been built up over a number of years.

The Committee plans for the progressive refreshing of the Board and, in 2011, it conducted searches for two new non-executive directors. The starting point for these searches was an analysis of the skills and experience we require in the boardroom. The search consultants, The Zygos Partnership, were engaged to assist the Committee in this work. They are signatories to the Voluntary Code of Conduct for Executive Search Firms. Paula Rosput Reynolds was appointed to the Board in April last year, and her appointment provides us with excellent US business and boardroom experience. Lee McIntire was appointed in June and, as the CEO of a global engineering services and construction company, he provides valuable long-term contracting and programme management skills and experience.

All of the principal activities of the Committee during 2011 are detailed below and more detailed governance disclosures can be found on page 108.

Dick Olver, Nominations Committee Chairman

Principal activities

– Reviewed the composition of the Board and the skills and experience available to it, and conducted searches for new non-executive directors.

– Proposed that the Board extend Carl Symon's term of office for a further three years, such extension being supported by the Board's externally facilitated annual performance evaluation.

– Following the appointment of new directors, reviewed the composition of the principal board committees and proposed changes for the Board's approval.

– Reviewed with management the Group's management resources, and the succession and development plans for the most senior executive positions.

– Reviewed any potential directors' conflicts of interest (in accordance with UK company law).

108 For more information on the Nominations Committee

Remuneration Committee report

Carl Symon, Chairman

Lee McIntire

Nick Rose

Overview

The Committee is responsible for agreeing the remuneration policy and individual packages applicable to the Chairman, executive directors, members of the Executive Committee (EC), the Company Secretary and other senior executives. Within the agreed policy, the Committee determines the terms and conditions to be included in service agreements, including termination payments and compensation commitments, where applicable.

The Committee determines performance targets applicable to the Company's short- and long-term incentive plans, and approves any employee share-based incentive schemes and associated performance conditions.

The members of the Committee are independent non-executive directors, with the Chief Executive and the Company's Chairman attending meetings by invitation only. They do not attend where their individual remuneration is discussed and no director is involved in deciding his own remuneration. The Company Secretary acts as secretary to the Committee.

To ensure that it has access to professional advice that is independent of executive management, the Committee has appointed Kepler Associates as its Independent Adviser. Kepler is a founding member of the Remuneration Consultants Group (RCG) and complies with the RCG's code of conduct for Remuneration Consultants to the FTSE 350. Kepler will not undertake any work for the Company whilst they are retained as the Committee's Independent Adviser. Representatives from Kepler have attended each of the Committee's eight meetings during 2011 and will be in attendance at all meetings unless specifically requested otherwise by the Committee.

Legal advice to the Committee has been provided by Linklaters who are appointed by the Company, and who also provided services to the Company during the year. The Committee is satisfied that the services provided to it by Linklaters are of a technical nature and did not create any conflict of interest. If a conflict of interest were to arise in the future, the Committee would appoint separate legal advisers from those used by the Company.

PricewaterhouseCoopers (PwC), who are appointed by the Company and also provided services to the Company during the year, provided detailed information on market trends and the competitive positioning of packages. New Bridge Street (Aon Hewitt Limited), who are appointed by the Committee, provided advice on the Total Shareholder Return (TSR) figures for assessing the performance condition under the Performance Share Plan (PSP).

During the year, the Committee received material assistance and advice on remuneration policy from the Group's Human Resources Director, Alastair Imrie, and the Human Resources Director, Reward, Paul Farley. Dick Olver, Chairman, and Ian King, Chief Executive, also provided advice that was of material assistance to the Committee.

All of the principal activities of the Committee during 2011 are detailed below and governance disclosures can be found on page 109.

BAE Systems is one of the world's largest and most geographically diverse defence, aerospace and security companies. We operate with a clearly defined strategy to deliver sustainable growth in value to shareholders, operating in highly technologically complex markets. The Group continues to face a more challenging trading environment as governments look for cost savings to address budgetary pressures.

Our remuneration strategy is intended to recognise this business environment, whilst fostering a Total Performance culture at all levels of the Group, taking into account seniority and local market practice. In addition, it is used to drive performance in certain areas of corporate responsibility that the Company places particular focus on, namely safety, the environment, and diversity and inclusion.

In setting remuneration levels, the Committee is sensitive to the pay and conditions of other employees within the Group. Many of our employees work at the very leading edge of technology. We have a diverse workforce operating in many countries. Employee remuneration packages are therefore determined locally to meet local needs, whilst respecting our culture and Values. In 2011, general salary increases for our two largest employee populations in the UK and US typically averaged 2.5% and 3.5%, respectively.

In determining the levels of executive reward, the Remuneration Committee believes it is of utmost importance to ensure a strong link between actual remuneration received, and the achievement of our strategic and business objectives.

In 2011, our performance against targets was as follows. Our Earnings per Share (EPS) of 45.4p was close to stretch; year-end cash was slightly above target; and the stretch target for average cash was achieved. Order intake was below target. Our TSR performance reflects the sustained under-performance of our share price. The EPS performance against which the annual incentive payment was determined was significantly lower at 42.3p as a result of the Committee agreeing that only a portion of the research and development tax credit would count towards the annual incentive. The outcomes for the PSP and Share Matching Plan (SMP) long-term incentives are based on reported diluted underlying EPS of 45.4p. This will also form the baseline EPS figure against which performance of the 2012 PSP and SMP awards will be measured.

Against this performance background, the main aspects of our remuneration policy and practice for the year are set out below:

- for 2012, the salaries of the Chief Executive and the President and Chief Executive Officer of BAE Systems, Inc. were increased by 3.0% and 3.5%, respectively. The salary of the Group Finance Director was increased by 5% as his salary on appointment in April 2011 was intentionally set by the Committee below market in order to provide scope for further increases provided his performance merited this.
- annual bonus payouts for the executive directors under the annual incentive plan ranged from 65.6% to 69.5% of maximum.
- the growth of EPS over the three-year performance period for the 2009 awards under the long-term incentive plans was approximately 7.57% pa. Consequently:
  - the SMP award granted in 2009 earned a 0.85 match; and
  - of the 50% of the awards of shares granted in March 2009 under the EPS portion of the PSP, 42.42% vest.
- the Company's TSR for the 50% of awards of shares granted in March 2009 under the TSR portion of the PSP was below the median position when compared against the comparator group of 18 other defence and aerospace companies, and the related awards accordingly lapsed.

109 For more information on the Remuneration Committee

CORPORATE GOVERNANCE *(continued)*

Remuneration Committee report *(continued)*

- for 2012 onwards, the composition of the TSR comparator group has been revised to focus on 12 companies which are more representative of the Group's strategic focus as a defence and security company as set out in greater detail on page 89.
- the annual incentive opportunity applicable to the Group Finance Director has been increased from 75% to 80% at on-target and from 150% to 160% at stretch to ensure the totality of the package remains competitive in accordance with our stated remuneration policy. The long-term incentive multiple for the President and Chief Executive Officer of BAE Systems, Inc. has been increased to 300% to align the package more closely with the US defence and aerospace market.
- we retained the requirement for one-third of executive directors' annual incentives (25% for EC members and other senior executives) to be compulsorily deferred into the SMP.
- our requirement for executive directors to build up a shareholding of 200% of salary over time, remains unchanged. In parallel with the proposed increase in the long-term incentive multiple applicable to the President and Chief Executive Officer of BAE Systems, Inc., the associated minimum shareholding requirement will increase from 200% to 350% of salary. The Chief Executive's own shareholding comfortably exceeds his minimum shareholding requirement level. At 31 December 2011, the Group Finance Director, and the President and Chief Executive Officer of BAE Systems, Inc. held shares representing approximately 128% and 149% of salary, respectively, reflecting their more recent appointments.
- we are seeking shareholder approval for the introduction of a Share Option Plan in place of half the current expected value of the PSP, thereby creating a stronger linkage between absolute share price improvement and actual remuneration received. Vesting of option awards made to the executive directors will be subject to a TSR performance condition.

The Company's remuneration strategy and policy, and details of executive remuneration are set out on pages 81 to 100 of this report.

Carl Symon, Remuneration Committee Chairman

Principal activities

Remuneration review
- Set the basis for the Committee's annual review of executive remuneration, with particular focus on ensuring close alignment between the Group's reward framework and creation of shareholder value.
- Determined the appropriate market comparator group against which to assess the competitiveness of the total reward package for senior executives, including pensions.
- Reviewed actual pay and bonus levels received against comparator group actuals.
- Considered relevant corporate governance trends and developments in the UK, EU and US.
- Consulted with shareholders in respect of proposed changes to the remuneration structure and individual packages.
- Reviewed the pay arrangements for senior executives below the Executive Committee.

Directors' and EC members' remuneration
- Set annual bonus opportunity and share plan grant levels for each of the executive directors and EC members.
- Approved remuneration packages for each EC member.
- Reviewed prior year financial and non-financial performance, and agreed individual bonus amounts payable.

Annual bonus and Long-Term Incentive Plans
- Set financial and non-financial targets and objectives for the annual incentive applicable to executive directors and EC members.
- Tested the satisfaction of performance conditions applicable to awards granted under the Company's various Long-Term Incentive Plans.
- Reviewed progress of actual performance against targets at regular intervals throughout the year.

Share plans
- Reviewed share-based reward arrangements taking account of market trends, and tested the available dilution capacity for the Company's executive and all-employee share schemes.
- Considered and approved the grant policy for Spring and Autumn awards to be made to directors and executives under our Long-Term Incentive Plans.
- Approved the operation of the Group All-Employee Free Shares Plan and agreed the level of award to be made based on the Company's performance for the previous year.
- Sought necessary shareholder approval at the AGM for the introduction of a new Restricted Share Plan to apply to our US executives.
- Reviewed and set the policy in respect of the minimum shareholding requirement applicable to senior executives across the Group.

Remuneration reporting and governance
- Received a report on best practice in remuneration disclosure and opportunities for improvement.
- Reviewed and approved the Remuneration Report contained in the Company's Annual Report.
- Periodically reviewed the Committee's Terms of Reference and the output of the annual review of Board effectiveness.

REMUNERATION REPORT

Remuneration strategy, policy and packages

Following the annual review in November 2011, the Committee concluded that the current remuneration strategy remains generally appropriate, but the following key changes have been introduced:

– to further emphasise the importance of financial performance, the financial element of the annual incentive plan is being increased from two-thirds to four-fifths, with the one-fifth non-financial element being split equally between corporate responsibility objectives and personal objectives. The financial element will be targeted on earnings and cash, each with an equal weighting, and a substantial part of the personal objectives element will be focused on winning new business; and

– to achieve optimal alignment of the reward framework with the creation of shareholder value, shareholder approval is being sought at the AGM to introduce a Share Option Plan in place of half of the current expected value of the Performance Share Plan (PSP), with the awards made to the executive directors being subject to a Total Shareholder Return (TSR) performance condition.

Other than these changes, the Committee intends to continue with the executive remuneration policy as detailed in this report in 2012 and subsequent years for executive directors and Executive Committee members, and this policy will be flowed down to the most senior executives within the Group globally (approximately 280) to create a consistent global approach to reward. The principles of the remuneration strategy are applied consistently across the Group below this level, taking account of seniority and local market practice.

The Committee will continue to consult on material changes with principal shareholders.

The Committee has considered the UK Corporate Governance Code requirement regarding remuneration incentives being compatible with risk policies and systems, and continues to be satisfied that the Company is well placed to meet this requirement as profit recognition on long-term programmes is intrinsically linked to risk reduction.

REMUNERATION STRATEGY

The Company's remuneration strategy is to provide a remuneration package that:

– helps to attract, retain and motivate;

– is aligned to shareholders' interests;

– is competitive against the appropriate market;

– encourages and supports a Total Performance culture aligned to the achievement of the Company's strategic objectives;

– is fair and transparent;

– can be applied consistently throughout the Group; and

– balances overall commonality of design with appropriate tailoring to ensure competitiveness in our different principal markets.

REMUNERATION POLICY

To achieve the strategy, the remuneration policy for executive directors and Executive Committee members is to:

– set base salary with reference to median of the relevant market competitive level;

– reward stretching superior performance with upper quartile reward;

– provide an appropriate balance between:

  – short-term and long-term reward; and

  – fixed and variable reward

  with the balance becoming more long term and more highly geared with seniority; and

– provide a competitive package of benefits.

ELEMENTS OF PACKAGE	PURPOSE
Base salary	Recognise market value of role and individual's skills, experience and performance.
Annual incentive	Drive and reward annual performance of individuals, teams and the Company on both financial and non-financial metrics, including behaviours.
Share Matching Plan	Directly align short-term and long-term reward through compulsory deferral of annual incentive into shares, and drive and reward delivery of sustained long-term Earnings per Share (EPS) performance through co-investment aligned to the interests of shareholders.
Performance Share Plan	Drive and reward delivery of sustained long-term EPS and TSR performance aligned to the interests of shareholders.
Share Option Plan	Drive and reward delivery of TSR performance and sustained improvement in the Company's share price.
Restricted Share Plan	Provide long-term reward and address retention issues, through time-vesting awards principally in the Company's US market.
Pension provision and other benefits	Provide competitive cost-effective retirement plans and other employee benefits through leveraging the Company's size and scale.

REMUNERATION REPORT *(continued)*

2011 remuneration review
The 2011 review not only considered the Company's executive remuneration packages against the market, but also the Company's performance to date and the strategic actions designed to shape the business portfolio and strengthen performance over the longer term.

Information on the market for comparable management positions was provided by PricewaterhouseCoopers so that the Committee could form a view as to where to position the various elements of the package relative to comparable companies.

The methodology used was to construct appropriate comparator groups for the individual positions, taking account of company size, scale of operations and breadth of role. The comparator group for the UK executive directors comprises 24 FTSE 100 companies where BAE Systems is positioned towards the median in terms of market capitalisation and which the Committee believes is appropriate for benchmarking UK executive directors' packages.

For the President and Chief Executive Officer of BAE Systems, Inc., the comparator group was drawn from companies in the US aerospace, defence and general industry sector, adjusted, as appropriate, to produce market figures consistent with the size, scale and relative independence of the US business, and adjusting where necessary to reflect the extra responsibility for her plc Board role.

The base salary, total cash reward (base salary plus annual incentive), total direct reward (total cash reward plus long-term incentives) and total reward (total direct reward plus pension) were analysed at the lower quartile, median and upper quartile for the relevant posts in the comparator group companies. This gives the Committee a view on the competitiveness of the individual elements of the package as well as the package as a whole.

The Committee also reviewed market trends around the individual elements of remuneration to ensure that the structure of the package stays in line with market practice. The remuneration structure overall also takes account of the performance of the individual, the Company as a whole, and the pay and conditions of Group employees.

Overall, while the review indicated that the structure is broadly in line with the market, some adjustments, particularly in respect of the overall market-competitiveness of the packages for our senior executives in the US, were deemed necessary to ensure that it remained so.

Base salary
The Committee reviewed base salaries, taking into account the current economic climate, the challenges facing the business, their respective positions against benchmark, and the pay environment for employees in general. In particular, the salary of the Group Finance Director has been increased by 5% as his salary was below market on appointment to the role in April 2011.

The annual base salary levels of executive directors with effect from 1 January 2012 are as follows:

Name	2011 salary	**2012 salary**	Increase
Ian King	£935,000	**£963,050**	3.0%
Peter Lynas	£520,000	**£546,000**	5.0%
Linda Hudson	$1,010,000	**$1,045,350**	3.5%

Incentives
The Group's strategy is set out on page 6 along with the Group Strategic Framework. This explains how the Group's mission is to deliver sustainable growth in shareholder value through its commitment to Total Performance – Customer Focus, Programme Execution, Financial Performance and Responsible Behaviour. Underpinning the drive for Total Performance are the Group's Values – Trusted, Innovative and Bold. The Group's strategy focuses on supporting its customers in safeguarding their vital interests, and driving shareholder value by improving financial performance and competitive positions across the business. The five Strategic Actions, which translate the strategy into operational plans, are underpinned by the Integrated Business Plan (IBP), which sets out the business plan for future years.

Each year, the Board agrees the Executive Committee's key objectives which are critical to delivering the Group's strategy. For 2012, these are set out on page 6, and are used as the basis to set the individual objectives for the executive directors and Executive Committee members which are agreed by the Chairman, Dick Olver, and the Remuneration Committee. These then flow down to the senior leadership team to ensure that all businesses within the Group are aligned with the overall Group strategy.

The remuneration strategy incentivises and rewards executives to deliver their contribution to the achievement of the Group's strategy through the combination of short-term incentives targeted at Group performance, business performance, personal performance and leadership behaviours, and long-term incentives targeted at Group performance (and business performance in the case of our US senior executives). To directly align short-term and long-term reward, executive directors will be required to invest at least one-third of their net 2012 annual incentive into the SMP when the annual incentive is paid in 2013. Further investment can be made on a voluntary basis up to a maximum investment of half their net annual incentive, except in the case of the US executive director who participates in the Restricted Share Plan following its approval by shareholders at the 2011 AGM.

Annual incentive plan
The annual incentives for 2012 continue to focus on a combination of in-year financial performance, and longer-term performance and risk management (both business risk and reputation risk). Four-fifths is driven off in-year financial performance, and one-fifth based on driving performance and improvement in the area of corporate responsibility and safety, combined with the other non-financial objectives supporting the Group's strategy.

The financial targets are derived from the IBP, and are based on earnings and cash targets, each with equal weighting. These are seen as the key indicators of both short-term and long-term financial performance and value creation, and are supported by the Company's major shareholders. At Group level, EPS is used whereas EBITA[1] is used to measure earnings performance at a business level. To incentivise improved phasing of cash generation throughout the year, a combination of year-end and average quarterly net cash/debt has been in place since 2009 and will continue for 2012. Due to the stretching nature of the plan, and following the introduction in 2010 of a threshold paying 20% of maximum for the profit element, a threshold payout of 20% of maximum will apply in 2012 for all financial performance measures. The payout for on-target performance is 50% of maximum. Payout for performance between targets is calculated on a straight-line basis.

The table below summarises the overall structure of the annual incentives for executive directors.

	Proportion of annual incentive	
Performance measure	2011	**2012**
In-year financial	66.7%	**80.0%**
Business conduct and safety	15.0%	**–**
Corporate responsibility and safety	–	**10.0%**
Other objectives	18.3%	**10.0%**

In setting targets for the annual incentive plan, the Committee expects that these should represent positive progression relative to the level of performance achieved in the prior year.

The Committee believes that the annual incentive targets for the executive directors are stretching but achievable. The structure of the 2012 annual incentive plan for executive directors is summarised in their individual sections on pages 84 to 86.

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

Long-Term Incentive Plans (LTIPs)

The Company currently operates two LTIPs – the Performance Share Plan (PSP) and the Share Matching Plan (SMP), the details of which are set out on pages 88 to 90. In addition, following shareholder approval at the 2011 AGM, the US executives participate in the Restricted Share Plan (RSP) which provides approximately 35% of the total LTIP package without performance conditions other than time vesting. Further detail on the RSP is contained on page 90.

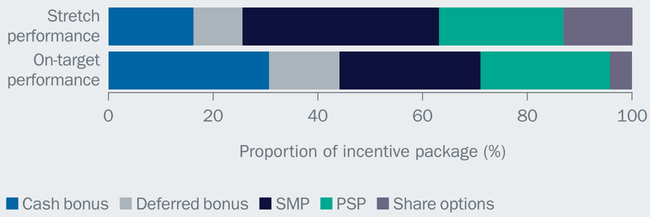
In order to ensure the package remains competitive, a number of structural changes are proposed to the LTIP framework for 2012, specifically:

– in order to strengthen the link between absolute share price improvement and reward outcomes, one half of the current expected value of the PSP will be delivered in the form of grants under a new Share Option Plan, subject to receiving shareholder approval of this at the 2012 AGM. The combined face value of awards under the PSP and the new Share Option Plan will be calculated in such a way as to ensure no increase to the overall expected value of the LTIP package; and

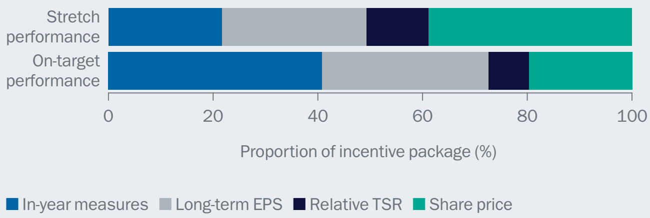
– despite the changes introduced in 2011 to the long-term incentive package applicable to the President and Chief Executive Officer of BAE Systems, Inc., the 2011 remuneration review highlighted that there continues to be a significant gap between the current incumbent's total direct remuneration opportunity and what is required for this to be competitive against compensation levels for a US divisional lead in the US defence and aerospace market. The Committee has addressed this by increasing the aggregated 'expected value' of the long-term incentive applicable to the President and Chief Executive Officer of BAE Systems, Inc. to 300% of salary. A corresponding increase in the minimum shareholding requirement for the President and Chief Executive Officer of BAE Systems, Inc. from 200% to 350% of salary will also apply for 2012 onwards.

The combination of the annual incentive plan, SMP, PSP and share options provides a balance between short-term cash reward and longer-term share-based reward as shown below. The proportion of the incentive package delivered through longer-term performance is significantly higher at stretch payout than at on-target payout, demonstrating that the package supports the achievement of superior long-term performance and strongly aligns the interests of executives to those of shareholders through long-term reward being delivered in shares. The second graph shows which performance metrics are driving the value of the incentives. This shows that, at on-target performance, the higher influence of the annual incentive means that in-year measures drive around 40% of the package value, with long-term EPS (which underpins the SMP and half the PSP awards) accounting for a similar proportion. But, at stretch performance, the influence of the annual incentive is reduced, and the SMP, PSP and share options account between them for four-fifths of the value of the incentive package, with the most important drivers of value becoming long-term EPS and share price. This shows that achieving strong performance on the in-year measures is important but, to maximise the value of their incentive package, executives need to drive growth in long-term EPS and share price.

Proportion of Chief Executive's incentive package delivered by the various incentive plans (%)



Performance drivers of Chief Executive's incentive package (%)



Personal shareholding policy

The Committee has agreed a policy whereby all executive directors are required to establish and maintain a minimum personal shareholding equal to 200% of base salary (350% in the case of the President and Chief Executive Officer of BAE Systems, Inc.). As a minimum, a holding equal to 100% (175% for the President and Chief Executive Officer of BAE Systems, Inc.) of 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 using 50% of the shares that vest or 50% of the options which are exercised on each occasion. Thereafter, executive directors are required to increase their personal shareholding gradually, on each occasion using 25% of the shares that vest or 25% of the options exercised each year, until a personal shareholding equal to 200% of annual base salary (350% for the President and Chief Executive Officer of BAE Systems, Inc.) is achieved and maintained. These limits are reviewed periodically. A similar arrangement applies to senior executives eligible for share-based long-term incentives with limits aligned to the levels of awards made under these plans.

Details of the directors' personal shareholdings are shown in Table A on page 94.

Pension provision

No changes to the pension arrangements for executive directors were made in 2011. Further detail on current arrangements is provided on page 91.

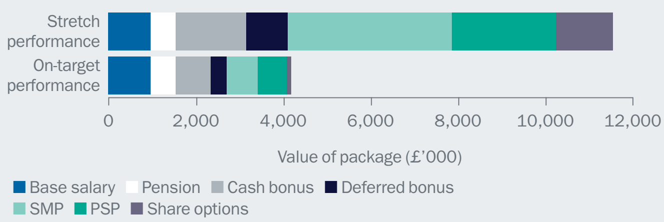
REMUNERATION REPORT *(continued)*

STRUCTURE OF INDIVIDUAL EXECUTIVE DIRECTORS' PACKAGES

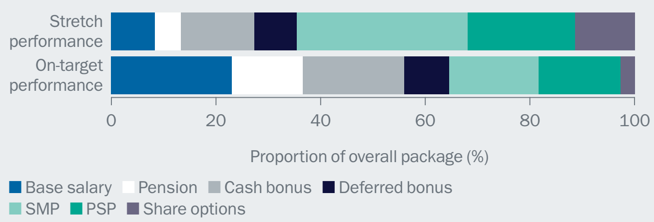
Ian King (Chief Executive)		**2012**		2011	
Base salary		**£963,050 pa**		£935,000 pa	
Annual incentive	On-target/maximum (% of salary)	**112.5%/225%**		112.5%/225%	
	Structure (% of salary)	**On-target**	**Stretch**	On-target	Stretch
	Group EPS	**45%**	**90%**	30%	60%
	Group cash	**45%**	**90%**	30%	60%
	Order intake	**Not applicable**		15%	30%
	Safety	**5.625%**	**11.25%**	Up to 16.875%	
	Corporate responsibility/business conduct	**5.625%**	**11.25%**	Up to 16.875%	
	Other objectives	**11.25%**	**22.5%**	Up to 41.25%	
	Deferral into SMP	**⅓ compulsory plus voluntary up to total of 50% of net annual incentive**			
SMP	Gross match	**2:1**			
	Performance condition	**EPS growth of 5% – 11% pa**			
PSP	Grant (% of salary)	**125%**		250%	
	Performance condition	**½ on relative TSR against 12 other international defence companies; ½ on EPS growth of 5% – 11% pa**		½ on relative TSR against 18 other global aerospace and defence companies; ½ on EPS growth of 5% – 11% pa	
Share Option Plan	Grant (% of salary)	**300%**		Not applicable	
	Performance condition	**Relative TSR against 12 other international defence companies**		Not applicable	
Pension accrual		**1/30th of three-year final average salary from age 62 for 8% member's contributions**			

The graphs below show the value of the package at on-target and stretch performance together with the proportion of the package delivered through fixed and variable reward.

Value of package (£'000)



Proportion of package value delivered through fixed and performance-related reward (%)

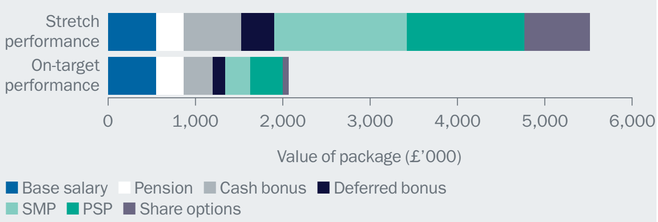


STRUCTURE OF INDIVIDUAL EXECUTIVE DIRECTORS' PACKAGES *(continued)*

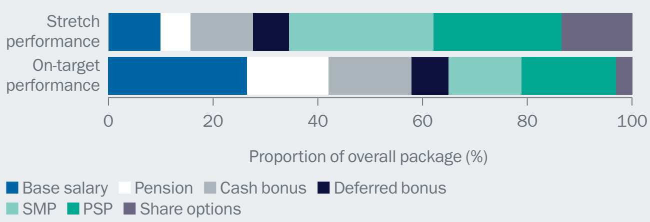
Peter Lynas (Group Finance Director)		**2012**		2011	
Base salary		**£546,000 pa**		£520,000 pa	
Annual incentive	On-target/maximum (% of salary)	**80%/160%**		75%/150%	
	Structure (% of salary)	**On-target**	**Stretch**	On-target	Stretch
	Group EPS	**32%**	**64%**	20%	40%
	Group cash	**32%**	**64%**	20%	40%
	Order intake	**Not applicable**		10%	20%
	Safety	**4%**	**8%**	Up to 11.25%	
	Corporate responsibility/business conduct	**4%**	**8%**	Up to 11.25%	
	Other objectives	**8%**	**16%**	Up to 27.5%	
	Deferral into SMP	**⅓ compulsory plus voluntary up to total of 50% of net annual incentive**			
SMP	Gross match	**2:1**			
	Performance condition	**EPS growth of 5% – 11% pa**			
PSP	Grant (% of salary)	**125%**		250%	
	Performance condition	**½ on relative TSR against 12 other international defence companies; ½ on EPS growth of 5% – 11% pa**		½ on relative TSR against 18 other global aerospace and defence companies; ½ on EPS growth of 5% – 11% pa	
Share Option Plan	Grant (% of salary)	**300%**		Not applicable	
	Performance condition	**Relative TSR against 12 other international defence companies**		Not applicable	
Pension accrual		**1/30th of three-year final average salary from age 62 for 8% member's contributions**			

The graphs below show the value of the package at on-target and stretch performance together with the proportion of the package delivered through fixed and variable reward.

Value of package (£'000)



Proportion of package value delivered through fixed and performance-related reward (%)



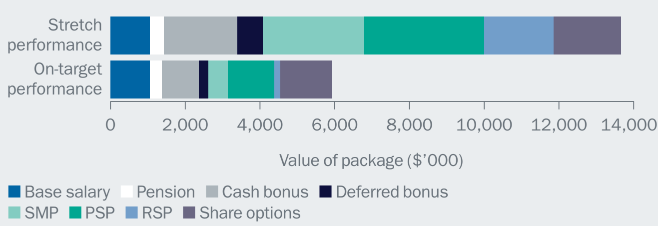
REMUNERATION REPORT *(continued)*

STRUCTURE OF INDIVIDUAL EXECUTIVE DIRECTORS' PACKAGES *(continued)*

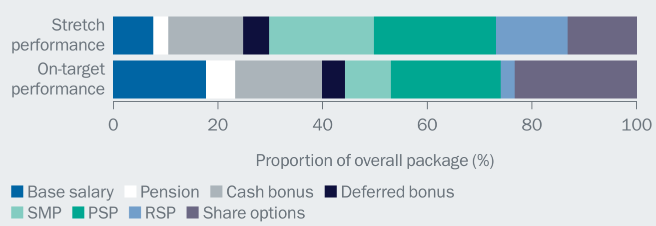
Linda Hudson (President and Chief Executive Officer of BAE Systems, Inc.)		2012		2011	
Base salary		**$1,045,350 pa**		$1,010,000 pa	
Annual incentive	On-target/maximum (% of salary)	**112.5%/225%**		112.5%/225%	
	Structure (% of salary)	**On-target**	**Stretch**	On-target	Stretch
	Group EPS	**15%**	**30%**	10%	20%
	Group cash	**15%**	**30%**	10%	20%
	Order intake	**Not applicable**		5%	10%
	Business EBITA[1]	**30%**	**60%**	20%	40%
	Business cash	**30%**	**60%**	20%	40%
	Business order intake	**Not applicable**		10%	20%
	Safety	**5.625%**	**11.25%**	Up to 16.875%	
	Corporate responsibility/business conduct	**5.625%**	**11.25%**	Up to 16.875%	
	Other objectives	**11.25%**	**22.5%**	Up to 41.25%	
	Deferral into SMP	**Compulsory ⅓ of net annual incentive. No voluntary element**			
SMP	Gross match	**2:1**			
	Performance condition	**EPS growth of 5% – 11% pa**			
PSP	Grant (% of salary)	**145%**		160%	
	Performance condition	**½ on long-term US operating cash; ½ on EPS growth of 5% – 11% pa**		½ on relative TSR against 18 other global aerospace and defence companies; ½ on EPS growth of 5% – 11% pa	
Share Option Plan	Grant (% of salary)	**390%**		Not applicable	
	Performance condition	**Relative TSR against 12 other international defence companies**		Not applicable	
RSP	% of salary	**100%**		65%	
Pension accrual		**Cash sum at retirement of 14.1% of career pay (salary plus bonus up to maximum of 150% of salary) for a contribution of 1.5% of pay, plus an 85% Company 401(k) match on contributions to a maximum of 6% of salary**			

The graphs below show the value of the package at on-target and stretch performance together with the proportion of the package delivered through fixed and variable reward.

Value of package ($'000)



Proportion of package value delivered through fixed and performance-related reward (%)



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

Performance in 2011
The structure of the 2011 annual incentive plan was set out in last year's Remuneration report and is summarised in the individual sections for each of the executive directors on pages 84 to 86 of this report.

Financial performance: Against the backdrop of a difficult business environment and the Group's strong performance in recent years, 2011 was particularly challenging. At the Group level, EPS was close to stretch performance, year-end cash was above target and the stretch target for average cash was achieved. As referred to on page 14, the Group's order intake performance was below target. At the operating group level, Programmes & Support missed its stretch profit target, achieved stretch performance on both cash targets, but missed the order intake target. International achieved its stretch profit target, missed year-end cash targets, delivered on-target performance for average cash, but missed the order intake target. BAE Systems, Inc. achieved stretch performance for both cash targets, achieved between threshold and on-target levels for EBITA[1], but missed order intake targets. For incentive purposes, the effect of the research and development tax credit on EPS performance was limited to reflect prior year impacts only.

Non-financial performance: Page 13 sets out the Executive Committee's top ten objectives for 2011 and the assessment of performance against these, whilst pages 55 to 59 provide more detailed information on the performance against the specific objectives relating to business conduct and safety.

Business conduct: The Group targeted the successful implementation of the 23 recommendations of the Woolf Committee which was completed in May 2011. Deloitte has assured BAE Systems' statements on 'Progress against Recommendations' on the Group's website.

Safety: The Group has continued to drive improvement of safety management, using its Safety Maturity Matrix (SMM) as the mechanism to measure and drive performance. Within BAE Systems, Inc. and Programmes & Support all sites designated to achieve Level 5 (highest level) were confirmed as having achieved this. Australia did not meet its plan to achieve Level 5 at its nominated sites. The Group achieved an 11% reduction in Lost Work Day Case Rate which did not meet the target of 20% set by the Corporate Responsibility Committee.

Other objectives: Of the remaining top ten Group objectives for 2011, good progress has been made and the Committee agreed an overall assessment of 75% of maximum. This sets the starting point with further adjustment, up or down, depending on the assessment of overall performance and leadership behavioural performance of the individual executive.

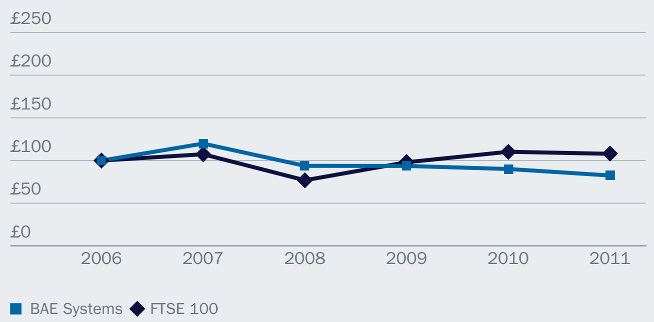
Accordingly, the Committee determined the payout under the 2011 annual incentive plan as follows:

2011 annual incentive payout	Ian King	Linda Hudson	Peter Lynas
% of target	137.2%	131.2%	139.0%
% of base salary	154.4%	147.6%	104.3%
Amount	£1,443,383	$1,490,621	£406,731

In addition:

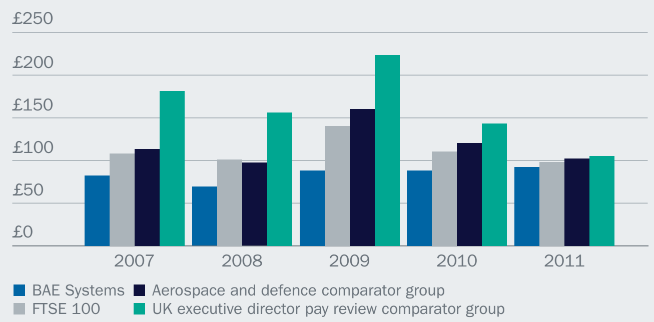
- the growth in EPS over the three years to 2011 was approximately 7.57% pa. Consequently:
  - the SMP award granted in 2009 earned a 0.85 match; and
  - of the 50% of the awards of shares granted in March 2009 under the EPS portion of the PSP, 42.42% vest.
- the Company's TSR for the 50% of awards of shares granted in March 2009 under the TSR portion of the PSP was below the median position when compared against the comparator group of 18 other defence and aerospace companies, and the related awards accordingly lapsed.

Value at 31 December 2011 of £100 investment at 31 December 2006 (£)



This graph, which has been produced in accordance with the requirements of Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, shows the value by 31 December 2011, on a total shareholder return basis, of £100 invested in BAE Systems on 31 December 2006 compared with the value of £100 invested in the FTSE 100 index. The FTSE 100 is considered to be an appropriate comparator for this purpose as it is a broad equity index. As BAE Systems is a constituent member of the FTSE 100, it was deemed to be the most appropriate general UK equity index.

Value at 31 December 2011 of £100 investment (£)



The graph above shows the value shareholders have achieved by their investment in BAE Systems over recent years as compared to (i) the FTSE 100 index; (ii) the companies forming the sectoral peer group for 2011 for the Performance Share Plan (see page 89); and (iii) the companies forming the comparator pay group for the 2011 executive pay review. The graph depicts the value for BAE Systems and the comparators at the end of 2011 of a single £100 investment made at the beginning of each of the last five years.

REMUNERATION REPORT *(continued)*

Summary of Long-Term Incentive Plans

Plan provisions
Performance conditions for grants of awards to be made under the Performance Share Plan, the Share Option Plan and the Share Matching Plan in 2012 are detailed below. Performance conditions for grants of awards made prior to 2012 are detailed on pages 95 and 96.

Clawback arrangements have operated in respect of the Performance Share Plan and Share Matching Plan from the 2010 awards onwards, and will operate for grants under the Share Option Plan from its inception. The arrangements are intended to cover situations, for example, where results are restated or otherwise turn out to be materially inaccurate or where the executive's employment can be terminated for cause.

PERFORMANCE SHARE PLAN (PSP)

Key features for PSP awards in 2012:

– awards of shares are granted based on a percentage of salary and share price at the date of grant;

– the shares are subject to satisfaction of three-year performance conditions;

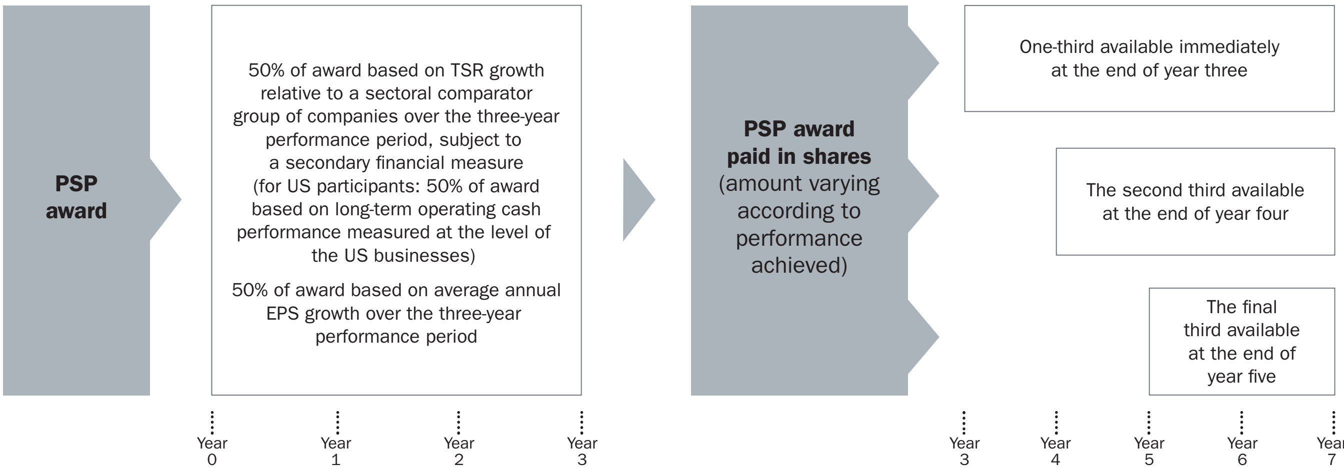
– half the PSP award will be based on a Total Shareholder Return (TSR) performance condition (PSP^{TSR}) and the other half on an Earnings per Share (PSP^{EPS}) performance condition. For US participants, the first half of the award will be based on long-term operating cash performance measured at the level of the US businesses, reflecting an increased emphasis from shareholders on cash flow generation;

– in addition, there is a further test on the PSP^{TSR} element to ensure that the TSR performance is supported by the underlying performance of the Company;

– shares under award after satisfaction of the performance condition vest at the end of year three. Awards that vest are exercisable in three tranches between the third and seventh anniversary of vesting. For US participants, the awards are automatically delivered at the end of years three, four and five, subject to the performance condition being achieved; and

– shares under award attract dividends prior to vesting.

HOW THE PSP OPERATES



For the US participants, the awards are automatically delivered at the end of years three, four and five, subject to the performance condition being achieved.

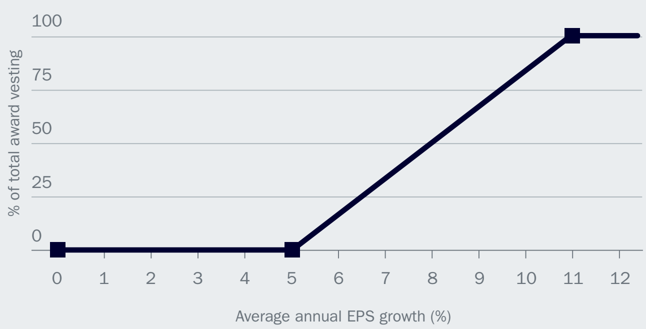
PERFORMANCE CONDITION – PSP^{EPS}

The proportion of the award capable of exercise is determined by the rate of average annual EPS growth over the three-year performance period, with nil vesting at average annual EPS growth of 5% and 100% vesting at 11% growth as set out opposite (15% to 33% growth over three years).

The rationale for the EPS performance measure is that major investors consider EPS to be a key indicator of long-term financial performance and value creation.

Summary of EPS performance to 31 December 2011
2011 EPS was 45.4p, and is approximately 7.57% greater (per annum) than the 2008 EPS of 37.0p. This is just below the mid-point of the performance range of 5% to 11% growth per annum. Accordingly, 42.42% of the EPS portion of the March 2009 PSP awards vest.

Performance condition – PSP^{EPS}



PERFORMANCE CONDITION – PSP[TSR]

The proportion of the award capable of exercise is determined by:

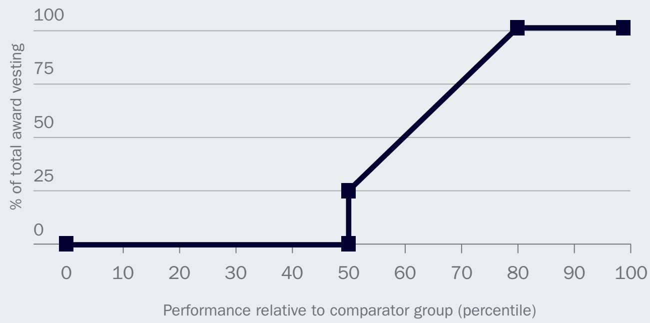
(i) the Company's TSR (share price growth plus dividends) ranking relative to a comparator group of 12 other international defence companies as shown in the table opposite*. Reflecting the Group's strategy to transition from a more diversified portfolio, the composition of the comparator group has changed to comprise those companies with a significant focus on defence and security. None of the shares vest if the Company's TSR is outside the top 50% of TSRs achieved by the sectoral comparator group, with 25% vesting at median, and 100% vesting if it is in the top quintile (i.e. top 20%) as set out opposite; and

(ii) whether there has been a sustained improvement in the Company's underlying financial performance and whether it is appropriate to release some or all of the awards. In taking such a view, the Committee may consider (but not exclusively) the following financial metrics: net cash/debt; EBITA[1]; order book; turnover; risk; and underlying project performance.

The rationale for TSR performance measures is that major investors regard TSR as an important indication of both earnings and capital growth relative to other major companies in the same sector and to ensure that awards only vest if there has been a clear improvement in the Company's performance over the relevant period.

* The previous comparator group for 2011 and prior years is also shown opposite.

Performance condition – PSP[TSR]



PSP[TSR] – sectoral peer group for 2012

Cobham	L-3 Communications	Raytheon
Finmeccanica	Lockheed Martin	SAIC
General Dynamics	Meggitt	Thales
ITT Exelis	Northrop Grumman	United Technologies

PSP[TSR] – sectoral peer group for 2011 and prior years

Boeing	General Dynamics	Raytheon
Cobham	GKN	Rockwell Collins
Dassault Aviation	Goodrich	Rolls-Royce
EADS	Honeywell International	Smiths Group
Embraer PN	Lockheed Martin	Thales
Finmeccanica	Northrop Grumman	United Technologies

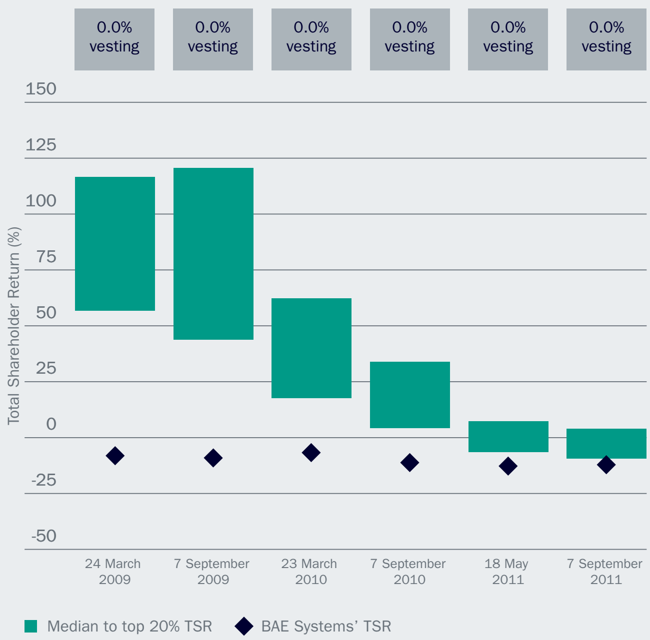
SUMMARY OF TSR PERFORMANCE TO 31 DECEMBER 2011

The chart opposite summarises the position on the TSR element for all outstanding awards under the PSP as at 31 December 2011.

The coloured box shows the range of TSR required for 25% vesting to full vesting, and the diamond shows BAE Systems' TSR. The proportion that would vest is shown in the boxes at the top of the chart.

This shows that the TSR portion of the March 2009 PSP award lapsed as the Company's TSR was below that of the comparator group.

TSR performance under the Performance Share Plan



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

REMUNERATION REPORT *(continued)*

SHARE OPTION PLAN*

Key features for option grants in 2012:

– options granted under the Share Option Plan are normally exercisable between the third and tenth anniversary of their grant; and

– for share option awards made to the executive directors only, exercise is subject to a TSR performance condition such that:

  – 25% of each option grant is exercisable if the Company's TSR (share price growth and dividends) is at the median relative to the comparator group (using the same 12 companies included in the sectoral peer group for the 2012 PSP[TSR] performance condition listed on page 89).

  – 100% of each option grant is exercisable if the Company's TSR (share price growth and dividends) is in the upper quintile relative to the comparator group. For performance between median and upper quintile, the proportion of options exercisable will be calculated on a straight-line basis.

Rationale for performance measure: major investors regard TSR as an important indication of both earnings and capital growth relative to other major companies in the same sector.

* Introduction of the Share Option Plan is subject to shareholder approval at the 2012 AGM.

SHARE MATCHING PLAN (SMP)

Key features for grants of awards in 2012:

– stand-alone share investment plan with the investment linked to the award under the annual incentive plan;

– participants are granted a conditional award of matching shares against the gross value of the annual incentive invested;

– matching shares attract dividends during the three-year deferral period, released on vesting of any matching shares;

– executive directors are required to invest one-third of their 2011 net annual incentive into the SMP; and

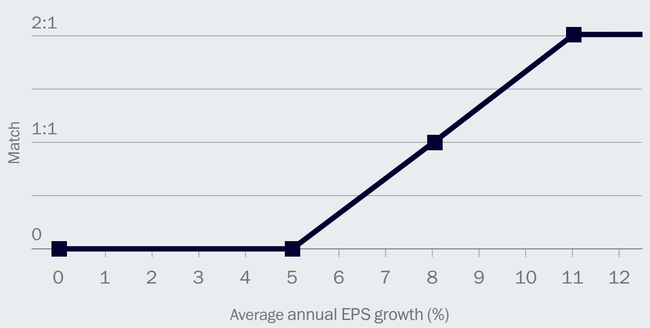
– maximum level of investment will be 50% of the net annual incentive.

Match and performance condition

– nil match for average EPS growth of 5% per annum increasing uniformly to a 1:1 match at 8% per annum and a maximum 2:1 match at 11% per annum growth (i.e. 15% to 33% growth over three years).

– Rationale for performance measure: major investors consider EPS to be a key indicator of long-term financial performance and value creation.

Performance condition – SMP



2009 SMP award

The 2009 SMP awards were based on nil match for average EPS growth of 5% per annum increasing uniformly to a maximum 2:1 match at 11% per annum growth. 2011 EPS was 45.4p, and is approximately 7.57% greater (per annum) than the 2008 EPS of 37.0p. Accordingly, the SMP award granted in 2009 earned a 0.85 match.

RESTRICTED SHARE PLAN (RSP)

Key features of awards in 2012:

– conditional awards of shares are granted based on a percentage of salary and share price at the date of grant;

– the shares are subject only to the condition that the participant remains employed by the Group at the end of the vesting date (three years after the award date); and

– shares under award attract dividends prior to vesting.

The RSP is not subject to a performance condition as it is designed to address retention issues principally in the US.

Clawback arrangements operate in respect of this Plan.

Other share schemes, pensions and executive directors' service contracts

Share Incentive Plan (SIP)
During 2011, the UK executive directors were eligible to participate in the all-employee free shares element of the SIP. As a result of the Company's performance in 2011, all eligible employees (including the UK executive directors) will be entitled to receive shares worth £469. A similar arrangement operates for non-UK employees on a cash or shares basis depending on local tax and security laws.

The Company operates a share purchase arrangement (Partnership Shares) under the SIP. Under this arrangement, UK-based employees (including executive directors) may purchase ordinary shares in BAE Systems by either monthly investments of between £10 and £125 a month, or lump sum investments of between £10 and £1,500 in a tax year, both limited to 10% of salary if less. The Partnership Shares attract matching shares. As the plan is an all-employee plan, the matching shares are not subject to performance conditions in accordance with legislation. One free matching share is awarded for each Partnership Share up to a maximum of £63 per month.

Dividends paid in respect of the shares in the SIP for UK-based employees are reinvested as Dividend Shares.

Share usage for employee share schemes
The Committee has agreed that, in respect of new issue or treasury shares, shares representing no more than 1% (and no more than 0.5% for the executive schemes) of the Company's issued share capital will be used in any one financial year for the grant of incentives under all of the Company's employee share schemes. The table below sets out the available dilution capacity for the Company's employee share schemes on this basis.

The Company currently intends to use new issue or treasury shares to satisfy future share awards under the executive long-term incentive plans and share option plans up to the 0.5% annual dilution limit, and to use treasury shares to satisfy awards of free shares and matching shares under the all-employee Share Incentive Plan.

	Number of shares
Total issued share capital as at 31 December 2011	3,588m
All schemes:	
10% in any consecutive years	358.8m
Remaining headroom	202.2m
Executive schemes:	
5% in any consecutive ten years	179.4m
Remaining headroom	79.2m

Where it is appropriate to use shares purchased in the market to satisfy employee share scheme commitments, a discretionary ESOP trust is used to acquire Company shares using funds loaned by the Group. Further detail on the ESOP Trust is provided in note 25 to the Group accounts.

Post-retirement benefits
UK pension benefits
UK executive directors are members of the BAE Systems Executive Pension Scheme (the ExPS) and members of the underlying employee pension plans. As such, they are subject to the same contribution rates payable by employees of the underlying plans, and the benefit changes introduced in 2006 for post-April 2006 service including the introduction of the Longevity Adjustment Factor, a reduction in the maximum level of pension increases and a change in the definition of Pensionable Pay.

The ExPS tops up the underlying employee plan to provide a target benefit for executive directors payable from normal retirement age of 1/30th of Final Pensionable Pay (FPP) for each year of ExPS pensionable service (subject to a maximum of two-thirds of FPP). FPP is defined as annual base salary averaged over the last 12 months prior to leaving service in respect of service accrued to 5 April 2006 and 36 months prior to leaving in respect of service from 6 April 2006. The ExPS also provides a lump sum death-in-service benefit equal to four times base salary at date of death, and a spouse's death-in-service pension equal to two-thirds of the prospective pension at normal retirement age. Children's allowances are also payable, usually up to the age of 18. Spouses' pensions and children's allowances are also payable upon death in retirement and death after leaving the Company's employment with a deferred pension. Once in payment, pensions are increased annually by the rise in the Retail Price Index subject to a maximum increase of 5% per year in respect of pre-6 April 2006 service and 2.5% per year in respect of service from 6 April 2006.

As a result of the 2006 age discrimination legislation, executive directors' retirement age is 65 but they retain any previous rights they had to retire and draw their pensions without actuarial reduction for early payment at an earlier age.

Following the changes made to take account of the Pensions Simplification tax changes which came into effect from April 2006, UK executives reaching the Lifetime Allowance (LTA) were given a number of choices as previously reported. These were:

– remain in the pension scheme and pay any additional tax charge; or
– opt out of the pension scheme (and so earn no further pension benefits in respect of future service) and instead receive a taxable salary supplement. This supplement will be 30% of salary and 20% of salary for those senior executives with a two-thirds salary target after at least 20 years' and 30 years' service, respectively; or
– restrict scheme benefits to the value of the LTA with the remainder being provided directly from the Company as an unfunded promise. At retirement, the unfunded Company benefits can be either taken as pension or commuted in full for a taxable lump sum.

The Committee reviews these arrangements each year in the light of developing market practice, and believes they remain appropriate as they provide executives with competitive pension benefits and choices for dealing with the LTA which may better suit their needs whilst being broadly cost neutral to the Company, are in line with market practice and do not compensate executives for changes in taxation.

The review carried out in 2010 concluded that the arrangements should continue to be based on the Company's registered pension schemes and that, in appropriate circumstances, the Company will continue to have the option to offer an unfunded pension promise so as to mitigate the impact of the Lifetime Allowance (introduced in 2006) and the impact of the reduced Annual Allowance with effect from 6 April 2011. This arrangement addresses tax-inefficiencies arising for existing employees as a consequence of the pension tax changes although members will be given the choice to remain in the current arrangement and pay the increased tax. The Committee has decided that in cases where the Company is to pay an unfunded promise, executives will be given the choice to commute some or all of the benefit for a taxable lump sum, or take it as pension.

Ian King and **Peter Lynas** already have an unfunded promise from the Company arising from the 2006 changes, which has been extended to cover the reduced Annual Allowance at no additional cost to the Company.

Ian King and Peter Lynas are both members of the BAE Systems 2000 Pension Plan (the 2000 Plan), applicable to former employees of Marconi Electronic Systems (MES), and members of the ExPS with a normal retirement age of 62. The 2000 Plan provides a pension of 1/50th of Final Pensionable Earnings (FPE) for each year of pensionable service, payable from a normal retirement age of 65 and members pay contributions of 8% of Pensionable Earnings. FPE under

REMUNERATION REPORT *(continued)*

the 2000 Plan is the best consecutive three-year average of base salary and bonus in the ten Plan Years prior to leaving, less an offset for State pensions. The Company decided in 2006 to limit pensionable bonuses in the 2000 Plan in the 2006/07 Plan Year to 20% of base salary and to 10% of base salary for the 2007/08 Plan Year and thereafter. However, there is a guarantee that the FPE figure for benefits in respect of service prior to 6 April 2007 will not be less than the FPE figure at 5 April 2007 to ensure that employees do not lose the benefit of contributions paid on past bonuses. Ian King and Peter Lynas joined the ExPS in 1999 following the BAe/MES merger. Therefore their individual total pensions are the sum of their 2000 Plan benefits plus the top up from the ExPS, some of which is provided through the unfunded promise referred to above.

US pension benefits

Linda Hudson is a member of the 2006 Plan and a Non-Qualified Plan which provide a cash sum at retirement equal to a percentage of career average pay (salary plus bonus subject to a maximum bonus of 150% of salary). The cash accrual rate of the combined plans from 1 January 2010 is 14.1% of career average pay. Executive directors pay contributions at the same rates as other employees in the plan, being 1.5% of earnings. Linda Hudson also receives a company match on her contributions to her 401(k) plan up to a maximum contribution of 6% of salary, up to regulatory limits ($245,000). From 1 January 2010, the company match was 85%.

Details of post-retirement benefits for each of the executive directors who served during 2011 are shown in Table D on page 100 and are calculated in accordance with the requirements of Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Other benefits

Other benefits provided to executive directors are detailed under Table C on page 99.

Further to his appointment as Group Finance Director on 1 April 2011, it was agreed that Peter Lynas would be provided with Company support to establish a second home in London as the Committee believed this to be a more cost-effective option for the Company than requiring full relocation of his principal residence from outside London. This support is in accordance with Company policy, and consists of a lump sum of £22,200, together with a monthly allowance totalling £33,300 in year one declining on a uniform basis to £6,660 in year five (such monthly allowances over the five-year period totalling £99,900), and zero thereafter. Clawback provisions operate during the first two years of this arrangement whereby he would be required to repay these monies on a pro-rata basis should he leave the Company in certain circumstances, e.g. resignation or termination. No payments have yet been made under this arrangement.

Executive directors' service contracts

It is the Committee's policy that executive directors should normally have service contracts that provide for the Company to give the individual 12 months' notice of termination. This policy has been chosen because it provides a reasonable balance between the need to retain the services of key individuals and the need to limit the liabilities of the Company in the event of the termination of a contract. The executive directors have service contracts with Group companies and details of these are shown below.

Director	Date of contract	Unexpired term	Notice period
Linda Hudson	26 October 2009 (amended 8 January 2010)	31 December 2012*	90 days either party
Ian King	27 June 2008	No fixed term	12 months either party
Peter Lynas	16 February 2011 (effective 1 April 2011)	No fixed term	12 months either party

* Subject to automatic renewal for one-year periods each year unless either party gives notice of non-renewal.

In the event of the termination of an executive director's contract it is the Committee's policy to seek to limit any payment made in lieu of notice to a payment equal to the amount of one year's base salary. The service contracts for Ian King and Peter Lynas contain specific provisions to the effect that the Company has the right to pay a sum equivalent to 12-months' salary in lieu of notice.

Linda Hudson's contract of employment automatically renews for one-year periods from 31 December each year, unless one party gives notice of non-renewal. Separately, there is a 90-day termination provision. If the employment is (a) terminated by the Company (other than for cause as defined in the contract or in the event it is not extended following her 65th birthday) or (b) she resigns for a 'Good Reason' (as defined in her contract), she is entitled to a termination payment equal to (i) one year's base salary, (ii) a pro-rated bonus for the relevant financial year, and (iii) the continuation of 18-months' medical benefits, plus a further 18-months' subsidy of a portion of the premiums (or a cash payment in lieu of this benefit).

George Rose retired from the Company, and as a director, on 31 March 2011. He was employed under a service contract dated 16 November 1998 (amended 3 December 1999, 15 January 2004 and 17 October 2005). No termination payments were made when his contract ended. All outstanding long-term incentive awards and share options will vest in accordance with the rules of the respective share plans, i.e. subject to the attainment of the related performance conditions and pro-rating in accordance with the length of his service against the relevant performance period. As reported last year, on leaving the Company, he was granted consent from the Company to early retirement and his pension benefits became payable from 1 April 2011, one year early. His pension was subject to the normal actuarial reduction for early payment that would be applied to any other member of the Executive Pension Scheme in these circumstances.

No executive director has provisions in his or her service contract that relate to a change of control of the Company (and neither does the Chairman nor the non-executive directors in their letters of appointment).

Policy on external board appointments

The long-standing policy of allowing executive directors to hold external non-BAE Systems-related non-executive directorships with the prior approval of the Committee will continue. The Committee considers that external directorships provide the Company's senior executives with valuable experience that is of benefit to BAE Systems. It is also considered appropriate for BAE Systems to contribute to the pool of non-executive expertise available for the benefit of the wider business community, thereby reciprocating the benefit that it in turn has received from other organisations which have permitted members of their senior management teams to serve on the BAE Systems Board. The Committee believes that it is reasonable for the individual executive director to retain any fees received from such appointments given the additional personal responsibility that this entails. Such fees retained by executive directors in 2011 for the period in which they served on the BAE Systems Board were as follows: Ian King £44,000 in respect of his non-executive directorship of Rotork plc and George Rose £22,750 in respect of his non-executive directorship of National Grid plc.

Chairman's appointment, term and fees

Dick Olver was appointed Chairman on 1 July 2004. His appointment was for an initial fixed three-year term with effect from 17 May 2004 (the date that he was appointed to the Board as a non-executive director) and was subsequently extended in 2007 for a second term of three years to 16 May 2010. Following the approval of the Board under the chairmanship of Sir Peter Mason, Senior Independent Director, it was extended again in 2009 for a third term to 16 May 2013, and subsequently in 2011 to 16 May 2014 unless terminated earlier in accordance with the Articles of Association or with either party giving the other not less than six months' prior written notice.

The Chairman's appointment is documented in a letter of appointment which is not a contract of employment and he is required to devote no fewer than two days a week to his duties as Chairman. His appointment as Chairman will automatically terminate if he ceases to be a director of the Company. Recognising that the Chairman's fees had not changed since 2007, the Remuneration Committee undertook a review of the level of his fees in 2011 taking into account, amongst other things, the scope of the duties performed by the Chairman of the Company. As a result, his fee was set at £725,000 per annum with effect from 1 June 2011. This fee will not be reviewed again during his current term of office, which ends on 16 May 2014.

Non-executive directors' appointment, term and fees

The non-executive directors do not have service contracts but do have letters of appointment detailing the basis of their appointment. The dates of their original appointment were as follows:

Non-executive director	Date of appointment	Expiry of current term*
Paul Anderson	08.10.2009	07.10.2012
Harriet Green	01.11.2010	31.10.2013
Michael Hartnall	10.06.2003	02.05.2012
Lee McIntire	01.06.2011	31.05.2014
Sir Peter Mason	22.01.2003	21.01.2013
Paula Rosput Reynolds	01.04.2011	31.03.2014
Nick Rose	08.02.2010	07.02.2013
Carl Symon	11.06.2008	10.06.2014

* Subject to re-election at the AGM following their appointment and subsequently at intervals of no more than three years in accordance with the Company's Articles of Association.

The non-executive directors are normally appointed for two consecutive three-year terms subject to review after the end of the first three-year period and with any third term of three years being subject to rigorous review and taking into account the need progressively to refresh the Board. They do not have periods of notice and the Company has no obligation to pay compensation when their appointment terminates. Under the Company's Articles of Association, they are subject to re-election at the AGM following their appointment and subsequently at intervals of no more than three years.

Sir Peter Mason completed his third three-year term as a non-executive director on 21 January 2012. After careful consideration by the Board as to whether he remained independent despite the length of time that he had served on the Board, the Board concluded that he did remain independent and that his appointment should continue for a further 12 months to 21 January 2013. Further details on the rationale for this decision are set out on page 105.

Having completed a three-year term of appointment, Ravi Uppal retired from the Board on 1 April 2011 having originally been appointed to the Board on 2 April 2008. Roberto Quarta retired from the Board on 31 December 2011 having originally been appointed to the Board on 7 September 2005. Michael Hartnall will stand down from the Board at the AGM on 2 May 2012.

In compliance with the UK Corporate Governance Code, all members of the Board submit themselves for re-election on an annual basis at the AGM.

Non-executive directors are proposed by the Nominations Committee and are appointed by the Board on the basis of their experience to provide independent judgement on issues of strategy, performance, resources and standards of conduct.

Following publication of the UK Corporate Governance Code in 2010, the time commitment expectations for non-executive directors were reviewed and, with their agreement, their Letters of Appointment were amended to reflect that they need to commit approximately two days for each of the Board meetings scheduled during the year, to cover attendance and preparation for the meeting. Additional time commitments will include attending scheduled Board committee meetings, strategy review meetings and ad hoc meetings of the Board (or sub-committees of the Board) that may be called from time to time. The non-executive directors are aware that it is not possible to be specific as to exact time commitments as this will vary according to the nature of the matters that the Board is required to deal with at any point in time. Newly appointed non-executive directors also have to dedicate additional time to induction activities. The level of their fees is set by the Non-Executive Directors' Fees Committee to reflect this time commitment and responsibility, and after reviewing practice in other comparable companies. Having undertaken its review in January 2012, the Committee decided to increase the fee for the Audit Committee Chairman to £25,000 per annum and to increase the travel allowance by £500. The non-executive directors' fees for 2012 will therefore be as follows:

	2011 fee	**2012 fee**
Base fee	£75,000	**£75,000**
Additional fee for chairing committees:		
Audit Committee	£20,000	**£25,000**
Corporate Responsibility Committee	£20,000	**£20,000**
Remuneration Committee	£20,000	**£20,000**
Additional fee for Senior Independent Director	£20,000	**£20,000**
Travel allowance (per meeting)*	£4,000	**£4,500**

* The travel allowance of £4,500 (2011 £4,000) per meeting is paid on each occasion that a non-executive director's attendance at a Board meeting necessitates air travel of more than five hours (one-way) to the meeting location, subject to a maximum of six travel allowances per year.

The table below summarises the fee structure for 2011 and 2012:

Non-executive director	2011 fee*	**2012 fee***
Chairman Audit Committee	£95,000	**£100,000**
Chairman Corporate Responsibility Committee	£95,000	**£95,000**
Chairman Remuneration Committee	£95,000	**£95,000**
Senior Independent Director	£95,000	**£95,000**
Other non-executive directors	£75,000	**£75,000**

* Excludes the travel allowance per meeting referred to above.

On behalf of the Board

Dick Olver
Chairman

15 February 2012

REMUNERATION REPORT *(continued)*

Tabular information on directors' shareholdings, share-based incentives, emoluments and pensions

TABLE A: DIRECTORS' INTERESTS

	As at 1 January 2011*					**As at 31 December 2011**				
	Ordinary shares	Executive Share Option Plan	Share Matching Plan	Performance Share Plan	Restricted Share Plan	**Ordinary shares**	**Executive Share Option Plan**	**Share Matching Plan**	**Performance Share Plan**	**Restricted Share Plan**
P M Anderson	10,000	–	–	–	–	**60,000**	–	–	–	–
H Green	–	–	–	–	–	–	–	–	–	–
M J Hartnall	20,000	–	–	–	–	**20,000**	–	–	–	–
L P Hudson	253,390	133,740	196,291	685,355	–	**329,289**	**133,740**	**415,901**	**917,265**	**119,743**
I G King	873,422	1,132,008	912,728	1,712,771	–	**1,103,928**	**1,132,008**	**1,229,194**	**2,070,716**	–
P J Lynas[1]	212,598	162,795	75,026	295,401	–	**233,937**	**162,795**	**108,578**	**541,563**	–
Sir Peter Mason	25,283	–	–	–	–	**25,283**	–	–	–	–
L McIntire[2]	–	–	–	–	–	–	–	–	–	–
R L Olver	40,000	–	–	–	–	**53,343**	–	–	–	–
R Quarta[3]	–	–	–	–	–	–	–	–	–	–
P Rosput Reynolds[1,4]	1,200	–	–	–	–	**1,200**	–	–	–	–
N C Rose	55,000	–	–	–	–	**55,000**	–	–	–	–
C G Symon	10,000	–	–	–	–	**20,000**	–	–	–	–

* or upon appointment.

1 Appointed as a director on 1 April 2011.
2 Appointed as a director on 1 June 2011.
3 Retired as a director on 31 December 2011.
4 The ordinary shares held by Paula Rosput Reynolds are represented by 300 American Depositary Shares.

The table above gives details of the interests in ordinary shares in BAE Systems plc held by directors and their connected persons for those individuals who were directors of the Company as at 31 December 2011. There have been no changes in the interests of the current directors listed in the table above between 31 December 2011 and 15 February 2012 with the exception of the interests in the ordinary shares of Ian King who has acquired an additional 118 ordinary shares since 31 December 2011 under the partnership and matching shares elements of the Share Incentive Plan so that his beneficial shareholding at the date of this report stood at 1,104,046.

The Company's register of directors' interests (which is open to inspection) contains full details of directors' share interests.

Information subject to audit
The Auditors are required to report on the information contained in Tables B, C and D on pages 95 to 100.

TABLE B: SHARE OPTIONS AND LONG-TERM INCENTIVE PLAN (LTIP) AWARDS – IAN KING

Share options	1 January 2011	Granted during the year	Exercised during the year	Lapsed during the year	31 December 2011	Exercise price £	Date of grant	Date of exercise or lapse	Market price on exercise £	Date from which exercisable	Expiry date
PSP^{TSR}	26,601	–	26,601	–	–	nil	12.04.06	08.09.11	2.76	12.04.11[1,2]	12.04.13
PSP^{TSR}	122,039	–	–	122,039	–	nil	26.03.08	07.03.11	–	26.03.11[3]	26.03.15
PSP^{EPS}	122,039	–	–	6,652	–	nil	07.05.08	07.03.11	–	26.03.11[3]	26.03.15
		–	38,462	–	76,925	nil		18.05.11	3.33	26.03.11[1,4]	26.03.15
PSP^{TSR}	103,467	–	–	103,467	–	nil	08.09.08	10.08.11	–	08.09.11[3]	08.09.15
PSP^{EPS}	103,467	–	–	5,639	–	nil	08.09.08	10.08.11	–	08.09.11[3]	08.09.15
		–	32,609	–	65,219	nil		08.09.11	2.76	08.09.11[1,4]	08.09.15
PSP^{TSR}	328,227	–	–	–	328,227	nil	24.03.09	–	–	24.03.12[5]	24.03.16
PSP^{EPS}	328,228	–	–	–	328,228	nil	24.03.09	–	–	24.03.12[5]	24.03.16
PSP^{TSR}	289,351	–	–	–	289,351	nil	23.03.10	–	–	23.03.13[6]	23.03.17
PSP^{EPS}	289,352	–	–	–	289,352	nil	23.03.10	–	–	23.03.13[6]	23.03.17
PSP^{TSR}	–	346,707	–	–	346,707	nil	18.05.11	–	–	18.05.14[6]	18.05.18
PSP^{EPS}	–	346,707	–	–	346,707	nil	18.05.11	–	–	18.05.14[6]	18.05.18
	1,712,771	**693,414**	**97,672**	**237,797**	**2,070,716**						
ExSOP	318,314	–	–	–	318,314	1.72	30.09.03	–	–	30.09.06[1]	30.09.13
ExSOP	272,388	–	–	–	272,388	2.01	30.03.04	–	–	30.03.07[1]	30.03.14
ExSOP	221,903	–	–	–	221,903	2.64	24.03.05	–	–	24.03.08[1]	24.03.15
ExSOP	145,443	–	–	–	145,443	4.28	12.04.06	–	–	12.04.09[1]	12.04.16
ExSOP	173,960	–	–	–	173,960	4.57	30.03.07	–	–	30.03.10[1]	30.03.17
	1,132,008	**–**	**–**	**–**	**1,132,008**						

LTIPs	1 January 2011	Granted during the year	Vested during the year	Lapsed during the year	31 December 2011	Market price at date of award £	Date of award	Date of vesting	Market price on vesting £
SMP	109,411	–	109,411	–	–	4.86	26.03.08	28.03.11[1]	3.29
SMP	371,616	–	–	–	371,616	3.43	24.03.09	24.03.12[5]	–
SMP	431,701	–	–	–	431,701	3.80	23.03.10	23.03.13[6]	–
SMP	–	425,877	–	–	425,877	3.37	18.05.11	18.05.14[6]	–
	912,728	**425,877**	**109,411**	**–**	**1,229,194**				

Ian King's SMP award that vested on 28 March 2011 attracted reinvested dividends which equated on vesting to an additional 14,290 shares. The market price on vesting was £3.29.

His PSP awards exercised on 18 May 2011 and 8 September 2011 also attracted reinvested dividends which equated on exercise to an additional 4,360 and 3,696 shares, respectively. The market prices on exercise were £3.33 and £2.76, respectively.

Note: Performance conditions for the options and awards set out above are detailed in the notes to Table B on pages 95 and 96.

1 Subject to a performance condition that has been met.
2 'Date from which exercisable' refers to the date on which the portion of the option exercised during the year became exercisable.
3 The award lapsed, or partially lapsed, during the financial year under review having not met the full performance condition.
4 As (2) above. The option over shares remaining at the year end is exercisable in two tranches on the fourth and fifth anniversary of grant.
5 The outstanding award lapsed, or partially lapsed, after the end of the financial year having not met the full performance condition.
6 Subject to a performance condition that is yet to be tested.

PERFORMANCE SHARE PLAN (PSP)

A full description of the PSP is set out on pages 88 and 89. PSP awards granted since 2008 attract dividends prior to vesting.

PSP^{TSR} – nil vesting if the Company's Total Shareholder Return (TSR) at the end of the three-year performance period is outside the top 50% of TSRs achieved by a sectoral comparator group; 25% vesting if TSR is at median (50%); and 100% vesting if TSR is in the top 20%, with vesting on a straight-line basis between these two points.

PSP^{EPS} – proportion of the award exercisable is determined by the rate of average annual EPS growth over the three-year performance period, with nil vesting at average annual EPS growth of 5% or less, 100% vesting at 11% growth, and vesting on a straight-line basis between these two points.

Awards that vest are exercisable in three tranches at the end of years three, four and five (except for US executives where the awards are automatically delivered at the end of years three, four and five, subject to the performance condition being achieved).

REMUNERATION REPORT *(continued)*

TABLE B: SHARE OPTIONS AND LONG-TERM INCENTIVE PLAN (LTIP) AWARDS – PETER LYNAS

Share options	1 April 2011	Granted during the year	Exercised during the year	Lapsed during the year	31 December 2011	Exercise price £	Date of grant	Date of exercise or lapse	Market price on exercise £	Date from which exercisable	Expiry date
PSP[TSR]	13,880	–	13,880	–	–	nil	12.04.06	24.06.11	3.06	12.04.11[1,2]	12.04.13
PSP[EPS]	37,976	–	12,658	–	25,318	nil	26.03.08	24.06.11	3.06	26.03.11[1,3]	26.03.15
PSP[TSR]	63,822	–	–	–	63,822	nil	24.03.09	–	–	24.03.12[4]	24.03.16
PSP[EPS]	63,822	–	–	–	63,822	nil	24.03.09	–	–	24.03.12[4]	24.03.16
PSP[TSR]	57,950	–	–	–	57,950	nil	23.03.10	–	–	23.03.13[5]	23.03.17
PSP[EPS]	57,951	–	–	–	57,951	nil	23.03.10	–	–	23.03.13[5]	23.03.17
PSP[TSR]	–	136,350	–	–	136,350	nil	18.05.11	–	–	18.05.14[5]	18.05.18
PSP[EPS]	–	136,350	–	–	136,350	nil	18.05.11	–	–	18.05.14[5]	18.05.18
	295,401	**272,700**	**26,538**	**–**	**541,563**						
ExSOP	13,386	–	–	–	13,386	3.56	22.12.05	–	–	22.12.08[1]	22.12.15
ExSOP	75,887	–	–	–	75,887	4.28	12.04.06	–	–	12.04.09[1]	12.04.16
ExSOP	73,522	–	–	–	73,522	4.57	30.03.07	–	–	30.03.10[1]	30.03.17
	162,795	**–**	**–**	**–**	**162,795**						

LTIPs	1 April 2011	Granted during the year	Vested during the year	Lapsed during the year	31 December 2011	Market price at date of award £	Date of award	Date of vesting	Market price on vesting £
SMP	42,142	–	–	–	42,142	3.43	24.03.09	24.03.12[4]	–
SMP	32,884	–	–	–	32,884	3.80	23.03.10	23.03.13[5]	–
SMP	–	33,552	–	–	33,552	3.37	18.05.11	18.05.14[5]	–
	75,026	**33,552**	**–**	**–**	**108,578**				

The above table reflects the position on Peter Lynas' appointment to the Board on 1 April 2011 to the year end. Peter Lynas' 2008 PSP award exercised on 24 June 2011 attracted reinvested dividends which equated on exercise to an additional 1,652 shares. The market price on vesting was £3.06.

Note: Performance conditions for the options and awards set out above are detailed in the notes to Table B on pages 95 and 96.

1 Subject to a performance condition that has been met.
2 'Date from which exercisable' refers to the date on which the portion of the option exercised during the year became exercisable.
3 As (2) above. The option over shares remaining at the year end is exercisable in two tranches on the fourth and fifth anniversary of grant.
4 The outstanding award lapsed, or partially lapsed, after the end of the financial year having not met the full performance condition.
5 Subject to a performance condition that is yet to be tested.

EXECUTIVE SHARE OPTION PLAN (EXSOP)

No options have been granted under this Plan since 2007. The Plan was established in 2001 and its ten-year life expired in 2011. No further grants will be made under this Plan. Options granted under this Plan are normally exercisable between the third and tenth anniversary of grant. The maximum duration of an option is ten years.

(i) **2005-2007 grants** – 33.33% of each option grant is exercisable if the Company achieves on average real EPS growth pa of 3% but less than 4% over the three-year performance period; 66.67% for real EPS growth pa of 4% but less than 5%; and 100% for real EPS growth of 5% or more;

(ii) **2004 grant** – as in (i) but performance is retested at the end of year five against the full period from grant; and

(iii) **2003 grant** – as in (i) but performance is retested at the end of years four and five against the full period from grant.

SHARE MATCHING PLAN (SMP) – MATCHING SHARES

A full description of the SMP is set out on page 90. SMP awards attract dividends prior to vesting.

2009-2011 awards – nil match for average EPS growth of less than 5% pa increasing uniformly to a 2:1 match at 11% pa growth.

2008 award – nil match for average EPS growth of 5% pa or less, increasing uniformly to a 1:1 match for 8% pa growth.

RATIONALE FOR KEY PERFORMANCE MEASURES FOR PSP, EXSOP AND SMP

EPS – importance to major investors as a key indicator of long-term financial performance and value creation.

TSR (and secondary financial measure) – importance to major investors as an indication of both earnings and capital growth relative to major companies in the same sector, and to ensure that awards only vest if there has been a clear improvement in the Company's performance over the relevant period.

TABLE B: SHARE OPTIONS AND LONG-TERM INCENTIVE PLAN (LTIP) AWARDS – LINDA HUDSON

Share options	1 January 2011	Granted during the year	Released during the year	Lapsed during the year	31 December 2011	Exercise price £	Date of grant	Date of exercise, release or lapse	Market price on release £	Date from which exercisable	Expiry date
PSP^{TSR}	45,881	–	–	45,881	–	nil	26.03.08	07.03.11	–	26.03.11[1]	26.03.15
PSP^{EPS}	45,882	–	–	2,501	–	nil	26.03.08	07.03.11	–	26.03.11[1]	26.03.15
		–	14,460	–	28,921	nil		28.03.11	3.29	26.03.11[2,3]	26.03.15
PSP^{TSR}	104,813	–	–	–	104,813	nil	24.03.09	–	–	24.03.12[4]	24.03.16
PSP^{EPS}	104,813	–	–	–	104,813	nil	24.03.09	–	–	24.03.12[4]	24.03.16
PSP^{TSR}	191,983	–	–	–	191,983	nil	23.03.10	–	–	23.03.13[5]	23.03.17
PSP^{EPS}	191,983	–	–	–	191,983	nil	23.03.10	–	–	23.03.13[5]	23.03.17
PSP^{TSR}	–	147,376	–	–	147,376	nil	18.05.11	–	–	18.05.14[5]	18.05.18
PSP^{EPS}	–	147,376	–	–	147,376	nil	18.05.11	–	–	18.05.14[5]	18.05.18
	685,355	**294,752**	**14,460**	**48,382**	**917,265**						
ExSOP	133,740	–	–	–	133,740	4.57	30.03.07	–	–	30.03.10[2]	30.03.17
	133,740	**–**	**–**	**–**	**133,740**						

LTIPs	1 January 2011	Granted during the year	Vested during the year	Lapsed during the year	31 December 2011	Market price at date of award £	Date of award	Date of vesting	Market price on vesting £
SMP	99,908	–	–	–	99,908	3.43	24.03.09	24.03.12[4]	–
SMP	96,383	–	–	–	96,383	3.80	23.03.10	23.03.13[5]	–
SMP	–	219,610	–	–	219,610	3.37	18.05.11	18.05.14[5]	–
	196,291	**219,610**	**–**	**–**	**415,901**				
RSP	–	119,743	–	–	119,743	3.37	18.05.11	18.05.14	–
	–	**119,743**	**–**	**–**	**119,743**				

Linda Hudson's PSP award which vested on 28 March 2011 also attracted reinvested dividends which equated on release to an additional 1,888 shares. The market price on vesting was £3.29.

Note: Performance conditions for the options and awards set out above are detailed in the notes to Table B on pages 95 and 96.

1 The award lapsed, or partially lapsed, during the financial year under review having not met the full performance condition.
2 Subject to a performance condition that has been met.
3 'Date from which exercisable' refers to the date on which the portion of the award released during the year became available for release. The portion of the award of shares remaining at the year end will be delivered in two tranches on the fourth and fifth anniversary of grant.
4 The outstanding award lapsed, or partially lapsed, after the end of the financial year having not met the full performance condition.
5 Subject to a performance condition that is yet to be tested.

Note: Awards granted to Linda Hudson (a US national) under the PSP are technically characterised as long-term incentives rather than options as, subject to the attainment of the performance condition, they are delivered automatically on the third, fourth and fifth anniversary of grant without the need to exercise an option. They are shown in the top portion of the table for ease of comparison. Gains on delivered PSP awards for Linda Hudson are included in the directors' gains on LTIPs figure on page 98 whilst PSP gains for the UK-based directors are included in the share option gain figure.

RESTRICTED SHARE PLAN (RSP)

The RSP is the time-vesting long-term incentive plan element applicable to senior executives in the US. Approved by shareholders at the 2011 AGM, it does not have performance elements attached to it other than time-vesting conditions as it seeks to mirror US remuneration practices where performance-related LTIP awards only typically make up around one-third of the overall long-term incentive package for a US executive.

REMUNERATION REPORT *(continued)*

TABLE B: SHARE OPTIONS AND LONG-TERM INCENTIVE PLAN (LTIP) AWARDS – GEORGE ROSE[1]

Share options	1 January 2011	Granted during the year	Exercised during the year	Lapsed during the year	31 December 2011	Exercise price £	Date of grant	Date of exercise or lapse	Market price on exercise £	Date from which exercisable	Expiry date
PSP[TSR]	33,972	–	33,972	–	–	nil	12.04.06	08.06.11	3.21	12.04.10[2,3]	12.04.13
PSP[TSR]	122,039	–	–	122,039	–	nil	26.03.08	07.03.11	–	26.03.11[4]	26.03.15
PSP[EPS]	122,039	–	–	6,652	–	nil	07.05.08	07.03.11	–	26.03.11[4]	26.03.15
		–	115,387	–	–	nil		08.06.11	3.21	26.03.11[2,3]	26.03.15
PSP[TSR]	227,024	–	–	75,675	151,349	nil	24.03.09	31.03.11	–	24.03.12[1,5]	24.03.16
PSP[EPS]	227,024	–	–	75,675	151,349	nil	24.03.09	31.03.11	–	24.03.12[1,5]	24.03.16
PSP[TSR]	200,135	–	–	133,424	66,711	nil	23.03.10	31.03.11	–	23.03.13[1,6]	23.03.17
PSP[EPS]	200,135	–	–	133,424	66,711	nil	23.03.10	31.03.11	–	23.03.13[1,6]	23.03.17
	1,132,368	**–**	**149,359**	**546,889**	**436,120**						
ExSOP	185,747	–	–	–	185,747	4.28	12.04.06	–	–	12.04.09[2]	12.04.16
ExSOP	183,807	–	–	–	183,807	4.57	30.03.07	–	–	30.03.10[2]	30.03.17
	369,554	**–**	**–**	**–**	**369,554**						

LTIPs	1 January 2011	Granted during the year	Vested during the year	Lapsed during the year	31 December 2011	Market price at date of award £	Date of award	Date of lapse	Date of vesting	Market price on vesting £
SMP	52,286	–	52,286	–	–	4.86	26.03.08	–	28.03.11[2]	3.29
SMP	175,413	–	–	58,471	116,942	3.43	24.03.09	31.03.11	24.03.12[5]	–
SMP	129,400	–	–	86,267	43,133	3.80	23.03.10	31.03.11	23.03.13[6]	–
	357,099	**–**	**52,286**	**144,738**	**160,075**					

George Rose's SMP award that vested on 28 March 2011 attracted reinvested dividends which equated on vesting to an additional 6,827 shares. The market price on vesting was £3.29. His 2008 PSP award exercised on 8 June 2011 also attracted reinvested dividends which equated on exercise to an additional 13,080 shares. The market price on exercise was £3.21.

Note: Performance conditions for the options and awards set out above are detailed in the notes to Table B on pages 95 and 96.

1 Retired as a director and from the Company on 31 March 2011. As at that date, options and awards outstanding totalled 369,554 under ExSOP, 585,479 under the PSP and 160,075 under the SMP. As stated in last year's Annual Report, all outstanding long-term incentive awards and share options will vest in accordance with the rules of the respective share plans, i.e. subject to the attainment of the related performance conditions and pro-rating in accordance with the length of his service against the relevant performance period. Pro-rating for the awards granted in 2009 and 2010 is shown in the 'Lapsed during the year' column.
2 Subject to a performance condition that has been met.
3 'Date from which exercisable' refers to the date on which the portion of the option exercised during the year became exercisable.
4 The award lapsed, or partially lapsed, during the financial year under review having not met the full performance condition.
5 The outstanding award lapsed, or partially lapsed, after the end of the financial year under review having not met the full performance condition.
6 Subject to a performance condition that is yet to be tested. Award has been pro-rated in accordance with length of service against performance period.

SHARE PRICE INFORMATION

The mid-market price for the Company's ordinary shares at 31 December 2011 was 285.1p (2010 330.0p). The range during the year was 248.1p to 361.1p.

AGGREGATE AMOUNT OF GAINS MADE BY DIRECTORS

The aggregate amount of gains made by directors from the exercise of share options in 2011, as calculated at the date of exercise, was £402,249 (2010 £655,392). The net aggregate value of assets received by directors in 2011 from Long-Term Incentive Plans, as calculated at the date of vesting, was £654,645 (2010 £198,770).

TABLE C: DIRECTORS' REMUNERATION

	2011						2010					
	Base salary £'000	Fees £'000	Bonus £'000	Benefits £'000	Other pay £'000	Total £'000	Base salary £'000	Fees £'000	Bonus £'000	Benefits £'000	Other pay £'000	Total £'000
Chairman												
R L Olver	–	673	–	31	–	704	–	600	–	13	–	613
Executive directors												
L P Hudson	630	–	929	66	–	1,625	583	–	1,168	22	–	1,773
I G King	935	–	1,443	32	–	2,410	900	–	1,437	26	–	2,363
P J Lynas[1]	390	–	407	12	–	809	n/a	n/a	n/a	n/a	n/a	n/a
G W Rose[2]	160	–	–	10	–	170	623	–	645	28	–	1,296
Non-executive directors												
P M Anderson	–	95	–	–	20	115	–	76	–	–	20	96
P J Carroll[4]	n/a	n/a	n/a	n/a	n/a	n/a	–	23	–	–	8	31
H Green[3]	–	75	–	–	8	83	–	11	–	–	–	11
M J Hartnall	–	87	–	–	8	95	–	86	–	–	8	94
A G Inglis[4]	n/a	n/a	n/a	n/a	n/a	n/a	–	45	–	–	–	45
Sir Peter Mason	–	95	–	–	8	103	–	86	–	–	8	94
L McIntire[1]	–	44	–	–	8	52	n/a	n/a	n/a	n/a	n/a	n/a
R Quarta[2]	–	75	–	–	8	83	–	66	–	–	4	70
P Rosput Reynolds[1]	–	56	–	–	12	68	n/a	n/a	n/a	n/a	n/a	n/a
N C Rose[3]	–	83	–	–	8	91	–	59	–	–	4	63
C G Symon	–	95	–	–	20	115	–	86	–	–	20	106
R K Uppal[2]	–	19	–	–	–	19	–	66	–	–	20	86
	2,115	1,397	2,779	151	100	6,542	2,106	1,204	3,250	89	92	6,741

1 Appointed in 2011.
2 Retired in 2011.
3 Appointed in 2010.
4 Retired in 2010.

All emoluments and compensation paid to the directors during the year are shown above. Where the individual was appointed during the year the amount is shown from appointment.

The benefits received by the UK-based executive directors include, where appropriate, the provision of a car allowance and the private use of a chauffeur-driven car. The benefits received by the Chairman, Dick Olver, include the private use of a chauffeur-driven car and spousal attendance at events.

The benefits received by the US-based executive director include a cash allowance for a car and parking, private use of a chauffeur-driven car, medical examination, dental benefits, and insured life and disability benefits. In addition, her benefit figure includes £29,535 for private use of a Company aircraft (2010 £1,265).

The other pay received by the non-executive directors represents the travel allowance of £4,000 per meeting as set out on page 93.

There were no payments to former directors during the year other than the Company pension payments to Sir Richard Lapthorne, Sir Peter Gershon and George Rose referred to on page 100.

REMUNERATION REPORT *(continued)*

TABLE D: POST-RETIREMENT BENEFITS

	Age	NRA*	Accrued benefit at 1 January 2011[1] £ pa	Accrued benefit at 31 December 2011[1] £ pa	Change in accrued pension after allowing for inflation £ pa	Transfer value at 1 January 2011[2] £	Transfer value at 31 December 2011 £	Director's contributions £	Increase in value less director's contributions £
L P Hudson[3]	61	65	514,438	722,752	192,881	389,262	589,333	2,291	197,780
I G King[4]	55	62	585,228	677,983	74,947	8,174,403	11,645,676	82,000	3,389,273
P J Lynas[5]	53	62	236,127	282,937	39,610	3,111,808	4,631,241	41,496	1,477,937
G W Rose[6]	59	60	388,568	393,875	(6,542)	7,374,857	8,831,948	14,776	1,442,315

* Normal Retirement Age

1 Accrued benefits may be reduced if they are taken before the normal retirement age of the scheme. In addition, a longevity adjustment factor applies to UK pension accrued after 5 April 2006.

2 Transfer values have been calculated in accordance with GN11 issued by the actuarial profession. For UK-based directors the assumptions are the same as those used in the calculation of cash equivalents from the schemes. For US-based directors the assumptions are the same as those used for accounting disclosures. The increase in transfer value arising from the change in assumptions is: Linda Hudson: £7,077; Ian King: £1,840,533; Peter Lynas: £776,848.

3 Linda Hudson is a member of a US retirement plan which provides a cash sum at retirement equal to a percentage of career average pay. The accrued benefit shown above is a cash lump sum amount payable at normal retirement age. This benefit comprises £77,623 from a contributory Qualified Plan and £645,129 from Non-Qualified Plans. In addition, Linda Hudson participates in a Section 401(k) defined contribution arrangement set up for US employees in which the Company will match employee contributions up to a limit. In 2011, the Company paid contributions of £7,788 into this 401(k) arrangement during the year. Linda Hudson is paid in US dollars. Of the change in the accrued benefit and the transfer value £4,712 and £3,842, respectively, is due to currency movements.

4 Ian King has an unfunded unapproved retirement arrangement for benefits in excess of the Lifetime Allowance. The pension and transfer value figures shown are in respect of his total benefit.

5 Peter Lynas has an unfunded unapproved retirement arrangement for benefits in excess of the Lifetime Allowance. Peter Lynas was appointed as a director from 1 April 2011 and was a member of these pension arrangements before he became a director. The figures quoted for Peter Lynas' benefits assume one year of benefit accrual from 1 January 2011 to 31 December 2011.

6 George Rose retired from the Board on 31 March 2011. For the nine-month period between 1 April 2011 and 31 December 2011, the Company paid George Rose a pension of £150,978 (£50,774 from his funded approved arrangement and £100,204 from his unfunded unapproved arrangement) after having exchanged part of his approved pension for a tax-free lump sum of £450,000. The transfer value as at 31 December 2011 allows for this exchange of pension for tax-free cash.

Sir Peter Gershon and Sir Richard Lapthorne, both former directors, have unfunded pension arrangements. In 2011, the Company paid Sir Peter Gershon a pension of £117,113 (2010 £109,280) and Sir Richard Lapthorne a pension of £105,522 (2010 £102,382) in respect of these arrangements.

CORPORATE GOVERNANCE REPORT

Applying the principles of the UK's Corporate Governance Code
The following report details how the Board has applied the principles in the Financial Reporting Council's UK Corporate Governance Code (the 'Code'), as required by the UK Listing Rules.

Leadership

Principles – An effective board collectively responsible for the long-term success of the company • A clear division of responsibilities at the head of the company between the running of the board and the executive. No one individual should have unfettered powers of decision • The chairman is responsible for the leadership of the board and ensuring its effectiveness on all aspects of its role • Non-executive directors should constructively challenge and help develop proposals on strategy.

The Company's governance structure is based on the leadership principles in the Code. The core activities of the Board and its committees are documented and planned on an annual basis, and this forms the basic structure within which the Board operates. The Board has adopted a document, the Board Charter, in which there is a statement of governance principles that reflect principles contained in the Code, and covers the following:

- **Strategy** – reviewing and agreeing strategy;
- **Performance** – monitoring the performance of the Group and also evaluating its own performance;
- **Standards and values** – setting standards and values to guide the affairs of the Group;
- **Oversight** – ensuring an effective system of internal controls is in place, ensuring that the Board receives timely and accurate information on the performance of the Group and the proper delegation of authority; and
- **People** – ensuring the Group is managed by individuals with the necessary skills and experience, and that appointments to the Board are managed effectively.

The Board Charter also details the separate and distinct roles of the Chairman and the Chief Executive, and also those of the Senior Independent Director and Company Secretary. These are detailed on page 102, the role of the Chief Executive having been amended in 2011 with the addition of the following:

- Owning, and enacting when required, the Company's Crisis Management Procedures and supporting manual, including liaison with the Board.

Whilst the Board is ultimately responsible for the success of the Company, given the size and complexity of its operations, all but the most important matters are managed on a delegated basis by the Chief Executive and the executives working for him. The Board appoints the Chief Executive and monitors his performance in leading the Company, and providing operational and performance management in delivering the agreed strategy. Specifically, he is responsible for developing, for the Board's approval, appropriate values and standards to guide all activities undertaken by the Company, and also making recommendations on appropriate delegated responsibilities. The Operational Framework is the output from this process. It is a document that has evolved over time, subject to an annual review process that culminates in the Board's review and approval. In approving it the Board is agreeing the following:

- **Performance requirements and values** – i.e. Total Performance and the Values underpinning it.
- **Organisation structure** – the roles and accountabilities of the Board and certain senior individuals.
- **Governance standards** – the Group's trading principles, internal controls, operational assurance framework and risk management framework.
- **Core business processes** – covering business planning, project management, mergers and acquisitions, individual executive performance, and management of performance against business objectives, measures and milestones.
- **Delegated responsibilities** – dealing with the Board's delegation of authority concerning financial, commercial and legal matters.

The Board and its committees monitor the application of values, standards and processes. This includes a range of activities such as the formal review of the effectiveness of internal controls (see page 105).

To ensure that non-executive directors can constructively challenge and help develop proposals on strategy, the Board has adopted a process of reviewing the development of strategy and formally approving the agreed strategy for the Company on an annual basis. In 2011, the Board members were provided with opportunities to engage in strategy development through informal meetings and workshops as well as formal board meetings.

Effectiveness

Principles – Board and committees having an appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively • A formal, rigorous and transparent procedure for the appointment of new directors • All directors to be able to allocate sufficient time to the company to discharge their responsibilities effectively • All directors to receive induction on joining and should regularly update and refresh skills and knowledge • The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties • The board should undertake a formal and rigorous annual evaluation of its performance, and that of its committees and individual directors • All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Succession planning is used by the Board to deliver two key responsibilities, firstly to ensure that the Group is managed by executives with the necessary skills, experience and knowledge, and secondly to ensure that the Board itself has the right balance of individuals to be able to effectively discharge its responsibilities. The Nominations Committee has specific responsibilities in this area but the Board as a whole is also involved in overseeing the development of management resources in the Group with the aim of ensuring we have the individuals with the right skills to meet the needs of an increasingly complex and global business. The procedures for the appointment of non-executive and executive directors are detailed in the Nominations Committee report.

Following review by the Nominations and Corporate Responsibility committees, the Board adopted the statement shown on page 74 to act as a guide to future Board succession planning activity and to make a clear public statement of its support for greater diversity in the boardroom. This included the following with regards specifically to the Board:

- It shall have an aspirational target of at least 25% of the Board being women by 2015.
- In seeking candidates for appointment to the Board, the Nominations Committee shall only engage the services of search consultants who have open and inclusive recruitment processes that draw from an appropriately diverse pool of candidates.
- It shall report progress against targets and action taken in the Annual Report and Accounts.

There are currently three women on the BAE Systems Board, 25% of the total membership. Below the Board, there are two women on the Executive Committee, 17% of its total membership, and 19% of the Group's employees are women.

58 For more information on diversity and inclusion

CORPORATE GOVERNANCE REPORT *(continued)*

ROLES AND RESPONSIBILITIES

The role of the Chairman

The Chairman is responsible for creating the conditions for the effective working of the Board and is specifically responsible for the following:

- Chairing Board meetings and setting the agenda for such meetings, taking full account of the issues and concerns of all directors and encouraging their active engagement in Board discussion.
- Promoting the highest standards of corporate governance, including compliance with the UK Corporate Governance Code wherever possible.
- Promoting the requirement that all Board members are exemplars of the Company's values, principles and standards.
- Through the Nominations Committee, ensuring that the Board comprises individuals with an appropriate mixture of skills, experience and knowledge.
- Ensuring that the Company maintains effective communication with shareholders, and that their views and any concerns are understood by the Board.
- Working with the Chief Executive to ensure that the Board receives accurate and timely information on the performance of the Company.
- Representing the Company at the highest level and, in conjunction with the Chief Executive, developing strategic relationships with major customers and political leaders worldwide.
- Leading the evaluation of the performance of the Board, its committees and individual directors.
- Establishing an effective working relationship with the Chief Executive, providing support and advice whilst respecting executive responsibility.
- Ensuring that a well constructed induction programme is provided for new directors, that all directors have the opportunity to develop their understanding of the Company and that they are kept informed of matters affecting the Company.

The role of the Chief Executive

The Chief Executive is responsible for the leadership, and the operational and performance management of the Company within the strategy and business plan agreed by the Board.

The Chief Executive is specifically responsible for the following in respect of his/her relationship with the Board:

- Developing a business strategy for the Company to be approved by the Board on an annual basis.
- Producing business plans for the Company to be approved by the Board on an annual basis.
- Overseeing the management of the executive resource and succession planning processes, and presenting annually the output from these to the Board and Nominations Committee.
- Ensuring that effective business and financial controls, and risk management processes are in place across the Company, and that all relevant laws and regulations are complied with.
- Making recommendations to the Board on the appropriate delegation of authority within the Group.
- Keeping the Board informed regularly as to the performance of the Company and bringing promptly to the Board's attention all matters that materially affect, or are capable of materially affecting, the performance of the Company and the achievement of its strategy.
- Developing for the Board's approval appropriate values and standards to guide all activities undertaken by the Company.
- Providing clear and visible leadership in business conduct.
- Promoting the requirement that all Senior Leaders are exemplars of the Company's values, principles and standards.
- Owning the Company's commitment to all aspects of corporate responsibility.
- Owning, and enacting when required, the Company's Crisis Management Procedures and supporting manual, including liaison with the Board.

The role of the Senior Independent Director

The Senior Independent Director shall be responsible for the following:

- Being available to shareholders if they have concerns which contact through the normal channels of Chairman, Chief Executive or other executive directors has failed to resolve or for which such contact is inappropriate.
- Providing a sounding board for the Chairman and serving as an intermediary for the other directors when necessary.
- Chairing the Nominations Committee when it is considering the Chairman's succession.
- Providing feedback on the Chairman's performance as derived from the evaluation exercise undertaken by the Board.

The role of the Company Secretary

The Company Secretary is specifically responsible for the following:

- Under the direction of the Chairman, ensuring good information flows within the Board and its committees, and between senior management and non-executive directors, as well as facilitating induction activities for directors and assisting with their development as required.
- Advising the Board through the Chairman on all governance matters.

Effectiveness *(continued)*
All non-executive directors are advised of the likely time commitments at appointment and are asked to seek approval from the Nominations Committee if they wish to take on additional external appointments. The ability of individual directors to allocate sufficient time to the discharge of their responsibilities is considered as part of the directors' annual evaluation process overseen by the Chairman. Any issues concerning the Chairman's time commitment are dealt with by the Nominations Committee, chaired for this purpose by the Senior Independent Director.

An induction programme is agreed for all new directors aimed at ensuring that they are able to develop an understanding and awareness of the Company's core processes, its people and businesses. A typical induction programme is shown below.

In addition to the above, as part of the induction process, new directors will typically visit the Group's principal operations in order to meet employees and gain an understanding of the Group's products and services. Ongoing training is provided for the Board and individual directors as required.

The Chairman, with the assistance of the Chief Executive and Company Secretary, is responsible for ensuring that directors are supplied with information in a timely manner that is in a form and of a quality appropriate to enable them to discharge their duties. In the normal course of business, such information is provided by the Chief Executive in a regular report to the Board that includes information on operational matters, strategic developments, reports on the performance of Group operations, financial performance relative to the business plan, business development, corporate responsibility and investor relations.

For the last seven years, our annual Board effectiveness evaluations have been undertaken by Sheena Crane, an experienced consultant, whose only interest with BAE Systems is her work with the Board and undertaking similar performance evaluation work for the Executive Committee. She was appointed to perform this work in consultation with the Nominations Committee. The evaluation process is based on the facilitator interviewing each of the directors and recording their views on how the Board and its committees work, and on the performance of individual directors. Feedback on Board performance is presented to a meeting of the Board, which agrees actions and objectives for the following year based on the information the facilitator provides and the conclusions that the Board derives from this.

Individual directors are also subject to annual performance evaluation, and the Chairman meets with each director and provides feedback on a one-to-one basis. Committee chairmen also get feedback on committee performance. Feedback on the Chairman's performance is provided by the consultant directly to the Board's Senior Independent Director, who discusses this with the other non-executive directors before discussing this with the Chairman on a one-to-one basis. Subject to continued satisfactory performance, directors seek re-election on an annual basis.

Accountability

Principles – The board to present a balanced and understandable assessment of the company's position and prospects • The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems • The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles, and for maintaining an appropriate relationship with the company's auditor.

TYPICAL NON-EXECUTIVE DIRECTOR INDUCTION PROGRAMME

Head Office functions (approximately ten hours)	
Matters covered	*Facilitated by*
Duties of a director, conflicts of interest, Board procedures, corporate governance, Code of Conduct	Company Secretary
Business planning and control processes – Integrated Business Planning, financial controls	Director, Financial Control and Reporting
Strategy and planning processes	Group Strategy Director
Enterprise Metrics – the measures used by the Board and management to measure and monitor performance	Managing Director, Performance Excellence
Investor Relations	Investor Relations Director
Corporate Responsibility	Managing Director, Corporate Responsibility
Internal Audit	Head of Internal Audit
Business Development	Group Business Development Director
Meetings with senior executives (approximately four hours)	
Matters covered	*Facilitated by*
UK and International (London-based)	
Programmes & Support (UK defence businesses)	Group Managing Director, Programmes & Support
International (Saudi Arabia, Australia, India)	Group Managing Director, International
BAE Systems, Inc.	President and Chief Executive Officer, BAE Systems, Inc. Executive Vice Presidents, BAE Systems, Inc.
Operational site visits (approximately five days)	
UK	
Military Air & Information – Warton and Samlesbury, Lancashire	
Maritime (Naval Ships) – Portsmouth, Hampshire	
US	
Electronic Systems – Nashua, NH	
US Combat Systems – York, PA	

Governance

CORPORATE GOVERNANCE REPORT *(continued)*

Through this report and, as required, through other periodic financial statements, the Board is committed to providing shareholders with a clear assessment of the Company's position and prospects.

The arrangements established by the Board for the application of risk management and internal control principles are detailed on page 105. The Board has delegated to the Audit Committee oversight of the management of the relationship with the Company's auditors, further details of which can be found in the Audit Committee report on page 76.

Remuneration

Principles – Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance • There should be a formal and transparent procedure for developing policy on executive remuneration, and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

The Board has delegated to the Remuneration Committee responsibility for agreeing remuneration policy, and the individual remuneration of the executive directors, the Chairman, members of the Executive Committee and the Company Secretary (see Remuneration Report on pages 81 to 100). The Committee is formed exclusively of independent non-executive directors.

Relations with shareholders

Principles – There should be a dialogue with shareholders based on the mutual understanding of objectives • The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place • The board should use the AGM to communicate with investors and to encourage their participation.

The Company has a well-developed investor relations programme managed by the Chief Executive, Group Finance Director and Investor Relations Director. In addition, the Chairman is available to meet with major shareholders and is in regular contact with them so as to keep them informed of progress on corporate governance matters. In order to assist in developing an understanding of the views of major shareholders, each year the Company commissions a survey of investors undertaken by external consultants. The results of the survey are presented to the Board.

The Company maintains a comprehensive Investor Relations website that provides, amongst other things, information on investing in BAE Systems and copies of the presentation materials used for key shareholder presentations. This can be accessed via the Company's website, www.baesystems.com

The Company's AGM provides all shareholders with the opportunity to vote on the resolutions put to shareholders either electronically via the Company's website or by post. All resolutions detailed in the Notice of Meeting are voted on by way of a poll so as to ensure that all votes are counted on the basis of one vote for every share held. The result of the voting on all resolutions is published on the Company's website.

Compliance with the provisions of the Code

The Company was compliant with the provisions of the Code throughout 2011.

The Board

The Board comprises a non-executive chairman, eight non-executive directors and three executive directors.

The attendance by individual directors at meetings of the Board and its committees in 2011 is shown in the table below.

The Board considers all of the non-executive directors, with the exception of the Chairman, to be independent for the purposes of the Code. Each of these directors has been identified on pages 70 and 71 of this report.

The Board has appointed Sir Peter Mason as the Senior Independent Director. Amongst the duties undertaken by Sir Peter during the year was to meet with the non-executive directors without the Chairman present to discuss the Chairman's performance.

ATTENDANCE BY INDIVIDUAL DIRECTORS AT MEETINGS OF THE BOARD AND ITS COMMITTEES IN 2011

Director	Board	Audit Committee	Corporate Responsibility Committee	Nominations Committee	Remuneration Committee	Non-Executive Directors' Fees Committee
Mr P M Anderson	9 (9)	–	5 (5)	7 (7)	–	–
Ms H Green	8 (9)	–	5 (5)	–	–	–
Mr M J Hartnall	9 (9)	4 (4)	–	–	–	–
Ms L P Hudson	8 (9)	–	–	–	–	1 (1)
Mr I G King	9 (9)	–	–	–	–	1 (1)
Mr P J Lynas[1]	6 (6)	–	–	–	–	–
Sir Peter Mason	9 (9)	6 (6)	5 (5)	7 (7)	–	–
Mr L McIntire[2]	5 (5)	–	–	–	3 (3)	–
Mr R L Olver	9 (9)	–	–	7 (7)	–	–
Mr R Quarta[3]	8 (9)	1 (1)	–	–	4 (4)	1 (1)
Ms P Rosput Reynolds[1]	6 (6)	5 (5)	–	–	–	–
Mr G W Rose[4]	2 (3)	–	–	–	–	–
Mr N C Rose	8 (9)	6 (6)	–	–	8 (8)	–
Mr C G Symon	8 (9)	–	–	–	8 (8)	–
Mr R K Uppal[5]	2 (3)	1 (1)	–	–	–	–

Figures in brackets denote the maximum number of meetings that could have been attended.

1 Appointed to the Board on 1 April 2011.
2 Appointed to the Board on 1 June 2011.
3 Retired from the Board on 31 December 2011.
4 Retired from the Board on 31 March 2011.
5 Retired from the Board on 1 April 2011.

Sir Peter Mason has recently completed his third three-year term. Consequently, as required by the Code, the Board has considered whether he is independent notwithstanding the fact that he has served as a director for more than nine years. The Board used its externally facilitated annual evaluation process to provide Board members with the opportunity to consider individually whether they believed that Sir Peter remained independent despite the length of time he has served on the Board. The results of this were provided to the Chairman and he discussed the matter collectively with directors without Sir Peter in attendance. The directors concluded that he remains independent, and as such his appointment as Senior Independent Director and his membership of board committees should continue for a further period of 12 months. In reaching this decision, the Board noted that his period of office had not coincided to any significant degree with that of any of the current executive directors.

In 2011, the Board was scheduled to meet seven times and in addition two days were spent reviewing strategy. Additional Board meetings are called as required and in total the Board met nine times during the year.

The Company's Articles of Association require that all new directors seek re-election to the Board at the following AGM. In addition, the Board has agreed that in compliance with the UK Corporate Governance Code all directors shall seek re-election on an annual basis. The Board has set out in the Notice of Annual General Meeting their reasons for supporting the re-election of those directors seeking re-election at the forthcoming AGM.

Risk management and internal control

During the year, the Company announced that it had agreed a civil settlement with the US Department of State in connection with violations of the US defence export control regulations that were the subject of the Company's settlement with the US Justice Department in 2010. The Board has reviewed the control failures associated with these settlements, and believes that the Company has systematically enhanced relevant compliance policies and processes since the conduct referred to occurred.

The Board has conducted a review of the effectiveness of the Group's system of risk management and internal control processes, including financial, operational and compliance controls and risk management systems, in accordance with the Code and the Turnbull guidance (as revised).

BAE Systems has developed a system of internal control that was in place throughout 2011 and to the date of this report, that encompasses, amongst other things, the policies, processes, tasks and behaviours that, taken together, seek to:

– facilitate the effective and efficient operation of the Company;

– enable it to respond appropriately to significant operational, financial, compliance and other risks that it faces in carrying out its business;

– assist in ensuring that internal and external reporting is accurate and timely, and based on the maintenance of proper records supported by robust information-gathering processes; and

– assist in ensuring that the Company complies with applicable laws and regulations at all times, and also internal policies in respect of the standards of behaviour and conduct mandated by the Board.

On pages 60 and 61 of this report, you will find details of the processes the Company has put in place to manage risk. For the Board, the key requirements are that the Company has robust processes to identity, evaluate and manage risk, and that the directors have visibility of the major risks.

Risks are identified on a 'bottom-up' basis as part of the Company's Operational Assurance Statement (OAS) process. This process is mandated across the Group, and requires that the heads of all businesses and functions identify their key risks. As part of this process, an assessment is made of the probability of the risk arising and its potential impact on the Group's business plan. All risks have an owner who is responsible for production and implementation of plans aimed at mitigating the risk.

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

Management responsibility for the management of the Group's most significant non-financial risks is allocated at the Executive Committee's risk workshops. The OAS and Non-financial Risk registers are reviewed regularly by the Executive Committee to monitor the status and progression of mitigation plans, and these key risks are reported to the Board on a regular basis.

The Audit Committee is responsible for reviewing the ongoing effectiveness of the Company's risk management processes as part of its review of the effectiveness of internal controls. Also, twice a year, the Audit Committee receives reports on the output from the OAS process, details of the changes in the risks identified by it and the status of mitigation plans. The Corporate Responsibility Committee undertakes a similar role in respect of the Non-financial Risk Register. The Board receives reports from the chairmen of these two committees, providing details of the work they have undertaken.

Each year, the Board specifically reviews the risks identified in the risk management processes. This is aimed at providing the Board with an appreciation of the key risks within the business and oversight of how they are being managed.

Reporting within the Company is structured so that key issues are escalated through the management team ultimately to the Board if appropriate. The Operational Framework provides a common framework across the Company for operational and financial controls, and is reviewed on a regular basis by the Board. The business policies and processes detailed within the Operational Framework draw on global best practice and their application is mandated across the organisation. Lifecycle Management (LCM) is such a process, and promotes the application of best practice programme execution and facilitates continuous improvement across the Group. It considers the whole life of projects from inception to delivery into service and eventual disposal, and its application is critical to our capability in delivering projects to schedule and cost.

Further key processes are Integrated Business Planning (IBP), Quarterly Business Reviews (QBR) and Total Performance Leadership (TPL). The IBP, approved annually by the Board, results in an agreed five-year business plan for each business, together with detailed near-term budgets. The QBRs evaluate progress against the IBP, and business performance against objectives, measures and milestones. TPL drives business success by linking individual goals to those of the organisation, enabling employees to understand how their own success contributes to the success of the whole business.

Whilst the quality of the control processes is fundamental to the overall control environment, the consistent application of these processes is equally important. The consistent application of world-class control processes is a key management objective. The Company is committed to the protection of its assets, which include human, property and financial resources, through an effective risk management process, underpinned where appropriate by insurance.

The Internal Audit team independently reviews the risk identification procedures and control processes implemented by management. It provides objective assurance as to the operation and validity of the systems of internal control through a programme of cyclical reviews making recommendations for business and control improvements as required.

The Board has delegated to the Audit Committee responsibility for reviewing in detail the effectiveness of the Company's system of internal controls. Having undertaken such reviews, the Committee

CORPORATE GOVERNANCE REPORT *(continued)*

reports to the Board on its findings so that the Board as a whole can take a view on this matter. In order to assist the Audit Committee and the Board in this review, the Company has developed the OAS process (see below). This has been subject to regular review over a number of years, which has resulted in a number of refinements being made.

The overall responsibility for the system of internal control within BAE Systems rests with the directors of the Company. Responsibility for establishing and operating detailed control procedures lies with the line leaders of each operating business.

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

The responsibility for internal control procedures with joint ventures and other collaborations rests, on the whole, with the senior management of those operations. BAE Systems' employees on the boards of such entities are required to exert such influence as the Company may have to encourage the adoption of a governance structure that is substantially equivalent to the Operational Framework.

Going concern
The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Reporting segment reviews on pages 20 to 43. The financial position of the Group, including information on cash flow, treasury policy and liquidity, can be found in the Financial review on pages 46 to 54. Principal risks are detailed on pages 62 to 67. In addition, the financial statements include, amongst other things, notes on finance costs (page 125), loans and overdrafts (page 149), and financial risk management (page 163).

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

OPERATIONAL ASSURANCE STATEMENT (OAS) – KEY CHARACTERISTICS

A half-yearly review process to provide assurance that mandated policies and processes are being complied with, and a formal assessment of business risk.

All senior executives with specific profit or loss accountability for a line of business (Line Leaders) and functional directors are required to implement robust local processes to determine how their OAS should be completed. OAS returns are submitted to the Chief Executive and reviewed by the head of Internal Audit and Director, Financial Control and Reporting. Results from the OAS are presented to the Audit and Corporate Responsibility committees, and form part of the Board's regular review of risk. All returns are made available to the Group's auditors for use in their audit activities.

The OAS is formed of the following two parts:

1. Assessment of compliance with the Operational Framework

- Line Leaders of all businesses and relevant functional directors are required to complete and sign off an OAS recording their formal review of compliance against the Company's Operational Framework covering, amongst other things, the following:
  - Health and safety
  - Environment
  - Product safety
  - Sponsorship and charitable giving
  - Product trading policy and pursuit of exports
  - Lobbying and political support
  - Advisers
  - Engineering
  - Business planning
  - Lifecycle Management (a core Group project management process)
  - Mergers, acquisitions and disposals
  - General compliance with the Operational Framework
  - Effectiveness of internal controls in joint ventures and associated undertakings
  - Ethical business conduct
  - Compliance with law, regulation and codes of practice
  - Delegated authorities
  - Financial controls
  - Risk management
  - People
  - Gifts and hospitality
  - Conflicts of interest
  - Security
  - Use of IT
- Where simple yes/no answers are not appropriate, an assessment of compliance is required to be made against structured qualitative guidance.
- Minimum satisfactory levels of compliance are set by policy. If not compliant, a robust plan to achieve compliance is mandated and monitored through the Group's performance management processes and at the relevant audit review board.

2. Identification and management of key risks

- Line Leaders of all businesses and functional directors are required to identify their key risks (nominally 20), and analyse them in terms of size of impact and probability. An owner is required to be assigned to each risk, and mitigation plans produced and managed by the relevant business.
- The Executive Committee conducts risk workshops to analyse and allocate management responsibility for the management of the Group's most significant non-financial risks.

For non-controlled entities in which the Company has board representation, the completion of a separate joint venture OAS is mandated. BAE Systems' employees on the boards of such entities are required to exert such influence as the Company may have to encourage the adoption of a governance structure that is substantially equivalent to the Operational Framework.

Board committee governance

AUDIT COMMITTEE

Members
Nick Rose (Chairman), Sir Peter Mason, Paula Rosput Reynolds

Ravi Uppal was a member of the Committee up to 1 April 2011. Michael Hartnall was a member of the Committee and its chairman up to 31 July 2011, Mr Rose having succeeded him as chairman on 1 August 2011. Roberto Quarta was a member of the Committee up to 30 March 2011.

Responsibilities
– Reviewing the effectiveness of the Group's financial reporting, internal control policies, and procedures for the identification, assessment and reporting of risk.

– Monitoring the integrity of the Group's financial statements.

– Reviewing significant financial reporting issues and judgements.

– Monitoring the role and effectiveness of the Internal Audit function including approving the appointment or removal of the head of Internal Audit.

– Approving, in conjunction with the Corporate Responsibility Committee, an annual programme of internal audit work.

– Considering and making recommendations to the Board on the appointment of the Auditors.

– Agreeing the scope of the Auditors' annual audit programme and reviewing the output.

– Keeping the relationship with the Auditors under review, including the terms of their engagement and fees, their independence and expertise, resources and qualification, and assessing the effectiveness of the audit process.

– Developing and implementing policy on the engagement of the Auditors to supply non-audit services.

The full terms of reference of the Audit Committee can be found on the Company's website or can be obtained from the Company Secretary.

Governance
The Audit Committee was in place throughout 2011.

All its members are independent in accordance with provision B1.1 of the Code.

Nick Rose has been chairman of the Committee since 1 August 2011. He was formerly the finance director of a FTSE 100 company and as such has recent and relevant experience. His predecessor as chairman of the Committee, Michael Hartnall, had similar experience.

The Committee has asked that the Chief Executive, Group Finance Director, Director, Financial Control and Reporting, and the head of Internal Audit normally attend its meetings.

During the year, the Committee held individual meetings without Group executives present, without the head of Internal Audit present, solely with the head of Internal Audit present, and also solely with the external auditors present.

The Auditors and head of Internal Audit have direct access to the Chairman of the Committee.

The Committee may obtain at the Company's expense independent professional advice on any matters covered by its terms of reference.

The Committee accepts that certain work of a non-audit nature is best undertaken by the external auditors. The Committee reviews regularly the amount and nature of non-audit work they perform. It believes that it is not appropriate to limit the level of such work by reference to a set percentage of the audit fee, as this does not take into account important judgements that need to be made concerning the nature of work undertaken to help safeguard the Auditors' independence. The Committee has agreed the policy below regarding services provided by the Auditors.

POLICY ON NON-AUDIT SERVICES PROVIDED BY THE AUDITORS

Prohibited Non-Audit Services
– Book-keeping and work relating to the preparation of accounting records and financial statements that will ultimately be subject to external audit;

– Financial information system design and implementation;

– Appraisal or valuation services in respect of material assets;

– Actuarial services;

– Internal auditing;

– Investment adviser or broking;

– Advocacy services;

– Secondments to management positions that include decision-making; and

– Any work where a mutuality of interest is created that could compromise the independence of the Auditors.

Audit-Related Services
– Reporting required by law or regulation to be provided by the Auditors;

– Reviews of interim financial information;

– Reporting on regulatory returns;

– Reporting to a regulator on client assets;

– Reporting on government grants;

– Reporting on internal financial controls when required by law or regulation; and

– Extended work undertaken at the request of those charged with governance on financial information (this does not include accounting services) and/or financial controls performed where this work is integrated with the audit work, and is performed on the same principal terms and conditions.

Permitted Non-Audit Services, subject to approval under the policy
– Tax compliance services;

– Tax advisory services;

– Due diligence services relating to acquisitions of new businesses or significant investments in businesses, joint ventures or strategic alliances;

– Public reporting on investment circulars;

– Private reporting to sponsors or similar parties in connection with investment circulars (including comfort letters and reporting on working capital statements);

– Preparing information for third parties relating to acquisitions and disposals, including the conversion of financial statements into other accounting standards;

– Liquidation services in respect of redundant subsidiaries or associate companies;

– Participation in the evaluation of Internal Audit; and

– Accounting advice.

CORPORATE GOVERNANCE REPORT *(continued)*

On an annual basis the Committee's effectiveness is reviewed as part of the Board's externally facilitated evaluation process.

Meetings
The Committee met six times in 2011 and details of attendance at these meetings are provided on page 104.

CORPORATE RESPONSIBILITY COMMITTEE

Members
Paul Anderson (Chairman), Harriet Green, Sir Peter Mason

Responsibilities
– Assisting the Board in overseeing the development of strategy, and policy on social, environmental and ethical matters.
– Keeping under review the effectiveness of the Company's internal control policies and procedures for the identification, assessment, management and reporting of reputational risks, including health and safety, workplace policies, environmental impact and business ethics.
– Monitoring and reviewing the role and effectiveness of the Company's Internal Audit function in relation to corporate responsibility and monitoring the development of the capability and capacity of the function to perform its role with regards to corporate responsibility assurance and, in particular, ethical business conduct.
– Providing oversight of the Company's compliance with corporate responsibility-related policies and procedures.
– Reviewing audit and assurance reports produced by the Corporate Responsibility Assurer (an independent entity appointed to act as an external assurer of the Company's corporate responsibility reporting) and assessing management responsiveness to recommendations in such reports.
– Overseeing and supporting key stakeholder engagement on social, environmental and ethical issues.
– Making proposals to the Remuneration Committee regarding appropriate corporate responsibility-related performance objectives for executive directors and, in due course, providing its assessment as to performance against such objectives.
– Reviewing the Company's arrangements for employees to obtain further advice on ethical issues or raise and report concerns, in confidence, where there may be possible improprieties.
– Ensuring that the Code of Conduct is regularly reviewed and reflects best practice for such codes.
– Ensuring the Corporate Responsibility section of the Company's Annual Report and Accounts includes an examination of ethical business conduct within the Company.

The full terms of reference of the Corporate Responsibility Committee can be found on the Company's website or can be obtained from the Company Secretary.

Governance
The Corporate Responsibility Committee was in place throughout 2011.

All its members are independent in accordance with provision B1.1 of the Code.

The Committee has asked that the Chief Executive, Group General Counsel, Managing Director, Corporate Responsibility and the head of Internal Audit normally attend its meetings.

The head of the Company's Internal Audit function and Managing Director of the Corporate Responsibility function have direct access to the Chairman of the Committee.

The Committee is responsible for appointing the Corporate Responsibility Assurer (presently Deloitte), and keeping under review its fees, independence and objectivity, scope of work, and the expertise and resources available to it.

The Chairman of the Committee reports on the proceedings of all Committee meetings to the Board and all directors receive copies of the Committee's minutes.

The Committee may obtain at the Company's expense independent professional advice on any matters covered by its terms of reference.

On an annual basis, the Committee's effectiveness is reviewed as part of the Board's externally facilitated evaluation process.

Meetings
The Committee met five times in 2011 and details of attendance at these meetings are provided on page 104.

NOMINATIONS COMMITTEE

Members
Dick Olver (Chairman), Paul Anderson, Sir Peter Mason

Responsibilities
– Reviewing regularly the structure, size and composition of the Board, and making recommendations to the Board on any appropriate changes.
– Identifying and nominating for the Board's approval suitable candidates to fill any vacancies for non-executive and, with the assistance of the Chief Executive, executive directors.
– Planning for the orderly succession of directors to the Board.
– Recommending to the Board the membership and chairmanship of the Audit, Corporate Responsibility and Remuneration committees.

The full terms of reference of the Nominations Committee can be found on the Company's website or can be obtained from the Company Secretary.

Governance
The Nominations Committee was in place throughout 2011. It is chaired by the Chairman of the Company. Whilst he is not deemed to be independent, the other two members of the Committee are independent non-executive directors in accordance with provision B1.1 of the Code.

When dealing with any matters concerning his membership of the Board the Chairman will absent himself from the meeting as required, and meetings will be chaired by the Board's Senior Independent Director, Sir Peter Mason.

The Committee normally asks the Chief Executive to attend its meetings.

During the year, the Committee retained the services of the search consultants Zygos Partners to assist in identifying potential candidates for nominations to the Board.

Meetings
The Committee met seven times in 2011 and details of attendance at these meetings are provided on page 104.

REMUNERATION COMMITTEE

Members
Carl Symon (Chairman), Lee McIntire, Nick Rose

Roberto Quarta was a member of the Committee up to 29 June 2011. Lee McIntire joined the Committee with effect from the same date.

Responsibilities
– Agreeing a policy for the remuneration of the Chairman, executive directors, members of the Executive Committee (EC), the Company Secretary and other senior executives.
– Within the agreed policy, determining individual remuneration packages for the Chairman, executive directors and EC members.
– Agreeing the policy on terms and conditions to be included in service agreements for the Chairman, executive directors, EC members, the Company Secretary and other senior executives, including termination payments and compensation commitments, where applicable.
– Approving any employee share-based incentive schemes and any performance conditions to be used for such schemes.
– Determining any share scheme performance targets.

The full terms of reference of the Remuneration Committee can be found on the Company's website or can be obtained from the Company Secretary.

Governance
The Remuneration Committee was in place throughout 2011.

All its members are independent in accordance with provision B1.1 of the Code.

The Chief Executive and the Company's Chairman attend Committee meetings by invitation only. They do not attend where their individual remuneration is discussed and no director is involved in deciding his own remuneration. The Company Secretary acts as secretary to the Committee.

Meetings
In 2011, the Committee met eight times and details of attendance at these meetings are provided on page 104.

NON-EXECUTIVE DIRECTORS' FEES COMMITTEE

Members
Dick Olver, Philip Bramwell, Linda Hudson, Ian King

Responsibilities
– Reviewing the fees payable to non-executive directors (excluding the Chairman) and making changes to such fees as deemed appropriate. The Non-Executive Directors' Fees Committee has delegated authority from the Board to agree fees payable to non-executive directors on its behalf.

Governance
The Board has approved the following guidelines to be used by the Committee when discharging its responsibilities:
– fees shall be sufficient to attract and retain individuals with the necessary skills, experience and knowledge required to ensure that the Board is able to discharge its duties effectively;
– in setting fees the Committee shall have regard to the amount of time individual non-executive directors are required to devote to their duties, and also the scale and complexity of the business, and the responsibility involved;
– fees payable to non-executive directors shall be paid in cash and shall not be performance-related; and
– non-executive directors shall not participate in the Company's share-based incentive schemes or pension scheme.

Meetings
The Committee meets each year to consider the fees paid to the non-executive directors. Details of attendance at its meeting in 2011 are provided on page 104.

OTHER STATUTORY AND REGULATORY INFORMATION

Principal activities
BAE Systems is a global defence, aerospace and security company. The BAE Systems Group delivers, through its subsidiaries and equity accounted investments, a full range of products and services for air, land and naval forces, as well as advanced electronics, security, information technology solutions and support services.

Company registration
BAE Systems plc is registered in England and Wales with the registered number 1470151.

Directors
The current directors who served during the 2011 financial year are listed on pages 70 and 71. Of those directors, Peter Lynas and Paula Rosput Reynolds were appointed to the Board on 1 April 2011, and Lee McIntire on 1 June 2011. In addition, George Rose, Ravi Uppal and Roberto Quarta served as directors during the period up to their respective retirements from the Board on 31 March 2011, 1 April 2011 and 31 December 2011.

Dividend
An interim dividend of 7.5p per share was paid on 30 November 2011. The directors propose a final dividend of 11.3p per ordinary share. Subject to shareholder approval, the final dividend will be paid on 1 June 2012 to shareholders on the share register on 20 April 2012.

Annual General Meeting (AGM)
The Company's AGM will be held on 2 May 2012. The Notice of Annual General Meeting is enclosed with this Annual Report and details the resolutions to be proposed at the meeting.

Office of Fair Trading undertakings
As a consequence of the merger between British Aerospace and the former Marconi Electronics Systems businesses in 1999, the Company gave certain undertakings to the Secretary of State for Trade and Industry (now the Secretary of State for Business, Innovation and Skills). In February 2007, the Company was released from the majority of these undertakings and the remainder have been superseded and varied by a new set of undertakings. Compliance with the undertakings is monitored by a compliance officer. Further information regarding the undertakings and the contact details of the compliance officer may be obtained through the Company Secretary at the Company's registered office or through the Company's website.

Research and Development (R&D)
The Group's R&D activities cover a wide range of programmes, and include technological innovations and techniques to improve the manufacturing and service of products.

In 2011, R&D expenditure was £1,149m (2010 £1,298m) of which £222m (2010 £270m) was funded by the Group.

Supplier payment policy
It is Group policy that suppliers should be paid in accordance with the payment terms and conditions stated in the applicable purchase order. In the UK, the Group is a signatory to the government's Prompt Payment Code (see www.promptpaymentcode.org.uk), under which it has undertaken to pay suppliers on time, give clear guidance on payment procedures and encourage the adoption of the code throughout its supply chain.

The average number of days' credit provided in 2011 by suppliers was 35 days (2010 34 days).

Employees
Regular internal communication, including newsletters and the intranet, keeps employees involved and motivated.

The Group has constructive relationships with trade unions, and regularly communicates and discusses business developments which impact the Group and its employees.

The Group welcomes employees becoming shareholders in BAE Systems, and offers a number of employee share plans to support this.

The Group is committed to giving full and fair consideration to applications for employment from disabled people who meet the requirements for roles, and making available training opportunities and appropriate accommodation to disabled people employed by the Group.

Principal customers
The Group's most significant customers are the governments of the US, UK, Kingdom of Saudi Arabia and Australia. In the US, BAE Systems is subject to a Special Security Agreement that safeguards US national security interests, as a result of which BAE Systems is allowed to supply products and services of a highly sensitive nature to the US government. Agreements between the governments of the UK and Kingdom of Saudi Arabia relating to defence co-operation programmes remain essential to the development of the Group's business in Saudi Arabia. In Australia, BAE Systems is subject to an Overarching Deed with the Commonwealth of Australia that protects their national security and other interests, and allows the Group to own certain Australian defence-related industrial assets.

Indian government policy on Foreign Direct Investment mandates that foreign partners can hold a maximum of 26% equity in defence ventures.

Charitable donations
During 2011, the amount donated for charitable purposes in the UK was £1.4m (2010 £1.5m). In line with the Company Giving strategy, this included:

- £911,000 given to armed forces charities, with major donations being made to ABF The Soldiers' Charity, Combat Stress, Erskine Hospital, Soldiers, Sailors, Airmen and Families Association (SSAFA) Forces Help, and The Royal British Legion;
- £461,000 donated to education charities, including donations to Arkwright Scholarships Trust, Engineering Development Trust, Furness Academy, Smallpeice Trust, Enthuse Charitable Trust and The Prince's Trust; with
- the remaining £71,000 donated for other charitable purposes, including the advance of health and culture/heritage.

Political donations
No political donations were made in 2011.

Issued share capital
As at 31 December 2011, BAE Systems' issued share capital of £89,689,008 comprised 3,587,560,298 ordinary shares of 2.5p each and one Special Share of £1.

Treasury shares
During the year, 184,393,049 ordinary shares of 2.5p each were repurchased under the buyback programme announced on 28 July 2011 and such repurchased shares are held in treasury. The total consideration for the purchase of the shares, including commission and stamp duty, was £503,128,215.

As at 1 January 2011, the number of shares held in treasury totalled 178,377,628 (having a total nominal value of £4,459,441 and representing 4.97% of the Company's called up share capital at 1 January 2011). During 2011, the Company used 11,013,823 treasury shares (having a total nominal value of £275,346 and representing 0.31% of the Company's called up share capital at 31 December 2011) to satisfy awards under the Free and Matching elements of the Share Incentive Plan (8,130,818 shares in aggregate), awards vested under the Performance Share Plan (1,441,347 shares) and the Share Matching Plan (1,366,377 shares), and options exercised under the Executive Share Option Plan (75,281 shares). The treasury shares utilised in respect of the Share Incentive Plan, the Performance Share Plan and the Share Matching Plan were disposed of by the Company for nil consideration. The 75,281 shares disposed of by the Company in respect of the Executive Share Option Plan were disposed of by the Company for an aggregate consideration of £153,056. As at 31 December 2011, the number of shares held in treasury totalled 351,756,854 (having a total nominal value of £8,793,921 and representing 9.8% of the Company's called up share capital at 31 December 2011).

The rights to treasury shares are restricted in accordance with the Companies Act and, in particular, the voting rights attaching to these shares are automatically suspended.

Rights and obligations of ordinary shares
On a show of hands at a general meeting every holder of ordinary shares present in person and entitled to vote shall have one vote, and every proxy entitled to vote shall have one vote (unless the proxy is appointed by more than one member in which case the proxy has one vote for and one vote against if the proxy has been instructed by one or more members to vote for the resolution and by one or more members to vote against the resolution; or if the proxy has been instructed by one or more shareholders to vote either for or against a resolution and by one or more of those shareholders to use his discretion how to vote). On a poll, every member present in person or by proxy and entitled to vote shall have one vote for every ordinary share held. Subject to the relevant statutory provisions and the Company's Articles of Association, holders of ordinary shares are entitled to a dividend where declared or paid out of profits available for such purposes. Subject to the relevant statutory provisions and the Company's Articles of Association, on a return of capital on a winding-up, holders of ordinary shares are entitled, after repayment of the £1 Special Share, to participate in such a return. There are no redemption rights in relation to the ordinary shares.

Rights and obligations of the Special Share
The Special Share is held on behalf of the Secretary of State for Business, Innovation and Skills (the 'Special Shareholder'). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British.

The holder of the Special Share is entitled to attend a general meeting, but the Special Share carries no right to vote or any other rights at any such meeting, other than to speak in relation to any business in respect of the Special Share. Subject to the relevant statutory provisions and the Company's Articles of Association, on a return of capital on a winding-up, the holder of the Special Share shall be entitled to repayment of the £1 capital paid up on the Special Share in priority to any repayment of capital to any other members.

The holder of the Special Share has the right to require the Company to redeem the Special Share at par or convert the Special Share into one ordinary share at any time.

Restrictions on transfer of securities
The restrictions on the transfer of shares in the Company are as follows:

– the Special Share may only be issued to, held by and transferred to the Special Shareholder or his successor or nominee;

– the directors shall not register any allotment or transfer of any shares to a foreign person, or foreign persons acting in concert, who at the time have more than a 15% voting interest in the Company, or who would, following such allotment or transfer, have such an interest;

– the directors shall not register any person as a holder of any shares unless they have received: (i) a declaration stating that upon registration, the share(s) will not be held by foreign persons or that upon registration the share(s) will be held by a foreign person or persons; (ii) such evidence (if any) as the directors may require of the authority of the signatory of the declaration; and (iii) such evidence or information (if any) as to the matters referred to in the declaration as the directors consider appropriate;

– the directors may, in their absolute discretion, refuse to register any transfer of shares which are not fully paid up (but not so as to prevent dealings in listed shares from taking place);

– the directors may also refuse to register any instrument of transfer of shares unless the instrument of transfer is in respect of only one class of share and it is lodged at the place where the register of members is kept, accompanied by a relevant certificate or such other evidence as the directors may reasonably require to show the right of the transferor to make the transfer;

– the directors may refuse to register an allotment or transfer of shares in favour of more than four persons jointly;

– where a shareholder has failed to provide the Company with certain information relating to their interest in shares, the directors can, in certain circumstances, refuse to register a transfer of such shares;

– certain restrictions may from time to time be imposed by laws and regulations (for example, insider trading laws);

– restrictions may be imposed pursuant to the Listing Rules of the Financial Services Authority whereby certain of the Group's employees require the Company's approval to deal in shares; and

– awards of shares made under the Company's Share Incentive Plan are subject to restrictions on the transfer of shares prior to vesting.

The Company is not aware of any arrangements between its shareholders that may result in restrictions on the transfer of shares and/or voting rights.

Significant direct and indirect holders of securities
As at 31 December 2011, the Company had been advised of the following significant direct and indirect interests in the issued ordinary share capital of the Company:

Name of shareholder	Percentage notified
AXA S.A. and its group of companies	5.00%
Barclays PLC	3.98%
BlackRock, Inc.	5.16%
Invesco Limited	12.00%
Franklin Resources Inc., and affiliates	4.92%
Legal & General Group Plc	3.99%
Silchester International Investors LLP	3.01%

Subsequent to 31 December 2011, Invesco Limited has made the following notifications of its direct and indirect interests in the issued ordinary share capital of the Company: 11.98% on 3 January 2012 and 12.00% on 5 January 2012.

Exercise of rights of shares in employee share schemes
The Trustees of the employee trusts do not seek to exercise voting rights on shares held in the employee trusts other than on the direction of the underlying beneficiaries. No voting rights are exercised in relation to shares unallocated to individual beneficiaries.

Restrictions on voting deadlines
The notice of any general meeting shall specify the deadline for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be proposed at the general meeting. The number of proxy votes for, against or withheld in respect of each resolution are publicised on the Company's website after the meeting.

Appointment and replacement of directors
Subject to certain nationality requirements mentioned below, the Company may by ordinary resolution appoint any person to be a director.

The majority of directors holding office must be British. Otherwise, the directors who are not British shall vacate office in such order that those who have been in office for the shortest period since their appointment shall vacate their office first, unless all of the directors otherwise agree among themselves. Any director who holds the office

OTHER STATUTORY AND REGULATORY INFORMATION *(continued)*

of either Chairman (in an executive capacity) or Chief Executive shall also be British.

The Company must have six directors holding office at all times. If the number is reduced to below six, then such number of persons shall be appointed as directors as soon as is reasonably practicable to reinstate the number of directors to six. The Company may by ordinary resolution from time to time vary the minimum number of directors.

At each AGM of the Company, any director who was elected or last re-elected at or before the AGM held in the third calendar year before the then current calendar year must retire by rotation and such further directors must retire by rotation so that in total one-third of the directors retire by rotation each year. A retiring director is eligible for re-election. It is the Board's intention that all directors will stand for election or re-election in 2012 in compliance with the UK Corporate Governance Code.

Amendment of the Company's Articles of Association
The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders. Where class rights are varied, such amendments must be approved by the members of each class of shares separately.

In addition, certain provisions of the Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British.

Powers of the directors
The directors are responsible for the management of the business of the Company and may exercise all powers of the Company subject to applicable legislation and regulation, and the Articles of Association.

At the 2011 AGM, the directors were given the power to buy back a maximum number of 340,993,986 ordinary shares at a minimum price of 2.5p each. The maximum price was the higher of (i) an amount equal to 105% of the average of the middle market quotations of the Company's ordinary shares as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which such ordinary shares are contracted to be purchased, and (ii) the higher of the price of the last independent trade and the highest current independent bid on the London Stock Exchange as stipulated in Article 5(1) of the Buy-back and Stabilisation Regulation. This power will expire at the earlier of the conclusion of the 2012 AGM or 30 June 2012. A special resolution will be proposed at the 2012 AGM to renew the Company's authority to acquire its own shares.

At the 2011 AGM, the directors were given the power to issue new shares up to a nominal amount of £28,413,323. This power will expire on the earlier of the conclusion of the 2012 AGM or 30 June 2012. Accordingly, a resolution will be proposed at the 2012 AGM to renew the Company's authority to issue further new shares. At the 2011 AGM, the directors were also given the power to issue new issue shares up to a further nominal amount of £28,413,323 in connection with an offer by way of a rights issue. This authority too will expire on the earlier of the conclusion of the 2012 AGM or 30 June 2012, and a resolution will be proposed at the 2012 AGM to renew this additional authority.

Conflicts of interest
As permitted under the Companies Act 2006, the Company's Articles of Association contain provisions which enable the Board to authorise conflicts or potential conflicts that individual directors may have.

To avoid potential conflicts of interest the Board requires the Nominations Committee to check that any individuals it nominates for appointment to the Board are free of potential conflicts. In addition, the Board's procedures and the induction programme for new directors emphasise a director's personal responsibility for complying with the duties relating to conflicts of interest. The procedure adopted by the Board for the authorisation of conflicts reminds directors of the need to consider their duties as directors and not grant an authorisation unless they believe, in good faith, that this would be likely to promote the success of the Company. As required by law, the potentially conflicted director cannot vote on an authorisation resolution or be counted in the quorum. Any authorisation granted may be terminated at any time and the director is informed of the obligation to inform the Company without delay should there be any material change in the nature of the conflict or potential conflict so authorised. The Nominations Committee has been asked to review on an annual basis any authorisations granted and to make recommendations to the Board as appropriate.

Directors' indemnities
The Company has entered into deeds of indemnity with all its current directors and those persons who were directors for any part of 2011 which are qualifying indemnity provisions for the purpose of the Companies Act 2006.

The directors of BAE Systems Pension Funds Trustees Limited, BAE Systems 2000 Pension Plan Trustees Limited, BAE Systems Executive Pension Scheme Trustees Limited and Alvis Pension Scheme Trustees Limited benefit from indemnities in the governing documentation of the BAE Systems Pension Scheme, the BAE Systems 2000 Pension Plan, the BAE Systems Executive Pension Scheme and the Alvis Pension Scheme, respectively, which are qualifying indemnity provisions for the purpose of the Companies Act 2006.

All such indemnity provisions are in force as at the date of this Directors' report.

Change of control – significant agreements
The following significant agreements contain provisions entitling the counterparties to exercise termination, alteration or other similar rights in the event of a change of control of the Company:

– The Group has entered into a £2bn Revolving Credit Facility dated 8 December 2010 which provides that, in the event of a change of control of the Company, the lenders are entitled to renegotiate terms, or if no agreement is reached on negotiated terms within a certain period, to call for the repayment or cancellation of the facility. The Revolving Credit Facility was undrawn as at 31 December 2011.

– The Company has entered into a Restated and Amended Shareholders Agreement with European Aeronautic Defence and Space Company EADS N.V. (EADS) and Finmeccanica S.p.A. (Finmeccanica) relating to MBDA S.A.S. dated 18 December 2001 (as amended). In the event that control of the Company passes to certain specified third-party acquirors, the agreement allows EADS and Finmeccanica to exercise an option to terminate certain executive management level nomination and voting rights, and certain shareholder information rights of the Company in relation to the MBDA joint venture. Following the exercise of this option, the Company would have the right to require the other shareholders to purchase its interest in MBDA at fair market value.

  The Company and EADS have agreed that if Finmeccanica acquires a controlling interest in the Company, EADS will increase its shareholding in MBDA to 50% by purchasing the appropriate number of shares in MBDA at fair market value.

– The Company, BAE Systems, Inc., BAE Systems (Holdings) Limited and BAE Systems Holdings Inc. entered into a Special Security Agreement dated 8 November 2010 with the US Department of Defense regarding the management of BAE Systems, Inc. in order to comply with the US government's national security requirements. In the event of a change of control of the Company, the Agreement may be terminated or altered by the US Department of Defense.

– In July 2009, BVT Surface Fleet Limited (now BAE Systems Surface Ships Limited) and the UK MoD entered into a definitive Terms of

Business Agreement (ToBA) which sets out a 15-year partnering arrangement, including lead roles for the BVT business on defined surface shipbuilding and support programmes. Where the MoD considers that a proposed Change in Control of BAE Systems Surface Ships Limited would be contrary to the defence, national security or national interest of the UK, then the Change in Control shall not proceed until agreement with the MoD is established. In the event that there is a Change in Control of BAE Systems Surface Ships Limited notwithstanding the objection of the MoD on such grounds, the MoD shall be entitled to terminate the ToBA immediately without compensation or termination charges.

In addition, the Company's share plans contain provisions as a result of which options and awards may vest and become exercisable on a change of control of the Company in accordance with the rules of the plans.

Auditors
KPMG Audit Plc, the auditors for the Company, have indicated their willingness to continue in office and a resolution proposing their re-appointment will be put to the AGM.

Statement of directors' responsibilities in respect of the Annual Report and financial statements
The directors are responsible for preparing the Annual Report, and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and applicable law, and have elected to prepare the parent company financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company, and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the directors are required to:

– select suitable accounting policies and then apply them consistently;
– make judgements and estimates that are reasonable and prudent;
– for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
– for the parent company financial statements, state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
– prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions, and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group, and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a directors' report, directors' remuneration report and corporate governance statement that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement of disclosure of information to auditors
The directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that he/she ought to have taken to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

On behalf of the Board

David Parkes
Company Secretary

15 February 2012

RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE ANNUAL REPORT AND FINANCIAL STATEMENTS

Each of the directors listed below confirms that to the best of their knowledge:

– the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company, and the undertakings included in the consolidation taken as a whole; and
– the Directors' report includes a fair review of the development and performance of the business, and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

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

On behalf of the Board

Dick Olver
Chairman

15 February 2012

FINANCIAL STATEMENTS

At Military Air & Information in Samlesbury, UK, BAE Systems provides manufacturing and support capabilities to a number of internationally important aircraft programmes, including Eurofighter Typhoon, the most advanced swing-role aircraft in the world, and F-35, the largest contract of its kind in the world. The site is a centre of excellence for high technology.

INDEX TO THE ACCOUNTS

GROUP ACCOUNTS

PREPARATION AND CONSOLIDATION

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 106, 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 available-for-sale financial assets, and other relevant financial assets and financial liabilities (including derivative instruments).

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates and judgements.

The directors consider the following potential key areas of judgement required to be made in applying the Group's accounting policies:

– the determination of the revenue recognition approach to apply to individual contracts;

– the classification of retirement benefit plans between defined benefit and defined contribution arrangements;

– the classification of financial assets or liabilities;

– the classification of investments as subsidiaries, equity accounted investments or otherwise; and

– the determination of assumptions underpinning goodwill impairment testing.

The directors do not consider that the practical application of the judgements is significantly uncertain or subjective in nature.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out in note 32. These policies have been consistently applied to all the years presented, unless otherwise stated. There were no changes in these accounting policies in the year.

An explanation of the critical accounting estimates and judgements used in producing these consolidated financial statements is made in the Directors' report on page 54.

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, all of which are prepared to 31 December.

Subsidiaries

A subsidiary is an entity controlled by the Group. Control is the power to govern the operating and financial policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries are included in the income statement from the date of acquisition.

Prior to the disposal of the Regional Aircraft Asset Management business, subsidiaries included the special purpose entities that the Group transacted through for the provision of guarantees in respect of residual values, and head lease and finance payments on certain regional aircraft sold.

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Equity accounted investments

An entity is regarded as a joint venture if the Group has joint control over its operating and financial policies. Joint ventures are accounted for under the equity method where the consolidated income statement includes its share of their profits and losses, and the consolidated balance sheet includes its share of their net assets.

CONSOLIDATED INCOME STATEMENT
for the year ended 31 December

		2011		Restated[1] 2010	
	Notes	£m	Total £m	£m	Total £m
Continuing operations					
Combined sales of Group and share of equity accounted investments	1		**19,154**		22,275
Less: share of sales of equity accounted investments	1		**(1,384)**		(1,295)
Revenue	1		**17,770**		20,980
Operating costs	2		**(16,478)**		(19,662)
Other income	4		**157**		152
Group operating profit			**1,449**		1,470
Share of results of equity accounted investments	1		**131**		131
Underlying EBITA[2]		**2,025**		2,179	
Non-recurring items[3]		**(78)**		(15)	
EBITA		**1,947**		2,164	
Amortisation		**(239)**		(392)	
Impairment		**(109)**		(125)	
Financial income/(expense) of equity accounted investments	5	**8**		(2)	
Taxation expense of equity accounted investments		**(27)**		(44)	
Operating profit	1		**1,580**		1,601
Financial income		**1,294**		1,355	
Financial expense		**(1,408)**		(1,547)	
Finance costs	5		**(114)**		(192)
Profit before taxation			**1,466**		1,409
Taxation expense	6		**(206)**		(418)
Profit for the year – continuing operations			**1,260**		991
(Loss)/profit for the year – discontinued operations	7		**(4)**		90
Profit for the year			**1,256**		1,081
Attributable to:					
Equity shareholders			**1,240**		1,052
Non-controlling interests			**16**		29
			1,256		1,081
Earnings per share	8				
Basic earnings per share			**36.9p**		30.5p
Diluted earnings per share			**36.7p**		30.3p
Earnings per share – continuing operations					
Basic earnings per share			**37.0p**		27.9p
Diluted earnings per share			**36.8p**		27.7p

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3 Non-recurring items comprises loss on disposal of businesses £29m (2010 profit £1m), pension curtailment gains £nil (2010 £2m) and regulatory penalties £49m (2010 £18m).

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December

	Notes	2011 Other reserves[1] £m	2011 Retained earnings £m	2011 Total £m	2010 Other reserves[1] £m	2010 Retained earnings £m	2010 Total £m
Profit for the year		**–**	**1,256**	**1,256**	–	1,081	1,081
Other comprehensive income							
Net actuarial (losses)/gains on defined benefit pension schemes		**–**	**(1,522)**	**(1,522)**	–	874	874
Currency translation on foreign currency net investments		**(19)**	**–**	**(19)**	160	–	160
Recycling of cumulative currency translation reserve on disposal	7	**(14)**	**–**	**(14)**	(17)	–	(17)
Amounts charged to hedging reserve		**(56)**	**–**	**(56)**	(84)	–	(84)
Recycling of cumulative net hedging reserve on disposal		**–**	**–**	**–**	(4)	–	(4)
Fair value movements on available-for-sale investments	15	**–**	**5**	**5**	–	14	14
Recycling of fair value movements on available-for-sale investments	5	**–**	**(21)**	**(21)**	–	–	–
Share of other comprehensive income of equity accounted investments	25	**(17)**	**(45)**	**(62)**	(6)	40	34
Tax on other comprehensive income	6	**17**	**387**	**404**	22	(274)	(252)
Total other comprehensive income for the year (net of tax)		**(89)**	**(1,196)**	**(1,285)**	71	654	725
Total comprehensive income for the year		**(89)**	**60**	**(29)**	71	1,735	1,806
Attributable to:							
Equity shareholders		**(89)**	**44**	**(45)**	71	1,706	1,777
Non-controlling interests		**–**	**16**	**16**	–	29	29
		(89)	**60**	**(29)**	71	1,735	1,806

1 An analysis of other reserves is provided in note 25.

NOTES TO THE GROUP ACCOUNTS – INCOME STATEMENT

1. SEGMENTAL ANALYSIS

The Group has revised its reporting segments to align with the Group's strategic direction and improve visibility in areas of recent development of the business, notably its Cyber & Intelligence activities and in Electronic Systems.

The Group has six reporting segments:

- **Electronic Systems** comprises the US- and UK-based electronics activities, including electronic warfare systems and electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems;
- **Cyber & Intelligence** comprises the Group’s cyber, secure government, and commercial and financial security activities within the US-based Intelligence & Security business, and the UK-headquartered BAE Systems Detica business;
- **Platforms & Services (US)** comprises the US-headquartered Land & Armaments business, with operations in the US, UK, Sweden and South Africa, together with US-based services and sustainment activities, including ship repair and modernisation services;
- **Platforms & Services (UK)** comprises the Group’s UK-based air and maritime activities, and certain shared services activities, including the UK-based Advanced Technology Centre;
- **Platforms & Services (International)** comprises the Group’s businesses in Saudi Arabia, Australia, India and Oman, together with its 37.5% interest in the pan-European MBDA joint venture; and
- **HQ** comprises the Group’s head office activities, together with a 49% interest in Air Astana.

Management monitors the results of these reporting segments to assess performance and make decisions about the allocation of resources. Segment performance is evaluated based on combined sales of Group and share of equity accounted investments, and underlying EBITA[1]. Underlying EBITA[1] is reconciled below to the reporting segment result and the operating profit in the consolidated financial statements. Finance costs and taxation expense are managed on a Group basis.

Sales and revenue by reporting segment

	Combined sales of Group and share of equity accounted investments		Less: sales by equity accounted investments		Add: sales to equity accounted investments		Revenue	
	2011 £m	Restated[2,3] 2010 £m	**2011 £m**	Restated[3] 2010 £m	**2011 £m**	Restated[3] 2010 £m	**2011 £m**	Restated[2,3] 2010 £m
Electronic Systems	**2,645**	2,969	**(49)**	(49)	**49**	49	**2,645**	2,969
Cyber & Intelligence	**1,399**	1,201	**–**	–	**–**	–	**1,399**	1,201
Platforms & Services (US)	**5,305**	7,671	**(52)**	(42)	**2**	–	**5,255**	7,629
Platforms & Services (UK)	**6,258**	6,529	**(1,476)**	(1,445)	**1,374**	1,339	**6,156**	6,423
Platforms & Services (International)	**3,794**	4,325	**(1,039)**	(1,012)	**–**	–	**2,755**	3,313
HQ	**233**	209	**(233)**	(209)	**–**	–	**–**	–
	19,634	22,904	**(2,849)**	(2,757)	**1,425**	1,388	**18,210**	21,535
Intra-group sales/revenue	**(480)**	(629)	**3**	21	**37**	53	**(440)**	(555)
	19,154	22,275	**(2,846)**	(2,736)	**1,462**	1,441	**17,770**	20,980

	Intra-group revenue		Revenue from external customers	
	2011 £m	Restated[2,3] 2010 £m	**2011 £m**	Restated[2,3] 2010 £m
Electronic Systems	**118**	119	**2,527**	2,850
Cyber & Intelligence	**22**	28	**1,377**	1,173
Platforms & Services (US)	**79**	132	**5,176**	7,497
Platforms & Services (UK)	**214**	269	**5,942**	6,154
Platforms & Services (International)	**7**	7	**2,748**	3,306
	440	555	**17,770**	20,980

1 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see page 47).
2 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
3 Restated following changes to the Group’s reporting segments.

1. SEGMENTAL ANALYSIS *(continued)*

Sales and revenue by customer location

Customer location	Sales 2011 £m	Sales Restated[1] 2010 £m	Revenue 2011 £m	Revenue Restated[1] 2010 £m
United Kingdom	**3,893**	4,284	**3,749**	4,139
Rest of Europe	**2,830**	2,717	**1,966**	1,960
Saudi Arabia	**2,460**	3,186	**2,313**	2,994
Rest of Middle East	**136**	216	**70**	161
United States	**7,924**	10,128	**7,921**	10,125
Canada	**82**	77	**82**	77
Australia	**1,071**	1,021	**1,070**	1,020
Rest of Asia and Pacific	**374**	334	**240**	252
Africa, Central and South America	**384**	312	**359**	252
	19,154	22,275	**17,770**	20,980

Revenue by category

	2011 £m	Restated[1] 2010 £m
Long-term contracts	**9,380**	11,757
Sale of goods	**4,684**	5,771
Provision of services	**3,698**	3,445
Royalty income	**8**	7
	17,770	20,980

Revenue by major customer

Revenue from the Group's three principal customers, which individually represent over 10% of total revenue, is as follows:

	2011 £m	Restated[1] 2010 £m
UK Ministry of Defence[2]	**4,802**	5,059
US Department of Defense	**5,675**	7,696
Kingdom of Saudi Arabia Ministry of Defence and Aviation	**2,276**	2,870

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 Platforms & Services (UK) and Platforms & Services (International) reporting segments.

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Revenue from the UK Ministry of Defence includes £1.3bn (2010 £1.3bn) generated under the Typhoon work share agreement with Eurofighter GmbH. This revenue is included within Rest of Europe in the analysis by customer location above.

NOTES TO THE GROUP ACCOUNTS — INCOME STATEMENT *(continued)*

1. SEGMENTAL ANALYSIS *(continued)*

Reporting segment result

	Underlying EBITA[1]		Non-recurring items[4]		Amortisation of intangible assets		Impairment of intangible assets		Reporting segment result	
	2011 £m	Restated[2,3] 2010 £m	**2011 £m**	Restated[3] 2010 £m	**2011 £m**	Restated[3] 2010 £m	**2011 £m**	Restated[3] 2010 £m	**2011 £m**	Restated[2,3] 2010 £m
Electronic Systems	**386**	455	**–**	2	**(15)**	(8)	**–**	–	**371**	449
Cyber & Intelligence	**136**	108	**–**	–	**(64)**	(28)	**–**	(11)	**72**	69
Platforms & Services (US)	**478**	728	**(29)**	–	**(118)**	(293)	**(75)**	(30)	**256**	405
Platforms & Services (UK)	**658**	522	**–**	1	**(32)**	(38)	**(34)**	(77)	**592**	408
Platforms & Services (International)	**449**	449	**–**	–	**(10)**	(25)	**–**	(7)	**439**	417
HQ	**(82)**	(83)	**(49)**	(18)	**–**	–	**–**	–	**(131)**	(101)
	2,025	2,179	**(78)**	(15)	**(239)**	(392)	**(109)**	(125)	**1,599**	1,647
Financial income/(expense) of equity accounted investments									**8**	(2)
Taxation expense of equity accounted investments									**(27)**	(44)
Operating profit									**1,580**	1,601
Finance costs									**(114)**	(192)
Profit before taxation									**1,466**	1,409
Taxation expense									**(206)**	(418)
Profit for the year – continuing operations									**1,260**	991

Share of results of equity accounted investments by reporting segment

	2011 £m	Restated[3] 2010 £m
Share of results excluding finance costs and taxation expense:		
Electronic Systems	**1**	1
Platforms & Services (US)	**1**	8
Platforms & Services (UK)	**11**	24
Platforms & Services (International)	**116**	114
HQ	**21**	30
	150	177
Financial income/(expense)	**8**	(2)
Taxation expense	**(27)**	(44)
	131	131

1 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
2 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
3 Restated following changes to the Group's reporting segments.
4 Non-recurring items comprises loss on disposal of businesses £29m (2010 profit £1m), pension curtailment gains £nil (2010 £2m) and regulatory penalties £49m (2010 £18m).

2. OPERATING COSTS

	2011 £m	Restated[1] 2010 £m
Raw materials and other bought-in items	**6,947**	8,471
Change in inventories of finished goods and work-in-progress	**198**	986
Cost of inventories expensed	**7,145**	9,457
Staff costs (note 3)	**5,356**	5,608
Depreciation, amortisation and impairment	**695**	851
Loss on disposal of property, plant and equipment	**4**	10
Loss on disposal of businesses	**29**	–
Rationalisation (recoveries)/costs[2]	**(6)**	153
Regulatory penalties[3]	**49**	18
Oman Offshore Patrol Vessel charge[4]	**160**	–
Trinidad and Tobago Offshore Patrol Vessel (income)/charge[5]	**(60)**	100
Other operating charges	**3,106**	3,465
	16,478	19,662
Included within the analysis of operating costs are the following expenses:		
Minimum lease and sublease payments	**178**	176
Research and development expense including amounts funded under contract	**1,149**	1,298

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Includes a £125m benefit from a UK Ministry of Defence settlement agreement relating to the recovery of rationalisation costs charged to the income statement in prior years.
3 Regulatory penalties of £49m reflect the US Department of State fine. The prior year charge reflects the exchange rate movement on payment of the global settlement with the US Department of Justice.
4 Charge in 2011 reflects an increase in planned costs to complete the Omani Offshore Patrol Vessel programme.
5 Income in 2011 reflects an increase in the carrying value of these vessels upon agreement of a sale to the Brazilian Navy. A charge of £100m was taken in 2010 upon termination of the contract with the Government of the Republic of Trinidad and Tobago.

Fees payable to the Company's auditor and its associates included in operating costs

	2011			Restated[1] 2010		
	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*	**1,535**	**–**	**1,535**	1,484	–	1,484
Fees payable to the Company's auditor and its associates for other services						
The audit of the Company's subsidiaries pursuant to legislation*	**2,435**	**4,227**	**6,662**	2,399	4,536	6,935
Other services pursuant to legislation:						
Interim review	**604**	**–**	**604**	579	–	579
Other	**96**	**38**	**134**	92	–[2]	92
Further assurance services						
Advice on accounting matters	**4**	**25**	**29**	51	17	68
IT advisory	**–**	**27**	**27**	–	–	–
Due diligence	**–**	**270**	**270**	365	337	702
Tax services						
Compliance	**550**	**1,263**	**1,813**	637	2,026	2,663
Advisory	**227**	**376**	**603**	290	379	669
Other services						
M&A	**516**	**79**	**595**	58	638	696
Other	**251**	**18**	**269**	148	240	388
Total fees payable to the Company's auditor and its associates	**6,218**	**6,323**	**12,541**	6,103	8,173	14,276
* Total fees payable to the Company's auditor and its associates for audit services			**8,197**			8,419

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Restated to exclude £139,000 in respect of the audit of the US pension schemes.

In addition to the amounts above, the auditor's fees for audit services in respect of the Group's pension schemes were £135,000 in the UK and £99,000 overseas (2010 £144,000 and £139,000, respectively).

Tax services include tax compliance support and services in relation to the Group's expatriate employees based around the world. PricewaterhouseCoopers will perform these services from 1 January 2012 following a competitive tender process.

NOTES TO THE GROUP ACCOUNTS — INCOME STATEMENT *(continued)*

3. EMPLOYEES

The weekly average and year-end numbers of employees, excluding those in equity accounted investments, were as follows:

	Weekly average		At year end	
	2011 Number '000	Restated[1,2] Number 2010 '000	**2011 Number '000**	Restated[1,2] Number 2010 '000
Electronic Systems	**13**	13	**13**	13
Cyber & Intelligence	**8**	8	**9**	8
Platforms & Services (US)	**25**	30	**24**	28
Platforms & Services (UK)	**30**	32	**28**	31
Platforms & Services (International)	**12**	11	**12**	11
HQ	**1**	1	**1**	1
	89	95	**87**	92

The aggregate staff costs of Group employees, excluding employees of equity accounted investments, were:

	2011 £m	Restated[1] 2010 £m
Wages and salaries	**4,603**	4,864
Social security costs	**385**	407
Share options granted to directors and employees (note 28)	**24**	16
Pension costs – defined contribution plans (note 23)	**119**	110
Pension costs – defined benefit plans (note 23)	**225**	209
US healthcare costs (note 23)	**–**	2
	5,356	5,608

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Restated following changes to the Group's reporting segments.

4. OTHER INCOME

	2011 £m	Restated[1] 2010 £m
Rental income from operating leases – property, plant and equipment	**21**	26
Rental income from operating leases – investment property	**22**	22
Profit on disposal of investment property	**21**	–
Profit on disposal of property, plant and equipment	**12**	12
Profit on disposal of businesses	**–**	1
Management recharges to equity accounted investments (note 29)	**17**	14
Pension curtailment gains (note 23)	**–**	2
Other[2]	**64**	75
	157	152

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 There are no individual amounts in excess of £10m.

5. FINANCE COSTS

	2011 £m	Restated[1] 2010 £m
Interest income	**30**	37
Income from financial assets at fair value through profit or loss	**4**	–
Expected return on pension scheme assets (note 23)	**989**	916
Recycling of fair value movements on available-for-sale investments	**21**	–
Gain on remeasurement of financial instruments at fair value through profit or loss[2]	**174**	176
Foreign exchange gains	**76**	226
Financial income	**1,294**	1,355
Interest expense on bonds and other financial instruments[3]	**(217)**	(203)
Facility fees	**(7)**	(4)
Net present value adjustments	**(33)**	(26)
Interest charge on pension scheme liabilities (note 23)	**(965)**	(996)
Loss on remeasurement of financial instruments at fair value through profit or loss	**(163)**	(225)
Foreign exchange losses	**(23)**	(93)
Financial expense	**(1,408)**	(1,547)
Net finance costs	**(114)**	(192)

Additional analysis

	2011 £m	Restated[1] 2010 £m
Net finance costs:		
Group	**(114)**	(192)
Share of equity accounted investments	**8**	(2)
	(106)	(194)
Analysed as:		
Underlying interest (expense)/income:		
Group	**(223)**	(196)
Share of equity accounted investments	**11**	5
	(212)	(191)
Other:		
Group:		
Net financing credit/(charge) on pensions	**24**	(80)
Market value and foreign exchange movements on financial instruments and investments	**85**	84
Share of equity accounted investments	**(3)**	(7)
	(106)	(194)

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Includes a £17m fair value gain (2010 £26m) in respect of the remaining 10.25% shareholding in Saab AB, which was sold in June 2011.
3 Includes £41m relating to the early redemption of debt in June 2011 in connection with the disposal of the Regional Aircraft Asset Management business in July 2011, £28m of which would have been incurred in future years.

NOTES TO THE GROUP ACCOUNTS — INCOME STATEMENT *(continued)*

6. TAXATION EXPENSE

	2011 £m	Restated[1] 2010 £m
Current taxation		
UK		
Current tax	**(155)**	(122)
Double tax relief	**2**	3
Adjustment in respect of prior years	**187**	(29)
	34	(148)
Overseas		
Current year	**(171)**	(263)
Adjustment in respect of prior years	**5**	26
	(166)	(237)
	(132)	(385)
Deferred taxation		
UK		
Origination and reversal of temporary differences	**(43)**	(22)
Adjustment in respect of prior years	**7**	23
Tax rate adjustment[2]	**(8)**	(6)
Overseas		
Origination and reversal of temporary differences	**(56)**	(9)
Adjustment in respect of prior years	**26**	(19)
	(74)	(33)
Taxation expense	**(206)**	(418)
UK	**(10)**	(153)
Overseas	**(196)**	(265)
Taxation expense	**(206)**	(418)

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 The UK current tax rate will be reduced from 26% to 25% with effect from 1 April 2012. In line with this change, the rate applying to UK deferred tax assets and liabilities has been reduced from 27% to 25%, creating a rate adjustment, 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.

	2011 £m	Restated[1] 2010 £m
Profit before taxation	**1,466**	1,409
UK corporation tax rate	**26.5%**	28.0%
Expected income tax expense	**(388)**	(395)
Effect of tax rates in foreign jurisdictions, including US state taxes[2]	**(67)**	(72)
Expenses not tax effected[2]	**(32)**	(41)
Income not subject to tax[2]	**24**	34
Research and development tax credits	**40**	32
Goodwill impairment	**(28)**	(24)
Chargeable gains and non-deductible losses on disposal of businesses	**(19)**	(2)
Utilisation of previously unrecognised tax losses	**27**	3
Current year losses not tax effected	**(3)**	–
Recoverable deferred tax asset previously unrecognised	**30**	–
Prior year benefit of UK tax agreement[3]	**197**	–
Adjustments in respect of prior years	**28**	1
Adjustments in respect of equity accounted investments	**35**	37
Regulatory penalties	**(13)**	(5)
Tax rate adjustment[4]	**(8)**	(6)
Other[2]	**(29)**	20
Taxation expense	**(206)**	(418)

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Prior year item reclassified to reflect current year treatment.
3 Reflects the benefit of an agreement with the UK tax authorities addressing a number of items, including the interpretation of complex tax rules relating to research and development tax credits.
4 The UK current tax rate will be reduced from 26% to 25% with effect from 1 April 2012. In line with this change, the rate applying to UK deferred tax assets and liabilities has been reduced from 27% to 25%, creating a rate adjustment, which is partly reflected in the consolidated income statement and partly in the consolidated statement of comprehensive income.

NOTES TO THE GROUP ACCOUNTS — INCOME STATEMENT *(continued)*

6. TAXATION EXPENSE *(continued)*

Tax recognised in other comprehensive income

	2011			2010		
	Before tax £m	Tax benefit/ (expense) £m	Net of tax £m	Before tax £m	Tax benefit/ (expense) £m	Net of tax £m
Net actuarial (losses)/gains on defined benefit pension schemes	(1,522)	443	(1,079)	874	(234)	640
Currency translation on foreign currency net investments	(19)	–	(19)	160	–	160
Recycling of cumulative currency translation reserve on disposal	(14)	–	(14)	(17)	–	(17)
Amounts (charged)/credited to hedging reserve	(56)	17	(39)	(84)	22	(62)
Recycling of cumulative net hedging reserve on disposal	–	–	–	(4)	–	(4)
Fair value movements on available-for-sale investments	5	–	5	14	–	14
Recycling of fair value movements on available-for-sale investments	(21)	–	(21)	–	–	–
Share of other comprehensive income of equity accounted investments	(62)	13	(49)	34	(12)	22
Share-based payments	–	–	–	–	1	1
Tax rate adjustment[1]	–	(69)	(69)	–	(23)	(23)
Other	–	–	–	–	(6)	(6)
	(1,689)	404	(1,285)	977	(252)	725

	2011			2010		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings £m	Total £m
Current tax						
Financial instruments	3	–	3	(2)	–	(2)
Share-based payments	–	–	–	–	2	2
Pensions	–	44	44	–	69	69
Other	–	–	–	–	(1)	(1)
	3	44	47	(2)	70	68
Deferred tax						
Subsidiaries	15	398	413	24	(309)	(285)
Tax rate adjustment[1]	(1)	(68)	(69)	–	(23)	(23)
Equity accounted investments – pensions	–	13	13	–	(12)	(12)
	14	343	357	24	(344)	(320)
Tax on other comprehensive income	17	387	404	22	(274)	(252)

1 The UK current tax rate will be reduced from 26% to 25% with effect from 1 April 2012. In line with this change, the rate applying to UK deferred tax assets and liabilities has been reduced from 27% to 25%, creating a rate adjustment, which is partly reflected in the consolidated income statement and partly in the consolidated statement of comprehensive income.

7. DISCONTINUED OPERATIONS

Regional Aircraft
On 15 July 2011, the Group sold its Regional Aircraft Asset Management business.

The Group's Regional Aircraft Support & Engineering business is expected to be sold in the first half of 2012 and has been classified as held for sale at 31 December 2011.

The Asset Management and Support & Engineering businesses comprised the Group's Regional Aircraft line of business within the HQ reporting segment. It has been presented within discontinued operations for the current and prior years.

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

Results from discontinued operations

	2011 £m	2010 £m
Revenue	84	128
Operating costs[1,2]	(104)	(110)
Other income[3]	10	17
Group operating (loss)/profit	(10)	35
Share of results of equity accounted investments	–	2
Operating (loss)/profit	(10)	37
Financial income	–	3
Financial expense	(3)	(3)
(Loss)/profit before taxation	(13)	37
Taxation (expense)/credit	(5)	1
(Loss)/profit for the year	(18)	38
Profit on disposal of discontinued operations	14	52
(Loss)/profit for the year – discontinued operations	(4)	90
Regional Aircraft	(4)	36
Saab AB	–	54
(Loss)/profit for the year – discontinued operations	(4)	90

1 Includes depreciation and impairment of £56m (2010 £48m). The 2011 charge includes £40m in respect of the carrying value of the Regional Aircraft Asset Management business.
2 Operating costs in 2010 include fees paid to the Company's auditor of £0.1m.
3 Includes profit on disposal of property, plant and equipment of £9m (2010 £11m).

Profit on disposal of discontinued operations

	£m	£m
Cash consideration	117	
Transaction costs	(4)	
Amount receivable in respect of sales price adjustments	3	
Proceeds		116
Net assets disposed:		
Property, plant and equipment	(95)	
Inventories	(7)	
Trade and other receivables	(10)	
Deferred tax assets	(16)	
Cash and cash equivalents	(15)	
Trade and other payables	17	
Current tax payable	6	
Provisions	4	
		(116)
Cumulative currency translation gain		14
Profit on disposal of discontinued operations		14

The net assets were measured at fair value less costs to sell at disposal.

NOTES TO THE GROUP ACCOUNTS — INCOME STATEMENT *(continued)*

8. EARNINGS PER SHARE

	2011 £m	2011 Basic pence per share	2011 Diluted pence per share	Restated[1] 2010 £m	Restated[1] 2010 Basic pence per share	Restated[1] 2010 Diluted pence per share
Profit for the year attributable to equity shareholders	**1,240**	**36.9**	**36.7**	1,052	30.5	30.3
Represented by:						
Continuing operations	**1,244**	**37.0**	**36.8**	962	27.9	27.7
Discontinued operations	**(4)**	**(0.1)**	**(0.1)**	90	2.6	2.6
Add back/(deduct):						
Loss/(profit) on disposal of businesses	**29**			(1)		
Pension curtailment gains, post tax	**–**			(1)		
Regulatory penalties	**49**			18		
Net financing (credit)/charge on pensions, post tax	**(18)**			59		
Market value movements on derivatives, post tax	**(61)**			(57)		
Charges relating to early redemption of debt, post tax[2]	**10**			–		
Amortisation and impairment of intangible assets, post tax	**188**			307		
Impairment of goodwill	**94**			84		
Underlying earnings, post tax	**1,531**	**45.5**	**45.3**	1,461	42.4	42.1
Represented by:						
Continuing operations	**1,535**	**45.6**	**45.4**	1,371	39.8	39.5
Discontinued operations	**(4)**	**(0.1)**	**(0.1)**	90	2.6	2.6
	1,531	**45.5**	**45.3**	1,461	42.4	42.1

	2011 Millions	2011 Millions	2010 Millions	2010 Millions
Weighted average number of shares used in calculating basic earnings per share	**3,365**	**3,365**	3,451	3,451
Incremental shares in respect of employee share schemes		**17**		20
Weighted average number of shares used in calculating diluted earnings per share		**3,382**		3,471

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Excludes £28m of charges that would have been incurred in future years and, therefore, remain within underlying earnings.

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

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December

	Notes	2011 £m	2010 £m
Profit for the year		**1,256**	1,081
Taxation expense		**211**	417
Share of results of equity accounted investments	1, 7	**(131)**	(133)
Net finance costs		**117**	192
Depreciation, amortisation and impairment		**751**	899
Profit on disposal of property, plant and equipment	2, 4, 7	**(17)**	(13)
Profit on disposal of investment property	4	**(21)**	–
Loss/(profit) on disposal of businesses	2, 4, 7	**15**	(53)
Cost of equity-settled employee share schemes		**68**	58
Movements in provisions		**(148)**	101
Decrease in liabilities for retirement benefit obligations		**(287)**	(452)
(Increase)/decrease in working capital:			
Inventories		**(85)**	318
Trade and other receivables		**191**	183
Trade and other payables		**(969)**	(1,063)
Cash inflow from operating activities		**951**	1,535
Interest paid		**(212)**	(221)
Taxation paid		**(257)**	(352)
Net cash inflow from operating activities		**482**	962
Dividends received from equity accounted investments	14	**88**	71
Interest received		**32**	48
Income from financial assets at fair value through profit or loss		**4**	–
Purchases of property, plant and equipment, and investment property		**(359)**	(408)
Purchases of intangible assets		**(24)**	(19)
Proceeds from sale of property, plant and equipment, and investment property		**115**	70
Purchase of subsidiary undertakings (net of cash acquired)	26	**(532)**	(179)
Purchase of equity accounted investments	14	**–**	(2)
Equity accounted investment funding	14	**(1)**	(7)
Proceeds from sale of subsidiary undertakings (net of cash disposed)	9	**124**	–
Proceeds from sale of equity accounted investments		**–**	93
Proceeds from sale of financial assets at fair value through profit or loss		**152**	–
Proceeds from sale of other investments		**1**	–
Net proceeds from sale/(purchase) of other deposits/securities	15	**265**	(40)
Net cash outflow from investing activities		**(135)**	(373)
Capital element of finance lease rental payments		**–**	(7)
Proceeds from issue of share capital		**–**	6
Purchase of treasury shares		**(503)**	(503)
Purchase of own shares		**(6)**	(23)
Equity dividends paid	25	**(606)**	(574)
Dividends paid to non-controlling interests		**(22)**	(32)
Cash outflow from matured derivative financial instruments		**(34)**	(123)
Cash inflow from movement in cash collateral		**–**	11
Cash inflow from loans		**2,693**	1,317
Cash outflow from repayment of loans		**(2,541)**	(1,576)
Net cash outflow from financing activities		**(1,019)**	(1,504)
Net decrease in cash and cash equivalents		**(672)**	(915)
Cash and cash equivalents at 1 January		**2,802**	3,678
Effect of foreign exchange rate changes on cash and cash equivalents		**6**	39
Cash and cash equivalents at 31 December		**2,136**	2,802
Comprising:			
Cash and cash equivalents[1]		**2,141**	2,813
Overdrafts		**(5)**	(11)
Cash and cash equivalents at 31 December		**2,136**	2,802

1 Includes £403m (2010 £1m) of cash held in Trust for the benefit of the Group's main pension scheme (see note 23).

NOTES TO THE GROUP ACCOUNTS — CASH FLOW STATEMENT

9. CASH FLOW ANALYSIS

Operating business cash flow

	2011 £m	2010 £m
Cash inflow from operating activities	**951**	1,535
Assets contributed to Trust	**(137)**	(25)
Purchases of property, plant and equipment, and investment property	**(359)**	(408)
Purchases of intangible assets	**(24)**	(19)
Proceeds from sale of property, plant and equipment, and investment property	**115**	70
Proceeds from sale of other investments	**1**	–
Equity accounted investment funding	**(1)**	(7)
Dividends received from equity accounted investments	**88**	71
Cash held for charitable contribution to Tanzania	**–**	(30)
Operating business cash flow	**634**	1,187

	2011 £m	Restated[1,2] 2010 £m
Electronic Systems	**268**	367
Cyber & Intelligence	**123**	89
Platforms & Services (US)	**410**	967
Platforms & Services (UK)	**69**	191
Platforms & Services (International)	**80**	190
HQ	**(308)**	(671)
Discontinued operations	**(8)**	54
Operating business cash flow	**634**	1,187

Cash flows from discontinued operations

	2011 £m	2010 £m
Operating business cash flow	**(8)**	54
Less: Net proceeds from purchases/sales of property, plant and equipment	**(6)**	(1)
Less: Dividends received from equity accounted investments	**–**	(4)
Cash (outflow)/inflow from operating activities	**(14)**	49
Cash inflow from investing activities	**104**	101
Cash outflow from financing activities	**(39)**	(1)
Cash flows from discontinued operations	**51**	149
Regional Aircraft	**51**	53
Saab AB	**–**	96
Cash flows from discontinued operations	**51**	149

Cash flows from disposal of businesses in 2011

	Regional Aircraft Asset Management £m	Other[3] £m	Total £m
Proceeds from sale of subsidiary undertakings	113	30	143
Cash and cash equivalents disposed of with subsidiary undertakings	(15)	(4)	(19)
Proceeds from sale of subsidiary undertakings (net of cash disposed)	**98**	**26**	**124**

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Restated following changes to the Group's reporting segments.
3 Other disposals generated a loss on disposal of £29m (see note 2) based on net assets of £59m at the date of disposal.

10. NET DEBT (AS DEFINED BY THE GROUP)

	2011 £m	2010 £m
Debt-related derivative financial instrument assets – current	–	17
Debt-related derivative financial instrument assets – non-current	56	28
Other investments – current	–	260
Cash and cash equivalents	2,141	2,813
	2,197	3,118
Loans – non-current	(2,682)	(2,133)
Loans – current	(513)	(909)
Overdrafts – current	(5)	(11)
Loans and overdrafts – current	(518)	(920)
Less: Cash received on customers' account[1]	(3)	(16)
Less: Assets held in Trust	(403)	(261)
Less: Cash held for charitable contribution to Tanzania	(30)	(30)
	(3,636)	(3,360)
Net debt (as defined by the Group)	**(1,439)**	(242)

Movement in net debt (as defined by the Group)

	2011 £m	2010 £m
Operating business cash flow	634	1,187
Interest	(180)	(173)
Income from financial assets at fair value through profit or loss	4	–
Taxation	(257)	(352)
Free cash inflow	201	662
Acquisitions and disposals	(256)	(88)
Proceeds from issue of share capital	–	6
Equity dividends paid	(606)	(574)
Dividends paid to non-controlling interests	(22)	(32)
Purchase of own shares, including treasury shares	(509)	(526)
Cash outflow from matured derivative financial instruments	(34)	(123)
Cash inflow from movement in cash collateral	–	11
Movement in cash received on customers' account[1]	13	7
Foreign exchange translation	(20)	(20)
Other non-cash movements	36	32
Movement in net debt (as defined by the Group)	(1,197)	(645)
Opening net (debt)/cash (as defined by the Group)	(242)	403
Closing net debt (as defined by the Group)	**(1,439)**	(242)

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

CONSOLIDATED BALANCE SHEET
as at 31 December

	Notes	2011 £m	2010 £m
Non-current assets			
Intangible assets	11	**11,465**	11,216
Property, plant and equipment	12	**2,496**	2,714
Investment property	13	**130**	134
Equity accounted investments	14	**783**	787
Other investments	15	**5**	11
Other receivables	16	**314**	282
Other financial assets	17	**118**	110
Deferred tax assets	18	**1,409**	1,160
		16,720	16,414
Current assets			
Inventories	19	**716**	644
Trade and other receivables including amounts due from customers for contract work	16	**3,369**	3,559
Current tax		**60**	51
Other investments	15	**–**	260
Other financial assets	17	**77**	289
Cash and cash equivalents		**2,141**	2,813
Assets of disposal group held for sale		**18**	–
		6,381	7,616
Total assets	20	**23,101**	24,030
Non-current liabilities			
Loans	21	**(2,682)**	(2,133)
Trade and other payables	22	**(571)**	(694)
Retirement benefit obligations	23	**(4,673)**	(3,456)
Other financial liabilities	17	**(74)**	(255)
Deferred tax liabilities	18	**(26)**	(6)
Provisions	24	**(501)**	(425)
		(8,527)	(6,969)
Current liabilities			
Loans and overdrafts	21	**(518)**	(920)
Trade and other payables	22	**(8,531)**	(9,352)
Other financial liabilities	17	**(284)**	(109)
Current tax		**(468)**	(625)
Provisions	24	**(453)**	(652)
Liabilities of disposal group held for sale		**(21)**	–
		(10,275)	(11,658)
Total liabilities		**(18,802)**	(18,627)
Net assets		**4,299**	5,403
Capital and reserves			
Issued share capital	25	**90**	90
Share premium		**1,249**	1,249
Other reserves	25	**5,381**	5,470
Accumulated losses		**(2,480)**	(1,477)
Total equity attributable to equity holders of the parent		**4,240**	5,332
Non-controlling interests		**59**	71
Total equity		**4,299**	5,403

Approved by the Board on 15 February 2012 and signed on its behalf by:

I G King
Chief Executive

P J Lynas
Group Finance Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December

	Attributable to equity holders of the parent						
	Issued share capital £m	Share premium £m	Other reserves[1] £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 January 2011	90	1,249	5,470	(1,477)	5,332	71	5,403
Profit for the year	–	–	–	1,240	1,240	16	1,256
Total other comprehensive income for the year	–	–	(89)	(1,196)	(1,285)	–	(1,285)
Share-based payments	–	–	–	68	68	–	68
Share options:							
Purchase of own shares	–	–	–	(6)	(6)	–	(6)
Purchase of treasury shares	–	–	–	(503)	(503)	–	(503)
Ordinary share dividends	–	–	–	(606)	(606)	(22)	(628)
Other	–	–	–	–	–	(6)	(6)
At 31 December 2011	**90**	**1,249**	**5,381**	**(2,480)**	**4,240**	**59**	**4,299**
At 1 January 2010	90	1,243	5,399	(2,141)	4,591	72	4,663
Profit for the year	–	–	–	1,052	1,052	29	1,081
Total other comprehensive income for the year	–	–	71	654	725	–	725
Share-based payments	–	–	–	58	58	–	58
Share options:							
Proceeds from shares issued	–	6	–	–	6	–	6
Purchase of own shares	–	–	–	(23)	(23)	–	(23)
Purchase of treasury shares	–	–	–	(503)	(503)	–	(503)
Ordinary share dividends	–	–	–	(574)	(574)	(32)	(606)
Other	–	–	–	–	–	2	2
At 31 December 2010	90	1,249	5,470	(1,477)	5,332	71	5,403

1 An analysis of other reserves is provided in note 25.

NOTES TO THE GROUP ACCOUNTS – BALANCE SHEET

11. INTANGIBLE ASSETS

	Goodwill £m	Programme and customer related[1] £m	Other[2] £m	Total £m
Cost or valuation				
At 1 January 2010	13,224	1,820	448	15,492
Additions:				
Acquired separately	–	–	17	17
Internally developed	–	–	2	2
Acquisition of subsidiaries (note 26)	161	37	4	202
Adjustment to fair value of consideration (note 26)	(64)	–	–	(64)
Disposals	(12)	–	(6)	(18)
Asset reclassifications	–	27	(27)	–
Transfer from property, plant and equipment	–	–	3	3
Transfer from inventories	–	–	3	3
Exchange adjustments	279	60	21	360
At 31 December 2010	13,588	1,944	465	15,997
Additions:				
Acquired separately	–	–	17	17
Internally developed	–	–	7	7
Acquisition of subsidiaries (note 26)	291	179	91	561
Adjustment on finalisation of provisional goodwill (note 26)	5	–	–	5
Business disposals	(33)	(10)	(6)	(49)
Transfer from property, plant and equipment	–	–	3	3
Exchange adjustments	49	11	–	60
At 31 December 2011	13,900	2,124	577	16,601
Amortisation and impairment				
At 1 January 2010	3,003	967	216	4,186
Disposals	–	–	(6)	(6)
Amortisation charge	–	327	65	392
Impairment charge	84	30	11	125
Asset reclassifications	–	15	(15)	–
Transfer from property, plant and equipment	–	–	1	1
Exchange adjustments	36	34	13	83
At 31 December 2010	3,123	1,373	285	4,781
Business disposals	–	(9)	(5)	(14)
Amortisation charge	–	158	81	239
Impairment charge	94	13	2	109
Exchange adjustments	7	10	4	21
At 31 December 2011	3,224	1,545	367	5,136
Net book value				
At 31 December 2011	**10,676**	**579**	**210**	**11,465**
At 31 December 2010	10,465	571	180	11,216
At 1 January 2010	10,221	853	232	11,306

1 Relates to intangible assets recognised on acquisition of subsidiary companies, mainly in respect of ongoing programme relationships and the acquired order book.
2 Other intangibles includes patents, trademarks, software and internally funded development costs.

The Group has no indefinite life intangible assets other than goodwill.

Impairment testing
In order to calculate the recoverable amount of the Group's goodwill, all goodwill balances have been considered with regard to value-in-use calculations, with the exception of the Safety Products business within Land & Armaments which is based on fair value less costs to sell.

The value-in-use calculations use risk-adjusted future cash flow projections based on the Group's five-year Integrated Business Plan (IBP) and include a terminal value based on the projections for the final year of that plan, with growth rate assumptions applied. The IBP process includes the use of historic experience, available government spending data and the Group's order book. Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital of 7.37% (2010 7.28%) (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.

11. INTANGIBLE ASSETS *(continued)*

Significant CGUs
Goodwill allocated to CGUs which are largely dependent on US government spending on defence, aerospace and security represents £8.9bn (2010 £8.8bn) of the Group's total goodwill balance.

		Allocated goodwill		Pre-tax discount rate	
Significant CGUs	Key assumptions	**2011 £bn**	2010 £bn	**2011 %**	2010 %
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	**3.2**	3.1	**9.2**	9.1
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	**1.4**	1.3	**9.2**	9.1
Support Solutions (within Platforms & Services (US))	Continued demand in the US for complex infrastructure, maritime and aviation services, and operations support	**0.8**	0.8	**9.2**	9.1
Land & Armaments (within Platforms & Services (US))	Continued demand in the Group's principal markets for existing and successor military wheeled and tracked vehicles, naval guns, missile launchers, artillery systems, munitions, law enforcement products, upgrade programmes, and support	**3.5**	3.6	**8.8**	9.0

The final year growth rate assumption in the value-in-use calculations, after adjusting for assumed 3% inflation, is 0% (2010 0%).

The Group monitors changes in defence budgets on an ongoing basis. Whilst there is uncertainty as to the impact of potential deficit reduction actions on US government spending in 2013 and beyond, the future cash flow projections used in the IBP include an assumption regarding both the level and composition of US defence expenditure.

The headroom, calculated as the difference between the allocated goodwill as at 31 December 2011 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 final year growth rate assumption used in the value-in-use calculations.

	Headroom as at 31 December		Headroom assuming a 1% reduction in final year growth rate assumption	
	2011 £bn	2010 £bn	**2011 £bn**	2010 £bn
Electronic Systems	**2.6**	4.4	**1.5**	2.9
Intelligence & Security	**0.2**	0.5	**(0.1)**	0.1
Support Solutions	**1.0**	1.6	**0.6**	1.1
Land & Armaments	**1.4**	3.7	**0.4**	2.2

Other CGUs
The remaining goodwill balance of £1.8bn (2010 £1.7bn) is allocated across multiple CGUs, including £0.6bn in the Surface Ships CGU and £0.5bn in the Detica CGU, with no individual CGU exceeding 6% 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.

Impairment – goodwill
In 2011, the impairment charge of £94m comprises the Safety Products business within the Land & Armaments CGU (£60m) and Surface Ships (£34m). The impairment in respect of the Safety Products business reflects the agreement, in December 2011, to sell the business at a price below its total carrying value. The Surface Ships impairment reflects the underperformance of its export ship contracts. The pre-tax discount rate was 10.4%.

In 2010, the total goodwill impairment charge of £84m mainly arose in Surface Ships (£70m) reflecting the underperformance of the ex-VT Group export ship contracts. The pre-tax discount rate was 10.4%.

Impairment – intangible assets
In 2011, the impairment charge of £15m relates to the Land & Armaments business within the Platforms & Services (US) reporting segment and includes £6m in respect of the Safety Products business.

In 2010, the total intangible assets impairment charge of £41m comprised £30m relating to programme and customer related intangibles, and £11m relating to other intangibles. The charge impacted the Cyber & Intelligence (£11m) and Platforms & Services (US) (£30m) reporting segments.

NOTES TO THE GROUP ACCOUNTS – BALANCE SHEET *(continued)*

12. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £m	Plant and machinery £m	Aircraft £m	Total £m
Cost				
At 1 January 2010	2,195	2,551	759	5,505
Additions	159	225	20	404
Acquisition of subsidiaries (note 26)	98	15	–	113
Transfers to inventories	–	(4)	(5)	(9)
Transfer to investment properties	(15)	–	–	(15)
Transfer to other intangible assets	–	(3)	–	(3)
Reclassification between categories	17	(18)	1	–
Disposals	(41)	(136)	(95)	(272)
Exchange adjustments	64	51	21	136
At 31 December 2010	2,477	2,681	701	5,859
Additions	89	240	7	336
Acquisition of subsidiaries (note 26)	8	2	–	10
Adjustment on finalisation of provisional fair values on acquisitions	–	(2)	–	(2)
Transfers (to)/from inventories	–	(5)	1	(4)
Transfer to investment properties	(7)	–	–	(7)
Transfer to other intangible assets	–	(3)	–	(3)
Transfer to held for sale[1]	(4)	(72)	(643)	(719)
Reclassification between categories	8	1	(9)	–
Disposals	(84)	(142)	(42)	(268)
Business disposals	(2)	(17)	–	(19)
Exchange adjustments	8	8	(15)	1
At 31 December 2011	2,493	2,691	–	5,184
Depreciation and impairment				
At 1 January 2010	644	1,745	564	2,953
Depreciation charge for the year	101	201	34	336
Impairment charge for the year	29	–	14	43
Transfers to inventories	–	(5)	(3)	(8)
Transfer to investment properties	(1)	–	–	(1)
Transfer to other intangible assets	–	(1)	–	(1)
Reclassification between categories	(12)	13	(1)	–
Disposals	(32)	(123)	(80)	(235)
Exchange adjustments	12	29	17	58
At 31 December 2010	741	1,859	545	3,145
Depreciation charge for the year	133	188	10	331
Impairment charge for the year	30	11	44	85
Impairment write back	(16)	–	(1)	(17)
Transfers to inventories	–	(5)	–	(5)
Transfer to held for sale[1]	(4)	(72)	(543)	(619)
Reclassification between categories	5	3	(8)	–
Disposals	(55)	(130)	(34)	(219)
Business disposals	–	(9)	–	(9)
Exchange adjustments	4	5	(13)	(4)
At 31 December 2011	838	1,850	–	2,688
Net book value				
At 31 December 2011	**1,655**	**841**	**–**	**2,496**
At 31 December 2010	1,736	822	156	2,714
At 1 January 2010	1,551	806	195	2,552

1 Net book value transferred to held for sale comprises the Regional Aircraft Asset Management (£95m) and Regional Aircraft Support & Engineering (£5m) businesses.

12. PROPERTY, PLANT AND EQUIPMENT *(continued)*

Net book value

	Land and buildings £m	Plant and machinery £m	Aircraft £m	Total £m
Freehold property	1,462	–	–	1,462
Long leasehold property	130	–	–	130
Short leasehold property	63	–	–	63
Plant and machinery	–	760	–	760
Fixtures, fittings and equipment	–	81	–	81
Aircraft	–	–	–	–
At 31 December 2011	**1,655**	**841**	**–**	**2,496**

Net impairment

	2011 £m	Restated[1,2] 2010 £m
Electronic Systems	**2**	10
Platforms & Services (US)	**7**	3
Platforms & Services (International)	**12**	16
Discontinued operations	**47**	14
	68	43

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).
2 Restated following changes to the Group's reporting segments.

2011
The net impairment charge of £68m comprises £21m from continuing operations and £47m in respect of the Regional Aircraft line of business within discontinued operations (see note 7). The charge to continuing operations within Platforms & Services (International) has been more than offset by a provision release of £22m.

2010
The impairment charge of £43m in 2010 mainly comprised charges in respect of the carrying values of land and buildings in Saudi Arabia (£16m) and the US (£10m), and aircraft within the Regional Aircraft business (£14m).

Assets in the course of construction

	Land and buildings £m	Plant and machinery £m	Total £m
At 31 December 2011	**57**	**144**	**201**
At 31 December 2010	67	77	144

Operating leases
The future aggregate minimum lease income from the non-cancellable elements of operating leases for assets capitalised (including investment property (note 13)) are as follows:

	2011 £m	2010 £m
Receipts due:		
Not later than one year	**21**	68
Later than one year and not later than five years	**82**	173
Later than five years	**157**	185
	260	426

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. There is no lease income relating to assets held by the Group under capitalised finance leases within the above.

NOTES TO THE GROUP ACCOUNTS — BALANCE SHEET *(continued)*

13. INVESTMENT PROPERTY

	£m
Cost	
At 1 January 2010	155
Additions	14
Transfer from property, plant and equipment	15
Disposals	(7)
At 31 December 2010	177
Additions	21
Transfer from property, plant and equipment	7
Disposals	(29)
At 31 December 2011	176
Depreciation and impairment	
At 1 January 2010	44
Depreciation charge for the year	3
Transfer from property, plant and equipment	1
Disposals	(5)
At 31 December 2010	43
Depreciation charge for the year	3
Impairment	1
Disposals	(1)
At 31 December 2011	46
Net book value of investment property	
At 31 December 2011	**130**
At 31 December 2010	134
At 1 January 2010	111

Fair value of investment property	
At 31 December 2011	**228**
At 31 December 2010	233

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.

14. EQUITY ACCOUNTED INVESTMENTS

Principal equity accounted investments

Joint ventures	Principal activities	Group interest in allotted capital	Principally operates in	Country of incorporation
Eurofighter Jagdflugzeug GmbH *(Held by BAE Systems plc)*	Management and control of the Typhoon programme	33% ordinary	Germany	Germany
MBDA SAS *(Held via BAE Systems Electronics Limited and BAE Systems (Overseas Holdings) Limited)*	Development and manufacture of guided weapons	37.5% ordinary	Europe	France

The Company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to equity accounted investments whose results or financial position, in the opinion of the directors, principally affected the financial statements. A full list of subsidiary, equity accounted investments and other associated undertakings as at 31 December 2011 will be annexed to the Company's next annual return filed with the Registrar of Companies.

Carrying value of equity accounted investments

	Share of net assets £m	Purchased goodwill[1] £m	Carrying value £m
At 1 January 2010	464	382	846
Share of results after tax	133	–	133
Acquisitions	2	–	2
Equity accounted investment funding	7	–	7
Disposal	(125)	(30)	(155)
Dividends received	(71)	–	(71)
Market value adjustments in respect of derivative financial instruments, net of tax	3	–	3
Actuarial gains on defined benefit pension schemes, net of tax	28	–	28
Foreign exchange adjustment	4	(10)	(6)
At 31 December 2010	445	342	787
Share of results after tax	131	–	131
Acquisitions[2]	1	–	1
Equity accounted investment funding	1	–	1
Dividends received	(88)	–	(88)
Actuarial losses on defined benefit pension schemes, net of tax	(32)	–	(32)
Foreign exchange adjustment	(7)	(10)	(17)
At 31 December 2011	**451**	**332**	**783**

1 Includes £57m (2010 £59m) relating to the goodwill arising on acquisitions made by the Group's equity accounted investments subsequent to their acquisition by the Group.
2 Equity accounted investment acquired with Norkom Group plc (see note 26).

Share of the assets and liabilities of equity accounted investments

	2011 £m	2010 £m
Assets:		
Non-current assets	**745**	803
Current assets	**3,108**	3,014
	3,853	3,817
Liabilities:		
Non-current liabilities	**(462)**	(466)
Current liabilities	**(2,608)**	(2,564)
	(3,070)	(3,030)
Carrying value	**783**	787

Contingent liabilities

The Group is not aware of any material contingent liabilities in respect of its equity accounted investments.

NOTES TO THE GROUP ACCOUNTS — BALANCE SHEET *(continued)*

15. OTHER INVESTMENTS

	2011 £m	2010 £m
Non-current		
Available-for-sale financial assets		
Equity securities	5	11
	5	11
Current		
Available-for-sale financial assets		
Government bonds[1]	–	260
	–	260

Reconciliation of movements

	2011 £m	2010 £m
Non-current		
At 1 January	11	6
Disposals	(1)	–
Fair value movements	–	5
Recycling of fair value movements[2]	(5)	–
At 31 December	5	11
Current		
At 1 January	260	211
Additions	13	40
Disposals	(278)	–
Fair value movements	5	9
At 31 December	–	260

1 The government bonds were held in a Trust in respect of the Group's UK pension schemes (see page 50).
2 Relates to the acquisition of the remaining 91.3% interest in Fairchild Imaging, Inc. (see note 26).

16. TRADE AND OTHER RECEIVABLES

	2011 £m	2010 £m
Non-current		
Pension prepayment (note 23)	**53**	49
Prepayments and accrued income	**16**	15
Other receivables	**245**	218
	314	282
Current		
Long-term contract balances	**6,459**	6,586
Less: attributable progress payments	**(5,532)**	(5,680)
Amounts due from contract customers	**552**	579
Amounts due from customers for contract work[1]	**1,479**	1,485
Trade receivables	**1,141**	1,252
Amounts owed by equity accounted investments (note 29)[2]	**234**	307
Prepayments and accrued income	**268**	315
Other receivables	**247**	200
	3,369	3,559

1 There are no retentions against long-term contracts (2010 £nil) and no amounts that are past due within amounts due from customers for contract work (2010 £nil).
2 Includes £50m (2010 £6m) past 180 days overdue and not impaired.

The aggregate amount of costs incurred and recognised profits (less recognised losses) to date in respect of contracts in progress at 31 December 2011 are estimated to be £30.3bn (2010 £31.9bn).

The ageing of trade receivables is detailed below:

	2011			2010		
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Not past due and not impaired	**942**	**–**	**942**	1,065	–	1,065
Up to 180 days overdue and not impaired	**121**	**–**	**121**	117	–	117
Up to 180 days overdue and impaired	**–**	**–**	**–**	1	(1)	–
Past 180 days overdue and not impaired	**78**	**–**	**78**	70	–	70
Past 180 days overdue and impaired	**39**	**(39)**	**–**	40	(40)	–
	1,180	**(39)**	**1,141**	1,293	(41)	1,252

Trade receivables are disclosed net of a provision for impairment losses. Movements on the provision are as follows:

	2011 £m	2010 £m
At 1 January	**41**	47
Created	**18**	23
Released	**(20)**	(22)
Exchange adjustments	**(1)**	1
Acquisitions	**3**	–
Utilised	**(2)**	(8)
At 31 December	**39**	41

Other receivables do not contain assets which are considered to be impaired.

The Group has material receivables due from the UK, US and Saudi Arabian governments where credit risk is not considered an issue. For the remaining trade receivables, the provision has been calculated taking into account individual assessments based on past credit history and prior knowledge of debtor insolvency or other credit risk.

NOTES TO THE GROUP ACCOUNTS — BALANCE SHEET *(continued)*

17. OTHER FINANCIAL ASSETS AND LIABILITIES

	2011 Assets £m	2011 Liabilities £m	2010 Assets £m	2010 Liabilities £m
Non-current				
Cash flow hedges – foreign exchange contracts	**38**	**(67)**	57	(77)
Other foreign exchange/interest rate contracts	**24**	**(7)**	25	(178)
Debt-related derivative financial instruments – assets[1]	**56**	**–**	28	–
	118	**(74)**	110	(255)
Current				
Cash flow hedges – foreign exchange contracts	**42**	**(58)**	92	(68)
Other foreign exchange/interest rate contracts	**35**	**(226)**	53	(41)
Fair value of 10.25% shareholding in Saab AB	**–**	**–**	127	–
Debt-related derivative financial instruments – assets[2]	**–**	**–**	17	–
	77	**(284)**	289	(109)

1 Includes fair value hedges of £15m (2010 £9m).
2 Includes fair value hedges of £nil (2010 £17m).

The debt-related derivative financial liabilities are presented as a component of loans and overdrafts (see note 21).

The notional principal amounts of the outstanding contracts are detailed in note 27.

Cash flow hedges
The hedged, highly probable forecast transactions denominated in foreign currency are predominantly expected to occur at various stages during the next 12 months. The majority of those extending beyond 12 months are expected to have been transacted within five years of the balance sheet date.

Amounts debited to the hedging reserve in respect of cash flow hedges were £56m (2010 £84m).

The amount credited from equity and included in contract-related non-financial assets and liabilities was £11m (2010 £1m).

Fair value hedges
The net loss arising in the income statement on fair value hedging instruments was £10m (2010 £6m), which comprises gains of £6m less losses of £16m. The net gain arising in the income statement on the fair value of the underlying hedged items was £11m (2010 £6m), which comprises gains of £17m less losses of £6m. The ineffective portion recognised in the income statement that arises from fair value hedges amounts to a gain of £15m (2010 £6m).

18. DEFERRED TAX

Deferred tax assets/(liabilities)

	Deferred tax assets		Deferred tax liabilities		Net balance at 31 December	
	2011 £m	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m
Property, plant and equipment	**–**	14	**(106)**	(118)	**(106)**	(104)
Intangible assets	**–**	–	**(176)**	(207)	**(176)**	(207)
Provisions and accruals	**367**	394	**–**	–	**367**	394
Goodwill	**–**	–	**(151)**	(110)	**(151)**	(110)
Pension/retirement plans:						
Deficits	**1,239**	1,060	**–**	–	**1,239**	1,060
Additional contributions and other	**101**	18	**–**	–	**101**	18
Share-based payments	**11**	11	**–**	–	**11**	11
Financial instruments	**27**	20	**(14)**	(12)	**13**	8
Other items	**40**	58	**(2)**	(2)	**38**	56
Rolled over capital gains	**–**	–	**(16)**	(17)	**(16)**	(17)
Capital losses carried forward	**16**	17	**–**	–	**16**	17
Trading losses carried forward	**47**	28	**–**	–	**47**	28
Deferred tax assets/(liabilities)	**1,848**	1,620	**(465)**	(466)	**1,383**	1,154
Set off of tax	**(439)**	(460)	**439**	460	**–**	–
Net deferred tax assets/(liabilities)	**1,409**	1,160	**(26)**	(6)	**1,383**	1,154

NOTES TO THE GROUP ACCOUNTS — BALANCE SHEET *(continued)*

18. DEFERRED TAX *(continued)*

Movement in temporary differences during the year

	At 1 January 2011 £m	Exchange movements £m	Acquisitions and disposals[1] £m	Recognised in income £m	Recognised in equity £m	**At 31 December 2011 £m**
Property, plant and equipment	(104)	–	(13)	11	–	**(106)**
Intangible assets	(207)	1	(53)	75	8	**(176)**
Provisions and accruals	394	1	5	(33)	–	**367**
Goodwill	(110)	(2)	1	(40)	–	**(151)**
Pension/retirement plans:						
Deficits	1,060	5	–	(159)	333	**1,239**
Additional contributions and other	18	1	–	93	(11)	**101**
Share-based payments	11	–	–	–	–	**11**
Financial instruments	8	–	–	(9)	14	**13**
Other items	56	–	11	(29)	–	**38**
Rolled over capital gains	(17)	–	–	1	–	**(16)**
Capital losses carried forward	17	–	–	(1)	–	**16**
Trading losses carried forward	28	1	1	17	–	**47**
	1,154	7	(48)	(74)	344	**1,383**

	At 1 January 2010 £m	Exchange movements £m	Acquisitions and disposals[2] £m	Recognised in income £m	Recognised in equity £m	At 31 December 2010 £m
Property, plant and equipment	(46)	–	(46)	(12)	–	(104)
Intangible assets	(325)	(10)	(14)	138	4	(207)
Provisions and accruals	432	18	8	(64)	–	394
Goodwill	(69)	(2)	–	(39)	–	(110)
Pension/retirement plans:						
Deficits	1,430	11	–	(47)	(334)	1,060
Additional contributions and other	15	–	–	–	3	18
Share-based payments	22	–	–	(11)	–	11
Financial instruments	(4)	–	–	(11)	23	8
Other items	52	2	1	5	(4)	56
Rolled over capital gains	(18)	–	–	1	–	(17)
Capital losses carried forward	18	–	–	(1)	–	17
Trading losses carried forward	19	3	1	5	–	28
Unremitted overseas dividends	(3)	–	–	3	–	–
	1,523	22	(50)	(33)	(308)	1,154

1 Acquisitions and disposals includes net deferred tax liabilities on acquisitions (Norkom £18m, ETI £14m and other £3m) and the transfer of net deferred tax assets into the disposal group held for sale (£13m).
2 Acquisitions and disposals includes net deferred tax liabilities on the acquisitions of Atlantic Marine (£40m) and Tenix Defence (£10m).

18. DEFERRED TAX *(continued)*

Unrecognised deferred tax assets
Deferred tax assets have not been recognised in respect of the following items:

	2011 £m	2010 £m
Deductible temporary differences, including tax credits	**11**	3
Capital losses carried forward	**43**	56
Trading and other losses carried forward	**86**	194
	140	253

These assets have not been recognised as the incidence of future profits in the relevant countries and legal entities cannot be sufficiently accurately predicted at this time.

Due to changes in UK tax legislation during 2009, there are no unrecognised deferred tax liabilities arising on the aggregate temporary differences associated with investments in subsidiaries, branches, associates and joint ventures (2010 £nil). Any withholding tax due on the remittance of future earnings is expected to be insignificant.

Future changes in tax rates
The UK current tax rate was reduced from 28% to 26% with effect from 1 April 2011. Under the Finance Act 2011, the UK current tax rate will reduce to 25% with effect from 1 April 2012. The Chancellor has also proposed changes to further reduce the current tax rate by 1% per annum to 23% by 1 April 2014. This will reduce future current tax charges accordingly.

The reduction from 26% to 25% was substantively enacted before 31 December 2011. In line with this change, the rate applying to UK deferred tax assets and liabilities has been reduced from 27% to 25%, creating a rate adjustment, which is partly reflected in the consolidated income statement and partly in the consolidated statement of comprehensive income. Accordingly, both recognised and unrecognised UK deferred tax balances as at 31 December 2011 have been calculated at 25%.

The reduction in the rate from 25% to 23% has not yet been substantively enacted. If these reductions had been substantively enacted by 31 December 2011, the effect would have been to reduce the net deferred tax asset at that date from £1,383m to £1,307m. Of this reduction, it is estimated that £8m would have been charged to the consolidated income statement and £68m charged to the consolidated statement of comprehensive income. In addition, unrecognised deferred tax assets as at 31 December 2011 would have been reduced from £140m to £133m.

NOTES TO THE GROUP ACCOUNTS — BALANCE SHEET *(continued)*

19. INVENTORIES

	2011 £m	2010 £m
Short-term work-in-progress	**251**	245
Raw materials and consumables	**276**	287
Finished goods and goods for resale	**189**	112
	716	644

The Group recognised £6m (2010 £10m) as a write down of inventories to net realisable value.

20. GEOGRAPHICAL ANALYSIS OF ASSETS

Analysis of non-current assets by geographical location

	Carrying value of non-current assets	
Asset location	2011 £m	2010 £m
United Kingdom	**2,515**	2,582
Rest of Europe	**1,274**	1,105
Saudi Arabia	**703**	734
United States	**10,000**	10,022
Australia	**617**	610
Rest of Asia and Pacific	**7**	11
Africa, Central and South America	**24**	31
Non-current reporting segment assets	**15,140**	15,095
Financial instruments	**139**	354
Inventories	**716**	644
Trade and other receivables	**3,369**	3,559
Total reporting segment assets	**19,364**	19,652
Tax	**1,469**	1,211
Retirement benefit obligations (note 23)	**53**	49
Assets of disposal group held for sale	**18**	–
Cash (as defined by the Group) (note 10)	**2,197**	3,118
Consolidated total assets	**23,101**	24,030

21. LOANS AND OVERDRAFTS

	2011 £m	2010 £m
Non-current		
Class B and Class G certificates	**–**	266
Euro-Sterling £100m 10¾% bond, repayable 2014	**100**	100
US$500m 4.95% bond, repayable 2014	**321**	318
US$750m 5.2% bond, repayable 2015	**482**	477
US$350m 3.5% bond, repayable 2016	**224**	–
Albertville Hangar Bond, repayable 2018	**6**	6
US$1bn 6.375% bond, repayable 2019	**656**	645
US$500m 4.75% bond, repayable 2021	**320**	–
US$500m 7.5% bond, repayable 2027	**319**	317
US$400m 5.8% bond, repayable 2041	**254**	–
Debt-related derivative financial instruments – liabilities	**–**	4
	2,682	2,133
Current		
Bank loans and overdrafts	**5**	11
US$1bn 6.4% bond, repaid 2011	**–**	656
Class B and Class G certificates	**–**	108
Debt-related derivative financial instruments – liabilities	**–**	1
US$ Commercial Paper	**513**	144
	518	920

The maturity of the Group’s borrowings is as follows:

	Less than one year £m	Between one and five years £m	More than five years £m	Total £m
At 31 December 2011				
Carrying amount[1]	**518**	**1,142**	**1,540**	**3,200**
Debt-related derivative financial instruments – assets	**–**	**(15)**	**(41)**	**(56)**
Carrying amount including debt-related derivative financial instruments – assets	**518**	**1,127**	**1,499**	**3,144**
Contractual cash flows, including future interest payments	**661**	**1,636**	**2,336**	**4,633**
At 31 December 2010				
Carrying amount[1]	920	1,171	962	3,053
Debt-related derivative financial instruments – assets	(17)	(9)	(19)	(45)
Carrying amount including debt-related derivative financial instruments – assets	903	1,162	943	3,008
Contractual cash flows, including future interest payments	1,052	1,548	1,390	3,990

1 The carrying amount of loans and overdrafts at 31 December 2011 excludes debt-related derivative financial assets of £56m (2010 £45m) presented as other financial assets.

Contractual cash flows in respect of all other financial liabilities are equal to the balance sheet carrying amount. Current contractual amounts relating to other financial liabilities, such as trade payables, are settled within the normal operating cycle of the business.

The Class B and Class G certificates were repaid in June 2011 in connection with the disposal of the Regional Aircraft Asset Management business in July 2011.

The US$500m 4.95% bond, repayable 2014, was converted on issue to a floating rate bond utilising a series of interest rate swaps giving an effective rate during 2011 of 2.43%.

US$500m of the US$1bn 6.375% bond, repayable 2019, has been converted to a floating rate bond utilising a series of interest rate swaps that mature in December 2014 and give an effective rate during 2011 of 5.44%.

The US$500m 7.5% bond, repayable 2027, was converted at issue to a sterling fixed rate bond by utilising a cross-currency swap and has an effective interest rate of 7.73%.

The US$1bn 6.4% bond was repaid in December 2011.

The debt-related derivative financial instruments represent the fair value of certain interest rate and cross-currency derivatives relating to the US$1bn 6.375% bond, repayable 2019, and the US$500m 7.5% bond, repayable 2027. These derivatives have been entered into specifically to manage the Group’s exposure to foreign exchange or interest rate risk.

NOTES TO THE GROUP ACCOUNTS — BALANCE SHEET *(continued)*

22. TRADE AND OTHER PAYABLES

	2011 £m	2010 £m
Non-current		
Amounts due to long-term contract customers	93	181
Accruals and deferred income	47	174
Other payables[1]	431	339
	571	694
Current		
Amounts due to long-term contract customers	4,354	5,036
Amounts due to other customers	254	193
Cash received on customers' account[2]	3	16
Trade payables	966	1,114
Amounts owed to equity accounted investments (note 29)	1,161	1,232
Other taxes and social security costs	63	57
Accruals and deferred income[3]	1,236	1,068
Other payables[4]	494	636
	8,531	9,352

Included above:

	2011 £m	2010 £m
Amounts due to long-term contract customers	4,449	5,224
Advances from long-term contract customers, including progress payments in respect of work not yet performed	4,164	5,026

1 Other payables includes £28m in respect of the US Department of State fine.
2 Cash received on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance. This includes £2m (2010 £7m) in respect of long-term contract customers.
3 Includes £125m in respect of the three Offshore Patrol Vessels under the terminated Trinidad and Tobago contract (2010 £125m included within non-current accruals and deferred income).
4 Other payables includes £30m in respect of the global settlement with the UK's Serious Fraud Office (2010 £30m).

23. RETIREMENT BENEFIT OBLIGATIONS

Pension plans
BAE Systems plc operates pension plans for the Group's qualifying employees in the UK, US and other countries. The principal plans in the UK and US are funded defined benefit plans, and the assets are held in separate trustee administered funds. The plans in other countries are defined contribution plans. Pension plan valuations are regularly carried out by independent actuaries to determine pension costs for pension funding and to calculate the IAS 19, Employee Benefits, deficit.

The disclosures below relate to post-retirement benefit plans in the UK, US and other countries which are accounted for as defined benefit plans in accordance with IAS 19. The valuations used for the IAS 19 disclosures are based on the most recent actuarial valuation undertaken by independent qualified actuaries as updated to take account of the requirements of IAS 19 to assess the deficits of the plans at 31 December each year.

Post-retirement benefits other than pensions
The Group 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 the Group's subsidiaries in the US. The latest valuations of the principal plans, covering retiree medical and life insurance plans in certain US subsidiaries, were performed by independent actuaries as at 1 January 2011. These plans were rolled forward to reflect the information at 31 December 2011. The method of accounting for these is similar to that used for defined benefit pension plans.

Financial assumptions used to calculate liabilities for the principal plans

	UK			US		
	2011 %	2010 %	2009 %	**2011 %**	2010 %	2009 %
Discount rate	**4.8**	5.5	5.7	**5.0**	5.5	5.9
Inflation rate	**2.9**	3.4	3.5	**2.5**	3.0	3.0
Rate of increase in salaries[1]	**3.4**	4.4	4.5	**4.5**	4.5	4.5
Rate of increase for pensions in payment	**1.9 – 3.4**	2.3 – 3.6	2.3 – 3.7	**–**	–	–
Rate of increase for deferred pensions[2]	**2.0/2.9**	2.8/3.4	3.5	**–**	–	–
Long-term healthcare cost increases	**–**	–	–	**5.3**	5.3	5.3

1 The rate of increase in salaries for the UK schemes is assumed to be 0.5% (2010 1.0%) above the Retail Prices Index (RPI) inflation of 2.9% (2010 3.4%), plus a promotional scale.
2 The assumption for the rate of increase for deferred pensions is 2.0% (2010 2.8%) in respect of those schemes which refer to the Consumer Prices Index as the relevant measure and 2.9% (2010 3.4%) where RPI is the relevant measure.

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice. The bid values of plan assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present values of plan liabilities, which are derived from cash flow projections over long periods and therefore inherently uncertain, as at 31 December are shown in the tables below.

Discount rate assumptions are based on third-party AA corporate bond indices and yields that reflect the maturity profile of the expected benefit payments. The inflation rate 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. The inflation assumptions are used to derive the rate of increase for pensions in payment and the rate of increase in deferred pensions where there is such an increase.

For its UK pension arrangements the Group has, for the purpose of calculating its liabilities as at 31 December 2011, used the SAPS S1 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 plan members. In addition, to allow for future improvements in longevity, the CMI 2010 tables (published by the Institute of Actuaries) have been used, with an assumed long-term rate of future annual mortality improvements of 1%, for both pensioner and non-pensioner members. The mortality tables used for the UK pension arrangements have been updated since last year as a result of the formal actuarial valuations carried out on a number of the UK pension arrangements during 2011. The mortality tables used for the US pension arrangements have also been updated this year, from the RP 2000 tables, to the most recently published tables, the 2012 IRS Static Tables. The mortality tables are projected to 2018 for pensioners and to 2026 for non-pensioners. The current life expectancies underlying the value of the accrued liabilities for the main UK plans range from 22 to 24 years for current male pensioners at age 65 and 24 to 25 years for current female pensioners at age 65 and, for the main US plans, 19 years for current male pensioners at age 65 and 21 years for current female pensioners at age 65.

The Group has a number of healthcare arrangements in the US. The long-term healthcare cost increases shown in the table above are based on the assumptions that the increases are 9.0% in 2012 reducing to 5% by 2020 for pre-retirement and 8.5% in 2012 reducing to 5% by 2019 for post-retirement.

A summary of the movements in the retirement benefit obligations is shown overleaf. The full disclosures, as required by IAS 19, are provided in the subsequent information.

NOTES TO THE GROUP ACCOUNTS — BALANCE SHEET *(continued)*

23. RETIREMENT BENEFIT OBLIGATIONS *(continued)*

Summary of movements in retirement benefit obligations

	UK £m	US and other £m	**Total £m**
Total IAS 19 deficit at 1 January 2011	(3,438)	(665)	**(4,103)**
Actual return on assets below expected return	(305)	(117)	**(422)**
Increase in liabilities due to changes in assumptions and experience	(1,192)	(213)	**(1,405)**
Additional contributions	129	–	**129**
Recurring contributions in excess of service cost	184	62	**246**
Past service cost	(45)	(2)	**(47)**
Net financing (charge)/credit	(9)	31	**22**
Exchange translation	–	(10)	**(10)**
Movement in US healthcare plans	–	5	**5**
Total IAS 19 deficit at 31 December 2011	(4,676)	(909)	**(5,585)**
Allocated to equity accounted investments and other participating employers	965	–	**965**
Group's share of IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments and other participating employers at 31 December 2011	(3,711)	(909)	**(4,620)**

During the year, the Group contributed an additional £137m, including £112m relating to the share buyback programme, into Trust for the benefit of the Group's main pension scheme (2010 £25m). The cumulative contributions totalling £387m, plus fair value gains of £16m, are reported within cash and cash equivalents (£403m) at 31 December 2011. The use of these assets is restricted under the terms of the Trust. The Group considers these contributions to be equivalent to the other lump sum contributions it makes into the Group's pension schemes and, accordingly, presents below a definition of the pension deficit including them.

	2011 £m	2010 £m
Group's share of IAS 19 deficit, net	**(4,620)**	(3,407)
Assets held in Trust	**403**	261
Pension deficit (as defined by the Group)	**(4,217)**	(3,146)

23. RETIREMENT BENEFIT OBLIGATIONS *(continued)*

Amounts recognised on the balance sheet

	2011				2010			
	UK defined benefit pension plans £m	US and other pension plans £m	US healthcare plans £m	Total £m	UK defined benefit pension plans £m	US and other pension plans £m	US healthcare plans £m	Total £m
Present value of unfunded obligations	(50)	(145)	(10)	(205)	(28)	(138)	(11)	(177)
Present value of funded obligations	(19,636)	(3,315)	(136)	(23,087)	(17,990)	(3,002)	(137)	(21,129)
Fair value of plan assets	15,010	2,567	130	17,707	14,580	2,496	127	17,203
Total IAS 19 deficit, net	(4,676)	(893)	(16)	(5,585)	(3,438)	(644)	(21)	(4,103)
Allocated to equity accounted investments and other participating employers	965	–	–	965	696	–	–	696
Group's share of IAS 19 deficit, net	(3,711)	(893)	(16)	(4,620)	(2,742)	(644)	(21)	(3,407)
Represented by:								
Pension prepayments (within trade and other receivables)	–	34	19	53	–	34[1]	15[1]	49
Retirement benefit obligations	(3,711)	(927)	(35)	(4,673)	(2,742)	(678)[1]	(36)[1]	(3,456)
	(3,711)	(893)	(16)	(4,620)	(2,742)	(644)	(21)	(3,407)
Group's share of IAS 19 deficit of equity accounted investments	(129)	–	–	(129)	(88)	–	–	(88)

1 Restated.

Amounts for the current and previous four years are as follows:

Defined benefit pension plans	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Defined benefit obligations	(23,146)	(21,158)	(20,488)	(17,133)	(17,109)
Fair value of plan assets	17,577	17,076	14,915	12,978	15,110
Total deficit before tax and allocation to equity accounted investments and other participating employers	(5,569)	(4,082)	(5,573)	(4,155)	(1,999)
Actuarial (loss)/gain on plan liabilities	(1,405)	55	(3,342)	1,433	952
Actuarial (loss)/gain on plan assets at bid value	(422)	1,043	1,258	(3,724)	(156)

Total cumulative actuarial losses recognised in equity since the transition to IFRS are £4.1bn (2010 £2.5bn).

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

NOTES TO THE GROUP ACCOUNTS – BALANCE SHEET *(continued)*

23. RETIREMENT BENEFIT OBLIGATIONS *(continued)*

Assets of defined benefit pension plans

	2011							
	UK			US			Total	
	£m	%	Expected return %	£m	%	Expected return %	£m	%
Equities	7,548	50	7.25	1,452	57	8.70	9,000	51
Bonds	6,164	41	3.40	912	35	4.50	7,076	40
Property[1]	1,117	8	6.00	203	8	7.30	1,320	8
Other	181	1	1.00	–	–	–	181	1
Total	**15,010**	**100**	**5.50**	**2,567**	**100**	**7.10**	**17,577**	**100**

	2010							
	UK			US			Total	
	£m	%	Expected return %	£m	%	Expected return %	£m	%
Equities	8,544	59	8.25	1,690	68	9.00	10,234	60
Bonds	4,765	33	4.70	613	25	6.00	5,378	31
Property[1]	1,084	7	6.00	108	4	7.00	1,192	7
Other	187	1	1.00	85	3	4.00	272	2
Total	14,580	100	6.83	2,496	100	8.01	17,076	100

1 Includes £185m (2010 £181m) of properties occupied by Group companies.

Changes in the fair value of plan assets are as follows:

	UK defined benefit pension plans £m	US and other pension plans £m	US healthcare plans £m	Total £m
Value of plan assets at 1 January 2010	12,780	2,135	108	15,023
Expected return on assets	883	180	8	1,071
Actuarial gain	917	126	8	1,051
Actual return on assets	1,800	306	16	2,122
Contributions by employer	653	113	8	774
Contributions by employer in respect of employee salary sacrifice arrangements	108	–	–	108
Total contributions by employer	761	113	8	882
Members' contributions (including Department for Work and Pensions rebates)	37	16	–	53
Currency gain	–	65	3	68
Benefits paid	(798)	(139)	(8)	(945)
Value of plan assets at 31 December 2010	14,580	2,496	127	17,203
Expected return on assets	967	195	9	1,171
Actuarial loss	(305)	(117)	(6)	(428)
Actual return on assets	662	78	3	743
Contributions by employer	474	111	4	589
Contributions by employer in respect of employee salary sacrifice arrangements	103	–	–	103
Total contributions by employer	577	111	4	692
Members' contributions (including Department for Work and Pensions rebates)	36	15	–	51
Currency gain	–	18	1	19
Benefits paid	(845)	(151)	(5)	(1,001)
Value of plan assets at 31 December 2011	**15,010**	**2,567**	**130**	**17,707**

23. RETIREMENT BENEFIT OBLIGATIONS *(continued)*

Changes in the present value of the defined benefit obligations before allocation to equity accounted investments and other participating employers are as follows:

	UK defined benefit pension plans £m	US and other pension plans £m	US healthcare plans £m	Total £m
Defined benefit obligations at 1 January 2010	(17,786)	(2,702)	(151)	(20,639)
Current service cost	(159)	(53)	(2)	(214)
Contributions by employer in respect of employee salary sacrifice arrangements	(108)	–	–	(108)
Total current service cost	(267)	(53)	(2)	(322)
Members' contributions (including Department for Work and Pensions rebates)	(37)	(16)	–	(53)
Past service cost	(39)	–	–	(39)
Actuarial gain/(loss) on liabilities	314	(259)	6	61
Curtailment gains	–	2	5	7
Interest expense	(1,001)	(165)	(8)	(1,174)
Currency loss	–	(86)	(6)	(92)
Benefits paid	798	139	8	945
Defined benefit obligations at 31 December 2010	(18,018)	(3,140)	(148)	(21,306)
Current service cost	(161)	(49)	(2)	(212)
Contributions by employer in respect of employee salary sacrifice arrangements	(103)	–	–	(103)
Total current service cost	(264)	(49)	(2)	(315)
Members' contributions (including Department for Work and Pensions rebates)	(36)	(15)	–	(51)
Past service (cost)/credit	(45)	(2)	2	(45)
Actuarial (loss)/gain on liabilities	(1,192)	(213)	3	(1,402)
Curtailment gains	–	–	2	2
Interest expense	(976)	(164)	(7)	(1,147)
Currency loss	–	(28)	(1)	(29)
Benefits paid	845	151	5	1,001
Defined benefit obligations at 31 December 2011	**(19,686)**	**(3,460)**	**(146)**	**(23,292)**

Contributions

The Group contributions made to the defined benefit plans in the year ended 31 December 2011 were £515m (2010 £695m) excluding those amounts allocated to equity accounted investments and participating employers of £70m (2010 £71m). This includes contributions of £20m into the UK schemes relating to the share buyback programme (2010 £157m). In 2011, the Group paid an additional £112m into Trust relating to the share buyback programme and expects to pay £25m into Trust in 2012 in respect of the BAE Systems 2000 Pension Plan, taking total contributions for the 2011 share buyback to £157m. In 2012, the Group expects to make regular contributions at a similar level to those made in 2011.

The Group incurred a charge in respect of the cash contributions of £119m (2010 £110m) paid to defined contribution plans for employees.

NOTES TO THE GROUP ACCOUNTS — BALANCE SHEET *(continued)*

23. RETIREMENT BENEFIT OBLIGATIONS *(continued)*

The amounts recognised in the income statement after allocation to equity accounted investments and other participating employers are as follows:

	2011				Restated[1] 2010			
	UK defined benefit pension plans £m	**US and other pension plans £m**	**US healthcare plans £m**	**Total £m**	UK defined benefit pension plans £m	US and other pension plans £m	US healthcare plans £m	Total £m
Included in operating costs:								
Current service cost	**(131)**	**(49)**	**(2)**	**(182)**	(127)	(53)	(2)	(182)
Past service cost	**(43)**	**(2)**	**2**	**(43)**	(29)	–	–	(29)
	(174)	**(51)**	**–**	**(225)**	(156)	(53)	(2)	(211)
Included in other income:								
Pension curtailment gains	**–**	**–**	**–**	**–**	–	2	–	2
US healthcare curtailment gains	**–**	**–**	**2**	**2**	–	–	5	5
	–	**–**	**2**	**2**	–	2	5	7
Included in finance costs:								
Expected return on plan assets	**785**	**195**	**9**	**989**	728	180	8	916
Interest on obligations	**(794)**	**(164)**	**(7)**	**(965)**	(823)	(165)	(8)	(996)
	(9)	**31**	**2**	**24**	(95)	15	–	(80)
Included in share of results of equity accounted investments:								
Group's share of equity accounted investments' operating costs	**(7)**	**–**	**–**	**(7)**	(8)	–	–	(8)
Group's share of equity accounted investments' finance costs	**(1)**	**–**	**–**	**(1)**	(3)	–	–	(3)

A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	One percentage point increase £m	One percentage point decrease £m
(Increase)/decrease in the aggregate of service cost and interest cost	(0.2)	0.2
(Increase)/decrease in defined benefit obligations	(3.0)	2.5

A 0.5 percentage point change in discount rates used to value liabilities would have the following effect:

	0.5 percentage point increase £bn	0.5 percentage point decrease £bn
Decrease/(increase) in defined benefit obligations	1.9	(1.9)

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).

24. PROVISIONS

	Warranties and after-sales service £m	Reorganisations – continuing operations £m	Legal, contractual and environmental £m	Other £m	Total £m
Non-current	107	7	242	69	425
Current	74	224	279	75	652
At 1 January 2011	181	231	521	144	1,077
Created	88	186	33	44	351
Released	(37)	(80)	(57)	(27)	(201)
Utilised	(50)	(129)	(68)	(49)	(296)
Acquisitions (note 26)	1	–	1	1	3
Adjustment on finalisation of provisional fair values on acquisitions	–	–	–	2	2
Transfer to held for sale	–	–	–	(4)	(4)
Discounting	–	–	21	1	22
Reclassifications	–	–	(8)	8	–
Exchange adjustments	(1)	–	–	1	–
At 31 December 2011	**182**	**208**	**443**	**121**	**954**
Represented by:					
Non-current	96	65	266	74	501
Current	86	143	177	47	453
	182	**208**	**443**	**121**	**954**

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. Such 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 – continuing operations
The costs associated with the reorganisation programmes are supported by detailed plans and based on previous experience as well as other known factors. Such 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.

The reorganisation provisions totalling £186m created in 2011 include £60m for which the Group is contractually entitled to reimbursement from the customer. This amount is included in prepayments and accrued income at 31 December 2011.

Legal, contractual and environmental
The Group holds provisions for expected legal, contractual and environmental costs that it expects to incur over an extended period. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome.

Reflecting the inherent uncertainty within many legal proceedings, the timing and amount of the outflows could differ significantly from the amount provided.

Other
There are no individually significant provisions included within other provisions.

NOTES TO THE GROUP ACCOUNTS – BALANCE SHEET *(continued)*

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 2010	3,585	90	1	1	90
Exercise of options	2	–	–	–	–
At 1 January 2011	3,587	90	1	1	90
Exercise of options	1	–	–	–	–
At 31 December 2011	**3,588**	**90**	**1**	**1**	**90**

Special Share
One Special Share of £1 in the Company is held on behalf of the Secretary of State for Business, Innovation and Skills (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
During the year, 184,393,049 ordinary shares of 2.5p each were repurchased under the buyback programme (2010 143,951,447).

As at 31 December 2011, 351,756,854 (2010 178,377,628) ordinary shares of 2.5p each with an aggregate nominal value of £8,793,921 (2010 £4,459,441) were held in treasury. During 2011, 11,013,823 treasury shares were used to satisfy awards and options under the Share Incentive Plan, Share Matching Plan, Performance Share Plan and Executive Share Option Plan (2010 9,526,179 in respect of the Share Incentive Plan and Share Matching Plan).

Own shares held
Own shares held, including treasury shares and shares held by BAE Systems 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. A dividend waiver was in operation for shares within the ESOP Trust, other than those owned beneficially by the participants, for the dividends paid in June and November 2011.

At 31 December 2011, the ESOP held 2,402,305 (2010 2,202,800) ordinary shares of 2.5p each with a market value of £7m (2010 £7m). 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 in operation during 2011 and remains over shares within the Company's Share Incentive Plan Trust other than those shares owned beneficially by the participants. A dividend waiver was also in operation for the dividends paid in June and November 2011 over shares in the Group All-Employee Free Shares Plan Trust other than those shares owned beneficially by participants.

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

At 31 December 2011, the Group's capital was £4,291m (2010 £5,356m), which comprises total equity of £4,299m (2010 £5,403m), less amounts accumulated in equity relating to cash flow hedges of £8m (2010 £47m). Net debt (as defined by the Group) was £1,439m (2010 £242m).

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; continuing to pursue organic investment opportunities; paying dividends in line with the Group's policy of long-term sustainable cover of around two times; making accelerated returns of capital to shareholders when the balance sheet allows; and investing in value enhancing acquisitions, where market conditions are right and where they deliver on the Group's strategy.

25. SHARE CAPITAL AND OTHER RESERVES *(continued)*

Equity dividends

	2011 £m	2010 £m
Prior year final 10.5p dividend per ordinary share paid in the year (2010 9.6p)	**359**	335
Interim 7.5p dividend per ordinary share paid in the year (2010 7.0p)	**247**	239
	606	574

After the balance sheet date, the directors proposed a final dividend of 11.3p. The dividend, which is subject to shareholder approval, will be paid on 1 June 2012 to shareholders registered on 20 April 2012. The ex-dividend date is 18 April 2012.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 11 May 2012.

Other reserves

	Merger reserve £m	Statutory reserve £m	Revaluation reserve £m	Translation reserve £m	Hedging reserve £m	Total £m
At 1 January 2010	4,589	202	10	485	113	5,399
Currency translation on foreign currency net investments	–	–	–	160	–	160
Recycling of cumulative currency translation reserve on disposal	–	–	–	(17)	–	(17)
Amounts charged to hedging reserve	–	–	–	–	(84)	(84)
Recycling of cumulative net hedging reserve on disposal	–	–	–	–	(4)	(4)
Share of other comprehensive income of equity accounted investments	–	–	–	(6)	–	(6)
Tax on other comprehensive income	–	–	–	–	22	22
At 1 January 2011	4,589	202	10	622	47	5,470
Currency translation on foreign currency net investments	–	–	–	(19)	–	(19)
Recycling of cumulative currency translation reserve on disposal	–	–	–	(14)	–	(14)
Amounts charged to hedging reserve	–	–	–	–	(56)	(56)
Share of other comprehensive income of equity accounted investments	–	–	–	(17)	–	(17)
Tax on other comprehensive income	–	–	–	–	17	17
At 31 December 2011	**4,589**	**202**	**10**	**572**	**8**	**5,381**

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 the statutory reserve may only be applied in paying up unissued shares of the Group to be allotted to members of the Group 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.

Translation reserve
The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

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.

Share of other comprehensive income of equity accounted investments

	2011			2010		
	Translation reserve £m	**Retained earnings £m**	**Total £m**	Translation reserve £m	Retained earnings £m	Total £m
Currency translation on foreign currency net investments	**(17)**	**–**	**(17)**	(6)	–	(6)
Net actuarial (losses)/gains on defined benefit pension schemes	**–**	**(45)**	**(45)**	–	40	40
Share of other comprehensive income of equity accounted investments	**(17)**	**(45)**	**(62)**	(6)	40	34

NOTES TO THE GROUP ACCOUNTS – OTHER INFORMATION

26. ACQUISITION OF SUBSIDIARIES

Subsidiaries acquired during 2011
The Group has acquired L-1 Identity Solutions, Inc.'s Intelligence Services Group (L-1 ISG), Norkom Group plc (Norkom) and ETI A/S (ETI) in the Cyber & Intelligence reporting segment. The Group also acquired Fairchild Imaging, Inc. (Fairchild) in the Electronic Systems reporting segment and stratsec.net Pty Limited (stratsec), an Australian information security company, in the Platforms & Services (International) reporting segment.

If the acquisitions had occurred on 1 January 2011, combined sales of Group and share of equity accounted investments would have been £19.2bn, revenue £17.8bn and profit £1,252m from continuing operations for the year ended 31 December 2011.

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

Summary

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

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

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

Material acquisitions

		Consolidated results for the period from acquisition to 31 December 2011		
Acquisition	Support for residual goodwill[1]	Revenue £m	EBITA[2] £m	Loss after tax[3] £m
L-1 ISG	– Complements Intelligence & Security's existing security and intelligence capabilities; – Enhances existing knowledge and expertise, and better positions the Group to compete for future upgrades and new contracts; – Increases penetration of target markets through existing sales, marketing and in-service support capabilities; and – Provides a skilled assembled workforce with high level security clearance.	112	8	(2)
Norkom	– Complements Detica's existing enterprise fraud products, particularly Detica NetReveal®; – The combination of two of the sector's strongest technologies creates a market-leading offering to compete for new customers in new geographies; – Creates opportunities for cost synergies; and – Provides a skilled assembled workforce.	42	9	(3)
ETI	– Complements Detica's existing communications and interception businesses; – Creates a stronger end-to-end solution and a top tier market competitor, which enhances the Group's ability to compete for new customers in new geographies; and – Provides a skilled assembled workforce with high level security clearance.	39	5	(9)

1 Goodwill recognised is attributable to specific opportunities and synergies which do not translate into separately identifiable intangible assets, but represent a proportion of the assessed value within each acquired entity.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense excluding integration costs.
3 Loss after tax includes amortisation charges on acquired intangible assets totalling £39m.

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

26. ACQUISITION OF SUBSIDIARIES *(continued)*

Fair values

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

	L-1 ISG £m	Norkom £m	ETI £m	Other £m	Total £m
Intangible assets	63	99	79	29	270
Property, plant and equipment	–	1	7	2	10
Equity accounted investments	–	1	–	–	1
Inventories	–	–	10	6	16
Trade receivables	13	8	4	7	32
Other receivables	10	7	–	1	18
Deferred tax assets	–	2	8	–	10
Trade and other payables	(15)	(24)	(22)	(6)	(67)
Current tax payable	–	–	(8)	–	(8)
Deferred tax liabilities	–	(20)	(22)	(3)	(45)
Provisions	–	–	(2)	(1)	(3)
Cash and cash equivalents	–	37	5	1	43
Net assets acquired	**71**	**111**	**59**	**36**	**277**
Goodwill	109	66	76	40	291
Less: Fair value of existing interest in Fairchild	–	–	–	(5)	(5)
Total consideration	**180**	**177**	**135**	**71**	**563**
Add: Amounts receivable in respect of purchase price adjustments	4	–	–	–	4
Add: Net amounts paid in respect of prior year acquisitions	–	–	–	8	8
Cash consideration	**184**	**177**	**135**	**79**	**575**

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

During the year, the Group paid $22m (£13m) of deferred consideration in respect of the acquisition of OASYS Technology, LLC (OASYS) in 2010 and $6m (£4m) relating to purchase price adjustments in respect of the acquisition of Atlantic Marine Holding Company (Atlantic Marine) also in 2010. The Group received A$15m (£9m) from the former owners of the Tenix Defence business acquired in 2008 following resolution of outstanding acquisition issues in 2010.

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

Intangible assets

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

Trade receivables

Acquisition	Gross contractual amounts due £m	Unrecoverable amount £m	Fair value £m
L-1 ISG	13	–	13
Norkom	8	–	8
ETI	7	(3)	4
Other			7
			32

NOTES TO THE GROUP ACCOUNTS — OTHER INFORMATION *(continued)*

26. ACQUISITION OF SUBSIDIARIES *(continued)*

Subsidiaries acquired during 2010

In 2010, the Group acquired Atlantic Marine and OASYS. If the acquisitions had occurred on 1 January 2010, combined sales of Group and share of equity accounted investments would have been £22.4bn[1], revenue £21.1bn[1] and profit £986m[1] from continuing operations for the year ended 31 December 2010.

For all acquisitions made during 2010, fair values were finalised during 2011.

1 Restated following the classification of the Regional Aircraft line of business as a discontinued operation (see note 7).

Summary

Acquisition	Description	Acquisition date	Percentage share acquired	Total consideration Currency	Total consideration £m
Atlantic Marine	US naval services and marine fabrication business	13 July 2010	100%	$372m	245
OASYS	US manufacturer of electro-optical systems and sub-assemblies	19 October 2010	100%	$53m	33

IFRS 3 disclosures are provided individually for the Atlantic Marine acquisition below. The acquisition of OASYS is not material.

Material acquisitions

		Consolidated results for the period from acquisition to 31 December 2010	
Acquisition	Support for residual goodwill[2]	Revenue £m	Profit after tax £m
Atlantic Marine	– Complements existing ship repair and upgrade capabilities servicing the US Navy, and strategy to address anticipated growth in Services activity; – Operates two facilities in deep water ports along some of the busiest trade routes in the US; and – Operates a facility at the second largest home port of US Navy surface combatants on the East and Gulf coasts, and proposed as the new home port for an aircraft carrier in the 2010 Quadrennial Defense Review.	74	3

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

The post-acquisition results above exclude acquisition-related costs of £5m related to external legal fees and due diligence costs, which are included in operating costs.

Fair values

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

	Atlantic Marine £m	Other £m	Total £m
Intangible assets	37	4	41
Property, plant and equipment	113	–	113
Inventories	1	4	5
Receivables	14	1	15
Deferred tax assets	1	–	1
Payables	(15)	(5)	(20)
Deferred tax liabilities	(41)	–	(41)
Provisions	(16)	–	(16)
Cash and cash equivalents	18	1	19
Net assets acquired	**112**	**5**	**117**
Goodwill[3]	133	28	161
Total consideration	**245**	**33**	**278**
Less: Deferred consideration payable	–	(18)	(18)
Less: Amounts received in respect of purchase price adjustments	–	(65)	(65)
Add: Purchase of non-controlling interests	–	3	3
Cash consideration	**245**	**(47)**	**198**

3 In accordance with IFRS 3, the Group has adjusted the fair values attributable to the Atlantic Marine acquisition during 2011. The net increase in goodwill from £133m to £138m mainly reflects £4m of additional consideration payable. This has not had a material impact on the consolidated accounts and, as such, the Group has not restated the balance sheet at 31 December 2010.

The intangible assets acquired as part of the acquisition of Atlantic Marine of £37m primarily relate to customer relationships.

Total consideration in respect of the acquisition of OASYS includes $29m (£18m) contingent upon the achievement of certain revenue targets for 2010 and 2011.

26. ACQUISITION OF SUBSIDIARIES *(continued)*

Outstanding issues concerning the acquisition of the Tenix Defence business in 2008, including the completion accounting process, were resolved successfully with agreement of contingent payments totalling A$127.5m (£74m, net of legal fees) from the former owners of the business. In September 2010, the Group received a payment of A$112.5m (£65m, net of legal fees) with the remainder received in 2011. These payments reduced goodwill in 2010 by £64m (£74m, less £10m deferred tax).

27. FINANCIAL RISK MANAGEMENT

A discussion of the Group's treasury objectives and policies, and the use of financial instruments can be found in the Directors' report. Financial instruments comprise net debt (as defined by the Group) (note 10) together with other financial assets and other financial liabilities (note 17).

Hedging instruments

The notional, or contracted, amounts of derivative financial instruments are shown below, analysed between foreign exchange contracts and interest rate contracts, classified by year of maturity.

	31 December 2011				31 December 2010			
Foreign exchange contracts	Not exceeding one year £m	Between one year and five years £m	More than five years £m	Total £m	Not exceeding one year £m	Between one year and five years £m	More than five years £m	Total £m
Net forward (sales)/purchase contracts								
US dollar	(1,332)	66	4	(1,262)	(887)	5	15	(867)
Euro	1,531	470	43	2,044	1,851	495	8	2,354
Other	560	(18)	–	542	249	65	–	314
	759	518	47	1,324	1,213	565	23	1,801

	31 December 2011				31 December 2010			
Interest rate contracts	Not exceeding one year £m	Between one year and five years £m	More than five years £m	Total £m	Not exceeding one year £m	Between one year and five years £m	More than five years £m	Total £m
Interest rate swap contracts								
US dollar	–	643	–	643	512	639	–	1,151
Sterling	–	–	–	–	31	84	–	115
	–	643	–	643	543	723	–	1,266

	31 December 2011				31 December 2010			
Cross-currency swap contracts	Not exceeding one year £m	Between one year and five years £m	More than five years £m	Total £m	Not exceeding one year £m	Between one year and five years £m	More than five years £m	Total £m
Net forward purchase contracts								
US dollar	772	–	322	1,094	51	945	320	1,316
	772	–	322	1,094	51	945	320	1,316

Fair value of financial instruments

The fair value of a financial instrument is the price at which one party would assume the rights and/or duties of another party.

The fair values of financial instruments have been determined based on available market information at the balance sheet date, and the valuation methodologies listed below:

– the fair value of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates;

– the fair value 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 value of loans and overdrafts has been estimated by discounting the future cash flows to net present values using appropriate market-based interest rates prevailing at 31 December.

NOTES TO THE GROUP ACCOUNTS — OTHER INFORMATION *(continued)*

27. FINANCIAL RISK MANAGEMENT *(continued)*

Due to the variability of the valuation factors, the fair values presented at the balance sheet date may not be indicative of the amounts the Group would expect to realise in a current market environment.

The following table compares the estimated fair values of certain financial assets and liabilities to their carrying values at the balance sheet date[1].

	Net carrying amount 2011 £m	Estimated fair value 2011 £m	Net carrying amount 2010 £m	Estimated fair value 2010 £m
Assets				
Non-current				
Other receivables[2]	**261**	**261**	233	233
Other financial assets	**118**	**118**	110	110
Current				
Available-for-sale investments	**–**	**–**	260	260
Other financial assets	**77**	**77**	289	289
Cash and cash equivalents	**2,141**	**2,141**	2,813	2,813
Liabilities				
Non-current				
Loans	**(2,682)**	**(3,554)**	(2,133)	(2,598)
Other financial liabilities	**(74)**	**(74)**	(255)	(255)
Current				
Loans and overdrafts	**(518)**	**(518)**	(920)	(940)
Other financial liabilities	**(284)**	**(284)**	(109)	(109)

1 The estimated fair values of the remaining financial assets and liabilities are consistent with their carrying values at the balance sheet date.
2 Net carrying amount approximates to estimated fair value as there is no active market.

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).

The following table presents the Group's assets and liabilities that are measured at fair value.

	2011			2010[1]		
	Level 1 £m	**Level 2 £m**	**Total £m**	Level 1 £m	Level 2 £m	Total £m
Assets						
Available-for-sale investments	**–**	**–**	**–**	260	–	260
Derivatives used for hedging	**–**	**80**	**80**	–	149	149
Financial assets at fair value through profit or loss	**–**	**59**	**59**	127	78	205
Debt-related derivative financial instruments	**–**	**56**	**56**	–	45	45
Total assets	**–**	**195**	**195**	387	272	659
Liabilities						
Loans	**–**	**(335)**	**(335)**	–	(801)	(801)
Derivatives used for hedging	**–**	**(125)**	**(125)**	–	(145)	(145)
Financial liabilities at fair value through profit or loss	**–**	**(233)**	**(233)**	–	(219)	(219)
Debt-related derivative financial instruments	**–**	**–**	**–**	–	(5)	(5)
Total liabilities	**–**	**(693)**	**(693)**	–	(1,170)	(1,170)

1 Restated due to reassessment of hierarchy classifications.

27. FINANCIAL RISK MANAGEMENT *(continued)*

Collateral
As shown above, the Group has entered into a number of financial derivative contracts to hedge certain long-term foreign currency and interest rate exposures. Cash collateral payments can be required to be made periodically to the counterparty dependent on the market value of these financial derivatives. Cash deposited in this way is treated as a non-current receivable and at 31 December 2011 totalled £nil (2010 £nil).

Interest rate risk
The Group's objective is to mitigate its exposure to interest rate fluctuations on borrowings through varying the proportion of fixed rate debt relative to floating rate debt with derivative instruments, mainly interest rate swaps.

The Group's interest rate management policy is that a minimum of 50% (2010 50%) and a maximum of 75% (2010 75%) of gross debt is maintained at fixed interest rates. At 31 December 2011, the Group had 63% (2010 65%) of fixed rate debt and 37% (2010 35%) of floating rate debt based on a gross debt of £3.1bn, including debt-related derivative financial assets (2010 £3.0bn).

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	2,141	–	–
Loans and overdrafts	(1,167)	(649)	–

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 2011, the Group had a total of $1.8bn (2010 $1.5bn) of this type of swap outstanding with a weighted average duration of 2.8 years (2010 4.6 years). In respect of the fixed rate debt, the weighted average period in respect of which interest is fixed was 10.4 years (2010 5.7 years).

Given the level of short-term interest rates during the year, the average cost of the floating rate debt was 3.1% (2010 3.3%), 3.1% on US dollars and 2.5% on sterling (2010 2.7% on US dollars and 1.8% on sterling). The cost of the fixed rate debt was 6.0% (2010 6.5%).

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 £12m (2010 £12m).

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 £7m (2010 £16m).

Liquidity risk
The Group's objective is to maintain adequate undrawn committed borrowing facilities.

At 31 December 2011, the Group had a committed Revolving Credit Facility (RCF) of £2bn (2010 £2bn). The RCF is contracted until 2015 and was undrawn throughout the year. The RCF also acts as a back stop to Commercial Paper issued by the Group. At 31 December 2011, the Group had £513m (2010 £144m) of Commercial Paper in issue.

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 interest bearing current accounts, term deposits, money market deposits and marketable securities, choosing instruments with appropriate maturities or sufficient liquidity to provide sufficient headroom as determined by cash forecasts.

Credit risk
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. It is deposited with financial institutions with the strongest credit ratings for short periods. The cash and cash equivalents balance at 31 December 2011 of £2,141m (2010 £2,813m) was invested with 24 (2010 24) financial institutions. A credit limit is allocated to each institution taking account of its market capitalisation, credit rating and credit default swap price. The Group has no exposure to Greek, Irish, Italian, Portuguese or Spanish banks. Additionally, the Group monitors its exposure to banks which have exposure to those countries.

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 credit risk through this process.

The Group has material receivables due from the UK and US governments where credit risk is not considered to be an issue. For the remaining trade receivables, no one counterparty constitutes more than 6% of the balance (2010 5%).

NOTES TO THE GROUP ACCOUNTS — OTHER INFORMATION *(continued)*

27. FINANCIAL RISK MANAGEMENT *(continued)*

Currency risk
In order to protect itself against currency fluctuations, the Group's policy is to hedge all material firm transactional exposures.

The Group's objective is to reduce its exposure to volatility in earnings and cash flows from movements in foreign currency exchange rates, mainly the US dollar, Euro and Saudi Arabian riyal.

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, unless otherwise approved as exceptions by the Treasury Review Management Committee, 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 statement or balance sheet of foreign subsidiaries and equity accounted investments it regards as long-term investments. Hedges are, however, undertaken in respect of investments that are not considered long term or core to the Group.

28. SHARE-BASED PAYMENTS

Details of the terms and conditions of each share-based payment plan are given in the Remuneration report on pages 81 to 100.

Expense/(credit) in year

	2011			2010		
	Equity-settled £m	Cash-settled £m	Total £m	Equity-settled £m	Cash-settled £m	Total £m
Executive Share Option Plan (ExSOP)	–	(2)	(2)	2	(2)	–
Performance Share Plan (PSP)	18	–	18	14	–	14
Restricted Share Plan (RSP)	1	–	1	–	–	–
Share Matching Plan (SMP)	7	–	7	2	–	2
	26	(2)	24	18	(2)	16

The Group also incurred a charge of £28m (2010 £29m) in respect of the equity-settled all-employee free shares element of the Share Incentive Plan.

ExSOP
Equity-settled options

	2011		2010	
	Number of shares '000	Weighted average exercise price £	Number of shares '000	Weighted average exercise price £
Outstanding at the beginning of the year	12,607	3.67	18,230	3.48
Exercised during the year	(390)	2.15	(3,242)	2.26
Expired during the year	(1,593)	4.38	(2,381)	4.13
Outstanding at the end of the year	10,624	3.61	12,607	3.67
Exercisable at the end of the year	10,624	3.61	12,607	3.67

Cash-settled share appreciation rights

	2011		2010	
	Number of shares '000	Weighted average exercise price £	Number of shares '000	Weighted average exercise price £
Outstanding at the beginning of the year	5,857	2.20	10,088	2.62
Exercised during the year	(544)	2.29	(1,531)	2.25
Expired during the year	(70)	2.43	(2,700)	3.74
Outstanding at the end of the year	5,243	2.19	5,857	2.20
Exercisable at the end of the year	5,243	2.19	5,857	2.20

	2011		2010	
	Equity-settled	Cash-settled	Equity-settled	Cash-settled
Range of exercise price of outstanding options (£)	1.72 – 4.79	1.72 – 3.56	1.72 – 4.79	1.72 – 3.56
Weighted average remaining contracted life (years)	4	3	5	3

28. SHARE-BASED PAYMENTS *(continued)*

PSP
Equity-settled options

	2011 Number of shares '000	2010 Number of shares '000
Outstanding at the beginning of the year	**28,277**	26,195
Granted during the year	**10,892**	11,167
Exercised during the year	**(2,112)**	(3,123)
Expired during the year	**(5,359)**	(5,962)
Outstanding at the end of the year	**31,698**	28,277
Exercisable at the end of the year	**707**	1,029

Cash-settled share appreciation rights

	2011 Number of shares '000	2010 Number of shares '000
Outstanding at the beginning of the year	**25**	817
Exercised during the year	**–**	(780)
Expired during the year	**–**	(12)
Outstanding at the end of the year	**25**	25
Exercisable at the end of the year	**25**	25

	2011		2010	
	Equity-settled	**Cash-settled**	Equity-settled	Cash-settled
Weighted average remaining contracted life (years)	**5**	**–**	5	1
Weighted average fair value of options granted (£)	**2.61**	**–**	3.00	–

The exercise price for the PSP is £nil (2010 £nil).

RSP
All awards are equity-settled.

	2011 Number of shares '000	2010 Number of shares '000
Outstanding at the beginning of the year	**–**	–
Granted during the year	**1,465**	–
Exercised during the year	**(3)**	–
Expired during the year	**(79)**	–
Outstanding at the end of the year	**1,383**	–
Exercisable at the end of the year	**2**	–

	2011	2010
Weighted average remaining contracted life (years)	**6**	–
Weighted average fair value of options granted (£)	**2.92**	–

The exercise price for the RSP is £nil.

NOTES TO THE GROUP ACCOUNTS — OTHER INFORMATION *(continued)*

28. SHARE-BASED PAYMENTS *(continued)*

SMP
All awards are equity-settled.

	2011 Number of shares '000	2010 Number of shares '000
Outstanding at the beginning of the year	**13,025**	8,680
Granted during the year	**5,979**	5,881
Exercised during the year	**(1,209)**	(307)
Expired during the year	**(1,174)**	(1,229)
Outstanding at the end of the year	**16,621**	13,025
Exercisable at the end of the year	**–**	–

	2011	2010
Weighted average remaining contracted life (years)	**1**	2
Weighted average fair value of options granted (£)	**3.37**	3.80

The exercise price for the SMP is £nil (2010 £nil).

Details of options granted in the year
The fair value of the equity-settled awards granted in the year has been measured using the weighted average inputs below and the following valuation models:

PSP – Monte Carlo

RSP and SMP – Dividend valuation model

	2011	2010
Range of share price at date of grant (£)	**2.64 – 3.37**	3.23 – 3.80
Expected option life (years)	**3 – 4**	3 – 4
Volatility	**25 – 32%**	33 – 34%
Risk free interest rate	**0.8 – 1.4%**	1.0 – 1.8%

Volatility was calculated with reference to the Group's weekly share price volatility, after allowing for dividends and stock splits, for the greater of 30 weeks or for the period until vest date.

The average share price in the year was £3.04 (2010 £3.42).

The liability in respect of the cash-settled elements of the schemes shown above and reported within liability provisions at 31 December 2011 is £4m (2010 £5m).

The intrinsic value of cash-settled options that have vested at 31 December 2011 is £4m (2010 £6m).

29. RELATED PARTY TRANSACTIONS

The Group has a related party relationship with its directors and key management personnel (see below), equity accounted investments (note 14) and pension plans (note 23).

Transactions occur with the equity accounted investments 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 party		Purchases from related party		Amounts owed by related party		Amounts owed to related party		Management recharges	
Related party	**2011 £m**	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m
Advanced Electronics Company Limited	**–**	–	**153**	149	**1**	1	**–**	–	**–**	–
CTA International SAS	**2**	–	**–**	–	**2**	–	**–**	–	**–**	–
Eurofighter Jagdflugzeug GmbH	**1,353**	1,313	**–**	–	**206**	283	**142**[2]	143[2]	**–**	–
FADEC International LLC	**49**	49	**–**	–	**–**	–	**–**	–	**–**	–
Gripen International KB	**–**	1	**–**	1	**10**	11	**68**[2]	67[2]	**–**	–
MBDA SAS	**24**	36	**65**	162	**9**	10	**951**[2]	1,010[2]	**17**[2]	14[2]
Panavia Aircraft GmbH	**34**	40	**98**	92	**4**	1	**–**	12	**–**	–
Saab AB[1]	**–**	3	**–**	20	**–**	–	**–**	–	**–**	–
Other	**–**	2	**1**	–	**2**	1	**–**	–	**–**	–
	1,462	1,444	**317**	424	**234**	307	**1,161**	1,232	**17**	14

1 To date of sale of half of the Group's 20.5% shareholding (3 June 2010).
2 Also relates to disclosures under Financial Reporting Standard 8, Related Party Disclosures, for the parent company, BAE Systems plc. At 31 December 2011, £1,158m (2010 £1,220m) was owed by BAE Systems plc and £3m (2010 £nil) by other Group subsidiaries.

The Group considers key management personnel as defined under IAS 24, Related Party Disclosures, to be the members of the Group's Executive Committee and the Company's non-executive directors. Fuller disclosures on directors' remuneration are set out in the Remuneration report on pages 81 to 100. Total emoluments for directors and key management personnel were:

	2011 £'000	2010 £'000
Short-term employee benefits	**14,807**	15,131
Post-employment benefits	**1,310**	1,300
Share-based payments	**5,534**	4,033
	21,651	20,464

30. CONTINGENT LIABILITIES AND COMMITMENTS

Guarantees and performance bonds
The Group has entered into a number of guarantee and performance bond arrangements in the normal course of business. Provision is made for any amounts that the directors consider may become payable under such arrangements.

Operating lease commitments – where the Group is the lessee
The Group leases various offices, factories, shipyards and aircraft 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:

	2011 £m	2010 £m
Payments due:		
Not later than one year	**184**	222
Later than one year and not later than five years	**551**	608
Later than five years	**772**	670
	1,507	1,500
Total of future minimum sublease income under non-cancellable subleases	**234**	254

Capital commitments
Capital expenditure contracted for but not provided for in the accounts is as follows:

	2011 £m	2010 £m
Property, plant and equipment	**171**	103
Intangible assets	**15**	4
	186	107

NOTES TO THE GROUP ACCOUNTS — OTHER INFORMATION *(continued)*

31. GROUP ENTITIES

Principal subsidiary undertakings	Principal activities	Group interest in allotted capital	Principally operates in	Country of incorporation
BAE Systems (Operations) Limited *(Held via BAE Systems Enterprises Limited and BAE Systems (Overseas Holdings) Limited)*	Defence and commercial aerospace activities	100% Ordinary	UK	England and Wales
BAE Systems Information and Electronic Systems Integration Inc. *(Held via BAE Systems, Inc.)*	Designs, develops and manufactures electronic systems and subsystems	100% Common	US	US
BAE Systems Information Solutions Inc. *(Held via BAE Systems Technology Solutions & Services Inc.)*	Full-service information technology solution provider	100% Common	US	US
BAE Systems Land & Armaments LP *1300 North 17th Street, Suite 1400, Arlington VA 22209, USA* *(Partners: BAE Systems Land & Armaments Inc. and BAE Systems Land & Armaments Holdings Inc.)*	Manufactures and supports military vehicles	100%	US	US
BAE Systems Surface Ships Limited *(Held via BAE Systems Surface Ships (Holdings) Limited)*	Designs, develops and constructs surface ships in the naval arena, and provides fleet support services	100%	UK	England and Wales
BAE Systems Tactical Vehicle Systems LP *5000 Interstate 10 West, Sealy, TX 77474, USA* *(Partners: BAE Systems TVS Holdings LLC and BAE Systems TVS Inc.)*	Mobility and protection systems	100%	US	US

The Company has taken advantage of the exemption under Section 410(2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the directors, principally affected the financial statements. A full list of subsidiary, equity accounted investments and other associated undertakings as at 31 December 2011 will be annexed to the Company's next annual return filed with the Registrar of Companies.

No subsidiary undertakings are excluded from the Group accounts.

32. ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Revenue and profit recognition
Sales include the Group's net share of sales of equity accounted investments. Revenue represents sales made by the Company and its subsidiary undertakings, excluding the Group's share of sales of equity accounted investments.

Long-term contracts
The majority of the Group's long-term contract arrangements are accounted for under IAS 11, Construction Contracts. Sales are recognised when the Group has obtained the right to consideration in exchange for its performance. This is usually when title passes or a separately identifiable phase (milestone) of a contract or development has been completed.

No profit is recognised on contracts until the outcome of the contract can be reliably estimated. Profit is calculated by reference to reliable estimates of contract revenue and forecast costs after making suitable allowances for technical and other risks related to performance milestones yet to be achieved. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

Goods sold and services rendered
Revenue is measured at the fair value of the consideration received or receivable, net of returns, rebates and other similar allowances.

Revenue from the sale of goods not under a long-term contract is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, there is no continuing management involvement with the goods, and the amount of revenue and costs can be measured reliably. Profit is recognised at the time of sale.

Revenue from the provision of services not under a long-term contract is recognised in the income statement in proportion to the stage of completion of the contract at the reporting date. The stage of completion is measured on the basis of direct expenses incurred as a percentage of total expenses to be incurred for material contracts and labour hours delivered as a percentage of total labour hours to be delivered for time contracts.

Sales and profits on intercompany trading are determined on an arm's length basis.

Lease income
Rental income from aircraft operating leases is recognised in revenue on a straight-line basis over the term of the relevant lease. Lease incentives granted are charged to the income statement over the term of the lease.

Underlying EBITA
Management uses an underlying profit measure to monitor the year-on-year profitability of the Group, which is defined as earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items. This definition is referred to as Underlying EBITA. Underlying EBITA is the measure of profit on which segmental performance is monitored by management. As such, it is disclosed in note 1 to the Group accounts on a segmental basis. Non-recurring items are defined as items that are relevant to an understanding of the Group's performance with reference to their materiality and nature.

Finance costs
Financial income comprises interest income on funds invested, gains on the disposal of available-for-sale financial assets, changes in the fair value of financial assets at fair value through profit or loss, and gains on hedging instruments that are recognised in profit or loss.

Financial expense comprises interest expense on borrowings, unwinding of the discounts on provisions, changes in the fair value of financial assets at fair value through profit or loss, and losses on hedging instruments that are recognised in profit or loss.

Borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) are capitalised as part of the cost of that asset, until such time as the assets are ready for their intended use or sale.

All other borrowing costs are recognised in the income statement in the period in which they are incurred.

Tax
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 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. Current tax payable also includes any tax liability arising from the declaration of dividends.

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.

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.

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.

NOTES TO THE GROUP ACCOUNTS – OTHER INFORMATION *(continued)*

32. ACCOUNTING POLICIES *(continued)*

Discontinued operations
A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of or meets the criteria as held for sale. When an operation is classified as a discontinued operation, the comparative income statement is re-presented as if the operation had been discontinued from the start of the comparative period.

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.

Intangible assets
Goodwill
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. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Business combinations on or after 1 January 2010 (IFRS 3, Business Combinations)
Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. The Group measures goodwill as the acquisition-date fair value of the consideration transferred, including the amount of any non-controlling interest in the acquiree, less the net of the acquisition-date fair values of the identifiable assets acquired and liabilities assumed, including contingent liabilities as required by IFRS 3.

Consideration transferred includes the fair values of assets transferred, liabilities incurred by the Group to the previous owners of the acquiree, equity interests issued by the Group, contingent consideration, and share-based payment awards of the acquiree that are replaced in the business combination. Any contingent consideration payable is recognised at fair value at the acquisition date. Subsequent changes to the fair value of contingent consideration that is not classified as equity are recognised in the income statement. If a business combination results in the termination of pre-existing relationships between the Group and the acquiree, then the lower of the termination amount, as contained in the agreement, and the value of the off-market element, is deducted from the consideration transferred and recognised in other expenses.

Transaction costs that the Group incurs in connection with a business combination, such as finder's fees, legal fees, due diligence fees, and other professional and consulting fees, are expensed as incurred.

Non-controlling interests are measured at either the non-controlling interest's proportion of the net fair value of the identifiable assets, liabilities and contingent liabilities recognised or at fair value. The method used is determined on an acquisition-by-acquisition basis.

Accounting for acquisition of non-controlling interests that do not result in a change in control
Acquisitions of non-controlling interests are accounted for as transactions with equity holders in their capacity as equity holders and, therefore, no goodwill or profit or loss in the income statement is recognised as a result of such transactions.

Prior to 1 January 2010, goodwill was recognised on the acquisition of non-controlling interests in a subsidiary, which represented the excess of the cost of the additional investment over the carrying amount of the interest in the net assets acquired at the date of the transaction.

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 activities is written off as incurred and charged to the income statement.

Group-funded expenditure on development activities applied to a plan or design for the production of new or substantially improved products is capitalised as an internally generated intangible asset if certain conditions are met. The expenditure capitalised includes the cost of materials, direct labour and related overheads. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses.

Capitalised development expenditure is amortised over the expected life of the product.

Where the research and development activity is performed for customers, the revenue arising is recognised in accordance with the Group's revenue recognition policy.

Other intangible assets
Acquired computer software licences 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.

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. Capitalised software development expenditure is stated at cost less accumulated amortisation and impairment losses. Group-funded expenditure associated with enhancing or maintaining computer software programmes for sale is recognised as an expense as incurred.

Trademarks and licences have definite useful lives and are carried at cost less accumulated amortisation and impairment losses.

Intangible assets arising from a business combination are recognised at fair value, amortised over their estimated useful lives and subject to impairment testing. The most significant intangible assets recognised by the Group on businesses acquired to date are in relation to programmes. 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.

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of the intangible assets. The estimated useful lives are as follows:

Programme and customer related	up to 15 years
Other:	
Acquired computer software licences	2 to 5 years
Capitalised software development	2 to 5 years
Capitalised research and development expenditure	up to 10 years
Trademarks and licences	up to 20 years
Other intangibles	up to 10 years

32. ACCOUNTING POLICIES *(continued)*

Property, plant and equipment
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.

Depreciation is provided, normally on a straight-line basis, to write off the cost 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, motor vehicles and short-life works equipment	3 to 5 years
Research equipment	8 years
Other equipment	10 to 15 years, or the project life if shorter
Aircraft	up to 15 years, or the lease term 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. Where applicable, useful lives reflect the component accounting principle.

Assets obtained under finance leases are included in property, plant and equipment and stated at an amount equal to the lower of the fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses.

Impairment
The carrying amounts of the Group's intangible assets, property, plant and equipment, 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. All other assets are considered for impairment under the relevant standard.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

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 recoverable amount of assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at appropriate pre-tax discount rates.

The recoverable amount of other assets is the greater of their fair value less cost 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 inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss in respect of assets, other than goodwill, carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of goodwill is not reversed.

An impairment loss in respect of other assets is reversed 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.

Leases
Payments, including any incentives, made under operating leases are recognised in the income statement on a straight-line basis over the lease term.

Assets held for leasing out under operating leases are included in property, plant and equipment at cost less accumulated depreciation and accumulated impairment losses. Rental income is recognised in revenue on a straight-line basis.

Investment property
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 accumulated impairment losses.

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.

Other investments
The Group determines the classification of its other investments at initial recognition taking account of, where relevant, the purpose for which the investments were acquired. The Group classifies its other investments as follows:

(a) loans and receivables: term deposits, principally comprising funds held with banks and other financial institutions, are carried at amortised cost using the effective interest method;

(b) at fair value through profit or loss: financial instruments held for trading or designated by management on initial recognition. They are held at fair value and included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date;

(c) held to maturity: non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity;

(d) available-for-sale: investments other than interests in joint ventures and associates and term deposits and not classified as (b) or (c) above. They are held at fair value.

Purchases and sales of investments are recognised at the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss.

NOTES TO THE GROUP ACCOUNTS — OTHER INFORMATION *(continued)*

32. ACCOUNTING POLICIES *(continued)*

Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

Realised and unrealised gains and losses arising from changes in the fair value of the investments classified as fair value through profit or loss are included in finance costs in the income statement in the period in which they arise. Unrealised gains or losses arising from changes in the fair value of investments classified as available-for-sale are recognised in equity. When investments classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the income statement as gains and losses from investment securities within finance costs.

The fair values of quoted investments are based on bid prices at the balance sheet date.

Trade and other receivables
Trade and other receivables are stated at their amortised cost less impairment losses. A provision for impairment is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. Receivables with a short-term duration are not discounted.

An impairment loss is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

Amounts due from customers for contract work include long-term contract balances less attributable progress payments.

Long-term contract balances are stated at cost, plus attributable profit, less provision for any anticipated losses. Appropriate provisions for any losses are made in the year in which they are first foreseen.

Progress payments are amounts received from customers in accordance with the terms of contracts which specify payments in advance of delivery and are credited, as progress payments, against any expenditure incurred for the particular contract. Any unexpended balance in respect of progress payments is held in trade and other payables as customer stage payments or, if the amounts are subject to advance payment guarantees unrelated to company performance, as cash received on customers' account.

Cash received on customers' account is excluded from net cash/(debt) (as defined by the Group).

Inventories
Inventories are stated at the lower of cost, including all relevant overhead expenditure, and net realisable value.

Derivative financial instruments and hedging activities
The global 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 as well as to manage anticipated economic cash flow exposures over the medium term. The Group also 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 aims to achieve hedge accounting treatment for all derivatives that hedge material foreign currency exposures and those interest rate exposures where hedge accounting can be achieved.

In accordance with its treasury policy, the Group does not hold derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

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. Gains and losses on derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement for the period.

Cash flow hedges
Where a derivative financial instrument is designated as a hedge of cash flows relating to a highly probable forecast transaction (income or expense), 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 recycled from reserves 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.

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 in the income statement for the period.

Cash and cash equivalents
Cash and cash equivalents includes cash in hand, call deposits 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.

Held for sale
Disposal groups held for sale comprise assets and liabilities that are expected to be recovered primarily through sale rather than continuing use.

The disposal group is measured at the lower of its carrying value and fair value less costs to sell.

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 or fair value in respect of the hedged risk where hedge accounting has been adopted, with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

Trade and other payables
Trade and other payables are stated at their cost.

32. ACCOUNTING POLICIES *(continued)*

Pension obligations
Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

For defined benefit retirement schemes, 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. Actuarial gains and losses are recognised in full in the period in which they occur, and are recognised in the statement of comprehensive income. Past service cost is recognised immediately to the extent the benefits are already vested, or otherwise is recognised on a straight-line basis over the average period until the benefits become vested. Curtailments due to the material reduction of the expected years of future services of current employees or the elimination of the accrual of defined benefits for some or all of the future services for a significant number of employees are recognised immediately as a gain or loss in the income statement.

The retirement benefit obligations recognised in the balance sheet represent the present value of the defined benefit obligations as adjusted for unrecognised past service cost and as reduced by the fair value of scheme assets.

The Group has allocated an appropriate share of the pension deficit to its equity accounted investments and other participating employers using a consistent and reasonable method of allocation which represents, based on current circumstances, the directors' best estimate of the proportion of the deficit anticipated to be funded by these entities. The Group's share of the pension deficit allocated to equity accounted investments is included on the balance sheet within equity accounted investments.

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.

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 all possible outcomes against their associated probabilities.

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 publicly announced. Future operating costs are not provided for.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

Provisions for losses on contracts are recorded when it becomes probable that total estimated contract costs will exceed total contract revenues. Such provisions are recorded as write downs of work-in-progress for that portion of the work which has already been completed, and as liability provisions for the remainder. Losses are determined on the basis of estimated results on completion of contracts and are updated regularly.

Share-based payment compensation
The Group has granted equity-settled share options and Long-Term Incentive Plan (LTIP) arrangements, and cash-settled share options to employees. In accordance with the requirements of IFRS 2, Share-based Payment, the Group has applied IFRS 2 to all equity-settled share options granted after 7 November 2002 that were unvested as of 1 January 2005 and all cash-settled options outstanding at the balance sheet date.

Equity-settled share options and LTIP arrangements 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.

Cash-settled share options are measured at fair value at the balance sheet date. The Group recognises a liability at the balance sheet date based on these fair values, and taking into account the estimated number that will actually vest and the relative completion of the vesting period. Changes in the value of this liability are recognised in the income statement for the year.

Foreign currencies
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. These exchange differences are recognised in the income statement.

For consolidation purposes, the assets and liabilities of overseas subsidiary entities and equity accounted investments are translated at the exchange rate ruling at the balance sheet date. Income statements of such entities are translated at average rates of exchange during the year. All resulting exchange differences, including exchange differences arising from the translation of borrowings and other financial instruments designated as hedges of such investments, 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 since 1 January 2004 are recognised in the income statement as part of the profit or loss on sale.

COMPANY BALANCE SHEET

as at 31 December

	Notes	2011 £m	2010 £m
Fixed assets			
Tangible assets		**13**	15
Investments in subsidiary undertakings	2	**7,113**	6,793
		7,126	6,808
Current assets			
Debtors due within one year	3	**8,132**	7,348
Debtors due after one year		**9**	10
Other financial assets due within one year	4	**135**	178
Other financial assets due after one year	4	**140**	157
Cash at bank and in hand		**1,088**	1,700
		9,504	9,393
Liabilities falling due within one year			
Loans and overdrafts	5	**(5)**	(39)
Creditors	6	**(11,480)**	(11,854)
Other financial liabilities	4	**(311)**	(157)
		(11,796)	(12,050)
Net current liabilities		**(2,292)**	(2,657)
Total assets less current liabilities		**4,834**	4,151
Liabilities falling due after one year			
Loans	5	**(898)**	(200)
Creditors	6	**(40)**	(6)
Other financial liabilities	4	**(101)**	(310)
		(1,039)	(516)
Provisions for liabilities and charges	7	**(49)**	(52)
Net assets		**3,746**	3,583
Capital and reserves			
Issued share capital	9	**90**	90
Share premium account	11	**1,249**	1,249
Statutory reserve	11	**202**	202
Other reserves	11	**98**	116
Profit and loss account	11	**2,107**	1,926
Equity shareholders' funds		**3,746**	3,583

Approved by the Board on 15 February 2012 and signed on its behalf by:

I G King
Chief Executive

P J Lynas
Group Finance Director

NOTES TO THE COMPANY ACCOUNTS

1. ACCOUNTING POLICIES

Basis of preparation
The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss, and in accordance with applicable accounting standards in the United Kingdom (UK GAAP). The going concern basis has been applied in these accounts.

In the Company's accounts, all fixed asset investments (including subsidiary undertakings and joint ventures) are stated at cost (or valuation in respect of certain listed investments) less provisions for impairments. Dividends received and receivable are credited to the Company's profit and loss account. In accordance with Section 408(3) of the Companies Act 2006, the Company is exempt from the requirement to present its own profit and loss account. The amount of profit for the financial year of the Company is disclosed in note 11 to these accounts. The Company has no other recognised gains or losses in the current or preceding year and, therefore, no statement of recognised gains or losses is presented.

Relief under Sections 612 and 616 of the Companies Act 2006 is taken wherever possible. Accordingly, where such relief is available, the difference between the fair value and aggregate nominal value of shares is not recognised in either shareholders' funds or cost of investment.

Cash flow statement
The Company is exempt under the terms of FRS 1, Cash Flow Statements, from the requirement to publish its own cash flow statement, as its cash flows are included within the consolidated cash flow statement of the Group.

Foreign currencies
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. These exchange differences are recognised in the profit and loss account unless they qualify for hedge accounting treatment, in which case the effective portion is recognised directly in a separate component of equity.

Tangible fixed assets
Depreciation is provided, normally on a straight-line basis, to write off the cost or valuation of tangible fixed assets over their estimated useful economic lives to any estimated residual value using the following rates:

Buildings	up to 50 years, or the lease term if shorter
Computing equipment and short-life works equipment	3 to 5 years

No depreciation is provided on freehold land and assets in the course of construction.

Impairment reviews are undertaken if there are indications that the carrying values may not be recoverable.

Leases
Rental payments under operating leases are charged to the profit and loss account on a straight-line basis in arriving at operating profit.

Investments
The Company's investment in shares in Group companies is stated at cost less provision for impairment.

Financial instruments
The policies disclosed in the Group accounting policies on page 174 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Tax
The charge for taxation is based on the profit for the year and takes account of taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is recognised on an undiscounted basis in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date where there is an obligation to pay more tax, or a right to pay less tax, in the future.

Pensions and other post-retirement benefits
The Company contributes to Group pension plans operated in the UK. Details of the principal plans and the financial assumptions used are contained in the consolidated accounts of BAE Systems plc. As permitted by FRS 17, Retirement Benefits, the plans are accounted for as defined contribution plans, as the employer cannot identify its share of the underlying assets and liabilities of the plans. The employer's contributions are set in relation to the current service period and also to fund a series of agreed measures to address the pension scheme deficits.

Share-based payment compensation
The Company has granted equity-settled share options and Long-Term Incentive Plan (LTIP) arrangements to Group employees. Equity-settled share options and LTIP arrangements are measured at fair value at the date of grant. The fair value is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the number of shares that will actually vest.

In accordance with Urgent Issues Task Force (UITF) Abstract 25, National Insurance Contributions on Share Option Gains, the Company provides in full for the employer's national insurance liability estimated to arise on the future exercise of share options and LTIP arrangements granted, except where the employee has agreed to settle the employer's national insurance liability as a condition of grant.

Own shares held
As required under UITF Abstract 38, Accounting for ESOP Trusts, the cost to the Company of own shares held is shown as a deduction from shareholders' funds within the profit and loss account. Consideration paid or received for the purchase or sale of the Company's own shares in the ESOP Trust is shown separately in the reconciliation of movements in shareholders' funds.

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.

NOTES TO THE COMPANY ACCOUNTS *(continued)*

2. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

	£m
Cost	
At 1 January 2011	6,854
Additions	320
At 31 December 2011	7,174
Impairment provisions	
At 1 January 2011 and 31 December 2011	61
Net carrying value	
At 31 December 2011	**7,113**
At 31 December 2010	6,793

3. DEBTORS

	2011 £m	2010 £m
Due within one year		
Corporation tax recoverable	**16**	260
Amounts owed by subsidiary undertakings	**8,077**	7,040
Amounts owed by Group joint ventures	**6**	5
Prepayments and accrued income	**14**	23
Other debtors	**19**	20
	8,132	7,348

4. OTHER FINANCIAL ASSETS AND LIABILITIES

	2011 Assets £m	**2011 Liabilities £m**	2010 Assets £m	2010 Liabilities £m
Due within one year				
Cash flow hedges – foreign exchange contracts	**4**	**–**	5	–
Other foreign exchange/interest rate contracts	**131**	**(311)**	173	(157)
	135	**(311)**	178	(157)
Due after one year				
Cash flow hedges – foreign exchange contracts	**3**	**–**	1	–
Other foreign exchange/interest rate contracts	**96**	**(101)**	137	(310)
Debt-related derivative financial instruments – assets[1]	**41**	**–**	19	–
	140	**(101)**	157	(310)

1 The debt-related derivative financial instrument assets are presented as other financial assets. Debt-related derivative financial instrument liabilities are presented as a component of loans and overdrafts (see note 5).

Full disclosures relating to the Group's other financial assets and liabilities, and financial risk management strategies are given in the Financial review section of the Directors' report and note 27 to the Group accounts.

5. LOANS AND OVERDRAFTS

	2011 £m	2010 £m
Due within one year		
Bank loans and overdrafts	**5**	11
SYSTEMS 2001 Asset Trust Option Aircraft bond	**–**	27
Debt-related derivative financial instruments – liabilities	**–**	1
	5	39
Due after one year		
Euro-Sterling £100m 10¾% bond, repayable 2014	**100**	100
SYSTEMS 2001 Asset Trust Option Aircraft bond	**–**	96
US$350m 3.5% bond, repayable 2016	**224**	–
US$500m 4.75% bond, repayable 2021	**320**	–
US$400m 5.8% bond, repayable 2041	**254**	–
Debt-related derivative financial instruments – liabilities	**–**	4
	898	200

Bank loans and overdrafts are at a floating rate of interest.

The SYSTEMS 2001 Asset Trust Option Aircraft bonds were repaid in June 2011.

Loans and overdrafts are repayable as follows:

	Less than one year £m	Between one and two years £m	Between two and five years £m	More than five years £m	Total £m
At 31 December 2011					
Carrying amount	**5**	**–**	**324**	**574**	**903**
At 31 December 2010					
Carrying amount	39	29	171	–	239

6. CREDITORS

	2011 £m	2010 £m
Due within one year		
Amounts owed to subsidiary undertakings	**9,996**	10,330
Amounts owed to Group joint ventures	**1,158**	1,220
Accruals and deferred income	**36**	41
Other creditors[1]	**290**	263
	11,480	11,854
Due after one year		
Other creditors[2]	**40**	6
	40	6

1 Other creditors due within one year includes £30m in respect of the global settlement with the UK's Serious Fraud Office (2010 £30m).
2 Other creditors due after one year includes £28m in respect of the US Department of State fine.

7. PROVISIONS FOR LIABILITIES AND CHARGES

	Contracts and other £m
At 1 January 2011	52
Created	4
Utilised	(8)
Released	(3)
Discounting	4
At 31 December 2011	**49**

The Company holds provisions for expected contractual costs that it expects to incur over an extended period. These costs are based on past experience of similar items and represent management's best estimate of the likely outcome.

NOTES TO THE COMPANY ACCOUNTS *(continued)*

8. CONTINGENT LIABILITIES AND COMMITMENTS

Company guaranteed borrowings
Borrowings by subsidiary undertakings totalling £2,289m (2010 £2,548m) which are included in the Group's borrowings have been guaranteed by the Company.

9. 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 2010	3,585	90	1	1	90
Exercise of options	2	–	–	–	–
At 1 January 2011	3,587	90	1	1	90
Exercise of options	1	–	–	–	–
At 31 December 2011	**3,588**	**90**	**1**	**1**	**90**

Special Share
One Special Share of £1 in the Company is held on behalf of the Secretary of State for Business, Innovation and Skills (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
During the year, 184,393,049 ordinary shares of 2.5p each were repurchased under the buyback programme (2010 143,951,447).

As at 31 December 2011, 351,756,854 (2010 178,377,628) ordinary shares of 2.5p each with an aggregate nominal value of £8,793,921 (2010 £4,459,441) were held in treasury. During 2011, 11,013,823 treasury shares were used to satisfy awards and options under the Share Incentive Plan, Share Matching Plan, Performance Share Plan and Executive Share Option Plan (2010 9,526,179 in respect of the Share Incentive Plan and Share Matching Plan).

10. EMPLOYEE SHARE SCHEMES

Options over shares of the ultimate parent undertaking, BAE Systems plc, have been granted to employees of the Company under various schemes. Details of the terms and conditions of each share-based payment plan are given in the Remuneration report on pages 81 to 100 of this report.

	Executive Share Option Plan			
	2011		2010	
	Number of shares '000	**Weighted average exercise price £**	Number of shares '000	Weighted average exercise price £
Outstanding at the beginning of the year	**6,175**	**3.68**	8,745	3.41
Exercised during the year	**(96)**	**1.99**	(1,778)	2.22
Expired during the year	**(540)**	**4.39**	(792)	3.99
Outstanding at the end of the year	**5,539**	**3.64**	6,175	3.68
Weighted average remaining life (years)		**4**		5
Range of exercise price of outstanding options (£)		**1.72 – 4.79**		1.72 – 4.79
Expense/(credit) recognised for the year (£m)		**–**		(1)

	Share Matching Plan		Performance Share Plan		Restricted Share Plan	
	2011 Number of shares '000	2010 Number of shares '000	**2011 Number of shares '000**	2010 Number of shares '000	**2011 Number of shares '000**	2010 Number of shares '000
Outstanding at the beginning of the year	**4,998**	3,308	**11,057**	10,687	**–**	–
Granted during the year	**1,922**	1,972	**3,969**	3,831	**9**	–
Exercised during the year	**(714)**	(192)	**(880)**	(1,338)	**–**	–
Expired during the year	**(474)**	(90)	**(2,236)**	(2,123)	**–**	–
Outstanding at the end of the year	**5,732**	4,998	**11,910**	11,057	**9**	–
Weighted average remaining life (years)	**1**	1	**5**	5	**6**	–
Weighted average fair value of options granted (£)	**3.37**	3.80	**2.60**	2.93	**2.93**	–
Expense recognised for the year (£m)	**2**	1	**2**	4	**–**	–

The exercise price for the Share Matching Plan, Performance Share Plan and Restricted Share Plan is £nil (2010 £nil).

Information on options granted in the year can be found in note 28 to the Group accounts.

NOTES TO THE COMPANY ACCOUNTS *(continued)*

11. RESERVES

	Share premium account £m	Statutory reserve £m	Other reserves £m	Profit and loss account £m
At 31 December 2010	1,249	202	116	1,926
Profit for the year	–	–	–	1,222
Dividends paid	–	–	–	(606)
Share-based payments	–	–	–	55
Purchase of own shares	–	–	–	(6)
Purchase of treasury shares	–	–	–	(503)
Movements in non-distributable reserve	–	–	(19)	19
Movements in hedging reserve	–	–	1	–
At 31 December 2011	**1,249**	**202**	**98**	**2,107**

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.

Other reserves
Other reserves for the Company comprise: capital reserve £24m (2010 £24m); hedging reserve £7m (2010 £6m); and non-distributable reserve arising from property disposals to other Group undertakings £67m (2010 £86m). The non-distributable reserve arising from property disposals to other Group undertakings relates to the revaluation surplus realised by the Company on properties which were sold to other Group companies as part of operational reorganisations in prior years. Amounts within this reserve are transferred to the profit and loss account as distributable when the related properties are disposed of outside the Group, or written down following impairment.

Profit and loss account
The Company's profit for the financial year was £1,222m (2010 £2,223m). The non-distributable portion of the profit and loss account is £736m (2010 £736m).

Own shares held
Own shares held, including treasury shares and shares held by BAE Systems 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. A dividend waiver was in operation for shares within the ESOP Trust, other than those owned beneficially by the participants, for the dividends paid in June and November 2011.

At 31 December 2011, the ESOP held 2,402,305 (2010 2,202,800) ordinary shares of 2.5p each with a market value of £7m (2010 £7m). 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 in operation during 2011 and remains over shares within the Company's Share Incentive Plan Trust other than those shares owned beneficially by the participants. A dividend waiver was also in operation for the dividends paid in June and November 2011 over shares in the Group All-Employee Free Shares Plan Trust other than those shares owned beneficially by participants.

12. OTHER INFORMATION

Employees
The total number of employees of the Company at 31 December 2011 was 820 (2010 846). Total staff costs, excluding charges for share-based payments, were £112m (2010 £116m).

Total directors' emoluments, excluding Company pension contributions, were £6,542,000 (2010 £6,741,000). These emoluments were paid for their services on behalf of the BAE Systems Group. No emoluments related specifically to their work for the Company.

Company audit fee
Fees payable to the Company's auditor for the audit of the Company's annual accounts totalled £1,535,000 (2010 £1,484,000).

Related party transactions
Details of related party transactions are detailed in note 29 to the Group accounts.

The Company also has a related party relationship with its directors and key management personnel, and pension plans.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF BAE SYSTEMS PLC

We have audited the financial statements of BAE Systems plc for the year ended 31 December 2011 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Group and Parent Company Balance Sheets, the Consolidated Cash Flow Statement, the Consolidated Statement of Changes in Equity and related notes. The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors
As explained more fully in the Directors' Responsibilities Statement set out on page 113, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements
A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm

Opinion on financial statements
In our opinion:

– the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2011 and of the Group's profit for the year then ended;

– the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;

– the parent company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice; 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.

Opinion 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; and

– the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

– 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 and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or

– certain disclosures of directors' remuneration specified by law are not made; or

– we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

– the directors' statement, set out on page 106, in relation to going concern;

– the part of the Corporate Governance Statement on pages 104 to 108 in the Directors' Report relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and

– certain elements of the report to shareholders by the Board on directors' remuneration.

A G Cates (Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL

15 February 2012

FIVE-YEAR SUMMARY

Income statement for the year ended 31 December

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Continuing operations[1]					
Sales including Group's share of equity accounted investments[2]					
Electronic Systems	**2,645**	2,969	2,899	2,375	2,188
Cyber & Intelligence	**1,399**	1,201	1,302	957	799
Platforms & Services (US)	**5,305**	7,671	8,414	7,626	4,497
Platforms & Services (UK)	**6,258**	6,529	6,153	4,639	5,386
Platforms & Services (International)	**3,794**	4,325	3,658	2,755	2,877
HQ	**233**	209	172	171	132
Intra-operating group sales	**(480)**	(629)	(756)	(532)	(675)
	19,154	22,275	21,842	17,991	15,204
Underlying EBITA[2,3]					
Electronic Systems	**386**	455	348	333	329
Cyber & Intelligence	**136**	108	107	82	69
Platforms & Services (US)	**478**	728	747	666	363
Platforms & Services (UK)	**658**	522	661	501	453
Platforms & Services (International)	**449**	449	402	415	389
HQ	**(82)**	(83)	(114)	(101)	(81)
	2,025	2,179	2,151	1,896	1,522
(Loss)/profit on disposal of businesses	**(29)**	1	68	238	36
Pension curtailment gains	**–**	2	261	–	–
Regulatory penalties	**(49)**	(18)	(278)	–	–
Uplift on acquired inventories	**–**	–	–	–	(12)
EBITA	**1,947**	2,164	2,202	2,134	1,546
Amortisation and impairment of intangible assets	**(348)**	(517)	(1,259)	(303)	(297)
Finance costs including share of equity accounted investments	**(106)**	(194)	(694)	712	78
Profit before taxation	**1,493**	1,453	249	2,543	1,327
Taxation expense including share of equity accounted investments	**(233)**	(462)	(344)	(649)	(397)
Profit/(loss) for the year – continuing operations	**1,260**	991	(95)	1,894	930
(Loss)/profit for the year – discontinued operations	**(4)**	90	50	(126)	(8)
Profit/(loss) for the year	**1,256**	1,081	(45)	1,768	922

Balance sheet as at 31 December

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Intangible assets	**11,465**	11,216	11,306	12,306	9,559
Property, plant and equipment, and investment property	**2,626**	2,848	2,663	2,558	1,887
Non-current investments	**788**	798	852	1,040	787
Inventories	**716**	644	887	926	701
Assets held in Trust	**403**	261	227	–	–
Payables (excluding cash on customers' account) less receivables	**(5,386)**	(6,159)	(6,918)	(5,866)	(5,373)
Other financial assets and liabilities	**(219)**	(10)	(45)	240	52
Retirement benefit obligations	**(4,673)**	(3,456)	(4,679)	(3,365)	(1,629)
Provisions	**(954)**	(1,077)	(929)	(845)	(809)
Net tax	**975**	580	896	256	63
Net (debt)/cash (as defined by the Group)	**(1,439)**	(242)	403	39	700
Disposal groups held for sale	**(3)**	–	–	–	64
Non-controlling interests	**(59)**	(71)	(72)	(55)	(36)
Total equity attributable to equity holders of the parent	**4,240**	5,332	4,591	7,234	5,966

Movement in net (debt)/cash (as defined by the Group) for the year ended 31 December

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Cash inflow from operating activities	**951**	1,535	2,232	2,009	2,162
Net capital expenditure[4]	**(268)**	(364)	(489)	(503)	(262)
Dividends received from equity accounted investments	**88**	71	77	89	78
Assets contributed to Trust	**(137)**	(25)	(225)	–	–
Cash held for charitable contribution to Tanzania	**–**	(30)	–	–	–
Operating business cash flow	**634**	1,187	1,595	1,595	1,978
Acquisitions and disposals	**(256)**	(88)	(254)	(1,038)	(2,112)
Interest	**(176)**	(173)	(186)	(98)	(65)
Tax and dividends	**(885)**	(958)	(889)	(750)	(509)
(Purchase)/issue of equity shares	**(509)**	(520)	(20)	(27)	603
Preference share conversion	**–**	–	–	–	245
Exchange movements	**(20)**	(20)	262	(374)	36
Other movements[5]	**2**	(80)	(132)	5	57
Net (decrease)/increase in net funds	**(1,210)**	(652)	376	(687)	233
Movement in cash on customers' account	**13**	7	(12)	26	32
Movement in net (debt)/cash (as defined by the Group)	**(1,197)**	(645)	364	(661)	265
Opening net (debt)/cash (as defined by the Group)	**(242)**	403	39	700	435
Closing net (debt)/cash (as defined by the Group)	**(1,439)**	(242)	403	39	700

Other information

	2011	2010	2009	2008	2007
Continuing operations[1]					
Basic earnings/(loss) per share – total (pence)	**37.0**	27.9	(3.3)	53.2	26.8
Basic earnings per share – underlying[6] (pence)	**45.6**	39.8	39.1	37.1	31.1
Order book including the Group's share of equity accounted investments (£bn)	**36.2**	39.5	46.1	45.3	37.6
Including discontinued operations					
Dividend per ordinary share (pence)	**18.8**	17.5	16.0	14.5	12.8
Number of employees, excluding share of employees of equity accounted investments, at year end	**87,000**	92,000	98,000	94,000	88,000
Capital expenditure including leased assets (£m)	**381**	437	522	552	341

1 For the years ended 31 December 2007 to 2010, the Regional Aircraft line of business and Saab AB are presented as discontinued operations.
2 Restated following changes to the Group's reporting segments.
3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items. For 2007 and 2008, non-recurring items are profit on disposal of businesses and uplift on acquired inventories. For 2009 to 2011, non-recurring items are profit/loss on disposal of businesses, pension curtailment gains and regulatory penalties.
4 Includes net expenditure on property, plant and equipment, investment property, intangible assets, and other investments, and equity accounted investment funding.
5 Other movements include cash flows from matured derivative financial instruments, cash collateral and other non-cash movements.
6 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items. For 2007 and 2008, non-recurring items are profit on disposal of businesses and uplift on acquired inventories. For 2009 to 2011, non-recurring items are profit/loss on disposal of businesses, pension curtailment gains and regulatory penalties.

SHAREHOLDER INFORMATION

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Email: BAESystems@equiniti.com

Telephone: 0871 384 2044
Calls to the above number are charged at 8p per minute from a BT landline. Other telephony providers' costs may vary.

Lines are open from 8.30am to 5.30pm Monday to Friday.

Telephone number from outside the UK: +44 121 415 7058

If you have any queries regarding your shareholding or need to notify any changes to your personal details, please contact the registrars.

Dividend mandate
Shareholders can arrange to have their dividends paid directly into their bank or building society account, by completing a bank mandate form. The main benefit of this is that cleared funds are received into their bank account on the payment date – especially useful in 2012, as any dividend approved by shareholders at the 2012 AGM will be payable on Friday 1 June 2012. In the UK, in celebration of the Queen's Diamond Jubilee, both Monday 4 June and Tuesday 5 June 2012 are bank holidays and therefore shareholders who receive their dividend by cheque may experience delays in receiving cleared funds into their bank accounts. Receiving dividends directly into your bank account is also more secure than receiving a cheque through the post and you will still receive tax information about the dividend at the end of the year.

St Dunstan's
An independent future for blind ex-Service men and women

With the dividends paid in November 2010 and June 2011, shareholders were encouraged to mandate their dividends and help support the Company's work with UK armed services charities. For each new bank mandate instruction received, the Company undertook to donate £1 to St Dunstan's, a charity which supports and cares for blind ex-Service men and women. The response was tremendous, with a total of £7,000 being donated to the charity.

To arrange for dividends to be paid directly into a bank or building society account, a mandate form can be obtained from our website or by contacting Equiniti. Alternatively, bank details can be submitted via Shareview or, if the shareholding is held in a sole name, Equiniti can take instructions over the telephone.

Overseas shareholders can also arrange for dividends to be paid in their local currency and more information can be obtained from www.shareview.com/overseas

Electronic shareholder communications
An increasing number of shareholders receive communications from the Company using e-mail and web-based communications.

The use of electronic communications, rather than printed paper documents, helps us reduce the environmental impact of our activities and assists us in managing our costs.

We regularly consult with shareholders to check how they wish to receive information from us. Shareholders may receive electronic communications in one of two ways:

- Via e-mail – This option is available through Shareview. Shareholders receive an e-mail notification when a new document is made available.
- Via our website – Shareholders receive a notification by post when a new document is made available.

A shareholder is taken to have agreed to website communications if a response to a consultation has not been received. Any document or information required to be sent to shareholders is made available on the Company's website and a notification of availability is sent. Shareholders who receive such a notification are entitled to request a hard copy of the document at any time and may also change the way they receive communications at any time by contacting Equiniti.

Notwithstanding any election, the Company may, at its sole and absolute discretion, send any notification or information to shareholders in hard copy form.

Shareview services
Shareview is a free portfolio service offered by Equiniti to investors which gives shareholders online access to more information on their investments, including balance movements, indicative share prices and information on recent payments. It can also be used to sign up to receive all shareholder communications electronically and, once registered, arrange for dividends to be mandated or update your address.

To take advantage of Shareview, register online at www.shareview.co.uk. Click on 'Register' and follow the four easy steps.

Details of software and equipment requirements are given on the website.

Dividend reinvestment plan
The Company offers holders of its ordinary shares the option to elect to have their dividend reinvested in shares purchased in the market instead of cash. To make this election, please request a dividend reinvestment plan mandate from our registrars:

Equiniti Financial Services Limited
Aspect House, Spencer Road, Lancing
West Sussex BN99 6DA
United Kingdom

Telephone: 0871 384 2044
Calls to the above number are charged at 8p per minute from a BT landline. Other telephony providers' costs may vary.

Lines are open 8.30am to 5.30pm Monday to Friday.

Telephone number from outside the UK: +44 121 415 7058

Alternatively, a copy of the Terms and Conditions of the dividend reinvestment plan, along with the mandate form, can be downloaded from our website.

ShareGift
ShareGift, the share donation charity (registered charity number 1052686), accepts donations of small parcels of shares which may be uneconomic to sell. Details of the scheme are available from ShareGift at www.sharegift.org or by telephone on 020 7930 3737.

Share price information
The middle market price of the Company's ordinary shares on 31 December 2011 was 285.1p and the range during the year was 248.1p to 361.1p.

American Depositary Receipts
BAE Systems plc American Depositary Receipts (ADRs) are traded on the Over The Counter market (OTC) under the symbol BAESY. One ADR represents four BAE Systems plc ordinary shares.

JPMorgan Chase Bank, N.A. is the depositary.

If you should have any queries, please contact:

JPMorgan Chase & Co
PO Box 64504
St Paul
MN 55164-0504
USA

Email: jpmorgan.adr@wellsfargo.com

Telephone number for general queries: (800) 990 1135

Telephone number from outside the US: +1 651 453 2128

Warning to shareholders – boiler room fraud
Shareholders are advised to be very wary of any unsolicited advice. The Financial Services Authority (FSA) estimates that losses relating to share scams (or 'boiler room' fraud) now amount to £200m per year, with the average victim losing £20,000.

The tactics employed by the criminals, who can be very persistent and extremely persuasive, are constantly changing, but common ploys include cold-calls which offer to:

- 'buy' shares at an inflated price claiming that there is a 'secret' takeover or merger. This is followed by a request for an upfront cash bond to commit to the deal; or
- 'sell' what often turn out to be worthless or high-risk shares in US or UK investments.

If you receive any unsolicited investment advice:

- Make sure you get the correct name of the person and organisation.
- Check that they are properly authorised by the FSA before getting involved by visiting www.fsa.gov.uk/register/ and contacting the firm using the details on the register.
- Report the matter to the FSA either by calling 0845 606 1234 or by visiting www.fsa.gov.uk/pages/consumerinformation
- If the calls persist, hang up.

If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. The FSA can be contacted by completing an online form at www.fsa.gov.uk/pages/doing/regulated/law/alerts/overseas.shtml

Details of any share dealing facilities that the Company endorses will be included in Company mailings.

More detailed information on this or similar activity can be found on the FSA website www.fsa.gov.uk/pages/consumerinformation

Financial calendar

Financial year end	31 December
Annual General Meeting	2 May 2012
2011 final ordinary dividend payable	1 June 2012
2012 half-yearly results announcement	2 August 2012
2012 interim ordinary dividend payable	30 November 2012
2012 full year results – preliminary announcement	February 2013
– report and accounts	March 2013
2012 final ordinary dividend payable	June 2013

SHAREHOLDER INFORMATION *(continued)*

Analysis of share register at 31 December 2011

	Ordinary shares of 2.5p			
	Accounts		Shares	
	Number '000	%	Number million	%
By category of shareholder				
Individuals	100.0	92.4	99.3	2.8
Nominee companies	7.0	6.5	3,104.7	86.5
Banks	–	–	1.6	–
Other	1.2	1.1	382.0	10.7
	108.2	**100.0**	**3,587.6**	**100.0**
By size of holding				
1 – 99	22.1	20.4	1.0	–
100 – 499	30.9	28.6	8.3	0.2
500 – 999	21.6	19.9	15.4	0.4
1,000 – 9,999	31.4	29.0	75.1	2.1
10,000 – 99,999	1.4	1.3	34.4	1.0
100,000 – 999,999	0.5	0.5	180.6	5.0
1,000,000 and over	0.3	0.3	3,272.8	91.3
	108.2	**100.0**	**3,587.6**	**100.0**

GLOSSARY

AGM	Annual General Meeting.
ATIRCM	Advanced Threat Infrared Countermeasures.
C4ISR	Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance.
CIRCM	Common Infrared Countermeasures.
CPI	Consumer Prices Index.
CR	Corporate Responsibility.
CV90	Combat Vehicle 90.
D&IMM	Diversity & Inclusion Maturity Matrix.
EBITA	Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.
EC	Executive Committee.
EPS	Earnings per Share.
ESMM	Environmental Sustainability Maturity Matrix.
EU	European Union.
ExSOP	Executive Share Option Plan.
FMTV	Family of Medium Tactical Vehicles.
FPE	Final Pensionable Earnings.
FPP	Final Pensionable Pay.
FRS	Financial Reporting Standard.
GAAP	Generally Accepted Accounting Practice.
GCV	Ground Combat Vehicle.
IAS	International Accounting Standard.
IBP	Integrated Business Plan.
IDIQ	Indefinite Delivery, Indefinite Quantity.
IFRS	International Financial Reporting Standard.
ISR	Intelligence, Surveillance and Reconnaissance.
KPI	Key Performance Indicator.
LCM	Lifecycle Management.
LRIP	Low-Rate Initial Production.
LTA	Lifetime Allowance.
LTIP	Long-Term Incentive Plan.
M777	A lightweight 155mm field howitzer.
MEADS	Medium Extended Air Defence System.
MoD	Ministry of Defence.
MRAP	Mine Resistant Ambush Protected.
MSMO	Multi-Ship, Multi-Option.
OAS	Operational Assurance Statement.
OECD	Organisation for Economic Co-operation and Development.
OPV	Offshore Patrol Vessel.
QBR	Quarterly Business Review.
R&D	Research and Development.
RAF	Royal Air Force.
RCF	Revolving Credit Facility.
RG31	Mine protected armoured personnel carrier.
RPI	Retail Prices Index.
RSAF	Royal Saudi Air Force.
RSP	Restricted Share Plan.
SBDCP	Saudi British Defence Co-operation Programme.
SDSR	Strategic Defence and Security Review.
SIP	Share Incentive Plan.
SMM	Safety Maturity Matrix.
SMP	Share Matching Plan.
ToBA	Terms of Business Agreement.
TRMC	Treasury Review Management Committee.
TSR	Total Shareholder Return.
UAS	Unmanned Aircraft Systems.
UITF	Urgent Issues Task Force.

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– Search the Annual Report for key information and access links for further information
– Corporate responsibility information is integrated into the Annual Report
– Access the Notice of Annual General Meeting and vote online

VISIT: WWW.BAESYSTEMS.COM/REPORTING

Shareholder feedback
If you would like to give us any feedback on this year's Annual Report, please send your written comments to our investor relations team at:

BAE Systems
6 Carlton Gardens
London SW1Y 5AD
United Kingdom

or e-mail to investors@baesystems.com

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